

# THE PIPELINE

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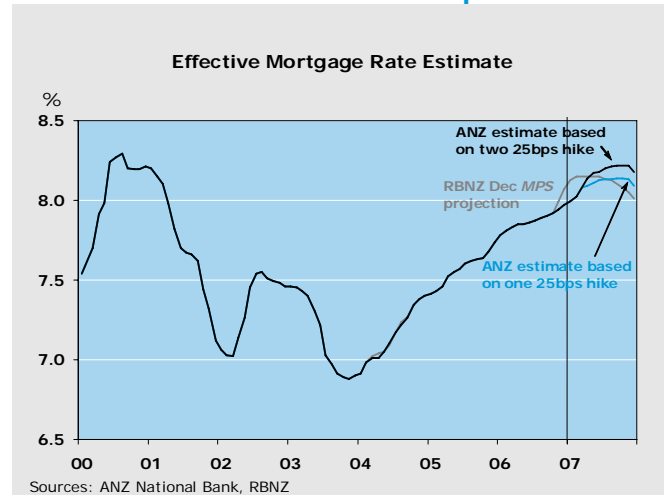
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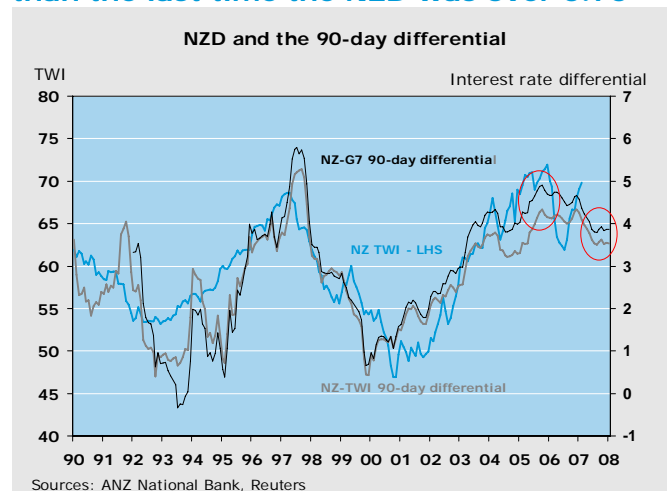
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## The effective mortgage rate is more muted than what the RBNZ expected.



## Interest rate differentials are far narrower than the last time the NZD was over 0.70



## ECONOMIC OVERVIEW

**A higher NZD continues to tighten financial conditions. But with no real evidence of outright stress in the tradable sector, it looks unlikely to deter the inevitable increase in rates.**

### What's ahead...

- NZ January Merchandise Trade (Monday 1045 NZDT) is expected to see a large headline deficit. Lower oil prices to reduce fuel bill but a high NZD will hold back exports.
- The February National Bank *Business Outlook* (Monday 1300 NZDT) is an important release for the Reserve Bank to help assess whether momentum in Q4 is being sustained into Q1.
- NZ January Credit Growth (Tuesday 1500 NZDT) will again be strong. Expect another 1 percent month.
- The RBNZ Survey of Expectations (Tuesday 1500 NZDT) should show an easing in inflation expectations in line with falls in petrol prices. However, 2-year expectations will remain elevated.
- NZ January Building Consents (Wednesday 1045 NZDT) should record a small technical rebound after two monthly falls.
- NZ January External Migration (Thursday 1045 NZDT) should report another 1,000+ month.

### What's the view

We noted last week that the path of least resistance for a weaker economy looked to be tighter financial conditions through the currency, and this is certainly looking the case. With the Reserve Bank set to hike in March, there is no point standing in the way of yield driven currency fervour.

The tradable sector has remained stout in the face of a stronger currency. This is more than a pure commodity price insulation story. Global demand has been strong. Domestic manufacturing activity is strengthening. While at current levels the downstream impact of the higher currency will only intensify, the reality is that hard economic data is giving the Reserve Bank an OK signal. This week saw another batch of lack-lustre earnings reports. But lack-lustre is a far cry from stress.

In this environment, a stronger currency will provide some food-for-thought but be unlikely to defer the inevitable. We are simply not at that inflection point where firms are being forced to take active steps on the employment or deployment front. While the headline inflation rate is easing, a persistent under-current of inflation pressure and strength in the labour market mean the Bank can ill afford to place excessive weight on anecdote.

The objective picture looks clear, although to be fair, tightening at this juncture in the cycle does leave us a bit queasy. When growth is spending

dominated and asset prices are always expected to go up – as it seems to be the case for house prices – bubbles emerge. The thing about bubbles is that they eventually pop. Just how close we are to the tipping or popping point, no one knows for sure. We may soon find out. After repeatedly ignoring the Reserve Bank's warnings, we will only have ourselves to blame.

We continue to hear anecdotes of the housing market maintaining strong momentum. Credit growth remains strong. Our business discussions have highlighted continued appetites to hire. There are growing hiring freezes emerging, but it seems that for each of these there is someone who is still looking. There seems no end to the number of public sector vacancies!

Interest rates will move up, and if the Reserve Bank seeks to recapture the opportunity lost in October last year (when there was a significant portion of mortgage roll-offs pending in a similar fashion to now), they will certainly deliver a very hawkish statement to keep the market pricing in a subsequent move (refer page 7). In the absence of re-rated sentiment towards global interest rate prospects, the NZD will continue to be biased up. Expect the equity market to remain under pressure. The end-game moves from a soft to a hard landing.

Liquidity, the credit channel of monetary policy, globalisation, changes in global perception towards work-life balance, demographic trends, relative price shifts and consumerism have been powerful forces leaning against the traditional business cycle and financial condition metrics. These wider trends look set to continue for some time, and imply financial conditions need to be more restrictive than historical benchmarks to get the same bang for your buck. For instance, rapid growth in private sector credit relative to GDP suggests the neutral 90-day rate may be closer to 6.5 percent than 6.

The challenge going forward is to catch onto the "new wave" of microeconomic trends that will shape the business cycle. Issues running through our head at present include protectionism (led via the US), evolution towards a savings culture (stepping up KiwiSaver), Asia's move from industrialisation to consumerism (think hard to soft commodities), inter-generational transfers and business or farm succession planning. There is a lot to think about.

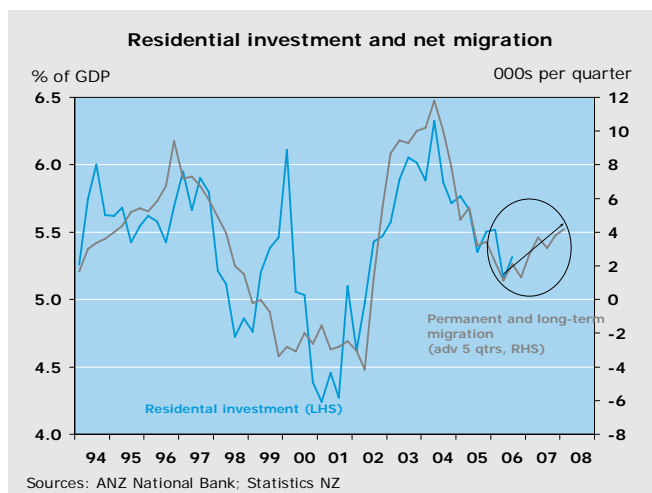
### Data last week...

- **NZ Credit Card Billings (Jan)** fell 1.1 percent following a 2.7 percent rise in December.
- **Bank of Japan** increased interest rates by 25bps to 0.5 percent. However, the monetary policy tightening cycle is now expected to be more drawn out than initially thought.
- **US CPI (Jan)** rose by 0.2 percent in January, while the core measure (excluding food and energy) rose by 0.3 percent, taking the annual rate to 2.7 percent.

## IMMIGRATION SNAPSHOT

**Fewer foreign students are being replaced by arrivals from other key nations including the UK, South Africa, and Germany. This different mix of migrants implies less demand for apartment style accommodation, but continued owner-occupier demand. There looks to be a back-log of arrivals still in the pipeline, which while helping to alleviate skill shortages, will equally provide near-term impetus to domestic demand.**

The steady rise in net migration has been one of the key pillars of support to the housing market. While obviously problematic for the Reserve Bank in terms of the impact on the housing market and domestic demand, new migrants nonetheless play an important role in expanding the labour force and alleviating skill shortages in the economy. We look at the overall trends in migration arrivals below.



### Where do they come from?

In 2006 calendar year, permanent and long-term (PLT) arrivals were 82,700, well down on the peak in 2003 of close to 99,000 but up from a recent trough of 78,000 in the year ended March 2005. In the late 1980s Australia was the largest source of PLT arrivals. However, the UK is now the largest source where currently around 23,000 people arrive from each year (28 percent of the total). This proportion has grown steadily since 2002 and may represent a lifestyle/retirement shift that is developing. There are significantly less PLT arrivals from China compared to previous years. During 2002, the proportion of arrivals from North Asia reached a peak of 24 percent of the total. This was partly as a result of students arriving from China. This has now fallen substantially to under 10 percent of total PLT arrivals (8,000 per year). In the past twelve months, strong growth in arrivals has come from South Africa, Germany and Latin America and could be an indication that firms are looking to less traditional regions to help alleviate skill shortages.

### Where do they go when they get here?

While the majority of PLT arrivals (38 percent) head to Auckland, its share of the total has been decreasing since the mid-1990s when it reached a peak of 46 percent. Regions that have experienced strong growth in PLT arrivals in the past 12 months have included Auckland and Wellington. It appears the growth in arrivals in the rural regions peaked 12-18 months ago, and they are now easing off. However, these trends are hard to distinguish as the data is very volatile. On a regional basis, we were unable to find a relationship between regional house price growth and PLT arrivals due to the volatile nature of each data series, although a clear relationship can be found at the nationwide level.

### What is the age of the immigrants?

The prime working age group (25-39 years old) makes up the largest proportion of arrivals (38 percent) and has remained around this level since 1990. It is not surprising that this characteristic dominates the arrival numbers given that residency and work permit requirements are skewed towards this age bracket. One observation that can be drawn is that there has been strong growth in the arrivals of those over 60 years old in the past 12 months, although they make up a small proportion of the total (4 percent). The increase looks to reflect New Zealand's growing attraction as a place to retire.

### What are the occupations of those arriving?

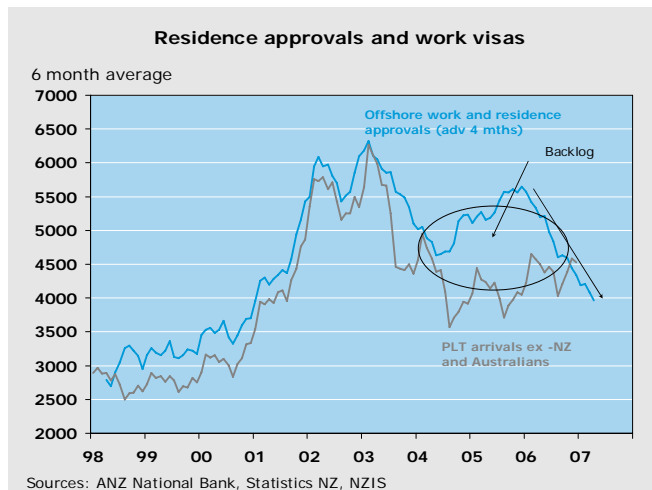
The largest group of arrivals are in the primary and early childhood education category, followed by specialist managers, housekeeping and restaurant servicing workers, and nursing and midwifery professionals. However, a significant proportion does not report an occupation.

Unsurprisingly, occupations linked to the construction sector and the housing market (eg labourers, electricians, building and related workers) has shown strong growth since March 2005 (the latest trough in arrivals). There has also been exceptional growth in machinery operating workers, which is somewhat surprising given the contraction in manufacturing employment since March 2005. But this could be an indication of the skill shortages faced by the manufacturing sector, which is having to recruit offshore for specialist skills.

### Outlook

We continue to expect PLT arrivals to remain steady. A tight labour market and continued demand for skilled labour will provide an attraction for new migrants. Although there has been a decline in the number of offshore approvals for work and residence applications (which provide a reasonable lead for future arrivals), this is likely due to changes in immigration policy that require processing to be done in New Zealand for applications from certain countries. In addition,

around 2,000 expatriate New Zealanders return home every month.



In April 2006, the Government announced *“the most comprehensive review of immigration legislation in 20 years.”* They have made significant changes to the way appeals are handled and have improved the technology used for decision making. Once this legislation passes, there will be just one independent tribunal to handle reviews and appeals of migration decisions rather than the four that currently exist. It will also be much easier to deport someone and use classified information in the deportation decisions. Although an improvement, the impact of this legislation is more a tidy up of a currently complicated system and should have very limited macroeconomic impact.

### Financial market implications

The different mix to recent migration trends implies an alternate mix to housing demand. The sharp drop-off in student numbers from China means less demand for apartment-style accommodation. A larger proportion of prime working age and retired migrants point to more demand for stand-alone owner occupied housing. While lifestyle and demographic trends are likely to be a key influence of migrant’s decision to relocate to New Zealand, particularly for older migrants, the tight labour market and demand for labour will continue to attract those who are skilled and in their prime working age.

Given the continued attractiveness of New Zealand as a host destination, immigration trends are and will remain a source of inflationary risk. However, the beneficial impact in terms of expanding the labour supply and alleviating skill shortages will help dampen longer-term wage and inflationary pressures.

The gap between past offshore approvals and recent arrivals suggest there could potentially still be a backlog of migrants who have been given approval but still to arrive. This suggest further upside risk on the arrival side.

## INTEREST RATE STRATEGY

Heavy data week ahead, with the National Bank *Business Outlook* to provide a glimpse of how activity is faring in early 2007. Swaps market unlikely to price in a higher probability of rate hikes until after the March *Monetary Policy Statement*. Further consolidation expected.

### Market themes...

- Further consolidation ahead of the March *Monetary Policy Statement*.
- Curves to invert further courtesy of offshore moves.
- Tight ranges expected this week, with the currency again the main focus.

### Outlook...

Lack of local data last week saw the local interest rate market largely track sideways, taking the lead from offshore moves. This week's fairly heavy schedule of data releases should help set some directional leads, although the market will be unlikely to head too far one way or the other with the March *Monetary Policy Statement* only a week and a half away. The swaps market is unlikely to price in a higher probability of a follow-up hike than what it already has. As far as the market is concerned, the Reserve Bank is locked and loaded to deliver a rate hike next week. The question is how hawkish the rhetoric will be, particularly given the NZD/USD is above 0.70 and the NZD/AUD above 0.89. This suggests further consolidation this week with only large data surprises to move swap yields.

Global developments will again be important this week. Investors have flocked to US bonds as a safe haven play on the back of concerns over the increasing default rates on subprime mortgages caused by the housing market slowdown and rising interest rates, as well as rising tensions with Iran over their nuclear programme. The decline in US yields, while contributing to USD weakness, can also be expected to wash up on our local interest rate market though not to the same extent.

The interest rate swaps markets are expected to trade in a tight range until the March *Monetary Policy Statement* on the 8<sup>th</sup>, outperforming offshore moves. It is unlikely that the trading market will reduce much of the pricing already priced in. The major concern for the rates market will be the NZD (with low volatility and a weak USD under pressure). This will encourage investors into the swaps curve favouring a higher NZD over the short term. We favour investing the belly of the swaps curve with mortgage flows slowing somewhat and issuance of NZD into the Euro markets dictating direction.

Gauges for NZ interest rates yields		
Gauge	Direction	Comment
RBNZ	↔/↑	March locked and loaded.
NZ data	↔	Tenor of data mixed so far. Today's National Bank <i>Business Outlook</i> key.
Fed Funds/front end	↓	US market still testing easing theme in second half.
RBA	↔/↑	Rate hikes seemingly off the table for now, but so is rate cuts.
US 10 year	↓	Subprime mortgages jitters sending investors to bonds as safe haven play.
NZ swap spreads	↓	To contract with receiving of the belly of the swaps curve. Domestic market feels long Governments.
Flow	↔	Issuance key driver
Technicals	↔	Sitting on support, awaiting Reserve Bank developments.

### Borrowing strategies we recommend at present

Upwards pressure on rates continues – the overall view remains the same with the majority of the market looking for a 25 basis point hike in March. There is still some pick-up in the 3-5 year part of the curve relative to floating and borrowers should ensure a high amount of fixed cover is in place to safeguard against further tightening. Option strategies can provide this protection whilst also allowing flexibility.

### Probability of 25bps increase as implied by market pricing

OCR dates	Last week	This week
Thu 8-Mar-07	80	76
Thu 26-Apr-07	120	128
Thu 7-Jun-07	132	144
Thu 26-Jul-07	132	144
Thu 13-Sep-07	128	136
Thu 25-Oct-07	128	136
Thu 6-Dec-07	124	124

### Trading themes we favour at present

Favour investing 1yr towards 8 percent. Curves to invert through the 5 years. Front end bills better buying against selling longer dated bills.

## THE PIPELINE

**The Reserve Bank is getting minimal policy traction through the effective mortgage rate, having missed a large chunk of the mortgages that were locked in at the height of the 2005 mortgage war. To get the curve to work in their favour, the Reserve Bank will need to back up a 25bps hike next week with very hawkish rhetoric, and the risk remains that they have to do more beyond that.**

The effective mortgage rate has not risen by as much as the Reserve Bank estimated in its December *Monetary Policy Statement*. The near 25bps increase in the effective rate that the Reserve Bank was expecting between October 2006 and February 2007 will be more muted, with only a 10bps increase likely by our estimates.

Although the effect from past monetary policy tightenings is still in the pipeline, it is filtering through at a slower rate than the Reserve Bank was expecting. Reasons for the slower passthrough include:

- Fixed rate discounting by retail banks, particularly at the longer end, which saw a further narrowing in mortgage margins.
- An increasing proportion of new or roll-off mortgages being written at longer term fixed rates, further delaying the pipeline effect.
- Mortgage holders shopping around along the mortgage curve for the best rates on offer.

The bulk of the re-financing of outstanding housing mortgage debt for those that fixed at low 2-year rates two years ago at the height of the 2005 mortgage war (some below 7 percent) has largely occurred.

However, there is still a significant amount of roll-offs to come in the next few months. By our estimates, around a third of outstanding fixed rate mortgages maturing in the next 12 months are due over March, April and May, but they are not at those record low 2-year rates. The largest roll-off over the next three months are those who fixed for 1-year a year ago (around 60-70 percent) and those that fixed for 2-years two years ago (around 20-25 percent).

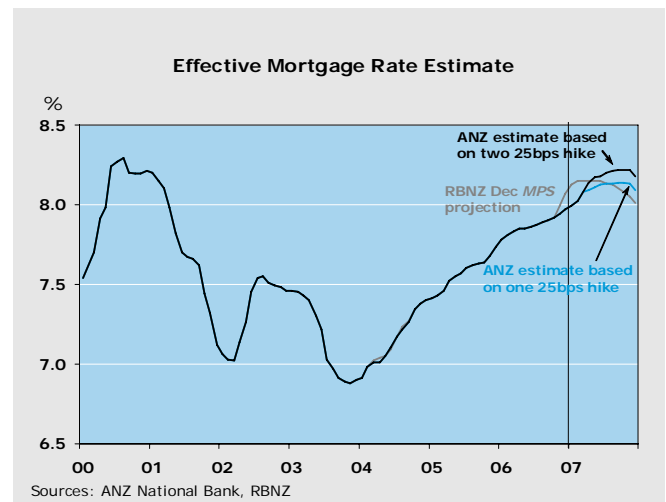
	Proportion roll-off over Mar, Apr and May (%)	Mortgage rate (%)
Weighted average of those with <12 mths	30	7.71
Mortgages fixed for 2-years two years ago	20-25	7.73-7.75
Mortgages fixed for 1-year a year ago	60-70	8.20-8.32
<b>2-year fixed rate currently</b>		<b>8.35</b>
<b>5-year fixed rate currently</b>		<b>7.94</b>

The change in interest rates at roll-over may be only minor. Those who fixed two years ago will be up for higher interest rates, but not significantly so if they opt for the current 5-year rate. Those that fixed a year ago for 1-year, which make up the majority of the total roll-off, could actually reduce their effective mortgage rate by going out along the 3-5 year part of the mortgage curve.

On the face of it the Reserve Bank, by not hiking rates in October last year, has effectively missed a substantial part of the pipeline effect over the end of last year and early this year. Sure, the effective mortgage rate is still moving up, but it is at a slower rate, and hence the impact on consumer spending has been more muted. The inverted shape of the yield curve continues to give borrowers the ability to duck for cover.

Having missed the part of the roll-off with the lowest effective rate, the Reserve Bank may be forced to do more in order to ensure the pipeline tightening it desires takes hold.

We model what the effective mortgage rate would look like based on one 25bps hike in March, and two consecutive 25bps hikes in March and April. We assume monthly mortgage growth of 1 percent, bank margins remain well below historical averages, and that most of the roll-off and new mortgages go into 2 and 5-year fixed rates (which is currently the case).



Under the scenario of one hike, the effective mortgage rate continues to rise, but at a very gradual pace. Based on our estimate of the pipeline effect, one 25bps move just looks to leave the effective mortgage rate unchanged from the Reserve Bank's December estimate, but delayed till the second half of the year. To get more traction in the effective mortgage rate requires two successive hikes, which will take the effective mortgage rate above where the Reserve Bank projected by mid this year (8.1 percent). We note that this would also take the effective rate to its highest level since 2000, when New Zealand had a domestic recession and the currency was sub 0.50 against the USD!

## Financial Market Implications

The implications we take from our analysis are four-fold.

- **It is going to take time for the Reserve Bank to get the policy traction it is after.** There is not going to be a large rise in the effective mortgage rate over the coming few months, given that the bulk of those who locked in at low 2-year rates at the height of the 2005 mortgage war have already refinanced. It is significant that those who fixed a year ago could reduce their effective rate by moving further out the mortgage curve.
- **The bias will remain towards more than one 25bps hike.** Given the need for the Reserve Bank to keep the yield curve up in order to maintain upward pressure on the effective mortgage rate, this points to the Reserve Bank backing up a 25bps hike in March with very hawkish rhetoric, with an explicit threat that further rate hikes are on the table.
- **Rates look set to remain high for sometime.** The Reserve Bank will likely need to stay in a tightening bias for an extended period. This could be a sticking point to a weaker currency by mid-year.
- **At some juncture, limited policy traction from fixed mortgages will have the reciprocal impact on monetary policy.** Given the inverted shape of the yield curve, borrowers will continue to seek shelter by lengthening duration. The reciprocal implies monetary policy will be equally slow to reflate the economy, and reinforces our view that while rates could remain high until late 2008, at some stage there will be an aggressive easing cycle.

## CURRENCY STRATEGY

**A week of consolidation for the NZD has laid the foundation to make an assault to higher levels. Global forces are needed to cap. But given the way the NZD reacted to the BoJ and stronger US CPI last week, this may not be enough.**

### Market themes...

- All about carry with local data confirming hike expectations for the RBNZ.
- BoJ hikes, but dovish tones and scene set for a gradual path.
- RBA Governor Stevens and wages data reinforces RBA hike risk.
- Fed Governors continue inflation rhetoric, and stronger US CPI confirms risk.

### Outlook...

Its all about carry at present with the combination of firming expectations for a hike from the RBNZ and dovish overtures from the BoJ cementing the yield game. The failure of the BoJ hike last week to dent the fortunes of the NZD as it consolidated within a broad 0.6980-0.7080 range means the prospects of a move higher this week look good. US CPI came in stronger although the bond market gave a sigh. With data and nuances across the Tasman leaving the bias towards a hike from the RBA, the NZD has also been caught riding in kanga's pouch.

At present short-term momentum is relatively neutral and leaves room for the test of higher levels. IMM positioning for the week ending 20th Feb 2007 has seen a slight increase on the long NZD positions as the RBNZ *Monetary Policy Statement* approaches.

Yield has continued to exert upward pressures on the NZD as participants realise that overall moves by the BoJ are likely to be very gradual. Emerging Japanese corporate reporting issues may see the move to 87JPYNZD early in the week particularly if USD weakness from geopolitical issues and notably Iran increases.

The NZD/AUD still looks biased towards a squeeze up given where the near-term respective paths for monetary policy lie. Selling interests are starting to build around 0.9000. Keep an eye on Australian data this week including construction, CAPEX, BOP, and retail sales. We've noticed a clear bias for global GDP stats to come in weak for Q3 2006, and strong for Q4. Certainly the NZ Q4 figure is looking solid, and in the absence of equivalent strength in Australian partials, the 0.90 level will be tested.

Technically, the NZD is incredibly overbought, which suggests that the kiwi will struggle to make further gains without a consolidation phase. The technicals on all NZD crosses suggest that the week leading up to the Reserve Bank's announcement will be a struggle, and we expect to see opportunity to buy the kiwi on dips as the technicals all correct lower from the extreme levels seen last week. This will leave the market fresh and poised ready to move on the 8th of March following the RBNZ's lead.

NZD vs AUD: monthly directional gauges		
Gauge	Direction	Comment
Fair value	↓	Above the 0.85-0.88 zone.
Yield	↑	RBA patient, RBNZ not, but is this priced in?
Commodities	↔	Hard continue to perform well. Dairy keeping pace but other softs lagging.
Partial indicators	↔	Like the cricket team, on a roll. Can it continue?
Technicals	↔	Overbought. Consolidation.
Sentiment	↔	Hard to see NZD strength being sustained but absence of sellers when RBNZ in play.
Other	↓/↑	Carry trade looks bullet proof...that's worrying.
<b>On balance</b>	↔/↑	<b>Holding pattern this week ahead of RBNZ.</b>

NZD vs USD: monthly directional gauges		
Gauge	Direction	Comment
Fair value – long-term	↓	Fair value 0.60. It may be higher given a structural shift in commodity prices.
Fair value – short-term	↔	NZD more fairly valued on commodity models.
Yield	↑	NZ yield still attractive.
Commodities	↔	Dairy prices are insulating the dairy sector but meat prices looking suspect.
Risk aversion	↔/↑	Low. Iran in play?
Partial indicators	↔	CPI higher in US.
Technicals	↔	Support in the 0.6960-0.7085 zone.
AUD	↔	Australian data improving.
Sentiment	↑/↔	No one can see a cloud.
Other	↓	Market very complacent on NZD's continued rise.
<b>On balance</b>	↔	<b>Wait and see this week.</b>

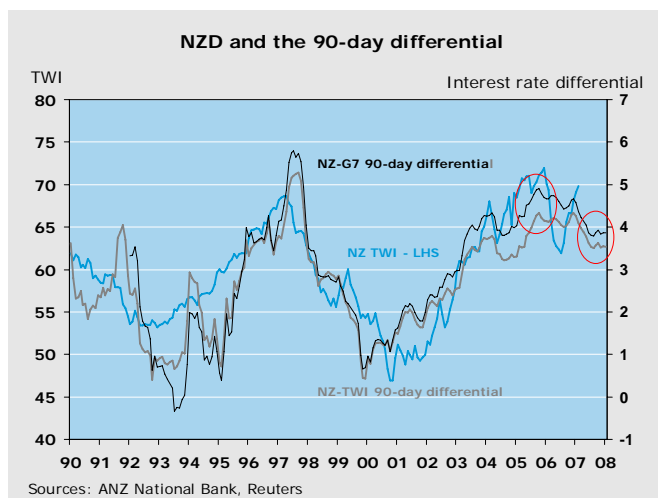
## A FAIR COP

**The Reserve Bank and the monetary policy framework are being taken to task over the impact they are having on the currency and tradable sector. An objective look at the facts shows monetary policy is not solely culpable.**

New Zealanders are well known for their arm chair prowess as referees, coaches, and selectors, notably when their national team or icons go through a rough patch. The armchair advice is typically endless. With the adverse impact of tight monetary policy falling on the export sector, New Zealanders have a new pastime or advisory capacity: the art of central banking.

While we sympathise with pockets of the tradable sector that are struggling under the burden of the higher NZD, we thought it prudent to take an impartial look at the facts.

- **The NZ-OECD or trade-weighted basket 90-day differential is far narrower** than the last time the NZD/USD was above 0.70. The NZ 90-day rate is only 10 points higher than in late 2005, while global interest rates are close to 70 basis points higher. The implication we take from this is that the NZD is looking frothy around current levels.

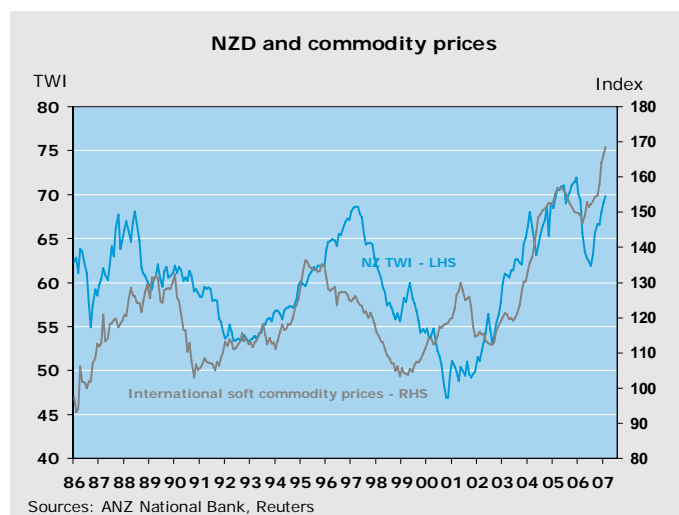


Note: The 90-day differential has been smoothed in 1997 and 1998 to remove the MCI debacle.

- **It's a liquidity story.** Global interest rates as a general proposition remain low, underpinning global liquidity. Liquidity is manifesting itself through low levels of risk aversion, low volatility and generally money that is looking for a home. The S&P VIX stood at 12 at the end of 2005, compared with 10.5 now. Emerging market spreads are narrower relative to late 2005, with the JP Morgan emerging market spread around 170 at present, well down on 240 at the end of 2005.
- **Commodity prices still matter.** The ANZ World Commodity Price Index has risen 13

percent in the past 12 months. Dairy prices are up 23 percent! Strength in commodity prices is insulating pockets of the export sector and elongating the economic cycle.

- **Get used to a higher currency on average.** The historical average of USD 0.58 is constantly noted by newspaper scribes. Such a level makes any push to 0.70 seem extreme. However, economic volatility has been low (the standard deviation of annual GDP has been 1.6 percent since the OCR was introduced, compared with 2.6 percent over the preceding 20 years). Just as less earnings volatility justifies a higher P/E, the same applies for an economy and currency. Moreover, given structural lifts in New Zealand's terms of trade and commodity prices, we would put fair value closer to USD 0.65 than 0.58. The run-up in the currency is not as extreme in such a context.



- **The mortgage "war" has had a huge impact.** Aggressive mortgage discounting has lowered the effective mortgage rate being faced by borrowers by as much as 50 basis points. All else equal, it has forced the Reserve Bank to compensate through an even higher OCR, which has buoyed the currency. Each time the housing market seems to slow, the mortgage price (discounting) card is played and the housing market gets another wind. While it's a case of all power to the consumer and competitive pressure, the indirect casualty is the tradable sector.
- **Positive aspects of a stronger currency are being overlooked.** As a nation we are wealthier when the NZD rises and poorer when it declines. If a weaker currency was the way to economic prosperity, Zimbabwe would be an economic giant.
- **Some of the cures being bandied about are worse than the disease.** Currency intervention, levies on housing, changes to the Reserve Bank Act, and a common currency are all promoted solutions in certain arenas.

Intervention does not come without risk, a levy on housing is merely a further distortion in the market, it would be ironic to change the Reserve Bank Act amidst the longest economic expansion since the 1960's, and a common currency would remove a key shock absorber.

- **The Government has not made the Reserve Bank's job any easier.** Public sector employment growth has been massive and wage gains have surpassed private sector equivalents. New Zealand's love affair with housing is a reflection of its tax advantages that current Government policy prescribe.
- **The currency is playing an increasing role as a stabilisation tool** by mirroring economic developments. Economic weakness in late 2005 was met by a lower currency in H2 2006. Rebuilding momentum in late 2006 has seen the currency squeeze up. Between 1999 and 2004, volatility in interest rates was the sacrificial pawn to stabilise growth and employment. From 2005, the pawn has been the currency.

The Reserve Bank does not get off scott free. How policy has been communicated has been disappointing. The Reserve Bank clearly should have hiked rates in October, and sent a strong message to the housing market that was starting to reflate. Sure the currency would have squeezed up, but from a position of USD 0.67.

However, an objective look at the facts shows that monetary policy is not solely culpable for a high NZD.

## DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZDT)
26 Feb	NZ	<b>Merchandise Trade Balance (Jan)</b>	<b>-\$0.645B</b>	<b>-\$0.433B</b>	<b>10:45</b>
		<b>Imports</b>	<b>\$3.05B</b>	<b>\$3.33B</b>	<b>10:45</b>
		<b>Exports</b>	<b>\$2.50B</b>	<b>\$2.90B</b>	<b>10:45</b>
		<b>National Bank Business Outlook Survey (Feb)</b>	-	<b>-7.7</b>	<b>13:00</b>
	JN	Bank of Japan to Release Minutes for Jan 17-18 meeting	-	-	18:00
	GE	GfK Consumer Confidence Survey (Mar)	4.8	4.8	20:10
27 Feb	EU	ECB's Quaden Presents Annual Report in Antwerp	-	-	05:00
		Euro-Zone M3 (Jan) – s.a. 3 mth. avg.	9.5%	9.2%	22:00
28 Feb	US	Durable Goods Orders (Jan)	-3.0%	2.9%	02:30
		Durables Ex Transportation (Jan)	0.3%	2.7%	02:30
		S&P/CaseShiller Home Price (Dec)	-	204.4	03:00
		Consumer Confidence (Feb)	108.7	110.3	04:00
		Richmond Fed Manufacturing Index (Feb)	-	-11	04:00
		Existing Home Sales (Jan)	6.24m	6.22m	04:00
		Existing Home Sales (Jan) – mom	0.3%	-0.8%	04:00
	NZ	<b>Building Consents (Jan) – mom</b>	-	<b>-4.9%</b>	<b>10:45</b>
	EU	ECB's Trichet Speaks in Brussels	-	-	12:00
		Euro-Zone Consumer Confidence (Feb)	-6	-7	23:00
		Euro-Zone Industrial Confidence (Feb)	5	5	23:00
		Euro-Zone Unemployment Rate (Jan)	7.4%	7.5%	23:00
		Euro-Zone CPI (Jan) – mom	-0.5%	0.4%	23:00
		Euro-Zone CPI – core (Jan) – yoy	1.9%	1.5%	23:00
		Business Climate Indicator (Feb)	1.41	1.40	23:00
		Euro-Zone Economic Confidence (Feb)	109.1	109.2	23:00
		Euro-Zone Services Confidence (Feb)	20	20	23:00
	UK	GfK Consumer Confidence Survey (Feb)	-8	-7	23:30
		Industrial Production (Jan P) – mom	-1.8%	0.9%	12:30
		Retail Trade (Jan) – yoy	0.1%	-0.2%	12:50
		Large Retailers' Sales (Jan)	-0.8%	-2.4%	12:50
		Bank of Japan Board Member Mizuno to Speak at Financial Meeting	-	-	14:00
		Vehicle Production (Jan) – yoy		7.9%	17:00
		Housing Starts (Jan) – yoy	4.0%	10.2%	18:00
		Housing Starts (Jan) – annualised	1.3m	1.3m	18:00
		Construction Orders (Jan) – yoy	5.0%	-5.6%	18:00
	AU	Private Sector Credit (Jan) – mom	1.0%	0.9%	13:30
		Construction Work Done (4Q)	1.5%	-2.1%	13:30
	GE	Unemployment Rate (Feb) – s.a.	9.4%	9.5%	21:55

Continued over page

Date	Country	Data/Event	Mkt.	Last	Time (NZDT)
1 Mar	US	GDP Annualised (4Q P)	2.3%	3.5%	02:30
		Personal Consumption (4Q P)	4.2%	4.4%	02:30
		GDP Price Index (4Q P)	1.5%	1.5%	02:30
		Core PCE (4Q P) – qoq	-	2.1%	02:30
		Chicago Purchasing Manager (Feb)	50.0	48.8	03:45
		New Home Sales (Jan)	1,080k	1,120k	04:00
		New Home Sales (Jan) - mom	-3.6%	4.8%	04:00
	EU	Fed's Geithner Speaks on Financial System in New York	-	-	02:50
		ECB's Trichet, EU's Almunia Speak at European Parliament	-	-	03:00
		PMI Manufacturing (Feb)	55.7	55.5	22:00
	NZ	<b>Tax Receipts and Revenue (Jan)</b>	-	-	-
		<b>Visitor Arrivals</b>	-	<b>-1.3%</b>	<b>10:45</b>
	AU	AiG PMI (Feb)	-	51.3	10:30
		Private Capital Expenditure (4Q)	3.5%	-6.0%	13:30
RBA Commodity Price Index SDR (Feb) – yoy		-	10.1%	18:30	
GE	PMI Manufacturing (Feb)	58.5	58.5	21:55	
UK	PMI Manufacturing (Feb)	53.0	52.8	22:30	
2 Mar	US	Personal Income (Jan)	0.3%	0.5%	02:30
		Personal Spending (Jan)	0.4%	0.7%	02:30
		PCE Core (Jan) – mom	0.2%	0.1%	02:30
		PCE Deflator (Jan) – yoy	2.3%	2.3%	02:30
		ISM Manufacturing (Feb)	50.0	49.3	04:00
		ISM Prices Paid (Feb)	54.5	53.0	04:00
		Construction Spending (Jan) – mom	-0.5%	-0.4%	04:00
	JN	Jobless Rate (Jan)	4.1%	4.1%	12:30
		National CPI (Jan) – mom	0.1%	0.0%	12:30
		National CPI Ex Fresh Food (Jan) – mom	0.1%	-0.1%	12:30
		National CPI Ex Food, Energy (Jan) – yoy	-	-0.3%	12:30
		Monetary Base (Feb) – yoy	-21.5%	-21.1%	12:50
		Labour Cash Earnings (Jan) – yoy	0.5%	-0.1%	14:30
		AU	Retail Sales (Jan)	0.5%	0.3%
Current Account Balance (4Q)	-\$14,000m		-\$12,084m	13:30	
UK	PMI Construction (Feb)	57.5	57.9	22:30	
EU	Euro-Zone PPI (Jan) – mom	0.2%	0.0%	23:00	
3 Mar	US	US Fed's Bernanke Speaks at Stanford University Economics Conference	-	-	15:45

Key: AU: Australia, CA: Canada, EU: European Union, GE: Germany, JP: Japan, NZ: New Zealand, UK: United Kingdom, US: United States.

Source: Dow Jones, Reuters, Bloomberg, ANZ National Bank. All \$ values in local currency. Na= not available. (Note: all surveys are preliminary and subject to change).

## NEW ZEALAND DATA WATCH

**Key focus over next four weeks:** The March *Monetary Policy Statement* is the main event. While the National Bank *Business Outlook* (today) and the Reserve Bank's Survey of Expectations (tomorrow) are important reads on the economy, they will have little bearing on the Reserve Bank's decision, with a rate hike locked and loaded. However, the National Bank *Business Outlook* survey will provide an important insight into whether momentum at the end of last year is carried into Q1 this year.

Date	Data/Event	Economic Signal	Comment
Mon 26 Feb (10:45)	Merchandise Trade (Jan)	Imbalanced	We expect a large headline deficit. Lower oil price to reduce fuel import bill, but higher NZD to hold back export growth.
Mon 27 Feb (13:00)	National Bank <i>Business Outlook</i> (Feb)	-	-
Tue 27 Feb (15:00)	Credit Growth (Jan)	Up	Should be strong. Expect another 1.0 percent month.
Tue 27 Feb (15:00)	RBNZ Survey of Expectations (Mar qtr)	Inflation easing	The 1-year inflation expectations to ease on the back of lower oil prices, but 2-year expectations to remain elevated.
Wed 28 Feb (10:45)	Building Consents (Jan)	Mixed	We expect a small technical rebound after two consecutive monthly falls.
Thu 1 Mar (10:45)	External Migration (Jan)	Steady	The tight labour market is encouraging New Zealanders to stay. Expect another 1,000+ month.
Mon 5 Mar (10:45)	Wholesale Trade Survey (Dec qtr)	Up	Growth in this quarter should be strong, in-line with retail sales growth.
Wed 7 Mar (1:00)	ANZ <i>Commodity Price Index</i> (Feb)	-	-
Thu 8 Mar (9:00)	RBNZ March <i>Monetary Policy Statement</i>	25 basis point hike	We expect the Reserve Bank to hike the OCR by 25bps, taking it to 7.50 percent and back that up with very hawkish rhetoric.
Thu 8 Mar (10:45)	OTIs (prices and volumes)	Terms of trade up	Large falls in oil prices and high commodity prices should see New Zealand's terms of trade increase.
Fri 9 Mar (10:45)	Value of Building Work Put in Place (Dec qtr)	Mixed	Residential work put in place to post a modest increase in real terms, but non-residential to show a decline although the level of activity remains high.
Tue 13 Mar (10:45)	Retail Trade Survey (Jan)	Up	A modest rise in retail spending expected, though a big increase in food prices will inflate the food related spending numbers.
Wed 14 Mar (10:45)	Manufacturing Survey (Dec qtr)	Mixed	Manufacturing sales to be subdued due to a high NZD, but a rebound in production expected as firms rebuild stock levels.
Tue 20 Mar (10:45)	External Migration (Feb)	Steady	The tight labour market is encouraging New Zealanders to stay. Expect another 1,000+ month.
Wed 21 Mar (15:00)	Credit Card Billings (Feb)	Steady	A modest rebound expected after January's decline, but not strongly accelerating away.
<b>On Balance</b>		<b>Q4 strength but early signs of Q1 mixed.</b>	<b>Strong momentum end of last year. Still questions over 2007.</b>

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## SUMMARY OF KEY MARKET FORECASTS

NZ FX rates	Actual		Current	Forecast (end month)						
	Nov 06	Dec 06	26 Feb 07	Mar 07	Jun 07	Sep 07	Dec 07	Mar 08	Jun 08	Sep 08
NZD/USD	0.669	0.692	0.707	0.700	0.680	0.640	0.620	0.600	0.580	0.550
NZD/AUD	0.866	0.880	0.894	0.909	0.895	0.853	0.849	0.833	0.817	0.786
NZD/EUR	0.520	0.524	0.537	0.530	0.523	0.496	0.481	0.472	0.464	0.447
NZD/JPY	78.5	81.0	85.5	84.0	79.6	72.3	68.2	64.8	61.5	59.4
NZD/GBP	0.350	0.352	0.360	0.361	0.354	0.337	0.328	0.321	0.312	0.299
NZ\$ TWI	66.7	68.1	69.9	69.5	67.7	63.7	61.7	60.0	58.2	55.8
NZ interest rates	Nov 06	Dec 06	26 Feb 07	Mar 07	Jun 07	Sep 07	Dec 07	Mar 08	Jun 08	Sep 08
OCR	7.25	7.25	7.25	7.50	7.50	7.50	7.25	7.00	7.00	7.00
90 day bill	7.61	7.66	7.77	7.80	7.70	7.60	7.20	7.20	7.20	7.10
10 year bond	5.71	5.78	5.97	6.00	6.00	6.20	6.10	6.20	6.40	6.50
International	Nov 06	Dec 06	26 Feb 07	Mar 07	Jun 07	Sep 07	Dec 07	Mar 08	Jun 08	Sep 08
US Fed funds	5.25	5.25	5.25	5.25	5.25	5.25	4.75	4.75	4.75	5.00
US 3-mth	5.37	5.36	5.36	5.40	5.40	5.00	4.60	4.75	4.90	5.25
AU cash	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.00	5.75
AU 3-mth	6.39	6.44	6.36	6.40	6.40	6.40	6.40	6.30	5.80	6.00

## KEY RATES

	23 Jan	19 Feb	20 Feb	21 Feb	22 Feb	23 Feb
Official Cash Rate	7.25	7.25	7.25	7.25	7.25	7.25
30 day bank bill	7.55	7.61	7.60	7.59	7.62	7.64
90 day bank bill	7.66	7.78	7.76	7.77	7.79	7.78
NZGB 07/09	6.44	6.58	6.59	6.61	6.62	6.64
NZGB 11/11	6.26	6.35	6.36	6.38	6.39	6.42
NZGB 04/13	6.10	6.15	6.15	6.16	6.17	6.20
NZGB 12/17	5.95	5.92	5.92	5.92	5.93	5.94
1 year swap	7.80	7.91	7.93	7.93	7.94	7.95
2 year swap	7.62	7.73	7.73	7.74	7.75	7.76
5 year swap	7.26	7.33	7.33	7.34	7.35	7.37
RBNZ TWI	69.5	69.4	69.2	69.4	69.8	69.8
NZD/USD	0.6988	0.7018	0.7003	0.7007	0.7046	0.7034
NZD/AUD	0.8861	0.8909	0.8901	0.8901	0.8911	0.8921
NZD/JPY	85.03	83.84	83.78	84.28	85.26	85.51
NZD/GBP	0.3532	0.3592	0.3585	0.3583	0.3608	0.3597
NZD/EUR	0.5401	0.5336	0.5315	0.5331	0.5366	0.5363
AUD/USD	0.7886	0.7877	0.7868	0.7872	0.7907	0.7885
EUR/USD	1.2939	1.3153	1.3177	1.3145	1.3131	1.3116
USD/JPY	121.68	119.46	119.64	120.28	121.01	121.56
GBP/USD	1.9784	1.9538	1.9533	1.9558	1.9531	1.9554
Oil	53.26	59.38	58.48	58.32	59.40	60.28
Gold	646.40	672.45	671.95	660.85	677.85	675.15
Electricity Price Index	2.90	4.53	4.66	4.76	4.93	4.99

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