Bank of New Zealand

Offshore Overview

28 February 2008

EXCHANGE RATES

	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
NZD/USD	0.816	0.798	0.767	0.758	0.701	.574
NZD/AUD	0.868	0.869	0.873	0.868	0.887	.858
NZD/JPY	86.9	86.3	82.2	82.4	82.9	66.8
NZD/GBP	0.411	0.411	0.388	0.367	0.357	.338
NZD/EUR	0.544	0.544	0.524	0.511	0.529	.51
NZD/CNY	5.83	5.70	5.53	5.60	5.43	4.68
USD/JPY	106.5	108.1	107.2	108.7	118.3	116.7
USD/GBP	1.985	1.942	1.976	2.07	1.964	1.687
USD/EUR	1.511	1.467	1.464	1.483	1.33	1.12
USD/CNY	7.142	7.14	7.21	7.39	7.741	8.168
AUD/USD	0.941	0.918	0.879	0.873	0.79	0.67

For addition to our emailing list for Thursday night receipt email "Subscribe WO" to tony.alexander@bnz.co.nz . To get off the list email 'Unsubscribe". Exporters seeking more background information on our six major export destinations may download relevant briefing papers from www.bnz.co.nz/tonyalexander

NZD MOVEMENTS

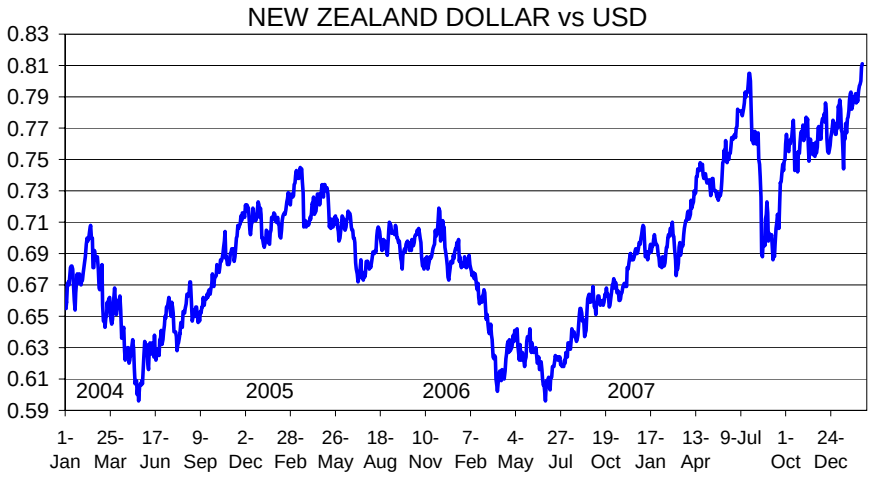
Onward and Upward

This week the NZD has set a new post-float high over US82.1 cents courtesy of

-weakness in the USD due to increased expectations of interest rate cuts,
-investors seeking out higher yielding riskier currencies associated with an improvement in sharemarkets,
-riding on the coat-tails of a rocketing Aussie dollar propelled higher by soaring minerals prices.

Volatility lies ahead and as we wrote here three weeks ago hitting 85 cents is possible before weakening underlying factors produce some mild decline later this year. At these levels the NZD is clearly stretched and if you happen to be a currency punter then we are once again in one of those environments when you have to ask yourself at what point is enough enough? Do you hold out for 83, 84, 85, or higher knowing that at some stage in the next 18 months we will trade below 70 cents? And by holding out will you miss out entirely?

Putting speculation to the side, as we have long been warning even before the Kiwi dollar fell away from 81.1 cents in July last year to 69.0 cents in September, our currency is very well supported by high commodity prices and high interest rates. When the Kiwi dollar fell away to 69.0 cents we repeated our belief that the currency would eventually rise again because the outlook for interest rates and commodity prices was not being changed as a result of the global liquidity crisis. In fact over the first half of 2007 our warning to exporters was that if something came along to make the NZD fall 10 cents it would do exactly what it did following similar falls in 2004 and 2006 and go right back up again.



What we pointed out in our publications and seminars was that the key reason the Kiwi dollar fell away sharply in the middle of last year was because of an increase in risk aversion around the world leading investors to move away from risky peripheral assets like the Kiwi dollar. Our warning has been that once investors stopped feeling quite so nervous the Kiwi dollar would go back up again and that has been a key reason why we have this week hit a new post float high against the greenback above 81.5 cents. Investors have been feeling slightly less panicked about the world economy in light of some good data out of Europe, a small improvement in the US sharemarket (up 2.1% for the week), and expectations of further interest rate cuts in the United States

With risk aversion easing a tad investors have been once again turning away from the low yielding Yen and seeking out high yielding currencies like the NZD. They have also been buying the AUD with a fury as their export prices soar and buying the NZD also as a proxy for the AUD while also anticipating our economy will have its slowdown mitigated to some degree by the boom in our biggest trading partner. Australia takes 22% of our merchandise exports and supplies 38% of our tourists.

So where does the Kiwi dollar go from here? Our currency is certainly over-valued at current levels and will one day go lower. But just because one's currency may be x% over-valued says zero about where it goes. It may be on its way to be twice as over-valued as that. After all we got to this position by being over-valued at much lower levels as well and yet knowing that did not stop us hitting post-float highs this week. Valuation measures give no insight into where an asset price will go in the short term.

While we can see signs of weakness in the New Zealand economy this doesn't automatically translate into lower interest rates and therefore a lower NZD because capacity availability has got worse during the period of monetary policy tightening rather than better. Falling house prices by themselves will certainly help the inflation outlook by restraining growth in consumer spending. But it is unreasonable to expect that growth in wages will slow down in an environment of high labour demand but poor labour availability.

We are also getting near daily messages about problems in New Zealand's increasingly South African-like electricity sector which can only push prices higher. (Hasn't anyone in government thought about planning power output growth to avoid blackout risk and hiking prices which seem mainly to benefit state-owned generators? Ahh – maybe that is the answer.)
http://www.bloomberg.com/apps/news?pid=20601085&sid=aIYVouTZpCYY&refer=europe

International food prices are soaring with talk of increased rationing of food aid to developing economies for instance. Oil prices are oscillating around US $100 a barrel, and the New Zealand government is most definitely going to ease fiscal policy this year which will stimulate growth in our economy. The dairy industry is booming in spite of drought affecting some farmers, and the carbon emissions trading scheme next year is going to boost inflation.

All of these things mean that the Reserve Bank will be very cautious about sending a signal of lower interest rates next Thursday morning when they review their cash rate again. In fact for those thinking that just because their house prices are falling and the currency is rising the central bank must cut interest rates we advise reading about what is happening in some economies overseas. In Australia interest rates have increased 0.75% over the past few months with another half percent increase likely in the near future because their economy is booming with major capacity shortages.

In Europe the central bank appears determined not to cut interest rates because of concerns about inflation at 3.2% which is well above the 2% target. The Bank of England expects to be writing a letter to the Chancellor of the Exchequer later this year explaining why inflation in the UK is closer to 3% than the Bank of England target of 2%.

And in the United States we have just seen bond yields rise to their highest levels this year partly because of worries about inflation being stoked by over-aggressive cuts in interest rates by the Federal Reserve.

Will our central bank intervene to try and lower the Kiwi dollar? Maybe they will but what they learnt in the middle of last year is that such intervention is not very effective and they eventually clarified their intervention rules to say that when the currency is unusually high they will sell it and when it is unusually low they will buy it. They didn't say they would be selling it to try and get it lower or buying it to try and get it higher.

We like to think that the consistent line we have run on the exchange rate over recent months will have encouraged a lot of exporters to get hedging on board down around the 69.0 cent area or at least in the low 70s last year. We also like to think that all those Kiwis and poms who have come here from the UK in the past two years waiting for a big decline in the Kiwi dollar against the pound will have shifted their money across at 34 pence last September. But at the time there were so many worries about the world economy and uncertainties that most people will have sat waiting for the Kiwi dollar to go lower and have been sitting ever since watching it go back up again. (There is no smugness here. One did exactly that in 2006 at cost to one's investment portfolio. We did not forecast the strength of the late-2006 NZD rebound)

There is a chance that in the next few months we will see the Kiwi dollar rise toward the 85.0 US cents mark with potentially massive volatility along the way. After all, hitting a post float high is going to attract the attention of punters around the globe. Some will take positions betting that momentum takes us much higher while others will be betting that we are due for a really big fall. That means it is also possible that in the next few months we hit 75 cents. Both outcomes look likely.

Because of New Zealand's relatively high persistent current account deficit and our expectation that growth in the economy will slow and eventually allow the Reserve Bank to ease monetary policy the Kiwi dollar is likely to decline further toward 12 months out and be even lower in two years time. But exporters have been hearing this line about the NZD correcting downward for the past four years. Those who ignored the forecasts and hedged assuming a strong currency will be reasonably placed – though not necessarily comfortable at the moment.

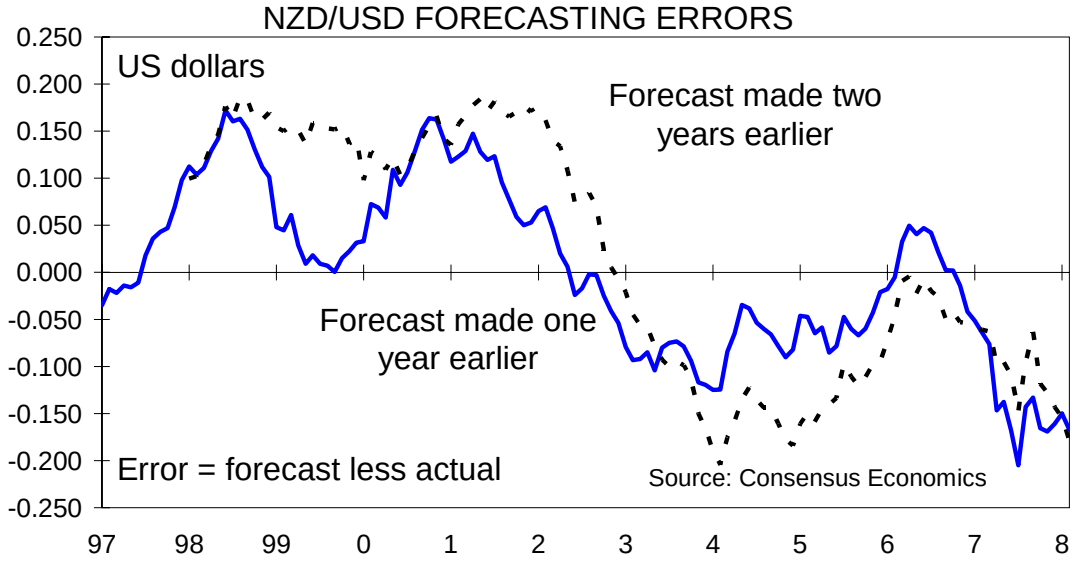
And note this. If the longer-term theories about what the Kiwi dollar is going to do really held validity we would be nowhere near where we are at the moment. One of these theories is called the interest rate parity theory. It says that over time an exchange rate will depreciate to reflect the difference between your interest rate and interest rates overseas. This does not hold for New Zealand with the Kiwi dollar continually trading at far higher levels than the interest-rate differential would suggest. There has been and continues to be an ongoing profit to be made by borrowing offshore and investing in Kiwi dollars and not having the currency depreciate to wipe out the interest rate difference over the long term.

In addition, our current account deficit has averaged 4.7% of GDP over the past 23 years. One would have thought that by now our persistent deficit would have generated a much lower currency. But no. In fact as we noted last week if the current account deficit really is the driving force then the fact that ours has improved over the past year from over 9% of GDP to 8.2% and is expected to hit 6.5% in a year's time would

count in favour of the Kiwi dollar not falling away by all that much. Plus the December month merchandise trade numbers were very positive with higher dairy receipts driving only the second December surplus in the past decade.

So You Think You Can Forecast?

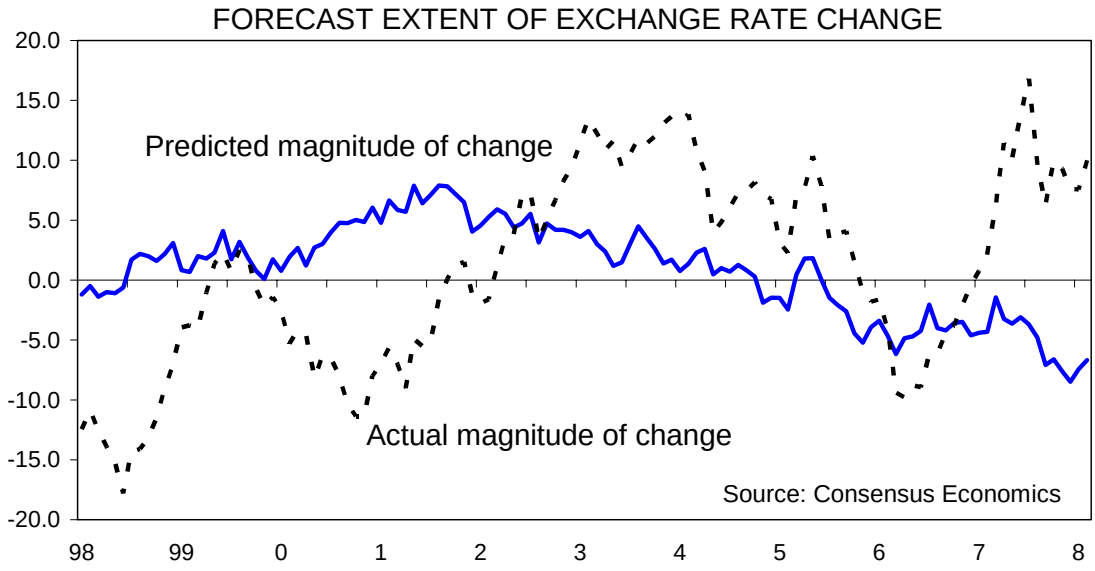
Here is a graph we like to put in about once a year derived from the monthly survey of NZ economists undertaken by Consensus Economics. Economists are asked where they see the NZD/USD exchange rate one and two years down the track. The two lines show the difference between these forecasts and the eventual outcome. When the dotted or blue line hits the zero axis the forecast was spot on. The one year ahead forecast has been correct 8 times over the 133 months covered. The two year ahead forecast has been correct twice out of 121 months covered.



A year ago the common expectation was the NZD/USD would currently be 62.7 cents. The error therefore is about 19 cents.

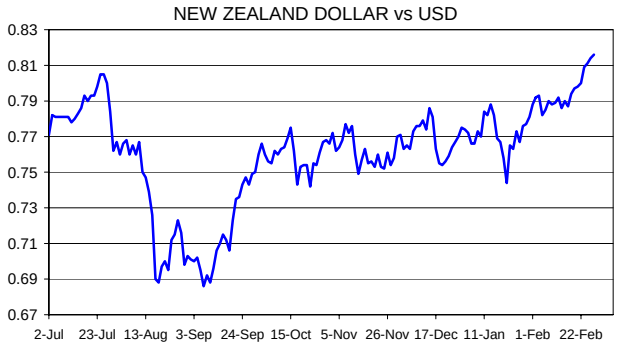
As we like to say, when considering foreign currency risk hedging only 5% of your decision should reflect an exchange rate view. The other 95% should reflect your business specifics. There is no evidence in the graph above to suggest exchange rates can be predicted – even allowing for our claim of some success in warning about risk earlier on in the Offshore Overview this week.

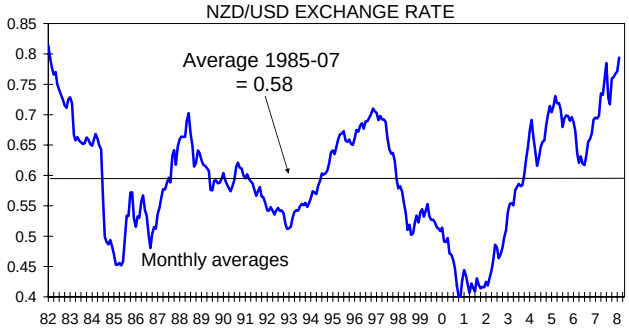
Still not convinced? Blessed are the believers. Consider the next graph. It shows predictions of how much the NZD/USD exchange rate will change over the coming year and how much it did actually change. What one hopes to see here is that the predicted direction of change is at least in the same direction of change as actually happened. But apart from early 1998 and a brief period late - 1999 to early 2000 this has only happened on a consistent basis from mid-2002 to mid-2004. For the 133 months analysed the direction of change was correct 64 times. That is a 48% success rate.



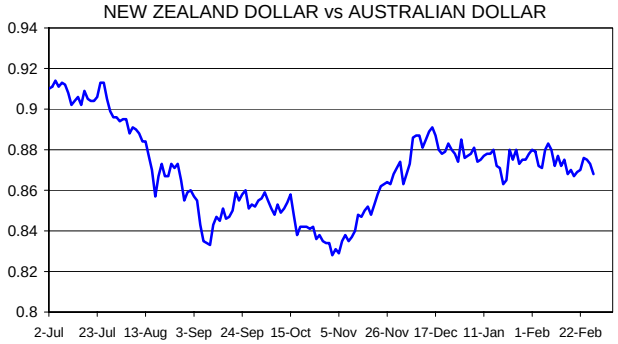
You would do better picking the direction the currency will go in the coming year by tossing a coin than averaging economists' forecasts. And it is not just over medium term time periods that currency forecasts fail. Just recently some analysts have been continually predicting a strong pullback in the NZD – and in doing so have been providing willing NZD sellers to the growing number of buyers overseas.

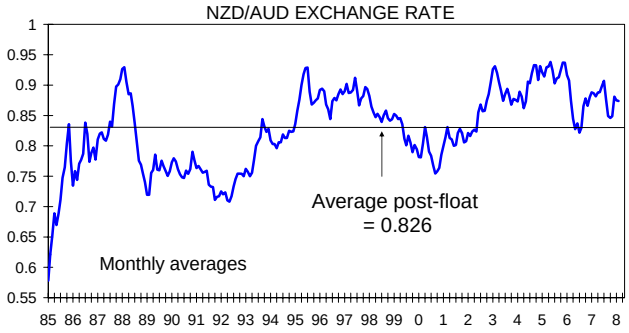
This afternoon the NZD has ended against the greenback near 81.6 cents having hit 82.1 cents overnight. Last week the rate was 79.8 cents and a month ago 76.7 cents.





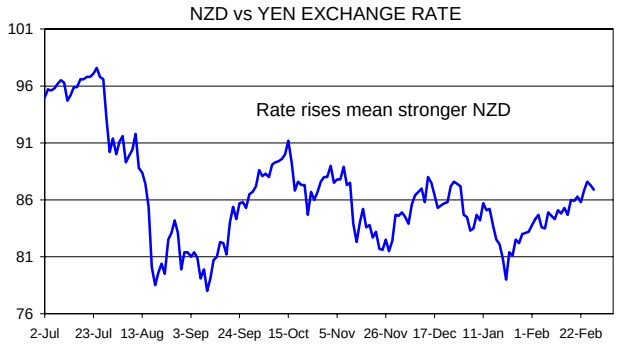
The Kiwi dollar may have hit its highest levels against the greenback since 1982 but that is most definitely not the case for third currencies. Against the AUD we have ended almost unchanged from a week ago near 86.9 cents and down from a month ago when we were at 87.3 cents. As discussed in our Australia section below the Aussie currency has soared to its highest level against the USD since 1984 due to sky rocketing commodity prices and tightening monetary policy.

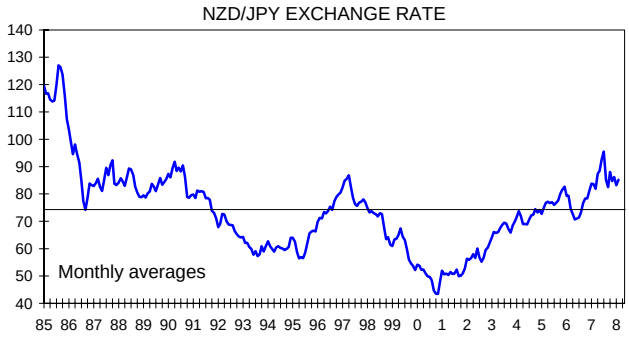




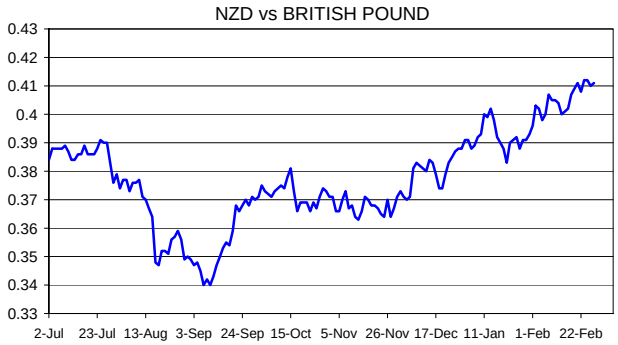
BNZ OFFSHORE OVERVIEW

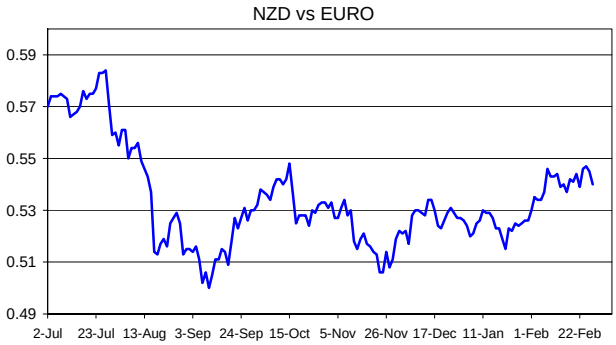
Against the Japanese yen we have risen over the week to end near 86.9 from 86.3 with the Yen struggling a bit in spite of a weakening USD as investors are quitting the currency to find higher yielding investments offshore.

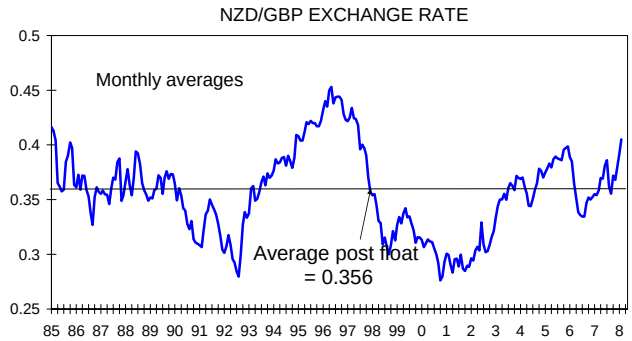


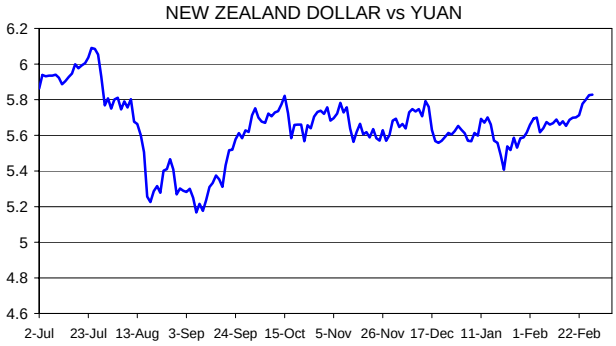


Against the British pound we have ended unchanged from last week at 41.2 pence, against the Euro we have eased slightly to 541 cents from 54.4, and against the Chinese Yuan we have risen to 5.84 from 5.7.









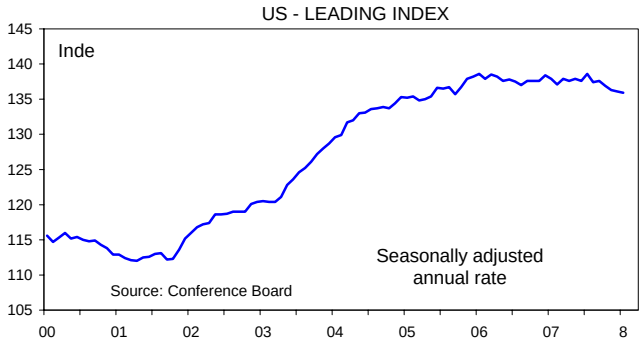
Here is a good article from the Economist magazine on why commodity prices are rising so strongly. They run through a whole range of special factors affecting specific commodities then general issues such as the time it takes to develop new mines etc. along with infrastructure to transport stuff around. But they also note the effect of funds looking for things to buy other than equities, bonds and property. Working out the fundamentals versus new bubble factors is anyone's guess it seems. Enjoy.
http://www.economist.com/daily/news/displaystory.cfm?story_id=10733130&top_story=1

THE WEEK'S MAIN OFFSHORE EVENTS

United States

GDP +0.6%, CPI +4.3%, funds rate 3.0%, 9% of NZ visitors & 12% of exports, $10.5b FDI in NZ, 21% global GDP. NZ exports to US -7.2% year to Dec, tourists -4.3%.

The data week started in the US with the Conference Board reporting the fourth month in a row of a decline in its leading index. Three months of decline is considered a precursor to a recession and the index has not fallen four months in a row since 1990. Over the past six months the index has declined 2% - with a 0.1% decline in January – and that has not happened since the start of the 1991 recession.



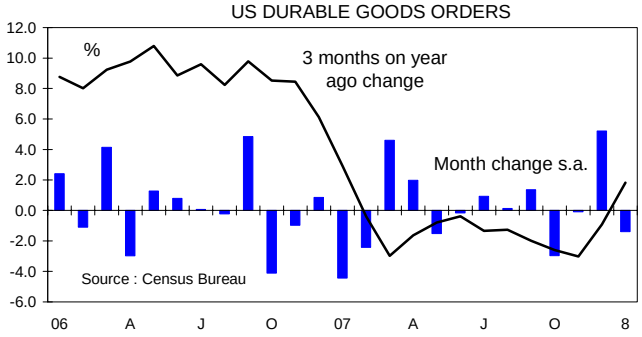
So the chances of a recession in the United States remain firm and this continuing awareness is capping the sharemarket while suppressing the US dollar and limiting the upward pressure on bond yields from worries about inflation further down the track.

Or at least it was until Monday. Then things changed – as they always do. Bond yields jumped up with the ten year US government bond yield rising to its highest level so far this year just over 3.9% while the sharemarket also rose almost 200 points. The improvement in sentiment was caused by Standard and Poor's deciding not to cut the ratings assigned to bond insurers.
http://dailybriefing.blogs.fortune.cnn.com/2008/02/25/ambac-almost-out-of-the-woods/

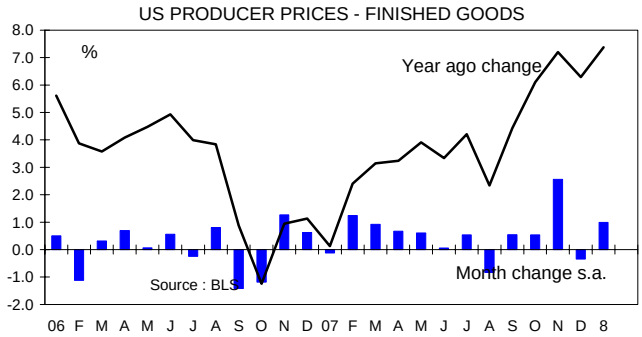
This is very important because in recent weeks major concerns have grown over these bond insurance companies. By providing insurance they allow issuers of bonds to pay lower interest rates than would otherwise be the case. If the credit ratings had gone down their insurance would have been worth less and yields for municipal and corporate bonds would have risen sharply thus decreasing the ability of US companies in particular to fund expansion through borrowing using bonds.

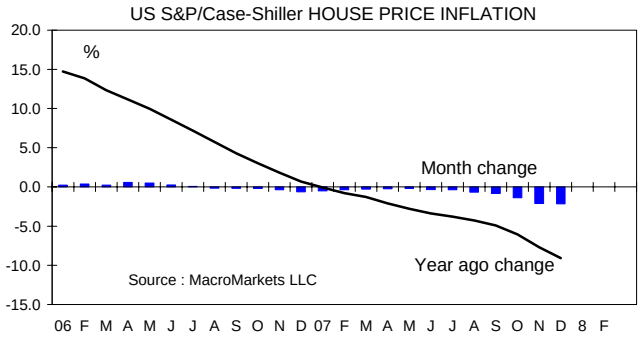
The news about the bond insurers more than swamped some more depressing data on the state of the US housing market. The average sale price for existing houses fell to a level 4.6% down from a year earlier in January of $201,100. This was a drop of 2.9% from the December outcome. The number of existing dwellings sold was down almost 24% from a year earlier while the month's worth of houses available for sale rose to 10.3 from 9.7 in December. There are 4.2 million dwellings currently for sale in the United States. More weakness basically although a few analysts have looked at the numbers and discerned some signs that the rate of decline may be easing.

Last night we also got some data indicating weakness in business capital spending. The seasonally adjusted value of orders placed for durable goods fell 5.3% in January. Having said that an underlying measure which excludes the defence force and aircraft fell 1.4% but this followed a 5.2% gain in December. This particular measure was 1.8% ahead of a year earlier which was the strongest annual rate of growth since 2.9% in January a year ago. Frankly the risk is this number does deteriorate on a more sustained basis in the near future.



Two nights ago we got confirmation that inflationary pressures in the United States are relatively intense. The producers price index rose by 1% seasonally adjusted in the month of January to sit 7.4% ahead of a year earlier. The lift in this and other measures of inflation at a time of slowing economic growth raises the question of whether the United States economy may enter a period of stagflation. This is an environment where inflation is high but growth very low. One would have to say that the term is probably misplaced in the current circumstances because it appeared in the 1970s when there were consumer inflation rates around 10% or above and growth rates near recessionary levels. No one is looking at inflation sitting at those sort of levels so to coin the phrase in this sort of environment is broadly inappropriate.





Of course when we discuss the inflation problem in the United States these days it is not with reference to the housing market. The monthly S&P Case-Shiller price index which tracks changes in the price of the same dwellings over time fell by 2.1% in January after falling 2.1% in December. This relatively reliable index was down 9.1% from a year earlier. As the graph above shows this price measure has been falling every month since August 2006.

The average sale price on newly built homes in January was down 15% from a year earlier with sales levels at their worst since 1995.

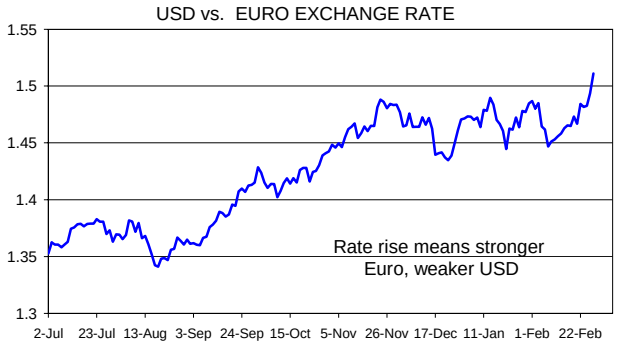
As an aside, while chewing the fat with a group of people at a function for trucking companies last week one attendee revealed that with the massive increase in mortgagee sales in the United States lots of relatively new boats, Harley-Davidson motorcycles, and flash cars were being repossessed by banks and auctioned off at some very good prices for buyers. It seems like now is a very good time for Kiwis with some spare cash who have always wanted to get a late-model Corvette for instance to take advantage of the high currency, hop across to the United States, and buy two of them for stuffing into a container and shipping back here. Or you could buy a boat as well and float them back yourself. Apparently the thing to do is to buy a boat and avoid any hassles with the 110 volt power system by stuffing it chock-full of cheap auctioned appliances! These are the glory days - if you've got the cash.

Overnight the Federal Reserve Chairman Ben Bernanke gave his six-monthly briefing to Congress and repeatedly outlined downside risks to growth. But he also indicated that the Fed. stands ready to cut interest rates again if necessary and this has kept the markets hopeful that if there is a recession in place or imminent it will not be deep or short-lived. The next Fed. rate review occurs on March 18 and it is likely they will cut their funds rate by 0.5% taking it to 2.5%.

Frankly the optimism in sharemarkets this week looks misplaced if one looks beyond the economic numbers. There is talk that the extent of losses associated with the sub-prime crisis may exceed $1tn and that so far banks have only taken $130bn worth of losses onto their books. Risks associated with the credit crunch spreading and deepening appear extreme and this is why one must be very cautious with the regard to the occasional positive market reaction to certain data releases and official statements.
http://www.newsweek.com/id/114713

Over the week the US sharemarket has gained 2.1% but the USD has weakened partly because of strong numbers in Europe leading to a flow of funds into the Euro, partly because of evidence that Japanese investors are selling Yen to get better yields (non-USD), and partly because of increased interest rate cut expectations. The Euro has hit a record high against the USD to end this afternoon near $1.51 from $1.473 last week and $1.464 a month ago. This movement is a clear break out of the trading range since November.

Against the pound the dollar has also weakened to end near $1.985 from $1.941 last week and against the yen it has ended near 106.5 from 108.1.



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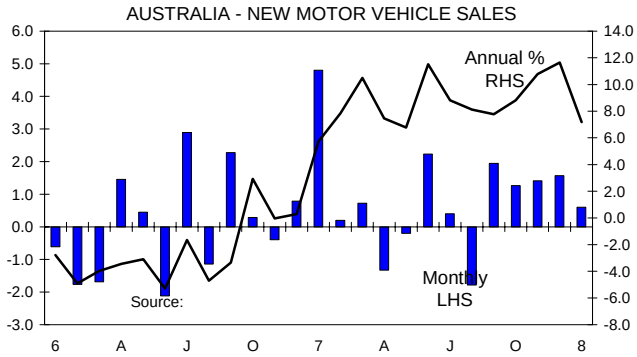
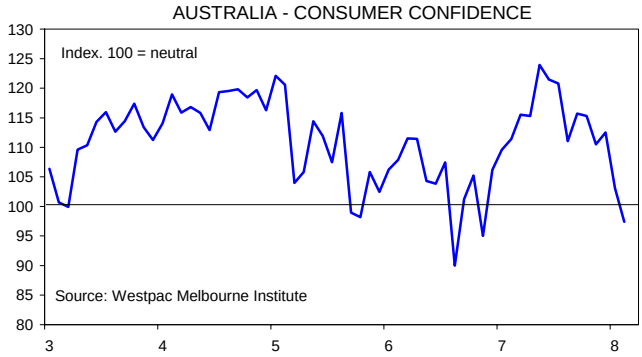
http://www.mfat.govt.nz/Countries/North-America/United-States.php

Australia

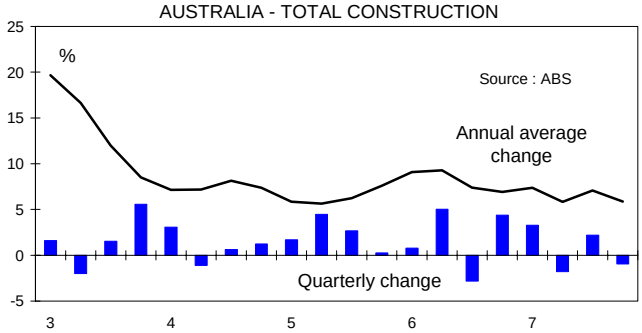
GDP +3.6%, CPI +2.9%, cash rate 7.0%, 38% of NZ visitors (but 16% spending) & 22% of exports, $47b FDI in NZ, 1.2% global GDP. NZ exports to Australia 13.3% year to Dec, tourists 5.2%.

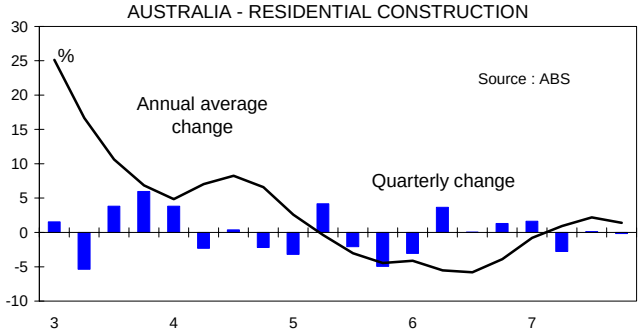
Consumers continue to spend up on passenger cars in Australia with sales in January up a seasonally adjusted 0.6% from December and 7.2% ahead of a year ago. But as the graph below shows the monthly gain was the smallest since August and the annual rate of increase dipped from 11.7% in December. So maybe there is some translation of the fall in confidence revealed last week into minor spending restraint – though not enough to forestall the hand of the RBA next week we believe.





During the week we learnt that the seasonally adjusted value of construction work undertaking during the December quarter was down by 1% after rising 2.2% the previous quarter. Residential construction work fell 0.2% meaning that for the full calendar year residential construction grew by 1.4% which was an improvement from a decline of 3.9% over 2006 and a fall of 4.4% over 2005. Non-residential construction worker fell by relatively strong 5.1% in the quarter but this followed a jump of 6.3% the previous quarter and meant that for 2007 as a whole non-residential construction activity rose by a reasonably healthy 5.7%. This growth reflects the strong underlying growth in the Australian economy pressing businesses to construct new premises, factories and so on. This rate of growth was however a slowdown from 10.9% over 2006 and 8.1% over 2005.



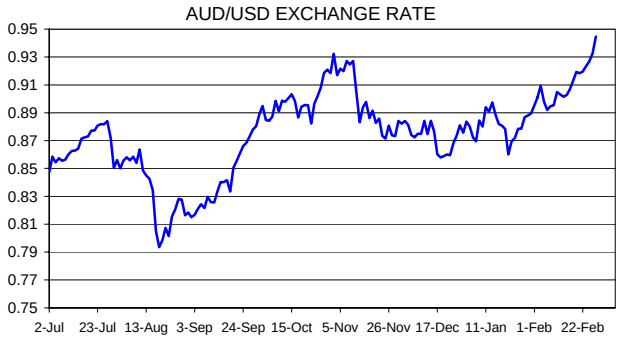


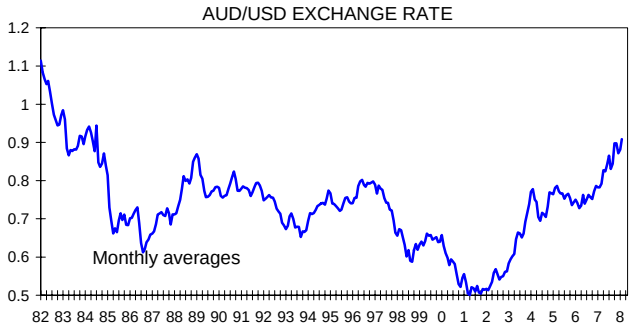
Reflecting the boom in infrastructure activity in Australia the value of engineering work in the quarter rose 0.7% to give growth for the full 2007 year of 9.7% from 15.7% over 2006 and a whopping 23% over 2005.

We also learnt today that private sector capital expenditure grew by a firm 5.1% over the December quarter in inflation and seasonally adjusted terms. Continued strong growth was also indicated by companies and this activity is one key factor expected to help underpin growth in the Australian economy over the coming two years.

Overall one can look at the numbers coming out of Australia and see some signs of restraint and weakening in confidence measures suggesting the rate of growth is going to slow from the 3.7% recorded last year. But one can also see massive underpinning for growth from the continuing and in fact strengthening boom in the minerals sector. Iron ore prices have just risen by 65% and it is likely that coal prices will double this year. With these two minerals accounting for almost 20% of Australia's merchandise exports the trade deficit is expected to be wiped out over the coming year and a trade surplus recorded.

This expectation of improved trade numbers is one reason the Australian dollar has jumped this week to end this afternoon against the greenback near 94.5 cents from 91.8 cents last week. Another reason is the expectation that next week the Reserve Bank of Australia will raise their cash rate another 0.25% and probably repeat their warnings from two or three weeks ago that they have in inflation problem which it may take quite some time to get under control.





Want to find out about exporting to Australia? Start here.

http://www.nzte.govt.nz/section/11728.aspx
http://www.mfat.govt.nz/Countries/Australia/Australia.php

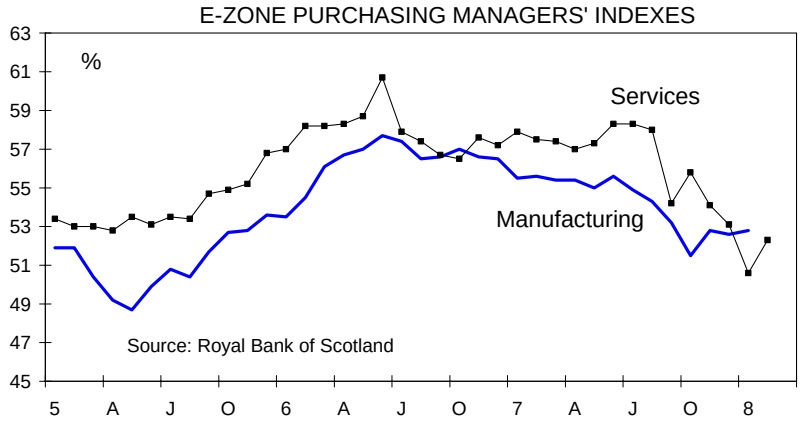
Euro-Zone

GDP +2.7%, CPI +3.2%, cash rate 4%, EU ex-UK=9% NZ visitors & 14% exports, $11.2b FDI in NZ. EU 23% global GDP, Ezone 16%. NZ exports to EU -4.7% year to Dec, tourists 1.0%.

During the week the European Commission updated their economic forecasts which were last released in November. They now see growth this year at 1.8% rather than the 2.2% predicted back then – in other words weaker but not tremendously so. Factors contributing to the slowdown in growth are fairly obvious - higher oil prices, more costly credit, and a slowdown in the United States. Plus there would be some lagged effect of the ECB raising its cash rate 0.5% in the first half of last year.

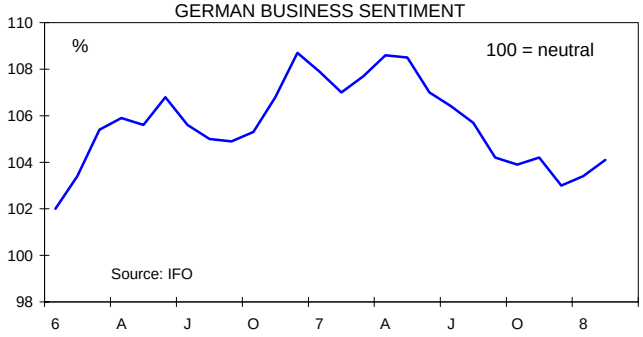
The worrying bit however was the EC forecast of inflation averaging 2.6% for the year which was a 0.5% rise from the previous forecast. These numbers fairly much encapsulate the issue for Europe. The growth outlook is acceptable with a slowdown from (for them) unusually strong growth of 2.7% last year, but inflation sitting at much too high a pace for comfort.

The lift in the inflation forecast generated a rise in EU wholesale interest rates during the week and delivered extra support to the Euro early in the week. This support was increased when the Bank of Scotland index of services for the Euro area was released on Friday. It showed a rise to 52.3 from 50.6 where a reading of 50 indicates neutral services sector growth. The outcome still left the index at its second lowest level in over four years but the rise was much more than the 51 expected. The importance of the reading is that it strengthens the argument that domestic growth momentum in Europe will leave it less affected by the US slowdown than would otherwise be the case. This reduces the chances of rate cuts from the ECB this year but is positive for NZ exporters to Europe as it implies continuing reasonable product demand.



The manufacturing index from Royal Bank of Scotland eased to 52.3 from 52.8 which was in line with expectations and suggests continuing growth at a mild pace in European manufacturing.
http://www.finfacts.com/irishfinancenews/article_1012680.shtml

And then two nights ago we got further data feeding into this view of the European economy being relatively well insulated against the problems of the United States. In Germany for the second month in a row the much watched IFO business climate index rose. It reached a reading of 104.1 in February from a two-year low of 103 in December and 107 a year ago. This reading suggests the business community in Germany is not aggressively troubled by rising oil prices and the credit crunch and therefore suggests there may be some continued strength in the German labour market at least along with sustained business capital expenditure.



Feeding into the general theme of Europe slowing only a bit in response to the possible US recession underway at the moment was a report from Europe's biggest engineering company Siemens that their business is not being affected by the global growth slowdown. Given the trends shown in various indicators such as the manufacturing one above one cannot read their comments as reflecting any universal business experience in Europe. But they do back up the mild decoupling theory.
http://www.bloomberg.com/apps/news?pid=20601085&sid=aqzFhSWJD8dE&refer=europe

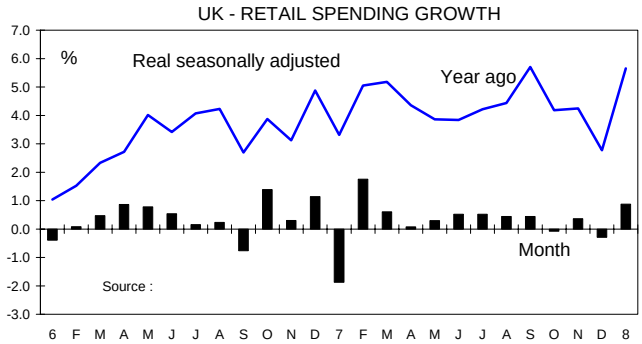
This week, as a result of some good economic indicators coming out of Europe at the same time as more bad news comes out of the United States we have seen the Euro rise to a fresh record high against the greenback above $1.51. It has ended against the greenback this afternoon near $1.512 from $1.467 a week ago and $1.464 a month ago. The graph for this exchange rate was included in the United States section above.

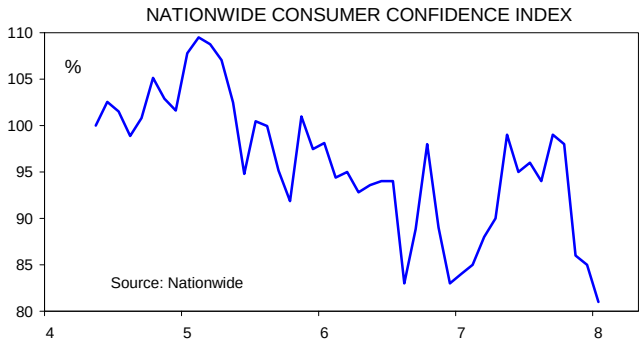
Want to find out about exporting to the EU? Start here.
http://www.nzte.govt.nz/section/11728.aspx
http://www.mfat.govt.nz/Countries/Europe/European-Union.php

United Kingdom

GDP +3.1%, CPI 2.2%, base rate 5.25%, 12% of NZ visitors & 5% of exports, $4b FDI in NZ, 3.3% global GDP. NZ exports to UK -3.1% year to Dec, tourists 7.0%.

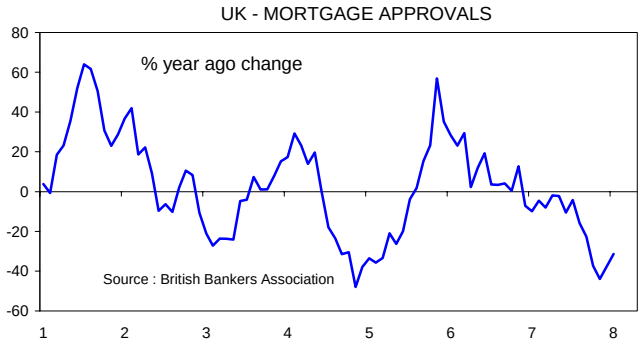
There was some good news to start the week in the UK with the National Statistics Office reporting that retail sales rose by a firm 0.8% in January. This was twice the increase expected and pushed sales to 5.6% ahead of a year earlier. The rise for the month was the biggest since February and while one might conclude that the result means plunging consumer confidence does not mean spending restraint that would not necessarily be true. There was hefty discounting undertaken by retailers in January and this would have given an artificial, unsustained, boost to spending in the month.



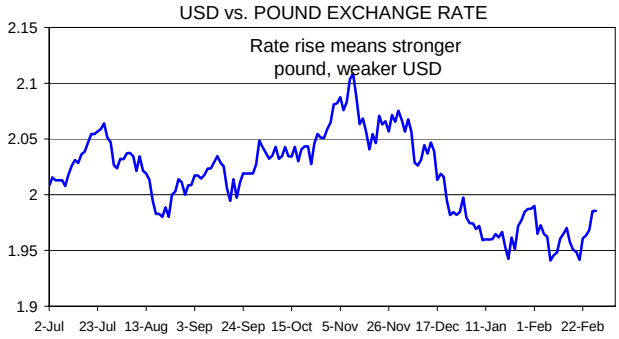


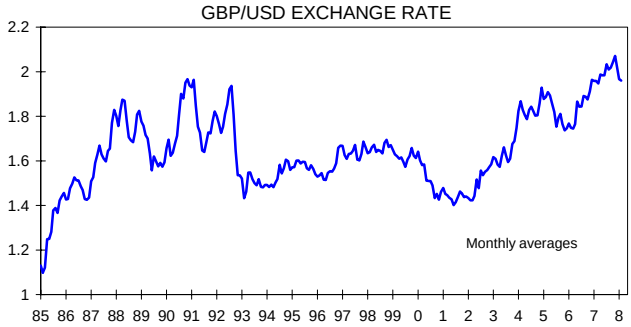
So the theme for household spending growth in the UK still remains one of restraint in light of rising energy costs, problems in the banking system, falling house prices and manufacturing sector weakness.

The biggest manifestation of woe in the UK economy is in the housing market and this week we learnt that the number of mortgages approved by members of the British Bankers Association rose in seasonally adjusted terms in January to 44,288 from 42,343 in December. This sounds good but the January result was down 31.3% from a year ago reflecting the extreme weakness in the UK housing market which appeared early last year and accelerated mid-year with the global liquidity crisis.



The British pound has gained firmly against the weakening greenback this week to end near $1.985 compared with $1.94 a week ago.





Want to find out about exporting to the UK? Start here.
http://www.nzte.govt.nz/section/11728.aspx
http://www.mfat.govt.nz/Countries/Europe/UK.php

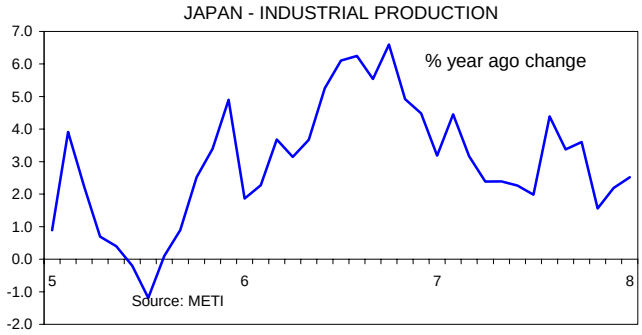
Japan

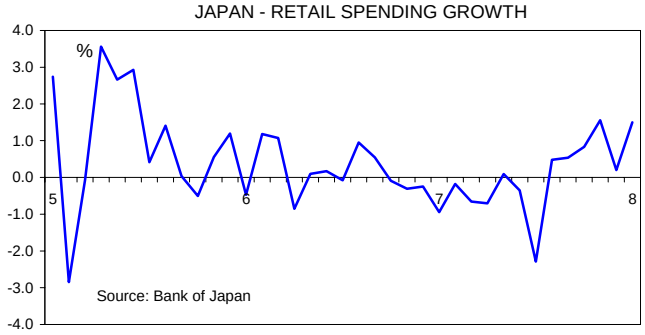
GDP +2.1%, CPI 0.7%, cash rate 0.5%, 5% of NZ visitors & 10% of exports, $1.8b FDI in NZ, 6.6% global GDP. NZ exports to Japan -5.0% year to Dec, tourists -10.8%.

The week in Japan started with the monthly Cabinet Office report on the economy revealing the first downgrading of growth expectations in 15 months. This is hardly earth-shattering stuff as private sector analysts have been cutting their forecasts for many months. But nonetheless official recognition of the deteriorating growth outlook has its own significance.
http://www.bloomberg.com/apps/news?pid=20601068&sid=avZOpr8Lcixc&refer=economy

In fact concerns about the immediate outlook for the economy and the fact that over the past few years strong growth has not been associated with a decent lift in consumer spending has encouraged the Cabinet office to set up a special economic panel. It will look at how to change the structure of the Japanese economy so it can handle in particular the ageing population and changes in the world economy in recent years.
http://enews.mcot.net/view.php?id=3005

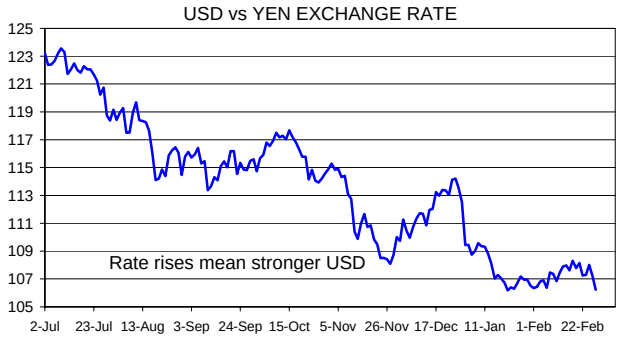
Today we got two very divergent pieces of economic data out of Japan. Industrial production in January fell in seasonally adjusted terms by 2% from December. This was much more than the 0.8% decline that had been expected and suggests that weakness in the United States economy is feeding through into the Japanese economy even if this is not strongly evident in Europe as discussed above.

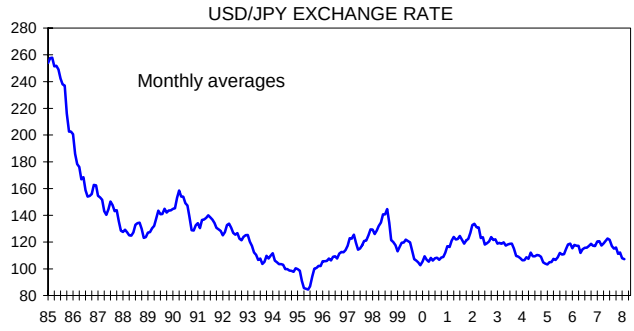




But we also learnt that in January retail spending in Japan was ahead 1.5% from a year earlier. The markets had been expecting a decline of 0.1% to be reported. To a great extent the increase can be put down to a 5.9% increase in expenditure on petrol as a result of rising prices. But it seems that even allowing for this there was still some strength in Japanese spending. Or at least to put that in perspective, consumer spending growth in Japan has been weak for a hugely long period of time but there is no evidence to suggest that there is fresh weakness happening at the moment because of concerns about the Japanese economy, US economy, weakening sharemarket and a whole long list of other factors in play. Truth be told these negative factors are likely to cause much slower growth in Japanese retail spending in the very near future.

The Japanese Yen had a generally weaker tone for the early part of this week assisted by Standard and Poors' decision not to cut the credit ratings of some key US bond insurers. Their actions have reduced riskiness in the current environment so led to some increased willingness to sell yen and invest in high yielding currencies like the NZD and AUD, along with equities. But with the greenback weakening again overnight we have seen the Yen firm over the week to end against the US dollar near 106.2 from 108.1 last week.





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http://www.nzte.gvt.nz/section/11728.aspx
http://www.mfat.govt.nz/Countries/Asia-North/Japan.php
http://www.jetro.go.jp/

China

GDP 11.2%, CPI +7.1%, 5% of visitors & 5% of exports, 11% global GDP. NZ exports to China 4.3% year to Dec, tourists 14.3%.

With regard to growth in the Chinese economy this year the negative influences are slowing world growth, the need to slow growth anyway to try and contain inflation, and the impact of recent bad weather.

The World Bank's Chief Economist this week predicted that China's economy will continue to grow in a range of 8% - 10% p.a. for the next 2-3 decades. Sounds reasonable. Worth trying to send some more exports there one thinks.
http://english.people.com.cn/90001/90776/90884/6358135.html

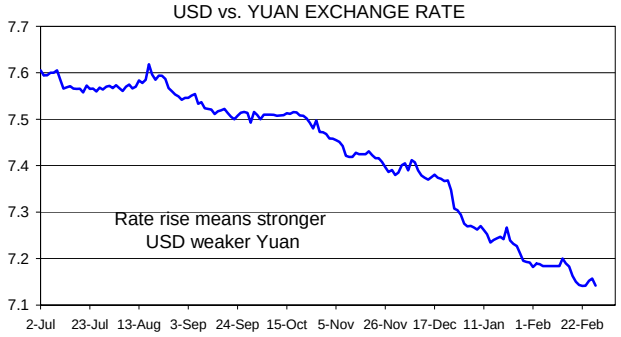
The good news coming out of China for NZ exporters is that the authorities have indicated increased willingness to allow faster strengthening of the Yuan. This is what we have written about in recent weeks in the context of inflationary pressures worsening so the need for higher interest rates growing, but at the same time concerns about domestic happiness leading to decreasing willingness to use the interest rate weapon. Export growth out of China has remained very strong over the past year and three months to January export receipts in USDs were 23.6% ahead of a year ago. January on year ago growth was 26.7%. Strong export growth means greater upward pressure on the Yuan in a freely floating situation and greatly willingness to tolerate strength in a controlled rate environment.

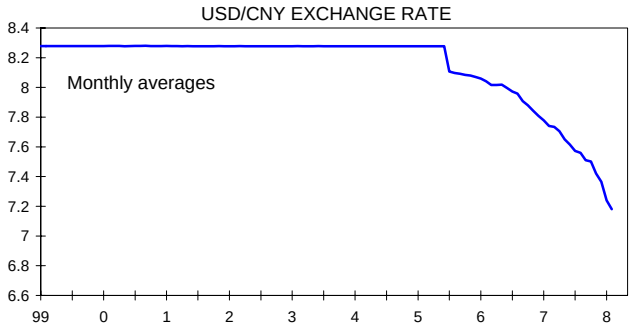
This week we saw the People's Bank of China in their fourth quarter monetary policy report note that China will "boost the exchange-rate's role in adjusting the balance of payments and in curbing inflation,"
The English translation should appear in the following link soon.
http://www.pbc.gov.cn/english/huobizhengce/huobizhengcezhixingbaogao/2007.asp

But having said that, as any person familiar with fixed exchange rate regimes knows the last thing the authorities want is for people to think their currency is a one-way bet either upward or downward. In this regard the view by every man and his dog on the Chinese Yuan is that it is going to keep on rising. A desire to make sure they are not having to fight against billions if not trillions of dollars of speculation of further appreciation helps explain why this week the People's Bank of China set the rate of exchange against the greenback at a lower level for three days in a row. The game is afoot - though it's a dangerous one when you are dealing with a one-party state.
http://www.bloomberg.com/apps/news?pid=20601089&sid=a5bnnMOijpBI&refer=china

Just to highlight the focus of the government on improving the lot of the roughly 56% of the population still living in rural areas the following article highlights an incentives programme to purchase household appliances. This easing of fiscal policy comes at the same time as the central bank is fighting inflation and illustrates the difficulties facing the central authorities. Inflation and betterment policies are fighting each other.
http://www.stuff.co.nz/4414937a19716.html

The Chinese currency has ended the week against the US dollar practically unchanged from a week ago near 7.142.





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