

A CLASSIC NZ BUSINESS CYCLE

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Page 2: Economic overview

- > 2007 ended on a solid note, reinforcing capacity pressures. However, indicators for 2008 have turned sharply weaker. While the pace of deceleration is worrying, this is what the NZ business cycle is, and has been typically all about, along with the bitter medicine required to restore some balance to the economy.

Page 4: Economic comment – National Bank *Business Outlook* update

- > The National Bank Business Confidence Survey is flagging a negative read on activity for Q1 with weakness extending through the year if confidence levels are sustained, according to our composite measure. Looking at current housing weakness, the global picture and weak NZ equity market, we are in no doubt that the turn will be sustained.

Page 6: Economic comment – global watch

- > Another week of generally softer US data. Consumer confidence has fallen sharply and spending is slowing. The housing market remains in a tumble. However, to date the weakness appears to remain limited to the US, with European data (German IFO) remaining surprisingly resilient. Asian ex-Japan data (barring Singaporean industrial production) also remained reasonably strong last week.

Page 7: Interest rate strategy

- > Focus for the rates market now firmly on Q1 dataflow. Weak business confidence should see bias on the receive side, but flows to still dominate and could yet see payside emerge the stronger as receive trades are unwound.

Page 8: Currency strategy

- > The NZD is struggling to maintain highs. With macro-momentum softening sharply, the interest rate curve repricing the RBNZ, and rising volatility across commodity markets, the kiwi looks to be on the cusp of a major and aggressive move lower over the coming months.

Page 9: Currency comment – macro-momentum currency gauge

- > Our currency macro-momentum gauge is a composite growth index that has tracked the NZD over the past decade. It reinforces the view that the NZD ultimately tracks growth as opposed to yield, although the two are often far from divorced. The gauge has been softening since October 2007. It currently suggests the NZD is around 7 percent “expensive” at present. Massive divergences in the indicator relative to the current TWI level have typically seen aggressive snap-backs in the latter.

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ECONOMIC OVERVIEW

2007 ended on a solid note, reinforcing capacity pressures. However, indicators for 2008 have turned sharply weaker. While the pace of deceleration is worrying, this is what the NZ business cycle is, and has been typically all about, along with the bitter medicine required to restore some balance to the economy.

What's ahead?

- > **NZ February Credit Growth** (Monday 1500 NZDT). Another soft result of around 0.7 percent for the month is likely given the weakness in the housing market.
- > **ANZ March Commodity Price Index** (Thursday 1500 NZDT).

What's the view?

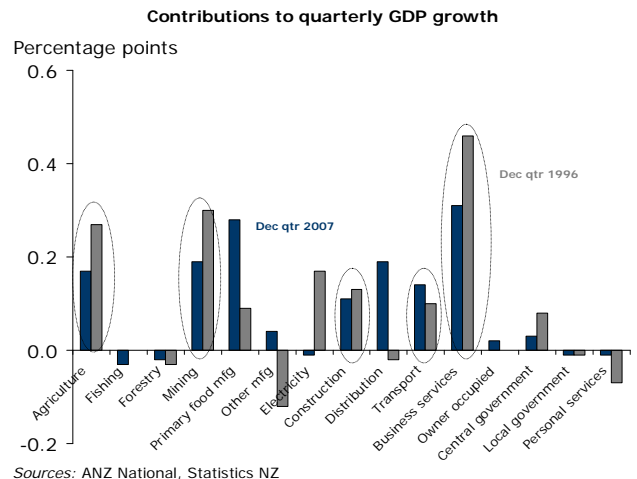
We have, at last, received the final pieces of data to enable us to close the book on the year that was 2007. As expected, the New Zealand economy ended the year on a reasonably solid footing. GDP expanded by 1.0 percent in the December quarter, taking year on year growth to 3.7 percent (or 3.1 percent looking at the change in annual values). The current account deficit reduced to 7.9 percent of GDP – the first time it is below 8 percent since the June 2005 quarter. And don't forget the fact that the unemployment rate hit a record low of 3.4 percent in the December quarter. The year ended strongly.

Looking at the detail in the GDP data, the strength was across the board, with the primary sector (up 4.8 percent), manufacturing (up 2.2 percent) and finance, insurance and business services (up 1.2 percent) making the largest contributions to growth. Strength in primary production was partly due to the ongoing contribution of the Tui oilfield, which we estimate added 0.2 percentage points to overall GDP growth.

On the expenditure side there were some positive developments. Growth was dominated by exports (particularly dairy, although much of this came from inventories), and business investment. The latter is a sign that firms are attempting to expand the supply-side capacity of the economy in the face of labour constraints. Despite "one-offs" in the form of the Tui contribution and the fact that dry weather conditions may have brought forward some primary production (which means lower production in March), the GDP data illustrates that the economy built up a strong base at the end of last year. This will reinforce the Reserve Bank's concern at the lack of spare capacity facing the economy, and given the stronger starting position, the Reserve Bank will now require a more substantial slowdown to be convinced that inflation pressure will subside.

If there was an eerie aspect to growth in the December quarter last year, it is the resemblance to the 1.3 percent increase in the December 1996 quarter, which was just prior to the 1997 recession. Growth in December 1996 was dominated by mining,

agriculture, food manufacturing and business services, which collectively contributed 1 percent to growth, in a similar fashion to what those sectors contributed in the December 2007 quarter. In looking at what drives those sectors (agriculture and food manufacturing – weather, business services – housing etc), it's not hard to envisage a massive u-turn. In fact, strength in late 1996 was followed up by a fall of 0.6 percent in the March 1997 quarter.



This leaves us strongly suspicious of some "statistical" noise and payback between Q4 2007 and Q1 2008, with underlying growth (averaging out the two quarters) probably around 0.3 to 0.4 percent, and consistent with where the ex-Tui economy was performing in the September 2007 quarter. The Reserve Bank was assuming an average of 0.5 percent growth across the two quarters in their March projections, so it is shaping up weaker. However, given the stronger labour force reads at the end of 2007 (notably from wages - as portenders of medium-term inflation pressure), growth needs to be weaker.

However, momentum has obviously stepped sharply lower in terms of the 'here and now' as opposed to averages, going by readings coming from key confidence gauges.

- The Westpac McDermott-Miller consumer confidence survey tumbled for the March quarter to 96.5 (from 110 in the December quarter) – the lowest reading in a decade. The direction of the movement is not at all surprising but the magnitude of the fall certainly was. Households are now clearly feeling the pinch of falling house values, increasing food and petrol prices, high mortgage rates as well as drought-like conditions over much of the country. The positives from pending tax cuts, low unemployment and high commodity prices are being dwarfed at present.
- Business confidence has plummeted. The National Bank *Business Outlook* for March, which was released this morning, also makes for sombre reading. A net 58 percent of businesses expect business conditions to deteriorate over the coming year. More disconcerting is the sharp fall in firms' own activity expectations, with a net 6 percent of

businesses expecting a deterioration in their own business over the coming year. Forget comparisons with 1997/98 – this is the weakest reading since 1991! Negative reads from own activity expectations have always coincided with a concurrent contraction in activity – hence our suspicion Q1 will print negative and reverse Q4 2007 strength. Moreover, our composite growth measures from the survey suggest the economy may do well to achieve our current forecast of 1 percent growth over the year. (Page 4 provides a graphical update of key leading indicators we track from the survey).

If the surveys are correct, the “official” data flow is now likely to take on a consistently negative tone. In this environment, the rates market will continue to push for easings, and the NZD will be vulnerable to a slide down the elevator, in a similar fashion to Q1 2006. While our currency projections envisage a steady downward path over the year, Q2 is now looking a strong contender for hosting the elevator ride (10 cent move) once again on the assumption dire confidence reads manifest in “official” (lagging) data.

Looking forward, we'd expect weakness across consumer and business confidence to show in the results of the NZIER Quarterly Survey of Business Opinion (due 8 April). This survey provides some key measures of capacity constraints in the economy and will provide some further comfort to the Reserve Bank. However, the sticking point will remain the inflation element, with the March quarter CPI read shaping up reasonably strong, with growing nuances and anecdotes of rents being the latest playing catch-up. Moreover, any currency weakness will exacerbate inflation pressures. While the Reserve Bank is correctly focused on non-tradable inflation, the stone cold reality is that lower commodity prices may be a necessary pre-condition to lower interest rates in order to mitigate inflationary pressure from a weaker currency, particularly given the extent of inflationary pressure coming from what we consider non-contestable or non-demand-driven pockets of the economy (e.g. Government charges)

Of course we've been here before, and the danger is we talk ourselves into a pall of gloom. A comment from Cleveland Federal Reserve President Pianalto stuck in our minds last week *“We know from studying economic history that booms are often followed by busts, and this pattern has repeated itself in our (US) housing market.”* This may seem a pretty innocuous comment to make, but coming from a monetary policymaker it is quite startling. Nonetheless, it could easily be applied to the situation which is also occurring in New Zealand at present. Massive swings in momentum are typical of how the New Zealand business cycle tends to unfold.

New Zealand has experienced its longest expansion since the 1960's. So we shouldn't be surprised to see a natural end to the cycle, with some unfortunate bitter medicine required to purge a number of imbalances. Last week's current account figures were a touch better than expectations, but we still have a

deficit of 7.9 percent of GDP, and is symptomatic of poor savings and an unsustainable mix to growth. Too much spending and investment in housing, no saving, and excluding dairying and Tui, weakening export performance. It's not a sustainable mix.

The more significant issue remains how long any adjustment will last. On that front we'll repeat what we've said over the past two weeks. It is the most important message we have at present. This end to the cycle is going to be driven by household de-leveraging as opposed to corporate de-leveraging, and the former will be a more arduous and drawn out affair, given a negative savings rate and weak balance sheets as opening positions. Sure, corporates – via weakening demand – will be drawn into it. But the major “adjustees” will be households. Early 2008 may well be only the start of proceedings.

In terms of the week ahead, as is typical after GDP is released, it is a quiet one on the data front. Excluding the data released this morning, only credit growth (this afternoon) and ANZ commodity prices are due. Credit growth is again expected to be soft, in-line with a weak housing market, although it is unlikely to get much attention. It will therefore remain a case of watching developments offshore. The RBA interest rate announcement, in particular, will be of note (although most now expect the Bank to leave rates unchanged). In the US, ISM data along with non-farm payrolls are big key reads and markets will look to them for further confirmation the US is in recession.

But rather than the US at the moment, the important data from New Zealand's point of view remains that of other countries. The US is weak, but the more important factor is whether this is spilling over. To date, other countries don't look like they have caught the US cold just yet (German IFO surprised on the upside last week). European economic confidence data and German labour market data this week will be important releases in this regard.

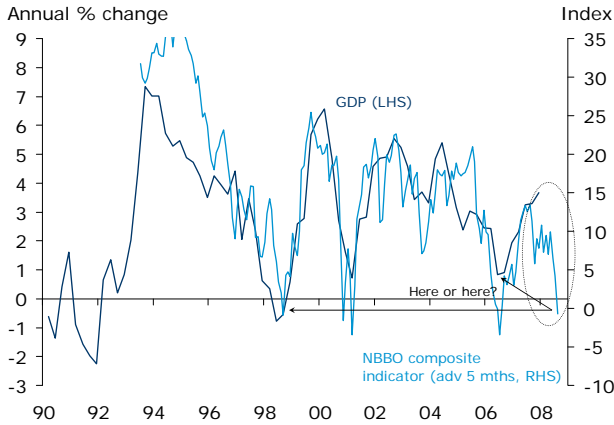
Recent data...

- > **NZ Credit Card Spending (February).** Total credit card billings rose 0.7 percent in the month, to be up 8.1 percent from a year ago.
- > **Westpac McDermott-Miller Consumer Confidence (March quarter).** The headline index fell from 110 in the December quarter to 96.5 in March – the lowest reading in 10 years.
- > **NZ Balance of Payments (March quarter).** The annual current account deficit improved to 7.9 percent of GDP from 8.4 percent of GDP in the September quarter.
- > **NZ Overseas Merchandise Trade (March).** A monthly trade surplus of \$258 million was recorded, taking the annual balance to \$4,413 million.
- > **NZ Gross Domestic Product (December quarter).** The economy expanded at a rate of 1.0 percent in the December quarter, taking annual average growth to 3.1 percent

NATIONAL BANK BUSINESS OUTLOOK UPDATE

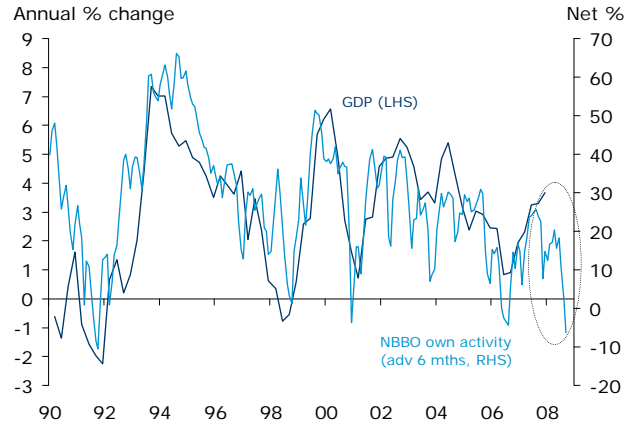
The National Bank Business Confidence Survey is flagging a negative read on activity for Q1 with weakness extending through the year if confidence levels are sustained, according to our composite measure¹. When we look at our composite growth indicators across sectors, manufacturing and construction look to be heading backwards. Agriculture is slowing markedly. As the largest sector, services remains the bellwether, and while growth expectations are positive, they are receding sharply. While there is no doubt the economy is set to slow, a lot of attention at present centres on whether we are seeing a repeat of late 2005 or a more sustained turn. Looking at current housing weakness, the global picture and weak NZ equity market, we are in no doubt that the turn will be sustained.

GDP vs NBBO composite indicator



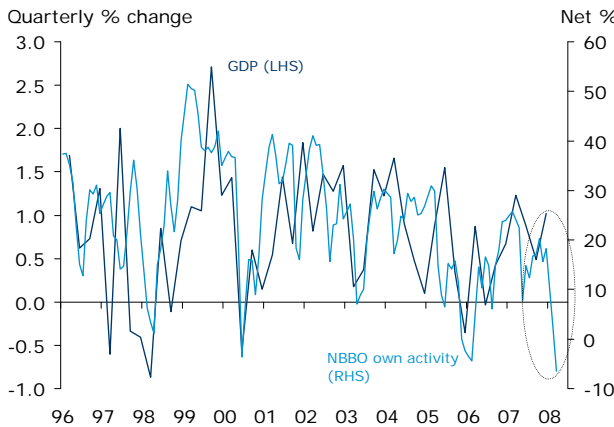
Sources: ANZ National, Statistics NZ

GDP vs NBBO own activity



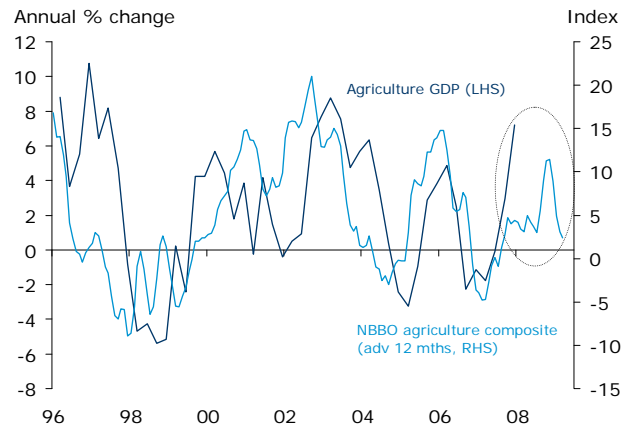
Sources: ANZ National, Statistics NZ

GDP vs NBBO own activity



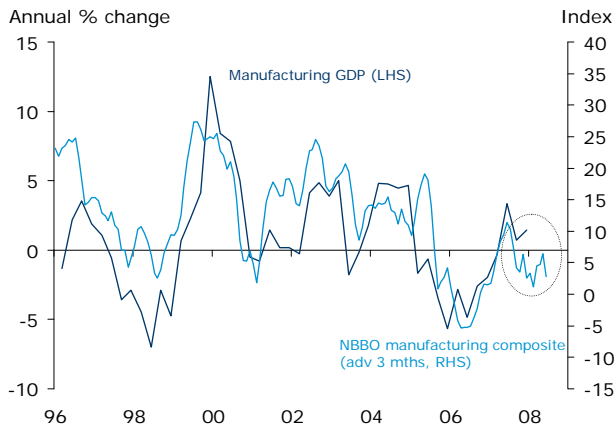
Sources: ANZ National, Statistics NZ

Agriculture GDP vs NBBO composite (12% of GDP)



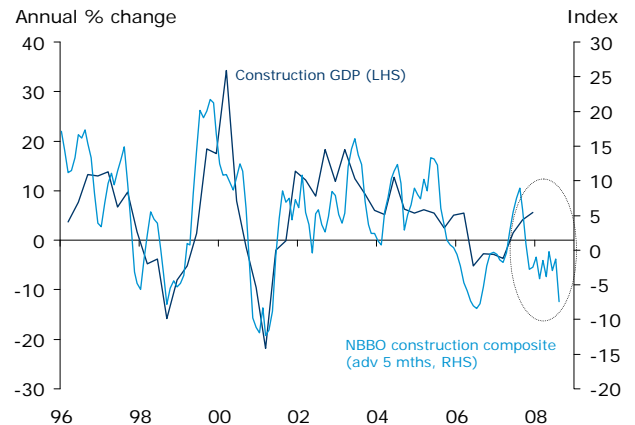
Sources: ANZ National, Statistics NZ

Manufacturing GDP vs NBBO composite (9% of GDP)



Sources: ANZ National, Statistics NZ

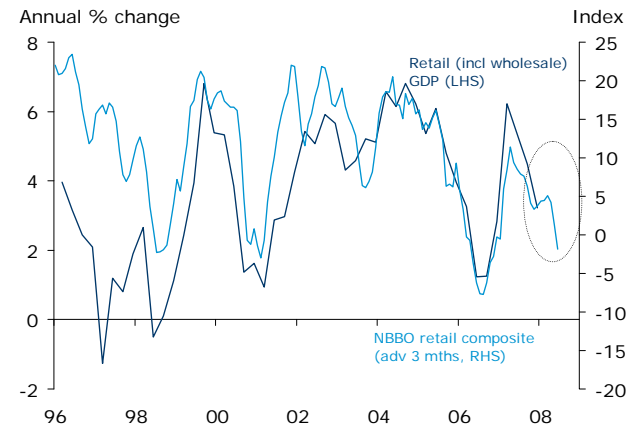
Construction GDP vs NBBO composite (5% of GDP)



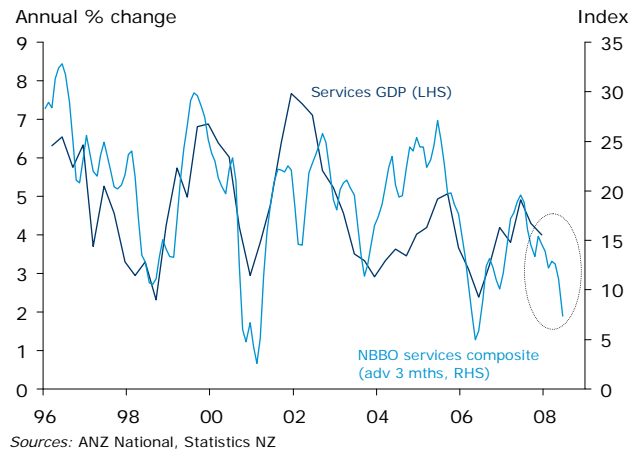
Sources: ANZ National, Statistics NZ

¹ Our composite measure uses the forward looking activity indicators from the National Bank Business Confidence Survey (own activity, investment intentions, employment intentions and profit expectations), combining them into a single index. The sectoral composite indicators use the same methodology as the economy-wide indicator.

Retail GDP vs NBBO composite (8% of GDP)



Services GDP vs NBBO composite (43% of GDP)



GLOBAL WATCH

We present a table of global data outturns over the past week given the significance of the international backdrop at present. Another week of generally softer US data. Consumer confidence has fallen sharply and spending is slowing. The housing market remains in a tumble. However, to date the weakness appears to remain limited to the US, with European data (German IFO) remaining surprisingly resilient. Asian ex-Japan data (barring Singaporean industrial production) also remained reasonably strong last week.

Country/ Area	Indicator	Mkt	Actual	Last	Outturn vs market
US	Consumer Confidence (Mar)	73.5	64.5	76.4	Weaker
	S&P/CS Composite-20 (Jan) – yoy	-10.5%	-10.7%	-9.0%	Weaker
	Richmond Fed Manufacturing Index (Mar)	-5	6	-5	Stronger
	Durable Goods Orders (Feb)	0.7%	-1.7%	-4.7%	Weaker
	New Home Sales (Feb) – mom	-1.7%	-1.8%	-1.6%	In-line
	GDP Annualised (4Q F) – qoq	0.6%	0.6%	0.6%	In-line
	Personal Income (Feb)	0.3%	0.5%	0.3%	Stronger
	Personal Spending (Feb)	0.1%	0.1%	0.4%	In-line
	PCE Deflator (Feb) – yoy	3.5%	3.4%	3.5%	Weaker
	PCE Deflator – Core (Feb) - yoy	2.1%	2.0%	2.0%	Weaker
	University of Michigan Confidence (Mar F)	70.0	69.5	70.5	Weaker
	Europe	Industrial New Orders (Jan) – mom	0.2%	2.0%	-3.6%	Stronger
German IFO (Mar)		103.5	104.8	104.1	Stronger
UK	Nationwide House Prices (Mar) – mom	-0.3%	-0.6%	-0.5%	Weaker
	GDP (4Q F) – qoq	0.6%	0.6%	0.6%	In-line
Asia Ex-Japan					
<i>China</i>	Industrial Profits YTD (Feb) – yoy	-	16.5%	36.7%	-
<i>Singapore</i>	Industrial Production (Feb) - mom	1.5%	-2.3%	10.8%	Weaker
<i>Philippines</i>	Total Imports (Jan) - yoy	-	27.7%	19.7%	-
<i>Vietnam</i>	GDP (1Q) - qoq	-	7.4%	8.5%	-
	Exports (Mar) – yoy	-	22.7%	29.2%	-
	Imports (Mar) – yoy	-	62.5%	63.7%	-
	Retail Sales (Mar) – yoy	-	29.2%	31.8%	-
	Industrial Output (Mar) – yoy	-	16.4%	16.1%	-
	CPI (Mar) – yoy	-	19.4%	15.7%	-
<i>Taiwan</i>	Benchmark Interest Rate	3.50%	3.50%	3.375%	In-line
Japan	Jobless Rate (Feb)	3.8%	3.9%	3.8%	(Weaker)
	Overall Household Spending (Feb) – yoy	2.4%	0.0%	3.6%	Weaker
	Nationwide CPI (Feb) – yoy	0.9%	1.0%	0.7%	Stronger
	Retail Trade (Feb) – mom	-2.4%	-1.0%	0.8%	Stronger
Australia	Conference Board Leading Index (Jan)	-	-0.3%	0.1%	-
	Job Vacancies (Feb)	-	-2.5%	5.5%	-

INTEREST RATE STRATEGY

Focus for the rates market now firmly on Q1 dataflow. Weak business confidence should see bias on the receive side, but flows to still dominate and could yet see payside emerge the stronger as receive trades are unwound.

Market themes...

- > NZ consumer confidence slumps in Q1, but GDP ended 2007 on a strong note.
- > Global markets still jittery and volatile.
- > RBNZ continues to see current OCR levels as appropriate but keeping a close eye on global developments.

Review and outlook...

It was a busy domestic data calendar last week but offshore volatility again played a role in dictating the local market's direction. The current account data was largely a non-event but the sharp slump in the Q1 Westpac consumer confidence survey suggests that households are really feeling the strain from higher cost of living pressures, despite everyone having a job. Credit card spending data for February suggests subdued spending when price rises for groceries are taking out. And yet, the Q4 GDP data showed that the economy ended 2007 on a strong footing, providing a decent buffer to softness in early 2008 and reinforcing the RBNZ's concern over near-term inflation pressure.

But with the last of the Q4 data now out of the way, the market's focus is now firmly on Q1 data and forward looking indicators. There is no doubt that economic activity is slowing. The question is how much it is slowing by, whether it is sustained, and whether it is sufficient to ease the RBNZ's inflation concern. RBNZ Governor Bollard's view that the OCR at 8.25 percent remains appropriate suggests a larger growth sacrifice is required, though today's National Bank business confidence survey showing a sharp deterioration in the own activity indicator points to growth undershooting the RBNZ's expectations.

We expect the domestic dataflow to turn consistently bearish on the economy, with clearer signs of the housing market correction broadening into other sectors of the economy. Next week's NZIER QSBO survey will provide a very important read on whether the slowdown early this year is translating through into easing resource pressure.

With the market increasingly attuned to the turn in the economic cycle, the bias is on the receive side. But once again, flows and offshore moves will likely play a bigger role this week, with the 2-year swap yield to continue trading between 8.1 and 8.35 percent. OIS pricing has a 50 percent chance of a cut by July, with two full rate cuts priced in by December.

In offshore news, the RBA takes centre stage though a no change decision is widely tipped. The RBA's latest view on the impact of global financial markets will be closely perused, though it is unlikely to contain anything different from their recently released

Financial Stability Review. The Tanken survey and Euro-zone business confidence reading will provide an indication of whether US weakness is spreading. In the US, the ISM and non-farm payrolls data are key reads on the current state of the US economy, which is now widely thought to be in recession.

Gauges for NZ interest rates yields		
Gauge	Direction	Comment
RBNZ	↔	Lack of inflation headroom means their hands are tied.
NZ data	↔/↓	NBBO confidence weak. Focus on QSBO next week.
Fed Funds/front end	↓	Market still expected further easings by the Fed. US housing still weak.
RBA	↔	RBA decision to be eyed for latest thoughts on global financial developments.
US 10 year	↑	Volatility set to continue with bonds trading off US equities.
NZ swap curve	↔	Paying through the front end should see curves flatten over the week.
Flow	↔/↑	Payside the stronger as receive trades are unwound.
Technical	↔	The technical picture remains unclear. US payrolls end of this week key.

Borrowing strategies we favour at present

Our strategy remains unchanged – pay the 18 months to 2-year, and for those with existing portfolios and whose durations are beyond 3 years to shorten duration. If weaker NZ economic data intensifies, the mid-points of the curve should outperform as investors look to obtain duration that covers multiple potential rate cuts. Our preference remains to keep borrowing short, no longer than two years.

Probability of 25bps increase as implied by market pricing

OCR dates	Last week	This week
Thu 24-Apr-08	-4	-2
Thu 5-Jun-08	-32	-26
Thu 24-Jul-08	-36	-50
Thu 11-Sep-08	-108	-70
Thu 23-Oct-08	-132	-150
Thu 4-Dec-08	-152	-210
Thu 15-Jan-09	-232	-210

Trading themes we favour at present

We continue to favour receiving in the 3-5 year part of the curve as the 2-year is expensive given the carry cost from the elevated 90-day rate.

CURRENCY STRATEGY

The NZD is struggling to maintain highs. With macro-momentum softening sharply, the interest rate curve repricing the RBNZ, and rising volatility across commodity markets, the kiwi looks to be on the cusp of a major and aggressive move lower over the coming months.

Market themes...

- > USD weakness returns.
- > Europe does not appear to have caught the US cold...yet.
- > NZD looking vulnerable given domestic setting, but remains stuck in range for now.

Review and outlook...

USD sentiment continues to dominate commentary. Greenback weakness returned last week (after a rally over the previous week) as the downward trend on Wall Street continued on the back of soft data and concerns over profitability in the US financial sector, which looks set to post its third consecutive quarterly decline for the first time in the history of the current classification system. This weakness provided a base under the NZD last week by default, as did solid Q4 GDP data. However, a late sell-off in commodity prices on Friday night saw the NZD under pressure and it starts the week looking a little fragile.

Looking forward, we are increasingly being drawn to four areas. First, NZ's macro environment is weakening sharply, as shown by consumer and business confidence figures. Now that we are beyond the overlap of Q4 and Q1 data, we are likely to see a consistently weak tone or trend, and markets like to run in trends. Second, the curve has actively repriced the RBNZ over the past six weeks, in a similar fashion to late 2005. Historically, the interest rate market has always led the currency. Thirdly, we are seeing a strong pickup in volatility across commodity markets, and there is growing talk (speculation) of speculative unwinds. Finally, current account deficit related nations are struggling to maintain highs, and indeed the Icelandic krona has taken a bath.

Collectively, we may well be on the cusp of another aggressive move lower in the NZ dollar, although a lot still depends on wider USD sentiment, particularly in so far as it depicts the path for commodity prices and the euro. As we have stated previously, the EUR remains a key barometer to assess the decoupling/recoupling thesis and recent European data has been surprisingly resilient. In fact, US data last week (confidence, durable goods) generally surprised on the downside, while European data (PMI and German IFO) has been coming in better than expected. This is backing up the ECB's claim that growth in that region will remain solid and is providing renewed support to the EUR (and hence the NZD). It may well be the sticking point to the timing of the corrective move in the NZ dollar.

Apart from the local data released this morning (building consents and NBNZ *Business Outlook*) the week is a quiet one on the local data front. Important offshore data/events include the RBA interest rate announcement on Tuesday, although no change in rates is expected. In the US, ISM manufacturing and non-manufacturing data will be important as well as non-farm payrolls at the end of the week, to provide the markets with further evidence of whether the US has entered recession or not (we suspect it has).

Technically, the support at 0.7900/20 again becomes critical for the NZD/USD. Topside, the 0.8065 region has firmed up and provides resistance. The NZD/AUD cross has rejected the upside probe above 0.8800 and is finally giving us confidence that the top is in place.

NZD vs AUD: monthly directional gauges		
Gauge	Direction	Comment
Fair value	↓	Growth differentials favouring AUD.
Yield	↓	Yield spreads narrowing
Commodities	↔	Commodities looking topy all round. Who does it affect more?
Partial indicators	↔/↓	Better across the Tasman.
Technicals	↓	Resistance at 0.8830.
Sentiment	↓	NZD is not a better a credit risk than AUD.
Other	↓	All eyes on commodities and equities.
On balance	↓	Top feels in place above 0.88.

NZD vs USD: monthly directional gauges		
Gauge	Direction	Comment
Fair value – long-term	↓	Fair value 0.65 (and rising) given a structural shift in commodity prices.
Fair value – short-term	↔/↓	Yield and commodity story factored in. Current account becoming an issue.
Yield	↑	Yield differentials still at phenomenal levels.
Commodities	↓	Still a key one to watch.
Risk aversion	↓	Fed action so far of little success.
Partial indicators	↔	Both economies weak.
Technicals	↔	0.7880/0.8215 range.
AUD	↔	Range trade AUD/USD.
Sentiment	↔/↓	Volumes decreasing in kiwi.
Other	↔	Still a USD story.
On balance	↓	Kiwi domestic story catching up with global slowdown.

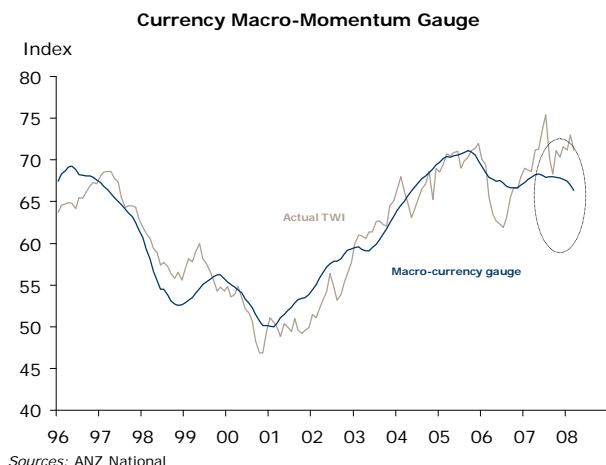
MACRO-MOMENTUM CURRENCY GAUGE

Our currency macro-momentum gauge is a composite growth index that has tracked the NZD over the past decade. It reinforces the view that the NZD ultimately tracks growth as opposed to yield, although the two are often far from divorced. The gauge has been softening since October 2007. It currently suggests the NZD is around 7 percent "expensive" at present. Massive divergences in the indicator relative to the current TWI level have typically seen aggressive snap-backs in the latter.

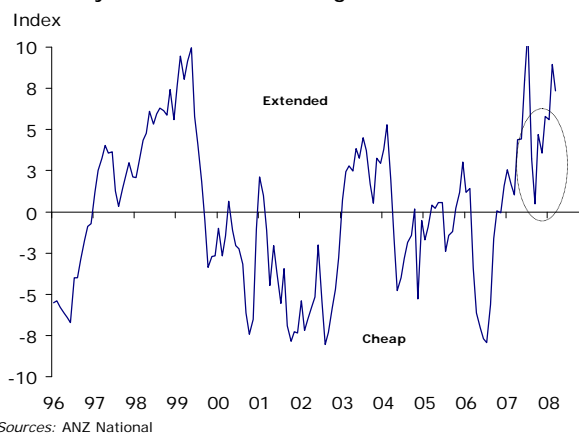
Which matters more for the NZD, growth or yield? Of course the two cannot be divorced. Slowing growth is typically associated with falling interest rates, particularly in the 90-day to 2-year part of the curve. Typically we see the early lead indicators turn, the bond (swaps) market re-assess the timing of monetary policy moves, and the NZ dollar follows.

A year ago we developed a currency macro-momentum gauge. Currencies are hugely responsive to more timely data nowadays, yet we have no indicator that gives us a reading on whether some sort of growth tipping point has been reached.

Our gauge is in effect an extension of our leading and composite growth indicators, overlaid on the NZ dollar. The macro-momentum gauge uses timely indicators that we know the currency market tends to react to. These include monthly trend information from confidence surveys, retail sales, the housing market, commodity prices and imports. We use two measures for each – one being directional (positive or negative), and the other the relative magnitude of either weakness or strength. The measures are then weighted to give us an impress of the overall tenor of the data. The results are then overlaid on the currency (on a TWI basis) using cumulative movements. We use cumulative movements because ultimately it is the trend in the data over time that is influential, such as sustained weakness or strength. Just as sub-par performance sees a share price fall, sub-par (trend) performance over time should see a currency decline. A simple regression links the index more explicitly to the actual TWI.



Currency Macro-Momentum Gauge - deviation from TWI



Does our gauge track the NZD? The answer is an overwhelming yes. Obviously divergences can and do occur. Our index includes no offshore factors. Yet it is striking how the two are still closely correlated based solely on macro-momentum for the NZ economy.

Of course our indicator is not saying where the currency should be in a structural sense, or likely to be on average – we rely on a host of other measures for that. But our indicator gives a useful guide and benchmark as to whether the NZD has diverged materially from where it should be in a cyclical sense, and whether the tenor of the data says it should be going up or down.

So what does the indicator tell us at this present stage?

Firstly, it has started to turn down in a directional sense. Macro-momentum "peaked" in October 2007, and has now been slowing for five successive months. Secondly, the pace of deceleration has intensified, as flagged by leading gauges. Third, a sizeable "disequilibrium" gap has opened up between the indicator and the NZ dollar, and the size of the mismatch is approaching magnitudes that historically have resulted in the currency "snapping back" aggressively.

The upshot

Historically there has been a clear pattern that precedes sharp turns in the NZ dollar. First, the NZ dollar is "extended" as flagged by our gauge. Second, economic sentiment wanes, as is being signalled by leading gauges and composite measures of activity. Third, the bond and swaps market "leads" the currency market. It has been noticed that yields across the NZ swaps curve are 30 basis points lower relative to six weeks ago. While "timing" remains uncertain, the bigger picture remains one of movements that, when they come, are likely to be aggressive. We saw a similar movement in the swaps curve in December 2005, and the NZD eventually ended up playing catch-up. Watch for a repeat.

DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZDT)
31 Mar	NZ	Building Permits (Feb) – mom	-	3.3%	10:45
		NBNZ Business Confidence (Mar)	-	-43.9	11:00
	JN	Nomura/JMMA Manufacturing PMI (Mar)	-	50.8	12:15
		Industrial Production (Feb P) – mom	-2.0%	-2.2%	12:50
		Labour Cash Earnings (Feb) – yoy	0.6%	1.0%	14:30
		Vehicle Production (Feb) – yoy	-	8.7%	17:00
		Housing Starts (Feb) – yoy	-1.0%	-5.7%	18:00
		Construction Orders (Feb) – yoy	-	-2.5%	18:00
	AU	TD Securities Inflation (Mar) – mom	-	0.3%	12:30
		Private Sector Credit (Feb) – mom	1.1%	1.1%	13:30
		HIA New Home Sales (Feb) – mom	-	11.3%	
	EU	ECB's Liikanen speaks in Helsinki	-	-	21:00
		M3 (Feb) – yoy	11.5%	11.5%	21:00
		CPI Estimate (Mar) – yoy	3.3%	3.2%	22:00
		Business Climate Indicator (Mar)	0.72	0.72	22:00
		Consumer Confidence (Mar)	-12	-12	22:00
		Economic Confidence (Mar)	100.0	100.1	22:00
		Industrial Confidence (Mar)	1	0	22:00
		Services Confidence (Mar)	10	10	22:00
	UK	GfK Consumer Confidence Survey (Mar)	-	-17	22:30
1 Apr	US	Chicago Purchasing Manager (Mar)	46.0	44.5	02:45
		Fed's Yellen speaks in San Francisco on Foreclosures	-	-	05:00
	AU	AiG Performance of Manufacturing Index (Mar)	-	51.4	11:30
		RBA Interest Rate Announcement	7.25%	7.25%	16:30
	JN	Tankan Lge Mfg Outlook (1Q)	13	15	12:50
		Tankan Non-Mfg Outlook (1Q)	10	15	12:50
		Tankan Large All Industry Capex (1Q)	0.1%	10.5%	12:50
	GE	ILO Unemployment Rate (Feb)	7.5%	7.6%	18:00
		Unemployment Rate (Mar)	7.9%	8.0%	20:55
		PMI Manufacturing (Mar F)	54.9	54.9	21:00
	EU	PMI Manufacturing (Mar F)	52.0	52.0	21:00
		Unemployment Rate (Feb)	7.1%	7.1%	22:00
	UK	PMI Manufacturing (Mar F)	51.0	51.3	21:30
2 Apr	US	ISM Manufacturing (Mar)	47.5	48.3	03:00
		ISM Prices Paid (Mar)	75.0	75.5	03:00
		Construction Spending (Feb) – mom	-1.0%	-1.7%	03:00
	UK	M4 Money Supply (Feb F) – mom	-	0.3%	21:30
		Net Consumer Credit (Feb)	0.9B	0.9B	21:30

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Date	Country	Data/Event	Mkt.	Last	Time (NZDT)
2 Apr cont.	UK	Mortgage Approvals (Feb)	72k	74K	21:30
		PMI Construction (Mar)	52.0	52.4	21:30
	EU	PPI (Feb) – yoy	5.2%	4.9%	22:00
3 Apr	US	ADP Employment Change (Mar)	-40k	-23k	01:15
		Fed's Bernanke Testifies Before Joint Economic Committee	-	-	02:30
		Factory Orders (Feb)	-0.8%	-2.5%	03:00
	AU	AIG Performance of Services Index (Mar)	-	53.2	11:30
	NZ	ANZ Commodity Price Index (Mar)	-	0.9%	15:00
	GE	PMI Services (Mar F)	52.5	52.2	21:00
	EU	PMI Services (Mar F)	51.7	51.7	21:00
		PMI Composite (Mar F)	51.9	51.9	21:00
		Retail Sales (Feb – mom)	0.2%	0.4%	22:00
	UK	PMI Services (Mar)	52.3	54.0	21:30
4 Apr	US	ISM Non-Manufacturing Composite Index (Mar)	48.5	49.3	03:00
		Fed's Mishkin speaks in New York	-	-	12:30
		Fed's Yellen speaks on US Economy	-	-	13:00
	NZ	Tax Receipts (Feb)	-	-	10:00
	AU	RBA Governor Testimony to Parliament	-	-	11:00
		Retail Sales (Feb)	0.3%	0.0%	0.0%
	GE	Factory Orders (Feb)	0.9%	-1.5%	23:00
5 Apr	US	Change in Non-Farm Payrolls (Mar)	-50k	-63k	01:30
		Unemployment Rate (Mar)	5.0%	4.8%	01:30
		Change in Manufacturing Payrolls (Mar)	-40k	-52k	01:30
		Average Hourly Earnings (Mar) – mom	0.3%	0.3%	01:30

Key: AU: Australia, EU: Euro-zone, GE: Germany, JN: Japan, NZ: New Zealand, UK: United Kingdom, US: United States.
Sources: Dow Jones, Reuters, Bloomberg, ANZ National Bank. All \$ values in local currency. (Note: all surveys are preliminary and subject to change).

NEW ZEALAND DATA WATCH

Key focus over the next four weeks: With the final pieces of 2007 data received last week all focus now shifts to indicators of Q1 and early signs of Q2 activity. On this front we expect the tenor from the real side of the economy to show a consistently weak bias.

Date	Data/Event	Economic Signal	Comment
Mon 31 Mar (15.00)	Credit Growth (Feb)	Soft	Another soft result around 0.7 percent for the month is likely given the weakness in the housing market.
Thu 3 Apr (15.00)	ANZ Commodity Price Index (Mar)	-	-
Tue 8 Apr (10.00)	NZIER QSBO (Q1)	Negative	Confidence expected to show a sharp drop, in line with the NBBO survey. Key to watch is whether indicators of resource pressure eased.
circa 11 Apr	REINZ housing report (Mar)	On the down	Further downward pressure on house prices, with the annual house price inflation rate expected to move into negative territory. House sales may show a slight rebound but days to sell to head higher.
Mon 14 Apr (10.45)	Retail sales (Feb)	Ongoing softness	Following fairly soft January retail sales, we expect the underlying trend to remain one of weakness. Higher food and petrol prices to again inflate the headline number.
Tue 15 Apr (10.45)	CPI (Q1)	Too high for comfort	Higher food and petrol prices to see annual inflation remain above the RBNZ's target band. Key focus is on whether non-tradable inflation reverses recent surprises on the downside.
Mon 21 Apr (10.45)	Net migration (Mar)	Lower	Stable arrivals but rising departures to see net migration continue to head lower.
Wed 23 Apr (10.45)	Electronic card transactions (Mar)	Easter effect	Early Easter this year to drag this reading lower.
Thu 24 Apr (09.00)	RBNZ <i>OCR Review</i>	Similar themes	With Q1 CPI expected to reinforce inflation issues, we expect the line to be reasonably similar to March. However, with some of the downside growth risks materializing, all will be looking for a slightly softer tone.
On Balance		A growth wall but inflation problems	Growth indicators are now expected to come in consistently weak.

SUMMARY OF KEY ECONOMIC FORECASTS

	Mar-07	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09
GDP (% qoq)	1.2	0.9	0.5	1.0	0.1	-0.2	0.1	0.2	0.3	0.4
GDP (% yoy)	2.3	3.2	3.3	3.7	2.5	1.4	1.0	0.2	0.4	1.0
CPI (% qoq)	0.5	1.0	0.5	1.2	0.8	0.8	0.9	0.8	0.5	0.7
CPI (% yoy)	2.5	2.0	1.8	3.2	3.5	3.2	3.6	3.2	2.9	2.8
Employment (% qoq)	1.2	0.6	-0.3	1.1	0.2	0.1	0.1	0.2	0.1	0.2
Employment (% yoy)	1.7	1.6	1.6	2.5	1.5	1.0	1.4	0.6	0.5	0.6
Unemployment Rate (% sa)	3.7	3.6	3.5	3.4	3.5	3.6	3.8	4.0	4.1	4.1
Current Account (% GDP)	-8.2	-8.1	-8.4	-7.9	-7.5	-6.9	-6.6	-6.8	-6.9	-6.9
Terms of Trade (% qoq)	1.5	0.4	3.7	2.9	1.1	-0.2	-1.2	-1.0	-0.8	-0.8
Terms of Trade (% yoy)	4.5	2.3	8.4	8.8	8.3	7.7	2.7	-1.3	-3.1	-3.6

KEY ECONOMIC INDICATORS

	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08
Retail Sales (% mom)	-0.4	0.2	0.2	1.1	-0.5	1.8	0.1	0.3	..	..
Retail Sales (% yoy)	4.8	5.7	6.3	4.1	5.8	7.2	5.4	6.3	..	..
Credit Card Billings (% mom)	1.6	0.1	0.8	2.1	-0.5	1.1	0.5	0.1	0.7	..
Credit Card Billings (% yoy)	9.0	7.9	8.5	9.3	7.8	9.5	7.5	8.7	8.1	..
Car Registrations (% mom)	-4.8	7.0	1.1	-6.6	5.7	-3.6	-2.6	5.4	-3.6	..
Car Registrations (% yoy)	-1.5	7.0	10.9	0.1	4.7	2.3	1.4	1.7	1.9	..
Building Consents (% mom)	12.3	-15.9	4.7	-9.2	-5.4	1.2	-3.9	3.3	-2.0	..
Building Consents (% yoy)	32.9	-4.5	-2.1	-15.2	-16.5	-4.3	-6.3	-4.5	-13.3	..
REINZ House Price (% yoy)	12.1	10.4	12.9	12.3	8.0	6.7	4.5	4.0	..	..
Household Lending Growth (% mom)	1.2	0.8	0.9	0.8	0.8	0.8	0.7	0.7	..	..
Household Lending Growth (% yoy)	13.5	13.5	13.4	13.0	12.8	12.6	12.2	11.8	..	..
Roy Morgan Consumer Confidence	121.0	121.1	122.4	121.3	122.0	121.9	126.6	121.2	116.0	..
NBNZ Business Confidence	-37.2	-38.5	-33.8	-26.5	-12.9	-19.6	-24.9	..	-43.9	-57.9
NBNZ Own Activity Outlook	14.8	12.4	16.7	17.2	20.3	15.7	18.2	..	2.4	-6.4
Trade Balance (\$m)	-518	-808	-947	-572	-774	-628	38	-316	258	..
Trade Balance (\$m annual)	-6226	-6340	-6336	-6282	-5883	-5691	-5307	-4798	-4413	..
ANZ World Commodity Price Index (% mom)	6.3	4.6	1.4	0.4	1.8	0.8	0.0	-1.4	0.9	..
ANZ World Commodity Price Index (% yoy)	29.8	35.1	36.3	35.7	37.8	35.9	30.9	27.4	26.7	..
Net Migration (sa)	610	460	720	650	250	470	20	70	170	..
Net Migration (annual)	10078	8966	8730	8309	7517	6588	5491	4799	4643	..

Figures in bold are forecasts. mom: Month-on-Month qoq: Quarter-on-Quarter yoy: Year-on-Year

SUMMARY OF KEY MARKET FORECASTS

NZ FX rates	Actual		Current	Forecast (end month)						
	Jan-08	Feb-08	31-Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
NZD/USD	0.772	0.797	0.796	0.780	0.740	0.690	0.660	0.640	0.630	0.620
NZD/AUD	0.876	0.873	0.868	0.830	0.804	0.767	0.759	0.762	0.778	0.795
NZD/EUR	0.524	0.540	0.503	0.506	0.490	0.469	0.465	0.464	0.474	0.488
NZD/JPY	83.2	85.5	78.7	79.6	74.0	70.4	69.3	69.1	69.3	70.1
NZD/GBP	0.392	0.406	0.398	0.390	0.379	0.359	0.349	0.344	0.342	0.341
NZ\$ TWI	71.2	73.0	70.5	69.6	66.6	63.0	61.6	60.9	61.2	61.7
NZ interest rates	Jan-08	Feb-08	31-Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
OCR	8.38	8.40	8.25	8.25	8.00	7.50	7.00	6.75	6.75	6.75
90 day bill	8.75	8.82	8.90	8.80	8.20	7.60	7.00	7.00	7.00	7.00
10 year bond	6.28	6.40	6.42	6.50	6.20	5.80	5.40	5.30	5.30	5.20
International	Jan-08	Feb-08	31-Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
US Fed funds	3.00	3.00	2.25	1.75	1.50	1.50	1.50	1.50	2.00	2.50
US 3-mth	3.11	3.06	2.70	2.00	1.75	1.75	1.75	2.00	2.50	3.00
AU cash	6.75	7.00	7.25	7.25	7.25	7.25	7.25	7.25	6.75	6.00
AU 3-mth	7.35	7.99	7.85	8.00	7.90	7.60	7.40	7.10	6.60	5.80

KEY RATES

	28 Feb	24 Mar	25 Mar	26 Mar	27 Mar	28 Mar
Official Cash Rate	8.25	n/a	8.25	8.25	8.25	8.25
90 day bank bill	8.84	n/a	9.06	8.96	8.98	9.04
NZGB 07/09	7.40	n/a	6.95	6.91	6.86	6.88
NZGB 11/11	7.11	n/a	6.59	6.56	6.51	6.53
NZGB 04/13	6.97	n/a	6.58	6.55	6.49	6.50
NZGB 12/17	6.45	n/a	6.48	6.45	6.38	6.39
2 year swap	8.47	n/a	8.24	8.20	8.22	8.25
5 year swap	8.06	n/a	7.83	7.80	7.80	7.83
RBNZ TWI	73.6	n/a	71.6	71.5	71.2	71.3
NZD/USD	0.8157	n/a	0.8018	0.8036	0.8038	0.8043
NZD/AUD	0.8646	n/a	0.8802	0.8774	0.8742	0.8740
NZD/JPY	86.74	n/a	80.48	80.28	79.36	80.14
NZD/GBP	0.4111	n/a	0.4027	0.4010	0.4009	0.4005
NZD/EUR	0.5399	n/a	0.5159	0.5140	0.5085	0.5093
AUD/USD	0.9434	n/a	0.9109	0.9159	0.9195	0.9202
EUR/USD	1.5107	n/a	1.5542	1.5633	1.5807	1.5791
USD/JPY	106.34	n/a	100.38	99.90	98.73	99.64
GBP/USD	1.9840	n/a	1.9911	2.0042	2.0051	2.0083
Oil	99.59	n/a	101.70	101.78	105.83	107.56
Gold	956.60	n/a	925.10	940.80	953.10	944.20
Electricity (Haywards)	18.86	12.04	17.50	18.57	19.88	18.66
Milk futures (US\$/contract)	130	130	130	130	130	130
Baltic Dry Freight Index	7332	n/a	7619	7679	7884	8069

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