



NEW ZEALAND ECONOMIC UPDATE

January 2007

NATIONAL ECONOMIC UPDATE

This New Zealand Economic Update is produced monthly and presents current information on recent national business events, along with an update of key economic indicators.

Headline inflation levelled off

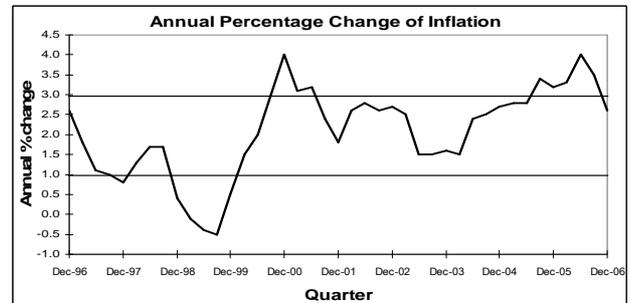
According to Statistics New Zealand (SNZ), the Consumer Price Index (CPI) decreased by 0.2% over the December 2006 quarter. This was the first decrease in the index since the June 2001 quarter. Between the December 2005 and December 2006 quarters the CPI increased by 2.6% down from an annual rate of 3.5% for the year to September 2006.

Over the December 2006 quarter there were decreases in the price level of three out of the eleven groups that make up the CPI, with the transport group contributing most to the overall decrease in the index. This was not surprising given that there was a 15.2% decrease in petrol prices over the December 2006 quarter. A decline in the price of petrol sold at New Zealand's petrol stations was driven by a fall in international crude oil prices, coupled with a strong New Zealand dollar. Newly introduced fuel discount schemes by supermarkets and petrol stations appear to have only had a small downside impact on the CPI.

Had the price of petrol remained unchanged, the CPI would have increased 0.6%. Seasonal effects pushed international airfares up by 9.7% over the December 2006 quarter, and prices of second-hand cars increased by 1.0%. These two sub-groups partly offset the overall downward movement in transport prices. The other two groups that recorded price decreases over the December quarter were communication (0.1%↓) and education (0.2%↓).

Following an increase of 1.9% over the September 2006 quarter, prices in the housing and household utilities group increased by 0.9% in the December 2006 quarter. Prices for buying a new house have increased for 31 quarters in a row. Over the December 2006 quarter new house prices increased by 1.0%. This was caused by higher construction costs, increased sub-contractors' charges, and escalating fittings prices. There were also price increases in the rental (0.7%↑), electricity (0.9%↑), and gas (4.7%↑) markets.

Prices in the recreation and culture group increased by 1.5% over the December 2006 quarter, driven by price increases in package holidays (10.5%↑) and accommodation services (3.7%↑). These increases were moderated by decreases in the prices of audio-visual (2.6%↓) and computing equipment (4.0%↓).



Source: Reserve Bank of New Zealand and Statistics New Zealand

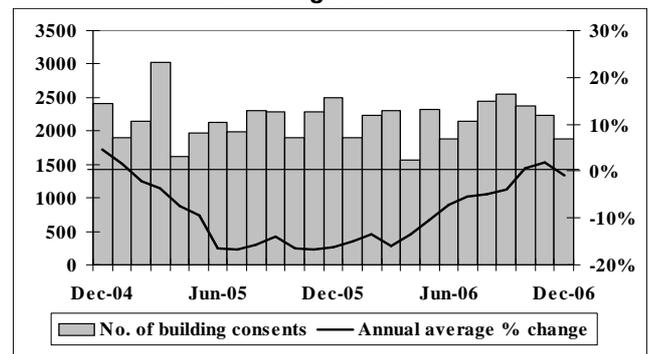
RBNZ held the OCR

In January 2007 the Reserve Bank of New Zealand held the Official Cash Rate (OCR) at 7.25% in its Official Cash Rate review. The tone of the Reserve Bank's announcement was particularly 'hawkish'. Following the review the Trade weighted Index jumped 50 basis points.

Despite the fact that GDP growth was weak in the September 2006 quarter and the CPI decreased by 0.2% over the December 2006 quarter, the RBNZ remains concerned about the resurgence of domestic demand. A continuing high level of housing market activity is particularly worrying the RBNZ. The medium term inflation outlook which is the RBNZ's main concern is projected to return to the high end of the target inflation range of 1% - 3% through 2008 and into 2009.

Key Indicator Trends

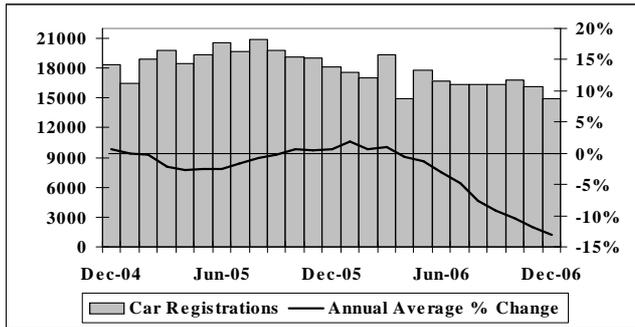
Building Consents



Source: Department of Statistics Building Surveys and Vitals Section

Due to seasonal impacts the number of new building consents issued in New Zealand decreased from 2,232 in November 2006 to 1,883 in December 2006, while there were 2,491 consents issued in December 2005. The annual average growth rate in the number of new building consents issued in New Zealand was negative 0.9% for the year ended December 2006.

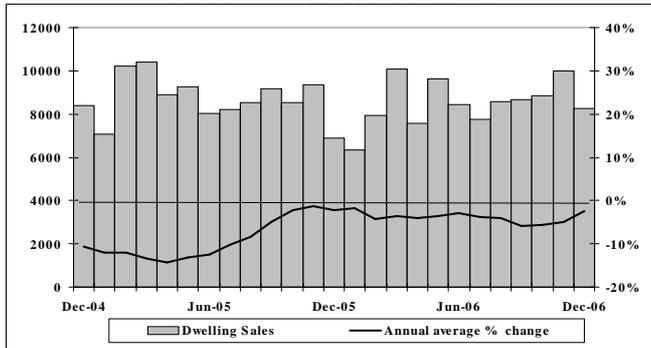
Car Registrations



Source: Land Transport Safety Authority

A downward trend has developed in the number of New Zealand car registrations. Monthly car registration numbers decreased from 16,117 in November 2006 (including both new and ex-overseas car types) to 14,916 in December 2006. This was only two car registrations greater than the lowest number recorded over the past five years in April 2006. The annual average growth rate in the number of car registrations recorded in New Zealand was negative 13.1% for the year ended December 2006.

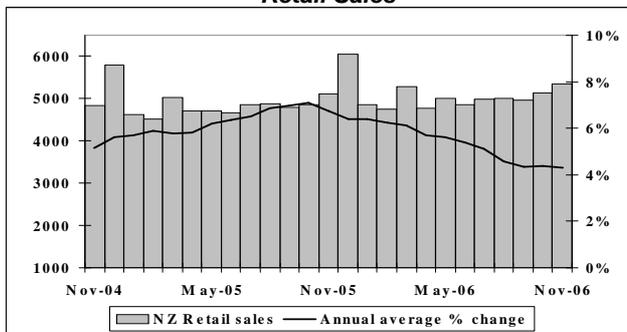
Residential Real Estate Sales



Source: Real Estate Institute of New Zealand

With only a three week trading period, housing activity normally shows a seasonal pattern in the Christmas season. Around 8,245 houses were sold in New Zealand during December 2006, less than the 9,990 houses sold in November 2006, and greater than the 6,906 houses sold in December 2005. The median sale price as at December 2006 remained at \$330,000 (the same as at November 2006). The annual average growth rate in the number of houses sold in New Zealand was negative 2.4% for the year ended December 2006.

Retail Sales

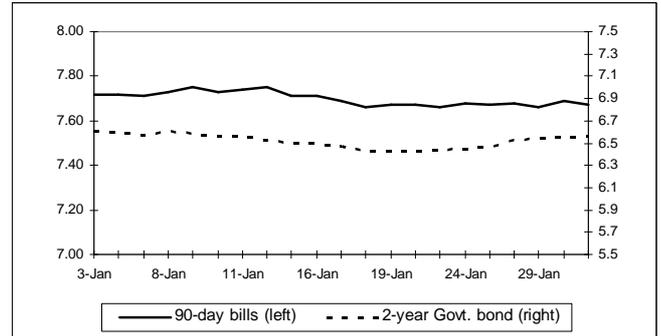


Source: Business Statistics Section, Statistics New Zealand

November 2006 saw the value of national retail sales reach \$5,340.5 million, up from \$5,145.7 million recorded in October 2006, and above the \$5,110.6 million recorded

in November 2005. The annual average growth rate in the value of New Zealand's retail sales was 4.3% for the year ended November 2006.

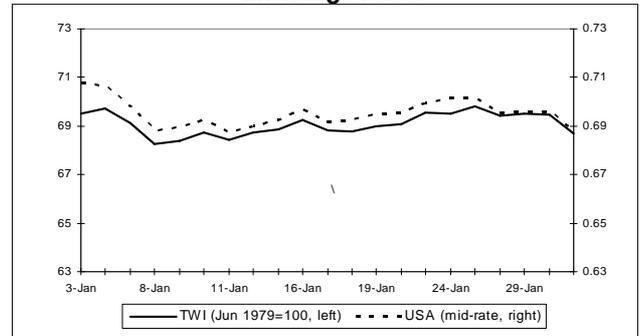
Interest Rates



Source: Reserve Bank of New Zealand

New Zealand wholesale interest rates were relatively stable during January 2007 despite the 'hawkish' statement made by the RBNZ. By the end of January 2007 the 90-day bill rate stood at 7.69%.

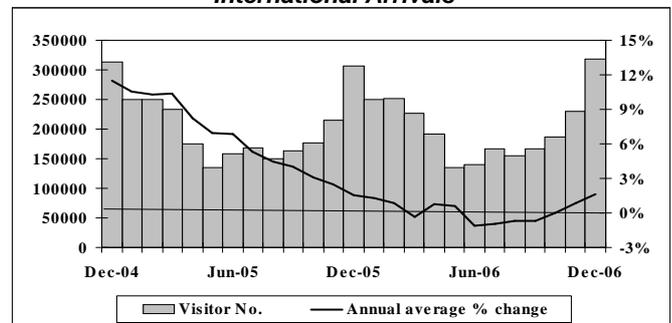
Exchange Rates



Source: Reserve Bank of New Zealand

In the first week of January 2007, New Zealand's exchange rates depreciated. However, the New Zealand currency regained some ground over the rest of the month primarily due to the RBNZ's comments on the likelihood of further monetary policy tightening. By the end of the month, NZ\$1.00 was worth US\$0.69 and the Trade-Weighted Index (TWI) stood at 68.7 points (compared with 69.6 a month earlier).

International Arrivals



Source: Statistics New Zealand

There was a total of 319,040 international visitor arrivals to New Zealand during December 2006, the greatest monthly total ever recorded. This represented a 3.9% increase on the number of international visitors recorded in December 2005. The annual average growth rate in the number of international visitor arrivals to New Zealand was 1.6% for the year ended December 2006.

Summary

An easing of inflation pressure combined with a resurgent housing market and relatively strong retail activity, have helped business confidence increase over the past few months.

The latest edition of the Quarterly Survey of Business Opinion (QSBO) published by the New Zealand Institute of Economic Research (NZIER) in January 2007 showed that a net 5% (seasonally adjusted) of firms expected the general economic conditions to deteriorate over the next six months. While pessimists outnumbered optimists this represented a significant improvement in respondents' outlook compared with the September 2006 quarter's result when a net 24% of respondents possessed a negative outlook.

The improvement in the mood of business opinion was reflected across all New Zealand's regions and business sectors. Importantly, firms felt confident about their own level of business activity with a net 6% reporting an increased level of activity (by volume) over the past three months, and a net 13% expecting an increase over the next three months.

The service sector was the most optimistic with a net 27% of firms recording (positive) growth, and a net 23% anticipating an expansion in services volume over the March 2007 quarter. Notably in the manufacturing sector a net 7% of firms reported an increase in output over the

December 2006 quarter compared to a net 5% who reported a decline in output in the previous QSBO.

The general tenor of recently released economic data appears to suggest that domestic demand accelerated in the December 2006 quarter. This resurgence in domestic demand was underpinned by increasing net migration, a strong labour market and consumer confidence bolstered by lower petrol prices. However, a large number of fixed term loans have expired recently, implying that borrowers will move onto higher interest rates and household expenditure may be therefore curbed. It is certainly difficult to give a definitive forecast as to whether recent increases in consumer confidence will result in increased economic activity and therefore significantly higher inflationary pressures. Nevertheless, according to the Reserve Bank in its January 2007 Official Cash Rate review: "in the absence of clear indications of a moderation in housing and domestic demand, it is likely that further policy tightening will be required". This statement implies that a degree of further appreciation in the TWI due to interest rate increases is unavoidable going forward, and this will further delay a recovery in the export sector of the New Zealand economy.

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