Offshore Overview

15 May 2008

Mission Statement

To help Kiwi exporters make informed financial decisions by discussing foreign economies and the NZ dollar in a language they can understand.

EXCHANGE RATES

	This week	**Week ago**	**4 wks ago**	**3 months ago**	**Yr ago**	**10 yr average**
NZD/USD	0.772	0.772	0.788	0.79	0.738	.574
NZD/AUD	0.812	0.822	0.853	0.875	0.886	.858
NZD/JPY	79.9	80.9	79.6	85.3	88.8	66.8
NZD/GBP	0.388	0.395	0.40	0.401	0.373	.338
NZD/EUR	0.491	0.503	0.499	0.54	0.545	.51
NZD/CNY	5.29	5.40	5.51	5.68	5.68	4.68
USD/JPY	105.7	104.8	101.0	108.0	120.3	116.7
USD/GBP	1.948	1.95	1.975	1.97	1.98	1.687
USD/EUR	1.54	1.534	1.579	1.463	1.355	1.12
USD/CNY	7.0026	7.009	6.99	7.19	7.694	8.168
AUD/USD	0.931	0.939	0.924	0.902	0.833	0.67

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NZD MOVEMENTS

It has been another good week for Kiwi exporters with weak retailing data this morning following the weak employment numbers last week showing the Reserve Bank's goal of a much softer domestic economy has been achieved. Now the question is simply what the "safe" speed is for them to ease off the interest rates brake without risking new inflation problems surfacing over 2010.

Our pick is they start cutting interest rates by 0.25% every six weeks starting in September with the official cash rate potentially ending up below 6% come early 2010. But whatever the timing of the start, the speed, and the end-point the direction for the NZD over the next 18 months is clear – down.

For the past few months what we have been saying is that the next time the Kiwi dollar undergoes a ten cent decline the fall will "stick" because the weakness in the economy and eventual reduction in inflationary pressures will be more convincing than was the case at times of 10+ cent falls in 2004, 2006, and 2007.

At this stage we are anticipating a fall to near or below US 70 cents come the end of this year then 65 cents in 2009. But we have all played this game before – trying to pick a cyclically trending currency's position at various time points – usually with minimal success. History shows we tend initially to under-estimate how far a currency will fall – then when it really gets cranking downward we over-estimate how far it will go.

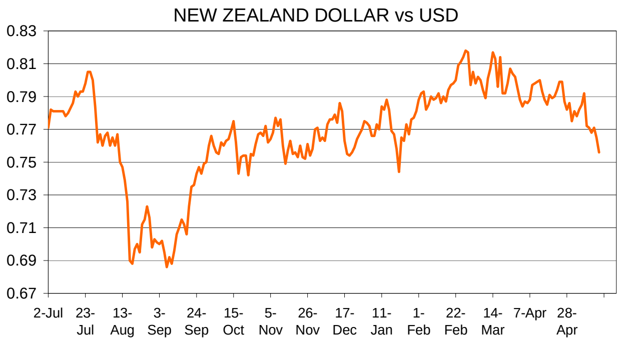
So please do not look for certainty when asking us about where the NZD is heading. The best honest answer is down – at unpredictable speed and at this stage to an unpredictable low at an unpredictable point in time. Exporters should just be pleased that the long awaited rebalancing of our economy is now at hand – and plan how to take advantage of developments to boost their profitability.

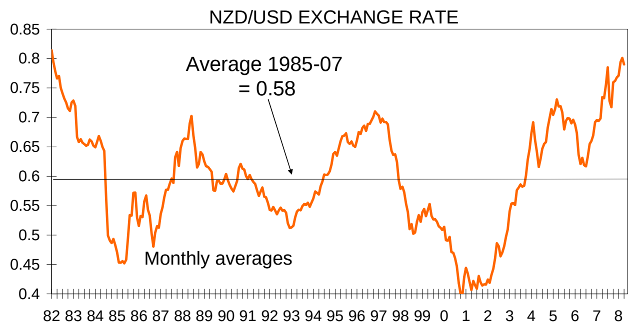
What we mean here is now that domestic activity levels are falling away you will find securing much needed employees slightly easier. Hire them as they get laid off. You will find debt servicing costs slowly falling. Concentrate for now on floating or short term fixed rates and take future rate falls as a bonus which make capital expenditure more profitable. Focus spending on boosting productivity more than capacity but also take the time to explore new products and distribution channels offshore.

Maybe initially you are well entitled to simply "cream" the effects of the lower NZD on your bottom line. But your best bet would be to build some cash reserves over the remainder of this year and the first half of 2009 to help finance expansion. Not that all exporters are going to be in this position for many months. It will take some time for hedging to roll off, and for some output prices remain poor and input costs crippling – fishing for instance.

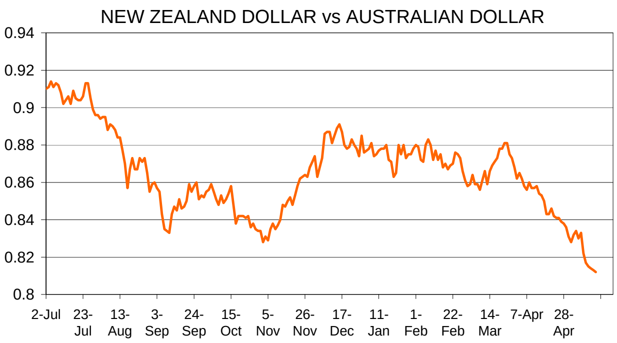
Watch what will happen with your imported input costs and while edging back from medium to long term export receipt hedging you should consider choices for hedging an increasing proportion of anticipated import costs. But perhaps mainly what you will do is what exporters in New Zealand traditionally do when we reach this rebalancing point in the NZ economic cycle. Keep quiet, let the newspapers remain filled with stories of domestic economic woes rather than your slowly building success, and therefore allow weak confidence levels to continue applying downward pressure on interest rates and therefore the exchange rate.

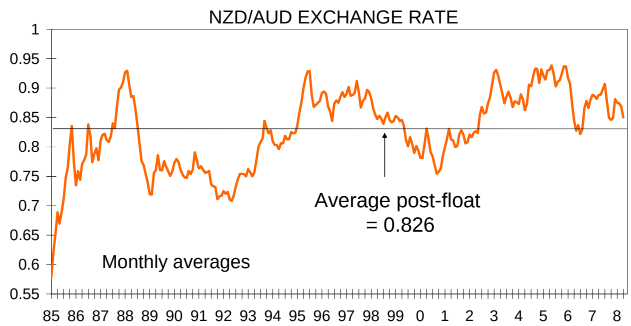
This afternoon the NZD has ended against the USD near 75.6 cents from 77.2 cents last week and 78.1 cents a fortnight ago.



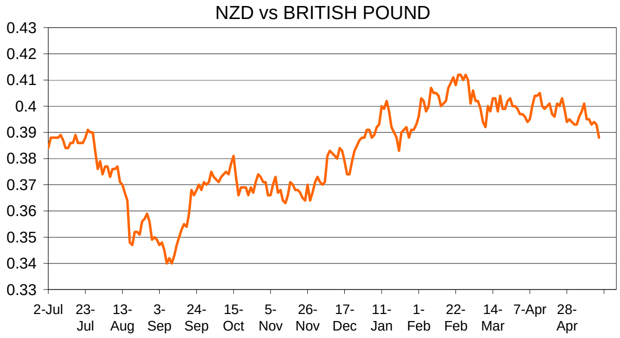


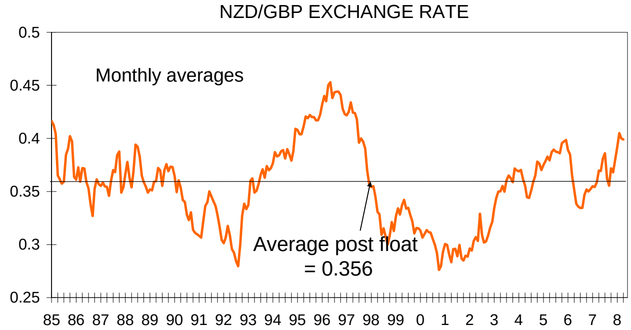
Against the AUD we have ended near 81.2 cents from 82.2 cents – the lowest level since August 2006.



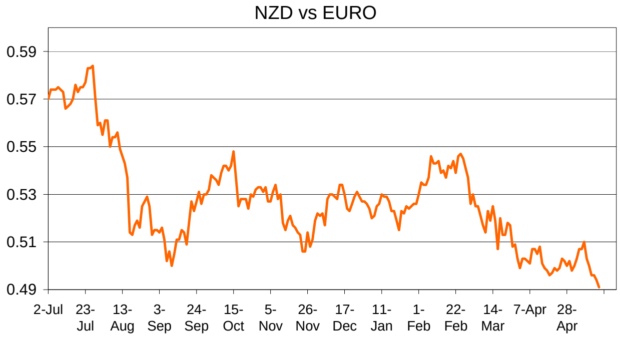


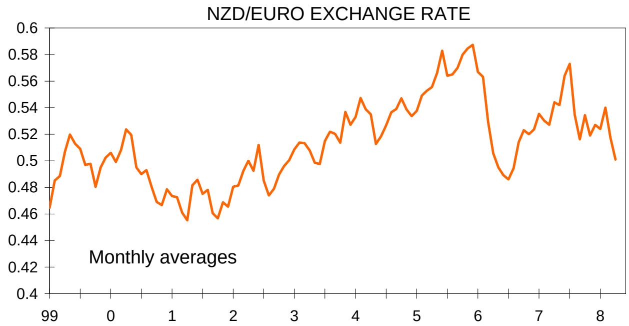
Against the British pound we have finished near 38.8 pence from 39.5 pence – the lowest level since just December last year.



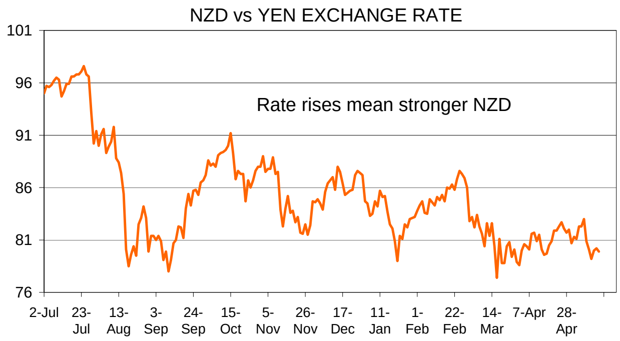


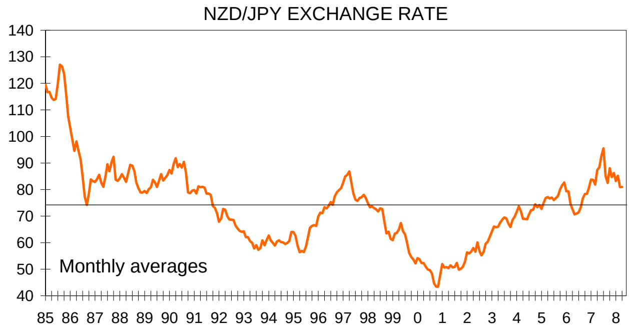
Against the Euro we have ended near a 21 month low of 49.1 cents from 50.3 cents last week.





Against the Japanese Yen the NZD has ended near 79.9 from 80.9. This is still within the range we have been trading since August last year.





Offshore Outlook Pulling Back From The Brink

One of the developing themes around the planet at the moment is that while the outlook remains fairly bad outside of certain parts of the world such as Asia, Australia, and the Middle East there is some light appearing at the end of the tunnel. Credit conditions have eased slightly in recent weeks as measured by the extra amount banks have to pay to borrow money in international markets pulling back – slightly. In addition some confidence in growth has seen the Baltic Dry Index measure of the cost of bulk sea freight rise sharply.

There has also been an improvement for the second month in a row of a survey undertaken by Bloomberg of 4,574 users of their services. In May the Global Confidence Index improved to 22.7 from 14.5 in April and 13.1 in March. However with a reading below 50 indicating overall negative sentiment it still remains reasonable to expect below average growth in the world economy in the near future, especially with considerable uncertainty about things like investor confidence in US banks, oil prices, inflation, and the US housing market.
http://www.bloomberg.com/apps/news?pid=20601068&sid=afz7LqTgYs_s&refer=economy

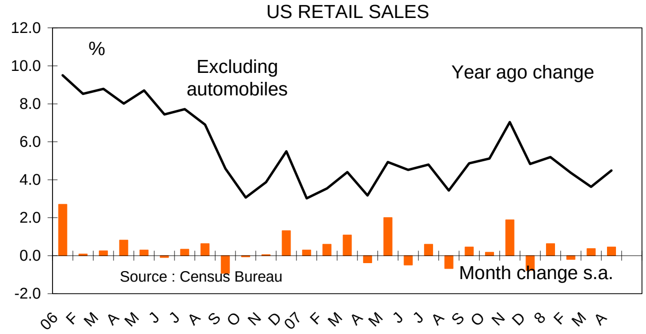
THE WEEK'S MAIN OFFSHORE EVENTS

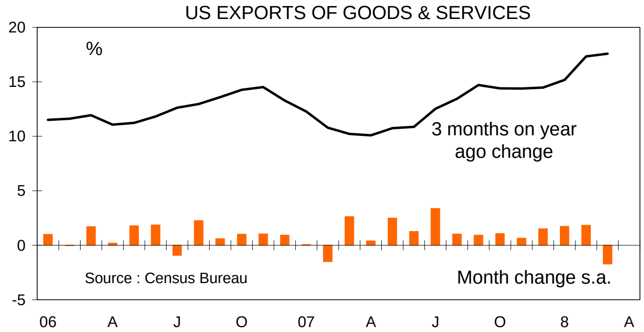
United States

GDP +0.6%, CPI +3.9%, funds rate 2.0%, 9% of NZ visitors & 12% of exports, $10.5b FDI in NZ, 21% global GDP. NZ exports to US -7.3% year to Feb, tourists -3.2%.

- Retail trade numbers firm = not a complete collapse of household spending
- Inflation less than expected = scope for another rate cut maybe

Somewhat countering the view that the US economy is well and truly munted were the retail trade numbers released this week which showed retail spending rose a much stronger than expected 0.5% excluding the volatile automotives sector in April. Compared with a year ago spending was ahead 4.5% though once one realises consumer prices on average have risen 4% in the past year it becomes clear that volume growth is small – but still present and that is probably the most important thing for the moment.



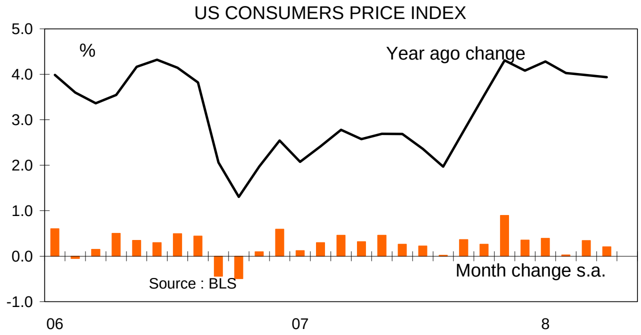


The same conclusion can be reached for exports where there is growth, but not as much as the nominal numbers suggest because of the lower NZD.

The US trade surplus came in at $58.2b in March to produce an annual deficit of $709b compared with $747b a year earlier. So the deficit is improving but it remains extremely large. The improvement over the past year has been caused by a combination of rising exports and slowing import growth hit by the weak domestic economy. Export receipts in the three months to March were ahead 17.6% from a year earlier while import payments were up 12%. But exports were down in the month for the first time in over a year suggesting weakness in other economies is hitting US production. Imports were down 2% in the month of March. The falling USD naturally boosts import costs and export receipts so volume movements will be substantially less than these numbers suggest.

Apart from these numbers nothing substantial was learnt about the US economy during the week except maybe that inflation is not necessarily scooting away to new horrible levels. The consumer price index annual rate of change eased to 3.9% in April from 4% in March with the core measure excluding food and energy rising a seasonally adjusted 0.1% after rising 0.2% in March. This measure is now 2.3% ahead of a year earlier. What this tells us is that if we get the unusual increases in food and energy prices slowing down overall inflation may ease off – unless the headline increases feed into higher wage claims.

BNZ OFFSHORE OVERVIEW



The US labour market is easing off but so far job losses are relatively mild averaging just 65,000 a month compared with around double that at the start of the last recession in 2000. But rising raw material prices could also spark increases in US business selling prices if they can get away with boosting prices given the weakness in the economy. They probably can't and with data last week showing good productivity growth there are hopes that inflation may not become too huge a problem.

But that is just the markets' view this week. The underlying risk is that inflation does remain an issue going forward as it already is in so many other economies. That means at best there could be just one more easing of US monetary policy to come and next year rates are likely to be going back up again.

If you are an exporter reading this then consider what that will mean for the NZD/USD exchange rate next year as our interest rates fall and theirs go up sometime. This is the point where if you have made it through the almost five years of an above average exchange rate you are probably very cost conscious with a lean mean operation. Now you can do two things. First start to anticipate better revenue once hedging rolls off. Second, start planning greater capacity to take advantage of that lift in profitability.

Remember to allow for the rising cost of imported inputs, but budget for lower debt servicing costs. Maybe take advantage of the long overdue weakness in New Zealand's domestic economy to secure staff which other companies are laying off.

The USD has ended the week not much changed against the other major currencies. While there was buying following the better than expected April retail sales report there was selling after the CPI increase came in lower than expected. The results have divergent implications for monetary policy at the margin. The markets are in a position where in a way the simple passage of time is awaited to see whether the Federal fiscal stimulus package will have any decent impact on consumer sentiment and spending, whether interest rate cuts by the Fed. stop the rout in the housing market, and whether investors start to regain some faith in US banks and the cost of borrowing funds in wholesale markets continues recent small moves down.

The USD has ended against the Japanese Yen near 105 from 104.8 last week, against the Euro near $1.55 from $1.53, and against the pound near $1.946 from $1.954.

Want to find out about exporting to the US? Start here.
http://www.nzte.govt.nz/section/11728.aspx
http://www.mfat.govt.nz/Countries/North-America/United-States.php

Australia

GDP +3.9%, CPI +4.2%, cash rate 7.25%, 39% of NZ visitors (but 16% spending) & 22% of exports, $47b FDI in NZ, 1.2% global GDP. NZ exports to Australia 20.2% (oil) year to Feb, tourists 6.3%.

No major developments have occurred in Australia over the past week to alter the prevalent view that growth will come in just below 3% this year and next with solid support from an infrastructure and minerals boom which could last a great number of years. Concerns are strong about high inflation and while interest rates may not be raised again they might not be cut until next year. Meantime these high rates are worsening a housing shortage.

The main piece of news in Australia this week was the Federal government's budget. A record surplus of $22b was announced, tax cuts delivering $20 a week to the average employee, a very small 1.1% rise in government spending, and ending of some tax benefits for upper income earners. The Treasurer's aim is to help the Reserve Bank fight inflation while keeping the raft of pre-election tax cut and spending promises. One interesting element is a sign that the massive boost to Australia's growth and the government's accounts from the minerals boom is not going to be squandered. Three special multi-billion dollar funds have been set up to invest in future years in the health, education, and infrastructure areas.

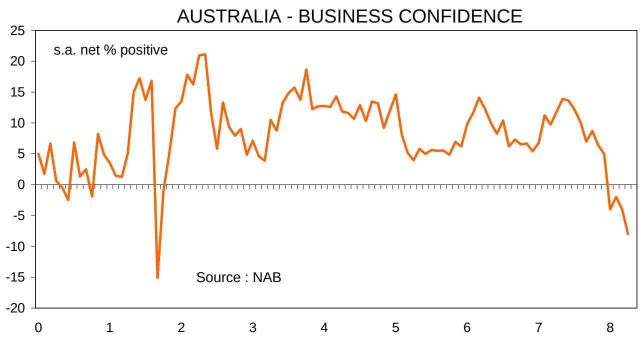
The economic forecasts contained in the Budget look reasonable but because at best there was only a small tightening of fiscal policy which matched market expectations the implications for monetary policy are only slightly positive from a borrowers point of view.

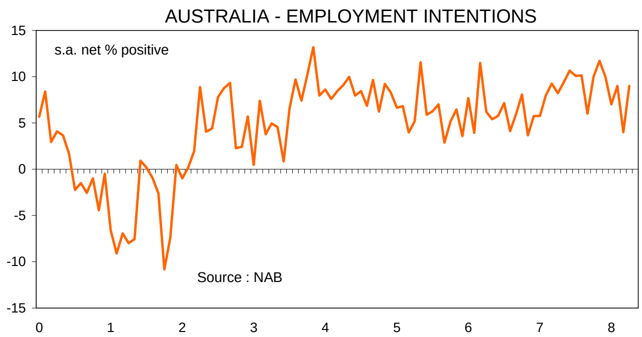
One good piece of news from an inflation point of view during the week was the release of data showing slower than expected wages growth. The private sector wage price index rose 0.9% in the March quarter seasonally adjusted after gaining 1.1% in the December quarter and 1.1% a year earlier. The annual rate of change eased therefore to 4.1% from 4.3% in December. The quarterly increase was the smallest in 18 months and at the margin takes a wee bit of pressure off the RBA to tighten again.

In March the seasonally adjusted number of housing finance approvals was down 6.1% from February following a 6.8% fall the previous month. The number of consents for investment properties fell 7.2% after falling 10.1% in February.

Other indicators for the housing sector also remain very downbeat and this is leading to a high degree of concern about ongoing rent increases in an environment where there is an under-supply of dwellings. Investors are being scared away from fresh construction because of high interest rates. But more dwellings are needed to cap rents.

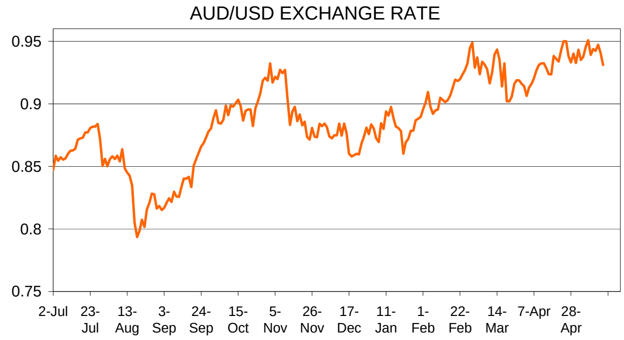
The NAB monthly Business Survey recorded another fall in business confidence in April to a net 8% of respondents feeling the economy will deteriorate over the coming year from 4% in March and 9% expecting an improvement six months ago.

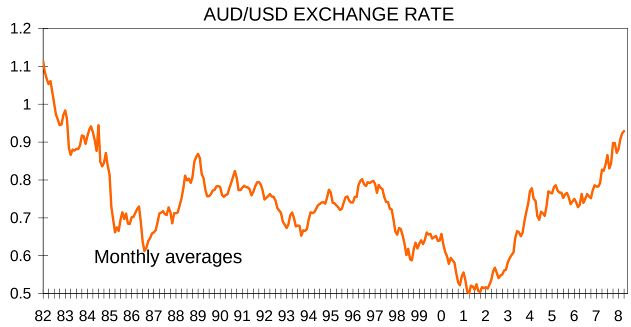




Interestingly however, in spite of reduced confidence employment intentions rose to a net 9% positive from 4% in March which is still well above the 4% average level for this index. Stock levels do not show signs of being a problem for businesses but capacity utilisation remains high and suggestive of continued firm capital expenditure levels.

With no earth-shattering data releases during the week the Aussie dollar has ended this afternoon against the greenback near 93.1 cents from 93.9 cents last week. There was support from some interest in high yielding currencies and oil prices hitting record levels, but also some profit-taking in an environment where some investors are becoming more willing to buy into the argument that the USD has finished its decline this cycle.





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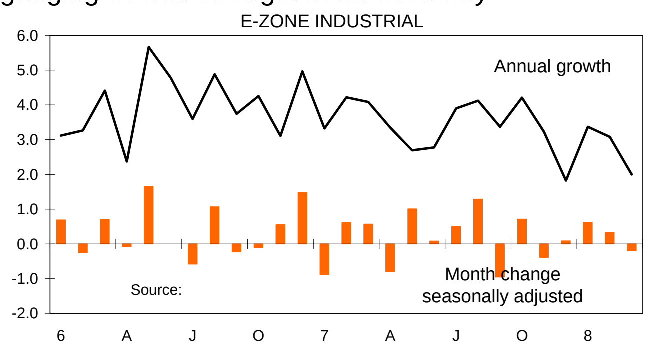
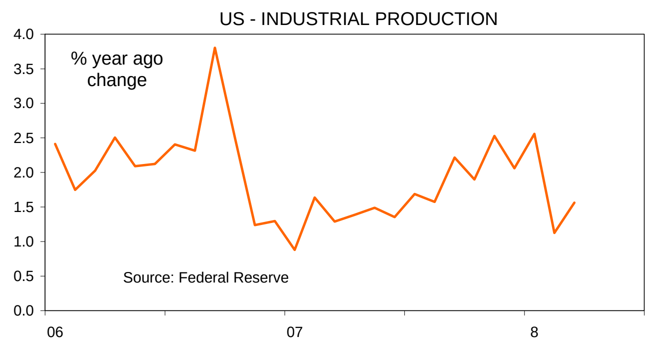
Euro-Zone

GDP +2.6%, CPI +3.3%, 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 -4.1% year to Feb, tourists 2.7%.

It has been a week where we have learnt little new about the current state of or prospects for the Euro-zone economy. Inflation concerns are paramount and increasingly over-riding worries about slowing growth associated with the credit crisis and rising fuel and food costs. A few officials have been talking the Euro down again trying to generate some momentum in its recent pullback against a USD showing minor signs of life on the back of a view that the US economy may not be as recessionary as previously feared.

Industrial production in seasonally adjusted terms weakened by 0.2% in March following a 0.3% rise in February and 0.6% rise in January. This pullback is quite mild then though the annual rate of growth in production fell to 2% from 3.2% in February. The graph shows there is a general slowing in growth underway but it is minor. Then again, the slowing is minor in the US as well, so this indicator is not strongly useful in gauging overall strength in an economy.

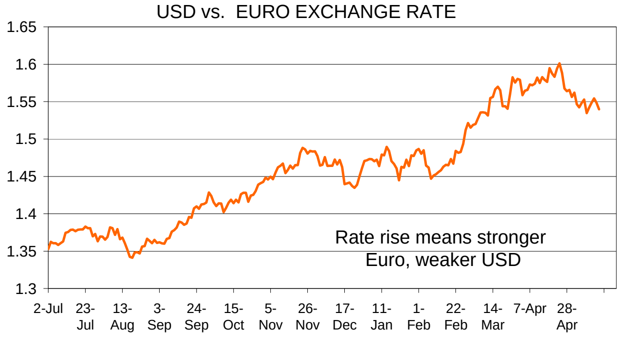


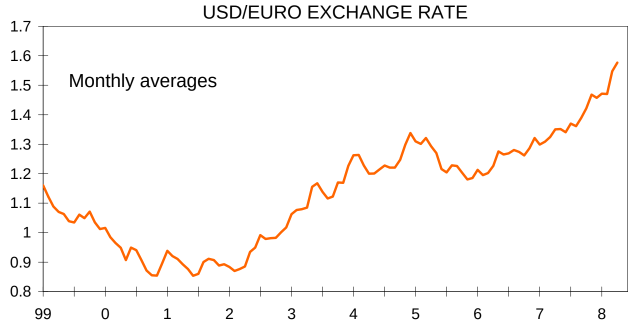


In the Euro-Zone expectations of lower interest rates in the near future remain very low with the ECB President yet again during the week reminding all and sundry that his focus is on inflation – not growth – and

that inflation is problematic. His concerns about inflation have been reinforced by the IMF's Deputy Chief warning that the speed-up in inflation poses challenges to economic stability.
http://www.bloomberg.com/news/economy/

The Euro has ended this afternoon against the greenback near $1.54 from $1.534 last week.





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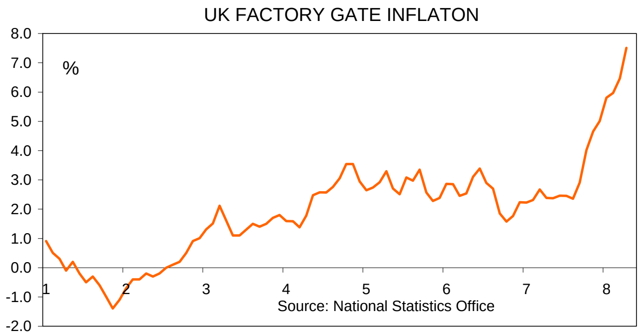
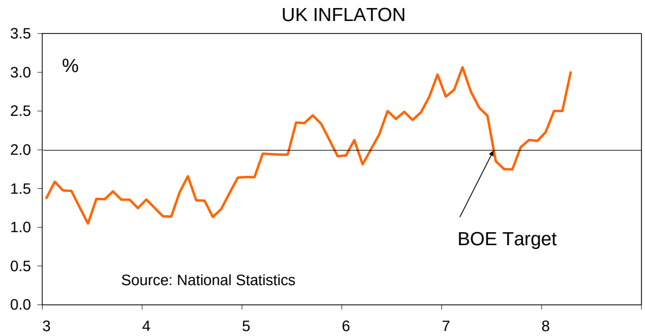
United Kingdom

GDP +3.0%, CPI 3%, base rate 5.00%, 12% of NZ visitors & 5% of exports, $4b FDI in NZ, 3.3% global GDP. NZ exports to UK -7.5% year to Feb, tourists -3.2%.

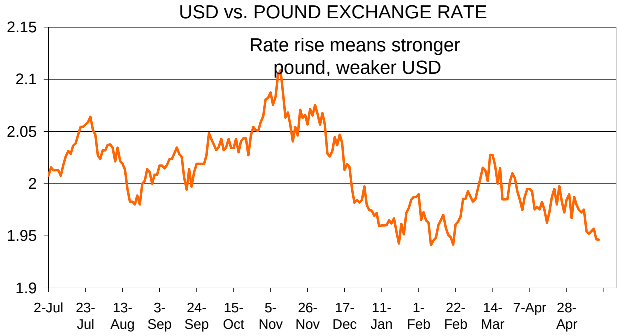
There was more bad news on the inflation front in the UK this week with factory prices on average rising a record 1.4% in April and 7.5% from a year earlier. Raw material prices were ahead a horrible 23% from a year earlier – though not horrible if you supply the raw materials like Australia does to China.

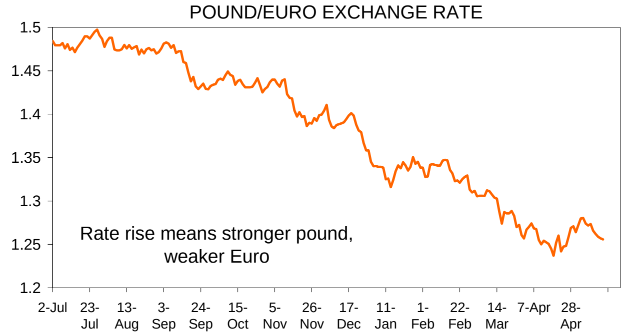




With factory output price inflation so high it is unsurprising that the annual rate of increase in consumer prices shifted to 3% in April from 2.5% in March. Once inflation goes above 3% the Bank of England Governor needs to write a letter explaining why there is so much divergence from the 2% target. Anticipating that letter the Governor this week warned that inflation above 3% is likely for several quarters and that further rate cuts would make matters worse.

His comments have led to a scaling back of market expectations that there will be additional monetary policy easing beyond the 0.75% already done since December last year. On the face of it one would expect such a change to boost the pound. But at the same time as the Governor warned of no further rate rises he said there could be a quarter or two of negative growth outcomes. That expression of concern about economic growth has dominated market sentiment so the pound has ended lower over the week against the USD near $1.946 from $1.954 and lower against the Euro near 1.255 Euro to buy one pound from 1.273 last week.





One should note that there is not inflation everywhere of course in the UK with house prices still tracking downward as buyers hold back because of high interest rates and an over-supply of buy-to-let properties. One report this week showed London house prices falling at their greatest rate in 14 years.
http://www.bloomberg.com/apps/news?pid=20601085&sid=aCm2hCtswJQs&refer=europe

The UK Chancellor announced a very small surprise fiscal package this week involving raising the threshold at which income tax becomes payable by £600 and at the same time lowering the threshold at which the top rate cuts in. In other words, more income redistribution. The size of the stimulus at about £2.7bn is tiny so it does not alter the outlook for continued restraint in retail spending.
http://www.fxstreet.com/news/forex-news/article.aspx?StoryId=1e2339ff-5ebe-4269-9413-42b433ef0b52

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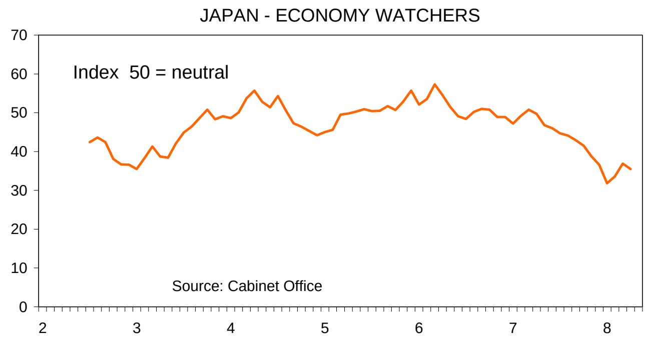
http://www.mfat.govt.nz/Countries/Europe/UK.php

Japan

GDP +2.0%, 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 -7.9% year to Feb, tourists -10.6%.

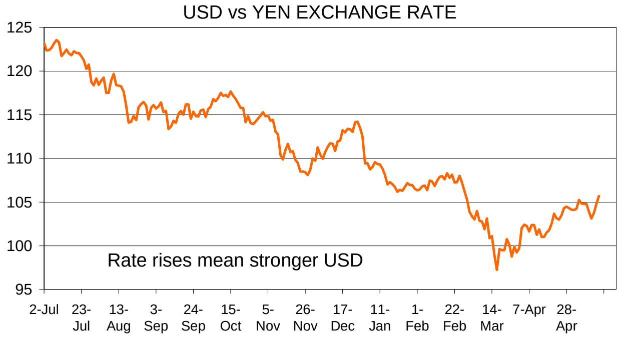
It has been a week of few data releases in Japan. One that did appear was the closely monitored monthly Economy Watchers Index. This declined in April to a reading of 35.5 from 36.9 in March and 49.7 a year ago. The index is still off its low of 31.8 in January but the decline seems to indicate increasing concern about rising household living expenses. The survey asks questions of those considered at the coalface of the economy such as taxi drivers, sales assistants, restaurant owners etc..

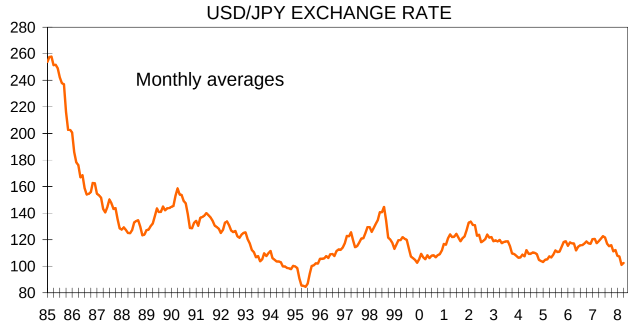


Apart from that little new has been learnt about the Japanese economy this week. Concerns about growth are strong, no-one seriously believes the inflation problems overseas will see underlying deflation worries in Japan end, the aging population is challenging those hoping for a sustained lift in consumer spending, and the capacity of the authorities to help the economy recover from the growth slowdown is near zero given interest rates are already at 0.5% and the fiscal accounts are in bad shape.

BNZ OFFSHORE OVERVIEW

The Yen has ended the week weaker against a slightly more favoured USD near 105.7 from 104.8 last week. This is the highest the greenback has been against the Yen since the end of February.





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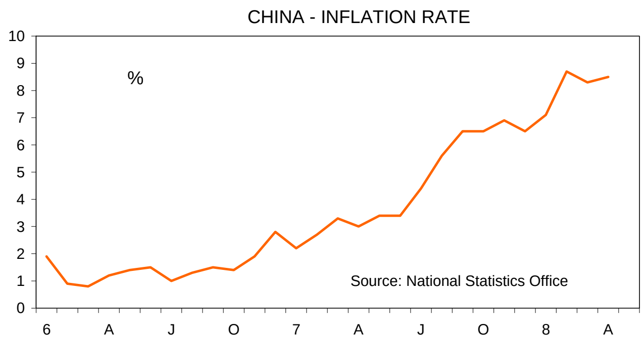
http://www.jetro.go.jp/

China

GDP 11.9%, CPI +8.5%, 5% of visitors & 5% of exports, 11% global GDP. NZ exports to China +8.1% year to Feb, tourists +8.5%

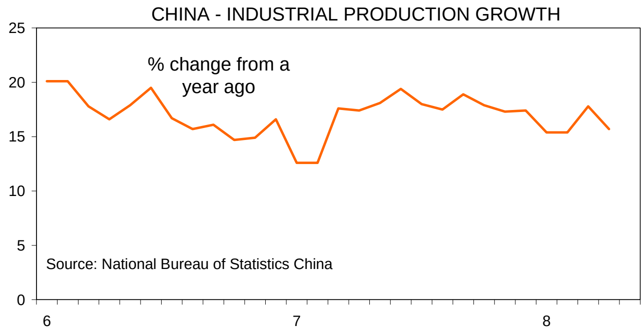
The past week has produced a raft of data releases in China showing high inflation, strong household spending, lots of business investment, but easing growth in factory output

The annual rate of inflation in China rose back to 8.5% in April from 8.3% in March. High inflation is a major issue in China with food costs increasing sharply over the coming year and creating concern about how happy the populace are with performance of the Chinese economy in an environment where wages growth may not always keep up with cost of living increases – not too many unions one suspects.



In response to the rise in inflation and concerns about more down the track the People's Bank of China for the fourth time this year increased the level of reserves banks must set aside when making loans. The reserve ratio now sits at a record 16.5%. Higher interest rates look highly likely to follow though the authorities will be concerned about the more direct impact this has on living costs than general attempts to restrict credit availability. Such attempts to restrict lending growth seem doomed to failure as efforts to stop the Yuan rising involve injecting cash into the Chinese monetary system.

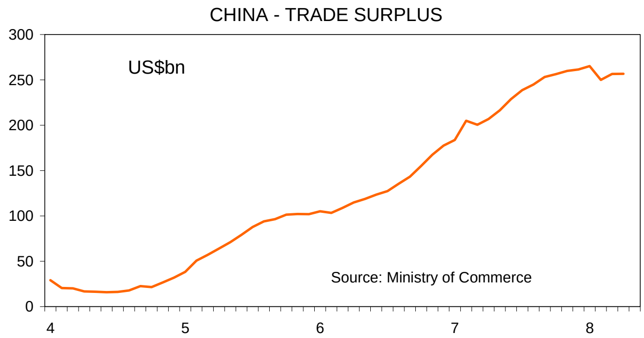
Retail spending in China in April was ahead 22% from a year earlier which was up from 21.5% growth in March and the fastest rate of growth since at least 1999. The firm result shows that domestic growth in the Chinese economy remains strong in spite of rising interest rates and some signs of cooling in the housing market. In other words, monetary policy tightening is not really having much impact. But then the main target of monetary policy tightening is reduced investment growth. A key concern about the Chinese economy is not just inflation but a potential boom bust cycle in construction of buildings, plant and even infrastructure



In that regard again one concludes monetary policy tightening is not working. The annual rate of growth in investment in urban fixed assets (factory and property spending according to some definitions) was 25.7% in April which was only slightly down from 25.9% in March, but up from 24.3% in February and 25.5% a year earlier.

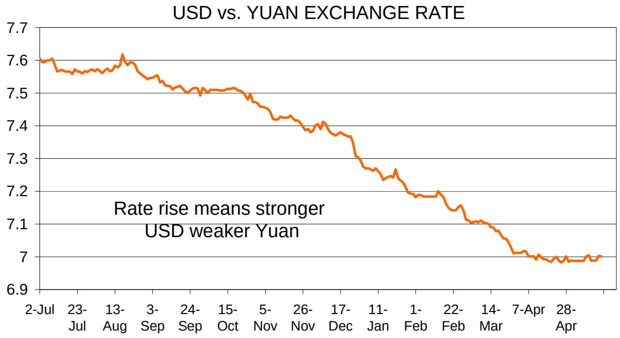
At least industrial production growth has slowed - to an annual rate of 15.7% in April from 17.8% in March. This mild easing in growth still leaves the rate at a relatively high level though which like the strong retail spending growth suggests firm monetary policy is not much hurting domestic activity.

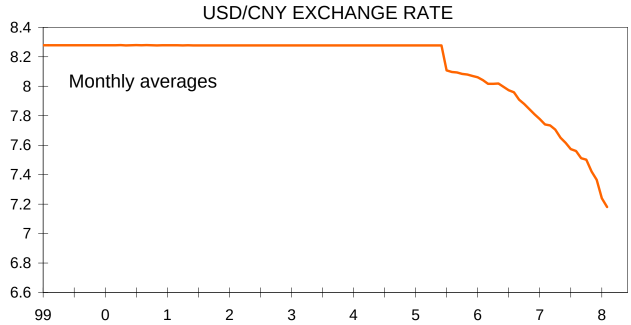
In April the USD value of China's exports was ahead 21.8% from a year earlier taking three month growth to 19.8% from 23.6% in the three months to January and 25.8% a year earlier. So there is a slowdown but the actual pace of export growth still remains very strong. With imports ahead 26.3% of a year earlier in April the trade surplus came in at US$16.8 in the month which was basically the same as a year ago. The annual trade surplus now stands at US$257b from US$207b a year ago and US$64b four years ago.



Over the week the Yuan has fallen back below then risen back above 7.0 to the USD to end little changed near 7.0014 from 7.0049. The pace of the Yuan's trend rise (meaning a fall in the exchange rate quoted here) against the USD has slowed recently with the authorities perhaps not wanting the rate to race away now that the 7.0 level has been breached downward a number of times since April 10.

BNZ OFFSHORE OVERVIEW





But with inflation staying high and growth indicators strong, it is inevitable that the Yuan will strengthen – though picking the pace is hard if one also buys into the argument that light at the distant end of the US credit crisis tunnel means some strength for the greenback. Good luck.

Want to find out about exporting to China? Start here.
http://www.nzte.govt.nz/section/11728.aspx
http://www.mfat.govt.nz/Countries/Asia-North/China.php

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