BNZ Weekly Overview

6 December 2007

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FINANCIAL MARKETS DATA

	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	8.25%	8.25	8.25	8.25	7.25	6.2
90-day bank bill	8.88%	8.89	8.72	8.85	7.62	6.4
10 year govt. bond	6.28%	6.22	6.57	6.05	5.60	6.5
1 year swap	8.86%	8.87	8.95	8.61	7.78	6.6
5 year swap	8.19%	8.20	8.39	7.87	7.19	7.0
NZD/USD	0.773	0.77	0.768	0.686	0.69	.567
NZD/AUD	0.886	0.871	0.835	0.835	0.87	.859
NZD/JPY	85.6	84.7	87.8	79.1	79.0	66.1
NZD/GBP	0.381	0.371	0.37	0.34	0.348	.342
NZD/EURO	0.528	0.519	0.531	0.502	0.515	.51

For addition to our emailing list for Thursday night receipt email "Subscribe WO" to tony.alexander@bnz.co.nz . To get off the list email 'Unsubscribe".

Last Survey For The Year

This is your last chance for 2007 to let us know what is happening in your industry. So if you have not already done so in the email used for sending this Weekly Overview out please copy and paste the URL below into your browser, click on it, and let us know whether you think the economy is likely to get better or worse over the coming year. As always, more importantly, let us know how things look at the moment in your particular industry. Results will be released early next week. Many thanks to those who have contributed to our surveys during the year.

http://www.closer.co.nz/bnzeconomist.asp

This week the big news as far as the New Zealand economy went was the Reserve Bank's review of its official cash rate this morning and release of the quarterly Monetary Policy Statement. As was universally expected amongst forecasters the official cash rate was left at the 8.25% level it was taken to at the end of July. But in an unexpected move in light of dovish central bank signals the past week overseas the RB strengthened its warning about inflation risks going forward while noting some increased uncertainty about global financial conditions and the global economy. The RBNZ's comments plus many other factors imply continued very strong NZD support with some upside interest rate risk.

Overseas - well frankly the most important thing was the start of the two week United Nations Climate Change Conference in Bali - but with regard to immediate economic matters it's all about what the Federal Reserve will do with their funds rate on December 11. A cut of at least 0.25% is expected with further reductions highly likely next year with evidence continuing to emerge of a deteriorating US housing market. Key to much of this however will be their labour market report due out this Friday night to see whether the housing woe is spreading to general hiring. The NZD implications are starkly obvious of the Fed. cutting rates plus reductions next year likely in Europe and UK plus a cut this week in Canada versus no scope for any NZ cut for ages.

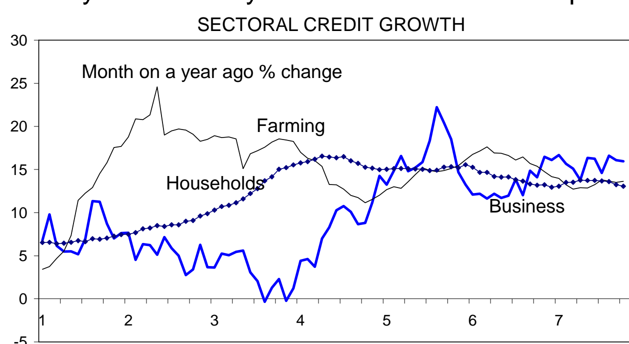
For those with a wider interest in the world than who punched who in government buildings this week our Further Reading section looks at Sovereign Wealth Funds, rising food prices, the spreading tentacles of the global liquidity crisis, and climate change.

THE WEEK'S NZ ECONOMIC DEVELOPMENTS

Thursday 29

Lending to the Private Sector Still Relatively Robust

In seasonally adjusted terms lending to the household sector rose by 0.8% in October which was the same increase as in September with both below the average increase in the previous six months of 1% a month. So there is an easing off in lending growth to the household sector under way but it is hardly a major decline and remains consistent with our expectation that the annual rate of lending growth to the household sector will probably fall to just below 10% this cycle rather than the low of 6.4% seen in early 2001. In October total household debt was ahead from a year earlier by 13.1% from 13.3% in September and 13.2% a year ago.



The annual rate of growth in lending to the business sector in October was 16% from 16.1% in September and 14.1% a year ago. In the three months to October business debt grew by $2.7 billion which was $1 billion more than growth in the same period a year earlier so things seem pretty robust in this area. This is extremely good because what our economy needs is a lot of business investment in order to boost our productivity. One hopes the investment is in nice energy saving greenhouse friendly stuff. The annual rate of growth in lending to the farming sector rose to 13.6% in October from 13.5% in September but was down from 15.4% a year earlier. In the three months to October farm debt grew by $1.1 billion which was almost the same as a year earlier. There is not really any acceleration or deceleration in lending growth to the farming sector but one suspects the high dairy returns will see strong lending continue in the next few years into this area which is great for our economy and growth in income per capita. Pity about the emissions of nitrous oxide, methane, and CO_2 and operators best think about investing and altering operations to minimise such emissions ahead of the sector entering the emissions trading system from 2013 and being taxed.

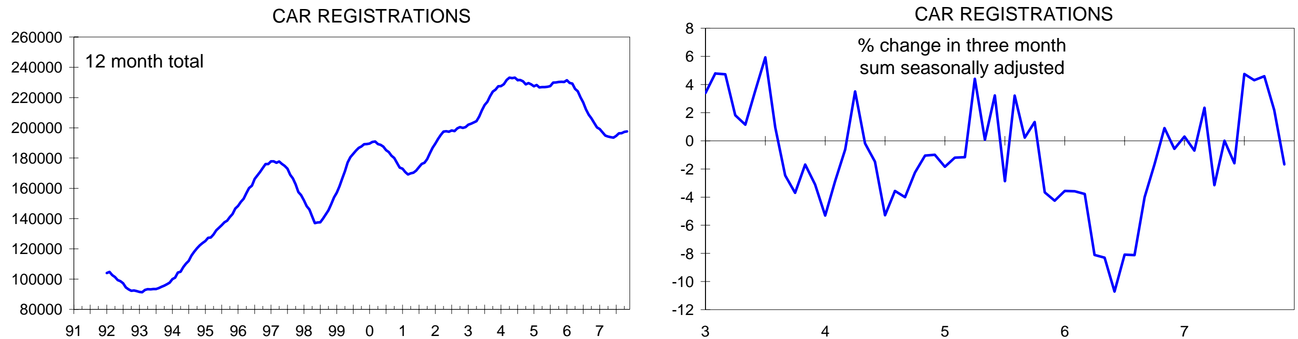
The total rate of growth in lending to the private sector eased marginally to 13.9% in October from 14.3% in September, 14.1% a year earlier, and average growth of 10.6% per annum over the past seven years.

Tuesday 4

Vehicle Registrations Growth Generally Flat

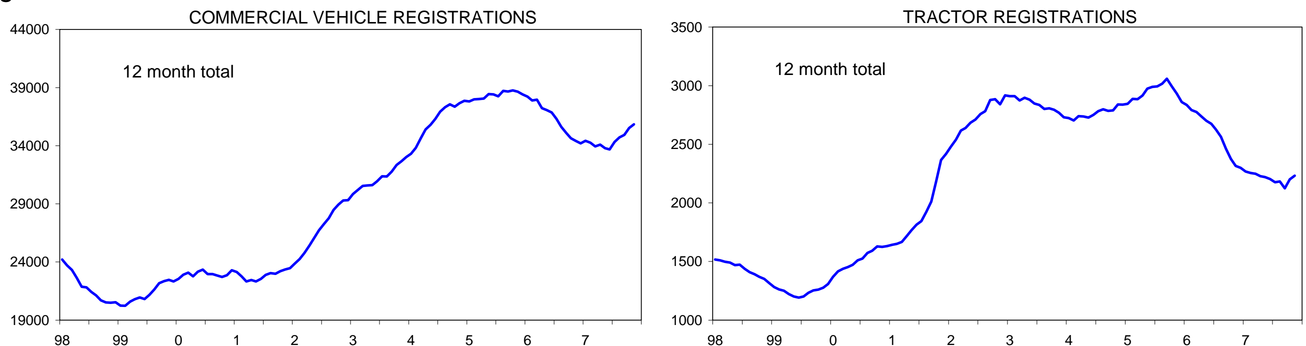
In November there were 16,491 cars registered around New Zealand. This was a 2.3% rise from a year earlier and meant that in the three months to November registrations were ahead only 2.4% from a year ago. In seasonally adjusted terms registrations have fallen about 1.5% over the past three months which is consistent with some weakness in consumer spending but nothing too outrageous suggestive of a domestic recession. These numbers matter because buying a car is a big decision and if people are fearful of their future incomes they will buy fewer. The rego numbers come out only a few days after the end of the month

so give us the earliest available insight into household spending prospects. If data released in the United States this week are anything to go by then maybe some mild switch is happening away from large petrol guzzling vehicles towards more efficient ones.
http://money.cnn.com/2007/12/03/autos/auto_sales.ap/index.htm?postversion=2007120313



In line with generally flat car regos we also have only mild growth in commercial vehicles. In November there were 3,165 commercial vehicles registered around New Zealand. This was almost a 12% rise from a year earlier taking the November quarter total to 14% ahead of a year earlier. Growth for the entire year has been just 4% and in seasonally adjusted terms commercial vehicle registrations have declined by 1.3% over the past three months. There may be growth but it is fairly mild and the best one can say is that the numbers do not really detract from our suspicion that there is still some reasonable business capital expenditure going on though its an area where we struggle to get accurate data and the anecdotes outside of the areas like infrastructure are tending to be a wee bit flat to negative.

Down on the farm things look similar with the number of tractors registered in November coming in at 252 which was a 14% rise from a year earlier and 6.7% gain from a year earlier for the quarter. For the entire year registrations have declined about 4% and they were also off about 4% in seasonally adjusted terms over the past three months. The year earlier comparison looks good but the seasonally adjusted numbers suggest farmers are not yet pushing each other aside to buy new CD playing air-conditioned GPS capable grunters.



Thursday 6

Monetary Policy Unchanged But Tightening Bias Strengthened

As was widely expected the Reserve Bank left their official cash rate unchanged at 8.25% this morning. However they strengthened their warnings about inflation risks going forward and explicitly noted that interest rates are likely now to remain higher than they previously thought. This is discussed in more detail immediately below.

BNZ WEEKLY OVERVIEW

INTEREST RATES

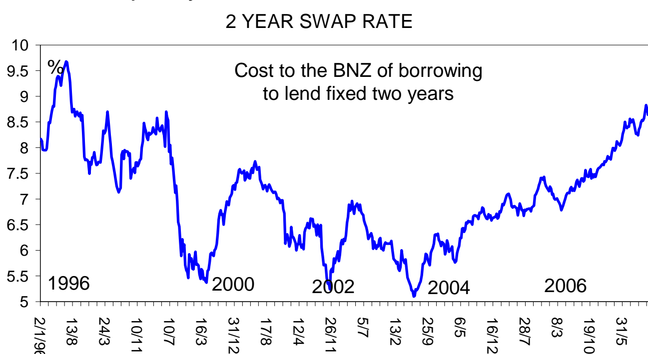
Our strongest warning for almost 4 years now has been that inflationary pressures in the New Zealand economy are generally greater than people are thinking implying far greater upside risk to the level of interest rates and how long they remain high. The Reserve Bank this morning backed up our concern by listing quite clearly the factors they see applying upside inflation risks in the near future. They cited likely cuts in personal income tax rates, higher oil prices, higher food prices, the upcoming emissions trading scheme, and higher dairy incomes. That's a long list and they wouldn't have taken such an effort to note all these factors if their concerns about inflation were not very strong.

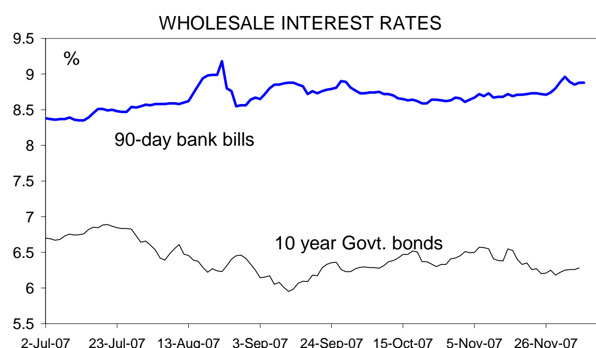
Their conclusion was, even after taking into account turbulence in global financial markets and downside risks to trading partner growth…

“Overall, inflationary pressures have increased, and interest rates are now likely to remain around current levels for longer than previously thought”

Read it and weep at http://www.rbnz.govt.nz/

The upshot of their comments is that we have seen wholesale interest rates move higher this morning after declining earlier in the week and the benchmark two year swap rate at which we banks borrow money to lend fixed for two year periods has ended practically unchanged from a week ago near 8.68%. 90 day bank bill yields have also ended unchanged near 8.88% with the gap between this rate and the official cash rate remaining greater than usual because of market expectations of further tightening from our Reserve Bank and mild liquidity strains in the market.





The chances are there will be no easing of New Zealand monetary policy until very late 2008 then only some mild easing in 2009. With regard to where fixed interest rates go this is going to depend a heck of a lot on what happens in the United States and just listening to the various economists speaking on the likes of CNN and CNBC as well as writing on numerous websites it is fairly clear there is major uncertainty about what the US yield curve will do next year.

This means this is not an environment where you would be wanting to take some large punt on a particular interest rate view. Uncertainty is high. But one has to keep in mind that in a world that is increasingly concerned about the global liquidity crisis and credit crunch, rising food and energy costs, and United States housing market and economic growth, local economic forces remain acceptable. Rising world food prices are good for us. That is why the comments from our central bank this morning stand in relatively stark contrast to those from other central banks over the past week who are paying far greater attention to tightening credit conditions in their markets.

To get close to the concern expressed by our central bank you’d probably have to be looking at the People's Bank of China. http://www.chinadaily.com.cn/china/2007-12/05/content_6300890.htm

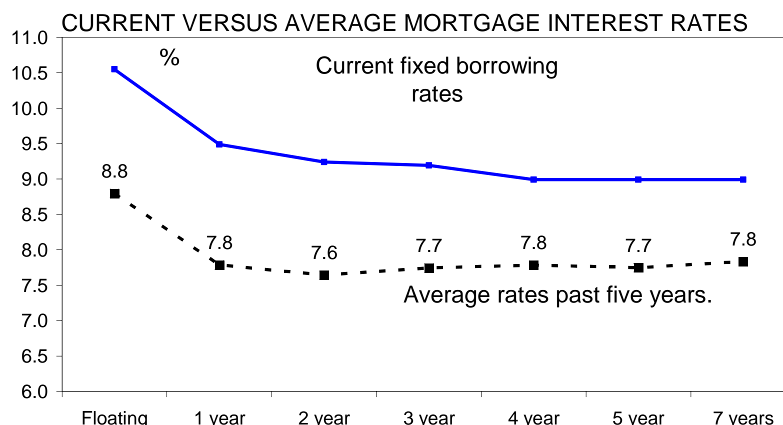
If I Were a Borrower What Would I Do?

The outlook for world growth has deteriorated over the past few weeks with the return of liquidity pressures increasing the potential for cuts in interest rates in the United States, fairly much taking away the chances of another increase in Europe, helping to explain the easing by the Bank of Canada this week, contributing to a less hawkish tone in the Reserve Bank of Australia's comments yesterday, and also being noted by our own Reserve Bank this morning. On the face of one might think this would suggest good falls in fixed borrowing costs next year. But these costs are heavily influenced by the extent of the liquidity squeeze and unless we see a return of strong willingness by overseas banks to lend to each other it is unlikely fixed borrowing costs will decline all that much in the near future.

Plus, while our central bank noted conditions overseas they placed far greater emphasis in their comments this morning on inflation risks such as easing fiscal policy and so on. The absence of anything remotely approaching an easing in New Zealand in the near future is going to keep short to medium-term fixed interest rates firm.

So I'd probably not be inclined to just sit floating for a few weeks thinking that I'm going to get a nice much lower fixed rate early next year. If I was more of a punter than I am I might fix for one year expecting that the slower world growth environment will produce better borrowing costs in a years time which seems a perfectly reasonable expectation.

At the moment I would probably still fix for a two-year period unless someone was offering a floating rate close to 9.5%.



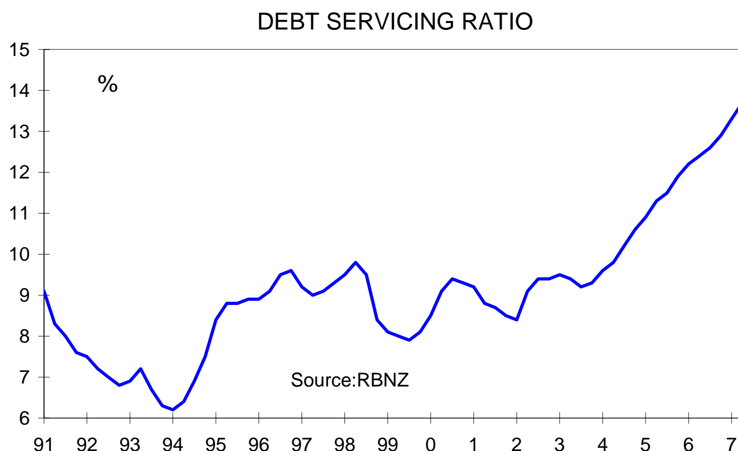
HOUSING MARKET UPDATE

During the week someone e-mailed us the following question.

“I understand the rationale behind not believing house prices will fall significantly (as you pointed out again in the newsletter, comparing to 1998). I still wonder if that's a totally valid comparison given presumably much poorer affordability of houses now (and much higher share of income that's going in to financing huge mortgages) compared to then? I'm not an economist but I just feel like the financial pressure on homeowners now might make them market a bit more vulnerable?”

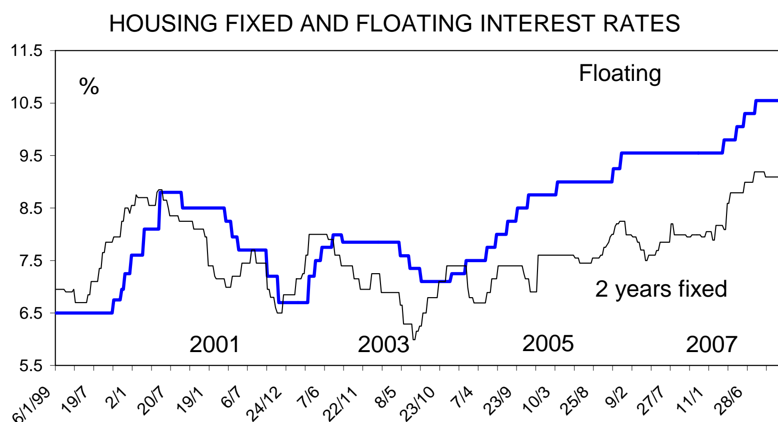
Your point is valid with debt servicing at a high level. This is all best guess stuff. We are not so much concerned about the housing market in the near future given insulating factors. But the high dependence of Kiwis on wage and salary income combined with high debt, debt servicing and house prices makes our economy hugely vulnerable to something which causes a labour market shock. Should something come

along to push the unemployment rate up about 1.5% in a short space of time then a 10% fall in house prices could be expected - though it always depends upon what else is going on and how much correction occurs by then in debt servicing, house prices to income etc. The good scenario is that prices go nowhere for 2-3 years while incomes rise. Then things become less stretched and our vulnerability to a shock less pronounced.



Rate Freeze in the United States

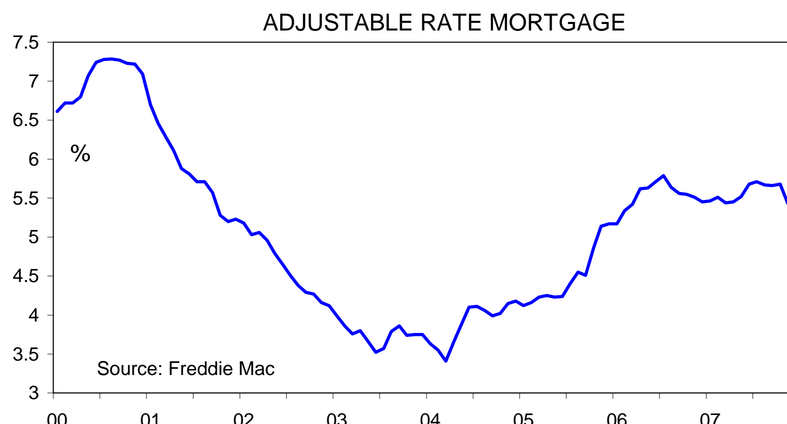
On average over the coming year the 40% or so of borrowers in New Zealand with fixed-rate mortgages having them come up for renewal will roll off a rate near 7.8% and roll on to something probably just over 9%. Here in New Zealand we have an insanely high tolerance of what by world standards would be relatively high interest rates and that tolerance is well known. But we also are well used to high volatility in our interest rates. We used to see variable mortgage rates moving all over the place and now we all know that fixed interest rates can also change quite a bit. For instance in the middle of 2003 you could get a nice medium to long-term fixed housing rate for below 6.5% whereas now many of these rates are around 9.2%.



In the United States things are different. Traditionally people would borrow at a 30 year fixed mortgage rate with ability to freely reset that rate when it declined in the retail markets but if the rate went up they just stuck with the old rate. In this way when interest rates fall strongly in the United States it can have quite a positive impact on the household sector as people refinance their 30 year fixed-rate maybe initially from 6.5% down to 6.25% then if rates keep falling down to 6% and so on.

But three or four years ago when there will worries about deflation in the United States both fixed and especially variable interest rates over there fell to low levels. People started borrowing at variable rates or more usually what are called adjustable rate mortgages maybe for a one-year term. Initially these rates would have been set at around 3.5% but they are now just below 5.5%. For us this would be a wonderful

situation and we would be pushing each other out of the way to get into the bank to borrow everything we could.



But in the United States the situation is relatively dire because people have not budgeted for a near 2% increase in their financing costs and a lot of the people who borrowed at these variable interest rates four years ago should never have been lent the money in the first place. This is the sub prime crisis currently underway over there which has so far caused house prices on average to fall almost 5% from a year ago. This sub prime housing market crisis is leading to worries about potential recession in the United States and has sparked the global liquidity crisis.

The relevance of this for our housing section is that the United States Treasury Secretary Henry Paulson has gathered together a group of investors, the government, and mortgage providers to try and come up with a scheme whereby the interest rates of some people do not jump up to market levels. A rate freeze in other words. The aim is to reduce the social impact of the mortgage crisis plus slightly improve the outlook for the United States economy and maybe contribute to a reduction in the liquidity crisis. There are plenty of articles about this and here are a few.
http://money.cnn.com/2007/12/04/real_estate/affordability/index.htm
http://money.cnn.com/2007/12/03/real_estate/Paulson_on_housing/index.htm

Could we see something similar here in New Zealand with some official move to stop people's fixed interest rates from going up? Zero probability. Here in New Zealand while most of us can think of people it would not be a good idea to provide over 90% housing finance to we do not have the sub prime (crap) lending situation that has developed in the United States. (That lending was confined to the finance companies.) Our economy has an acceptable outlook with strong support from easing fiscal policy, infrastructure spending, business investment to boost productivity, the biggest terms of trade boom in three decades, and a tight labour market delivering good job security and firm wages growth. There also seen to be plenty of investors waiting on the sidelines to snap up any discounted property.

In addition we have an inflation problem here and our central bank would probably quite like it if interest rates went even higher.

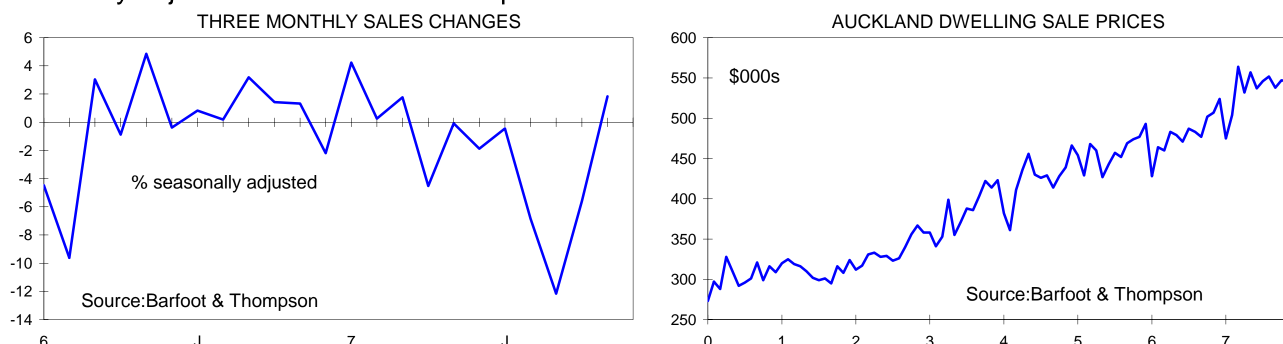
Plus, if, as some are forecasting, about 2 million people lose their homes in the coming year in the US that would be the equivalent of about 27,000 people in New Zealand. There are no official numbers but while we can see more notices of mortgagee sales in the newspapers the numbers will never remotely approach 27,000. Plus while in the US it is owner-occupiers losing their homes here in NZ the mortgagee sales seem to be overwhelmingly investors coming unstuck – in which case its more a matter of an inevitable and long predicted correction rather than a socioeconomic and global economy threatening rout.

However we are still left in New Zealand with a similar problem to many other countries of low housing affordability for many people because of the sharp rise in house prices in recent years. But that's a separate story about which the government is still developing policies. This week one has been advanced with the government presenting the Affordable Housing: Enabling Territorial Authorities Bill. This Bill will allow local

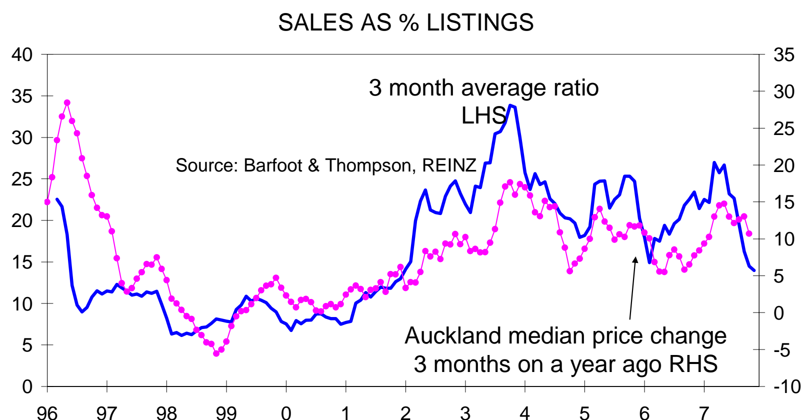
authorities to first of all undertake a good in-depth study of the affordable housing requirements in their area then implement requirements on developers to provide affordable housing in some way in their future elements. At the margin this will have some impact on housing affordability but in terms of the things we market economists are interested in - overall house price movements -the impact will almost certainly not be noticeable and undoubtedly won't be around this cycle. The proposals are opposed by developers who would prefer more land be made available.
http://www.parliament.nz/en-NZ/PB/Legislation/Bills/c/8/a/00DBHOH_BILL8369_1-Affordable-Housing-Enabling-Territorial-Authorities.htm

Barfoot and Thompson Monthly Data

The numbers released this morning weren't as bad as rumours had been suggesting. The average sale price was essentially unchanged from October at $546,000. In the month they sold 881 dwellings which was a 19.1% decline from a year earlier. However in rough seasonally adjusted terms sales improved about 4% in the month after improving 15% in October meaning that for the three months to November in rough seasonally adjusted terms sales have improved almost 2%.



We believe the housing market in New Zealand is still easing off but the picture in some ways is quite messy. Anecdotes tend to be on the negative side with a trip to Tauranga last week revealing investors generally off-loading excess properties. But there seem to be other investors sitting in the wings waiting for opportunities. The Barfoot and Thompson data show a ratio of sales to listings that is still falling away. This means more properties on the market. At the end of November their total listings stood at 6,041 which was the highest for any month since January 2002.



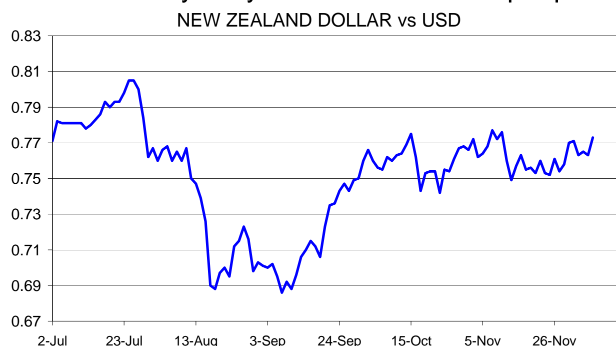
EXCHANGE RATES

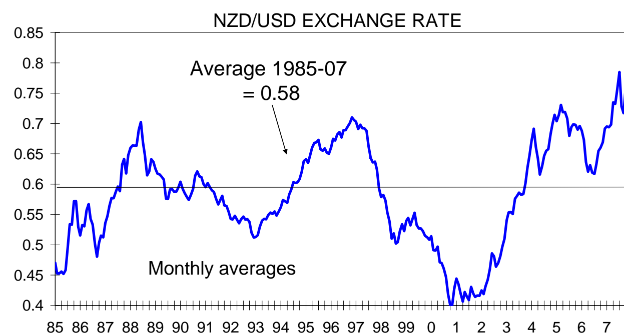
This week an emailer posed the following question.

Outlining that her daughter had just sold a house in Australia and settles on one in NZ come Jan. 18 the question was "As the NZ dollar has recently risen against the Australian dollar would you advise that she leaves the funds in Australia in the meantime in the hope that the exchange rate will be more favourable closer to the time when she needs the funds i.e. Jan 18th 08 as even two percentage points will make a considerable difference ?

Our reply was "Sorry but it is impossible to take a reasonable stab at what the NZD will do against the AUD in the next couple of months. Having said that I believe the risk is we edge lower so if I was prepared to gamble I would hold off switching into NZD. Good luck and keep one thing in mind. There is probably a level the NZD could rise to which would decimate the AUD receipts so much settlement of the NZ property could not be made. **Best figure that out**.

The Kiwi dollar has firmed against the greenback and on all cross rates this week assisted mainly by this mornings more hawkish than expected comments from the Reserve Bank. In particular they noted they now expect interest rates to remain high for longer than previously thought. At the time of writing early on Thursday afternoon we were trading near 77.3 against the greenback from 77.0 cents last week, 88.6 cents against the Aussie dollar from 87.1 last week, 85.6 yen from 84.7, 52.8 cents against the euro from 51.9, and 38.1 pence from 37.1 last week. Some assistance for our currency also came from the strong rebound in the US sharemarket overnight which is traditionally associated with some increased willingness of investors to buy risky assets such as the peripheral Kiwi dollar.

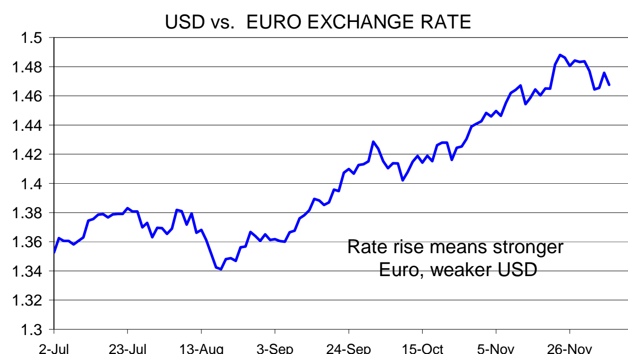


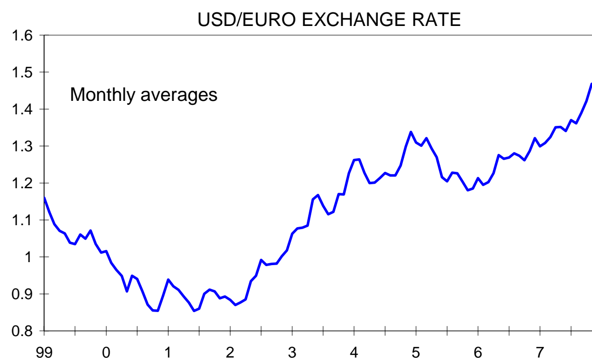


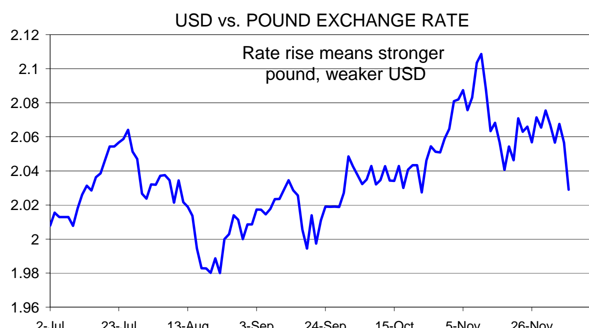
United States

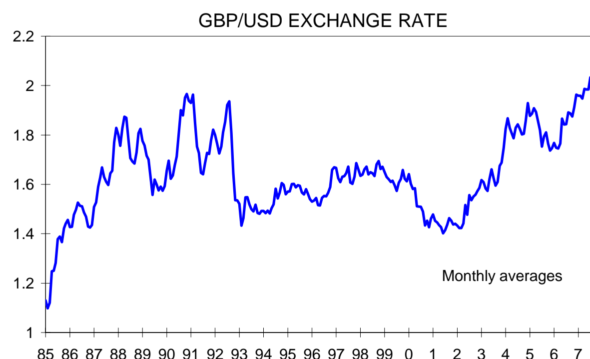
GDP +4.9%, CPI +3.5%, funds rate 4.50%, 9% of NZ visitors & 12% of exports

The US dollar has ended the week up against the Japanese yen near 110.7 from 110.0 and has made ground against a much weaker pound and a slightly weaker euro. Against the pound it has ended near $2.03 from $2.075 last week and against the euro near $1.464 from $1.484 last week.

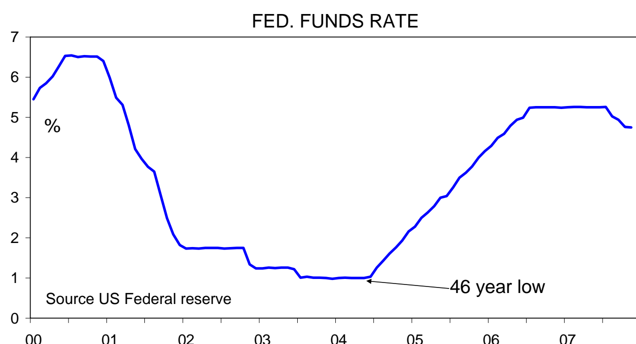


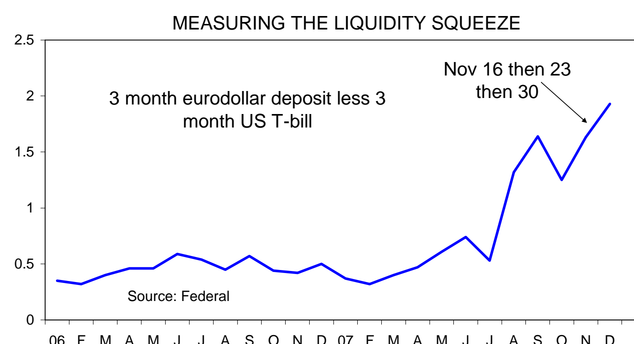






In the United States for the moment all attention is on what the Federal Reserve will do with their funds rate at the next review by the Open Market Committee on December 11. Up until about a week ago practically all the comments from regional Governors had been that the markets might be getting ahead of themselves expecting a cut. But then the vice-chairman of the Federal Reserve made comments suggesting a cut was likely and this was followed a day later with a speech by the Chairman Mr Bernanke warning that after growing at an unusually high annualised rate of 4.9% during the September quarter growth in the United States would fall away quite strongly for the December quarter. He also expressed concern about a deterioration in market conditions.



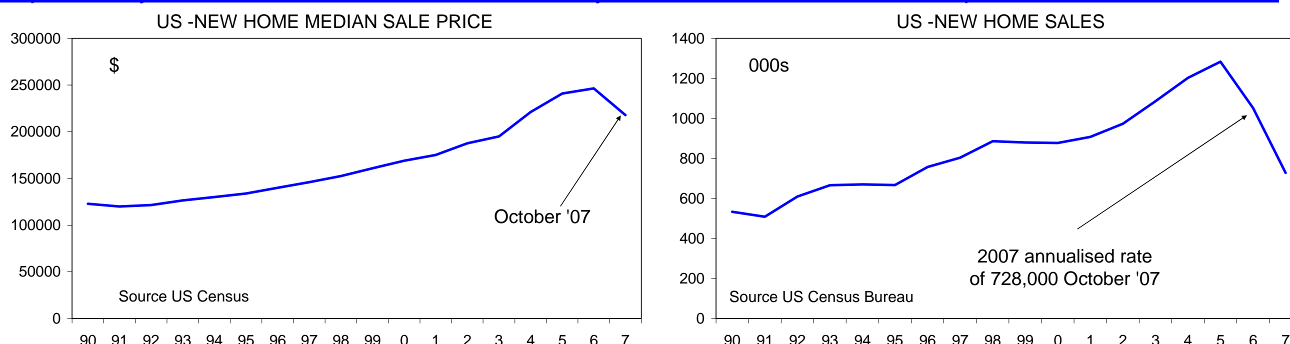


So the markets expect at least a 0.25% easing on Dec. 11 with about 30% factoring in of a 0.5% cut. This is relevant to us because the lower United States interest rates go the greater the relative interest rate support for the Kiwi dollar therefore the greater the chance we head back rapidly to 80 cents. Note that any US easing might not however affect the recent rapid return of very tight interbank liquidity conditions. By tightness we mean banks are less willing than usual to lend to each other and instead prefer to put any spare cash into safe assets like treasury bills. The second graph above shows a measure of this as the yield gap between 3 month Eurodollar deposit rates and 3 month treasury bills first blowing out when the liquidity crisis initially hit in August, then things easing a tad, and now tensions even worse.

The Fed., ECB and Bank of England have all reacted to tightening conditions in the past fortnight by taking various measures to improve liquidity conditions, often extending traditional overnight loans into January. This is because some of the current tension is caused by banks taking utmost effort to improve their books for year end accounting purposes. This is relevant to us because tight liquidity conditions in the big markets like the United States and Europe generates tight conditions here which manifests itself as upward pressure on fixed borrowing costs facing us banks which translates through to rises in fixed home lending rates.

Guess what? During the week we got more data showing the weak state of the United States housing market. In October builders responded strongly to the growing stock of unsold new dwellings by slashing prices on average to 13% of what they were year ago. This is the biggest annual rate of decline in this particular measure of a small section of the housing market since 1970. The pace at which new homes are selling is running at an annual rate of 728,000 which is about half of what it was a couple of years earlier – shown in the second graph below. This is bad news for New Zealand companies which may export timber

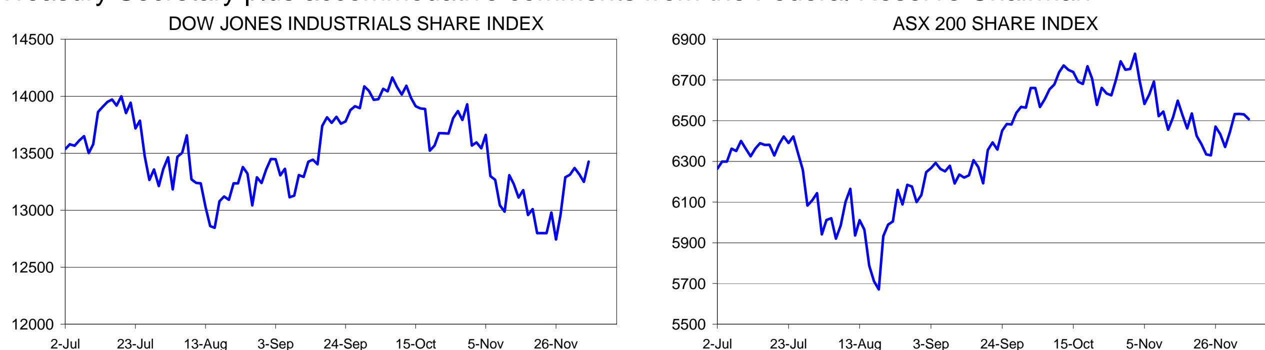
and other products that go into new dwelling construction in the United States and in case you do this and want some extra information on what is happening the following link discussing home sales may be useful.
http://money.cnn.com/2007/11/29/news/economy/newhome_sales/index.htm?postversion=2007112915



If you want to read about the hundreds of thousands of people losing their homes try the following link. The number might hit 2 million.
http://money.cnn.com/2007/11/29/real_estate/foreclosure_activity/index.htm?postversion=2007112908

But at least the manufacturing sector is still in acceptable condition with the monthly ISM manufacturing index coming in at a reading of 50.8 in November from 50.9 in October. A reading above 50 indicates growth. Not necessarily much though! Apparently the continued "strength" reflects better orders – actual and anticipated – in response to the low USD plus customers running very low inventories. The conclusion of still acceptable conditions in the industrial sector was backed up last night by data showing factory orders in October rose by 0.5% and the September result was respite upward slightly whereas no gain had been expected for October.

Last night however the main piece of news was a report by ADP Employer Services who conduct their own survey to make an early estimate of the monthly non-farm payrolls report. They estimate jobs growth in November was 189,000 people which has triple current market expectations of the data out tomorrow night. If they are right this reduces the chance for interest-rate cuts but suggests limited spread of the housing market weakness into other parts of the economy which would be a very good thing. This helps explain why the sharemarket has improved over the week with assistance from the housing bailout plan proposed by the Treasury Secretary plus accommodative comments from the Federal Reserve Chairman.

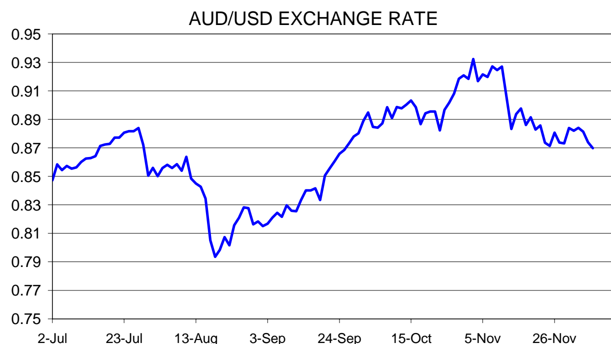


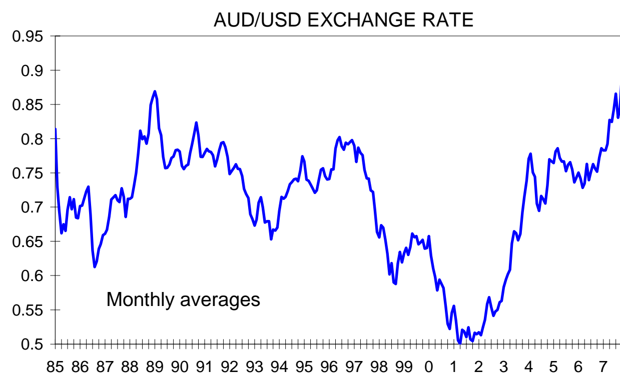
Australia

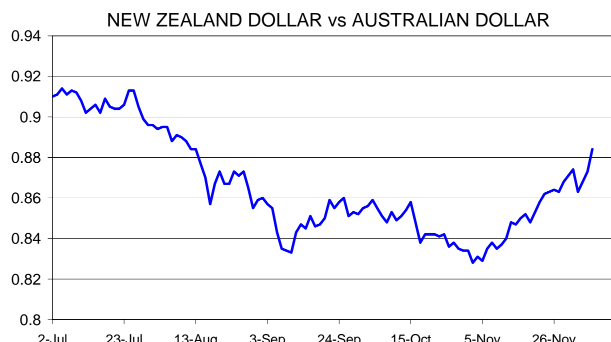
GDP +4.3%, CPI +1.9%, cash rate 6.75%, 38% of NZ visitors & 22% of exports.

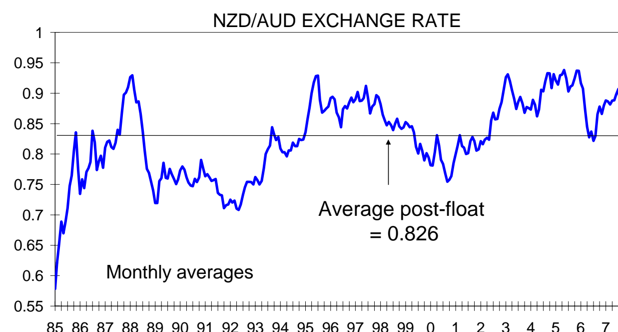
The Aussie dollar has fallen against a slightly stronger greenback over the week to end just over 87.0 cents from 88.4 cents last Thursday. Downward pressure has come from a better than expected trade deficit in October, a reduction in the Reserve Bank of Australia's hawkish bias in their comments yesterday, and a sharp fall in oil prices. Oil prices have declined on the back of expectations that Saudi Arabia will increase its production shortly and worries about US economic growth. The Kiwi dollar has risen against the weaker Aussie to end near 88.6 cents from 87.1 cents last week.

BNZ WEEKLY OVERVIEW



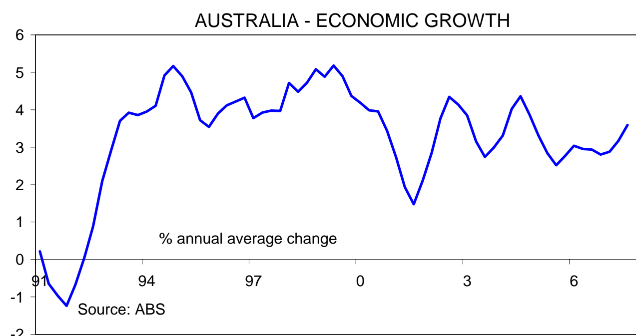


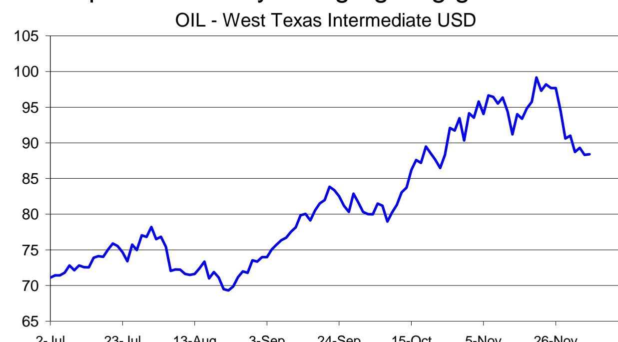




Across the ditch this week the focus has mainly been on the monthly decision by the RBA whether to change its cash rate or not. The rate was raised 0.25% last month ahead of the Federal election taking it to 6.75%. No-one really expected a change this week and so it proved to be. However while the RBA left a tightening bias in place they did downgrade their expectations for global growth and noted risks from turbulence in global financial markets. We still see a chance that at the next meeting in February a rise in the cash rate to 7.0% could occur. But the probability has diminished and might soon hit zero. We still retain a small tightening bias because the Aussie economy continues to grow strongly on the back of high commodities prices and massive demand out of China. Plus many – not all – economic indicators released recently continue to show firm growth with inflation risks.

This week we learnt for instance that the Australian economy grew by 1% during the September quarter with strong growth in infrastructure spending, the minerals sector and consumer spending. For the year growth was 3.6% though across the ditch they mainly compare the quarter with a year ago giving growth of 4.3%.





Some weakness in the Aussie dollar came early this week after the monthly trade deficit number for October came in much larger than expected with a negative balance near A$3b versus expectations of about A$1.2b. Then there was a further weakness in the Aussie currency on Tuesday following the release of data showing that retail spending rose by just 0.2% in October whereas the markets had been expecting a rise of 0.6%. But this still left sales about 7.4% ahead of a year earlier and it would not be too surprising if worries about rising interest rates and uncertainty ahead of the Federal election had combined to inject some caution into

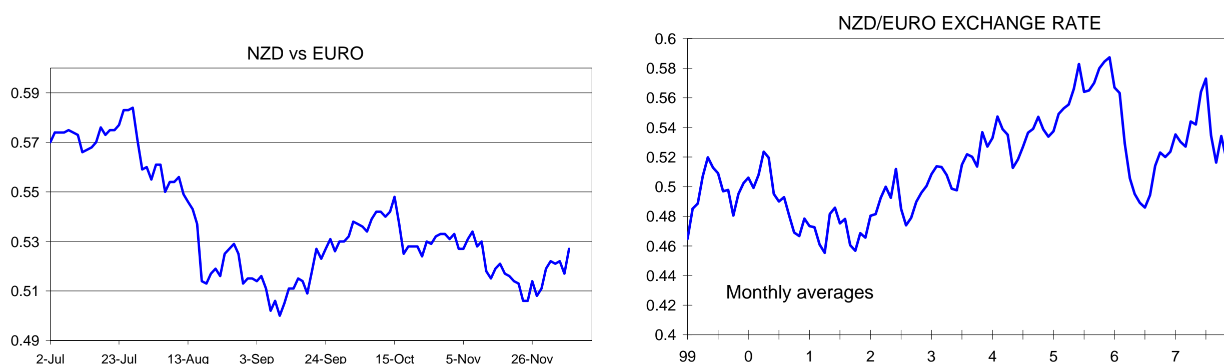
the minds of consumers and October. Having said that however you'd think the promises of tax cuts would have boosted spending.

Our estimate is that having grown about 4.25% this year Australia will grow around 3.25% next year with the slowing attributable to higher interest rates and a higher AUD. Some slight easing in world growth is also relevant. This is all very relevant to us in New Zealand because we get about 20% of our merchandise trade export receipts from across the ditch and they supply about one third of our tourists. Go Aussie.

Euro-Zone

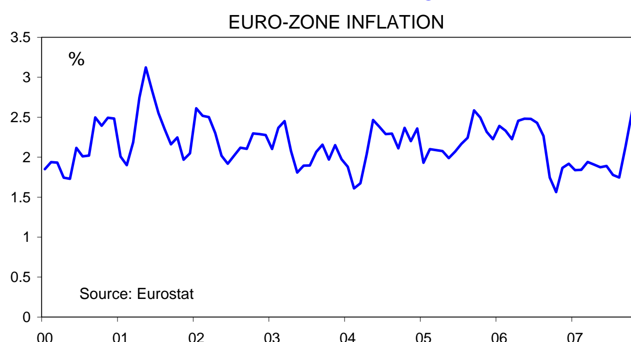
GDP +2.6%, CPI +3.0%, cash rate 4%, EU ex-UK=9% NZ visitors & 10% exports

As noted above the euro has lost some ground against the US dollar this week to end near $1.464 from $1.484 last week. The Kiwi dollar has therefore risen to a three-week high of 52.8 cents from 51.9 cents last week.



Concern has grown about the state of financial institutions in the euro zone exposed to the downturn in the United States sub-prime mortgage market. Rumours have been circulating about banks experiencing troubles and liquidity conditions have tightened up in money markets causing a rise in interbank lending rates to a six-year high near 4.85%. In fact the gap between one month interbank money and the ECB's base rate has jumped to a record high. The ECB has reacted by injecting extra liquidity into the interbank market but this hasn't stopped tensions ahead of calendar year end. In fact on Tuesday night an ECB official said "There may be a question mark over our hopes that Europe could decouple" In this context "decouple" means chugging along nicely while the US has a major slowdown or recession.

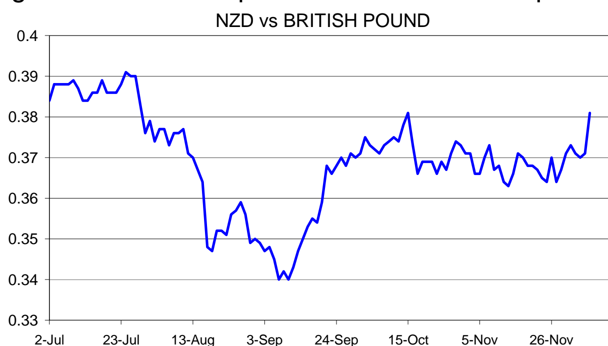
A central problem in the euro zone is that on the face of it interest rates should be falling because of concerns about tightening credit conditions and weakening world growth. Plus some local indicators are weak with euro-zone retail spending falling 0.7% in October for instance. However with food and energy prices rising strongly inflation has just hit a six-year high of 3% in November from 2.6% in October which is well above the ECB's targeted level of 2%. This inflation problem means it is very unlikely the ECB will follow the Fed. and cut rates soon – maybe not until the middle of next year.
http://www.bloomberg.com/apps/news?pid=20601068&sid=aegKLdBMtcQs&refer=economy

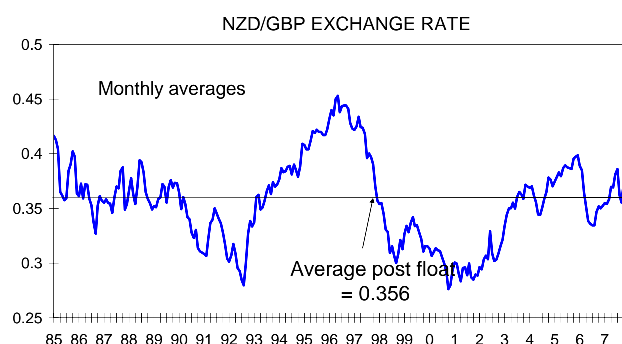


United Kingdom

GDP +3.2%, CPI 2.1%, base rate 5.75%, 12% of NZ visitors & 5% of exports.

The pound has fallen to a six-week low against the greenback and four-year low against the euro in response to weak economic data driving speculation the Bank of England might cut interest rates tonight. The pound has ended against the US dollar near $2.03 from $2.075 last week. The Kiwi dollar has jumped against the weaker pound to end near 38.1 pence from 37 pence last week.





The markets are becoming increasingly of the view that the Bank of England may immediately cut interest rates from 5.75% after raising the base rate 075% earlier this year. One of the many monthly nationwide house price measures fell sharply in November taking the annual rate of change down to 6.9% whereas a rise of 8.4% had been expected. Another showed house prices falling 1.1% in November after declining 0.7% in October. Another survey showed consumer confidence falling to the lowest level since March 2003 and confidence about making a big purchase falling to a 12 year low.
http://www.bloomberg.com/apps/news?pid=20601102&sid=aPM0NZf5zBbw&refer=uk

Other housing market measures have also been looking decidedly weak. In addition as in Europe and the US liquidity conditions between banks have tightened ahead of year end and the Bank of England has said it will offer commercial banks emergency funds with longer than usual repayment terms.

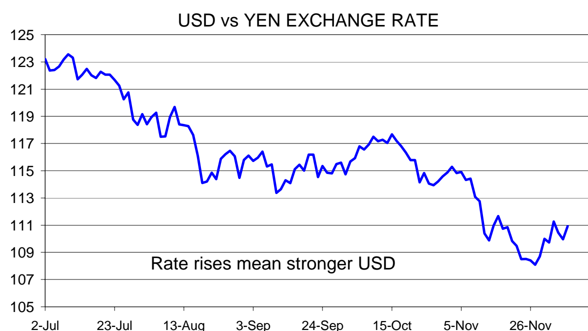
But while housing looks weak the manufacturing sector continues to look robust with the monthly Purchasing Managers Index coming in at 54.4 for November which was well above expectations of 52.5. A reading above 50 indicates growth in the manufacturing sector.

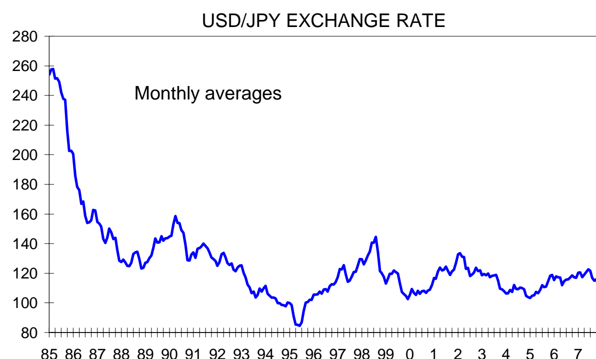
Basically things are slowing in the UK and rates are going to be cut in the near future. At this stage nobody is talking about an especially sharp slowdown in UK growth which is important for us because of 12% of visitors to New Zealand come from the UK and they account for about 5% of our merchandise trade export receipts.

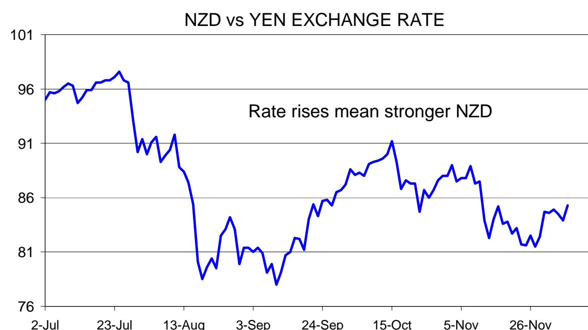
Japan

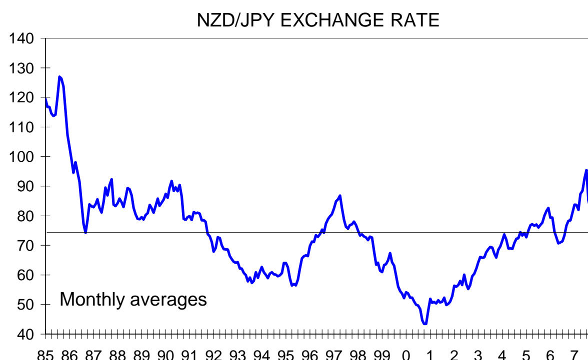
GDP +2.6%, CPI -0.2%, cash rate 0.5%, 5% of NZ visitors & 10% of exports.

As noted above the yen has weakened slightly against the greenback over the week to end near 110.7 from 110.0 a week ago. This means the Kiwi dollar has improved to end near a three-week high of 85.6 from 84.7 last week.

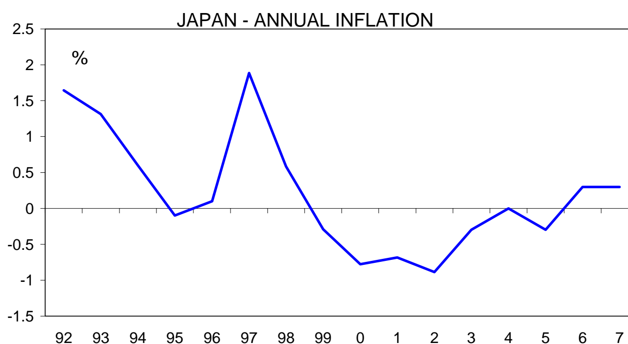








There was some mild excitement this week when the October inflation number came out slightly higher than expected showing that with increases in energy and food prices the annual rate of inflation rose to a 10 month high of 0.1%. This matters to us because if Japanese interest rates go up the attractiveness of the JPY-NZD carry trade diminishes and some NZD weakness would ensue. But exporters shouldn't get optimistic. The markets are only pricing in a 30% chance that the 0.5% Japanese cash rate will be increased by March next year and the risk is this probability comes down in light of worries about the United States economy, the firm yen, and a tightening of credit conditions. In fact this Monday the Bank of Japan Governor said he was "…in no hurry.." to raise the cash rate. So there.



Plus data were released this week showing a 1.2% fall in business capital spending over the September quarter following a 4.9% fall in the June quarter. In addition profit fell for the first quarter in five years. This is not good stuff as it seems to indicate good momentum in the economy earlier this year has not continued. Plus the domestic part of the economy – business investment, housing and private consumption – doesn't look robust. That leaves the economy still dependent upon exports therefore vulnerable to any slowdown in the US which takes about 23% of Japan's exports. China takes about 15%
http://www.bloomberg.com/apps/news?pid=20601068&sid=aJD89RFD5vJQ&refer=economy

Good up to date background article series on the Japanese economy, then a backgrounder on the growing rural/urban divide in Japan.
http://www.economist.com/specialreports/displayStory.cfm?story_id=10169956
http://www.iht.com/articles/2007/12/05/business/05gap.php#end_main

FURTHER READING

Sovereign Wealth Funds

These 28 funds may have assets of about US$3 trillion - about twice the size of the global hedge fund industry - and there is concern that their purchases may lead to politically influenced business dealings in the future. Various estimates suggest that in perhaps five years time their total assets may exceed $10 trillion by 2012.
http://www.csmonitor.com/2007/1126/p16s01-wmgn.html

The Europeans are going to have a look at ways to regulate them - see below.
http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2007/11/29/cnfunds129.xml

However it looks like the attention of the recently created US$200b Chinese Investment Fund may be shifting from overseas purchases which frighten foreign governments toward shoring up the Chinese banking system. There is significant concern that should the rate of growth in the Chinese economy slow down appreciably bad lending practices by banks would be revealed with potentially devastating consequences for the Chinese financial system, economy, and therefore the social stability and promise of betterment for all which the Communist Party relies on to hold the whole pack of cards together.
http://www.iht.com/articles/2007/11/28/business/yuan.php#end_main

Rising Food Prices

We export lots of food items so for us rising prices are a bit of a hassle at the supermarket but for our economy overall it is good news. This is not so much the case overseas where concerns about rising food prices are leading to industrial and sometimes civil unrest. In Russia industrial action in response to rising inflation appears to be picking up and this is the sort of thing less democratically minded governments get very concerned about. The links look at Russia, China.
http://www.iht.com/articles/2007/11/28/business/strikes.php
http://www.csmonitor.com/2007/1116/p01s01-woap.html
And if you're of running a not too democratic country worried about the way your citizens are protesting against food rises then the future doesn't necessarily look too good. On Tuesday a report was released by the International Food Policy Research Institute suggesting that because of factors such as economic growth, climate change, and biofuel production food prices are likely to keep on rising. That's good news for our export base and therefore our economy but bad news for developing economies whose agricultural production will be negatively affected by climate change whereas a positive impact will occur in many developed countries.
http://www.ifpri.org/pubs/agm07/jvbagm2007.asp
You're very unlikely to read the above lengthy report so here are some of the points in their conclusions section.

- Strong economic growth in developing countries is a main driver of a changing world food demand toward high-value agricultural products and processed foods. (**Our stuff**)
- Slow-growing supply, low stocks, and supply shocks at a time of surging demand for feed, food, and fuel have led to drastic price increases, and these high prices do not appear likely to fall soon. (**Hence often positive comments from Fonterra and our suggestion that eventually sheepmeat and beef prices will rise quite well.)**
- Biofuel production has contributed to the changing world food equation and currently adversely affects the poor through price-level and price-volatility effects.
- Many small farmers would like to take advantage of the new income-generating opportunities presented by high-value products (meat, milk, vegetables, fruits, flowers). There are, however, high barriers to market entry. (**Ask anyone considering converting to dairying**.)Therefore, improved capacity is

needed to address safety and quality standards as well as the large scales required by food processors and retailers.

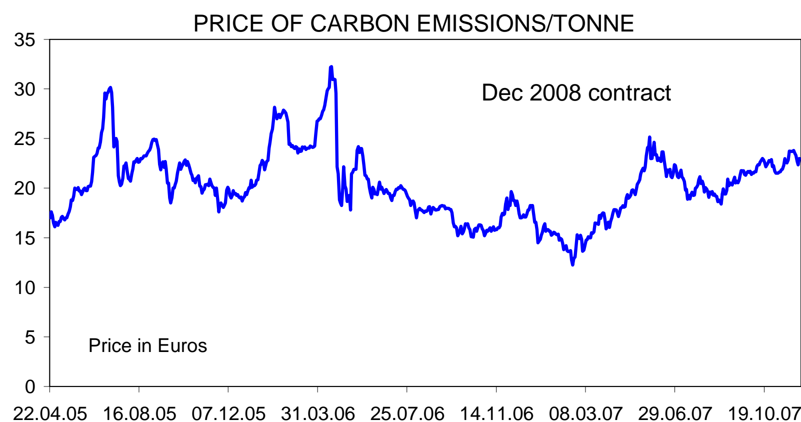
Spreading Tentacles of the Global Liquidity Crisis

In past financial meltdowns one has usually been able to identify reasonably early on where the losses lie. But a unique aspect of the current global liquidity crisis is that because the securities used to finance the sub prime loans in the United States were sold to investors all around the world the impact is A) global and B) unknown. The unknown aspect arises because the securities were sold so widely and while an individual may think they have no direct exposure it could be they have invested in a managed fund which has invested in other companies who may themselves have some exposure. The following article looks at the woe developing in a Norwegian town inside the Arctic Circle because of unwise investments in housing related securities. Note that another key aspect of the current liquidity crisis is that the true risky nature of the securities which were issued was not understood - in fact the way the collateralised debt obligations were structured the high risk was explicitly hidden.
http://www.nytimes.com/2007/12/02/world/europe/02norway.html?_r=1&hp&oref=slogin
http://www.economist.com/daily/news/displaystory.cfm?story_id=10231806

Climate Change

It would be wrong to say the business community is not aware of the increasingly dire need to reduce greenhouse gas emissions. Just this past week a meeting of 150 large global companies called for a legally binding UN framework to reduce emissions. Most significantly the 150 companies forming part of the Corporate Leaders Groups on Climate Change said – quoting from the article below "The overall targets for emissions reduction must be guided primarily by science. This is in contrast to the argument that has previously been made by some parts of the business community that it is concerns over competitiveness and cost that should set the limit of emission cuts." In other words sod the cost lets just do it – preferably in some manner that spreads the short term cost more evenly than many currently fear. For an example of that fear see last week's press release by the NZ business group the Greenhouse Policy Coalition expressing cost concerns. The unfair interpretation would be that they want to slow things down. The more realistic one would be that they want deep thought given to the design of our Emissions Trading Scheme. Fair call.
http://english.aljazeera.net/NR/exeres/1AD45C1D-DA37-420C-8CFC-8FA35B842606.htm
http://www.greenhousepolicy.org.nz/

For your guide, here is a graph showing the change in the price of carbon emissions traded on the European Carbon Exchange. Only futures contracts are traded and we have chosen to show the December 2008 contract. Contracts out to 2012 are traded. Best get used to seeing this – one way or the other we'll all be paying for heating up the planet. Working out what the price is NZ emitters will pay is not possible using these data as the ECX trades only contracts relevant to the European Union Emissions Trading Scheme.



For background details on the proposed NZ ETS scheme you can download the just released Climate Change (Emissions Trading & Renewable Preferences) Bill at
http://www.parliament.nz/en-NZ/PB/Legislation/Bills/c/0/4/00DBHOH_BILL8368_1-Climate-Change-Emissions-Trading-and-Renewable.htm
And don't forget the latest UN Intergovernmental Panel on Climate Change report at
http://www.ipcc.ch/
Best to go there.

Data Sources

Interest rates & exchange rates RBNZ at	http://www.rbnz.govt.nz/statistics/
Housing fixed interest rates – our data from 1991 email	tony.alexander@bnz.co.nz
House mortgage data – RBNZ	http://www.rbnz.govt.nz/statistics/monfin/rbssr/rbssrpartE/data.html
House price information - REINZ	http://www.reinz.org.nz/reinz/public/market-information/market-information_home.cfm
NZ economic data, most from Statistics NZ	http://www.stats.govt.nz
Government accounts, NZ Treasury at	http://www.treasury.govt.nz/financialstatements/
Australian data	http://www.abs.gov.au/ and http://www.rba.gov.au/
European data	http://epp.eurostat.ec.europa.eu
United States data	http://www.economagic.com/
Parliament, select committees, publications etc.	http://www.parliament.nz/en-nz

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ECONOMIC DATA

All %		Latest qtr only	Previous qtr only	Latest year	Year ago	2 Yrs ago
Inflation	RBNZ target is 1% - 3% on average	0.5%	0.7	1.8	3.5	3.4
GDP growth	Average past 10 years = 3.0%	0.7	1.2	2.2	2.2	3.3
Unemployment rate	Average past 10 years = 5.3%	3.5	3.6	......	3.8	3.7
Jobs growth	Average past 10 years = 1.9%	-0.3	0.6	1.5	1.5	3.3
Current a/c deficit	Average past 10 years = 5.5% of GDP	8.2	8.5	......	9.7	8.0
Terms of Trade		0.6	1.5	2.5	0.5	1.0
Wages Growth	Stats NZ experimental series	1.6	1.2	4.9	4.9	5.1
Retail Sales ex-auto	Average past 9 years = 3.8%.	0.2	-0.9	5.6	4.5	6.3
House Prices	Long term average rise 5% p.a.	2.8	4.3	13.7	10.3	13.7
Net migration gain	Av. gain past 10 years = 10,400	+7,520	8,970yr	......	13,780	5,987
Tourism – an. av grth	10 year average growth = 5.0%. Stats NZ	3.1	3.7	3.1	-0.0	3.1
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 2%. Colmar survey	2	-8	-4	-10	-7
Business activity exps	10 year average = 26%. NBNZ	15.7	20.3	7.8	23.7	0.0
Household debt	10 year average growth = 11.3%. RBNZ	13.3	13.6	13.5	13.3	15.3
Dwelling sales	10 year average growth = 3.5%. REINZ	-22.6	-32.0	8.2	4.0	3.9
Floating Mort. Rate	10 year average = 8.1%	10.55	10.55	10.05	9.55	9.00
3 yr fixed hsg rate	10 year average = 7.9%	9.19	8.80	8.70	7.99	7.90

ECONOMIC FORECASTS

Forecasts at Nov. 22 2007	March Years					December Years				
	2006	2007	2008	2009	2010	2005	2006	2007	2008	2009
GDP - annual average % change										
Private Consumption	4.4	2.4	3.7	1.3	0.5	4.8	2.1	4.3	1.5	0.7
Government Consumption	5.3	4.1	3.7	3.9	4	4.5	4.6	3.6	4	3.9
Investment	4.2	-3.1	4.2	2	2.9	3.1	-2.7	4.4	2	2.2
GNE	4	0.7	4.8	1.9	1.7	4.1	0.6	4.9	2.2	1.7
Exports	-0.1	3	1	2.6	3.9	-0.4	1.8	1.9	1.9	3.8
Imports	4.1	-1.4	6.8	4.1	3.1	5.4	-2.6	7	4.3	3.2
GDP	2.7	1.7	3.1	1.6	1.9	2.7	1.7	3.1	1.8	1.8
Inflation – Consumers Price Index	3.3	2.5	3.1	3.2	3.1	3.2	2.6	2.9	3.2	3
Employment	2.6	1.7	0.9	0.8	1	1.6	1.4	1.8	0.9	0.9
Unemployment Rate %	3.9	3.7	3.6	3.8	4.2	3.6	3.7	3.6	3.7	4.1
Wages	4.6	5.5	4.8	4.2	3.3	5.1	5.5	4.3	4.6	3.5
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.64	0.7	0.77	0.67	0.59	0.7	0.69	0.76	0.69	0.61
USD/JPY	117	117	108	111	109	119	117	109	112	110
EUR/USD	1.2	1.32	1.5	1.38	1.3	1.19	1.32	1.5	1.41	1.32
NZD/AUD	0.87	0.88	0.82	0.77	0.76	0.94	0.88	0.83	0.77	0.76
NZD/GBP	0.36	0.36	0.39	0.36	0.34	0.4	0.35	0.38	0.37	0.35
NZD/EUR	0.53	0.53	0.51	0.49	0.45	0.59	0.52	0.51	0.49	0.46
NZD/YEN	74.6	81.9	83.2	74.4	64.3	82.7	81	82.5	76.9	66.8
TWI	65.6	68.6	70	63.8	58.4	71.9	68	69.4	64.8	59.8
Official Cash Rate	7.25	7.50	8.25	7.5	6.5	7.0	7.50	8.25	7.75	6.75
90 Day Bank Bill Rate	7.55	7.78	8.68	7.7	6.73	7.49	7.64	8.74	7.95	6.98
10 year Govt. Bond	5.71	5.91	6.35	6.05	5.9	5.89	5.77	6.4	6.1	5.9
2 Year Swap	6.99	7.76	8.18	7.02	6.56	7.24	7.48	8.51	7.22	6.59

All actual data excluding interest & exchange rates sourced from Statistics NZ.

The BNZ Weekly Overview is prepared by Tony Alexander, Chief Economist at the Bank of New Zealand. Ph 04 474-6744.