Market Focus
New Zealand

DATE 18 December 2006

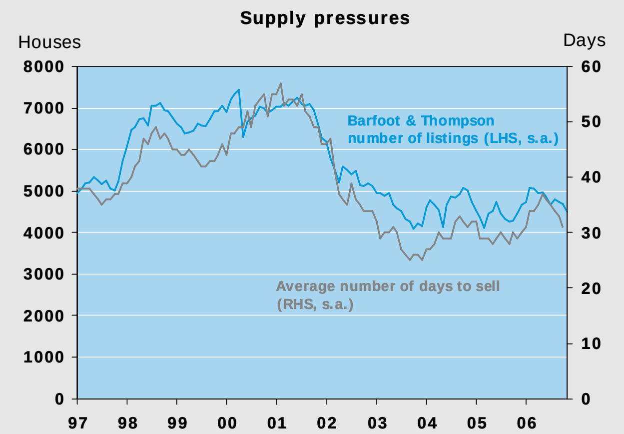
# A BIG WEEK

## CONTENTS



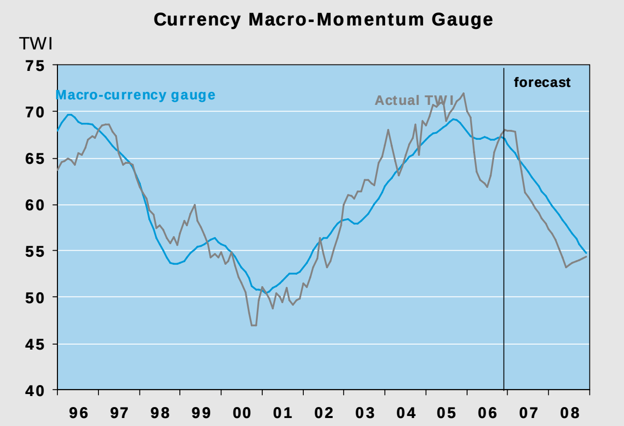
**Note: This is the final *Market Focus* for 2006. Look for the first issue of 2007 on Monday 15 January. We would like to wish our readers a happy and safe Christmas and New Year.**

### Fewer houses available for sale



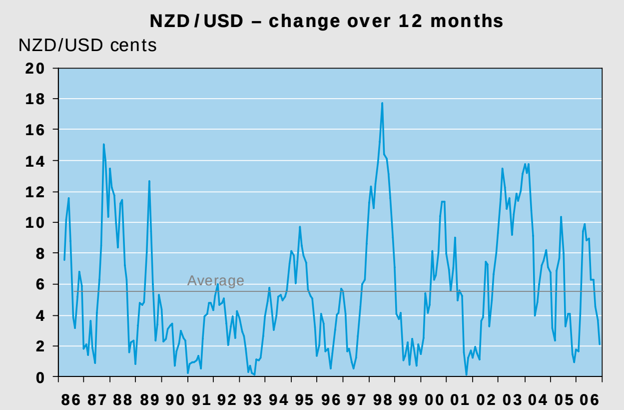
Sources: ANZ National Bank, Barfoot & Thompson, REINZ

### Short-term support for the NZD



Sources: ANZ National Bank, Reuters

### But when the NZD goes, it will go fast



Sources: ANZ National Bank, Reuters

# ECONOMIC OVERVIEW

**Retail spending looks to be showing renewed strength heading into the festive season. A rejuvenated consumer is the last thing the Reserve Bank wants, particularly in tandem with renewed momentum in the housing market. The door to a rate hike in January has opened wider.**

## Our core macro view…

We continue to expect a protracted period of subdued growth over the coming 2 years, as the economy switches from being consumer driven while the export sector takes time to take over the mantle of growth. Speculation of reflation within the economy still looks premature to us given the sizeable imbalances including inflation and a high current account deficit that have built up during the expansion phase.

| **Core projections** *(December quarter)* | 2006 | 2007 |
|---|---|---|
| Real GDP (ann. ave. % chg.) | 1.9 | 1.4 |
| Current Account (% of GDP) | -9.8 | -9.8 |
| CPI Inflation (%) | 3.0 | 3.2 |
| Official Cash Rate (%) | 7.25 | 7.00 |

## Recent developments…

- **NZ Terms of Trade.** The terms of trade fell 1.9 percent in the September quarter. Higher commodity prices were not sufficient to offset the rising NZD. Export volumes showed surprising strength across the board, while import volumes excluding fuel posted a modest 0.3 percent increase.
- **NZ Food Prices.** Food prices rose 0.1 percent in November, driven by a 0.6 percent increase in grocery prices. Compared to a year ago, food prices are 3.8 percent higher.
- **NZ Retail Sales.** Total retail sales increased 0.3 percent in October, while core sales increased 0.2 percent. This is after growth in September of 1.1 percent and 2.3 percent for total and core sales respectively.
- **NZ Manufacturing PMI.** The Business NZ PMI index fell 1.2 points to 55.4 in November, but the manufacturing sector remains in expansion mode heading into the end of the year.
- **NZ Manufacturing Sales.** Manufacturing sales in real terms were up 1.6 percent. However, most of the sales came from inventories, with production down.
- **US CPI.** Both headline and core CPI were unchanged in November.

## Assessment

Data released over the past week continued the picture of reflation and economic resilience. With the Reserve Bank explicitly putting a hike on the table in their December *Monetary Policy Statement* via a higher 90-day track – which implicitly means the data will need to be weaker for a hike to be averted – why are we not thinking the same and calling a hike?

While we believe the net weight of data – including the tenor of Q4 information – will justify a move in January, there are four areas that leave us wary.

- **The NZD.** If we get the traditional Christmas surge, and a break of NZD/USD 0.6950, the topside will be open. From a presentation perspective, hiking when the NZD/USD is above 0.70 would prove difficult.
- **The Reserve Bank's 0.7 percent forecast for Q3 GDP is looking high**.
- **One or two?** Hiking merely once is unlikely to dent economic prospects. If the Reserve Bank goes again in January, the implication is that a further follow up move will be required. Successive moves at this juncture represent a large late tightening cycle, and the economic consequences will be significant in terms of output foregone. This suggests the hurdle rate to a hike is still high.
- **The global environment remains uncertain.**

Moreover, January's decision may come down to playing the man versus the ball. We begrudgingly called a hike at the October *Review* when we saw early signs of the data turning, but the Reserve Bank failed to deliver. Given this, the tenor of the December *Statement* left us rather bemused.

This leaves us sitting on the fence at this stage – an uncomfortable position considering our typically forthright views. If pushed, our bias is towards hike(s) as a late cycle insurance policy with the housing market too buoyant to ignore, but we need a firm trigger to jump off the fence. From a pure presentation perspective we continue to believe a rising annual trajectory for non-tradable inflation – and a print above the Reserve Bank's 1.0 percent estimate for the December quarter, resulting in a rising annual rate – might well be the final confirmation that medium-term inflation pressure is rising and may prove to be just too hard to ignore.

## The week ahead…

- A big week ahead. National Bank Business Outlook due at 0100NZDT on Tuesday 19 December.
- November external migration due at 1045NZDT on Tuesday 19 December. Another 1000+ net gain expected in the month, taking the annual over 13k.
- Treasury's *Half Year Economic and Fiscal Update* (*HYEFU*) at midday Tuesday 19 December to show upward revisions in the Government's growth and tax forecasts. Bond tender programme will be largely unchanged.
- Balance of Payments (1045NZDT on Wednesday 20 December) and GDP (1045NZDT on Thursday 21 December) to close off the year. We expect an annual current account deficit of 9.5 percent of GDP and 0.5 percent growth for Q3 GDP (see page 5).

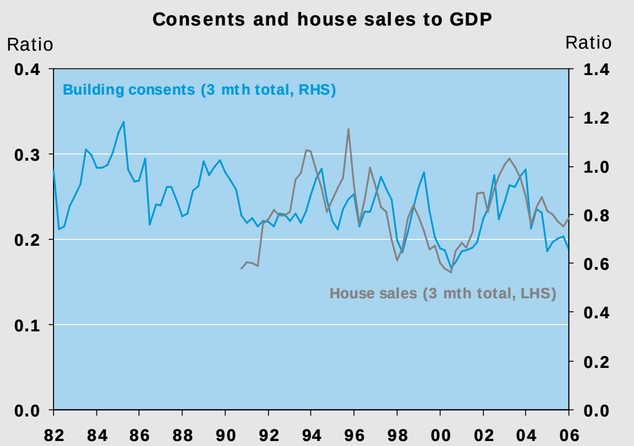
# WHERE HAVE ALL THE HOUSES GONE?

**Renewed vigour in the housing market looks to be partly a supply phenomenon, which implies no quick fix to tightness in the market.**

Despite the Reserve Bank's best efforts, activity in the housing market remains resilient. Annual house price growth remains close to 10 percent and the average number of days to sell a house is well below the historical average. This renewed strength is a concern to the Reserve Bank due to the implications for non-tradable inflation, which remains stubbornly high. At their December *Monetary Policy Statement*, the Reserve Bank stated that this "*new momentum*" in the housing market is one of the reasons why they are more concerned about medium-term inflation prospects. We are left asking ourselves where this renewed strength has come from and why does the current housing cycle appear to be more prolonged than previous cycles.

When commentators focus on the housing market, attention is typically directed at the demand side of the equation. That is, the focus is on migration, affordability, disposable incomes etc. Little analysis or commentary is provided on the supply of housing and we believe this is just as, if not more, important when analysing recent developments.

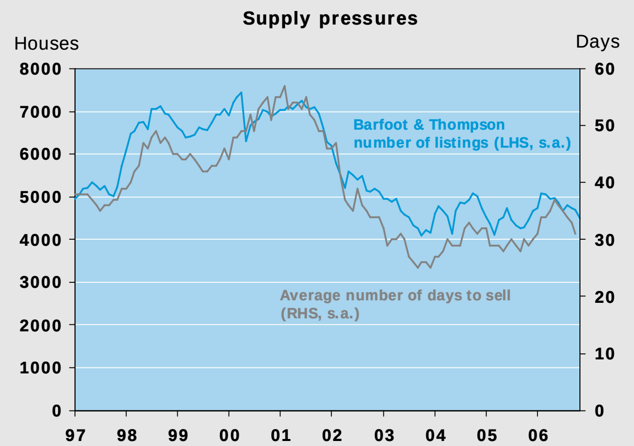
In the long-run, the supply of housing (or the real housing stock) grows at the same rate as a country's real potential GDP, i.e. the growth rate of working age population plus productivity growth (with an assumption for depreciation). We can proxy this by the ratio of residential investment to GDP, dwelling consents to GDP, or house sales to GDP.



Sources: ANZ National Bank, Statistics NZ, REINZ

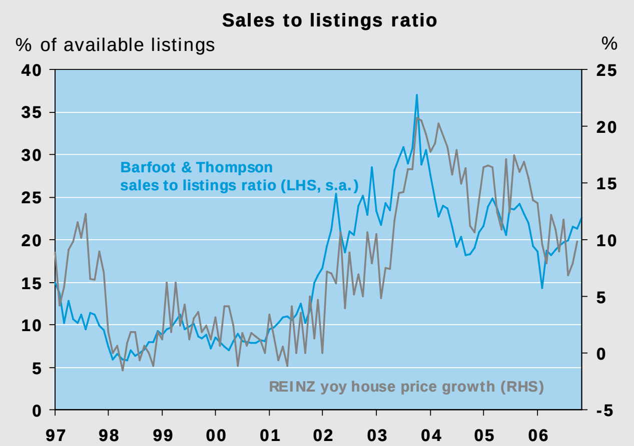
What is interesting about all these ratios is they show that housing activity has slowed to levels consistent with previous cycles. Yet inflationary pressure is not easing and the market remains hot. This suggests to us that the resilience in housing market activity is not strictly an excess demand phenomenon, which some commentators would have us believe, but supply limitations are playing a critical role in keeping activity at high levels.

Moreover, when we look at supply pressure, it is clear that limited supply is a key influence on average days to sell and therefore is likely to be a significant contributor to why house price growth has remained at elevated levels for some time, particularly when we look back to previous cycles.



Sources: ANZ National Bank, Barfoot & Thompson, REINZ

This relationship suggests a culmination of underinvestment over a decade may be partly responsible for the current tightness we see in the market.



Sources: ANZ National Bank, Barfoot & Thompson, REINZ

**But why might this be the case?** The possibility of underinvestment in housing suggests to us that there are constraints in the ability of supply to respond to relative price movements and increasing demand. Some of these constraints may include:

- **Land use restrictions.** There are vast amounts of anecdotal evidence to suggest the Resource Management Act is not working as it should. The time and effort involved in the consent process can often make it too costly to begin the process in the first place and therefore new subdivisions that are required are often delayed or never started.

- **Lack of skilled labour, particularly tradesmen.** The reduction in the number of apprenticeships during the 1990s may now be having impacts that were not thought of at the time. That is, the significant constraints facing the construction sector today could be a result of the lack of new skilled workers coming through the ranks over the past decade.

- **Local council zoning issues** also place constraints on the responsiveness of housing supply. The level of bureaucracy extends further than the central government. Local government also places significant compliance costs on developers that can make planning for new construction a lengthy process.

## The upshot

**So what do we take from this?**

- **There is likely to be no quick fix to excesses** within the housing market given that the supply of the housing stock looks constrained and is a factor driving the market at present.

- **The market is responding.** The trend measure of building consents and supply have been rising now for 6 months. But given a typical project lag of 6 to 12 months, the supply response is slow, and any supply response will also add to resource pressure in the near-term.

- **The Reserve Bank may have to work harder** and hit the demand side more. With the November REINZ housing report showing a further acceleration, this looks to be where the risk profile resides.

## CURRENT ACCOUNT – SEPT QTR (due Wednesday 20 Dec 10:45am)

| | ANZ National | RBNZ | Market |
|---|---|---|---|
| Quarter | **-$5,222m** | - | -$5,071m |
| Annual | **-$15,074m** | - | -$14,844m |
| As % of GDP | **-9.5%** | -9.5% | -9.5% |

### Key points

- **Annual current account deficit as a percentage of GDP to show improvement, but absolute number still a shocker.**
- **Net investment income deficit to again dominate.**
- **Given high NZD and renewed strength in consumer spending, current account deficit could yet deteriorate in coming quarters.**

**Current account deficit still a monster and unsustainable.** Although the annual current account deficit is expected to show an improvement from the previous quarter's monster 9.7 percent of GDP, it is still far from what is sustainable. But financial markets and credit rating agencies will once again tolerate such largesse, particularly when the Government is running one of the strongest sets of fiscal accounts in the developed world.

**High NZD to delay prospects for export recovery.** The surge in export volumes seen over the past two quarters looks to have come out of inventories, and with manufacturing production in contraction mode, export growth over the coming quarters may be a challenge. The NZD is also hurting the services balance, encouraging NZers to go on overseas holidays and reducing the purchasing power of tourists here.

**Profits accruing to foreign owners to remain elevated,** and see the annual investment income deficit hit another record high at 7.9 percent of GDP.

**We think it is too soon to call an end to the deficit peak.** The missing ingredient for a sustained improvement is a materially lower NZD, which is looking unlikely in the near-term.

### Market Implications

While a larger than expected deficit will see the NZD pull back, the moves are expected to be limited as the market awaits the Q3 GDP data. Looking ahead, it is difficult to envisage a material improvement in the current account deficit given the strength in the NZD, and renewed momentum in consumer spending and the housing market. Ultimately, a period of NZD weakness is needed to purge the external imbalance. Either that or consumers voluntarily shutting their wallets and saving more. We think the former is a more likely scenario.

## GDP –SEPT QTR (due Thursday 21 Dec 10:45am)

| | ANZ National | RBNZ | Market |
|---|---|---|---|
| GDP | **0.5% qoq**<br>**1.7% apc**<br>**1.7% aapc** | 0.7% qoq<br>1.9% apc<br>1.8% aapc | 0.6% qoq<br>1.8% apc<br>1.7% aapc |

### Key points

- **We expect Q3 GDP growth of 0.5 percent, below the market and RBNZ's estimates.**
- **Composition to show household spending remaining strong.**
- **Export growth sourced from inventory rundown, suggesting stocks will add impetus to next quarter's growth.**
- **Partials relating to Q4 suggest ongoing momentum in domestic demand, not what the Reserve Bank wants to see.**

**Headline GDP growth is expected to print 0.5 percent for Q3, similar to Q2's pace.** On the production side, all the growth is expected to come from the services sector, with the goods industries shrinking, led by a decline in manufacturing production. Despite reasonable manufacturing sales data, most of it was met from inventories. Retail and the finance and business services sectors are expected to show good growth. On the expenditure side, private consumption and residential investment will rebound from the previous quarter's weakness. Net exports will again make a positive contribution to growth, but business investment and possibly inventories will act as drags.

**Though this is weaker than what the Reserve Bank is expecting, they won't be heading into their Christmas break resting easy.** The composition to GDP is expected to keep the Reserve Bank on edge. Household spending will print solid, an inventory run-down in some sectors such as manufacturing is indicative of capacity constraints (which is consistent with high levels of capacity utilisation), and production could be expected to ramp up going forward. Certainly with domestic demand indicators such as October retail sales printing higher than expected and strong housing market data in November confirming the start of a third wind, a slightly softer Q3 needs to be balanced against firming momentum in Q4.

### Market Implications

**A weaker than expected GDP result has the potential to cap some of the potential upside risk for the NZD** over the liquidity sparse Christmas period. However, in a cruel twist, less upside in the NZD over the coming month keeps the potential for a January hike on the table. The net message in this environment looks set to remain one of the NZD remaining elevated, testing ranges, and being hostage to offshore direction.

# INTEREST RATE STRATEGY

**Domestically the market remains attuned to prospects for a further hike form the RBNZ, with the housing market in particular still going gangbusters. GDP this weak looks unlikely to be the nail in the coffin although the market will remain wary until the December quarter CPI report.**

## Market themes…

- Markets move to almost fully price a hike from the Reserve Bank.
- 2-year IRS remains under pressure from the pay side but at these levels we are seeing good 2-way flow.
- Offshore directional leads remain mixed with the Fed still warning of inflation risks but the tenor data proving to be a mixed bag, and a weak core CPI an eye-opener.

## Outlook…

Will they or won't they? The market remains divided over prospects for a further move from the Reserve Bank. The tenor of domestic data is certainly giving no respite with another monster housing report just showing too much resilience and potential pipeline inflation pressure.

The market has almost fully priced in a 25 basis point hike by the end of March (22 points priced in). While this is where the risk profile resides, the 2 year IRS looks to have some value up around 7.55, particular with a softer looking GDP result expected to print later in the week. We expect a 7.45-7.55 range to now pan out but would shift back to a payer bias on any move back towards the lower bound. Ranges look set to remain the order of the day until we either get firm direction from offshore, or some consistency in the tenor of domestic data. Moreover, some of the older heads around keep harping back to the massive U-turn in Fed policy in early 2000 and with the US core CPI printing soft for November this is an non-trivial risk. Markets just look too choppy at present to have something major on the table over Christmas.

In terms of the bonds there look to be only two positions to have at present: short or square. NZ bonds are now trading exceptionally tight to their Australian equivalents and EFP's feel just too wide. We remain very wary a currency related batch of selling at some stage, particularly if we see a squeeze up over Christmas.

### Gauges for NZ interest rates yields

| Gauge | Direction | Comment |
|---|---|---|
| RBNZ | ↑ | RB's projected 90-day tack is higher than the market at present |
| NZ data | ↔ | Domestic data continues to print strong but already factored at these levels |
| Fed Funds | ↔ | Data is just not consistent. |
| RBA | ↔ | On hold with a tightening bias. |
| US 10 year | ↔ | Technicals and data points to higher yields. |
| NZ swap spreads | ↓ | Risks point wider with offshore demand for bonds. |
| Flow | ↔ | Mortgage pressures limit rallies - but slowing and good receiving. |
| Technicals | ↔ | Tight ranges limiting technical picture. |

### Borrowing strategies we recommend at present

The swap curve sold off throughout the week as growth in domestic activity continued to outpace expectations. Yields are up around 6 basis points across the curve as the market now prices in a 60% chance of a January rate hike. The housing data released last week will not provide the RBNZ any room for comfort, with monthly average house prices and the number of sales on the rise again. The negative yield curve continues to dictate borrowers' preferences and our view remains unchanged with the 3-5 year part of the curve presenting best value. Given the current situation and risks of higher rates, borrowers that have not already done so should consider a suitable interest rate, with some form of optionality providing flexibility in the latter years.

### Trading themes we favour at present

We continue to like the 2/5/10 year swap fly. We also recommend receiving the 7 and 10 year swap and selling bonds +102bps, targeting +85bps.

# CURRENCY STRATEGY

**We remain comfortable calling the same story: the NZD continues to struggle to sustain new highs and will stay captive to USD direction. With the market now attuned to a potential hike from the RBNZ, downside probing looks limited.**

## Market themes…

- US data provides some support to US dollar.
- Domestic flavour back driving the NZ dollar.
- Eyes on the look out for the next hike from Reserve Bank of New Zealand.
- Carry trade in vogue for Christmas.

## Outlook…

The past week can be characterised as one that saw large movements in currencies but little net change.

Yield was once again the dominant directional gauge. The US Federal Reserve left interest rates unchanged and softened the tone of the statement accompanying their announcement. Nevertheless, the ongoing focus remains on medium term inflation and growth prospects, and they maintained a tightening bias. Retail spending data and mortgage lending statistics in the US emphasise that the US economy is not a basket case, and while CPI inflation data was softer than expected, it is likely that the Fed will remain on hold for some time. The US dollar index continues to grind higher from its early December lows, and, at least from a technical perspective, looks like it will see some further advances, particularly against the euro. Speculative positioning against the US dollar remains intense, but has eased back from highs recorded earlier this month. The net short US dollar position eased to US$20.6 billion in the week ended 12 December, down from US$24.3 billion the previous week.

Against the backdrop of a (generally) stronger US dollar, the NZ dollar has continued to outperform. Resilience in domestic economic activity was confirmed, with data showing stronger than expected retail spending in October, and a resilient housing market, released towards the end of the week. The currency market is building up a head of steam in anticipation of the Reserve Bank having to deliver an interest rate hike in January. The composition of December quarter CPI data (released on 17 January) will be key in this regard. September quarter Balance of Payments and GDP data will be released this week, and while neither is expected to provide the smoking gun to push the NZ dollar out of its recent 0.6750 – 0.6950 range, anticipation of a strong non-tradable inflation rate, along with diminished liquidity over the Christmas/New Year holiday period, has the potential to see the NZ dollar continue to outperform.

The carry trade still appears to still be alive and well, providing further ongoing support to the NZ dollar and other carry-trade currencies, such as the South African rand. The Bank of Japan is meeting to set interest rates this week, and they are widely expected to leave rates unchanged at 0.25 percent. Japanese Tankan data, released on Friday, was only fractionally above expectations and has done little to alter interest rate expectations. The EUR/JPY had a key reversal day on Friday, falling from 155.55 to 153.80.

**NZD vs AUD: monthly directional gauges**

| Gauge | Direction | Comment |
|---|---|---|
| Fair value | ↓ | Fair value 0.85-0.88. |
| Yield | ↔ | Yield differential of 75 bps seems fully priced in to us. |
| Commodities | ↓ | Stabilised of late but NZ's oil dependence makes it a drag. |
| Partial indicators | ↔ | NZ domestic economy remains resilient, but Aus looks better given massive jobs growth. |
| Technicals | ↔ | Overbought. Should see major resistance at 0.8900 cap again. |
| Sentiment | ↔ | No mans land. |
| Other | ↑ | Liquidity still plentiful. AUD positioning looks extreme. |
| **On balance** | ↔ | **Hard to bet against the NZD when the RBNZ opens the door.** |

**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 | ↔ | RBNZ supportive but US curve too inverted to us. |
| Commodities | ↔ | CRB higher but oil a net growth drag to NZ. |
| Risk aversion | ↑ | Low. |
| Partial indicators | ↔ | Both economies have similar imbalances. |
| Technicals | ↔ | NZD trying to break higher. 0.6950 key. |
| AUD | ↔ | Just keep prodding but not progressing. |
| Sentiment | ↔ | Are we back to chasing the tallest pygmy? |
| Other | ↔ | Are we back to chasing the tallest pygmy? |
| **On balance** | ↔ | **NZD hostage to wider USD direction, but breaking higher on crosses.** |

# FORECAST UPDATE

**Economic resilience and the signals flagged by our currency macro-momentum gauge have necessitated some changes to our core currency view. We expect a bid to be maintained into the new-year but a sharp shift lower in mid-2007, and a second leg of weakness in 2008.**

Groundhog day strikes again with yet another upward revision to our currency forecasts. While the broad spirit of our currency forecasts remains unchanged, prospects for an additional hike from the Reserve Bank, economic resilience, inversion in the US yield curve and the signals flagged by our currency macro-momentum gauge (see *Market Focus*, 11 December) are powerful supportive forces for the NZ dollar in the near-term.

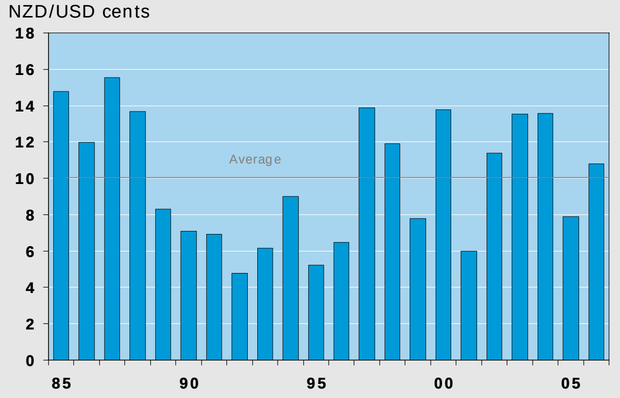
Near-term prospects heading into the liquidity sparse Christmas period appear tilted towards the upside given USD weakness and prospects for a rate hike from the RBNZ. While a hike from the Reserve Bank is not currently our central scenario, any upside surprise in GDP or the CPI, could be the catalyst that pushes the RBNZ over the rate-hike threshold. We are particularly wary of the prospects for a re-acceleration in non-tradables inflation, in light of ongoing activity within the construction sector, and pipeline pressures from that sector emerging in Producer Prices data.

Tactically we remain very wary of how far the topside could probe. A break of 0.6950 opens the door to 0.70-0.71. Domestically, GDP looks to hold the key. While we have a below-consensus 0.5 percent pick, which should contain topside momentum, global forces are expected to have a huge say over the coming six weeks.

Beyond that we remain comfortable calling an aggressive move down around mid-year with the majority of this move likely to occur over a 2 month period.

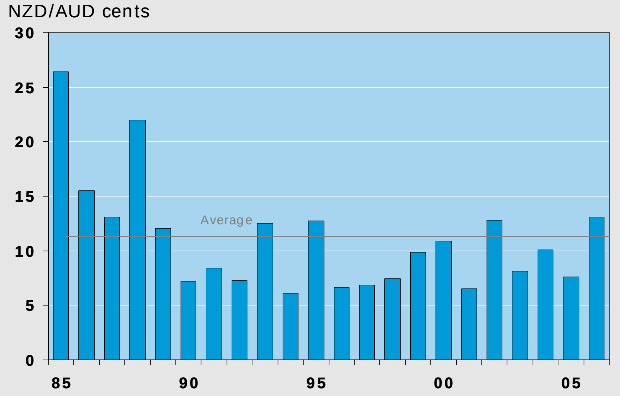
- History is supportive, and we only need to cast our mind back to the 7 cent moves in the NZD/USD and NZD/AUD between December 31st 2005 and March 31st 2006 to appreciate how quickly sentiment can turn. It is a small exit door when those long the NZD are all running for it! The absolute average hi-low move in the NZD/USD and NZD/AUD over a calendar year is 10 cents. The simple average move over a rolling 12 months is around 5 cents for the NZD/USD, with a standard deviation of 5 cents.

**Range in NZD/USD over calendar year**



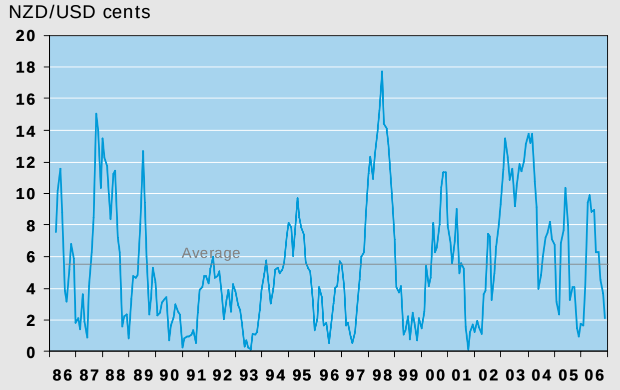

Sources: ANZ National Bank, Reuters

**Range in NZD/AUD over calendar year**

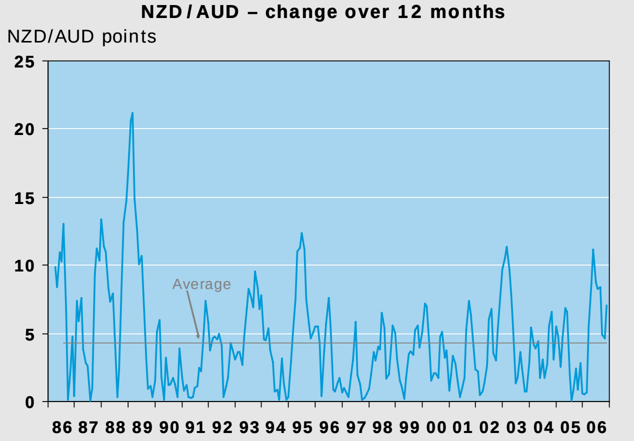



Sources: ANZ National Bank, Reuters

**NZD/USD – change over 12 months**




Sources: ANZ National Bank, Reuters



Sources: ANZ National Bank, Reuters

- Market positioning looks extreme with a net US$20.6 billion short the USD. At the same time the market is long the NZD by NZ$1.7 billion and long the AUD by A$8.1 billion. While such positioning could certainly dissipate over the coming months, we take the positioning itself as a signal as to how quickly the market could turn.

- The NZ economy tends to turn aggressively when financial conditions tighten sharply. Ironically, one last squeeze up in the NZD and hike(s) from the RBNZ may be the bitter medicine required to foster a sharp move lower in the growth-sensitive NZD. Business confidence will be a key gauge to watch in the new-year.

- The NZD has been heavily influenced by movements in the US 2-year Treasury note and we remain relatively more hawkish towards prospects for the Fed. Especially given New Zealand's experience where the housing market simply does not weaken the domestic economy sufficiently to dampen inflation pressures when liquidity is ample, and the unemployment rate is low.

- The Uridashi maturity profile heats up from Q3 with the speculative market likely to pre-empt, and a movement in the NZ-Aus 2 year swap differential below 90 basis points to accelerate switching out of NZ dollar assets into Australian dollar assets.

- Sentiment towards the cash and carry trade remains precarious.

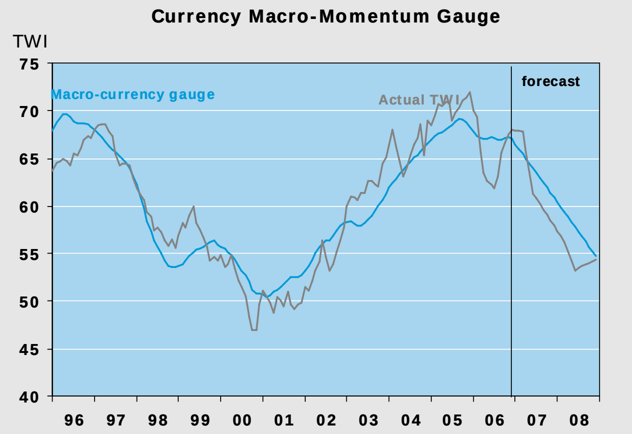
- Offshore bond holdings remain at near record levels, with 64 percent of NZ Government bonds and Treasury bills held by offshore investors.

While we are certainly coy over the timing of the turning point in the currency, these factors nonetheless still suggest the turning point, when it comes, will be aggressive. Our bias is tilted towards April and May, largely on our suspicion that the recent run of economic strength will peter out in the new-year.

Strategically we continue to look for a period of sustained currency weakness in 2008, or in effect a second drive lower with the trend in the currency over the period effectively mirroring sub-par (trend) economic performance. As noted in our *Market Focus* last week, economic growth puddling around 1.5 to 2 percent over 2008 – the sustained period of weakness the RBNZ is seeking – tilts our currency macro-momentum gauge downwards, to levels consistent with NZ$ TWI in the 55-60 range. The modifications we have made to our currency track, in effect, bring our forecasts closer to the trajectory flagged by this indicator.

It is clear that growth holds the key, judging from the aggressive movement in the NZD in the early part of the year in response to weak economic data, the way the USD has behaved of late, the yield growth inflection point the NZD hit in 2000, and the relationship between the NZD/USD and relative growth.

Unless the laws of economics have been repealed, or New Zealand's productivity growth is set to triple over the coming year, 2-3 percent growth just looks incompatible with the inflationary and current account imbalances that have built up. One of the paths of least resistance to purging such imbalances will inevitably be a fall in the currency.



Sources: ANZ National Bank, Reuters

# DATA AND EVENT CALENDAR

| Date | Country | Data/Event | Mkt. | Last | Time (NZDT) |
|---|---|---|---|---|---|
| 18 Dec | JP | Nationwide Department Store Sales (Nov) | na | -1.90% | 18:30 |
| **19 Dec** | **NZ** | **NBNZ Business Confidence (Dec)** | **na** | **-14** | **01:00** |
| | | **Visitor Arrivals (Nov)** | **na** | **1.50%** | **10:45** |
| | | **NZ Treasury's Half Year Economic and Fiscal Update** | **na** | **na** | **12:00** |
| 19 Dec | US | Current Account (Q3) | -$225.0b | -$218.4b | 02:30 |
| | | NAHB Housing Market Index (Dec) | 34 | 33 | 07:00 |
| | CA | Leading Indicators (Nov) | 0.30% | 0.20% | 02:30 |
| | JP | BoJ releases monthly report | - | - | 19:00 |
| | GE | PPI (Nov) – mom | 0.10% | 0.30% | 20:00 |
| | | PPI (Nov) – yoy | 4.80% | 4.60% | 20:00 |
| | | IFO Business Climate Survey (Dec) | 106.7 | 106.8 | 22:00 |
| | UK | RICS House Price Balance (Nov) | 45% | 48% | 13:30 |
| **20 Dec** | **NZ** | **WBC Consumer Confidence (Q4)** | **na** | **111.7** | **01:00** |
| | | **Current Account Balance (Q3)** | **-$5.1b** | **-$3.1b** | **10.45** |
| | JP | BoJ policy rate announcement | 0.25% | 0.25% | 02:30 |
| | US | PPI (Nov) – mom | 0.60% | -1.60% | 02:30 |
| | | - core PPI | 0.20% | -0.90% | 02:30 |
| | | PPI (Nov) – yoy | na | -1.60% | 02:30 |
| | | - core PPI | na | 0.60% | 02:30 |
| | | Housing Starts (Nov) | 1520k | 1486k | 02:30 |
| | | - Building Permits | 1530k | 1553k | 07:00 |
| | | Fed President Fisher speaks on the Economy in Texas | - | - | 01:00 |
| | CA | CPI (Nov) – mom | 0.30% | -0.20% | 01:00 |
| | | - core CPI | 0.20% | 0.10% | 01:00 |
| | | CPI (Nov) – yoy | 1.50% | 0.90% | 01:00 |
| | | - core CPI | 2.10% | 2.30% | 13:00 |
| | AU | DEWR Skilled Vacancies (Dec) | na | -0.10% | 21:00 |
| | EU | ECB's Trichet speaks to EU Parliament's Economic Committee | - | - | 22:30 |
| | UK | BoE releases minutes from the 7 Dec policy meeting | - | - | 22:30 |
| | | Business Investment (Q3 F) | 3.10% | 3.10% | 22:30 |
| | | CPI Distributive Trades Survey (Dec) | - | - | 00:00 |
| **21 Dec** | **NZ** | **GDP (Q3) – qoq** | **na** | **0.50%** | **10:45** |
| | AU | WBC Leading Index (Oct) | na | 0.40% | 01:00 |
| | | RBA Bulletin (Dec) | - | - | 22:30 |
| | US | Mortgage Applications (week ended 15 Dec) | na | 11.40% | 02:30 |
| | CA | Wholesale Sales (Oct) | na | -1.60% | 13:30 |
| | UK | GDP (Q3 F) – qoq | 0.70% | 0.70% | 22:30 |

Continued over page

| Date | Country | Data/Event | Mkt. | Last | Time (NZDT) |
|---|---|---|---|---|---|
| 21 Dec cont. | UK | GDP (Q3 F) – yoy | 2.7% | 2.7% | 22:30 |
| | | Current Account (Q3) | -£8.0b | -£7.0b | 22:30 |
| 22 Dec | JP | Trade Balance (Nov) | ¥575.0b | ¥610.6b | 12:50 |
| | | All Industry Activity Index (Oct) | na | -0.90% | 12:50 |
| | | Minutes released from 31 October and 15/16 November BoJ policy meetings | - | - | 18:00 |
| | | Supermarket sales (Nov) - yoy | na | -3.10% | 18:00 |
| | US | GDP (Q3 F) | 2.20% | 2.20% | 02:30 |
| | | - GDP Deflator | 1.80% | 1.80% | 02:30 |
| | | Jobless Claims (week ended 16 Dec) | 312k | 304k | 02:30 |
| | | Leading Indicators (Nov) | 0.00% | 0.20% | 04:00 |
| | | Philadelphia Fed Survey (Dec) | 4 | 5.1 | 06:00 |
| | | Fed President Lacker speaks on the economic outlook in North Carolina | - | - | 07:00 |
| | CA | GDP (Oct) | 0.10% | -0.30% | 02:30 |
| | | Retail Sales (Oct) | -0.50% | -1.20% | 02:30 |
| | | - ex autos | -0.20% | -0.90% | 02:30 |
| | EU | Euro-zone Current Account (Oct) | €1.0b | -€0.3b | 22:00 |
| | | Industrial New Orders (Oct) | 0.10% | -1.30% | 22:00 |

**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:** It's a big one this week. National Bank *Business Outlook*, the *HYEFU*, current account and GDP to end the year.

| Date | Data/Event | Economic Signal | Comment |
|---|---|---|---|
| Tue 19 Dec (01:00) | National Bank *Business Outlook* (Dec) | - | - |
| Tue 19 Dec (10:45) | External migration (Nov) | Steady | Another 1,000+ increase in net migration inflow keeping the annual total well above 13k. |
| Tue 19 Dec (12:00) | Treasury's 2006 *Half-year Economic and Fiscal Update* | Upward revision | Treasury's economic and tax forecasts to be revised up over the near-term. Government to signal it is largely sticking to its Budget allocation for next year. |
| Wed 20 Dec (10:45) | Balance of Payments (Sep qtr) | Slight improvement | Current account deficit to show a slight improvement to 9½ percent of GDP but recent trade data suggests it might deteriorate in Q4. Any substantial improvement is a long way away. |
| Circa Wed 20 Dec | Westpac McDermott Miller Consumer Confidence (Dec qtr) | On the up | Everyone who wants a job has a job, wage growth strong, annual house price growth still near 10 percent, and higher NZD to make imported goods cheaper. Wouldn't you feel confident? |
| Thu 21 Dec (10:45) | GDP (Sep qtr) | Resilient | Expect GDP growth of around ½ percent, driven by rebounds in consumption and residential investment. |
| Thu 21 Dec (15:00) | Credit card billings (Nov) | Modestly up | Billings expected to show modest increase as consumers take their credit cards for a workout in the run-up to the end of year holiday season. |
| Fri 29 Dec (13:00) | Credit growth (Nov) | Strong | Demand for credit to remain strong given renewed momentum in housing market. |
| Thu 4 Jan (10:45) | Merchandise Trade (Nov) | Still large deficit | Consumption imports to remain strong with high NZD suppressing exports. |
| Fri 12 Jan (10:45) | Building Consents (Nov) | Steady | Judging from the renewed strength in house sales, another 2k+ consents expected. |
| Tue 16 Jan (10:00) | NZIER QSBO (Mar qtr) | Up | Headline confidence and own activity to follow the National Bank *Business Outlook* lead and head up. Capacity utilisation should come off from the previous quarter's surge but stay historically high. |
| Wed 17 Jan (10:45) | CPI (Dec qtr) | Elevated | Headline to be flat, taking the annual inflation rate down but non-tradable to stay elevated. |
| Thu 25 Jan (09:00) | OCR January *Review* | No change | 50-50 call at this stage but we're sitting on the fence and expecting no change. |
| **On Balance** | | **Going beyond resilient?** | **Growth still one sided and in need of rebalancing.** |

**NZ Economics**

| | |
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## SUMMARY OF KEY MARKET FORECASTS

| | Actual | | Current | Forecast (end month) | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **NZ FX rates** | Oct 06 | Nov 06 | 18 Dec 06 | Dec 06 | Mar 07 | Jun 07 | Sep 07 | Dec 07 | Mar 08 | Jun 08 |
| NZD/USD | 0.661 | 0.669 | 0.6891 | 0.690 | 0.690 | 0.620 | 0.600 | 0.580 | 0.560 | 0.530 |
| NZD/AUD | 0.878 | 0.866 | 0.8829 | 0.885 | 0.885 | 0.816 | 0.800 | 0.795 | 0.778 | 0.736 |
| NZD/EUR | 0.524 | 0.520 | 0.5272 | 0.523 | 0.523 | 0.477 | 0.465 | 0.457 | 0.448 | 0.431 |
| NZD/JPY | 78.4 | 78.5 | 81.36 | 80.0 | 79.4 | 70.1 | 67.2 | 63.8 | 60.5 | 56.2 |
| NZD/GBP | 0.353 | 0.350 | 0.3530 | 0.356 | 0.356 | 0.323 | 0.316 | 0.307 | 0.299 | 0.285 |
| NZ$ TWI | 66.7 | 66.7 | 68.2 | 68.0 | 67.9 | 61.4 | 59.6 | 58.0 | 56.2 | 53.3 |
| **NZ interest rates** | Oct 06 | Nov 06 | 18 Dec 06 | Dec 06 | Mar 07 | Jun 07 | Sep 07 | Dec 07 | Mar 08 | Jun 08 |
| OCR | 7.25 | 7.25 | 7.25 | 7.25 | 7.25 | 7.25 | 7.25 | 7.00 | 6.50 | 6.00 |
| 90 day bill | 7.66 | 7.61 | 7.68 | 7.50 | 7.50 | 7.40 | 7.40 | 7.00 | 6.50 | 6.10 |
| 10 year bond | 5.82 | 5.72 | 5.84 | 6.00 | 6.00 | 6.00 | 6.20 | 6.10 | 6.20 | 6.40 |
| **International** | Oct 06 | Nov 06 | 18 Dec 06 | Dec 06 | Mar 07 | Jun 07 | Sep 07 | Dec 07 | Mar 08 | Jun 08 |
| US Fed funds | 5.25 | 5.25 | 5.25 | 5.25 | 5.25 | 5.25 | 5.00 | 4.50 | 4.50 | 4.50 |
| US 3-mth | 5.37 | 5.37 | 5.37 | 5.37 | 5.25 | 5.00 | 4.75 | 4.60 | 4.60 | 4.60 |
| AU cash | 6.00 | 6.25 | 6.25 | 6.25 | 6.25 | 6.25 | 6.25 | 6.25 | 6.25 | 6.25 |
| AU 3-mth | 6.38 | 6.39 | 6.40 | 6.40 | 6.40 | 6.40 | 6.40 | 6.40 | 6.40 | 6.40 |

## KEY RATES

| | 15 Nov | 11 Dec | 12 Dec | 13 Dec | 14 Dec | 15 Dec |
|---|---|---|---|---|---|---|
| Official Cash Rate | 7.25 | 7.25 | 7.25 | 7.25 | 7.25 | 7.25 |
| 30 day bank bill | 7.52 | 7.63 | 7.65 | 7.65 | 7.64 | 7.64 |
| 90 day bank bill | 7.62 | 7.64 | 7.64 | 7.64 | 7.66 | 7.66 |
| NZGB 07/09 | 6.44 | 6.48 | 6.48 | 6.46 | 6.49 | 6.48 |
| NZGB 11/11 | 6.12 | 6.21 | 6.20 | 6.19 | 6.22 | 6.23 |
| NZGB 04/13 | 5.89 | 5.97 | 5.96 | 5.95 | 5.98 | 5.99 |
| NZGB 12/17 | 5.66 | 5.75 | 5.75 | 5.73 | 5.76 | 5.77 |
| 1 year swap | 7.65 | 7.73 | 7.74 | 7.74 | 7.77 | 7.80 |
| 2 year swap | 7.41 | 7.53 | 7.52 | 7.50 | 7.55 | 7.56 |
| 5 year swap | 7.02 | 7.13 | 7.12 | 7.10 | 7.14 | 7.16 |
| RBNZ TWI | 66.1 | 67.6 | 67.7 | 67.8 | 68.3 | 68.0 |
| NZD/USD | 0.6616 | 0.6862 | 0.6895 | 0.6912 | 0.6937 | 0.6885 |
| NZD/AUD | 0.8642 | 0.8769 | 0.8782 | 0.8769 | 0.8820 | 0.8807 |
| NZD/JPY | 77.90 | 80.09 | 80.50 | 80.82 | 81.51 | 81.21 |
| NZD/GBP | 0.3491 | 0.3520 | 0.3514 | 0.3506 | 0.3527 | 0.3511 |
| NZD/EUR | 0.5164 | 0.5217 | 0.5199 | 0.5202 | 0.5252 | 0.5236 |
| AUD/USD | 0.7656 | 0.7825 | 0.7851 | 0.7882 | 0.7865 | 0.7818 |
| EUR/USD | 1.2812 | 1.3154 | 1.3263 | 1.3286 | 1.3209 | 1.3149 |
| USD/JPY | 117.75 | 116.72 | 116.75 | 116.93 | 117.50 | 117.95 |
| GBP/USD | 1.8954 | 1.9495 | 1.9619 | 1.9716 | 1.9666 | 1.9609 |
| Oil | 58.28 | 62.06 | 61.26 | 61.06 | 61.34 | 62.48 |
| Gold | 623.60 | 626.15 | 630.38 | 629.85 | 628.25 | 626.05 |
| Electricity Price Index | 4.40 | 3.38 | 3.40 | 3.38 | 3.53 | 3.73 |

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