Bank of New Zealand

BNZ Weekly Overview

29 November 2007

FINANCIAL MARKETS DATA

	This week	**Week ago**	**4 wks ago**	**3 months ago**	**Yr ago**	**10 yr average**
Official Cash Rate	8.25%	8.25	8.25	8.25	7.25	6.2
90-day bank bill	8.89%	8.73	8.63	8.56	7.62	6.4
10 year govt. bond	6.22%	6.27	6.41	6.42	5.69	6.5
1 year swap	8.87%	8.77	8.85	8.50	7.69	6.6
5 year swap	8.20%	8.16	8.25	7.89	7.11	7.0
NZD/USD	0.773	0.752	0.767	0.698	0.68	.567
NZD/AUD	0.871	0.862	0.835	0.855	0.87	.859
NZD/JPY	85.0	81.7	87.6	79.9	79.0	66.1
NZD/GBP	0.372	0.365	0.374	0.349	0.349	.342
NZD/EURO	0.521	0.506	0.533	0.513	0.516	.51

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A Week of Ups and Downs

This week we have learnt that there is an improving trend under way in New Zealand's external accounts in spite of the high level of the Kiwi dollar, non-residential construction still looks firm but when it comes to building houses there is a firm downward trend in place, and businesses are still very keen on hiring people. Business confidence has eased slightly in the past month but remains consistent with growth just over 2%. Wholesale interest rates have increased over the week with a few worries internationally about liquidity strains again. But with some new-found optimism in world markets overnight about the Federal Reserve cutting interest rates again in the near future it doesn't look like an upward trend as such is in place. But any easing from our Reserve Bank at the next official cash rate review on December 6 is very unlikely in light of legitimate worries about rising food and energy prices, easing fiscal policy, and policy induced changes such as the 2009 entry of the NZ transport sector into the carbon emissions trading regime.

On the world front we saw the French President go to China and amongst other things try to encourage the Chinese to allow their currency to go up. He got a very predictable response with the same thing happening to the European delegation following a few days later. In the United States most data releases have been negative with one showing house prices down about 4.5% on a year earlier. Strong concerns remain about the US economy but apart from a 7.5 US dollar billion investment by a sovereign wealth fund in Citigroup the big piece of news for the US markets during the week was a comment from the Federal Reserve Vice-Chairman suggesting an interest-rate cut is quite likely at the next review on December 11. Hence the sharemarket boom overnight.

Maybe the main positive news for the week was a fall in oil prices back to just over US $90 a barrel from almost $100 a week ago on the back of worries about the US economy, rumours that at the upcoming OPEC meeting a production increase of up to 750,000 barrels a day may be agreed upon, and better than expected oil inventories in the United States.

Some Thoughts On Japan

For those of you who do not receive one of the regional newspapers I write for here is the column written last week about my short trip to Tokyo.

I never did the big OE after graduating in 1984 and have always struggled to see the value in spending heaps of money travelling to foreign economies to do what in many instances one can do equally as well for a fraction of the price in one's homeland. But last week I spent four days in Japan at the invitation of the Japan New Zealand Business Council to attend their annual conference and give an address on the New Zealand economy. Obviously while there I had a decent look around.

That is, I saw a lot of the reclaimed island called Odaiba, went on a one-day tour of central Tokyo, and did lots of walking. I didn't really get to speak to any everyday Japanese people nor get into the countryside, so what follows is hardly anything remotely approaching a comprehensive commentary on Japan. But this is what I saw that seems worth commenting on.

Once someone has shown you how to use the ticket machine at a train station you are basically set for life with regard to making your own way around Tokyo and by the looks of it taking the bullet train to just about anywhere else in the country. You never have to run for a train because if you miss one another is going to be along within about seven minutes.

Mount Fuji looks very much like Mount Taranaki but it's only worth going up the Tokyo Tower if its a very clear day - luckily it was when I was up there and the mountain was very clear in the distance. A lot of the time you can't see very far in the distance but that has less to do with smog and more to do with heat haze. In fact the very small number of people I saw walking around with face masks weren't apparently doing it because of pollution worries but in order to avoid spreading their cold.

People are extremely courteous and making a purchase in a shop is no problem at all. But it took me a while to figure out that I was supposed to place my money in the little black tray from which I would subsequently be given my change.

Japanese people seem to love little doggies going by the amazing number of stores selling not only clothing for little dogs but doggy prams as well. The only shop more amazing than the doggie shops was one selling very large beetles.

Taking a quick cruise along one of the rivers is well worth the money as one will go under an amazing number of bridges and cover a lot of territory in a very pleasant manner. There are bicycles everywhere and when people leave their bike somewhere 95% of them are unlocked. I saw only one mountain bike with all other bikes being either very small Raleigh 20 types or the classic sit upright bikes you hardly even see in Christchurch nowadays.

I saw only one four wheel-drive vehicle the whole time I was there. We’ve got them all it seems. There were only three lollies which I recognised - a cake of Kiwifruit chocolate, some M&Ms, and a Kit Kat bar. All the rest were very colourful but I didn't buy any because for all I knew the red ones might all taste of rhubarb. I had no problem getting a decent cappuccino at a cost of about $3.50. In fact what I discovered is that an economy which has been experiencing deflation for a great number of years against which one's currency has appreciated is surprisingly very affordable.

It's cheaper to eat out and buy clothing in Japan than it is in New Zealand. Every eating place I saw had their meals beautifully presented in plastic out the front and most mains were around $12. You can get a decent single room at a reasonable hotel in central Tokyo for $150 a night.

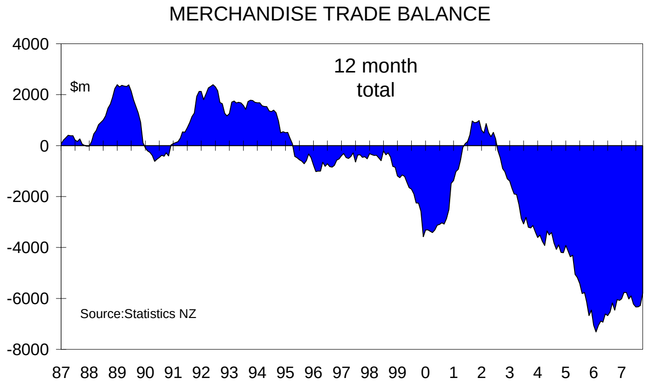
Personally I still remain a bit dubious about the concept of overseas travel and much as I love the outdoors the thing that would drag me overseas again on a voluntary basis would be more to experience a different culture rather than to see someone else's countryside. In that regard I would very willingly go back to Japan again and consider taking the whole family - all seven of us. And if Winston Peters gets invited to North Korea again I wouldn't mind tagging along for the ride.

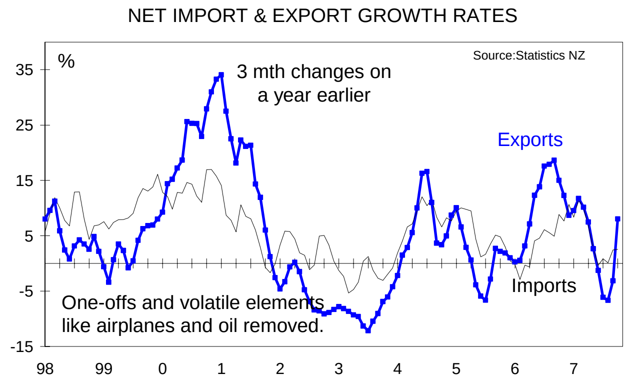
THE WEEK'S ECONOMIC DEVELOPMENTS

Monday 26

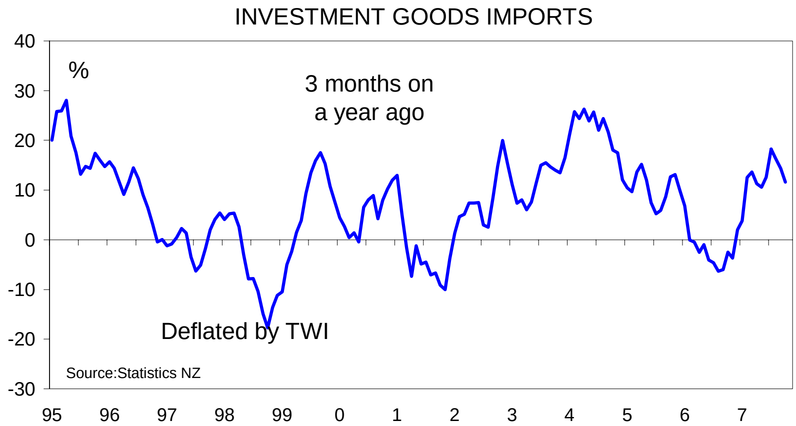
External Trade Account Improves

The merchandise trade account recorded a deficit in October of $689 million. This was a sharp improvement from the record October month deficit of $1.1 billion last year. Part of the improvement was because exports were 26% ahead of a year earlier led by an increase in oil exports plus record monthly exports of dairy products. The annual deficit now stands at $5.8 billion compared with $6.5 billion a year ago and a peak of $7.3 billion in February 2006.





The improvement to some extent reflects the absence of a large aircraft import which happened in October 2006. But then this time around an oil rig arrived and this accounts for the value of imports of machinery and plant being ahead 36% from a year ago at $720 million. These one off distortions mean that it can be hard to use this number as a measure of growth in capital expenditure by New Zealand companies. But if we gather together the monthly numbers on imports of machinery and mechanical appliances, tools, and electoral machinery and adjust for changes in the exchange rate we get the graph below.



There remains reasonable growth in imports of capital equipment which is a good sign with regard to productivity growth in the economy and suggests businesses continue to look through some of the current worries about the global economy, rising interest rates, and the high exchange rate. In contrast the value of imports of consumer goods was ahead only 5% from a year earlier in the month of October and 3% from a year really are in the three months ending October. This reflects weakness in household expenditure and will please the Reserve Bank which is hoping for household spending restraint in response to higher interest rates.

Wednesday 28

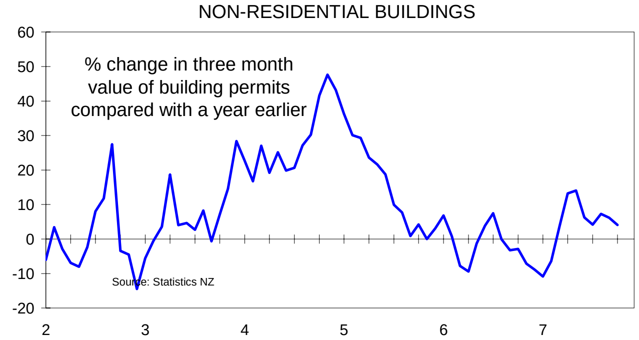
Businesses Still Anticipate Hiring More People

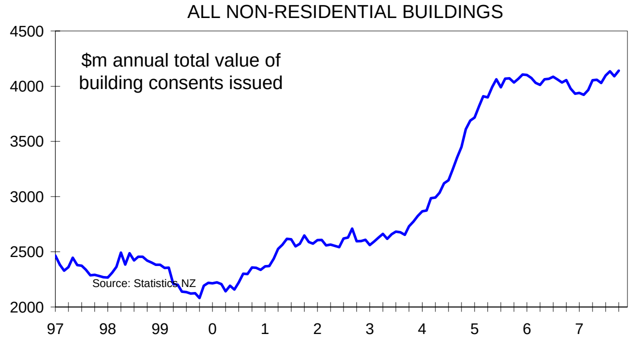
This report doesn't really anything new to what we already know about the extremely tight labour market in New Zealand. But for the record the six monthly Hudson survey of approximately 1,700 employers found a net 35.7% expect to hire more people over the coming six months. This was a gain of 1.7% from the same period a year earlier so the movement is very small but what it does illustrate is that in spite of worries about interest rates, the exchange rate, collapsing finance companies, tight margins, the global liquidity crisis, the United States housing market and economy businesses in New Zealand are still desperate to hire people. This is one reason why although the New Zealand housing market and retail spending growth will be muted over the next couple of years talk of extremely hard times would be misplaced because of the continuing support we expect from a tight labour market delivering firm wages growth. Then there are also the tax cuts to think about. Yummy
http://www.nzherald.co.nz/section/11/story.cfm?c_id=11&objectid=10478960

Thursday 29

Non-Residential Construction Still Relatively Firm

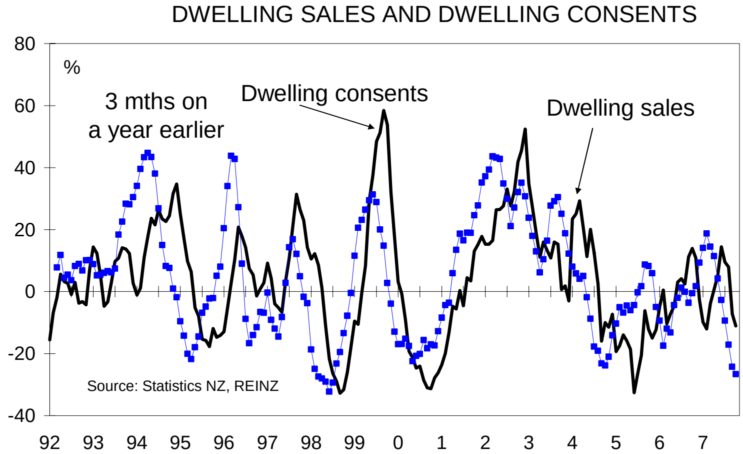
The value of consents issued for the construction of non-residential buildings rose to $381 million in October from $298 million in September. This was a firm 15.5% rise from a year earlier and means that in the three months to October the value of non-residential consents was ahead from a year ago by 4.1%. The gain for the entire year has been 2.1% which when one allows for about a 2% rise in construction costs indicates little volume change. Our belief is that with businesses having to invest in order to boost productivity many are going to find more efficient buildings as the best way to reduce cost per unit of output. This drive to boost productivity will tend to underpin expenditure on the likes of factories, warehouses, office buildings, with extra strength from investment in farm buildings. Even in the retailing sector the continual restructuring towards megastores and malls will tend to underpin construction consents. Non-residential construction is likely to be a factor helping underpin growth over the next few years though more in the form of the absence of a decline rather than the presence of a boom.





Residential Construction Falling Away

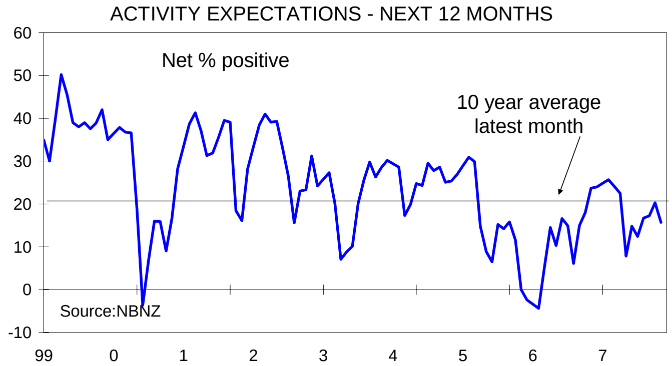
In seasonally adjusted terms the number of dwelling consents issued in October fell by 4.8% from September which followed a 10.3% fall the previous month. Over the three months to October the seasonally adjusted change from the three months to July was a decrease of 11.2%. There is a clear downward trend in dwelling consents issuance which is what we have been expecting because of the past good correlation between changes in the rate of growth of dwelling sales and changes in the rate of growth of dwelling consents as shown in the graph just below. For the year to October dwelling consent numbers were down by 2.8% to a total of 25,732 which is still above the average annual number for the past 10 years of 25,404.

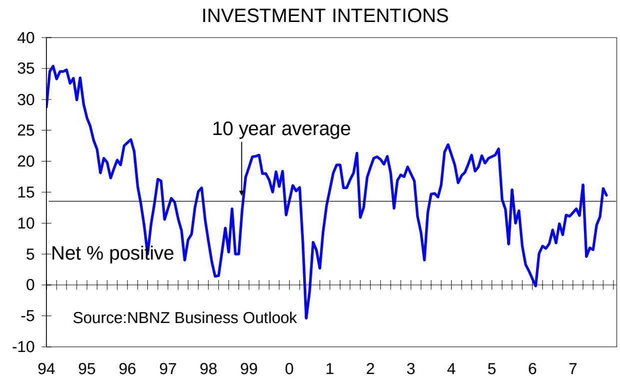


The easing in residential construction will free up some builders, electricians etc however many of these people are likely to find ready employment in the non-residential construction and infrastructure sectors. Unfortunately that means for you or I who may want to get a new bedroom or bathroom put onto the house the chances of getting a good discounted rate do not look particularly high.

Business Sentiment Declines

The monthly NBNZ Business Outlook survey has revealed a decline in business expectations of their own levels of activity over the coming year to a net 16% positive from 20% positive in October and 10 year average reading of 20%. As such the reading is consistent with below trend growth in the New Zealand economy in line with our expectation that GDP will improve between 2% and 2.5% over each of the next couple of years. Broadly all indicators eased back a little bit over the month perhaps because of a slight lift in expectations of interest rate increases and continued bad news stories about the global liquidity crisis. Employment intentions eased to a net 3% positive from 6% in October which is bang on the 10 year average. Investment intentions eased to 15% from 16% though remain above the average reading of 12%. Manufacturers export expectations declined somewhat surprisingly in light of the generally low level of the Kiwi dollar against the Aussie dollar to a net 26% positive from 33% in October and average reading of 33%.





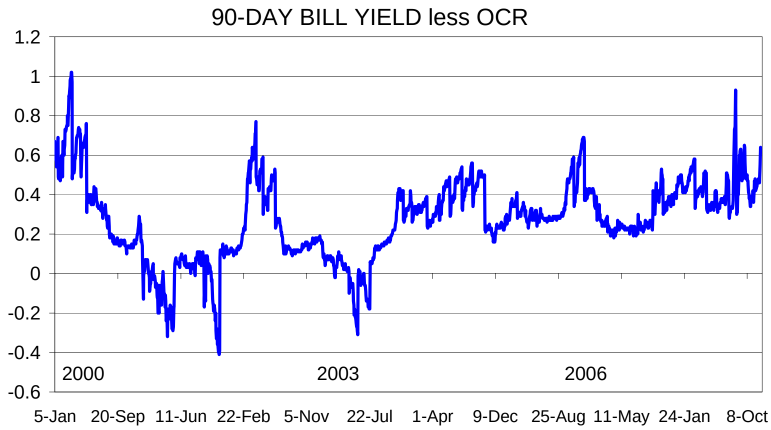
The Reserve Bank will be pleased by a fall in pricing intentions to an 11 month low reading of a net 27.4% positive from 31.3% in October. However this remains above the 10 year average reading of 22.6% and many inflation risks remain so we don't think they will take a huge amount of solace from this result. Inflation expectations eased only slightly to 3.11% from 3.18% in October which might seem a bit surprising in light of the annual rate of inflation declining when announced in the middle of October to 1.8% from 2% earlier on.

……. Debt growth numbers were released this afternoon but we'll cover those next week.

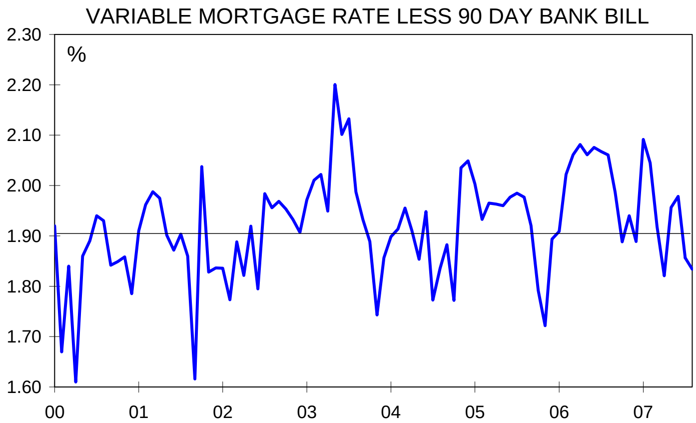
INTEREST RATES

Around the world there have been increasing signs of liquidity stress in various markets which has placed some upward pressure on short-term financing costs and this is one reason why we have seen bank bill yields in New Zealand increase relatively firmly over the past week. The yield on 90 day bank bills has ended today near 8.89% compared with 8.73% last week. This is the highest such rate since late September and before that the third week of August when the world was in the grip of a full-blown liquidity crisis to which central banks were starting to react.

The liquidity stress in the financial markets is posing a problem for lenders who traditionally base retail interest rates on the 90 day bank bill yield. Some of these interest rates can get changed relatively quickly as the borrowers are used to having their rate priced off the wholesale curve. But when it comes to the floating mortgage rate things are a bit different. Historically we banks have tended only to move the floating mortgage rate when the official cash rate changes. It's an easy thing to do, it's what the Reserve Bank is wanting, and the public pretty much know what is going to come along. But as the graph below shows an unusually large gap has opened up between the cost to us banks of financing variable rate lending and the official cash rate.

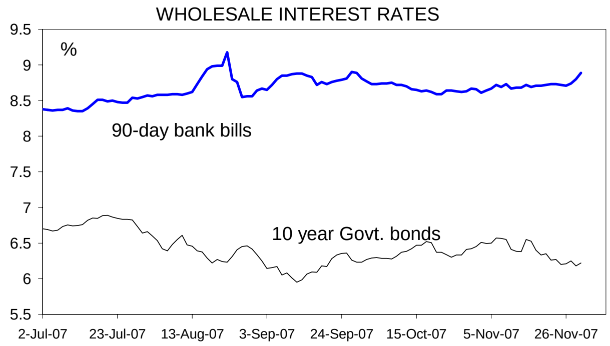


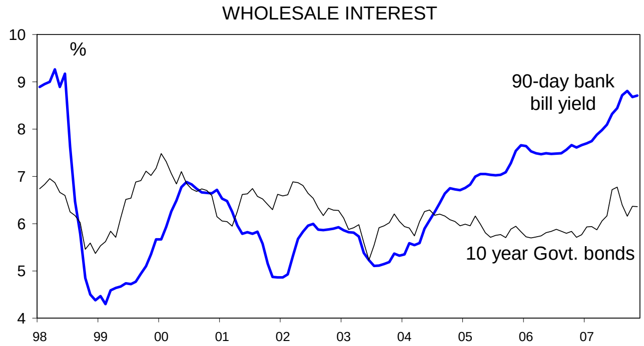
Will this lead to an increase in variable mortgage rates without the Reserve Bank moving the official cash rate? That of course depends upon competitive pressures in the marketplace and to what extent it looks like margins for variable rate lending will continue at below average levels in the near future. On average the difference between the variable mortgage rate and the 90 day bank bill yield has been 1.92% since the start of 2000. The graph below uses monthly average data with the latest observation showing the gap below average though if we took today's spot rate for the 90 day bank bill yield of approximately 8.89% the margin would be just 1.66%. Worth keeping an eye on.



BNZ WEEKLY OVERVIEW

In the swaps market rates have changed by little over the past week with the two year swap rate ending the week near 8.68% from 8.64% last week. Some upward pressure has been offset by rumours of a fresh euro Kiwi bond issuance overnight. In addition it seems a week doesn't go by without seeing the launch of a new Japanese investment trust targeting high interest rate countries like New Zealand.





The next review of New Zealand's cash rate happens on December 6. It is unlikely that we will see any change in the rate however the fact that will probably repeat a warning along the lines of the one they gave at the last review on October 25. To whit

"Despite ongoing surpluses in the government's operating balance, fiscal policy is contributing to inflationary pressure. Any further easing in fiscal policy beyond that already announced will add further upside risks to medium-term inflation. There are a number of other upside risks to inflation, including the direct effects of the proposed greenhouse emissions trading scheme and rising global food prices."

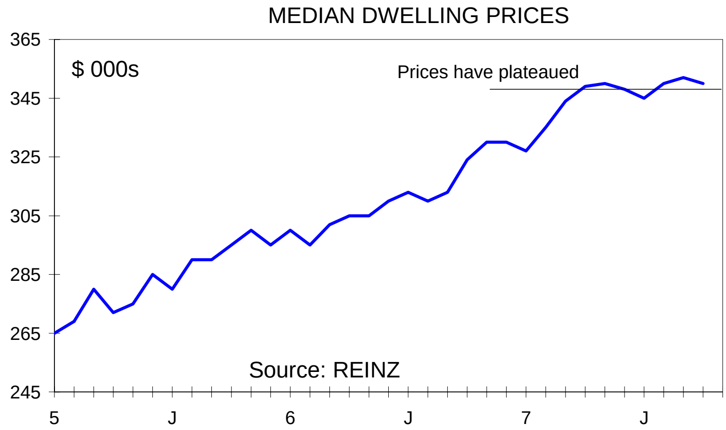
Lets not forget rising petrol prices, firm wages growth, cost to employers of implementing the Kiwisaver scheme and so on. Inflation risks in New Zealand going forward remain strong and unless we have a global recession - which we do not expect - scope for any easing of monetary policy here looks very slim in the coming year. And once we do enter the easing cycle, probably over 2009, the extent of the easing is likely to be less than in the past with the cash rate bottoming out nearer 6.5% than 4.5%..

If I Were a Borrower What Would I Do?

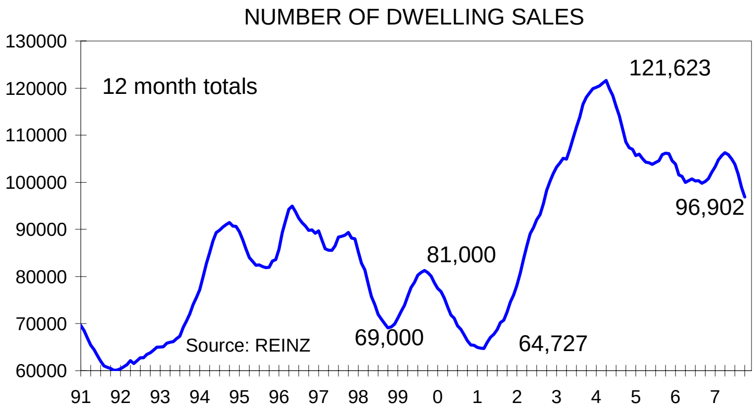
The recent increase in fixed interest rates makes it more difficult to advocate fixing now tough a direct comparison between these fixed rates plus where the common variable-rate sits just over 10.5% suggests value remains in fixing two years. But if one was able to access a floating rate near 9.5% then floating would appear optimal over the next couple of years.

HOUSING MARKET UPDATE

We have been going through one of those periods when very little fresh information has emerged regarding the New Zealand housing market. In a nutshell what we know is that average house prices around the country have been flat since May and in fact they may even have fallen slightly because the greatest decline in turnover is happening at the lower end of the market which could be imparting a slight upward bias to the median price measure used in the monthly REINZ release.



Turnover is running about 27% down from a year earlier and the real estate industry is going to go through quite a shakeup with the annual number of dwelling sales declining from 100,000 to perhaps close to 75,000. This comes at a time when there is strong concern about the industry's ability to regulate itself which led recently to the imposition of an outside disciplinary agency. Definitely a shakeup. http://www.beehive.govt.nz/Print/PrintDocument.aspx?DocumentID=31204



Given

- the pressures which are coming on household budgets from rising fuel and energy prices (the same here as practically every other country around the world one way or the other from Iran to Mexico, Italy etc.,
- loss of confidence in easy house price gains,
- below average net migration inflows,
- fixed housing rates largely above 9%, and
- reduced jobs growth partly because of limited labour force growth plus already very low unemployment,

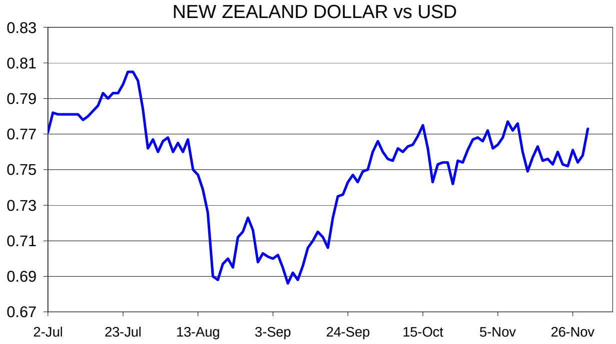
it would be unwise to expect much improvement in average house prices over the next couple of years. But expecting a rout as such in the housing market does not seem on. As we have been pointing out over the past few years what it took in 1998 for average house prices to fall on average about 4.0% was

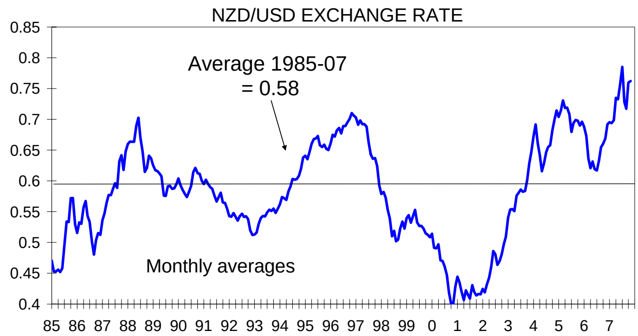
- net migration outflows of 6,000 people
- two years of drought
- the Asian Crisis
- a recession
- the Reserve Bank raising interest rates while we were in recession
- over a 1.5% jump in the unemployment rate.

We don't expect such things this time around.

EXCHANGE RATES

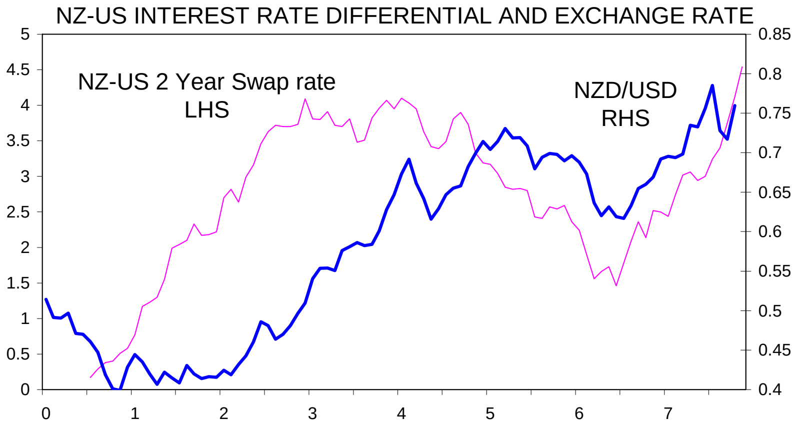
Over the past week we have seen the Kiwi dollar rise by two cents against the greenback to finish this afternoon near 77.3 cents. For practically all the week the Kiwi dollar was trading below 76.0 cents with the attraction of our high interest rates being offset by weakening global sharemarkets amidst worries about further turmoil in the United States financial sector, continuing bad data on the United States economy, and weakness in sharemarkets which at one stage saw the Dow Jones index fall to a seven-month low.





But developments such as the Abu Dhabi Investment Fund taking a 4.9% stake in Citigroup and comments from the Federal Reserve Vice-Chairman overnight about potential US monetary policy easing have seen the Kiwi dollar recover strongly in association with a 331 point jump in the Dow Jones index. Also last night there was a rumour about a fresh euro Kiwi bond issue plus continuing new investment funds being set up in Japan targeting high yielding currencies - which is definitely what we offer.

Our currency is influenced by many things and in the past we have noted some correlation between house prices and the exchange rate plus commodity prices and the exchange rate. The graph below shows a correlation between the NZD measured in US dollars and the difference between two year swap rates in New Zealand and the United States. As with the other correlations noted here the relationship is of course not exact but it is there.

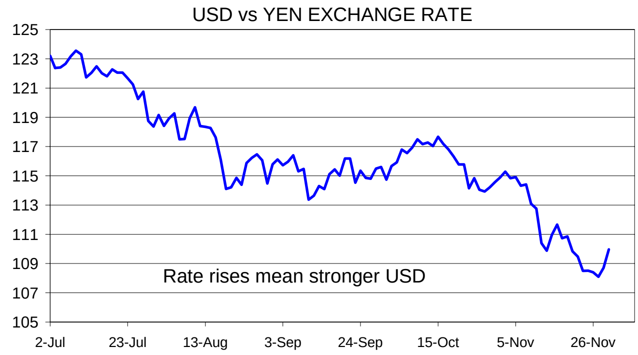


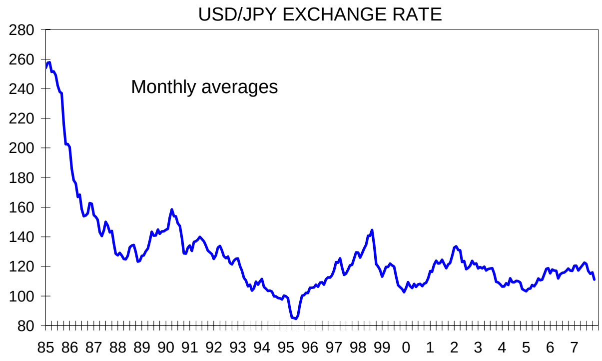
At the moment because of a surge in concerns about growth in the United States economy but limited expectation that the Reserve Bank here will be cutting interest rates for a long period of time the difference between these interest rates it is at its highest level since at least 2000 when our records start. There seems little chance that this differential is going to narrow for perhaps at least a year and that is why in the absence of something coming along causing a very strong recovery in the greenback we are probably going to trade above 80.0 US cents at some stage in the next few months. After all we're only 2.7 cents away from that level at the moment.

United States

GDP +2.6%, CPI +3.5%, funds rate 4.50%

Turning now to the other half of this exchange rate equation, the greenback, we find things not much changed from where they were a week ago against the euro near $1.48, but a small gain against the Japanese yen to 110.0 from 108.5, and a small loss against the pound back to $2.077 from $2.06 last week.

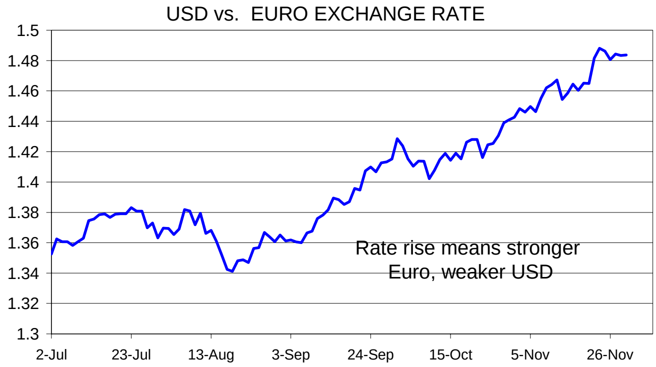


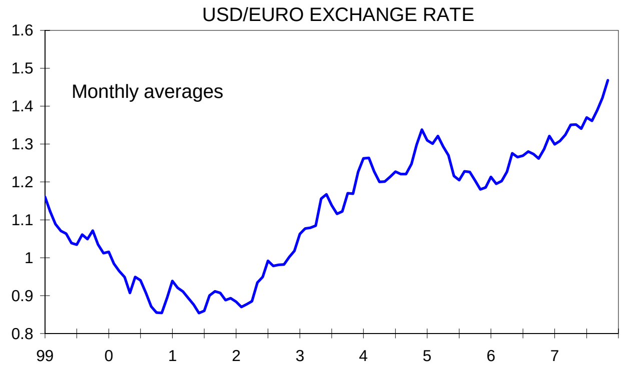


Financial markets were closed in the United States last Thursday for Thanksgiving day. The day after is known as Black Friday and is traditionally viewed as the start of the Christmas shopping season in the United States. Although there is evidence that consumer spending on average is down from the same period a year earlier, in the three days after Thanksgiving day the anecdotal reports from retailers were better than had generally been expected. This led to a slight reduction in worries about the impact of tightening up on home lending, bank losses, and the lowest consumer confidence reading in 15 years recently leading to a slump in consumer spending. But realistically you'd have to be fairly optimistic to take a positive view about US household spending on the basis of such reports.

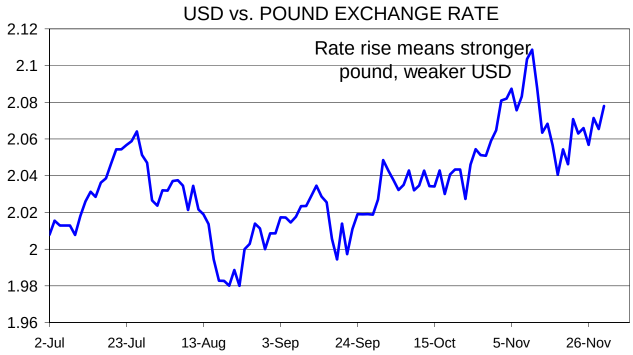
Note that in the US they have created a new day called Cyber Monday when people are supposed to go online and do lots of shopping. According to one report spending was up 21% from a year earlier and again this contributed to a pullback in worries about consumers completely closing their wallets.
http://www.reuters.com/article/ousiv/idUSN2638474320071126
http://money.cnn.com/2007/11/27/technology/bc.apfn.holiday.onlinesa.ap/index.htm?postversion=2007112718

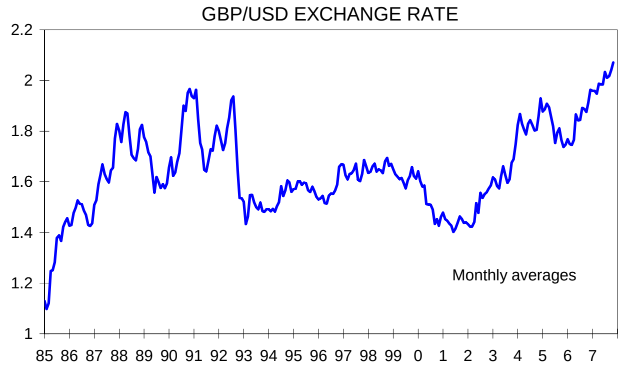
With regard to the data released in the United States over the past week we have seen one of the monthly consumer confidence measures fall to its lowest level in two years. The Conference Board index fell to a reading of 87.3 in November whereas a reading of 91.0 had been expected. We have also seen the Standard and Poor's Case Schiller house price index suffer its worst quarterly decline in the indexes' 21 year history to lie 4.5% down from a year earlier whereas a decline of 4.1% had been anticipated. And so it goes on with overnight economic data again surprising on the weak side with existing home sales in October falling by 1.2% whereas a decline of 0.8% had been expected. In addition orders for durable goods - which give insight into whether firms are confident enough to plan expansion - fell 0.4% in October versus an expected fall of 0.1%.



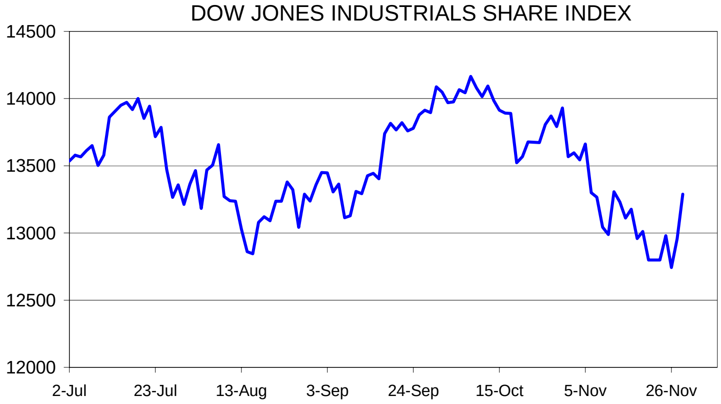


But while the economic data are important no one really expects to see too many positive numbers at the moment and instead most attention is on what is happening in the financial sector. Over the past couple of weeks we have seen far greater than anticipated losses being reported by financial institutions leading to increasing worries about reduced lending willingness not only by United States banks but banks overseas who presumably may also have greater than previously thought losses on their books from the decline in the US housing market. What was really worrying the markets up until overnight was that in spite of these loss revelations and further evidence of liquidity conditions in markets deteriorating comments from Federal Reserve officials remained along the lines of them being concerned about inflation in the future and maybe the markets should not be anticipating another interest-rate cut very soon. So far the Federal Reserve have cut their funds rate by 0.75% to 4.50%.





Amidst these worries we saw the Dow Jones share index fall to a seven-month low, and the US dollar fall to a 2 1/2 year low against the Japanese yen below 108.0. But then two key things happened. The first was on Tuesday when news came out that the Abu Dhabi Investment Authority was injecting US$7.5b into Citigroup giving them a 4.9% stake. The second came last night when the Federal Reserve's Vice-Chairman Mr Kohn said some of the recent turbulence in the financial markets had undone earlier improvement and this highlighted the need for " …flexible and pragmatic policy making…". His comments have given the markets strong hope that there will be another cut in interest rates in the near future and this contributed to a 331 point rally in the Dow Jones index last night. The index is now are almost 4% ahead of where it was a week ago at 13,289, though still well down from 14,164 on October 8.

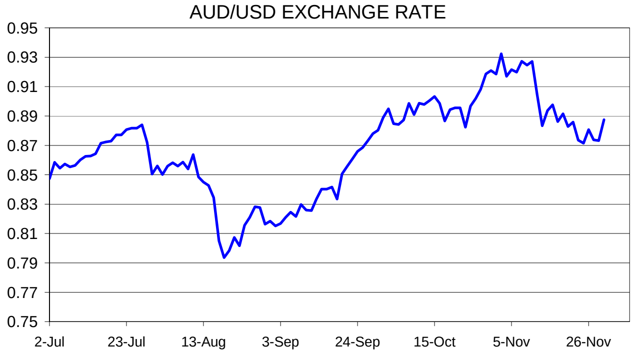


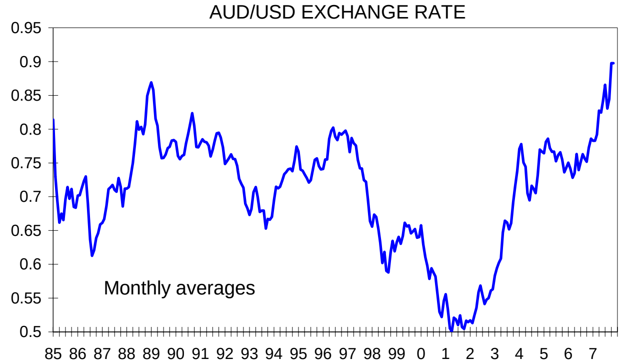
Looking ahead one should expect to see the US dollar continuing to move around on fluctuating opinions about what the Federal Reserve will do with interest rates in the short term, announcements by banks regarding their exposure to the sub prime mortgage market, bouts of speculation about the speed with which the US dollar will become less important in central bank reserves, commodity trading, and fixed exchange rate regimes, plus economic data. With regard to data the main focus will come in just over a week's time when the November non-farm payrolls report comes out. So far there is little strong evidence that the United States labour market has suffered as a result of the declining housing market. But if this evidence emerges then we can expect to see further scaling back of growth forecasts, sharemarket weakness, US dollar weakness, and extra interest rate cuts from the Federal Reserve.

Australia

GDP +4.3%, CPI +1.9%, cash rate 6.75%

Back in the first week of November it cost over 93.0 US cents to by one Australian dollar and there was increasing talk about parity on the back of soaring commodity prices. Since then a combination of profit-taking, over 5% average falls in Australia's export commodity prices, worries about United States and therefore world growth, and sharemarket weakness hitting high yielding currencies we have seen a strong pullback. Yesterday for a while the Aussie currency was trading below 87.0 cents but this afternoon has ended near 88.7 cents from 87.4 cents last week.





Like the Kiwi dollar the Aussie dollar has been lifted over the past 24 hours by the strong rise in the United States sharemarket overnight.

There was very little impact on the financial markets as a result of the landslide victory to the ALP in last weekend's Federal election. From an economic policy management point of view there are very few points of difference between the two major parties though going by statements ahead of the election the new government led by Prime Minister Kevin Rudd may engage in less extra Federal spending than if the Liberals had been re-elected. There may be some mild extra upward pressure on inflation eventually as a result of the new government's intention to repeal the Work Choices laws and individual workplace agreements being limited to those on high salaries.

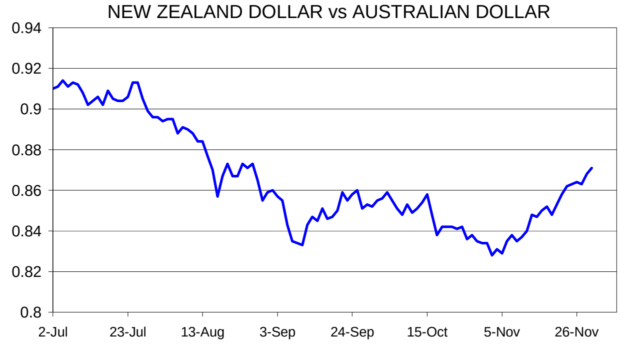
The change in labour laws will probably be the biggest impact on Australian businesses and just to show that there was some uncertainty heading into the election, although the NAB monthly confidence survey showed very strong business conditions a separate survey focusing only on small businesses found a record fall in business confidence. The Sensis Business Index quarterly survey based on interviews with about 1800 small business operators revealed that confidence fell 16 points to 43%. The survey has been running for 14 years and the latest result is the lowest in six years. The main concern seems to have been around changes in industrial relations law.

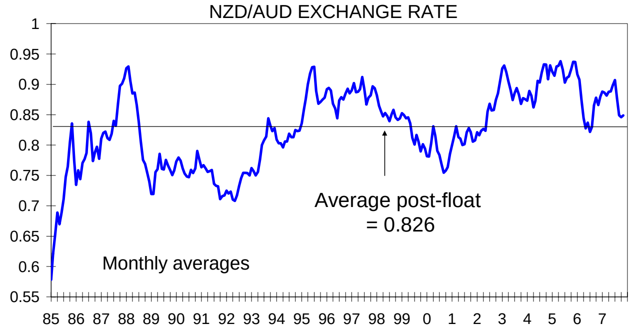
The new Prime Minister will meet the outgoing United States President early next year and discuss withdrawing Australian troops from Iraq and ratify the Kyoto protocol. This latter intension has already led to an invitation to next month's meeting in Bali to discuss plans for climate change policies which will follow the ending of the Kyoto agreement.

For a short while on Monday the Australian dollar got a lift on the back of rumours going around the market that the large Chinese sovereign wealth fund would put in a bid along with Chinese steel businesses for Rio Tinto. The rumour appears subsequently to have proved false although it highlights the extreme interest in the BHP bid for Rio Tinto.

The Kiwi dollar has gained ground against the Aussie currency for the fourth week in a row ending this afternoon near a three-month high of 87.1 cents from 86.2 cents last week and just below 83.0 cents four weeks ago. The main source of downward pressure has been a mild pullback in expectations that the

Reserve Bank of Australia will be raising its cash rate again in December to follow the increase just ahead of the election, along with an average 7% fall in Aussie commodity prices since the start of November.





The market expectation is that there is another rate rise in the pipe line with the common pick being February - seen as a 65% chance. A key factor influencing this decision will be the December quarter CPI result. Our expectation is that the move will come in February taking the cash rate up to 7.0%.

Euro-Zone

GDP +2.6%, CPI +2.6%, cash rate 4%

The euro has ended the week not much changed against the greenback near $1.488 but during the week every man and his dog based in Europe jumped on the bandwagon of moaning about the currency's strength. European Central bank officials expressed concern and even the German Chancellor (not a bloke) expressed concern about what the strength might mean for the German economy. Actually on the face of it some of these concerns may be mildly misplaced. During the week the widely watched monthly IFO survey of German business opinion unexpectedly improved 0.3 points to a reading of 104.2 in November.
http://www.bloomberg.com/apps/news?pid=20601068&sid=aBQeTsHZUSOs&refer=economy

In addition the euro zone purchasing managers index for November showed an increase to 52.6 from 51.5 in October which was better than expected. This indicates growth in the manufacturing sector. There was even a business survey in France which showed an improvement which might on the face of it seem surprising considering the industrial strife associated with Mr Sarkozy's attempts to introduce mild labour reforms.

Early in the week Airbus officials expressed concern that the rise in the euro may be life threatening. But they backed off such sensationalist comments fairly quickly with analysts pointing out that delays in production had a strong role to play as well.

Early in the week the French Prime Minister travelled to China and apart from receiving an order for over 160 Airbus planes and presiding over an agreement for a French company to build two nuclear reactors in China, lobbied hard for the Chinese to allow their currency to appreciate or at least become more flexible. Apparently until a couple of months ago the Europeans were focusing their currency moaning on the US dollar trying to talk it up and the euro down. But following the meeting of the Group of Seven industrialised countries in October they realised the true problem instead lies with China so that is where they are now focusing their efforts.

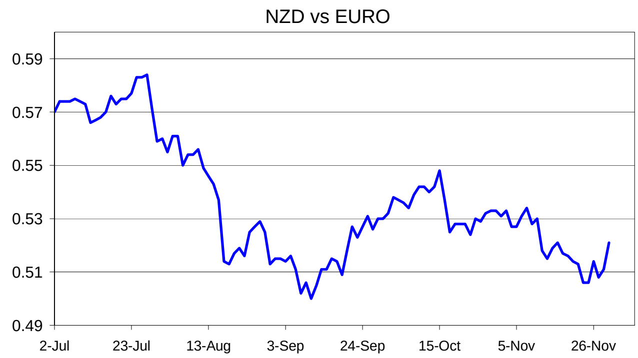
The Chinese have pegged their currency against a basket of other currencies since dropping the single pegged to the dollar in 2005. This year while their currency has risen 5% against the US dollar it has weakened about 7% against the euro.
http://www.iht.com/articles/2007/11/23/business/currency.php

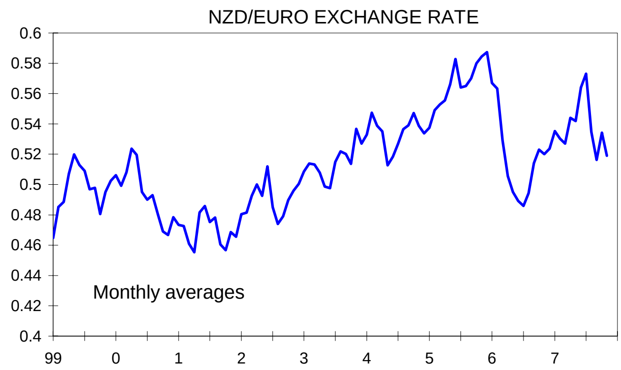
Not surprisingly the official Chinese response to requests for currency movements was a resounding "non". While a rise in the exchange rate would be very useful in getting down China's 6.5% inflation rate the Chinese are concerned about the losses they have already sustained on over $1 trillion worth of investments overseas plus are uncertain about the ability of their economy to switch from a predominant export focus

toward domestic growth. They fear the example set by the Japanese in the 1980s when the yen moved from 262 to about 120 in six years and contributed to what is known as the " lost decade" of growth in the Japanese economy with commercial property prices falling 80% and the sharemarket crashing. (Lots of other things were in play however including some fairly irresponsible lending and overinvestment in the 1980s.)
http://www.iht.com/articles/2007/11/27/business/yuan.php#end_main

With regard to whether euro goes from now, there is a strong expectation of slowing growth in the euro-zone area over the coming year but scope for the EU to cut its cash rate from the current 4% looks limited. Inflation was 2.6% in October which is above the 2% target set by the European Central Bank. Continued euro strength looks likely especially in light of ongoing worries about the United States economy that it is hard to imagine disappearing to any significant degree perhaps before the middle of next year.

The Kiwi dollar has risen against the euro over the week to end this afternoon near 52.1 cents from 50.6 cents last week. We are still well off the peak just under 58.0 cents reached late in July after our central bank had raised the cash rate to 8.25% and before the global liquidity crisis blew up and made people scared of high yielding peripheral currencies like the Kiwi dollar.

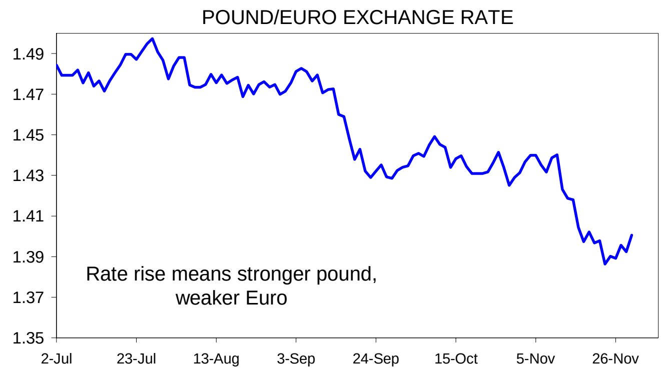


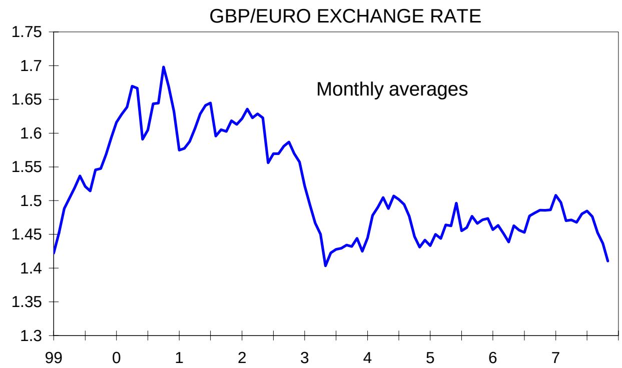


United Kingdom

GDP +3.2%, CPI 2.1%, base rate 5.75%

The British pound spent most of the week going backwards fallen for a while to near $2.05 to by one pound from above $2.07 for a while late last week. There was selling in response to the third-quarter GDP number coming in slightly weaker than expected at 0.7% growth for the quarter versus an anticipated rate of 0.8%. Note however that has about 60% of merchandise exports from the United Kingdom go to Europe and with the pound lying near a four-year low against the euro there is hope that as the domestic economy eases off export growth will provide some offset.

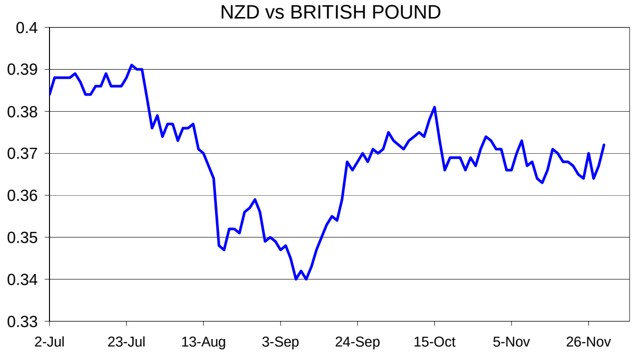


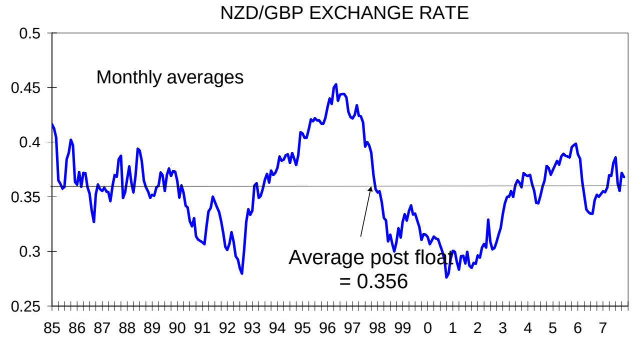


Some selling of the pound also followed emerging signs of weakness in the housing market with one report showing house prices on average falling for the second month in a row.
http://www.bloomberg.com/apps/news?pid=20601087&sid=agE3nBXNYVBc&refer=home

And the Bank of England Deputy Governor warned that the credit crisis could "trigger a damaging loss of confidence" and, giving hope to interest rate bulls, added that at "current interest-rate levels monetary policy may well be on the restrictive side "

But with some focus on the next rate differentials in the short term the pound managed to recover most of its lost ground to end this afternoon near $2.08 from $2.063 last week. The Kiwi dollar has finished against the pound near 37.2 pence from 36.5 pence last week.

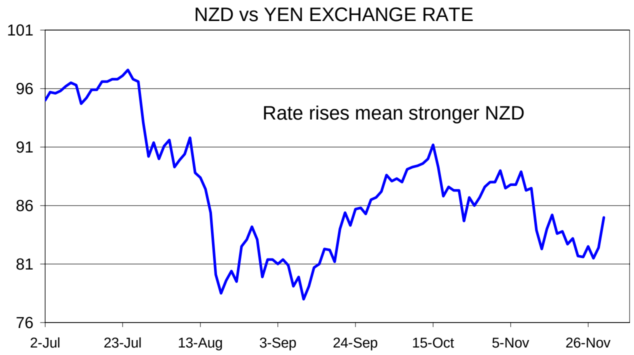


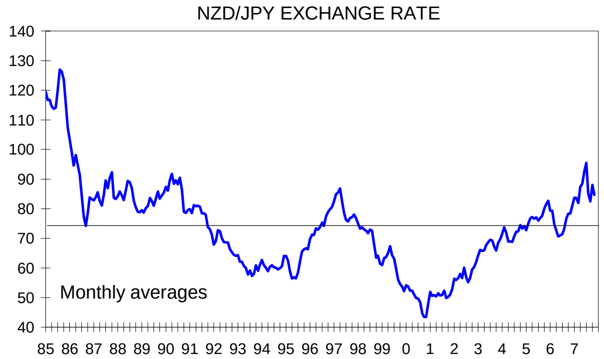


Japan

GDP +2.6%, CPI -0.2%, cash rate 0.5%

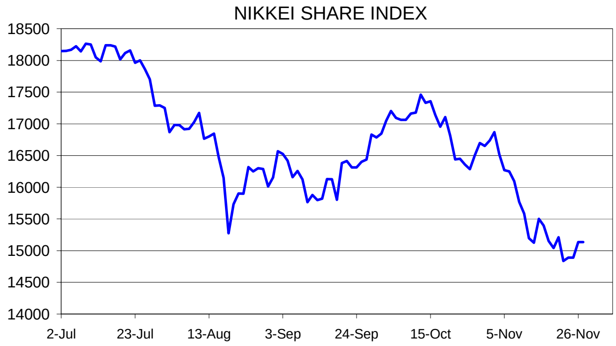
As noted above the US dollar managed to recover some ground against the yen this week to end near 110.0 from 108.5 last week. The Kiwi dollar has also risen against the yen - quite sharply overnight on the back of the recovering US sharemarket - to end near 85.0 from 81.7 last week.





During the week we learnt that Japanese retail sales grew by a relatively strong 0.8% in October from a year ago which was the third month in a row of annual gains. The rise was led by a surge in motor vehicle sales which on the face of all one might think was indicative of good consumer expectations about incomes going forward. However the lift in car sales was mainly because of the introduction of new models by Toyota and Mazda, while a lot of the rest of the rise in retail spending could be put down to higher petrol prices.

It doesn't seem reasonable to expect that the long-awaited and desired surge in household spending is at hand. Not with the Japanese sharemarket looking very wobbly, a weak labour market and falling wages, and consumer confidence at a three-year low.
http://www.bloomberg.com/apps/news?pid=20601068&sid=awIFOezQyqRc&refer=economy



FURTHER READING

Regular readers of the WO will know we occasionally experiment with new sections. That's what the following is and we'll see how things go.

Dairy Boom

A good article (dated August 31) about the boom in world dairy demand. A bit more over-arcing than the usual gushing commentary we see locally. Easy to read and good news for NZ.
http://www.iht.com/articles/2007/08/31/business/wbmilk.php?WT.mc_id=glob_mrktg_lead
If you're a real dairy info junky then check out the following US Department of Agriculture site. Untold stuff.
http://www.ams.usda.gov/dairy/

Japan's Dependencies

Last week we noted that one thing NZ participants were pointing out to the Japanese at the Japan-NZ Business Council meeting in Tokyo was the choice faced between securing good food products from NZ or perhaps less good ones from China. Anyone reading that might have thought we think we have a great point that the Japanese should quickly wake up to. Not so and the power of such a quality threat as it were is hardly earth-shattering for the Japanese. Japan has an economy that has long been dependent upon inputs of resources from overseas and that dependence is acknowledged. For instance the following article examines Japan's dependence upon rare metals for many of their high end manufacturing applications. Milk supply looks simple in comparison with securing such metals against rampant demand from China.
http://www.asahi.com/english/Herald-asahi/TKY200711220085.html

Tariffs On Carbon Emitting Goods?

Under the emissions trading policy announced by our government recently the transport sector will enter from 2009, electricity from 2010, and agriculture in 2013. This means higher petrol prices from 2009 (more inflation soon entering the Reserve Bank's target period), higher electricity prices from 2010, then higher food prices from 2013. In reality given the low pricing ability of NZ farmers internationally the tax they will have to pay will largely come off their bottom lines.

(Speaking about extra inflation, the new emission standards set for imported used vehicles will place some upward pressure on average imported vehicle prices but not necessarily the $5,000 indicated by the Independent Motor Vehicle Dealers Association. Older, cheaper, more polluting vehicles won't get in which is good for the environment and our contribution to reducing global climate change. It's not that the price of these older vehicles will go up. Instead, because we will be importing proportionately more younger vehicles the average goes up which will not have anywhere near the same impact on the consumers price index as say a $5,000 tariff on older vehicles.)
http://www.beehive.govt.nz/ViewDocument.aspx?DocumentID=31440

http://www.nzherald.co.nz/section/9/story.cfm?c_id=9&objectid=10477259&ref=rss

While the farming sector is going to get a free ride for many years subsidised by NZ taxpayers many farmers may have been getting very concerned recently about talk that some countries may impose carbon-related tariffs on imported goods. This clause is included in a bill working its way through the US system. But at least one ready producer of trade restraints appears to have backed away from this policy.

The link below produces a good article noting this backing away by the EU from something which may have been damaging to NZ interests. Now if the Americans can see things the same way… First they need to give better thought to emissions policy generally, especially as the rest of the world will be powering ahead with their post-Kyoto plans at the upcoming conference United nations Climate Change conference in Bali starting December 3. For a backgrounder on the Kyoto Protocol see the second link below.
http://www.ft.com/cms/s/0/7152b19a-9b7b-11dc-8aad-0000779fd2ac.html?nclick_check=1
http://unfccc.int/kyoto_protocol/items/2830.php

Global Liquidity Crisis

A reasonable overview of the way home lending became out of control in the US and the way in which everyone seems to be paying for it one way or another.
http://www.iht.com/articles/2007/11/23/opinion/edkrug.php
With US banks reporting huge and continuing losses there is concern about their willingness to lend from diminishing capital bases and the way this risks further depressing US then world growth. During the week these concerns saw sharemarkets weaken aggressively. But things improved somewhat on Tuesday after the Abu Dhabi Investment Authority - a sovereign wealth fund - took a 4.9% stake in the biggest US bank, Citigroup, injecting about US$7.5b. The injection seems positive but it highlights growing concern about the role of these funds which have assets of over US$2 trillion (no-one knows for sure). They tend to be controlled by countries with low democratic rule, dodgy legal systems, and high political control of their economies. The following article canvasses some of the issues especially regarding thoughts about restricting their purchases in the US.
http://www.reuters.com/article/reutersEdge/idUSN2751161320071127

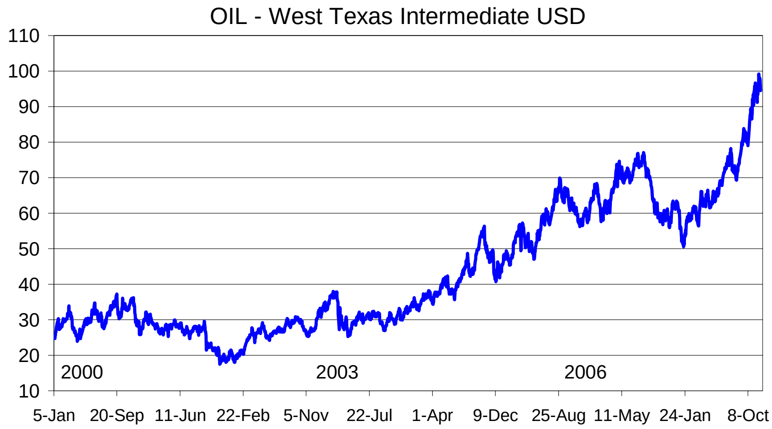
Cheap America

Its great to see economics in action. The most basic tenet of economics is that when something falls in price people will demand more of it – a downward sloping to the right demand curve. This week a journalist called to enquire about USD prospects in light of what she had seen on a trip to Canada. People were heading by their thousands across the southern border to buy cheap goods in the US. Canadian retailers are trying to stem this flow by placing full page advertisements in newspapers urging people to shop locally. Good luck. Before the mid-1980s we Kiwis used to fly back from Australia with 14 inch TVs on our laps.

There is a boom underway in the number of people from other countries travelling to the US to buy cheap stuff and have holidays. This boom comes on top of the reported 12% rise in US exports over the past year captured in official statistics. The following article takes a look at the marauding Irish seeking out bargains for instance.
http://www.iht.com/articles/2007/11/25/business/25outlet.php
Note however that tourist and business visits to the US have declined since late 2001 with the US customs and law enforcement agencies generally getting an appalling reputation from travellers. Its perhaps only the prospect of a bargain which seems to be making people willing to put up with the harassment. (A Kiwi is mentioned in the following article – as a possible criminal.)
http://www.newsweek.com/id/70991

Oil Boom

Oil prices have increased over 55% from a year ago and have been on a broad upward trend for over six years.



The sharp rise in price has delivered renewed massive wealth to oil producing countries and they are increasingly seeking foreign assets to invest their oil receipts. This week we saw a US$7.5b investment in distressed Citigroup by the Abu Dhabi Investment Fund, one of the many sovereign wealth funds set up by governments of oil producing nations to buy stuff overseas – maybe small countries like us. There is massive attention in financial markets on what these funds may do with strong concern about the risk of political interference in their operations. Rumours about whether the funds are interested in an asset or nor can have large price effects. This week shares in Rio Tinto soared on the back of a rumour (later shown false) that the recently created US$200b Chinese fund would try to buy Rio Tinto.

The following article is a backgrounder on the growth in these funds.
http://www.iht.com/articles/2007/11/28/business/28petrodollars.php

Data Sources

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

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

ECONOMIC FORECASTS

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

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

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