

BNZ Weekly Overview

15 May 2008

Mission Statement

To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

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- **Employers might think last week's shocking jobs data means they can ease off the staff hunt and wage offers. That could be a mistake. We examine why. Page 2**
- **We develop a model for estimating where dwelling over and under-supplies may exist around NZ's territorial authorities. There are shortages in Queenstown and non-central Auckland, and over-supplies in a range of regional locations. Page 5**
- **We analysis household budgets and conclude higher food & petrol prices and interest rates will take almost \$3b out of household wallets this coming year. Page 7**
- **A consumer spending crunch is confirmed with data this morning. Page 9**
- **Fixed housing interest rates have started to fall – fixing longer than one year does not appear optimal. Page 10**

The Weekly Overview is written by Tony Alexander. The views expressed are my own and do not purport to represent the views of the BNZ. To receive the WO and Offshore Overview each Thursday night email me at tony.alexander@bnz.co.nz with 'Subscribe' in the Subject line. You do not have to be a BNZ customer to receive the WO. To get off the list email 'Unsubscribe'.

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Finally – Rebalancing In Our Time

This is going to sound weird to many people, especially retailers, but here goes. Today's news that retail spending fell 1.2% in the March quarter is the best piece of news for our economy in over four years. Why? Because since 2004 the Reserve Bank have been raising then maintaining high interest rates with the explicit aim of generating weakness in the domestic parts of our economy which were generating most of our inflation – housing and retailing. We warned for over three years that they needed to get rates higher faster to achieve their goal so the period of pain for exporters would be shortened.

Now, with help from soaring food and fuel costs, collapsing finance companies, drought, and a global liquidity crisis Kiwi consumers have finally pulled their heads in – and in fact have been doing so for a full year now. This long overdue development means interest rates can start declining, the NZ dollar can head south, and finally we get a rebalancing from domestic growth toward where we really need it - exporting.

2009 will be a story of accelerating export growth and flat domestic activity. 2010 will involve export gains slowly spreading to the domestic sector with the usual lag. 2008 – its still mainly going to be bad for most.

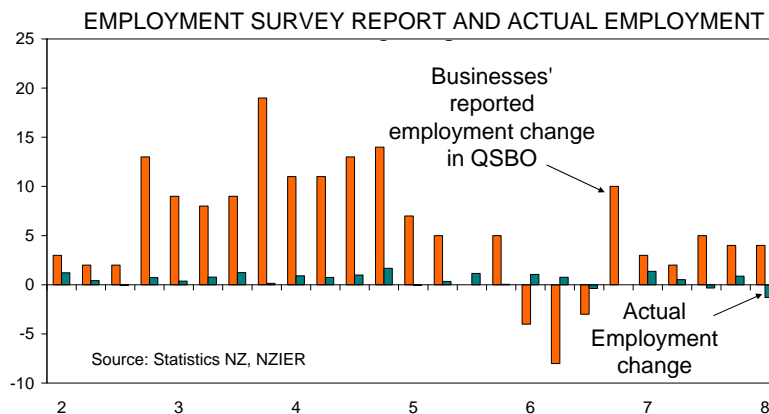
Employers Shouldn't Count Their Chickens

After five tough years trying to find suitable employees, has the tide turned in favour of the employer again? Not as much as you might think

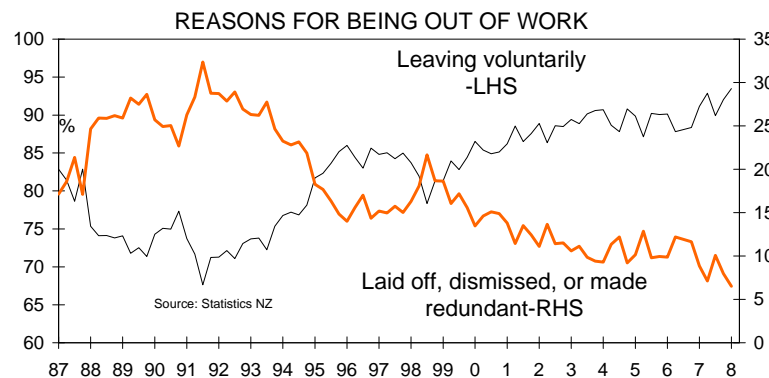
Last week's Household Labour Force Survey was something of a watershed in the financial markets with the Kiwi dollar and wholesale interest rates falling as forecasts for the timing of monetary policy easing were brought forward. Our own pick had been for the first cut to come in December, but now we think September is more likely.

But one can't shake off a suspicion that the employment numbers are overstating weakness in the labour market. The warning we would like to make to employers still struggling to find staff is not to think you can ease off aggressively on the intensive searching or back off on wage offers.

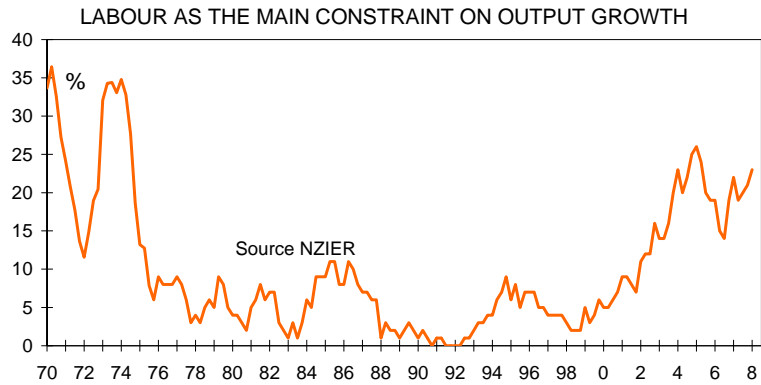
First, no other employment measure lines up with the 1.3% fall in jobs reported for the March quarter. The NZIER's Quarterly Survey of Business Opinion showed that over the March quarter a net 4% of businesses reported they had boosted job numbers. This reading is usually positive but even when it was negative over the first three quarters of 2006 job numbers only ended up falling 0.4% in one of those quarters.



Second, if the labour market were truly weak then one would not expect the HLFS to show that a record 93.5% of those out of work left their last job of their own accord. A record low 6.5% left involuntarily.

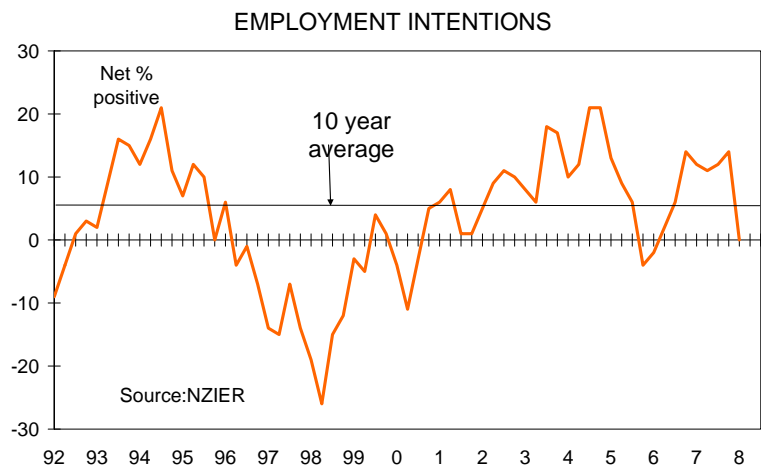


Third, again using the NZIER survey, if employers were truly shedding people in large numbers one would not expect to see a gross 23% reporting that the main reason they cannot boost output is a lack of staff. The ten year average for this measure is 16% and as the graph below shows tightness in the labour market has been worsening since the September quarter of 2007.

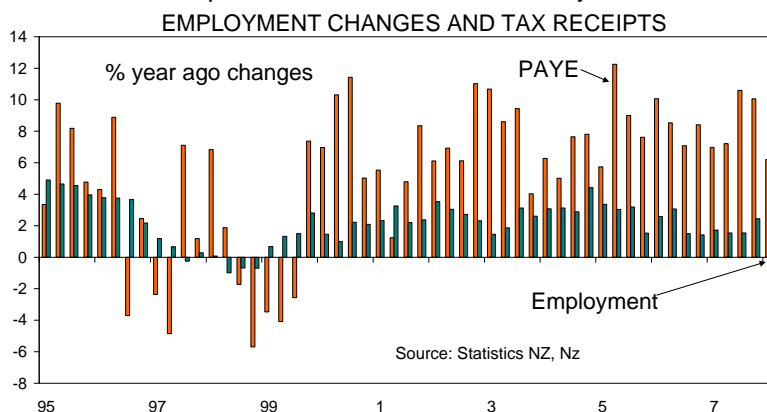


Fourth, if the labour market were muted one would definitely not expect to hear comments we have heard from union officials over the past week along the lines that layoffs are happening but people are being employed again in other firms relatively quickly. One noted that people failing to get work in residential construction are finding employment on infrastructure projects instead.

Fifth, if businesses were truly shedding labour in bulk one would not have expected the NZIER's quarterly survey to reveal a net 0% intend hiring more people. This is below the ten year average reading of a net 5% positive but still above negative results over 2005-06 and the -27% of early 1998 when in total employment for that recession fell just 1.1% over a two year period.



Sixth, at no time since the data series started in 1995 has an annual fall in employment come about without an associated annual fall in PAYE receipts either at the same time or just before as in 1997.

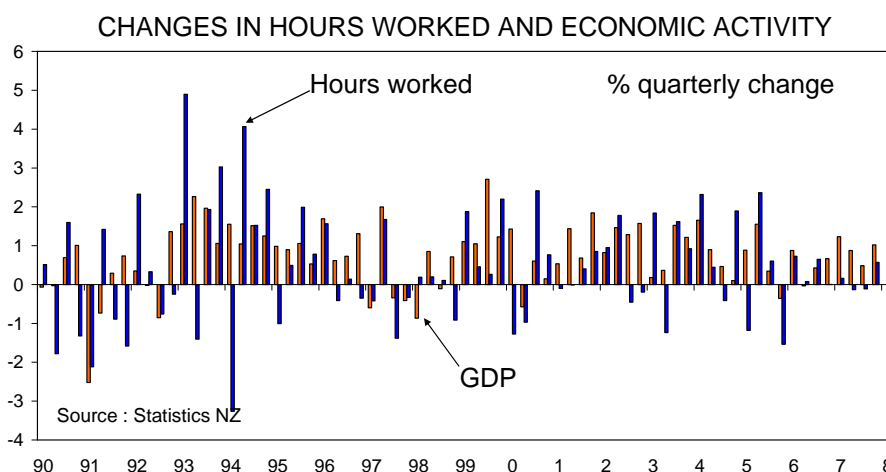


In a nutshell, the 1.3% seasonally adjusted fall in employment during the March is not very consistent with a wide range of other indicators. Instead it is probably best to stand back a bit and smooth the results of the past two quarters. This delivers falls in job numbers averaging 0.2% a quarter. So undeniably the labour market has weakened and there is more to come over the coming year.

But the important points to note are these. One, employers should not assume the labour market has structural shifted in their favour. This is a slight cyclical easing. Availability of staff remains poor so one should take advantage of the easing that is underway to secure staff sure to be needed a year to 18 months down the track – if not right now according to some surveys.

Second, while we believe the state of the economy is poor, the markets may have got ahead of themselves with talk of monetary policy easing starting in June or July. But third, our broader analysis suggests the extent to which monetary policy will need to be eased is probably more than the 1.5% worth of easing the markets are currently factoring in by the middle of next year. So we differ on timing and magnitude.

Just for your guide, since 1990 on 27 occasions the seasonally adjusted hours worked measure in the Household Labour Force Survey has declined. The data released last week showed the decline was a large 1.9% over the March quarter. But only on 7 occasions has the hours worked fall been matched with a fall in GDP for the same quarter. So while the latest jobs result does not rule out GDP shrinkage over the March quarter this year, it does mean that one should not automatically conclude the economy is shrinking – though we think it eventually will.



Accurate Numbers This Time

There is often a lot of confusion surrounding numbers on average incomes and spending levels. This confusion most commonly arises because some measures refer to individuals and some to households. In last week's Overview we fell into one of these definitional traps and said average "household" income for the June quarter of last year was \$667 a week. That was wrong. The number referred to average individual income applying to everyone 15 years of age and over including superannuitants, the employed, unemployed, those choosing to be out of the workforce and so on.

So let's present the proper numbers. For household expenditure one uses the three yearly Household Economic Survey. This survey showed that average household weekly expenditure over the year ending June 2007 was \$956. In Auckland the average was \$1,046, Wellington \$1,103, and Canterbury \$986.

For a couple with two dependent children average weekly expenditure was \$1,314, and for one parent with dependent children it was \$636. These numbers show average weekly spending across a massive number of items.

Now for the income side. For this information it looks like the only 2007 data come from the NZ Income Survey. This survey is undertaken every year in conjunction with the June quarter household Labour Force Survey. In the year to June 2007 average weekly gross income across all households was \$1,445.

For a couple with two dependent children the average was \$1,739 gross. For households with one parent and dependent children the average was \$775 gross. One can go on for hours looking at these numbers in a high degree of detail. But that's enough.

Where Should The Builders Go?

The housing market is undergoing a long overdue correction. But looking beyond the current market, which parts of the country still seem fundamentally short of dwellings, and which look over-supplied? Knowing this could give insight into which markets recover the fastest.

It hasn't been easy, but we have developed a model for estimating the extent to which there may be an under or over-supply of dwellings in the middle of this year for each territorial authority (TA) around the country. If you are interested in the method then read the next six paragraphs. If you just want to see the results then skip ahead to just above the big table below.

Given that the latest TA population estimates from Statistics New Zealand are only available for June 2007 we started there. First we estimated what the dwelling occupancy ratio would be in June 2007 for each TA based on the trend in this ratio for each since the census of 1986. We then calculated how many more dwellings would be needed in 2007 compared with the census of 2006 based on Statistics NZ estimated population change.

Next we looked at how many consents were issued by each TA in the 12 months up to December 2006 – not June 2007. This is because it takes maybe 3-6 months for a consent to be acted on. Now at this point we did not just compare the number of consents issued with the estimated extra number of dwellings needed. Instead we allowed for the fact that on average each year 8,000 more consents are issued than dwellings get recorded at the next census. This extra 8,000 p.a. must presumably be accounted for by demolition of existing dwellings and replacement with new ones, consents not acted on, and construction of holiday homes which are not counted as occupied come census night.

After scaling back each TA's consent number for the year we estimated the excess number of dwellings created. Then we updated it to the June quarter of this year. We estimated the population change for each TA between June 2007 and June quarter 2008 by assuming the same birth and death rate and allowing for the change in net migration flows. We have assumed the June quarter net migration flows this year are 2,000 less than last year spread across the country according to some separate work we will report next week analysing TA net migration flows and their relationship to the nationwide migration movement.

We then estimated the mid-2008 occupancy rate for each TA and estimated how many dwelling consents needed to be issued over calendar 2007 to meet that extra need. Adding the estimated over or under-supply from mid-2007 to the over or under-supply for the middle of this year we get the first column shown in the table below.

This first column is our estimate of the excess number of dwellings constructed in each TA beyond those currently "needed". The second column calculates this excess as a proportion of the known number of occupied dwellings in 2006 and we have ranked the TAs according to this measure.

The most valid measure will be this second column as it allows a comparison of one region with the other. The actual level of over or under-supply in each area will vary according to how much each was over or under at our starting point of June 2006. In that regard we would be highly concerned if we felt there was a large nationwide under or over-supply back then. The fact that annual consent numbers have been tracking the ten year average over the past three years suggests to us that if we are out in our June 2006 assumption it will probably not be by much. And again, it is the relative rankings that matter most.

Our analysis suggests there is a fundamental under-supply of dwellings that is most intense in the Queenstown-Lakes District (that seems to gel with the anecdotes), followed by Manukau, Rodney, and

BNZ WEEKLY OVERVIEW

Papakura, then Wellington. There appears to be a fundamental over-supply of property in the Thames-Coromandel District followed by Carterton then Ruapehu. Note that these calculations do not mean prices "should" not be correcting downward in under-supplied areas. Such conclusions require further analysis into TA deviation from some concept of an average price which is not what we have examined here. Instead the information we have supplied will be relevant to builders thinking about where spec. construction might be most dangerous and where it might be a good idea to divert resources to say 18 months from now.

Location	Over-Supply (+) Under-supply (-)	% %		Over-Supply (+) Under-supply (-)	% %
Queenstown-Lakes	-212	-2.5	Far North	260	1.3
Manukau	-1664	-1.8	Gisborne	207	1.3
Rodney	-570	-1.7	Hurunui	62	1.5
Papakura	-228	-1.5	New Plymouth	396	1.5
Wellington	-786	-1.2	Buller	61	1.5
Waitakere	-716	-1.2	Manawatu	158	1.5
Waimakariri	-82	-0.5	Whakatane	182	1.6
Tauranga	-163	-0.4	Porirua	242	1.6
North Shore	-226	-0.3	Southland	168	1.6
Waimate	-7	-0.2	Stratford	54	1.6
Central Otago	-12	-0.2	Hauraki	109	1.6
Christchurch	-169	-0.1	Waitomo	56	1.7
Kapiti Coast	-11	-0.1	Central Hawkes Bay	86	1.8
Auckland City	-19	0.0	South Wairarapa	65	1.8
Franklin	4	0.0	Napier	389	1.8
Hamilton	90	0.2	Nelson	317	1.9
Western BoP	31	0.2	Wanganui	351	2.1
New Zealand	4248	0.3	Kawerau	50	2.1
Upper Hutt	42	0.3	Tararua	144	2.1
Lower Hutt	131	0.4	Kaipara	155	2.3
Whangarei	137	0.5	Rangitikei	134	2.4
Westland	17	0.5	Masterton	214	2.4
Tasman	89	0.5	Opotiki	78	2.4
Ashburton	61	0.6	Taupo	323	2.7
Waipa	98	0.6	Horowhenua	332	2.8
Timaru	121	0.7	South Waikato	239	3.0
Dunedin	395	0.9	Mackenzie	44	3.1
Hastings	225	0.9	Gore	149	3.1
Marlborough	157	1.0	Wairoa	96	3.1
Selwyn	119	1.0	Matamata-Piako	353	3.1
Palmerston North	288	1.0	South Taranaki	329	3.3
Clutha	69	1.1	Kaikoura	54	3.8
Invercargill	227	1.1	Chatham Is.	10	4.1
Waitaki	98	1.2	Otorohanga	126	4.1
Waikato	184	1.2	Ruapehu	220	4.5
Rotorua	286	1.2	Carterton	126	4.6
Grey	66	1.3	Thames-Coromandel	510	4.7

Cost Increases Hit Households Heavily

Using the Household Economic Survey we make a rough estimate that the past year's rises in food and petrol prices plus higher interest rates are taking almost \$3b out of household budgets.

It would be good to get some feel for how much increases in the prices of things like petrol and food are taking spending power out of household wallets in New Zealand. This is not a straightforward exercise because although the annual Household Economic Survey reveals spending on individual items there is considerable under-reporting of spending. For instance if one adds up all the items reported as purchased in the HES the total for the year to June 2007 is \$77b. But the national accounts reveal private consumption expenditure for the same period was \$100b.

That means that we will probably under-estimate the increase in household bills in this exercise. Lets start with food. Households spent \$13b on food in the year to June 2007. The Food Price Index in April was 6% ahead of a year ago. If sustained for a full year these higher prices will take about \$780m out of household budgets. If we consider price increases averaging 2.5% to be "normal" then the extra restraint on households is at least \$0.5b for the coming year assuming no further above normal rise in food prices. Yeah right!

If we do the same exercise for petrol we get the following. The HES estimated the annual petrol bill in the year to June 2007 for private households was \$3.1b. (Note this measure does not capture businesses, tourists, government and the country's total petrol bill is double this amount.) With petrol prices now around 25% above their average over the year to June 2007 this implies about \$800m extra having to be spent. Again allowing for 2.5% "normal" price rises this means an unusual withdrawal from spending power due to petrol price rises of about \$700m in the coming year assuming no further above normal rise in prices.

Our analysis therefore suggests higher food and petrol prices are stripping \$1.2b at least out of household budgets and the total is likely to be more than \$1.5b allowing for under-reporting in the Household Economic Survey. Now lets do the same exercise for interest rates. The HES only captures about \$5.4b worth of interest payments on mortgages which is massively less than the \$10b worth of housing interest payments reported in the Household Income and Outlay Account for March 2007 and the \$13b bill implied by the Reserve Bank debt and average interest rate numbers.

Interest payments on investment properties account for some of the difference but nowhere near enough. So lets just use the fact that total housing debt in March this year was \$158b at an average interest rate of 8.6% from 8% applying a year earlier. Extra interest outflows (ignoring the actual rise in debt) work out at almost \$1b. In the coming few months this outflow will get higher as people on fixed interest rates on average roll off 8.1% to a rate closer to 9.5%. In the coming year \$45b in fixed rate debt will mature. Lets assume \$22b matures over the next six months when people may on average roll onto 9% and after that they roll onto about 8.1%. That is another hit to household bills of about \$220m in the coming year.

Adding it all up we get a hit to household spending availability somewhere within a range of \$2.5b to \$3.0b over the coming year. From estimated total nominal private consumption of about \$105b that is about 3%.

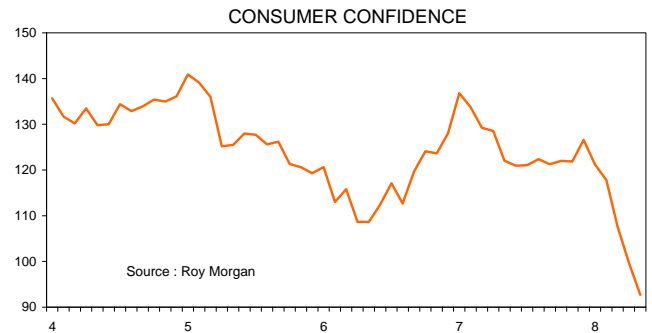
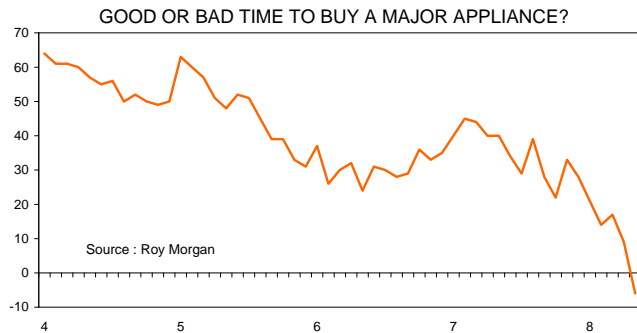
Our analysis suggests that even without looking at employment and wage prospects and "normal" cost of living increases of 2.5% on other items, higher food and petrol prices plus higher average effective interest rates will take away 3% off funds available for other areas of household spending in the coming year. That is why we are making so many cautious sounds about prospects for retailing and housing in the immediate future. Note though – the dairy boom almost exactly offsets this amount – so talk of major recession is misplaced.

NZ ECONOMIC DEVELOPMENTS

Monday 12

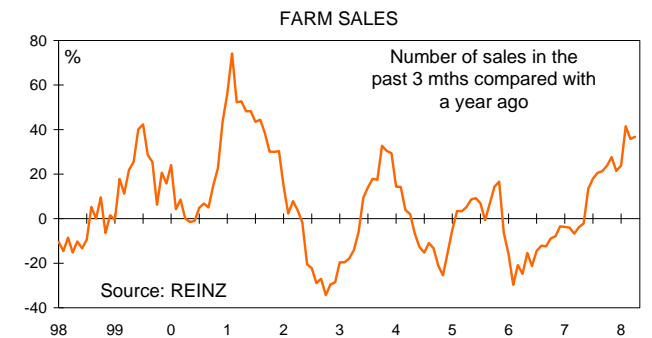
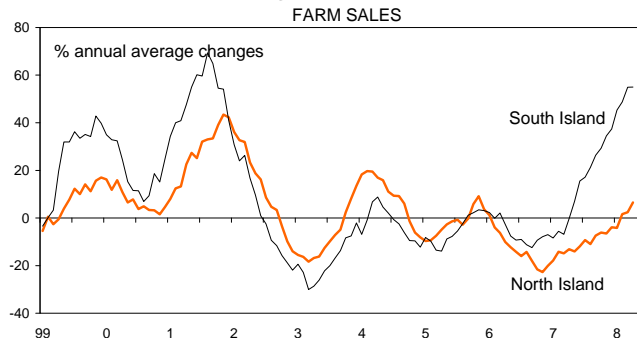
Consumers Still Getting More Pessimistic = bad for retailers heading into Winter

Ever fortnight Roy Morgan conduct a consumer poll to gauge sentiment. As yet there is no sign that people are seeing light at the end of the tunnel and in fact things are getting darker for retailers – be they sellers of discretionary items hit by high fuel and food cost rises, or durable goods like cars and fridges hit by medium term income and interest rate worries. In early May a net 6% of people said they feel it is a bad time to buy a major appliance. This was well down from positive 9% a month earlier and 33% six months ago. The overall sentiment measure fell to 92.7 from 99.7. Horrible basically. If you are a retailer and you haven't got your stock levels down yet you've got some pain coming.



Rural Real Estate Booming

In April there were 264 farms sold around New Zealand. This was a massive 41% rise from a year ago meaning sales in the three months to April were ahead 36% from a year ago while for the entire year they were ahead 26%. The result quite clearly shows a still rampant rural real estate market and like a few other indicators calls into question the more “doom and gloom” scenarios about our economy over the coming couple of years – though does not mean the economy will be “saved” as it were.



While it is true that agriculture directly only contributes about 5% of gross domestic product the fact that capital expenditure in the dairying sector is growing so strongly suggests good insulation in the regions against negatives like rising food and transport costs plus high debt servicing expenses. Soaring land prices also provide massive insulation to those sheep and beef farmers pressed hard by poor prices. The following measure can be questioned but for what it is worth the average farm sale price in the year to April was ahead 44% from the year to April 2007. 160,000 people are employed in the rural sector according to the Household Labour Force Survey with job numbers in the March quarter ahead 4.3% from a year earlier whereas nationwide job numbers (2,138,000) were down 0.2%.

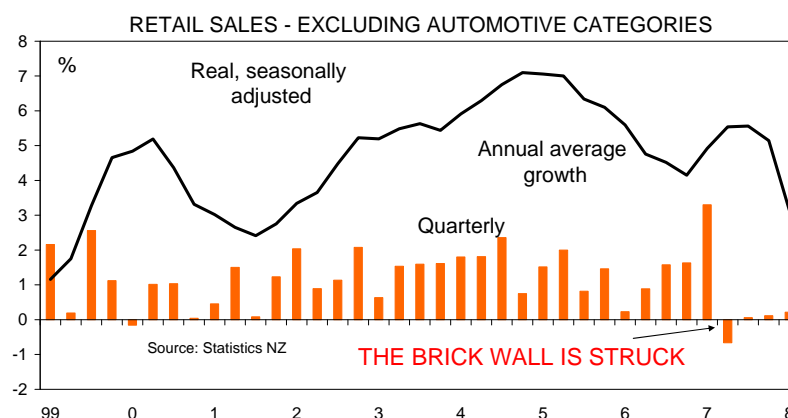
Thursday 14

Retail Spending Confirmed Weak

The Weekly Overview is already big enough this week so we are only going to report the quarterly Retail Trade Survey in brief. Deeper analysis of areas like storetypes showing inventory problems will be undertaken if time permits next week – depending upon how interesting the May 22 Budget is.

Looking at the headline numbers one gets a picture of a struggling retail sector. After adjusting for inflation and seasonal factors spending fell 1.2% in the March quarter which was the greatest quarterly fall since 1997. Sales were down 1.3% from a year ago which is the first annual rate of decline since the recession of 1998. This sounds very bad but there are two important caveats.

First, collapsing motor vehicle sales as revealed in our monthly Confidence Survey account for the bulk of the decline. If we remove the automotive categories then core retail spending still grew during the quarter – but only by 0.2% after 0.1% growth in each of the previous two quarters and a 0.6% fall in the June quarter last year. Retailing has been tough going since before the middle of last year in response to average interest rates finally hitting painful levels. Since then higher food and petrol prices have added to consumer woe.



Because of higher food prices nominal spending in supermarkets in the March quarter was ahead 11.5% from a year earlier and spending on fuel was up 27%. But total nominal spending was up just 4.1% for all retail store types with nominal spending declines for appliances 9.7% (price cuts mainly as volume -3%), clothes -1%, furniture-5%, takeaways -3%, fresh meat fruit & veges -3% plus other food.

Over the past few weeks in the Weekly Overview we have been examining the retail sector noting that for this year and next conditions will remain very tough. Given continuing falls in consumer confidence we remain of the opinion that retailers should continue to trim their sails. There will be some closures and less indebted operators who have seen periods of weakness before may be able to acquire some good premises if not more favourable terms from landlords. And as noted above, we'll do more analysis of these numbers for retailers next week.

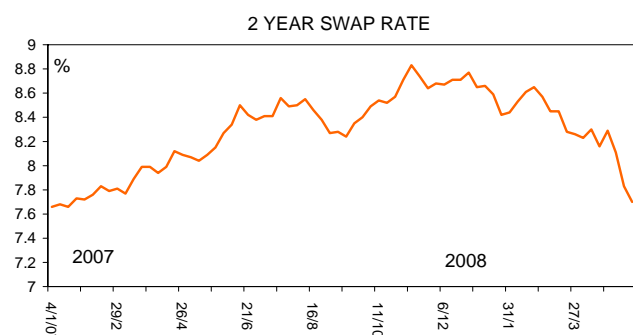
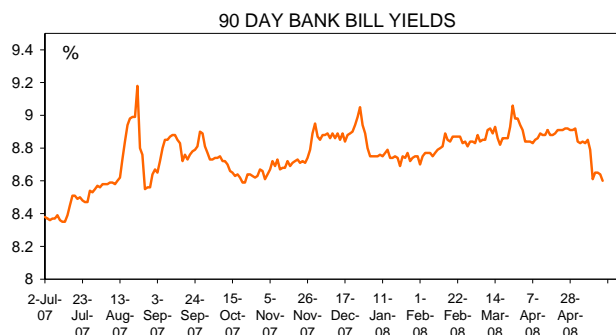
Feedback & Queries

If there are any issues in the Weekly Overview you wish to comment on or you have a query about the economy, send me an email at tony.alexander@bnz.co.nz Useful issues will be discussed in the WO.

INTEREST RATES

Wholesale interest rates have moved very little this week with the worse than expected retail trade numbers this morning not generating fresh rate falls. In other words, maybe the markets had got a bit ahead of fundamentals with the rally last week after the weak jobs number and this morning's retail data merely validated where things already were.

Expectations of monetary policy easing remain strong and the yield on 90-day bank bills has ended this afternoon near 8.63% from near 8.6% last week and the benchmark two year swap rate has ended near 7.72% from 7.8%.



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	7.75	6.2
90-day bank bill	8.63%	8.60	8.91	8.89	8.10	6.4
10 year govt. bond	6.30%	6.30	6.40	6.42	6.10	6.5
1 year swap	8.14%	8.15	8.73	8.86	8.25	6.6
5 year swap	7.44%	7.45	7.70	8.16	7.76	7.0

If I Were a Borrower What Would I Do?

Consider this. Because of the global liquidity crisis we banks are having to pay much more for money offshore than we used to. That means trying to figure out where fixed housing interest rates will go by looking at swap rates no longer works quite so well. But what if things were nice and settled offshore and swap rates were once again relevant? With the two year swap rate near 7.7%, where would two year fixed housing rates tend to be? On average over 2005-07 the margin between the two year swap and housing rates was about 0.6%. On that basis if things were "normal" now the two year fixed housing rate would be a tad below 8.5%. Things are not normal however so such a calculation is of academic interest only.

Looking ahead, if we take a conservative stance and assume no improvement in the situation offshore then our forecast of the two year swap rate falling from 7.7% currently to 6.5% at the end of this year implies a two year fixed housing rate late this year near 8.0% from above 9.2% now and an average for the past five years of 7.8%. If the liquidity situation offshore improves then we could see fixed interest rates getting close to 7.5% instead but that is a level of optimism we would not invite readers to accept.

So we see scope for fixed interest rates to fall about 1.2% between now and the end of the year. This is one reason we think it is wrong to get exceedingly pessimistic about the housing market over 2009 because as interest rates fall we expect the long queue of potential buyers to shuffle forward a few paces and start purchasing from what could be a decreasing pool of properties on the market as vendors choose to rent their properties rather than have them tainted by sitting unsold for so long.

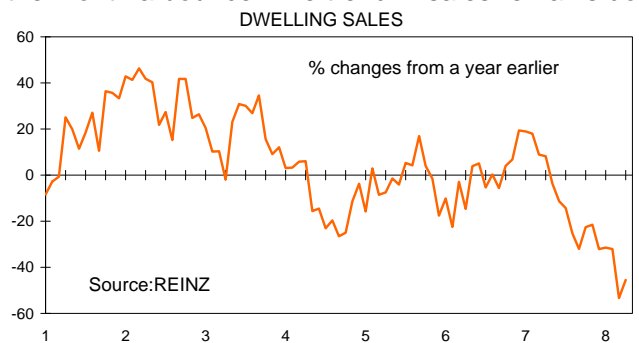
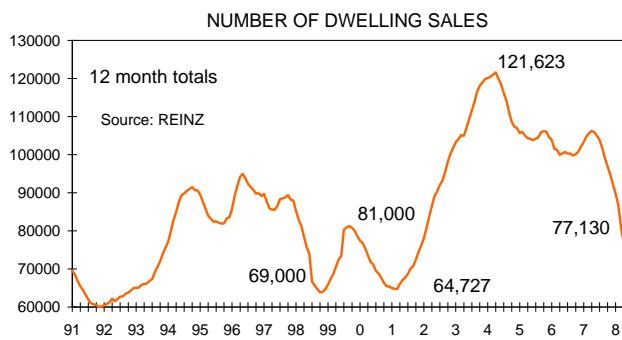
If I were borrowing at the moment I would fix one year at the absolute most.

HOUSING MARKET UPDATE

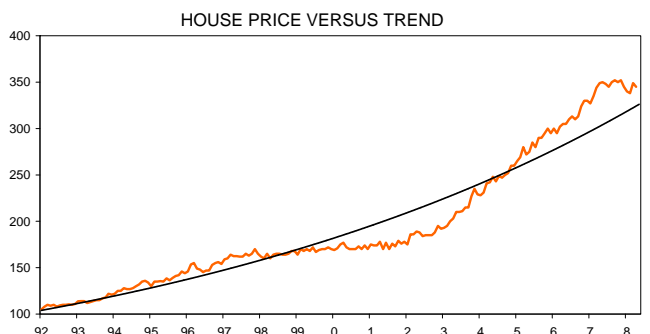
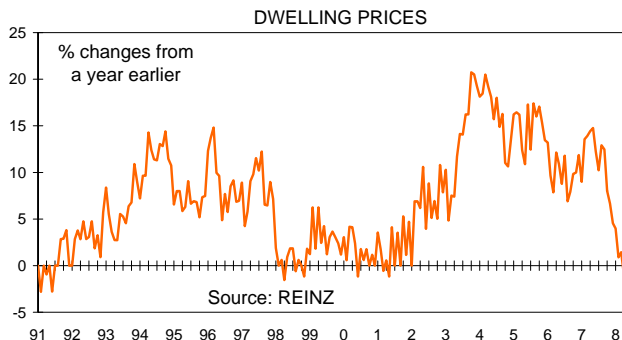
Nationwide dwelling sales were down 46% from last year in April, but prices are still hardly moving. Who will give in first? Desperate vendors wanting to get on with their lives or buyers eventually reacting to what could turn out to be large interest rate falls later this year – with some interesting rate cuts happening right now?

Last week we got the monthly Auckland real estate numbers from Barfoot & Thompson and this week the nationwide data from REINZ appeared. The latest numbers don't add all that much to what the BT data were telling us. Lots of sellers, few buyers, sellers largely unwilling to cut prices, buyers mainly waiting for lower prices, sellers taking properties off the market to rent, buyers emailing us asking opinions on when to buy. So interesting.

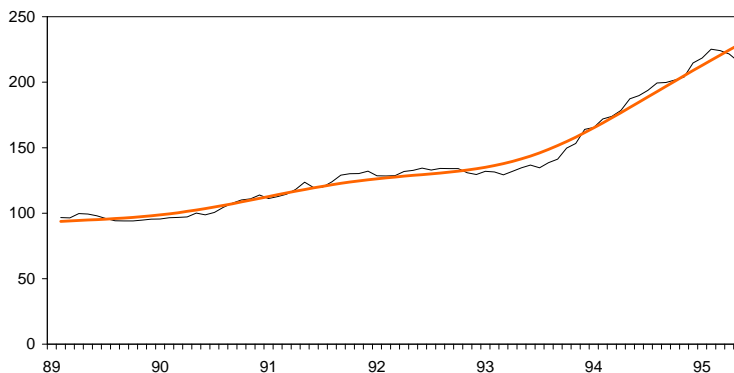
In April there were 4,464 dwellings sold around New Zealand. This was a 46% fall from a year ago whereas March sales were down 53%. But to the extent the March result was biased downward by Easter falling very early and April biased upward by sort of having an extra day or two one would have to be myopically optimistic to call the small seasonally adjusted gain in the month a bounce. The trend in sales remains down.



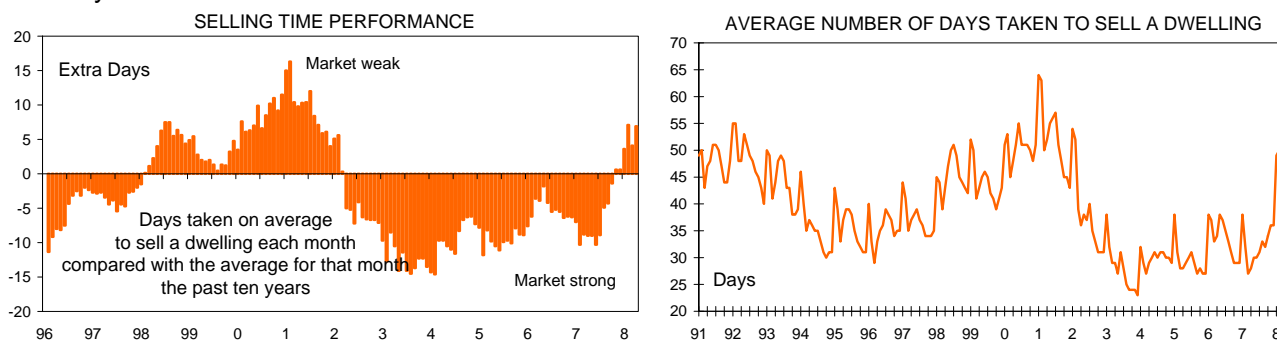
The median dwelling sale price eased to \$345,000 from \$349,000 in March to be down just 1.1% from a year ago and just 2% from last November's cyclical peak of \$352,000. So far the fall in house prices is looking quite mild but we can't help thinking prices will decline another 5% - 10% at most. Of course if vendors take their properties off the market then the price decline will be less. That is not something one can easily forecast.



Just for a laugh because trend valuation measures aren't really worth anything when it comes to picking where prices will go, the second graph shows a simple attempt at gauging how far away prices seem to be from their trend. Notice how the gap has really closed in but prices are still above what the trend would suggest. Of course it is easy to debate what trend to use so good luck with an alternative. In fact lets do one. If we deflate the rise in house prices since 1989 by the consumers price index then estimate the trend using a Hodrick Prescott filter we get the graph just below. It suggests prices are below trend in inflation adjusted terms. Too weird. These sort of valuation measures are essentially worthless so please ignore them.



In terms of the average number of days taken to sell a dwelling things got back on track in April with this number moving back out to 44 from 40 in March. This was a 16 rise from a year ago whereas March was ahead 13 days from a year ago and February 18. Compared with the average number of days taken to sell a dwelling in April over the past ten years the 44 day result was 6.9 longer than usual. March was 4.1, February 7.1.



Although this measure is likely to be distorted by vendors changing agents and restarting their days to sell clock, the same would have happened in past downturns. So far properties are not sitting on the market an aggressively long period of time compared with the 2000-2001 experience – but that may come.

All up, the data show the NZ housing market in a weak state with buyers holding back and vendors not yet discounting prices by much, but anecdotal evidence suggests some are taking their properties off the market. As Winter moves onto Spring and Summer it will be amazing to watch the interaction of some large forces.

- Vendors getting realistic and cutting asking prices because they want to move on with their lives.
- Other vendors taking properties off the market and renting them in a good rent market.
- Buyers coming out of the woodwork attracted by falling interest rates, tax cuts, wage rises, and a labour market easing but probably not producing an unemployment rate over 4.6%.

But this is nothing. Wait until late 2009 when buyers realise the collapse of so many developers means dwelling supply is not keeping up with demand. That will be interesting to see.

Interest rate Changes

With the Reserve Bank likely to start cutting interest rates in September and with cuts likely to progress quite quickly, we see scope for the benchmark two year fixed housing rate to now hit almost the 8% level late this year rather than in the middle of next year. That will be an important development in the housing market. First, for those on fixed rates already there will be some slowly appearing relief, but we emphasize the slow bit. In the coming year only about one-third of fixed rates come up for renewal and they roll off an average rate of 8.1%. So it will take 2-3 years before the bulk of existing borrowers feel some cash low benefit. This will keep retail spending suppressed.

But for those contemplating taking on a mortgage the situation is different. They will probably be able to get a fixed rate near the five year average for the two year term of 7.8% in the March quarter of 2009. That is one reason why we don't think buyers should be sitting comfortably thinking house prices are going to keep falling for a year or two.

The chances are the house price declines on average will come to an end late this year or early next year with average prices 5% - 10% lower than they are now at worst. Lower interest rates will make the numbers start to work for buyers – and perhaps for investors seeking yield in particular. We maintain our view that these long term yield focused investors should be doing more than kicking the tyres come the depths of Winter when things are likely to look quite bad and there will be many highly frustrated vendors who are tired of waiting for their properties to sell.

And lets not forget the other fundamental we think is going to produce an interesting situation 18 months to two years from now. With residential construction falling away but no evidence of a widespread large excess supply of newly constructed dwellings, we feel debate will shift to there being a shortage of places for people to live.

The message we have then is this. If you are wanting to buy a property then in the next few months prices are likely to fall as vendors get more desperate. But as time passes more and more vendors will take their properties off the market. That will mean the current great range of properties to choose from will slowly reduce. At the moment you could be thinking about throwing some “silly” offers around for the properties you like as maybe a vendor will accept one. Come Spring if you are still looking, then you may want to back away from the silly offers and start making some more serious ones.

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/>

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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	0.7%	1.0	3.4	2.5	3.4
GDP growth	Average past 10 years = 3.0%	1.0	0.5	3.1	1.5	2.7
Unemployment rate	Average past 10 years = 5.3%	3.6	3.4	3.7	3.9
Jobs growth	Average past 10 years = 1.9%	-1.3	0.9	-0.2	1.8	2.6
Current a/c deficit	Average past 10 years = 5.5% of GDP	7.9	8.4	9.0	9.0
Terms of Trade		2.9	3.7	8.8	3.8	-1.9
Wages Growth	Stats NZ analytical series	1.2	1.3	5.5	4.5	5.5
Retail Sales ex-auto	Average past 9 years = 3.8%	0.2	0.1	3.1	4.9	5.6
House Prices	Long term average rise 5% p.a.	0.4	0.3	8.0	9.7	15.3
Net migration gain	Av. gain past 10 years = 10,400	+4,675	5,494yr	12,090	9,746
Tourism – an. av grth	10 year average growth = 5.0%. Stats NZ	2.1	1.8	2.1	2.8	-0.4
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 2%. Colmar survey	-34	-25	2	-4	-34
Business activity exps	10 year average = 26%. NBNZ	-3.8	-6.4	20.3	22.5	14.5
Household debt	10 year average growth = 11.3%. RBNZ	10.8	11.6	13.2	13.5	14.6
Dwelling sales	10 year average growth = 3.5%. REINZ	-53.3	-32.1	-32.0	8.9	-2.9
Floating Mort. Rate	10 year average = 8.1%	10.69	10.55	10.55	9.80	9.55
3 yr fixed hsg rate	10 year average = 7.9%	9.59	9.49	8.99	8.80	7.6

ECONOMIC FORECASTS

Forecasts at May 8 2008

March Years

December Years

	2006	2007	2008	2009	2010	2005	2006	2007	2008	2009
GDP - annual average % change										
Private Consumption	4.7	2.7	3.4	-0.3	1.4	5	2.5	4.3	0	0.9
Government Consumption	5.1	4.3	4.4	4.1	4.2	4.2	4.7	4.4	4.1	4.2
Investment	5.2	-2.3	5.2	1.1	3.1	3.9	-1.6	4.9	1.9	1.7
GNE	4.2	1	4.8	0.9	2.3	4.3	1	5	1.3	1.7
Exports	-0.1	3.1	3.3	1.9	2.1	-0.4	1.7	3.6	2.9	1.4
Imports	4.1	-1.7	9.5	3.1	2.8	5.4	-2.8	8.9	4.2	2.6
GDP	2.7	1.5	3.2	0.8	2	2.7	1.5	3.1	1.4	1.3
Inflation – Consumers Price Index	3.3	2.5	3.4	3.7	2.5	3.2	2.6	3.2	3.6	2.7
Employment	2.6	1.8	-0.2	0.3	0.6	1.5	1.4	2.5	-0.9	0.2
Unemployment Rate %	3.9	3.7	3.6	4.4	5	3.6	3.8	3.4	4.2	4.9
Wages	4.6	5.5	4.4	4.2	3.3	5.1	5.5	4	4.4	3.5
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.64	0.7	0.8	0.68	0.64	0.7	0.69	0.77	0.69	0.65
USD/JPY	117	117	101	107	118	119	117	112	105	114
EUR/USD	1.2	1.32	1.55	1.47	1.34	1.19	1.32	1.46	1.5	1.37
NZD/AUD	0.87	0.88	0.87	0.77	0.77	0.94	0.88	0.88	0.77	0.77
NZD/GBP	0.36	0.36	0.4	0.37	0.36	0.4	0.35	0.38	0.37	0.37
NZD/EUR	0.53	0.53	0.52	0.46	0.48	0.59	0.52	0.53	0.46	0.47
NZD/YEN	74.6	81.9	81.1	72.8	75.5	82.7	81	86.3	72.5	74.1
TWI	65.6	68.6	71.6	63.1	62.7	71.9	68	71.6	63.1	62.8
Official Cash Rate	7.25	7.50	8.25	7	5.5	7.00	7.50	8.25	7.5	5.75
90 Day Bank Bill Rate	7.55	7.78	8.83	6.99	5.73	7.49	7.64	8.77	7.64	5.81
10 year Govt. Bond	5.71	5.91	6.35	6.15	6.1	5.89	5.77	6.38	6.2	6.1

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.