Bank of New Zealand

BNZ Weekly Overview

7 February 2008

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	8.74%	8.75	8.78	8.69	7.70	6.4
10 year govt. bond	6.30%	6.25	6.28	6.57	6.0	6.5
1 year swap	8.78%	8.72	8.84	8.95	7.95	6.6
5 year swap	8.09%	8.04	8.19	8.39	7.40	7.0

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". We maintain only ONE emailing list so recipients receive both the Weekly Overview and Offshore Overview.

Survey Time

If you haven't already done so in the email used for sending out the Weekly Overview and if time permits please cut and paste the URL below into your browser, click on it and let us know whether you think the economy will get better or worse over the coming 12 months. More importantly if time permits please let us know how things are at the moment in your particular industry specifying what that industry is. The results of our first monthly survey of the confidence of Weekly Overview readers will be released early next week.

http://survey.usuite.com/survey/7f801dd05f3742619b046cc119c15106.sur

This week the main things we have learnt about the New Zealand economy are that people are still quite prepared to spend on vehicles and farmers in particular are spending up large on tractors. Net migration inflows into the country continue to fall at an accelerating pace and the net gain may hit zero toward the middle of the year while in the tourism industry visitor numbers are going backward. But as we have been pointing out for a number of years now the New Zealand economy is short of resources and labour in particular. We been warning about strong wage increases and in that regard we saw a jump wages growth in data released this week.

But swamping all of that information was the quarterly Household Labour Force Survey released this morning. It showed that our unemployment rate fell to a record low of 3.4% in the December quarter from 3.5% in the September quarter. There are only four other countries in the OECD with lower unemployment rates. We also learnt that job numbers grew at four times the expected pace over the quarter.

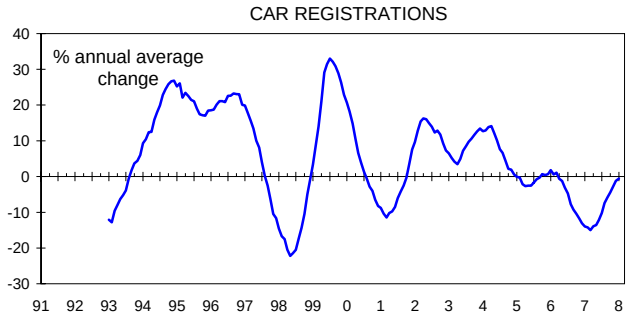
The main implication of the labour market data is that anyone thinking the increasingly bad housing market numbers are going to force the Reserve Bank to cut interest rates soon are dreaming. Not only that, but in a week in which we saw bad economic data appear in the United States the interest rate differential between New Zealand and the US in particular is going to remain huge and probably increase with further rate cuts likely across the Pacific. The Kiwi dollar looks set to consolidate above 80.0 US cents.

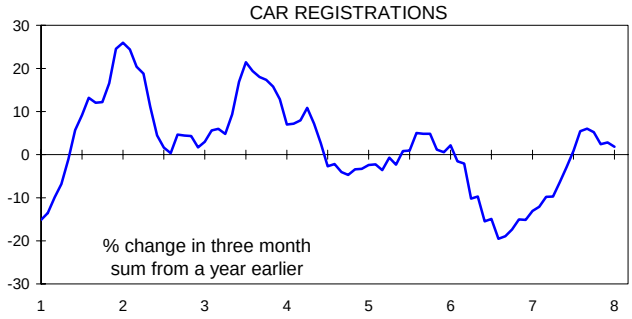
NZ ECONOMIC DEVELOPMENTS

Monday 4

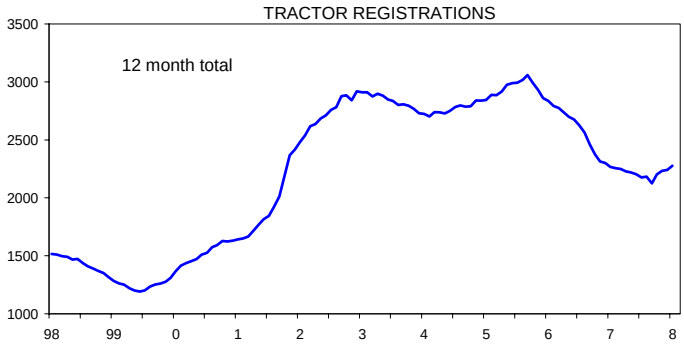
Spending on Motor Vehicles Rising Firmly

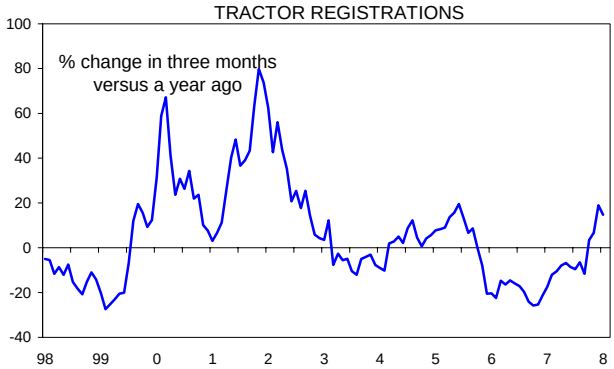
In January there were 16,877 cars registered around New Zealand. This was a small 1.7% increase from the same month a year earlier and for the three months to January registrations were ahead by 1.8% from a year ago. So there is some small growth occurring with regard to car registrations which is not what you would expect to see if people were very despondent about their incomes and employment prospects and worried about falling house prices and high interest rates. Instead the continuing growth in car registrations indicates people are still prepared to put their money where their mouth is when it comes to purchasing a large item. This is one of the reasons we don't believe the New Zealand economy is heading anywhere close to recession in the near future even though there are a few manufacturing and farm exporters who are wishing otherwise from an exchange-rate point of view. Note how the first graph below shows an improvement in this area from early 2007.





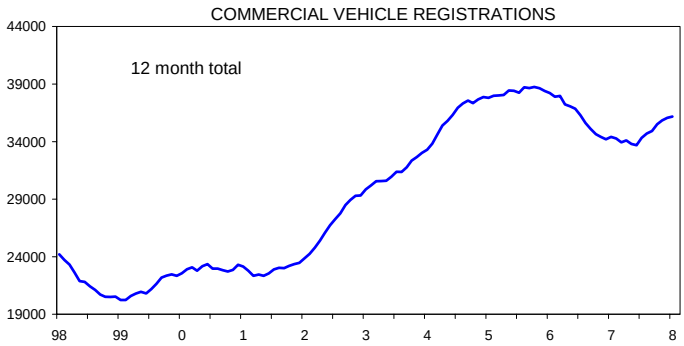
One thing we all should all know is that at the end of the day what happens in the farming sector in New Zealand is very important for our overall rate of economic growth. In that regard it is impossible to talk about recession or major problems for our economy when you look at some of the figures coming out of the farming sector. For instance in January there were 161 tractors registered around the countryside. This was a very large 29% increase from a year earlier and means that in the three months to January registrations of tractors were ahead by 14.7% from a year ago. Conditions are dry at the moment and there are problems for the sheepmeat sector in particular, but the dairy industry is booming and that accounts for over one third of agricultural output in New Zealand – and rising. Spending on tractors by dairy farmers and non-dairy farmers undertaking conversions is clearly offsetting any pullback on spending in this particular area at least.

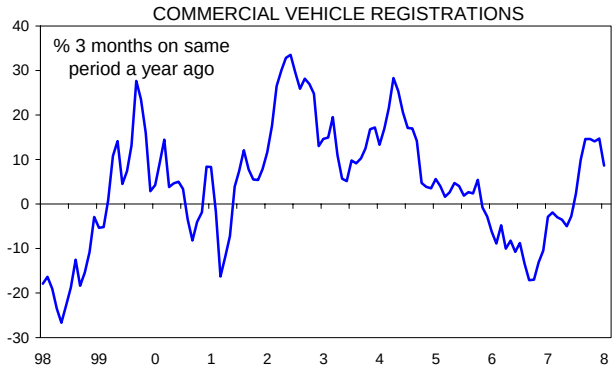




Spending on cars is rising slightly. Spending on tractors is booming. Spending on commercial motor vehicles is rising at a reasonably healthy pace. In January there were 2,656 commercial motor vehicles registered around New Zealand. This was a 4.9% increase from a year earlier and for the three months to January the increase on a year ago was 8.6%. This indicator is positive and it's very important that it is because what our economy desperately needs is an increase in business sector productivity. If businesses

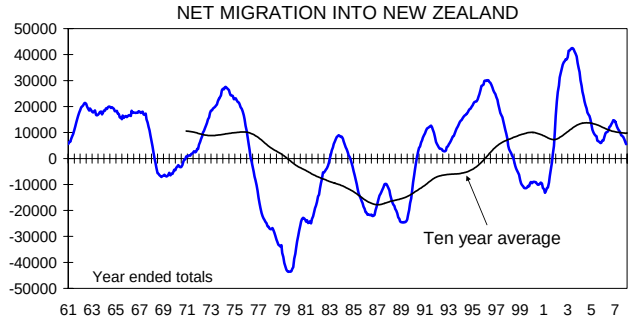
are investing in new motor vehicles hopefully this will lead to some increase in productivity and alleviate some of the pressures on business costs which hopefully may limit the extent to which inflation will rise.

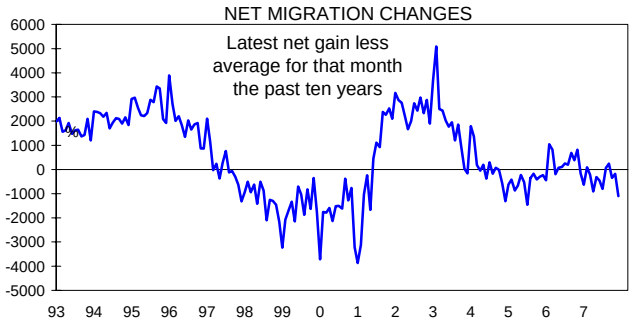




Migration Gain Eases Rapidly

There was a net loss to New Zealand's population from permanent and long-term migration flows in December of 106 people. This compared with a gain of 990 a year earlier and means for the year to December 2007 the net migration gain was just 5,494 people compared with 14,630 over calendar 2006 and a 10 year average annual gain of 9, 752. In seasonally adjusted terms the migration gain for December was only 20 people compared with gains averaging around 500 for the other months over 2007. It is only one month's worth of bad data but it is fairly shocking. The chances seem good that the net migration gain will head towards zero toward the middle of this year. With regard to what is driving the flows, over the December quarter the number of people leaving New Zealand was up about 15% from a year earlier while the number of people coming in was down 2%. So this is mainly a story of Kiwis leaving - predominantly across to Australia it seems. People perhaps are attracted by the booming Australian economy and labour shortages over there providing opportunities for major income increases.





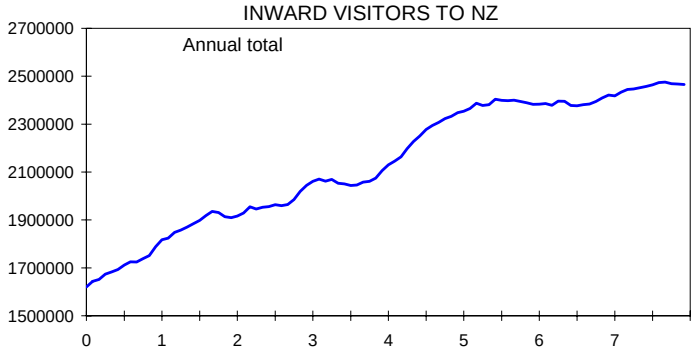
There are two major implications from this seemingly rapid deterioration in net migration inflows. The first is obviously reduced growth in demand for housing which will tend to place downward pressure on prices. In particular, with investors highly aware of the role which migration flows can play in New Zealand's housing market these latest numbers may encourage some extra rationalisation of residential property portfolios. This is likely to be particularly the case in Auckland which tends to attract about 50% of migrants and New Zealand.

The other major application is extra tightness in the labour market because of reduced growth in the labour supply. This will tend to place extra upward pressure on wages with the inflationary consequences of this probably or setting the disinflationary consequences of extra housing market weakness. In other words, the easing migration numbers do not increase the chances of the Reserve Bank easing monetary policy in the near future.

Tourist Numbers Falling

In December the number of overseas visitors to New Zealand was down by 0.6% from a year earlier. For the full calendar year visitor numbers were down 1.3% after rising 5.4% last year and falling 2.4% over 2005.

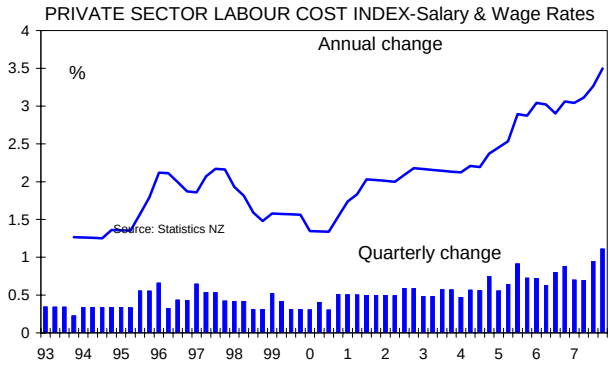
Tourist numbers have been reasonably static since the start of 2005 and we have other data in hand showing that over the past few years the average length of stay has declined from 25 days to 20 days per person. Given our expectation of a continued high level for the Kiwi dollar plus slowing growth overseas it is likely that over 2008 the number of foreign visitors to New Zealand will fall even further with additional declines in average length of stay and probably spend per day as well.

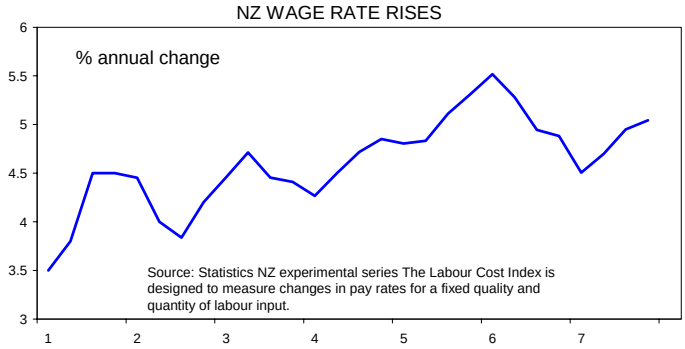


Tuesday 5

Wages Growth Strong and Accelerating

A firm acceleration in wages growth was evident in the Labour Cost Index released today. Private sector salary and ordinary time wage rates rose by 1.1% over the December quarter after rising 0.9% in the September quarter and 0.9% a year earlier. This is the strongest quarterly increase on record and takes the annual rate of increase in this particular wages measure to 3.5% from 3.3% in the September quarter and 3.1% a year earlier.



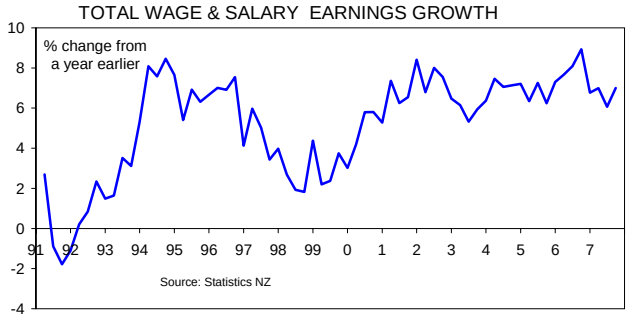


This strength in wages growth was also recorded in an experimental series put together by Statistics New Zealand which tracks the same jobs over time. This index increased for the private sector by 1.3% over the December quarter taking the annual rate of change to 4.8% from 4.7% in the September quarter and 4.7% a year earlier.

The Quarterly Employment Survey, released with the LCI, tends to be heavily influenced by compositional changes in the labour force so one can get a rise or fall in wages growth but not really be sure if this is something reflecting overall developments in the labour market or simply because of a shift in people from one industry to another. But for what it is worth average hourly ordinary time earnings in the private sector grew by 0.9% in the December quarter after rising 1.3% in the November quarter. Compared with a year ago this measure was up by 4.2% from 4% growth in the September quarter and 5% a year earlier.

Perhaps a more meaningful statistic to take out of the QES is the one showing growth in total wage and salary earnings. These rose by a strong 2.7% during the December quarter after rising 1.9% in the December quarter 2006 and 1.1% a year before that. The December quarter earnings increase was the strongest on record for that quarter though as the graph below shows although this gives 7% annual growth there was a higher annual increase recorded near 9% in the middle of 2006. The main thing to take out of

this is that people are still receiving more money in their pockets and this provides some support to retail spending and insulation to the housing market against the effects of easing migration and high interest rates.

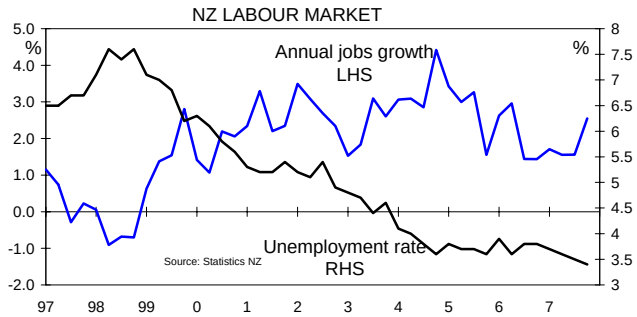


These earnings data releases show continued firm growth in wages in New Zealand helping to line the pockets of wage and salary earners.

Thursday 7

Labour Market Absolutely Booming

The Household Labour Force Survey showed that New Zealand's unemployment rate fell in the December quarter to a seasonally adjusted 3.4% from 3.5% in the September quarter and 3.8% a year ago. This was the lowest unemployment rate on record and was exactly opposite to what the markets had been expecting. This was because jobs growth in the quarter of 23,000 people was four times expectations. The 1.1% quarterly increase in employment compared with a fall of 0.3% over the September quarter and a 0.6% rise in the June quarter. Compared with a year earlier job numbers were up by 2.5% which was the strongest annual rate of growth in six quarters. New Zealand's labour market is incredibly tight and this has major implications for a great number of things.

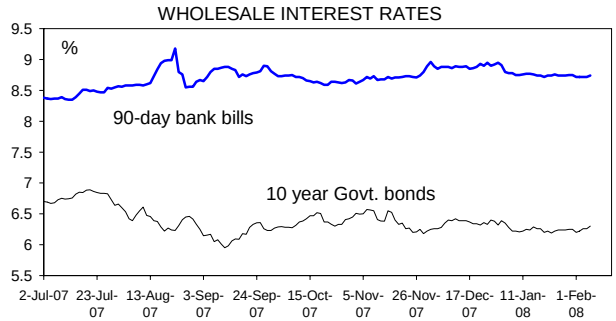


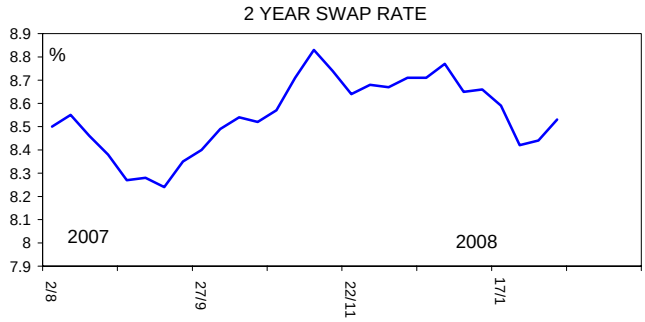
The first is that there is clearly an imbalance between demand and supply in the labour market at current wage levels. Wages growth is already accelerating and there is more to come. This is great from a household income and potential spending point of view and may even lead to some lift in savings in an environment where people no longer believe they can borrow money and make quick profit on a property investment. But it opposes a severe problem for our central bank which after four years is still battling and inflation problem they should have got under control some time ago. Having said that other countries are also battling inflation demons with the Australian cash rate for instance increased again this week.

Basically unless the New Zealand housing market completely crashes with prices falling 10% and at the same time the world economy falls over it is difficult to envisage our central bank cutting interest rates either very soon or when they do by very much. New Zealand borrowers should budget for continued high debt servicing costs over the next couple of years. Exporters meanwhile should not get optimistic about the Kiwi dollar falling. They should continue to assume it remains strong again for the next couple of years. We do think there is some depreciation likely late this year and through 2009 but if you are a regular reader of economic commentaries you will know that most people have been forecasting some depreciation of the Kiwi dollar about 12 months out ever since it broke through the US 65.0 cent level in January 2004. If you budget for the Kiwi dollar over the next two years averaging where it is now that would seem reasonable.

INTEREST RATES

If the economy were really slowing down aggressively one would expect to see spending on motor vehicles declining. That is not happening. There is massive growth in tractor registrations, healthy growth in commercial vehicle registrations, and acceptable growth in car registrations. If you knew nothing other than these figures you would have to say that scope for any easing of monetary policy in the near future does not look good. As it is we have many other indicators backing up our view that one should not be talking seriously in terms of policy easing anytime soon. This morning we learnt for instance that New Zealand's unemployment rate has fallen to a record low of 3.4% and jobs growth of 1.1% over the December quarter was four times market expectations.



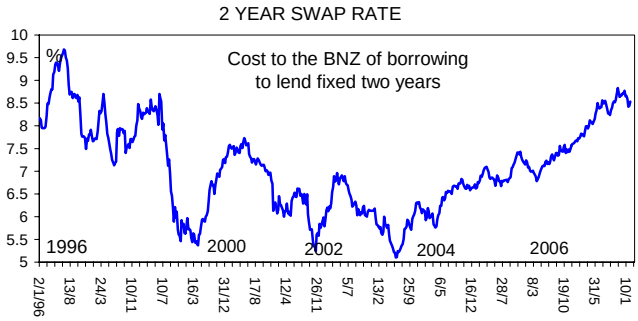


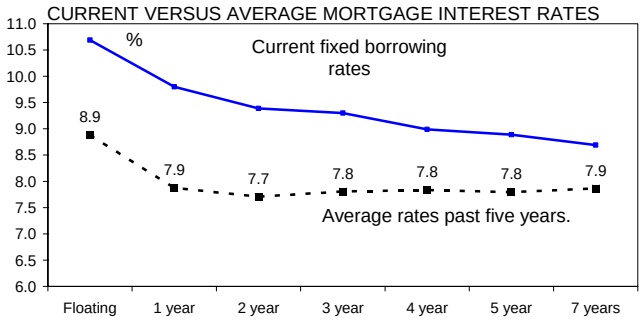
Inflation risks in our economy remain high and even though we are increasingly worried about both the New Zealand housing market and growth in our trading partners New Zealand's inflation worries from resource shortages and an upcoming stimulative fiscal package mean continued high interest rates for a long period of time. These worries manifested themselves this week with increasing wholesale interest rates. The two year swap rate at which we banks borrow to lend fixed for two year periods increased to around 8.55% from 8.44% last week. This rate is still below the 8.8% seen at the end of last year when worries about liquidity in financial markets were quite severe. We don't think this benchmark interest rate is headed back to the 8.8% level but perhaps more importantly we see only minimal scope for declines as the year advances.

Yields on 90 day bank bills finished the week unchanged from a week ago near 8.75%.

If I Were a Borrower What Would I Do?

I wouldn't be focusing on increasingly depressing commentary about the housing market and thinking that interest rates are going to fall soon. The Reserve Bank has more to worry about than just the housing market with labour availability deteriorating amidst an environment of easing fiscal policy and rising food and energy prices. I would probably fix two years though if someone offered a heavily discounted three-year or one year rate I may look there but not all that willingly.





HOUSING MARKET UPDATE

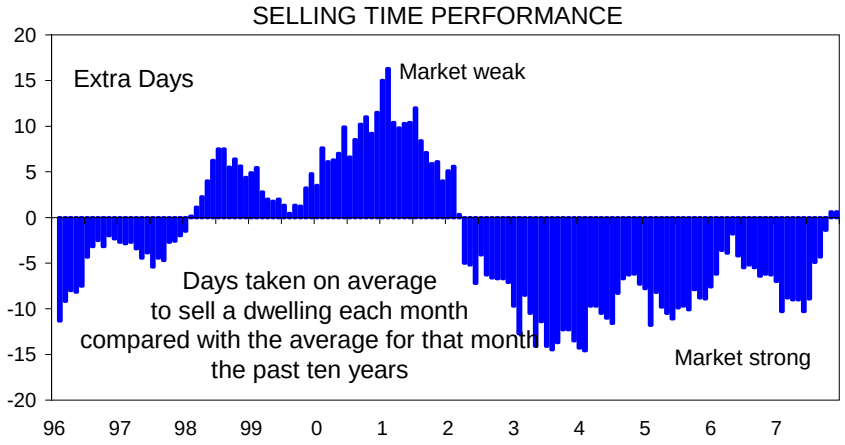
We received an enquiry from an accountant this week calling to ask our thoughts on the beachside property market. He said a dairy farmer client is contemplating making a purchase and wanted to know the outlook. We noted that there is a near complete absence of data on the market and that working out the economic fundamentals that drive it is a dogs breakfast – except in one regard. It appears to often be influenced by changes in fortunes in the dairy sector in particular. In other words, his enquiry gave us the information to supply the answer. Its probably going to be supported by cash rich dairy farmers!

Perhaps a bit more than that needs to be added. High end property prices and luxury things like beachside properties tend to be influenced less by what is happening with average incomes and general employment and more by the state of the small to medium sized business sector. In that regard although business profitability is going to be generally constrained by rising costs we see sufficient growth in the economy to prevent a business recession as it were.

The part of the property market most at risk in a proper recession probably is beachside, but given our outlook the risky part is the low priced end which has been attractive to investors these past few years. Financing costs are high and they are going to stay that way all year. The sheer persistence of negative cash flows is going to scare quite a number of people who for the moment may be thinking their poor cash position is temporary. It isn't. Rents are not going to be able to be increased to the extent and at the speed investors need to give them comfort.

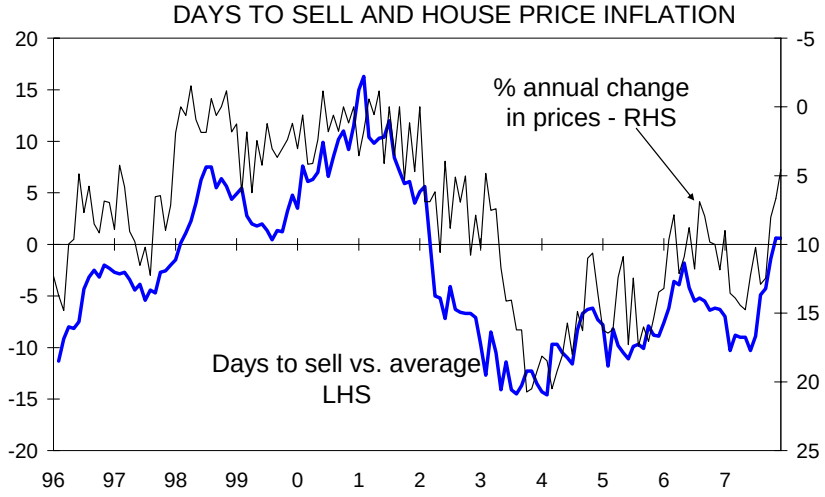
This means price declines are likely for mid to lower priced properties but not by all that much except in the occasional case of a fire sale. This is because it is at the low priced end of the market that financially stretched first home buyers are looking. They will currently be highly aware that the market has shifted away from favouring the vendor. But they are also probably aware it is not yet actively favouring the buyer. That will be more a story toward the middle of the year. Between now and then astute first home buyers would probably be best advised to scout out the market, build up their deposit, and wait for the interest rate decline dreams of cash strapped investors to be shattered.

Just to support the high probability of average price declines its best to take a close look at what has been happening with regard to the average length of time taken to sell a dwelling. On average in December it took 36 days to sell a dwelling. This was 0.6 days longer than the average December over the past ten years and shows up as the small blue bar above the zero line at the far right of the graph below. Six months earlier in June the days to sell was running 10.3 days faster than the June average. The turnaround has occurred over a short period of time and been relatively savage though not unprecedented. Note the deterioration from late 1997 into mid-1998. Note also the improvement near the start of 2002. What happened around these times?



The 1997-98 turnaround was associated with average house prices between September 1997 and July 1998 basically holding flat according to the REINZ monthly figures. If we use the smoother and ultimately more accurate QVNZ numbers we see an average price fall of 2.5%. Between February and June of 2002 prices on average fell $2,000. Using the QVNZ numbers they rose 2% over the two quarters.

What do we conclude? A rapid change in average length of time taken to sell a dwelling is not necessarily associated with a quick change in house price inflation. But there is a clear relationship between time on market and house price inflation – shown in the graph below. House price inflation is measured inversely (upside-down) on the right hand side. We see two things. Negative house price inflation is rare and it is only approached when days to sell get around 5 – 10 days worse than average.



Are we heading into that territory? Yep.

Exchange Rates & Foreign Economies

See the Offshore Overview

Data Sources

Interest rates & exchange rates RBNZ at	http://www.rbnz.govt.nz/statistics/
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/
Parliament, select committees, publications etc.	http://www.parliament.nz/en-nz

Want more detailed background information on the NZ economy? Start in these places.
http://www.treasury.govt.nz/economy/overview
http://www.oecd.org/country/0,3377,en_33873108_33873658_1_1_1_1_1,00.html
http://www.rbnz.govt.nz/monpol/statements/

BNZ WEEKLY OVERVIEW

ECONOMIC DATA

All %		Latest qtr only	Previous qtr only	Latest year	Year ago	2 Yrs ago
Inflation	RBNZ target is 1% - 3% on average	1.2%	0.5	3.2	2.7	3.2
GDP growth	Average past 10 years = 3.0%	0.5	0.8	2.7	1.6	3.1
Unemployment rate	Average past 10 years = 5.3%	3.4	3.5	.....	3.8	3.6
Jobs growth	Average past 10 years = 1.9%	1.1	-0.3	2.5	1.4	1.6
Current a/c deficit	Average past 10 years = 5.5% of GDP	8.3	8.2	.....	9.2	8.5
Terms of Trade		3.7	0.4	8.4	-1.3	0.9
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.	0.3	2.8	11.4	10.1	14.0
Net migration gain	Av. gain past 10 years = 10,400	+5,494	8,319yr	.....	14,630	6,960
Tourism – an. av grth	10 year average growth = 5.0%. Stats NZ	-0.6	1.3	1.8	1.6	1.5
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 2%. Colmar survey	-10	2	-10	-10	-34
Business activity exps	10 year average = 26%. NBNZ	18.2	15.7	14.8	24.0	-2.4
Household debt	10 year average growth = 11.3%. RBNZ	12.3	12.8	13.7	12.9	15.5
Dwelling sales	10 year average growth = 3.5%. REINZ	-32.1	-21.6	-11.3	19.4	-17.6
Floating Mort. Rate	10 year average = 8.1%	10.69	10.55	10.30	9.55	9.55
3 yr fixed hsg rate	10 year average = 7.9%	9.30	9.19	9.00	8.15	8.15

ECONOMIC FORECASTS

Forecasts at Jan 24 2008	**March Years**					**December Years**				
	2006	2007	2008	2009	2010	2005	2006	2007	2008	2009
GDP - annual average % change										
Private Consumption	4.6	2.6	3.3	0.5	1.7	4.9	2.4	4.1	0.7	1.2
Government Consumption	5	4.4	3.7	3.6	4.2	4.1	4.7	3.9	3.4	4.2
Investment	5.2	-2.3	4.1	1.5	2.7	3.9	-1.6	4.2	1.7	1.9
GNE	4.1	1	4.7	1	2.4	4.2	1	4.9	1.4	1.8
Exports	-0.1	3.1	2.1	3.7	3.8	-0.4	1.7	2.9	3.5	3.7
Imports	4.1	-1.7	8.3	3.4	3.1	5.4	-2.8	8.1	4	3
GDP	2.7	1.6	2.9	1.1	2.5	2.8	1.6	3	1.4	2
Inflation – Consumers Price Index	3.3	2.5	3.4	3.1	2.9	3.2	2.6	3.2	3	3
Employment	2.6	1.7	0.8	0.7	1.8	1.6	1.4	1.8	0.7	1.4
Unemployment Rate %	3.9	3.7	3.8	4.4	4.4	3.6	3.7	3.7	4.3	4.4
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	0.76	0.67	0.61	0.7	0.69	0.77	0.69	0.62
USD/JPY	117	117	107	112	119	119	117	112	110	118
EUR/USD	1.2	1.32	1.47	1.38	1.31	1.19	1.32	1.46	1.4	1.32
NZD/AUD	0.87	0.88	0.87	0.82	0.79	0.94	0.88	0.88	0.83	0.79
NZD/GBP	0.36	0.36	0.39	0.37	0.34	0.4	0.35	0.38	0.37	0.35
NZD/EUR	0.53	0.53	0.52	0.49	0.47	0.59	0.52	0.53	0.49	0.47
NZD/YEN	74.6	81.9	81.3	75	72.6	82.7	81	86.3	75.9	73.2
TWI	65.6	68.6	70.4	64.6	61	71.9	68	71.6	65.8	61.7
Official Cash Rate	7.25	7.47	8.25	7.75	6.75	6.99	7.44	8.19	8	7
90 Day Bank Bill Rate	7.55	7.78	8.73	7.95	6.98	7.49	7.64	8.77	8.2	7.23
10 year Govt. Bond	5.71	5.91	6.3	6.1	6.3	5.89	5.77	6.38	6.1	6.25
2 Year Swap	6.99	7.76	8.29	7.23	6.65	7.24	7.48	8.58	7.46	6.7

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

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