

BNZ Weekly Overview

10 August 2006

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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	6.75	6.3
90-day bank bill	7.51%	7.49	7.48	7.50	7.03	6.6
10 year govt. bond	5.81%	5.84	5.87	5.84	5.86	6.5
1 year swap	7.54%	7.50	7.52	7.39	6.98	6.7
5 year swap	7.00%	6.94	7.04	6.87	6.58	7.1
NZD/USD	0.633	0.618	0.611	0.622	0.691	.57
NZD/AUD	0.823	0.806	0.808	0.808	0.907	.86
NZD/JPY	72.9	70.6	69.4	69.2	76.9	66.0
NZD/GBP	0.332	0.329	0.33	0.335	0.386	.35
NZD/EURO	0.492	0.482	0.472	0.49	0.559	.509

For addition to our emailing list for Thursday night receipt email "Subscribe WO" to tony.alexander@bnz.co.nz

Monthly Survey

This week we are once again running our monthly confidence survey. If time permits and you have not already done so in the email attached to this document then please cut and paste the URL below into your browser, click on it, and tick whether you believe the economy will get better or worse over the next 12 months. As always, the more important bit is to take the extra time and in a sentence or two let us know how you are seeing things at the moment in your industry. Results will be distributed next week.

<http://www.closer.co.nz/bnzeconomist.asp>

The important news this week came out this morning with Statistics New Zealand revealing that our unemployment rate fell to an equal record low of 3.6% in the June quarter from 3.9% in the March quarter. This in itself is significant enough but it came about as a result of strong growth in the workforce being outpaced by strong growth in job numbers. Employment rose in seasonally adjusted terms by a strong 1% in the quarter after rising 1.1% in the March quarter. Given that full-time job numbers rose by 1.5% in the quarter this indicates that the labour market in New Zealand remains extremely strong when one considers the rate of growth in the economy is probably chugging along at about a 1.5% or 2% rate at the moment. And this is where one should be extremely concerned.

Job numbers are growing strongly but economic growth is running below trend and this surely means that productivity growth in the economy is extremely bad. The lower the rate of growth in productivity the lower the sustainable rate of growth in gross domestic product before inflation becomes a concern unless resource quantities are booming – which is definitely not the case. This merely reinforces our long-running concern about the soft landing in an environment of resource shortages producing continuing strong inflationary pressures in New Zealand with obvious implications for interest rates and to a certain extent for the exchange rate is well.

BNZ WEEKLY OVERVIEW

As a result of the much stronger than expected labour market data released this morning we have seen the New Zealand dollar consolidate just above 63 US cents while wholesale fixed borrowing costs have also edged back up again slightly as the markets now factor in a slightly higher probability that monetary policy will be tightened again this cycle. We still don't believe the Reserve Bank will tighten again with the Governor probably looking at other countries around the world also experiencing above average inflation but not running monetary policies aimed at generating a hard landing in order to get inflation back down. He is likely to feel that with the official cash rate at 7.25% enough work is being done to eventually get inflation back below 3% level.

However we retain our very strong concern that inflation will not be going back into the 1% to 3% target range for a very long period of time and that eventually one may be able to assess that the Reserve Bank has unfortunately failed in its job.

The main implications business people in New Zealand need to be aware of from this morning's employment data and many other releases such as those on the housing market showing some continuing strength, is that floating interest rates are not going to be going down for a long time. Fixed interest rates also look unlikely to enter a sustained downward trend for a long time given inflationary pressures in New Zealand and slowly rising world inflation as well. The interest rate implications of this morning's data reinforce our comments that the New Zealand dollar remains well supported by interest rates and that it is unreasonable to expect there will be any substantial decline in the near future. Eventually we expect the Kiwi dollar to consolidate between 50 and 55 US cents but that may not happen for quite some time. We also still do not believe there will be consolidation below 50 US cents given the risk of some weakness in the greenback along with the Reserve Bank being unable to cut interest rates to unusually low levels when they eventually complete the easing cycle sometime maybe in 2008 or 2009.

Tramping Trip

The tramping trip went exceptionally well. I had three days and four nights on the Heaphy track, met only three other people and suffered no one else at all in the huts each evening. The weather was cloudy but only light drizzle partway through. The aim of the tramp was to see whether the knee operation back in March to remove 10% of the medial meniscus was going to prevent me from getting out into the bush again. For a relatively flat track like the Heaphy there is no problem at all. Attempting something a bit more rugged would probably be too much at the moment but that is the next goal.

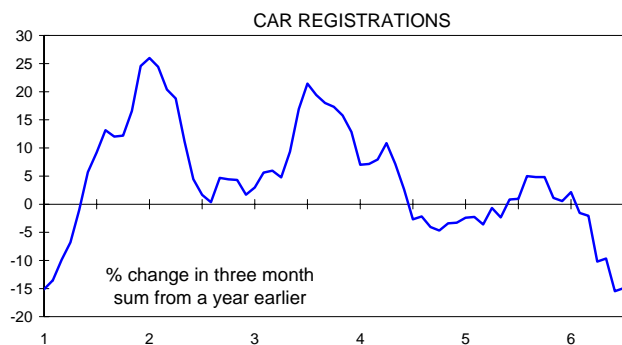
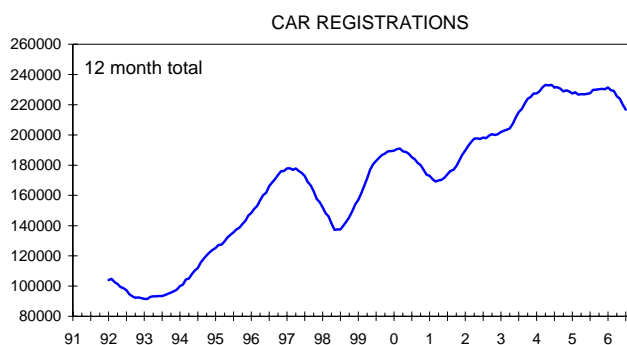
THE WEEK'S ECONOMIC DEVELOPMENTS

Friday 4

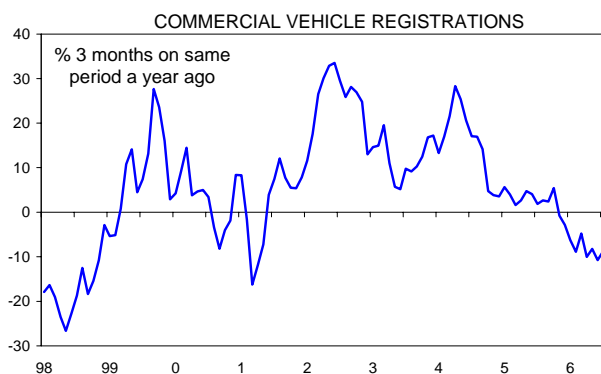
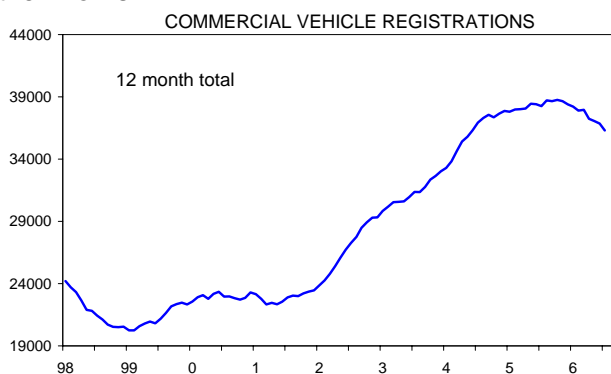
Vehicle Expenditure Declining

During July there were 16,307 cars registered around New Zealand. This was a relatively strong 17.2% decline from a year earlier and for the three months to July the number of car registrations was down by 14.9% from a year ago. For the year to July the decline was 4.8%. There is clearly a reasonably strong downward trend in this key area of consumer spending consistent with consumers generally putting their money away.

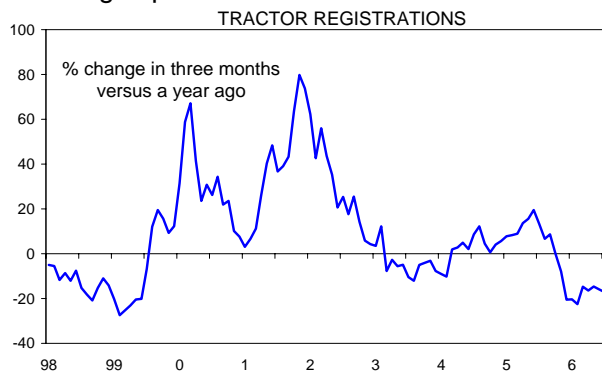
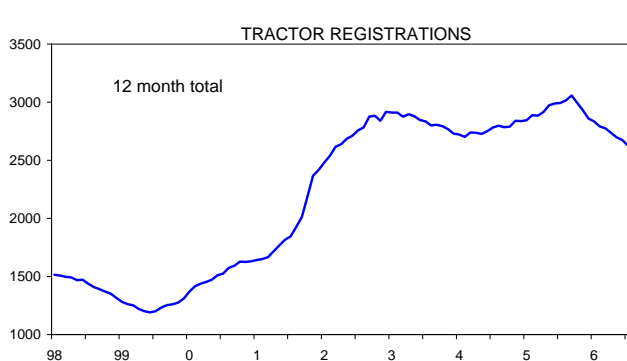
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At 2,891 the number of commercial vehicles registered in July was down by 16.1% from a year earlier with the number in the three months to July down by 8.7% from a year ago. Year to July registrations were also down by 5.1%. Again, there is a downward trend in this area of spending indicative of businesses pulling their horns in.



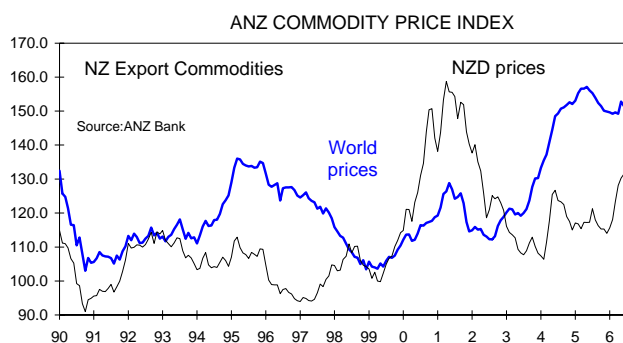
Finally, the number of tractors registered in July was down 22.2% from a year earlier at 172. For the quarter registrations were down 17.1% from a year ago and for the year to July registrations were down by 12.3%. Declining spending is evident in this important area of farming expenditure.



Monday 7 Commodity Prices Improve Slightly

The ANZ Commodity Price Index in world price terms improved by 0.4% in July to sit just 2.1% down from a year earlier and was 21.8% above its average for the past 10 years. In New Zealand dollar terms the index improved by 0.6% in the month and was up from a year ago by 9.1% while being 13.4% ahead of its 10 year average. Above average growth overseas continues to support New Zealand's export commodity prices and this goes a long way to explaining why this particular landing for the economy is a soft one. In the past the economy has tended to go into recession after commodity prices have fallen by 25% to 30%.

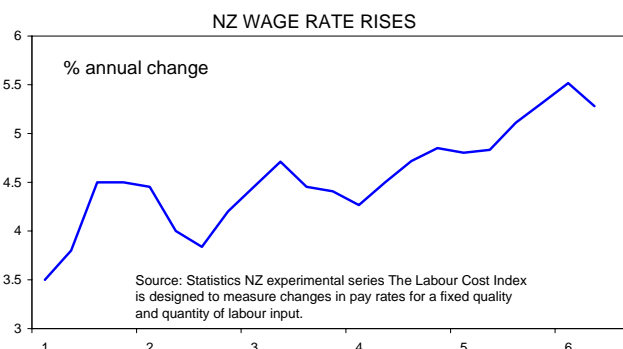
BNZ WEEKLY OVERVIEW



Wages Growth May Have Peaked

The annual rate of growth in private sector ordinary time hourly earnings calculated from the Quarterly Employment Survey accelerated in the June quarter to 4.9% from 4.6% in the March quarter. An alternative measure from the Labour Cost Index showed annual wages growth steady at 3%.

The wages data contained in the Quarterly Employment Survey tends to be distorted by changes in the composition of the workforce whereas the wages measure in the Labour Cost Index hardly ever shows much movement at all. Statistics New Zealand has started publishing an experimental series attached to the Labour Cost Index which attempts to track changes in pay rates for a fixed quantity and quality of labour input. This series recorded a quarterly rise of 1% following a 1.1% rise in the March quarter and 1.3% rise in the December quarter. This is the lowest quarterly gain since the March quarter of 2005 and caused the annual rate of growth in this measure to ease slightly to 5.3% from 5.5% in the March quarter. But this was still well up from 4.8% a year ago and average wages growth using this measure of 4.6% over the past five years.



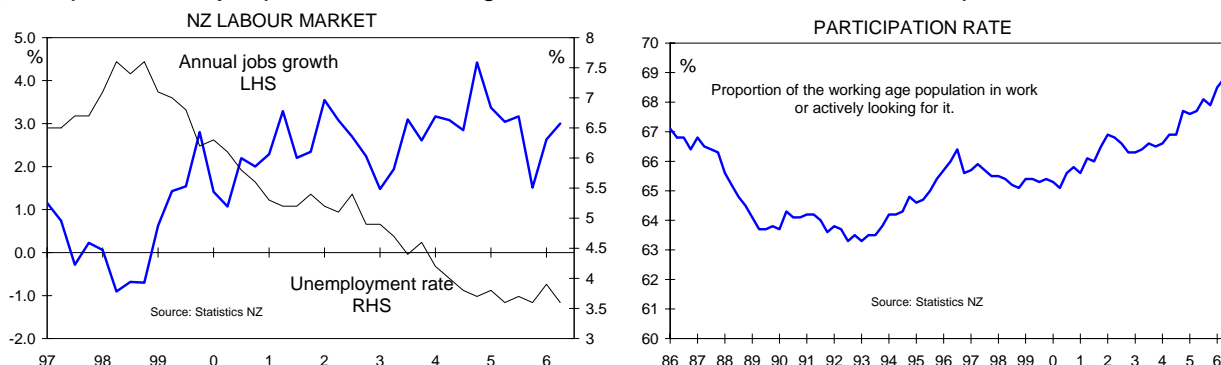
The data collectively suggest that we may have seen the peak in the annual rate of wages growth this cycle though one would want to be a very careful in this regard. We don't think the rate of inflation has peaked and with the labour market likely to remain relatively tight one could not entirely discount wages growth accelerating again although this is not highly probable. The more likely outcome is that wages growth is going to remain at a relatively strong pace in the next few years and companies will need to take this into account when they are considering their expenses and how best to grow output. As we started warning seven years ago companies in New Zealand are going to have to focus a lot more on boosting productivity in order to raise output and afford higher labour costs.

Thursday 10 Labour Market Still Buoyant

In the June quarter New Zealand's unemployment rate in seasonally adjusted terms fell to an equal record low of 3.6% from 3.9% in the March quarter. Job numbers increased by a strong 1% in the quarter whereas the markets had been expecting a rise of just 0.1% and during the March quarter job numbers increased an

BNZ WEEKLY OVERVIEW

equally strong 1.1%. The proportion of working age population actively in work or looking for it, the participation rate, jumped to a record high of 68.8% from 68.5% in the March quarter.



The implications of the strong labour market are continuing high inflation risks, limited ability for companies to grow output and a very strong need to boost productivity, and continuing interest-rate support for the New Zealand dollar.

INTEREST RATES

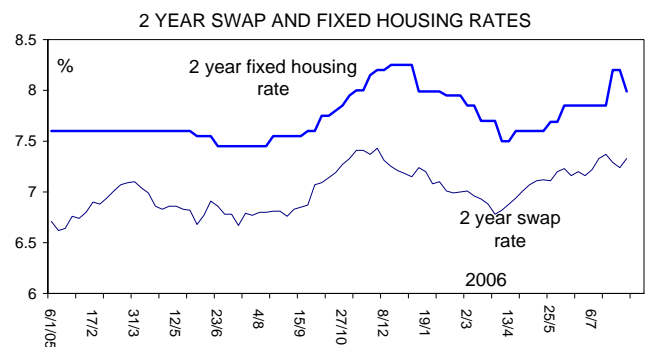
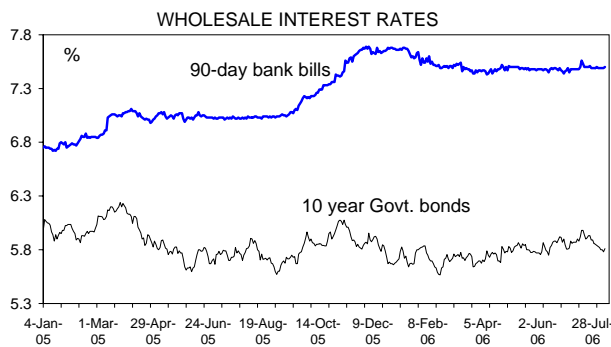
We've said it before and we'll say it again. The economy is having a soft landing in an environment of resource shortages and this brings extra inflationary pressure compared with downturns in the economy in the past. That means a mixture of upside risks for interest rates (as successfully forecast over the past 2 1/2 years) and limited scope for timely declines in interest rates, which is what is in play at the moment. The big piece of news this week was that New Zealand's unemployment rate fell to 3.6% in the June quarter from 3.9% in the March quarter with job numbers improving a seasonally adjusted 1% whereas the markets had been expecting a rise of just 0.1%. We had expected that the unemployment rate would decline slightly to 3.7% with jobs growth of 0.2% so the strong result is even more indicative of a tight labour market than we were thinking.

While labour market indicators tend to lag the economic cycle we think this one is particularly important because it reinforces our concern about job security continuing to underpin some areas of consumer spending and will continue to place strong upward pressure on wages. Wages growth may have conceivably peaked this cycle but the news this morning on the strong labour market backs up our feeling that wages growth is going to remain relatively strong going forward.

The upshot of all this is the need to repeat yet again that scope for any easing in monetary policy is extremely limited and borrowers should not be anticipating that when interest rates eventually decline in New Zealand the declines will be of any substantial magnitude. We are an economy short of resources and that means inflation settling at a higher level than the 2.1% average we have seen for the consumers price index over the past decade.

Unsurprisingly, following this morning's strong labour market numbers we have seen wholesale interest rates creep up. 90-day bank bill yields have ended slightly higher at 7.51% from 7.49% while the two year swap rate has ended near 7.33% from 7.24%.

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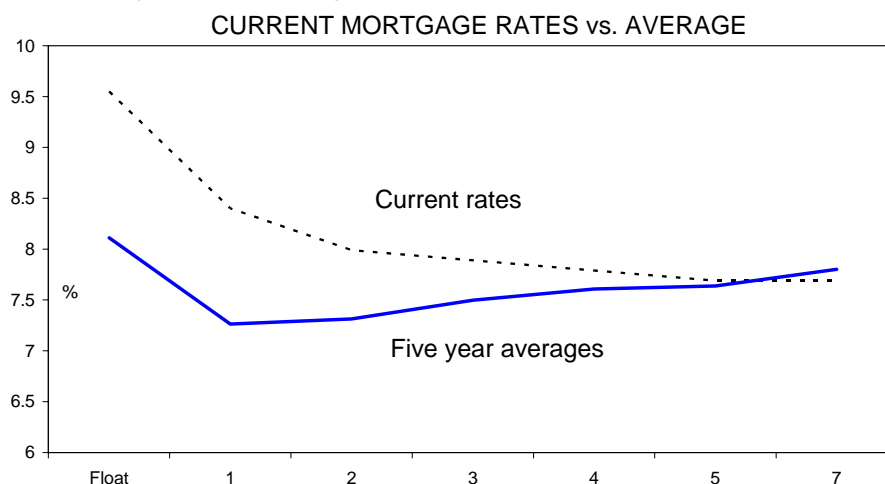


In other news, over the past week we have seen both the Bank of England and European Central Bank increase their cash rates by 0.25% with the Bank of England rate now at 4.75% and the European rate now 3%. In contrast, after raising their funds rate at each of the past 17 reviews by 0.25% the Federal Reserve this week decided to leave it unchanged at 5.25%. Their comments indicated they are leaving the door open to further increases if necessary but indicated that they want to see how recent developments with various economic indicators pan out.

In the United States the 10 year government bond yield has rallied marginally to end near 4.94% from 4.98% last week assisted by the July employment report coming in slightly weaker than was expected. Job numbers increased by 113,000 in the month whereas a rise closer to 142,000 had been expected.

If I Were a Borrower What Would I Do?

This week we have seen fixed housing rates reduce slightly in response to bank fixed wholesale borrowing costs easing off marginally (up until today!) and in response to competitive pressures in the marketplace. Where things sit at the moment with our two year fixed rate at 7.99% I would be inclined to go for that rate. But as pointed out many times over the past few weeks the longer term rates are not really all that unattractive compared with where these fixed rates have averaged over the past few years. For instance the current five-year fixed rate of 7.69% is only just above where this rate has averaged over the past five years of 7.64%. In fact the two-year break has averaged 7.31% over the past five years and paying a premium of 38 points does not seem all that much for getting good rate certainty for an extended period of time. And one must remember that inflation risks lie on the upside so one should not be anticipating any sizeable rally in NZ borrowing costs for a long time.



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BNZ Fixed Lending Interest Rates

	Housing	Average Past 5 yrs	Low Past 5 yrs	High 5 years
Float	9.55%	8.00%	6.70%	9.55%
1 yr	8.40	7.16	5.95	8.45
2	7.99	7.28	5.99	8.25
3	7.89	7.49	6.30	8.30
4	7.79	7.62	6.40	8.40
5	7.69	7.65	6.50	8.60
7	7.69	7.83	6.75	8.80

BNZ Term Deposit Rates

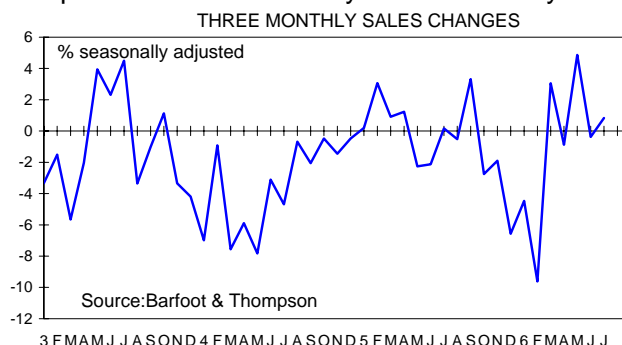
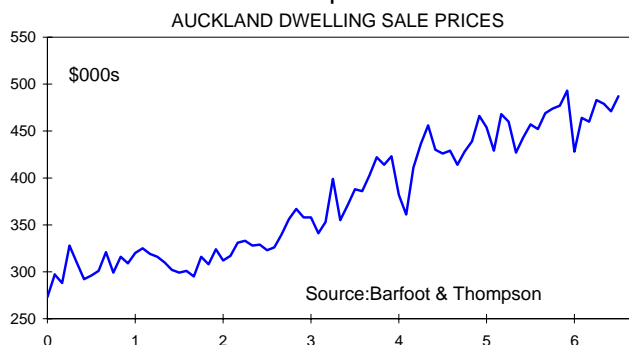
Days	\$10-50K	\$50-100K	\$100-250k
30	3.00	3.00	5.25
90	6.20	6.25	6.30
180	6.80	6.85	6.90
1 yr	6.60	6.65	6.70
5 yr	6.10	6.15	6.20

Note: Conditions may apply to these rates.

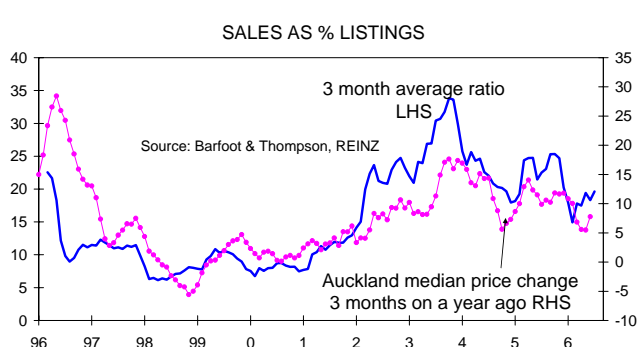
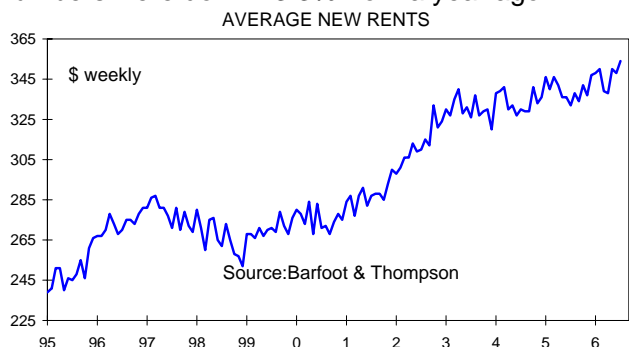
HOUSING MARKET UPDATE

Auckland Housing Data

Data from Barfoot and Thompson, who account for about one third of residential property sales in Auckland, show that in July they sold 4.7% fewer houses than in July a year ago and in the three months to July sale numbers were down by 7.7% from a year ago while being broadly flat in rough seasonally adjusted terms from the three months to April. These numbers indicate a pullback in sales activity of mild intensity.

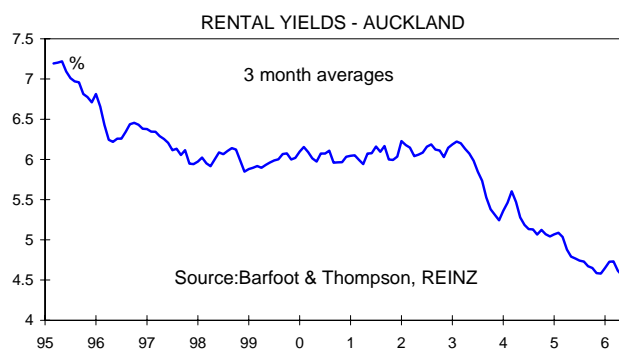
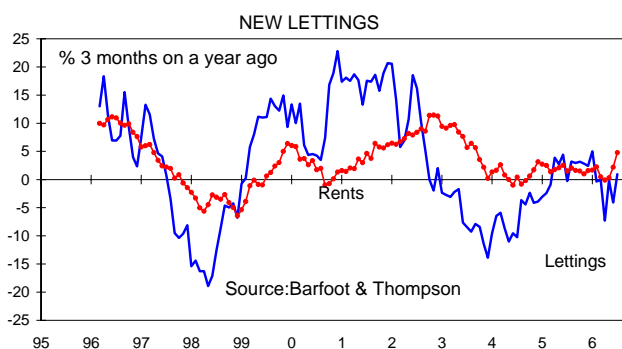


The median dwelling sale price rose to \$487,000 from \$471,000 in June and was up 6.6% from a year ago. House prices in Auckland continue to trend upward at a mild rate. The total number of listings at 4,508 was ahead from a year ago by 4.8% but this rate of increase was well down from over 23% in March. Perhaps further indicating that we are not seeing a flood of properties being put on the market the number of fresh listings in the month was ahead only 1.3% from a year ago while in the three months to July fresh listing numbers were down 13.3% from a year ago.



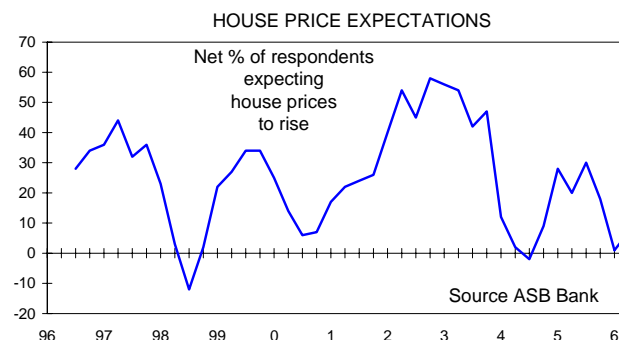
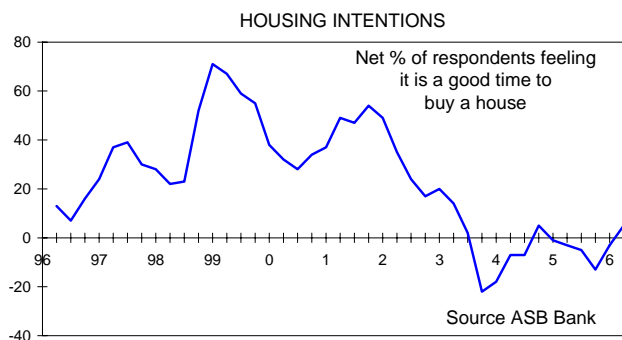
One could not look at these indicators and conclude that the Auckland housing market is going through any sort of a particularly rough patch. But they do indicate things are mildly easing. In the rental market the average weekly rent improved to \$354 from \$348 in June and this was ahead from a year ago by 6.6% which is the highest annual rate of increase since 7% recorded in August 2003. The number of fresh lettings however was down 1.7% from a year ago at 629. Things look at acceptable to firm in the rental market.

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Housing Survey

During the week we saw the ASB Housing Intentions Survey released. The report doesn't really add anything much to what we already know about the housing market but for the record over the three months to June a net 5% of people said they felt it was a good time to buy a house. This was an improvement from a net 3% who thought it was a bad time in the previous three months and the equal strongest result since the December quarter of 2004 and before that the June quarter of 2003. This number suggests that people do not fear what is happening in the housing market, indicating the interest-rate hikes engineered by the Reserve Bank have not bothered people that much.

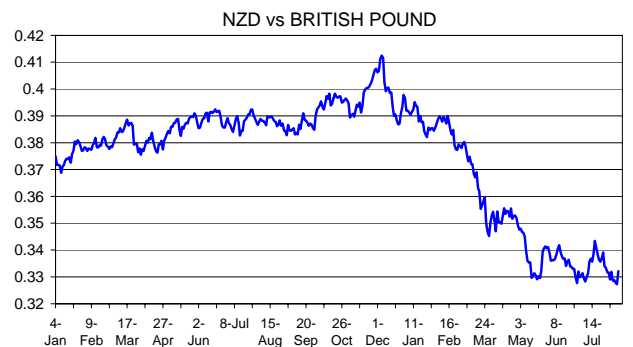
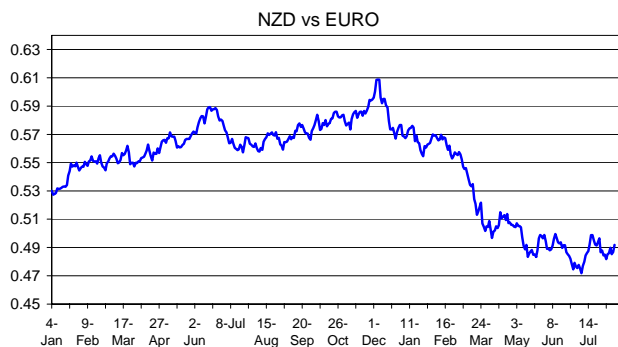
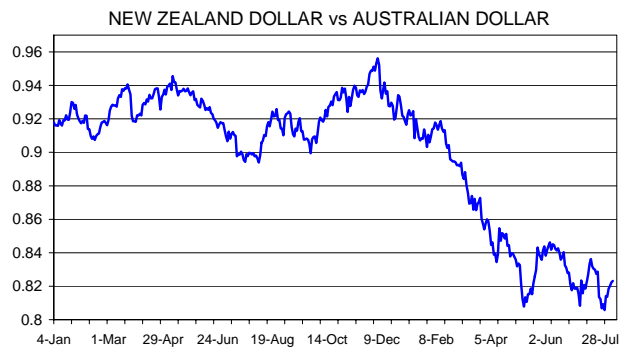
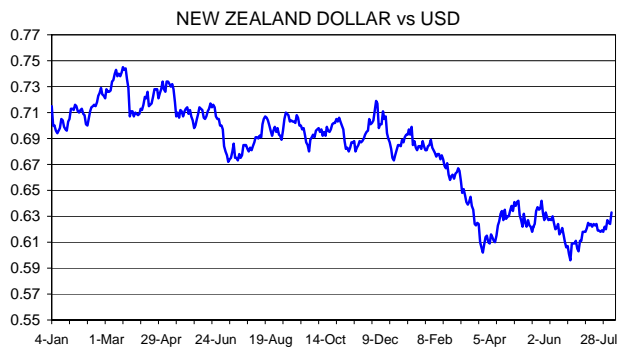


This view is further reinforced by a net 7% of people expecting house prices will rise over the coming 12 months. This was up from a net 1% during the March quarter though was below the average 24% reading over calendar 2004. People are aware it seems that prospects for house prices continuing to rise at recent rates are limited.

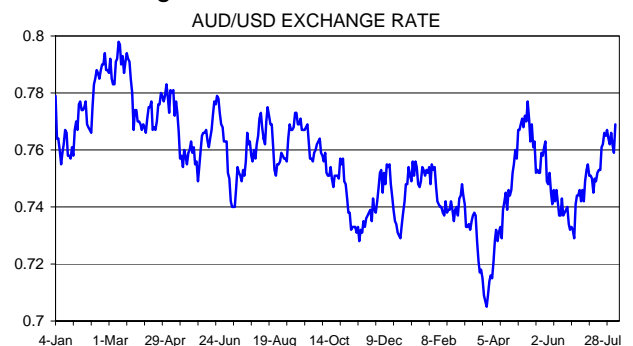
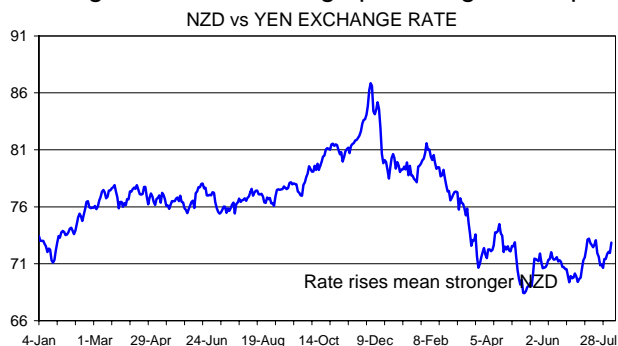
EXCHANGE RATES

The Kiwi dollar started the week buying 62.2 US cents and has finished higher at 63.3 US cents this afternoon. The rise reflects a combination of some mild weakness in the United States dollar, riding on the coat-tails of a stronger Australian dollar, and this morning's stronger than expected employment data. The strong labour market increases the chances that employees will naturally seek recompense for 4% inflation in their wage claims and that inflation will therefore risk consolidating easily above the 3% level over the next few years. There is an increased chance that the Reserve Bank will increase interest rates again although we don't think they will in fact make this move. However the chances are the easing will be further delayed and this implies extra interest-rate support for the exchange rate. That is what we have been warning about in recent months with regard to forecasting the Kiwi dollar being restrained on the downside because of continuing interest-rate support.

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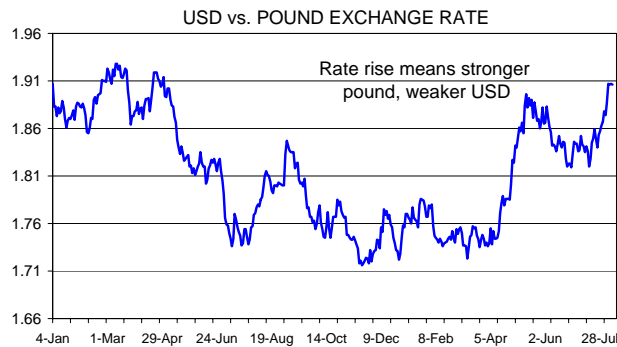
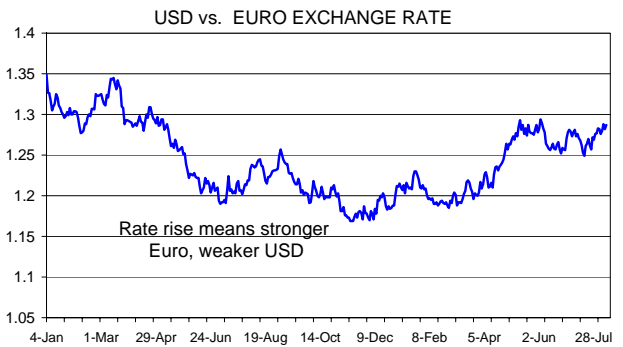
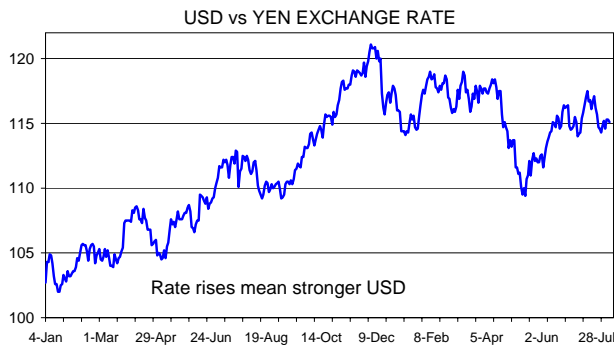
We don't think a new upward trend for the New Zealand dollar has commenced as a result of some of the recent stronger than expected economic data releases in New Zealand just as we don't believe fixed borrowing costs have entered a new upward trend as a result of both today's employment data and the numbers a few weeks ago on retail spending in particular. It's more a case of both interest rates and the exchange rate both holding up for longer than people were thinking.



The Australian dollar has ended this afternoon against the greenback near 76.9 US cents from 76.4 US cents a week ago lifted by their own stronger than expected set of employment numbers released early this afternoon. There is a reasonable chance that the Reserve Bank of Australia may increase interest rates again and this has naturally added some support for the Australian currency.

In contrast, following the slightly weaker than expected employment numbers out of the United States on Friday night and the decision by the Federal Reserve not to raise their funds rate at this weeks review the US dollar has faced some very minor downward pressure.

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The greenback has ended this afternoon against the British pound near \$1.906 from \$1.874 a week ago. Against the euro the greenback has ended near \$1.287 from \$1.282 while against the Japanese yen it has ended essentially unchanged near 115.

The Kiwi dollar has ended against the Australian dollar this afternoon near 82.3 cents from 81.4 cents last week, against the Japanese yen at 72.9 from 71.4, against the British pound unchanged at 33.2 pence, and against the euro stronger at 49.2 cents from 48.6 cents last week.

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BNZ WEEKLY OVERVIEW

ECONOMIC DATA

All %		Latest qtr only	Previous qtr only	Latest year	Year ago	2 Yrs ago
Inflation	RBNZ target is 1% - 3% on average	1.5%	0.6	4.0	2.8	2.4
GDP growth	Average past 10 years = 3.3%	0.7	-0.1	2.2	3.7	3.6
Unemployment rate	Average past 10 years = 5.7%	3.6	3.9	3.6	4.0
Jobs growth	Average past 10 years = 2.1%	1.0	1.1	3.0	3.0	3.1
Current a/c deficit	Average past 10 years = 4.9% of GDP	9.3	8.9	7.4	4.8
Terms of Trade		1.1	-2.5	-3.0	4.5	6.1
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%.	0.9	1.2	5.6	7.1	5.9
House Prices	Long term average rise 5% p.a.	2.5	3.9	12.3	13.4	23.3
Net migration gain	Av. gain past 10 years = 13,000	+10,690	10,200yr	8,599	22,008
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 8%. Colmar survey	-22	-38	-35	1	-1
Business activity exps	10 year average = 27%. NBZ	15	17	-3	15	30
Household debt	10 year average growth = 11.4%. RBNZ	14.1	14.2	15.2	15.1	16.3
Dwelling sales	10 year average growth = 4.6%. REINZ	5.0	3.9	-17.6	-4.1	-14.5
Tourist numbers	10 year average growth = 6.1%. Stats NZ	-11.2	-0.3	-1.9	16.9	20.4
Floating Mort. Rate	10 year average = 8.5%	9.55	9.55	9.55	9.00	8.00
3 yr fixed hsg rate	10 year average = 8.2%	7.89	7.75	7.99	7.45	7.65

ECONOMIC FORECASTS

Forecasts at June 29 2006	March Years					December Years				
	2005	2006	2007	2008	2009	2004	2005	2006	2007	2008
GDP - annual average % change										
Private Consumption	5.8	4.1	1.6	0.6	1.1	6.5	4.7	2.1	0.7	0.8
Government Consumption	5.2	5.6	4.6	2.7	3.9	5.6	5.7	4.5	3.5	3.1
Investment	8.0	5.9	-3.1	0.8	3.7	13.5	4.5	-1.4	0.4	3.1
GNE	6.4	4.2	0.7	1.1	2.5	8.1	4.5	1.1	1.0	2.0
Exports	3.9	0.0	3.6	4.3	5.0	5.6	-0.2	1.7	4.8	4.8
Imports	13.7	4.6	-0.4	2.3	3.0	16.6	6.5	-1.1	2.4	2.7
GDP	3.7	2.2	1.6	1.6	3.1	4.3	1.9	1.9	1.8	2.7
Inflation – Consumers Price Index	2.8	3.3	3.3	3.0	2.6	2.7	3.2	3.3	3.1	2.7
Employment	3.4	2.6	0.5	0.7	1.1	4.4	1.5	1.5	0.6	1.0
Unemployment Rate %	3.8	3.9	4.3	4.5	4.4	3.7	3.6	4.1	4.4	4.4
Wages	2.9	4.6	4.6	3.5	2.6	1.9	5.1	4.4	3.7	2.8
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.73	0.64	0.57	0.55	0.58	0.71	0.70	0.58	0.55	0.58
USD/JPY	105	117	103	105	103	104	119	105	105	104
EUR/USD	1.32	1.20	1.23	1.23	1.24	1.34	1.19	1.24	1.22	1.24
NZD/AUD	0.93	0.87	0.78	0.79	0.81	0.93	0.94	0.79	0.79	0.80
NZD/GBP	0.38	0.36	0.32	0.31	0.33	0.37	0.40	0.33	0.31	0.33
NZD/EUR	0.55	0.53	0.46	0.45	0.47	0.53	0.59	0.47	0.45	0.46
NZD/YEN	76.8	74.6	58.7	57.8	59.5	74.2	82.7	60.9	57.8	59.7
TWI	70.7	65.6	57.2	55.8	58.3	69	71.9	58.1	55.9	57.8
Official Cash Rate	6.5	7.25	7.00	6.00	5.75	6.5	7.0	7.25	6.25	5.75
90 Day Bank Bill Rate	6.86	7.55	7.23	6.13	6.12	6.73	7.49	7.49	6.39	5.95
2 Year swap	6.82	7.0	6.35	6.08	6.20	6.61	7.24	6.52	6.10	6.17
10 Year Govt Bond	6.04	5.71	5.90	5.6	5.7	6.03	5.89	6.05	5.65	5.65

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

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