Offshore Overview

13 November 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.

Currency Movements	**1**	**Australia**	**6**
United States	**5**	**Other Economies**	**7**

EXCHANGE RATES

	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
NZD/USD	0.562	0.598	0.60	0.693	0.749	.574
NZD/AUD	0.873	0.882	0.905	0.795	0.848	.858
NZD/JPY	53.9	58.6	60.4	75.8	82.3	66.8
NZD/GBP	0.375	0.377	0.35	0.366	0.363	.338
NZD/EUR	0.45	0.463	0.442	0.465	0.515	.51
NZD/CNY	3.84	4.08	4.10	4.75	5.56	4.68
USD/JPY	95.9	98.0	100.7	109.4	111.0	116.7
USD/GBP	1.499	1.586	1.71	1.89	2.06	1.687
USD/EUR	1.249	1.292	1.357	1.49	1.454	1.12
USD/CNY	6.8285	6.8269	6.8398	6.8613	7.4279	8.168
AUD/USD	0.644	0.678	0.66	0.871	0.883	0.67

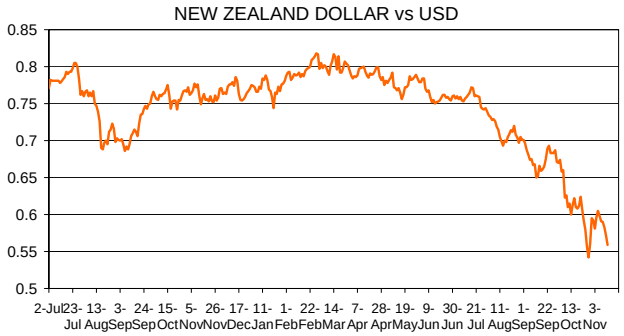
To receive this publication each Thursday night email me at tony.alexander@bnz.co.nz with "Subscribe" in the Subject line.

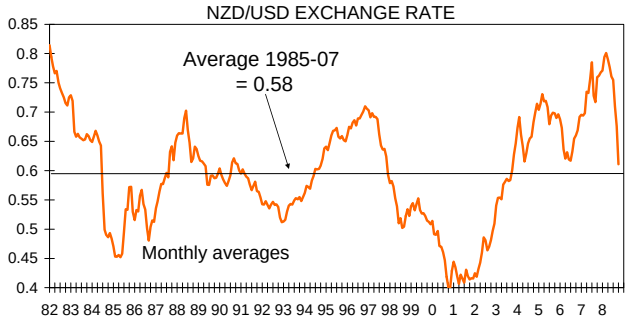
CURRENCY MOVEMENTS

The Kiwi dollar started the calendar week on a positive note with a boost on Monday above 60.0 US cents in response to hopes world growth prospects would be lifted by the large stimulus package announced in China over the weekend. But like so many other one-off developments recently the positive implications of the Chinese announcement have quickly been swamped by deepening concerns over the global recession.

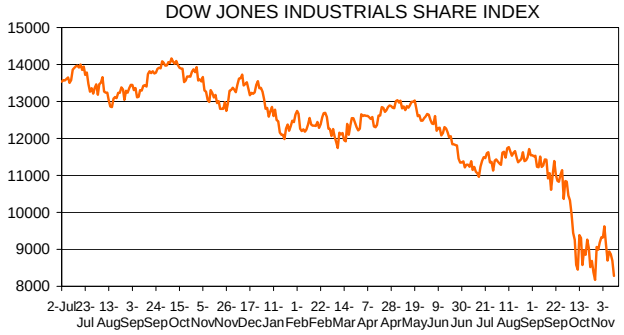
Only a month after releasing downwardly revised economic predictions the International Monetary Fund have further reduced their forecasts. They now expect world growth of 2.2% over 2009 which is down from a previous projection of 3%. They forecast the United States economy will shrink 0.7% next year, the euro area 0.5%, and Japan 0.2%. Activity in all advanced economies - as opposed to emerging economies - is expected to shrink by 0.3% which would be the first decline since World War II.
http://www.imf.org/external/pubs/ft/survey/so/2008/NEW110608A.htm

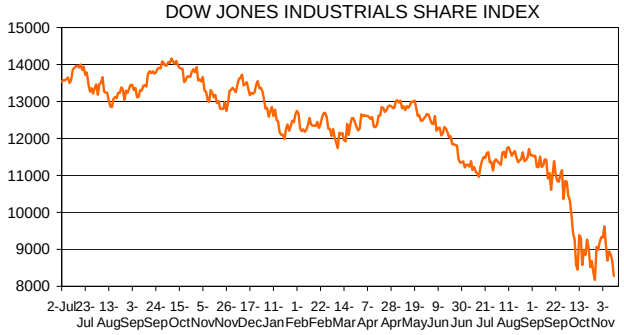
These renewed growth concerns have seen weakness reappear again for high yielding, commodity driven, risky currencies like the Kiwi and Aussie dollars. We have therefore ended this afternoon against the greenback near 56.0 cents which is roughly a four cent fall from a week ago.



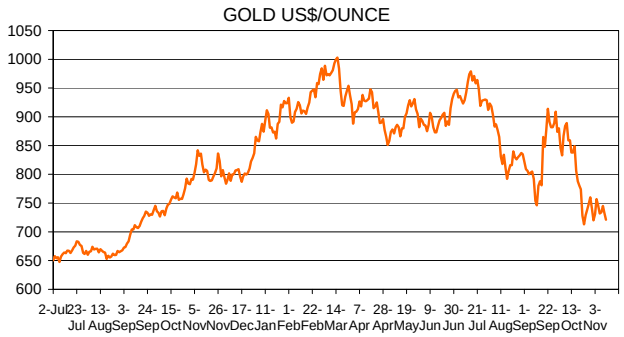


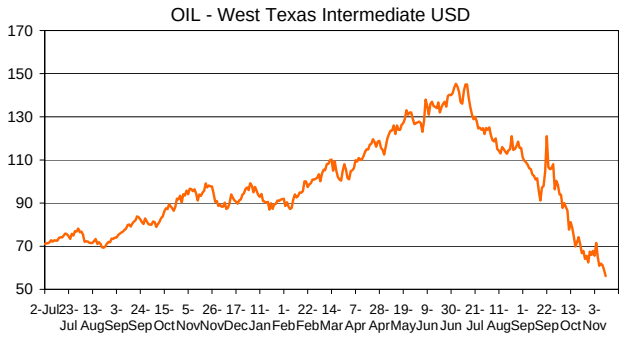
The jump in risk aversion which has driven the Kiwi dollar lower can also easily be seen in other measures. The Dow Jones index has fallen almost 10% over the week, the Nikkei share index 6%, the Australian market almost 10%, and the UK FT100 almost 8%.





Gold prices have weakened to around US$720 from just below US$750 last week, and oil prices have fallen 14% to around US$56.0 a barrel for West Texas Intermediate. At least that is something to be happy about with petrol prices likely to fall again in New Zealand in the very near future.



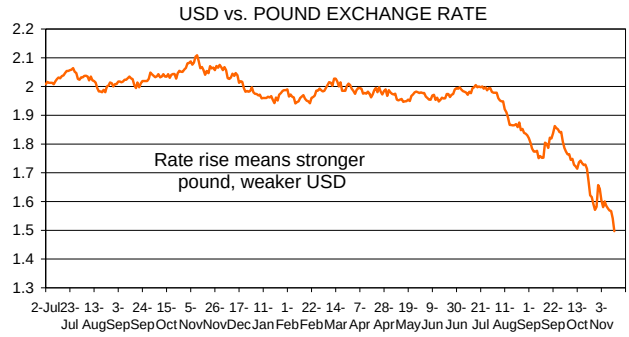


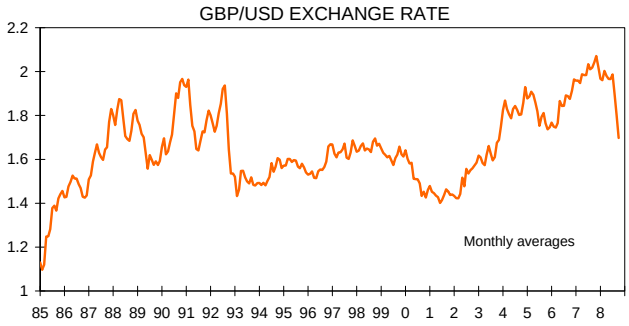
The trend in the Kiwi dollar is decidedly downward and it is likely we will decline below 50.0 cents over 2009. But whether that occurs in the first week of January or the last week of December is impossible to pick. Volatility in financial markets is huge at the moment with massive uncertainty about how bad conditions are going to get in the global economy next year and how quickly conditions in banking systems will improve. Thankfully improvements in credit markets are occurring as a result of the initiatives taken by governments and central banks over the past couple of months but the economic damage is not yet clear to see.

It should be noted however that weakness in the Kiwi dollar is so far mainly occurring against the greenback and the Japanese yen. That is because these currencies are the main beneficiaries of the current huge uncertainty about the world economy.

The pound for instance has fallen to a six year low against the USD near $1.499 from $1.586 last week. It has been pushed lower by a continuing stream of bad news out of the United Kingdom. Last night we learned about a further rise in unemployment, retailers keep releasing commentary about weakness in consumer spending, and housing market indicators released during the week show prices continuing to decline at a large rate exceeding 3.5% in the month according to one measure. The Bank of England

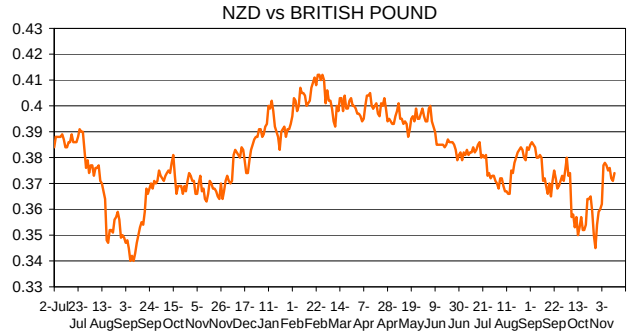
Governor has noted he will take interest rates as low as is necessary in order to offset the worst effects of the recession, with worries about inflation now completely thrown out the window. The Bank of England project inflation will fall below the 2% target next year and head towards 1% over 2010.

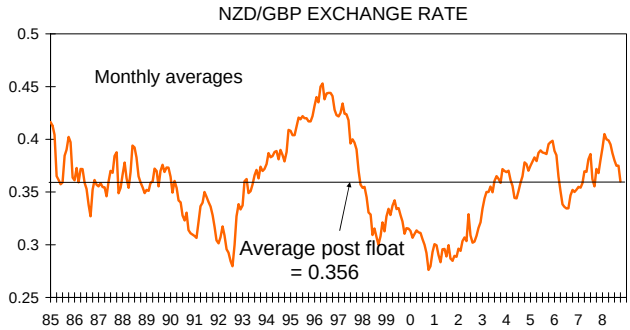




Having cut their interest rate by 1.5% last week to 3% it seems likely in the short term the BOE will take it down to 2.25%.

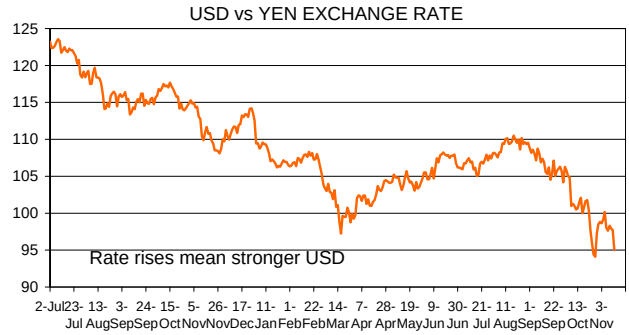
The weakening of the British pound has largely been matched by the weakening of the Kiwi dollar so we end this afternoon near 37.5 pence from 37.7 pence last week.

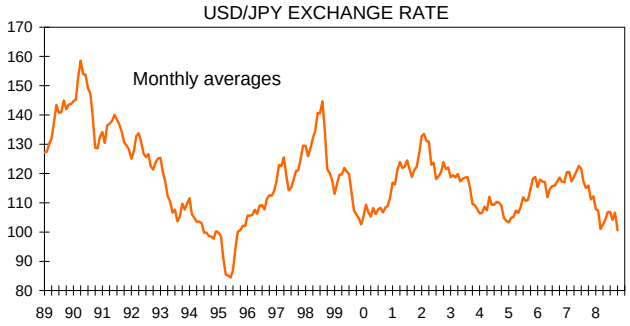




The fresh bout of concern about the depth of the global recession during the week has seen the Japanese yen once again rise strongly. It tends to rise when worries are strong because of expectations that Japanese investors will take even more of their funds out of other currencies and keep them close to their chests at home. In addition the worse things look internationally the greater the cuts in interest rates outside Japan and therefore the smaller the attractiveness to Japanese investors of foreign currency denominated assets.

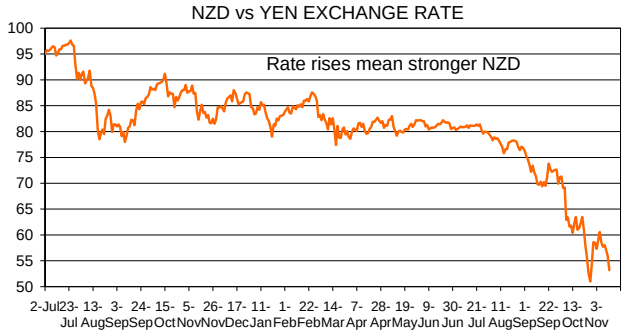
The Japanese yen has ended this afternoon against the greenback near 95.9 from 98 last week. This is back toward the level of ¥94 reached on October 28 and given the way sentiment overseas continues to deteriorate we could easily see that level breached again.

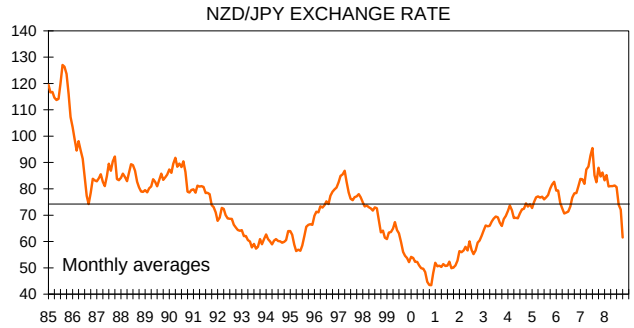




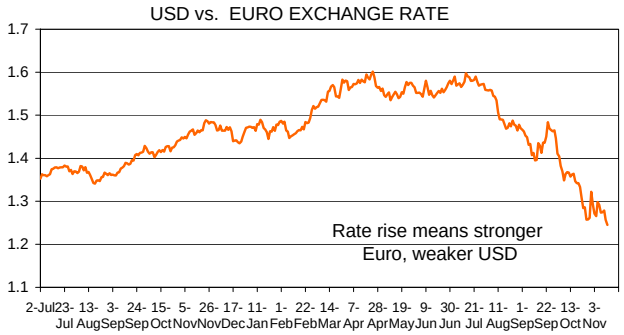
With the Japanese yen firming again it is unsurprising that we have seen the Kiwi dollar decline against it. But at the same time as the yen has been rising the Kiwi dollar itself has been facing individual downward pressure because of the rise in global risk aversion. As noted above we are viewed as a risky currency and with people increasingly worried about where things are going internationally they don't want high exposure to risky assets. That means they sell equities, commodities, and peripheral high yielding currencies like the Kiwi dollar. We have ended this afternoon against the Japanese yen close to 53.9 compared with 58.6 last

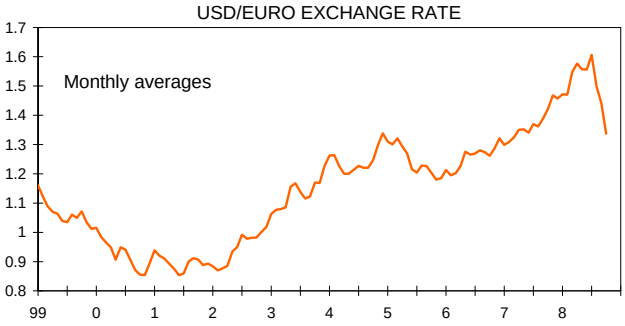
week. This is close to the low of 51 seen on October 28 and it is highly probable we will see that level breached again at some point in the future. One would have argued vociferously against this particular forecast a few months ago but at the moment one could not discount the Kiwi dollar falling back to the ¥44 level seen back in late 2000.



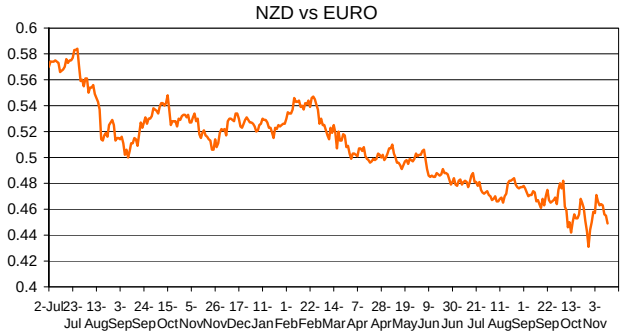


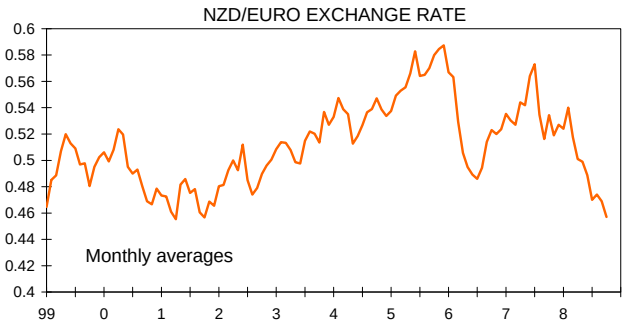
Because the euro has partially benefited from investors leaving the British pound it has only declined to a 1 1/2 year low against the greenback near $1.249 from $1.29 last week.



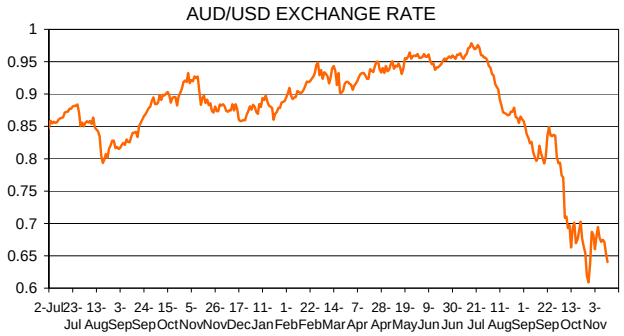


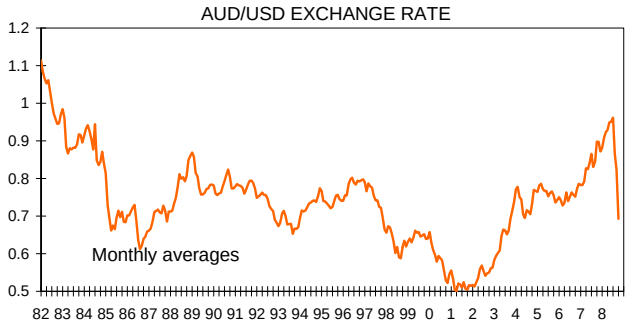
This less than appalling fall for the euro recently means the independent decline in the Kiwi dollar against the greenback has shown up with weakness against the euro and a rate this afternoon near 45.0 cents from 46.3 cents last week. This is still above the low just under 43.0 cents reached on October 28 - a number we are probably going to trade at again in the very near future.



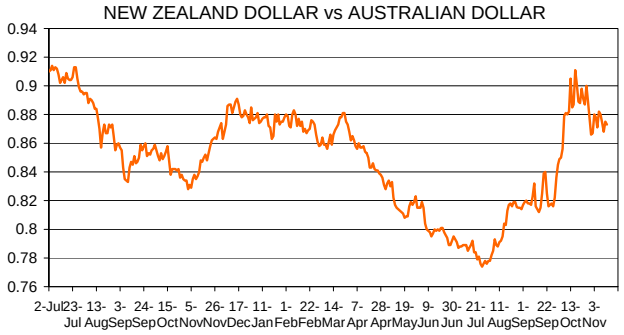


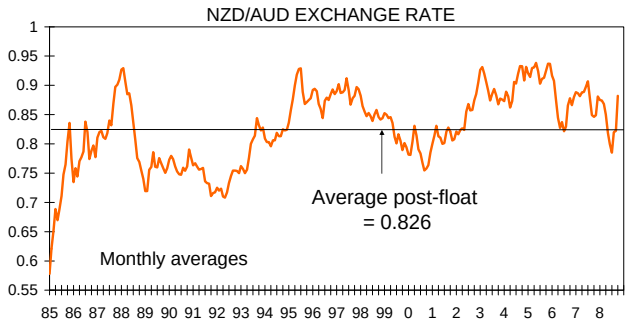
The Aussie dollar has fallen about 3 1/2 cents against the greenback over the past week to end near 64.4 cents from 67.8 cents last week. This weakness reflects enhanced expectations for the size of the Reserve Bank of Australia's next interest rate cut on December 2 in response to week business sentiment numbers during the week and downbeat comments about the economy from the Reserve Bank Governor.





In spite of this for the Kiwi dollar has still itself declined against the Aussie dollar to end this afternoon still at an above average level (by about four cents) near 87.3 cents from 88.3 cents last week.





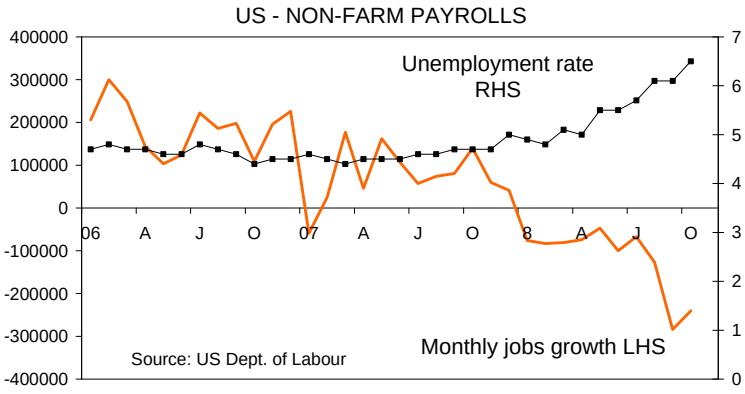
Currencies remain within the financial markets maelstrom and we are likely to see continued exceedingly high volatility in the coming weeks and months. The trend for the Kiwi dollar however is downward with a cyclical low point on a trade weighted basis likely to be reached perhaps in the second half of next year.

THE WEEK'S MAIN OFFSHORE EVENTS

United States Data

GDP -0.3%, CPI +4.9%, funds rate 1.0%, 9% of NZ visitors & 12% of exports, $10.5b FDI in NZ, 21% global GDP. NZ exports to US -7.0% year to August, tourists -1.3%.

The main piece of data out of the United States this week was the non-farm payrolls report for October. Job numbers fell by a slightly greater than expected 240,000 during the month while the unemployment rate jumped to a greater than expected 14 year high of 6.5% from 6.1% in September. Businesses are shedding jobs quickly in an environment where credit is exceptionally tight thus limiting new ventures and the financing of current operations. Sales are also weak as consumers slash spending because they also cannot get credit and as they grow despondent about falling housing and equity wealth plus the bad news from the financial markets.



The number of people in work is now 0.8% down from a year ago and over the past three months over 600,000 people have lost their jobs.

The other big piece of news out of the United States over the week, apart from huge discussion about the potential collapse of the motor vehicle industry, was a speech last night by current Treasury Secretary Henry Paulson. He noted that so far $125 billion worth of the $700 billion financial bailout package has gone towards capital injections of banks which account for about 55% of all bank assets in the United States. That is good. But what shocked the market and sent the Dow Jones down 411 points last night was the announcement that the TARP - Troubled Assets Relief Program - would not be used to purchase troubled mortgage assets from banks. This was the original plan which then morphed into some capital injections out of the $700 billion as well.

The Treasury Secretary said that he feels this is not the most appropriate use of the finances at his disposal and instead three other points of attack will be undertaken. First, more capital will be injected into financial institutions - hopefully with equal contributions from private investors. Second, Treasury are going to investigate purchasing high rated securities issued by organisations leading consumer finance. This new approach is driven by major concern over the way the shortage of consumer finance is slamming retailers and domestic producers of retail goods - such as the motor vehicle industry.

Third, some measures may be introduced to forestall mortgagee sales and thus the rate at which foreclosed houses are being placed on the market by banks.

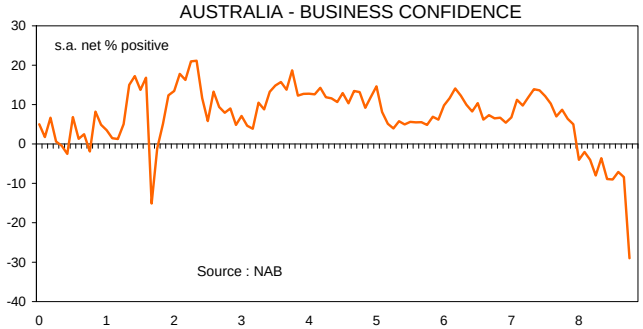
Its all just so many cups of water on the bonfire however and risks for US growth remain decidedly downbeat.

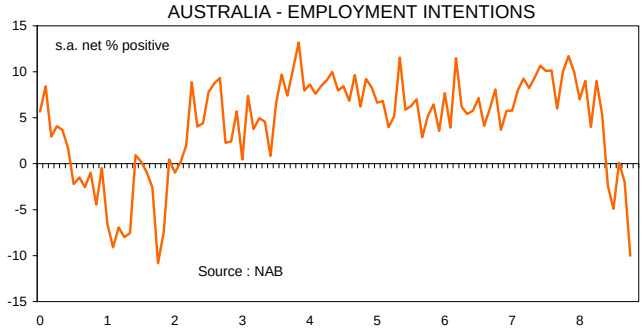
Want to find out about exporting to the US? Start here.
http://www.nzte.govt.nz/section/11728.aspx
http://www.mfat.govt.nz/Countries/North-America/United-States.php

Australian Data

GDP +3.7%, CPI +5.0%, cash rate 5.25%, 39% of NZ visitors (but 16% spending) & 22% of exports, $47b FDI in NZ, 1.2% global GDP. NZ exports to Australia 33.5% (oil) year to August, tourists 2.9%.

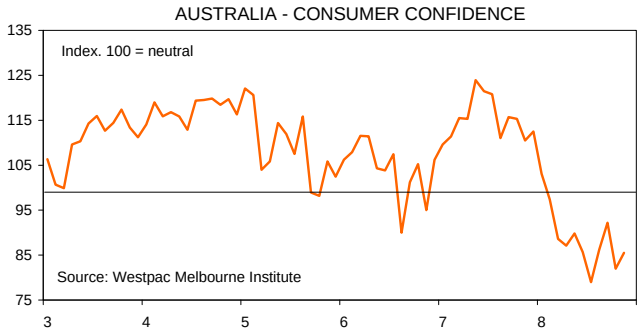
In Australia the key piece of bad news for the week was the results of the monthly business survey carried out by NAB. The business conditions index fell to its lowest level since 2001 and other indexes also plunged. Business confidence now sits at a reading of -29 compared with -8.4 in September. The average reading for the past 10 years has been +8. The employment index fell to its lowest level on record at -10 from -2 in September.





Businesses revealed sharply declining forward orders, but still rising business costs. The upshot is that it is highly likely the RBA will cut their cash rate another 0.75% at the next review on December 2. The relevance of this for us in New Zealand is that the cuts across the ditch since our last rave review on October 23 will add up to 1.5%. This will place considerable pressure on our own central bank to cut perhaps as much as 1%.

But not everybody is becoming more and more pessimistic about prospects for the Australian economy. Assisted by the government's $10 billion fiscal package, the bank retail deposit guarantee scheme, and falls in petrol prices and interest rates, consumer sentiment has improved. The Westpac Melbourne Institute index rose to 85.5 in early November compared with 82 of October. A reading of 100 is considered neutral and the result is still consistent with extremely poor retailing conditions and the housing market also remaining weak.



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

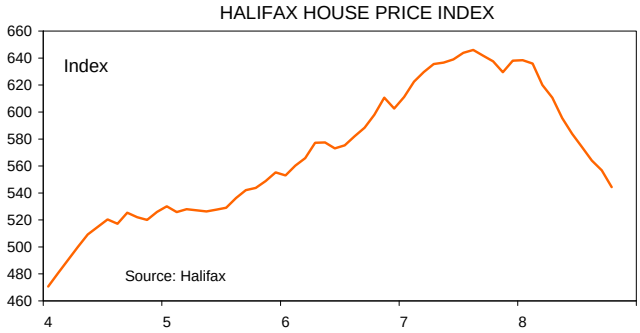
OTHER ECONOMIES

United Kingdom

The Bank of England surprised the markets last Thursday night with a 1.5% cut in the cash rate taking it down to 3%. A cut of 0.5% had largely been expected with a few forecasters thinking there may be as much as a 1% reduction. This is the largest one off reduction since 1981 and takes the interest rate down to its lowest level since 1954.

The Bank of England appears to have reacted to criticism that they are behind the curve with regard to easing monetary policy in response to the deteriorating economic situation in the UK and clearly want to catch the falling economy before it slips into an exceedingly deep recession. There are certainly no pieces of data being released indicating anything other than a continuing steep decline in the UK economy.

For instance the HBOS monthly house price index fell another 2.2% in October to lie 14.6% down from a year earlier. House prices have so far fallen approximately 16% from just over a year ago using this measure and further declines adding up to another 10% appear to be commonly expected over there.



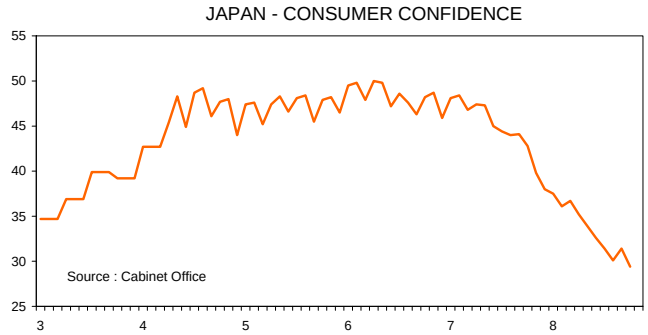
According to a survey by Deloitte and Touche Britons will spend about 7% less on Christmas presents and festivities this year than last year as discussed in the article referenced below.
http://www.bloomberg.com/apps/news?pid=20601085&sid=aOO2gV48h.Pg&refer=europe

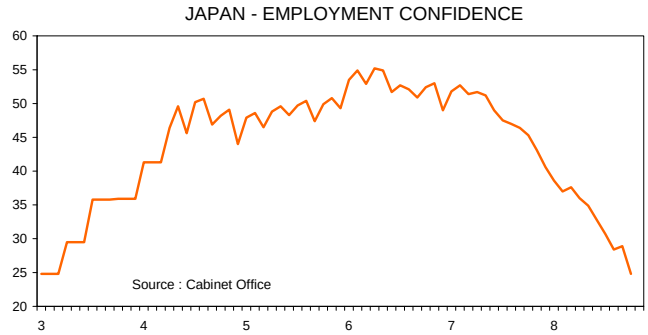
Europe

The European Central Bank joined in the round of interest rate cuts last week with a 0.5% reduction in its overnight cash rate which now sits at 3.25%. German business sentiment improved a tad in October. But overall the economic outlook remains seemingly poor. Credit availability is bad, export demand from previously strong markets like the Middle East, Eastern Europe, and emerging economies is falling, house prices are declining, sharemarkets a weakening, and unemployment is expected to rise relatively sharply.

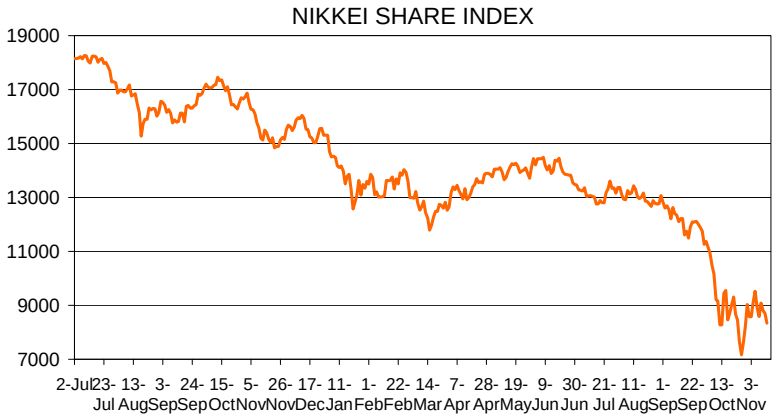
Japan

Consumer confidence in Japan has fallen to a record level according to the monthly Cabinet Office survey which was last carried out in the middle of October. The two graphs below show the appalling decline in consumer sentiment and optimism about employment since the first half of 2007. The survey will not have captured any positive impact on sentiment from the recent second instalment in the fiscal stimulus. But it would also not have captured the plunge in the sharemarket to over a three decade low in late October and the more recent recovery to levels still below where the market was at during survey time.





The Bank of Tokyo last week that their overnight interest rate by 0.2% down to just 0.3% but one struggles to see that this will have much of a positive impact on the economy. Worries in the export sector are high and not just because of recessions in trading partners but also the strength in the yen over the past few months.



China

China pulled out the stops this week with a huge fiscal stimulus spending plan of US$586bn and signals of some further easing of monetary policy. The package is equal to a huge 16% of GDP. The focus is on increased infrastructure spending along with more low rent housing, tax deductions for machinery investment, and increased farm subsidies and urban dweller allowances.

The announcement is important in a number of ways. It suggests that growth in the Chinese economy might remain relatively firm going forward and this has led to some strength in commodity prices during the week.

It is noteworthy however that a lot of the strength had disappeared within 48 hours because the impact of the Chinese package is going to be swamped by the deterioration in other economies.

At least there was a positive piece of data out of China this week. The annual rate of growth in retail spending held up at 22% in October from 23.2% in September and 21.9% in August. Hopefully the numbers vaguely resemble reality.

The BNZ Offshore Overview is prepared by Tony Alexander, Chief Economist at the Bank of New Zealand. Ph 04 474-6744.

This publication has been provided for general information only. Although every effort has been made to ensure this publication is accurate the contents should not be relied upon or used as a basis for entering into any products described in this publication. BNZ strongly recommends that readers seek independent legal/financial advice prior to acting in relation to any of the matters discussed in this publication. Neither the Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever that may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication.