BNZ Weekly Overview

26 June 2008

Mission Statement

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

In this week's issue….

- **We look at the range of nasty things hitting our economy. Page 1**
- **Confidence surveys can contain useful information for picking where the economy will go – but not necessarily over short time periods and magnitudes of changes in spending can vary substantially. Page 4**
- **More finance companies have decided to close their doors this week. We put the size of the sector into perspective. Page 6**
- **We examine why the Reserve Bank's coming easing of monetary policy may not lead to much reduction in interest rates for borrowers because of the global liquidity crisis worsening in the past month.**

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".

It Never Rains But It Pours

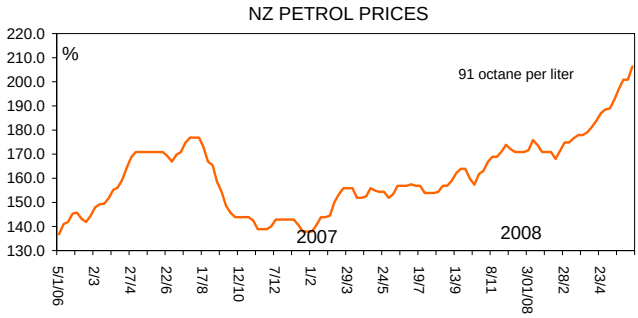
Tomorrow morning Statistics New Zealand will release data expected to show the New Zealand economy shrank slightly over the March quarter. Then in three months time when the June quarter numbers come out we expect a similar negative result. Thus the technical requirement for recession will be met of two negative quarters in a row. Why is it that our economy has suddenly slipped into this rather bad situation when a year ago most of us were expecting a soft landing although with some downside risk?

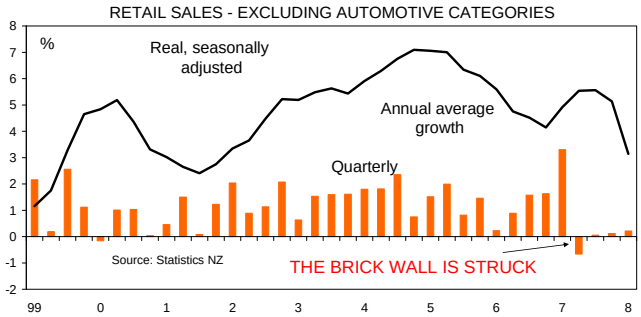
Back in the first half of 2007 we could see evidence that the Reserve Bank's extra 1% increase in the official cash rate from 7.25% was having the impact on household spending the Reserve Bank had been seeking since 2004. We could see evidence of a pullback in retail spending growth and also in the housing market. Adding an restraint from tight business margins, a well above average exchange rate, and below average net migration inflows most of us were speaking about the economy slowing down and eventually interest rates and the exchange rate moving lower.

But as luck would have it after three years of not tightening monetary policy at an optimal pace by the time the Reserve Bank finally got around to taking the right actions a lot of other negative stuff came along to hit the economy at the same time. Frankly it would have been useful if some of these things had happened earlier on in the tightening cycle so we wouldn't have had to have interest rates at that such a high level for such a long period of time and the exchange rate may not have gone so high and stayed there so long.

The things which have come along and generated extra downward pressure on the New Zealand economy include the following.

Food prices have risen on average 6% over the past year and as we calculated a few weeks ago in the Weekly Overview this has taken up to $1 billion worth of money away from households. Petrol prices have increased 35% and this is taking a similar amount of money away from other areas of expenditure.





The global liquidity crisis has depressed growth in our trading partners and led to a tightening of lending criteria for some areas in the New Zealand economy placing extra upward pressure on interest rates facing borrowers. We have also had a drought over summer which has depressed farm incomes and accounts for about 0.5% coming off the economy's growth rate. The drought has also led to a switch in electricity generation away from hydro towards more expensive thermal generation which acts as a drag on GDP. In addition some large businesses have reduced output to save electricity.

We have also had the collapse of many finance companies bringing extra worries about wealth for many investors. Plus in recent months buyers have gone on strike not prepared to pay anywhere near the prices been asked by vendors and this has generated a massive decline in dwelling turnover and by our calculation will help contribute to a near 30% decline in dwelling construction in the coming year or so.

These things have hit our economy in a very short period of time and for the household sector in particular have caused a radical change in spending plans which is leading to very depressed spending in the retail sector. Normally at this point in the cycle largely what would be happening is people pulling back from spending on durable items such as motor vehicles, fridges and televisions. But with income having to be diverted towards the necessities of petrol and food people are also scaling back spending on discretionary items as well as cutting back even further on durables expenditure. This explains why in the Westpac McDermott Miller Consumer Confidence survey a record low proportion of people think it is a good time to buy a major appliance.

Ironically, just as we get a strong gathering of evidence that the New Zealand economy is in recession we may in fact be past the worst of the hit to our economy. One way to help understand this is as follows. People are rapidly adjusting their spending levels to account for a permanent change in the proportions of their incomes they need to devote to food and petrol. During that rapid change spending goes backward. But eventually spending levels settle at a new equilibrium around which we will get the normal cyclical fluctuations. It is only a guess but maybe in the second half of this year we will hit that new equilibrium which one would have to say would be the low point for this particular economic cycle.

Come the second half of the year the worst of the effects of the drought will have passed although there will be a lingering negative influence on agricultural output. In addition surely the electricity situation will one day get better so affected companies can take production back up to optimal levels and the country will switch back towards cheaper generation methods.

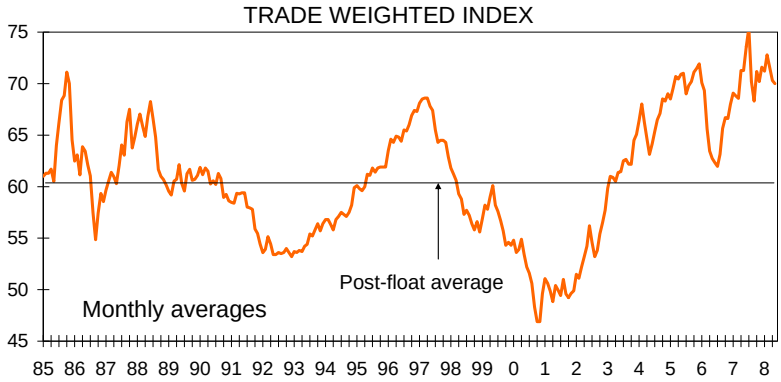
We also still have the many insulating factors at work that we have been noting for the past four a half years. Fiscal policy is easing and the way the political polls are going it looks highly likely that there will be further easing beyond that announced in this year's Budget. Infrastructure spending is also likely to receive a boost as alternative funding methods are likely to be examined later this year. Commodity prices are strong with massive investment occurring in the dairy sector and we expect the global search for food and protein will lead to improving prices for sheepmeat and beef.

We also think our arguments about the tight labour market still hold water. They are that businesses recognise the tightness in the labour market is more structural and cyclical so will continue where possible to invest in productivity enhancing buildings, information technology systems, and new plant and equipment. We also think wages growth will tend to remain relatively firm but there will definitely be a cyclical easing off in the pace of growth.

It should also be noted that although there continue to be downside risks to world growth continued firm activity in Australia and Asia generally is helping to insulating New Zealand economy against the downturn in the United States, Europe, and United Kingdom.

It is likely over the second half of this year that activity will flatten out and then we will see some improvement over 2009 assisted by depreciation in the Kiwi dollar and a slow decline in debt servicing costs facing New Zealand businesses and households. However we don't think it would be appropriate for anybody to speak in terms of an actual upturn in the New Zealand economy until some point in 2010 or 2011. It's going to take quite some time for households to become comfortable with borrowing money again and businesses will take a while to get cash flows under control and feel comfortable about the health of the domestic economy.

The rule of thumb is that it takes about 18 months for an upturn in the export sector to feed through to the domestic economy. Given that the Kiwi dollar is still trading at well above average levels one couldn't really say that export upturn has started yet. Maybe it will towards the end of this year in which case one can talk about the feed through of export sector growth into the domestic economy and the cities in particular coming in perhaps the middle of 2010.



All up, the data coming out show a severely crimped economy affected by a large range of negative factors hitting us at the same time monetary policy tightening finally has become effective. We may be past the worst of the shrinkage in the economy but it is going to be some time before people generally are speaking in terms of good trading conditions.

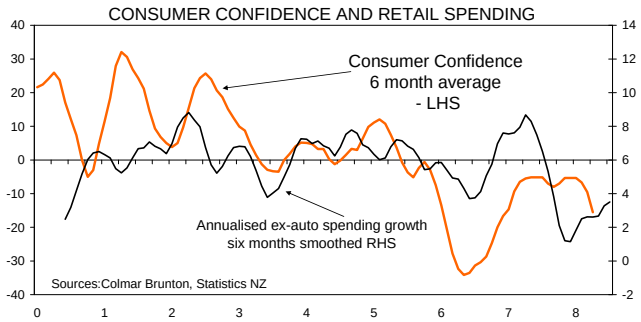
Confidence Surveys Need Cautious Treatment

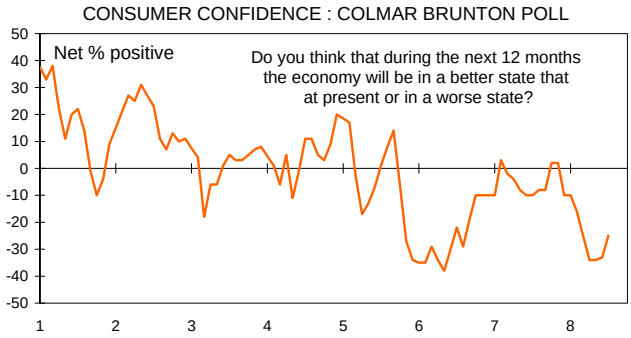
The easy thing for us economists to do is parrot back to our audiences the sentiment they express in surveys. That way people nod and say we understand what is happening. But survey results need to be treated with caution and we discuss why.

People sometimes think that all you need to pay close attention to when picking where the economy is going to are the business and consumer confidence surveys. After all, surely if people are feeling bad about the economy they will cut back spending and hiring and if they feel good they will spend more.

In the short term there is no correlation between changes in confidence readings and actual spending, but once one gets out to a 3-6 month period the correlation definitely exists. But there is not a great level of consistency between a level of confidence and the resulting strength in spending.

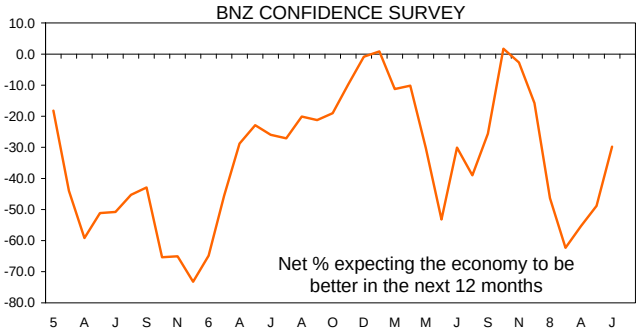
To see this consider the recent One News Colmar Brunton poll. It showed a reading of -25 in late-June meaning a net 25% of consumers expected the economy to deteriorate over the coming year. This was a deterioration from -10% in December and an average reading of 2%. With such low confidence recently it is unsurprising that in the March quarter the volume of retail spending was down 1.3% from a year earlier and 1.2% from the December quarter in seasonally adjusted terms.





But back in both the March and June quarters of 2006 confidence was a net 33% negative. Yet in the March quarter of 2006 retail spending was up 2.7% from a year ago and 0.7% from the December quarter. In the June quarter of 2006 spending was ahead 0.8% from a year earlier and flat in the quarter itself. Spending then soared 1.3% in the September quarter and 1.9% in the December quarter of 2006 while confidence was still below average at -10%.

So while we economists most definitely look at confidence measures we don't consider them the be all and end all. And that is why one should not look at the three recent surveys showing decreasing pessimism and conclude the economy has reached a turning point. Our monthly Weekly Overview survey four weeks ago showed an improvement in growth expectations for the next 12 months to a net 30% pessimistic from 49% in May and a peak of 62% in March.



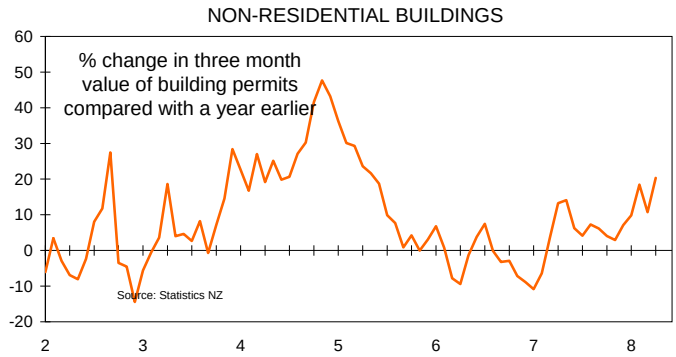
The One News Colmar Brunton poll mentioned just above improved to a net 25% pessimistic late this month from 33% earlier in the month. And the Auckland Chamber of Commerce quarterly survey found a net 43% of business respondents expect the economy to deteriorate over the next six months from 55% last quarter.

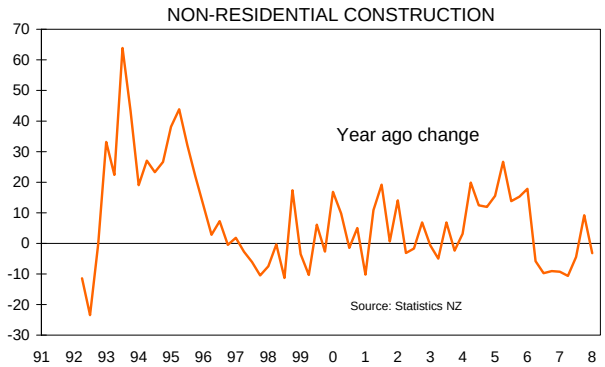
The key point to note from these surveys is that the results are still strongly in negative territory and that suggests still weak hiring, consumer spending, and business spending and investment plans over the remainder of this year.

In particular one can hardly get optimistic about growth in the near future when considering news over the past week. Yet more finance companies are having to cease repayments to debenture holders and are curtailing lending to property developers in particular. Those property developers are reporting that they cannot get previously achieved and currently desired levels of presales and they are defaulting on debt servicing commitments.

This backs up our expectation that residential construction has the capacity to fall 30% over the coming year as both householders directly pull back from construction and developers aggressively slow their activities and in many cases cease development entirely.

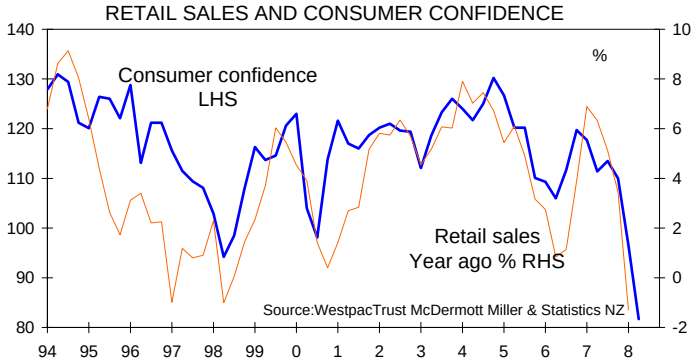
This applies not just to residential construction but non-residential as well. The recent data show businesses are still planning hefty levels of non-residential construction with the value of relevant consents ahead 20% in the past three months from a year ago.





But note how these consent values have been rising since early 2007 yet in the March quarter the volume of non-residential construction fell almost 6% to be near 3% down from a year earlier. And while companies undertaking their own construction projects will likely help underpin non-residential construction activity over the coming year, the risk is that non-residential building falls away further as developers shut up shop.

But the biggest challenge to any well premature conclusion of a turning point comes from the long running Westpac McDermott Miller Consumer Confidence Survey released yesterday. It produced the biggest one quarter decline on record from 96.5 in the March quarter to 81.7 in the June quarter. This is well below the 100 neutral level and 111.4 reading of a year ago. There is quite a good correlation between this survey result and the annual rate of change in the volume of retail spending. Bleak.



Finance Companies

To put some issues involving finance companies into perspective. The problems are negative for the economy but nowhere near as important as other factors like high interest rates, rising raw material costs, and hikes in food and petrol prices.

According to the Reserve Bank's May 2008 Financial Stability Report lending by finance companies (whether they take deposits directly from the public or not) stood at $18b at the end of 2007. In contrast total bank lending then stood at about $275b. Lending by finance companies to the business sector was almost $8.3b versus $71b for banks. The finance companies experiencing problems are mainly those classified as "deposit-taking" as opposed to "non-deposit-taking" ones that get funding from parent companies or parties perhaps offshore. http://www.rbnz.govt.nz/finstab/fsreport/3311557.pdf

Total lending by these deposit-taking finance companies stood at almost $10b at the end of 2007 with $5.8b of that to the business sector.

Hopefully these numbers help put things into perspective and explain why most of us feel that although the problems in the finance company sector are contributing to weakness in the economy, these problems are small in a macro sense compared with high food and petrol prices and high interest rates.

About half of total finance company assets are held by three companies with investment grade rankings from credit rating agencies. Again maybe this implies some extra perspective, especially when more informed commentators on the sector often note that struggling companies are speaking with one of these three players regarding taking over some of their business.

Furthermore, finance companies do not only finance property developments. They are also an important source of finance for business equipment like logging trucks for the forestry sector and restaurant equipment for the hospitality sector not to mention money so individuals can buy items such as whiteware. Finance companies also provide finance for motor vehicle purchases and in recent years the major area of expansion for finance companies has been into providing property finance.

As background information maybe the following will also be useful. In the early 1990s inflation in New Zealand settled near 2% and interest rates fell. Savers who had become used to high deposit rates went scrambling for the best rates on offer in a new low interest rate environment and flocked to finance companies and away from banks.

At the same time the economy embarked on near 15 years of strong growth broken only briefly by the 1998 recession. Plenty of profitable lending opportunities presented themselves to finance companies and good profits would have been made with few bad debt issues.

And also from the early 1990s we banks tightened up our lending criteria – there was obviously only one way to go after the lending of the 1980s! This change provided an increased market of more high risk borrowers available for finance companies to lend to.

And finally, over the past few years the continuing boom in the housing sector along with non-residential construction has seen increasing finance company lending for property developments.

The problems for the finance company sector first started appearing about two years ago in the context of bad lending in the second hand car market in South Auckland. Then it moved to a reluctance by investors to reinvest in finance companies and people trying to take their funds out early. Then the global liquidity crisis made getting extra lines of credit from other financial institutions and funders offshore more difficult. The development now hitting the sector is the lending they have done into the property sector turning sour and forcing repayment moratoriums etc.

The long overdue correction in the residential property sector in particular has meant developers cannot easily get the pre-sales they expected. They are going back to their finance company for extra funds but finding not only will no extra funds be forthcoming in many instances, but the lenders want money back that has already been lent. Throw in some subdivision developers placing whole projects on the market and the problem for the finance companies has shifted from bad lending, to unwilling investors, and now not so much bad lending as failing loans because of the property sector correction.

For the economy as a whole this is obviously a negative but it pales into insignificance beside the effects of rising food and petrol prices, high interest rates and a still over-valued exchange rate on average. But it does have relevance for the property development sector because weakness is now feeding back on itself. Of the $5.8b worth of business sector lending by deposit-taking finance companies at the end of 2007 some two-thirds is to the property sector – or about $4b.

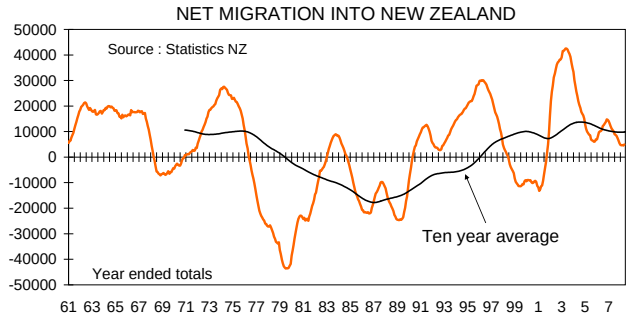
This is one reason we feel confident in our forecast of a coming 30% decline in residential construction. For non-residential construction the pullback will be much less.

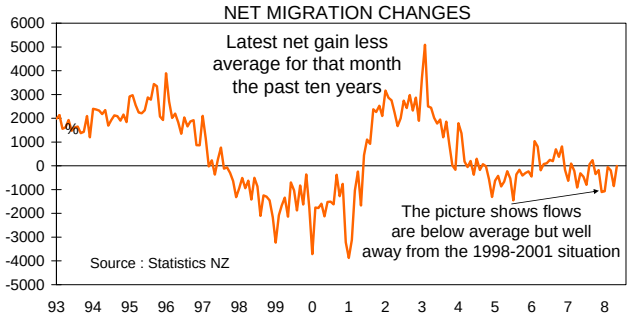
NZ ECONOMIC DEVELOPMENTS

Friday 20

Migration Numbers Improve Again

There was a net loss to New Zealand's population from permanent and long-term migration flows in May of 1,299 people. This was slightly better than the net loss of 1,570 a year earlier and means that the annual net migration inflow has improved to 4,938 in May from 4,667 in April. A year ago however the net gain was 10,680 people and on average over the past 10 years the net gain has been 9830. So the main conclusion here is that the net migration inflow to New Zealand is tracking at about half its long-term average level.



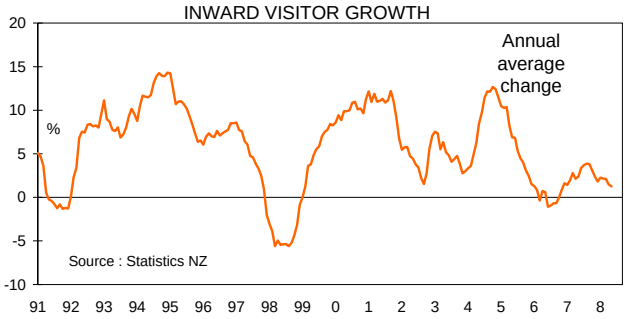


The second interesting thing however is that as we have noted over the past two to three months, in seasonally adjusted terms the net migration gain has been improving. This gain bottomed out at zero in the month of December but has been improving since then and was just over 1,000 in the month of May. In unadjusted terms the number of people arriving in New Zealand for a permanent or long-term stay was ahead 17% from a year earlier. The number of people leaving was ahead just below 9%.

Where things sit now one has to say that net migration flows are acting as a slightly negative force on the rate of growth in the New Zealand economy. But in contrast with the experience from 1998 through to 2001 when migration flows moved to negative territory over 10,000 per annum, we do not have this extra nasty influence on the housing market in play this time around.

The number of people visiting New Zealand in May was down by 0.2% from a year earlier and in the year to May growth in foreign visitor numbers was only 1.3%. The number of Kiwi's travelling offshore in May was ahead only 1.5% from a year ago but up 5% for the year two May. The inward tourism sector in New Zealand is likely to be experiencing an overall decline in revenue at the moment as the tiny increase in visitor numbers is outweighed by a decrease in the average length of stay and probably a decrease in the

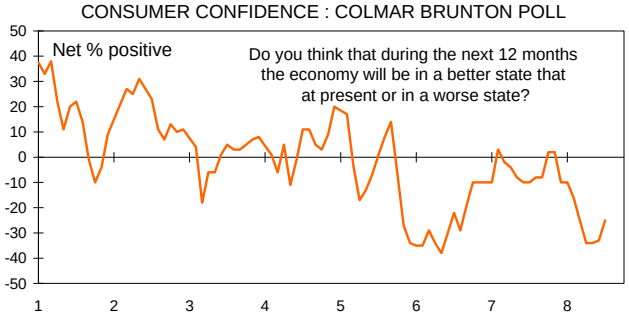
average spend per day as well. In particular the big drop off in the number of Japanese visiting New Zealand (down 10% over the past year) is likely to have dragged average spend per day down.



Monday 23

Consumer Pessimism Eases Slightly

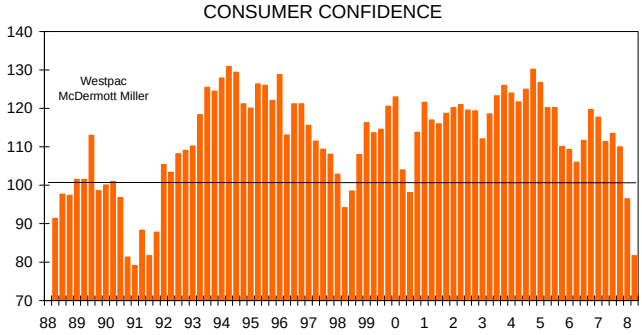
The One News Colmar Brunton report showed that a net 25% of consumers expect the economy to get worse over the coming year. This is an improvement from a net 33% feeling pessimistic in the previous months survey and is in line with our own confidence survey of four weeks ago showing a reduction in worries about the economy. Having said that however confidence is obviously still at a relatively low level suggestive of continued restraint in retail spending in the near future. At best the slight improvement in sentiment backs up our view that we are not looking at a deep recession and instead a lot of bad stuff has hit the economy in a relatively short period of time and an increasing number of people are willing to look through these large negative hits to less severe economic conditions down the track - but still relatively depressed times.

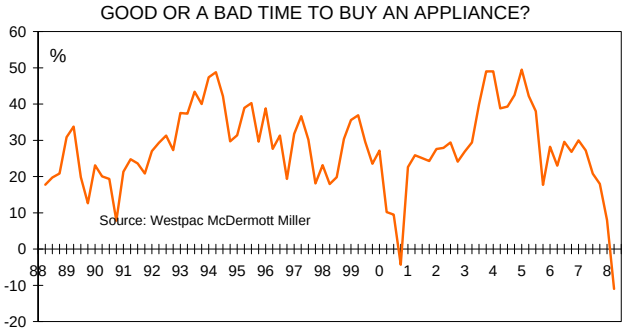


Wednesday

Consumer Pessimism Increases!

In contrast to the small improvement in sentiment recorded in the One News poll discussed just above, the Westpac McDermott Consumer Confidence Survey recorded its biggest three month decline on record to hit a 17 year low of 81.7 in the June quarter from 96.5 in the March quarter. A reading of 100 is neutral. The appalling result not seen since two recessions ago reflects the fact that households are being slammed by a wide range of factors. These include borrowing costs near ten year highs, food prices up 6% in the past year, petrol prices up 35%, employment falling 0.2% from a year ago, collapsing finance companies and easing house prices hitting perceived wealth, and drought affecting some rural incomes.





Why the divergence in poll results? Mainly it would reflect two things. First, the One news poll is more up to date reflecting responses of a week ago whereas the Westpac responses were from June 1-15. Second, the Westpac McDermott Miller confidence index is constructed from answers to five questions rather than one question about where people see the economy in a year's time. One of those questions is whether one feels it is a good or bad time to buy a major appliance. A net 11% said it is a bad time which as the second graph above shows is a record low. Ugly for retailers. Very ugly.

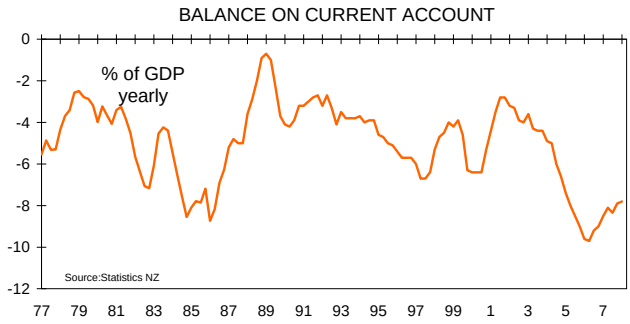
Should we pack up our bags on the basis of the confidence result and leave the country? No, and one reason is that such things need to be taken with a grain of salt. Broken down by region the most optimistic was Wellington at 92.8. The most pessimistic was the region experiencing a dairy income and dairy conversion and processing boom with soaring land prices, rising house prices, and coming energy boom – Southland. Go figure.

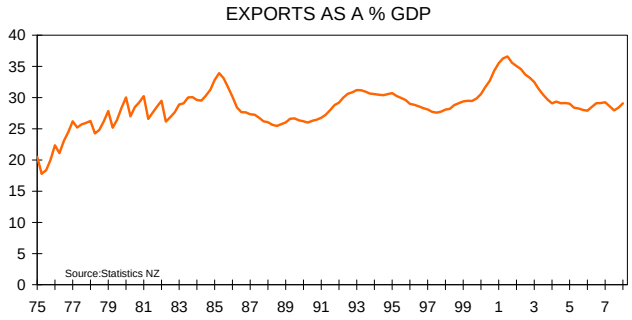
Thursday 26

Current Account improves Only Slightly

New Zealand's current account deficit in seasonally adjusted terms deteriorated over the March quarter to $3.5b from $3.1b in the previous quarter and $3.6b a year earlier. The deterioration mainly reflected a $300m deterioration in the balance on income and current transfers. This worsening was mainly driven by a surge in dividends earned by foreign investments in NZ assets – something it is almost impossible to forecast and which helps explain why the annual deficit outcome at 7.8% of GDP was worse than the general expectation of 7.4%.

Looking at the balance of goods and services – stuff we export and import – exports were ahead 7% from a year ago while imports were ahead 5%. As export income gets boosted by the easing NZD and rising export prices growth in this measure will likely remain strong. In contrast the weak economy will cut the volume of imports but the rising cost of imported fuel and some food will tend to limit the import bill decline. The result is likely to be some further improvement in the current account deficit over the coming year. A year ago the total deficit was 8.5% of GDP.





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

Writing in this section regarding the relevance of wholesale interest rate movements for retail interest rates has become extremely difficult. In fact its best described as a dog's breakfast and here's why. Before the international credit crisis broke out a year ago there was a reasonably stable relationship between changes in the 90-day bank bill yield and changes in floating interest rates such as floating mortgage rates. In the same way changes in the official cash rate would lead to an almost equal change in 90-day bank bill yields there would be near equal changes in floating mortgage rates. So all one needed to do to estimate where floating mortgage rates would go is talk about where one expected the official cash rate to go.

In similar vein although the margins would get moved around a bit because of changes in marketing campaigns and competitive pressures generally, one could speak in terms of a roughly stable relationship between changes in wholesale swap interest rates we discuss here and pressures on fixed lending rates to go up and down. We could even graph correlations between movements in the likes of the two year swap rate and the two-year fixed housing interest rate. And one could also extrapolate the implications of expected changes in the official cash rate for expected changes in swap rates and therefore give a reasonable expectation for where fixed housing rates for instance might go over the next year or so.

None of that is possible now. The outbreak of the global liquidity crisis in the middle of last year has led to a highly variable gap opening up between official cash rates in countries, their bank bill and swap rates, and actual bank lending rates. Around the world the investors who typically have provided funds to banks to undertake mainly medium to long-term lending for periods of one year and beyond have become extremely wary of financial institutions.

This wariness has arisen because of the way many people and institutions invested in United states subprime mortgage securities without being aware of the true riskiness of the lending that was done by those United States banks. The banks have lost hundreds of billions of dollars and so have the investors. And just as there are still people in New Zealand who won't by shares because of their experience in the 1987 sharemarket crash so too are there now potentially millions of investors around the world who are wary of lending to financial institutions because of the way they got burnt from the United States bank practices between 2003 and 2006.

For us New Zealand banks this is extremely important. Because the household savings rate in New Zealand is so appallingly low (maybe -15%) we banks have to get about one third of our funding from people overseas. In particular we have to predominantly fund our fixed rate lending from people offshore. That means fixed interest rates here in New Zealand that you and I would pay for a mortgage are highly dependent upon the willingness of those overseas investors to lend for terms of one year and beyond to institutions in a far-flung part of the planet.

In a nutshell, although it is widely known that New Zealand banks have essentially no exposure to the United states subprime crisis, this doesn't make any difference to the investors offshore. They have been burnt and now they demand higher premiums for lending to all financial institutions and in some cases especially those which are subsidiaries of institutions in other countries.

To give an example, it used to be the case that we would pay a premium above key wholesale interest rates overseas of maybe 0.1% a year or so ago. Now that premium is around 1.5%. The extent of that premium has nothing to do with the level of the official cash rate in New Zealand and it has blown out over a period of time when the Reserve Bank's cash rate has sat unchanged at 8.25%.

What this means is that although we can look at the likes of the two-year fixed housing rate near 9.2% and compare it with the two year swap rate currently near 7.9% that does not mean we are making a margin of 1.3%. The margin is fairly nonexistent. And it gets worse.

Over the past two to three weeks New Zealand financial institutions have gone to the markets overseas attempting to raise medium-term funds from foreign investors. Not all banks have been successful in doing so and for those that have the premium cost has been exceptionally high.

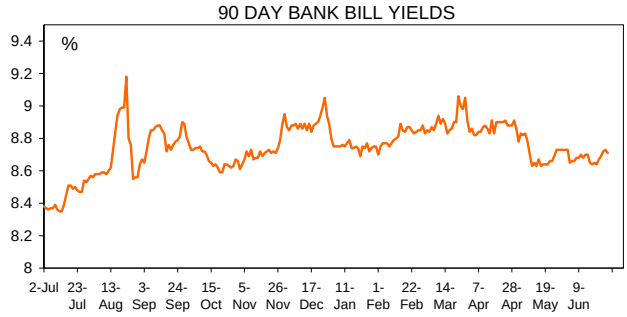
The relevance of all this to you borrowers out there thinking about interest rates going down as the Reserve Bank starts cutting its official cash rate from September is the following. Don't expect bank lending rates to fall all that much. They probably will decline but in light of the fresh deterioration in global credit markets over the past four weeks our previous comments about the two-year fixed housing rate perhaps getting to 8.5% late this year frankly now look way too optimistic given events of the past three weeks. It's not because we don't expect the Reserve Bank will be cutting its official cash rate any lesser degree than we were thinking previously. In fact they may cut it more rapidly given the horrible economic data released recently. It's just that the cost to us banks of raising money internationally has gone through the roof and the sheer availability of those funds isn't what it would normally be in a properly functioning market.

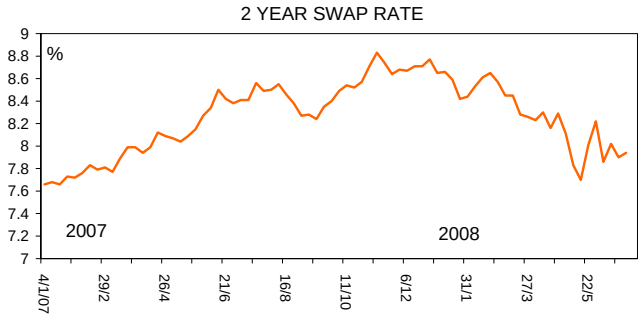
So this by and large is how our economy is being most affected by the global liquidity crisis. That crisis is certainly placing a dampener on world growth and hitting our export sector to some degree. But it is mainly manifesting itself here as higher debt servicing costs and frankly a decreased availability of funds in some cases. It's nowhere near as bad as what is happening in the finance sector which is facing a massive liquidity crisis. But the constraint is there for all of us banks nonetheless.

So going right back to the first two sentences in this section this week. Writing about where interest rates most people reading this publication are interested in will likely go in the future has become exceedingly difficult and we cannot simply blindly extrapolate expected movements in the official cash rate to likely changes in mortgage interest rates and commercial lending rates. As the Reserve Bank cuts its official cash rate from September (some think July 24 but for now we are sticking with September 11), housing and commercial interest rates will not fall by remotely similar amounts.

That means over the coming year cyclical relief to our weakening economy from falling interest rates will be minor. That means continued weakness in housing and retailing through 2009, and extra downside risk to areas not so obviously affected by the current crunch in household spending such as business investment in plant and machinery and non-residential construction.

For the record, the yield on 90-day bank bills has ended the week near 8.71% from 8.74% last week. The two year swap rate for what it is worth, has ended near 8.71% from 8.64%. It is perhaps interesting to note that in spite of the very weak consumer sentiment report on Wednesday wholesale interest rates have not fallen. That could mean the markets are already well positioned for a fall in interest rates.





Key Forecasts

- Monetary policy easing pre-election with the official cash rate close to 6% come late 2009.
- The two year fixed housing rate falling below 8.75% at a stretch late 2008, hitting the five year average of 7.8% late in 2009 optimistically, but going lower will require weaker data on the NZ economy and decent easing of global credit tensions – possible late in 2009. Falling to the 6.5% low of 1999, 2001 and 2003 is very unlikely this cycle.

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	8.00	6.2
90-day bank bill	8.65%	8.65	8.73	8.90	8.38	6.4
10 year govt. bond	6.37%	6.37	6.361	6.40	6.74	6.5
1 year swap	8.29%	8.28	8.58	8.73	8.49	6.6
5 year swap	7.61%	7.58	7.81	7.92	8.08	7.0

If I Were a Borrower What Would I Do?

Most people are now fixing for either six months or one year in expectation of borrowing costs falling further out due to a combination of monetary policy easing and hopefully some reduction in global liquidity tensions with have resurfaced strongly over the past three weeks. I would probably fix one year.

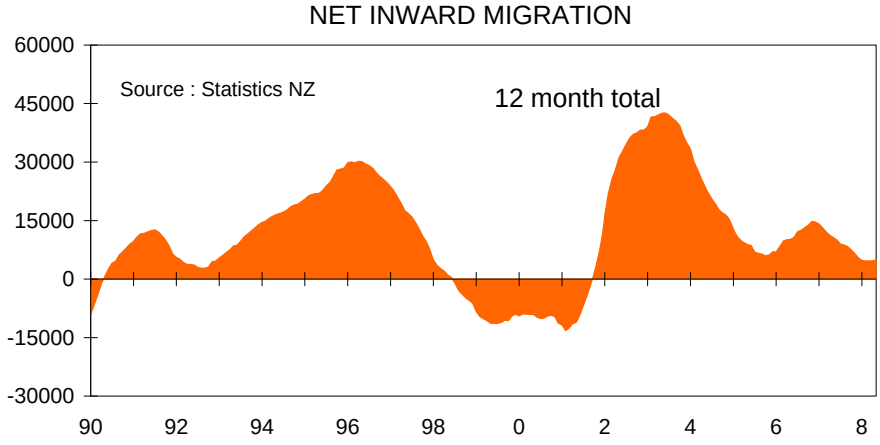
HOUSING MARKET UPDATE

No major housing related pieces of information have appeared this week – except maybe reinforcement of our projected 30% decline in construction from still more finance company closures related to property developments.

Migration Numbers Becoming Less Bad

A piece of news received during the week which is not so much positive for the housing market but in the form of the absence of a negative was the small rise in the net annual migration inflow to 4,938 people in May from 4,667 in April. The average net gain over the past decade has been almost 10,000 people per annum so the number is tracking at a below average level and therefore is detracting from the housing market compared with average experience.

But the key point to note here is that the numbers suggest we are not heading towards the situation seen between 1998 and 2001 when net migration outflows got worse than 10,000 per annum. So one could almost, though not quite, say that the migration numbers are having little if any impact on the housing market.



During the week an emailer noted the following.
"Your comments re housing ring especially true re the anticipated upturn. Meanwhile in our sector (rental residential) we have put up rents to unprecedented levels in Wellington and have found tenants aplenty even in the traditionally difficult Winter time. We are also being courted by real estate agents who cannot flick properties we enquired about 6 months ago. In addition the sale price of these properties has dropped to a level that makes economic sense with a lot of potential upside. A good time to be a property investor."

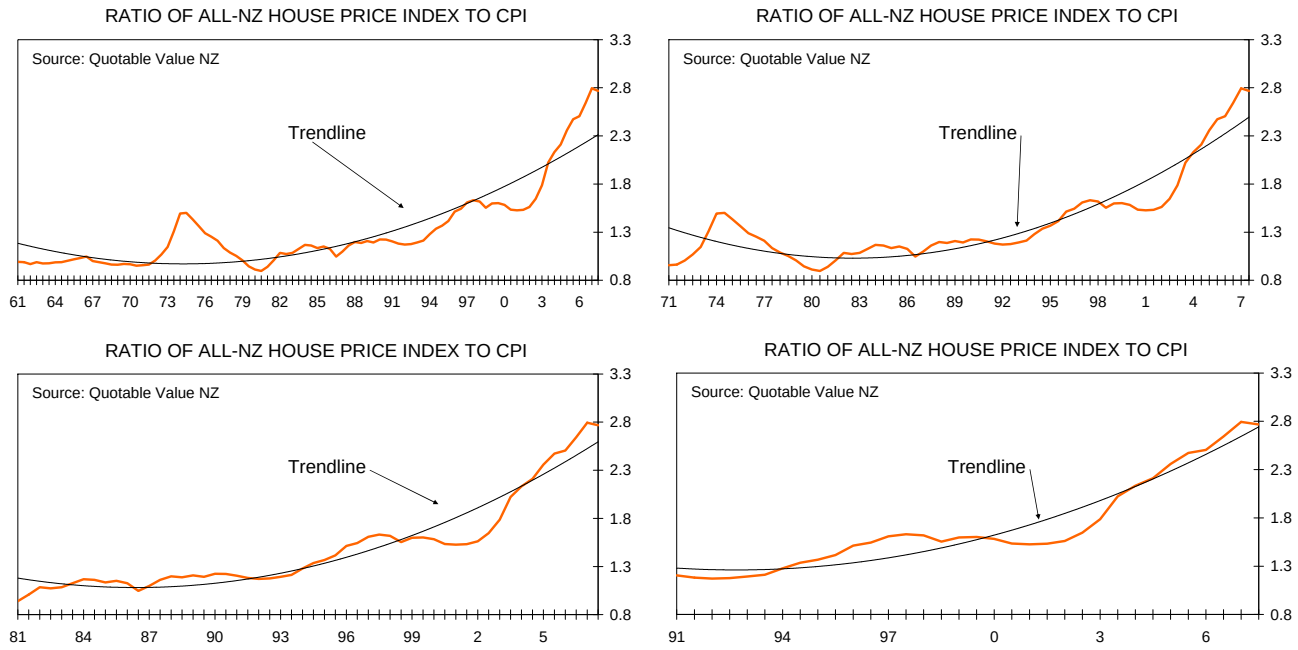
House Price Trend Valuation Measures

Another person asked if we could update a graph they had saved from a WO of 2004 looking at a ratio of the QVNZ House Price Index to the CPI. We do so below. But an important point to note is this. Measures of fair valuation – whatever dodgy construct one uses – are worthless when it comes to picking where asset prices will go. If valuation measures were any use at all then as soon as one moved above a trend line the implication would be the next moves should be down. But if an asset price moves 10% above trend that might only be because it is on its way to 20% over or 40% over.

In the same vein affordability measures applied to the housing market are of little use to anyone. If a measure shows affordability of housing is poor, for whom will this cause an alteration in behaviour? The

buyers who were willing to pay the high prices which helped produce low affordability in the first place? Think about it.

So for what it is worth we update the relevant graph discussed above but show four versions One uses a trend line calculated for the data series starting in 1961, the other 1971, another 1981, and then 1991. Depending upon what you choose as your starting point (and we are explicitly inviting you to choose) the housing market at the end of 2007 may be 22% over-valued or right on fair value. Good luck.



Key Forecasts

- Dwelling consent numbers to fall from 24,500 in the year to March 2008 to below 18,000 in the year to March 2009 with a slight recovery to March 2010 then above average activity after that as attention turns to a shortage of dwellings late in 2009.
- Real estate sales falling from 77,130 in the year to April 2008 to between 55,000 and 65,000 come the end of this year then recovering back over 65,000 in calendar 2009 with further growth over 2010.
- House prices down 5%-10% by the end of 2008, flat over 2009, rising slightly over 2010, possibly earlier.

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

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	7.8	7.9	.....	8.5	9.6
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	+4,938	4,644yr	.....	10,680	10,200
Tourism – an. av grth	10 year average growth = 5.0%. Stats NZ	1.3	2.2	1.3	2.4	0.6
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 2%. Colmar survey	-25	-33	-10	-10	-30
Business activity exps	10 year average = 26%. NBNZ	-4.4	-3.8	15.7	7.8	10.3
Household debt	10 year average growth = 11.3%. RBNZ	9.9	10.8	13.0	13.7	14.2
Dwelling sales	10 year average growth = 3.5%. REINZ	-52.9	-45.5	-21.6	-3.7	3.9
Floating Mort. Rate	10 year average = 8.1%	10.95	10.95	10.55	10.30	9.55
3 yr fixed hsg rate	10 year average = 7.9%	9.09	9.49	9.19	9.15	7.75

ECONOMIC FORECASTS

Forecasts at June 19 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	-0.9	1.5	5	2.5	4.3	-0.6	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	1.4	3.1	3.9	-1.6	4.9	2.2	1.8
GNE	4.2	1	4.8	0.6	2.4	4.3	1	5	1.1	1.7
Exports	-0.1	3.1	3	1.7	2.4	-0.4	1.7	3.6	2.2	1.9
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	3.1	0.3	2.1	2.7	1.5	3.1	0.9	1.3
Inflation – Consumers Price Index	3.3	2.5	3.4	4.6	2.2	3.2	2.6	3.2	4.6	2.6
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	111	115	119	117	112	110	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	75.5	73.6	82.7	81	86.3	75.9	74.1
TWI	65.6	68.6	71.6	63.5	62.5	71.9	68	71.6	63.6	62.8
Official Cash Rate	7.25	7.50	8.25	7	5.5	7.00	7.50	8.25	7.5	5.5
90 Day Bank Bill Rate	7.55	7.78	8.83	7.02	5.73	7.49	7.64	8.77	7.67	5.73
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.

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