Bank of New Zealand

BNZ Weekly Overview

30 November 2006

FINANCIAL MARKETS DATA

	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	7.25%	7.25	7.25	7.25	7.00	6.2
90-day bank bill	7.62%	7.61	7.55	7.49	7.68	6.4
10 year govt. bond	5.75%	5.75	5.82	5.77	5.84	6.5
1 year swap	7.69%	7.63	7.68	7.59	7.64	6.6
5 year swap	7.11%	7.08	7.08	6.94	7.13	7.0
NZD/USD	0.68	0.671	0.662	0.651	0.70	.57
NZD/AUD	0.866	0.864	0.862	0.854	0.945	.86
NZD/JPY	78.9	78.2	77.8	76.4	83.7	66.0
NZD/GBP	0.349	0.35	0.349	0.344	0.408	.34
NZD/EURO	0.516	0.519	0.52	0.507	0.595	.51

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Economy Looks Sound, Currency Firm

Three years ago when it became fairly clear that the rate of growth in our economy was going to slow down we warned businesses not to expect a recession and to keep investing to boost productivity and cut costs as we expected resource availability to remain poor. We also warned not to expect a rapid fall in the exchange rate and that the Reserve Bank would have to push interest rates up higher than people were thinking and keep them up for longer.

Very early this year when business and consumer confidence levels collapsed and again there was talk about recession we continued advising people to focus on the strong insulating factors for our economy including low fixed interest rates, high job security, good commodity prices, firm overseas growth, easing fiscal policy, infrastructure spending, and a backlog of orders in the construction sector. As we expected the period of major despondency ended and we have had confirmation of the absence of a recession along with a fresh bounce upwards in the Kiwi dollar and new warnings about inflation and monetary policy tightening from the Reserve Bank.

More recently we have been inviting people to pay close attention to the relatively strong economic data coming out suggesting not only that the economy is having a comfortable soft landing but that some sectors may be improving. We have focused on improving indicators in the housing market, rising net migration inflows, the surprisingly strong September quarter numbers for retail spending, accelerated growth in exports, along with strong recoveries in consumer and business confidence readings.

This week we have received further confirmation that the rate of growth in our economy has probably bottomed out in the form of the monthly Business Outlook survey from NBNZ.

The survey showed that in November business activity expectations improved to a net 23.7% positive from 18% positive in October and a low of -4.4% in February. This is not only a sharp improvement but the latest reading is above the 10 year average for the month of November of a net 22.2% positive. This is the first time the monthly reading has been above its average level since March 2005 and as such is strongly suggestive of growth in the economy at a rate between 2% and 2.5%. Perhaps more importantly with this indicator suggesting acceptable growth but with resource shortages continuing it implies very limited downward pressure on inflation in the near future once the effects of falling petrol prices have passed through.

This means we remain convinced as ever that there is not going to be any easing of monetary policy in New Zealand for a very long period of time and perhaps not at all over 2007. There remains a reasonable chance that the official cash rate may need to be increased one more time early next year and whether that happens or not will depend a lot upon economic data over the next seven weeks.

This week's confidence survey along with the other economic indicators and the obvious inflation and interest rate implications suggest strongly that exporters should not be expecting any exchange rate driven boom in their incomes in the near future. Not only is the exchange rate going to be held up by continuing firm interest rates but the better news on the New Zealand economy is likely to assuage any concerns investors may have had about the growth outlook here and implications for returns on their investments. Plus as much as ever the Reserve Bank needs the exchange rate to remain high and constrain growth in the export sector to leave them with some hope that inflation one day will consolidate back within the 1% to 3% target range. We still don't see that happening for a very long period of time.

The good news out of all this is that retail spending for the next 18 months, while likely to rise at below average rates, is probably going to be a wee bit better than we were thinking. In addition business investment prospects are improving and this is extremely vital for productivity growth and economic growth overall in the New Zealand economy. The NBNZ survey showed a rise in business investment intentions to a net 11.3% positive in November from 8.1% in October and a 10 year average of 11.9% for the month of November.

National Party New Leadership

During the week a number of people have asked us about the impact on the financial markets of the change in leadership of the National Party. On the face of it the apparent switch toward a more centrist set of economic and social policies and moves aimed at cultivating potential coalition partners increase the chances of victory for a National-dominated coalition at the next election. But this election won't happen for almost 2 years so unsurprisingly there was no reaction in any financial markets to the changes and it would be premature at this stage to take a view on the outcome of the 2008 election let alone the policy framework after it.

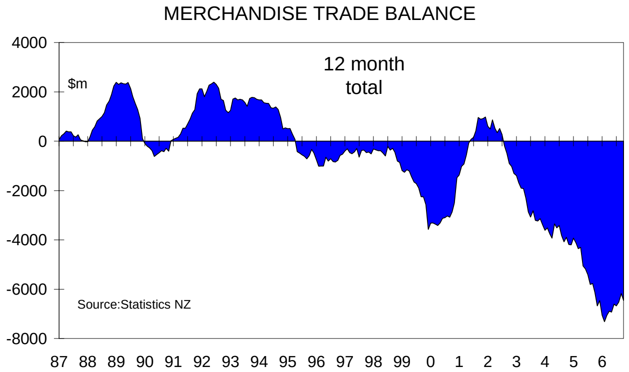
THE WEEK'S ECONOMIC DEVELOPMENTS

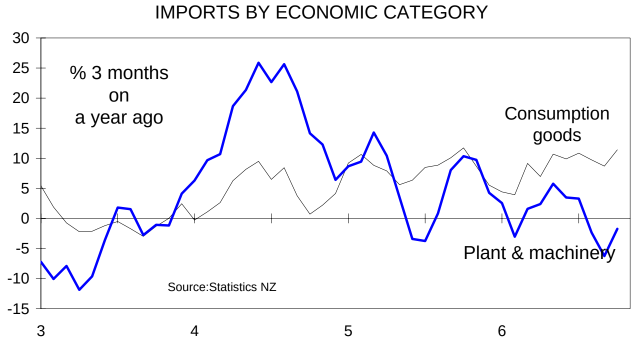
Friday 24

Trade Deficit Worsens

The recent improving trend in the monthly merchandise trade account took a small step backward in October with the deficit for the month coming in at a far greater than expected $1.2 billion compared with $0.9 billion a year ago. Compared with a year ago export receipts were up by 10.5% which was less than the average annual gain in the previous five months of just over 20%. Import payments were up by 15.8% from a year ago compared with just under 12% average growth from a year ago in the previous five months. The value of imports of consumer goods was up by a very strong 70% from October last year and by 11% in the three months to October compared with a year ago. But on the positive side from a long-term economic growth point of view the value of imports of machinery and plant were up 16% from a year ago but still down by 2%

in the three months to October compared with the same period a year ago. One has to be careful with monthly data in a small economy like New Zealand but the strength in imports does back up various other indicators suggesting that the domestic economy in New Zealand still remains relatively firm. These other indicators include stronger than expected retail spending over the September quarter, strong housing market measures, and continuing firm credit growth across the business, rural, and housing sectors.



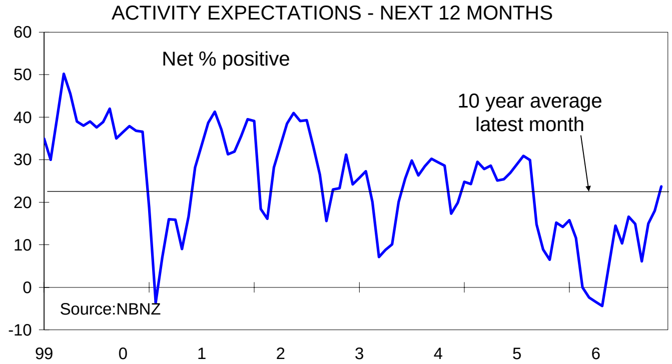


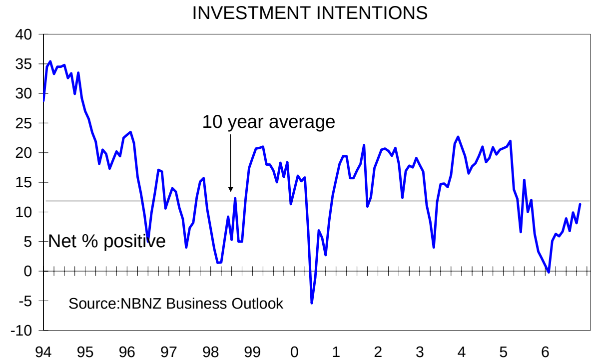
For the record the annual trade deficit now stands at $6.4 billion compared with $6.2 billion in September and $6.1 billion a year ago.

Tuesday 28

Business Sentiment Improves

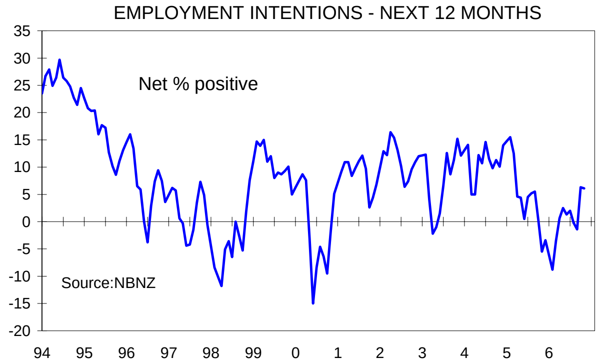
The monthly NBNZ Business Outlook survey revealed a rise in business activity expectations over the coming year to a net 24% positive from 18% in October and a 10 year average for the month of a net 22% positive. There was a very sharp jump in activity expectations for retailers from 13% in October to 32% in November while in the agricultural sector expectations declined from 16% to 15% with farmers probably despondent about the continued high level of the New Zealand dollar along with evidence that an increasing number are facing cash flow problems. This may explain why in spite of cutbacks in their capital expenditure levels farm debt growth still remains high. Employment intentions in the survey held steady at a net 6% positive which is above the 10 year average for November of a net 3.7% positive and suggestive of businesses continuing to want to hire people with reasonable abilities to read, write, and count with obvious implications for job security and continued upward pressure on wages.

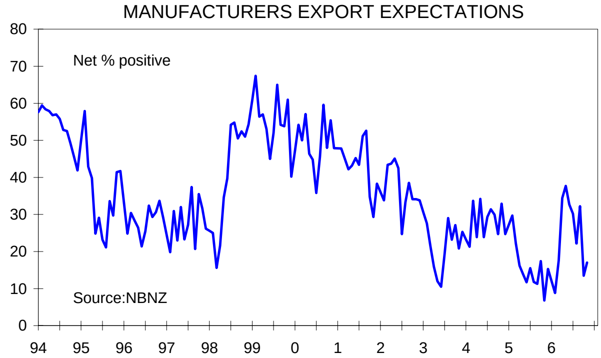




Investment intentions rose to a net 11% from 8% and commercial construction expectations jumped to a net 0% positive from -20% in October and a 10 year average reading of 3%. Reflective of the high exchange rate manufacturers' export expectations remained poor at a net 17% positive versus a 10 year average of 33%. This was however up from 13% in October. The Reserve Bank will be pleased by a slight decline in pricing intentions to 23.1% from 25.7% with this being the fourth month of decrease in a row. Year ahead inflation expectations declined marginally to 3.31% from 3.38% in October undoubtedly because of a fall in the headline inflation rate to 3.5% from 4% announced in the middle of October.

BNZ WEEKLY OVERVIEW



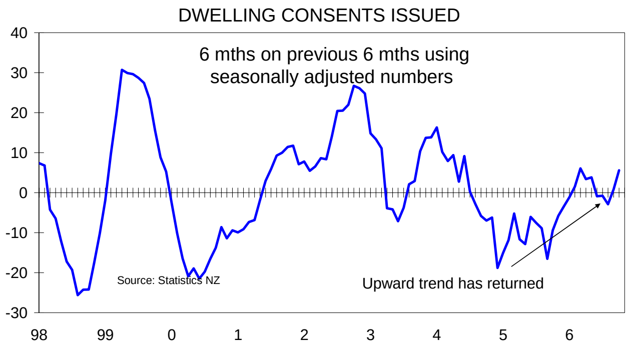


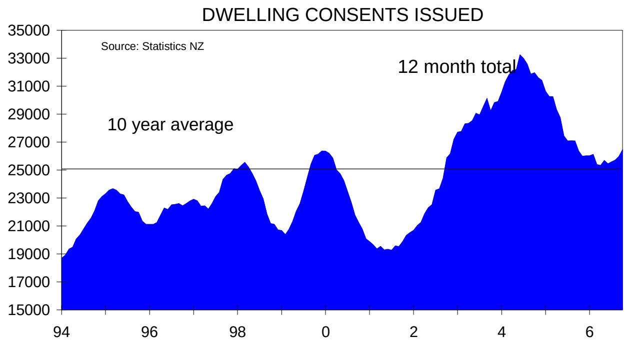
The results are strongly suggestive of growth in the economy in a range between 2% and 2.5%, continuing resource shortages, below average growth in exports, reasonable retail spending, a continuing large current account deficit, continuing above average inflationary pressures, and a complete absence of any prospect of a cut in interest rates from the Reserve Bank for a long period of time. The survey also implies continued strong support for the New Zealand dollar going forward.

Wednesday 29

House Construction Strong

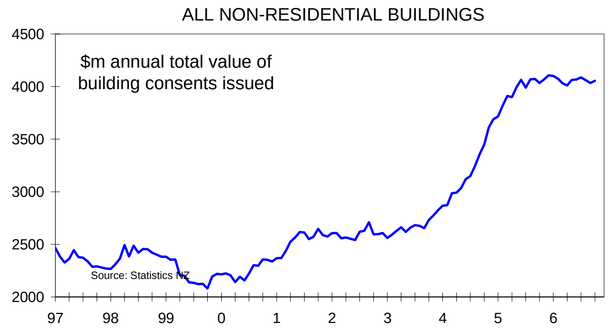
In seasonally adjusted terms there was a small decline in the number of dwelling consents issued in October of 1.8%. However this followed strong increases in earlier months and means that over the three months to October dwelling consent numbers in seasonally adjusted terms were ahead by 12% from the three months to July. For the entire year to October dwelling consent numbers where up by 0.3% and at 26,466 the total number of consents was 5.4% above the 10 year average. Activity remains strong in residential construction which is certainly not what the Reserve Bank would be hoping to see as a result of its increases in the official cash rate over the past two and half years. Even removing the very volatile apartment sector we see strength in house consents in seasonally adjusted terms with an increase of 7.6% over the past three months.

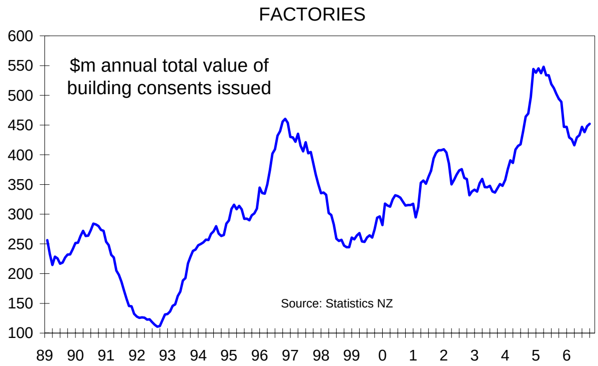




Commercial Construction Prospects Look Acceptable

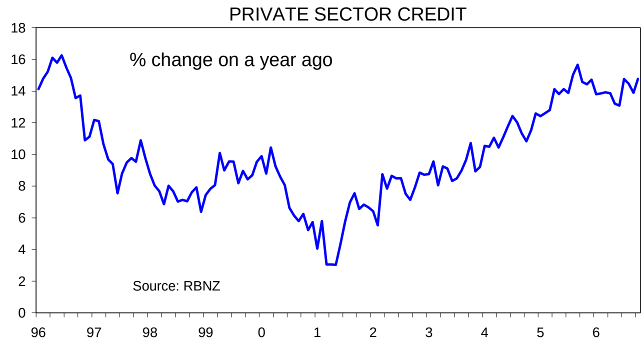
The value of consents issued for the construction of non-residential buildings was $330 million in October. This was a 6.7% increase from a year earlier but for the three months to October consent values were 2.7% down from a year ago and up just 0.5% in the entire year to October. Allowing for cost increases there is a very small volume decline occurring in non-residential construction. But it is hard to have a negative outlook for this sector when one considers the recent improvement in business activity expectations, investment intentions and construction intentions and many large projects being announced.

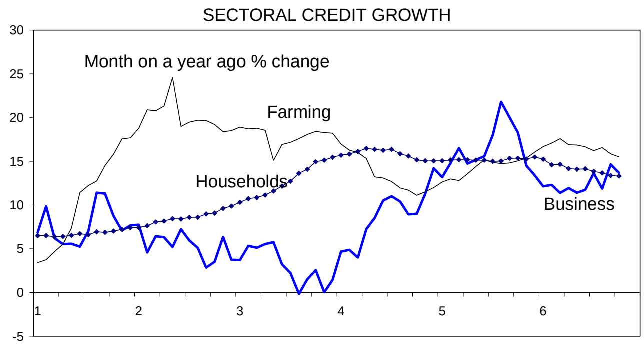




Lending Growth Remains Firm

The annual rate of growth in lending to the private sector increased in October to 14.8% compared with 13.9% in September and 14.6% a year ago. The improvement in the growth rate of this measure over recent months is consistent with other indicators suggesting we have seen the trough of this economic cycle. Having said that, with household, business, and farm debt levels already relatively high we still expect to see lending growth slow down over the next two or three years. In October the level of business debt compared with a year earlier was up by 13.7%, farm debt 15.5%, and household debt 13.3%.

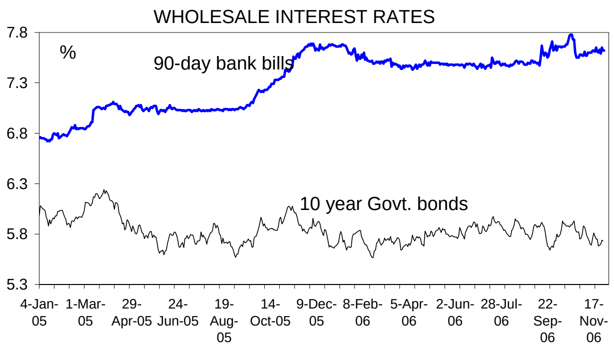


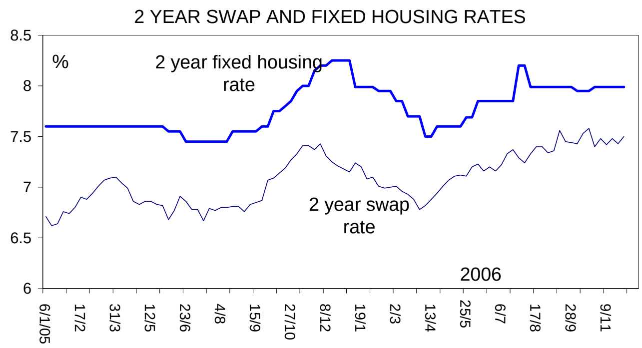


In seasonally adjusted terms lending to the household sector grew by a still firm 0.9% in October which is only just under average monthly growth in the previous six months of 1%.

INTEREST RATES

In spite of a small rally in United States interest rates we have seen New Zealand wholesale interest rates rise marginally over the past week but remain well within their trading ranges of the past few months. The 90-day bank bill yield has ended just over 7.6% while the two year swap rate at which we banks borrow to lend fixed for two year periods ended near 7.5% from 7.43% last week.





One would think that with the exchange rate running about 5% higher than the level assumed by the Reserve Bank in its most recent set of economic forecasts there would be little chance of a further increase in the official cash rate. However the strong exchange rate needs to be offset against the strong economic data we have been receiving recently which calls into serious question the Reserve Bank's contention that there is a rebalancing in growth happening in New Zealand away from the domestic economy and towards exports. This is what the Reserve Bank have been wishing for over the past three years as they have implemented monetary policy in a weak manner and the evidence suggests that they will have to start praying are whole lot harder if they are to avoid yet another embarrassing restart of the tightening cycle.

Over the past few weeks we have seen strong data released with regard to the real estate market, retail spending, exports, consumer confidence, business activity expectations investment intentions and employment intentions, residential construction, along with the absence of any strong evidence of scarce resources being freed up in the New Zealand economy.

This means one cannot rule out the Reserve Bank raising their cash rate again - not that this really matters for anyone other than the very small number of people left on floating mortgage rates - and exporters. As we have been pointing out in very strong terms over the past three years moving the floating interest rate by increasing the official cash rate is only going to have a decent impact on the housing market if one also gets fixed interest rates going up. But to get fixed interest rates going up you need both an absence of rallying or low interest rates in the United States and the Reserve Bank scaring the markets enough to believe that the cash rate will remain high for a long time and therefore this should be priced into where long-term interest rates sit.

While there is nothing the Reserve Bank can do with regard to interest-rate movements in the United States they should have been far stronger in their comments about what would likely happen with the official cash rate in their stop-start tightening over the past three years. By failing to offset the negative impact on fixed interest rates of continuing low rates in the United States the Reserve Bank have made their monetary policy less and less relevant to the domestic economy and more and more of a pain in the backside for exporters. If the Reserve Bank raise their official cash rate again we are likely to see the New Zealand dollar edge up even further but at the same time as this is happening there is a very high chance that fixed housing rates will be declining because of growing expectations of easing monetary policy in the United States next year. This means a further increase in the official cash rate in the next few months could conceivably have zero impact on the New Zealand domestic economy except to the extent that reducing export incomes leads to slightly slower economic growth

If I Were a Borrower What Would I Do?

I still like the look of the two or three-year fixed housing rates at 7.99%.

BNZ Fixed Lending Interest Rates						BNZ Term Deposit Rates			
	Housing	Average Past 5 yrs	Low Past	High 5 years		Days	$10-50K	$50-100K	$100-250k
Float	9.55%	8.18%	6.70%	9.55%		30	3.00	3.00	5.25
1 yr	8.40	7.32	5.95	8.45		90	6.20	6.25	6.30
2	7.99	7.34	5.99	8.25		180	6.90	6.95	7.00
3	7.99	7.51	6.30	8.30		1 yr	7.10	7.15	7.20
4	7.85	7.61	6.40	8.40		5 yr	6.20	6.25	6.30
5	7.75	7.63	6.50	8.60					
7	7.75	7.78	6.75	8.80					

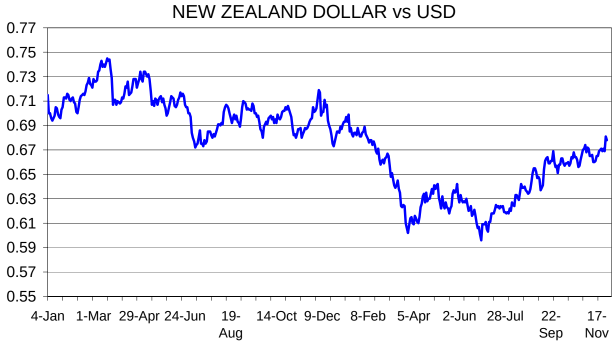
Note: Conditions may apply to these rates.

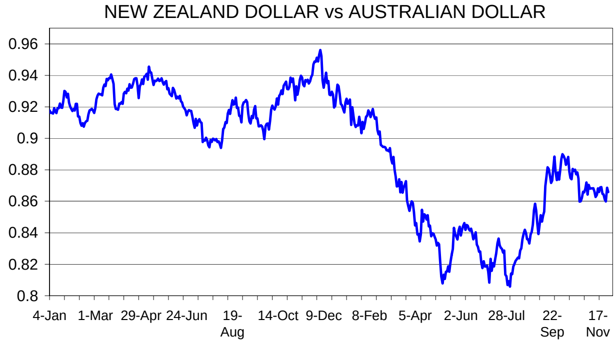
HOUSING MARKET UPDATE

We have received no fresh information on the New Zealand housing market this week apart from continuing strength in dwelling consent issuance which in October was 25% stronger than a year ago. Things still seem to be reasonably firm with no shortage of interest from buyers and no obvious increase in comments that vendor's are feeling they need to cut their asking prices by more - except maybe in the Auckland inner city apartment market where worries about continual growth in supply appear to be increasing. This is hardly surprising however and anyone who has bought an apartment there in the past few years has hopefully done so with their eyes wide open to this supply risk along with vulnerability to changes in student demand.

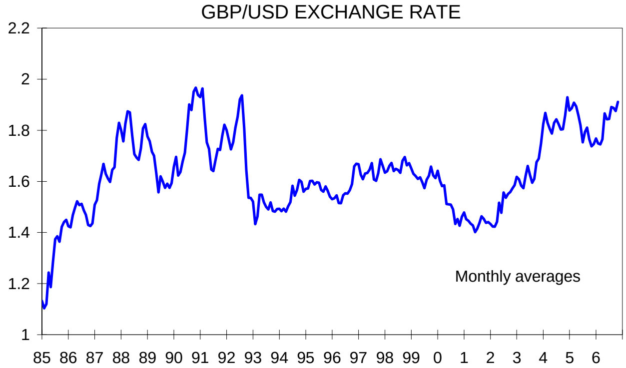
EXCHANGE RATES

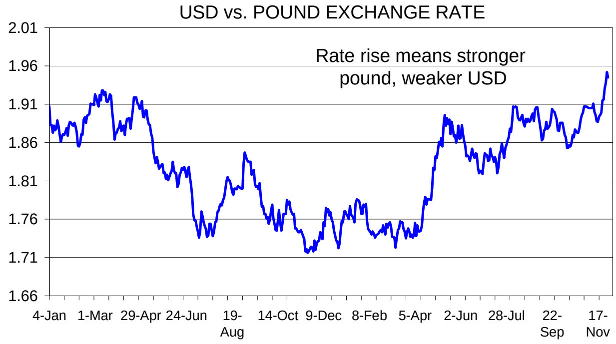
After a couple of months in which nothing really interesting has been happening with the Kiwi dollar following the strong rise between July and September we have seen a strong bounce up against the greenback this week with a close this afternoon near 68 US cents compared with 67 US cents last week and 66 US cents two weeks ago. The Kiwi dollar has been pushed higher on the back of some sudden weakness in the greenback along with a continued reaction to recent strong data releases in New Zealand.



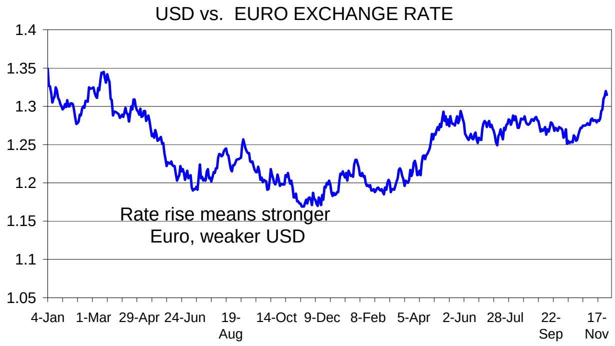


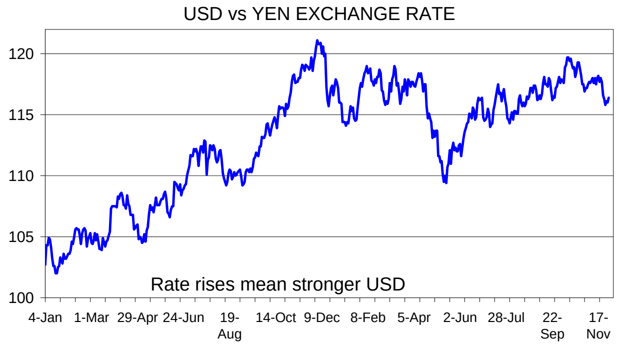
The US dollar weakened early in the week in response to worries that central banks in the Middle East and Asia may increase their diversification of foreign exchange reserves away from the greenback, plus continuing reaction to some of the recently released weaker than expected data especially on the housing market. At the same time the euro was supported by a business confidence reading in France hitting a five-year high and a confidence reading for the German business sector rising for the seventh quarter in a row.





The US dollar has ended this afternoon near a 15 year low against the British pound of $1.949 compared with $1.915 last week. Against the Japanese yen the greenback has ended slightly weaker than a week ago near a two-month low of 116.1. Against the euro the greenback has ended near a 20 month low of $1.317 from $1.294 last week.





Orders for durable goods fell by a relatively large 8.3% in November, and even excluding the volatile transport category they were still off by 1.7%. In addition the Conference Board's index of consumer optimism slipped to 102.9 in November from 105.1 in October.

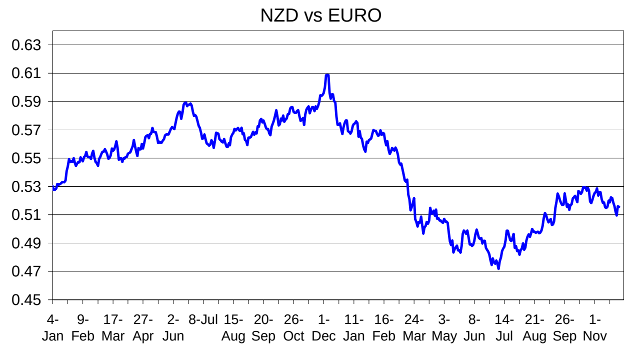
Yet in spite of some of the relatively weak economic data the chairman of the Federal Reserve Mr Bernanke made some hawkish comments during the week noting upside risks to inflation and that he was watching labour costs “carefully”. The markets are pricing in a 40% chance that the Federal Reserve will cut its funds rate in the in March 21 meeting next year.

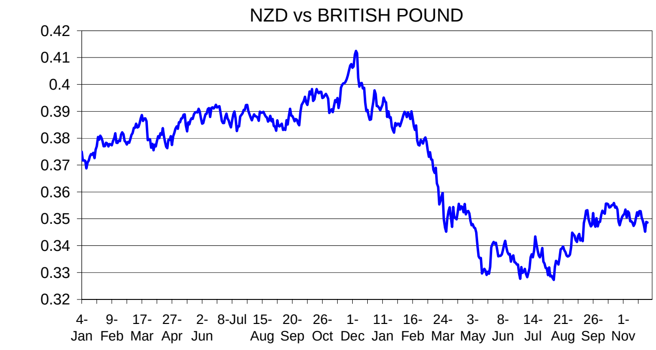
As with all other major currencies the British pound has risen firmly against the greenback this week with part of the rise attributable to the Chancellor of the Exchequer saying that economic growth would exceed their forecast this year. Meanwhile one of the many measures of house price inflation in the United Kingdom showed prices rising at their fastest annual pace in 17 months in October. These developments have encouraged the financial markets to increase their expectation of another increase in the Bank of England's base rate following the rise on November 9 to 5%.

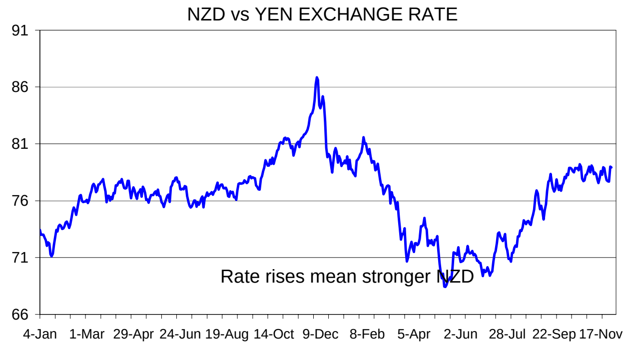
The yen also started the week stronger against the US dollar but most of the strength was offset by slightly weaker than expected retail spending data for October which showed a decrease in spending of 0.2% rather than the increase of 0.4% that had been expected by the markets. In addition there were some slightly dovish comments from the Bank of Japan Governor. The markets in Japan are very closely focused on the timing of the next increase in Japanese interest rates but the Governor said “… we don't perceive an immediate risk of excessive investment” and that the timing of any rate increases “… won't be influenced by a calendar.”

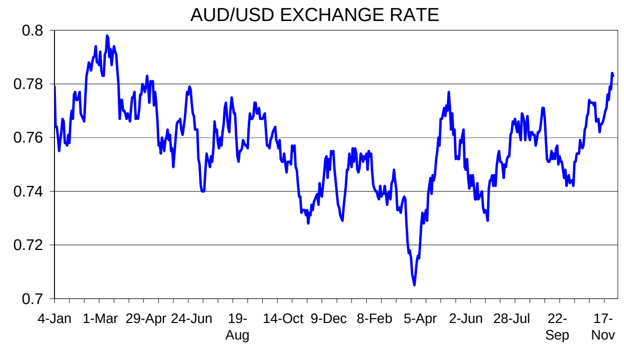
BNZ WEEKLY OVERVIEW

The Kiwi dollar has managed to remain firm over the week in spite of another comment from the Minister of Finance that the Kiwi dollar remains" stubbornly high" and the OECD saying they see scope for a "… significant rate cut" in New Zealand. Comments from the OECD aren't usually market moving anyway. If anyone is interested you can access the summarised comments on the outlook for the New Zealand economy via the following address
http://www.oecd.org/document/52/0,2340,en_2649_201185_19726196_1_1_1_1,00.html









Against the Australian dollar we have ended largely unchanged from a week ago near 86.6 cents, against the Japanese yen slightly stronger at 78.9 from 78.2, against the euro slightly weaker at 51.6 cents from 51.9, and against the British pound largely unchanged at 39 pence.

We continue to see no reason why exporters should have any great optimism that in the near future the Kiwi dollar is going to fall sharply. We continue to expect relatively firm support from high short term interest rates and an acceptable outlook for economic growth in New Zealand especially in light of some of the recent strong data.

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	0.7%	1.5	3.5	3.4	2.5
GDP growth	Average past 10 years = 3.3%	0.5	0.8	1.9	3.0	4.4
Unemployment rate	Average past 10 years = 5.7%	3.8	3.6	......	3.7	3.8
Jobs growth	Average past 10 years = 2.1%	-0.4	0.9	1.5	3.2	2.8
Current a/c deficit	Average past 10 years = 4.9% of GDP	9.7	9.5	......	8.0	5.1
Terms of Trade		0.7	0.8	-1.3	1.0	7.2
Wages Growth	Stats NZ experimental series	1.1	1.3	5.5	4.8	4.3
Retail Sales ex-auto	Average past 9 years = 4.2%.	1.1	0.8	4.6	6.3	6.8
House Prices	Long term average rise 5% p.a.	0.9	2.5	10.3	11.3	25.9
Net migration gain	Av. gain past 10 years = 13,000	+13,780	13,210yr	......	5,987	16,955
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 8%. Colmar survey	-10	-19	-34	-7	3
Business activity exps	10 year average = 27%. NBNZ	24	18	10	0	25
Household debt	10 year average growth = 11.4%. RBNZ	13.3	13.4	14.2	15.4	15.2
Dwelling sales	10 year average growth = 4.6%. REINZ	4.0	-5.6	-14.6	3.9	-25.0
Tourist numbers	10 year average growth = 6.1%. Stats NZ	5.9	1.7	9.7	-2.8	9.4
Floating Mort. Rate	10 year average = 8.5%	9.55	9.55	9.55	9.00	8.50
3 yr fixed hsg rate	10 year average = 8.2%	7.99	7.89	7.60	7.60	7.65

ECONOMIC FORECASTS

Forecasts at Nov. 16 2006	**March Years**					**December Years**				
	2005	2006	2007	2008	2009	2004	2005	2006	2007	2008
GDP - annual average % change										
Private Consumption	5.7	4.5	1.7	1.1	0.9	6.4	4.9	2.2	1.3	0.7
Government Consumption	4.5	5.4	4.1	2.9	4	5.7	4.6	4.5	3.2	3.5
Investment	8.1	5.6	-6.1	0.9	3.7	13.4	4.2	-3.5	-1.1	3.1
GNE	6.3	4.5	-0.3	1.6	2.3	8.1	4.5	0.4	1.4	1.9
Exports	3.8	-0.1	5.7	4.2	4.9	5.4	-0.5	3.4	5.1	4.8
Imports	12.8	5	-1.5	2.5	3	16.4	6.2	-1.8	2.4	2.7
GDP	3.5	2.2	2.2	2.1	3	4.2	2.1	2.2	2.3	2.6
Inflation – Consumers Price Index	2.8	3.3	3.3	3.2	1.9	2.7	3.2	3.1	3.6	1.9
Employment	3.4	2.6	0.9	1	1.5	4.4	1.5	1.9	0.9	1.4
Unemployment Rate %	3.8	3.9	3.9	4.3	4.4	3.6	3.6	4	4.3	4.4
Wages	2.9	4.6	5.4	4.4	3.3	1.9	5.1	5.5	4.4	3.3
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.73	0.64	0.61	0.54	0.57	0.71	0.7	0.65	0.54	0.57
USD/JPY	105	117	107	103	105	104	119	112	103	105
EUR/USD	1.32	1.2	1.29	1.29	1.24	1.34	1.19	1.28	1.3	1.24
NZD/AUD	0.93	0.87	0.85	0.76	0.78	0.93	0.94	0.88	0.76	0.78
NZD/GBP	0.38	0.36	0.33	0.3	0.32	0.37	0.4	0.35	0.29	0.32
NZD/EUR	0.55	0.53	0.47	0.42	0.46	0.53	0.59	0.51	0.42	0.46
NZD/YEN	76.8	74.6	65.3	55.6	59.9	74.2	82.7	72.8	55.6	59.9
TWI	70.7	65.6	60.7	53.6	57.2	69	71.9	64.9	53.5	57.2
Official Cash Rate	6.56	7.25	7.25	6.5	6	6.43	6.99	7.25	6.75	6
90 Day Bank Bill Rate	6.86	7.55	7.39	6.56	6.08	6.73	7.49	7.6	6.81	6.06
2 Year swap	6.82	6.99	7.15	6.26	6.22	6.61	7.24	7.43	6.34	6.21
10 Year Govt Bond	6.04	5.71	6	5.85	5.7	6.03	5.89	5.9	5.9	5.65

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

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