Offshore Overview

7 August 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.

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EXCHANGE RATES

	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
NZD/USD	0.719	0.734	0.759	0.792	0.765	.574
NZD/AUD	0.789	0.778	0.788	0.833	0.891	.858
NZD/JPY	78.7	79.4	81.0	83.0	89.9	66.8
NZD/GBP	0.369	0.371	0.383	0.401	0.375	.338
NZD/EUR	0.466	0.471	0.483	0.51	0.554	.51
NZD/CNY	4.92	5.02	5.21	5.53	5.79	4.68
USD/JPY	109.5	108.1	106.7	104.8	117.5	116.7
USD/GBP	1.95	1.978	1.982	1.975	2.03	1.687
USD/EUR	1.54	1.56	1.57	1.553	1.38	1.12
USD/CNY	6.8487	6.8344	6.86	6.9871	7.57	8.168
AUD/USD	0.911	0.943	0.963	0.951	0.859	0.67

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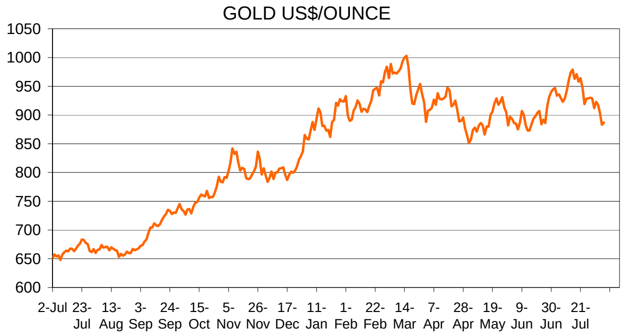
NZD MOVEMENTS

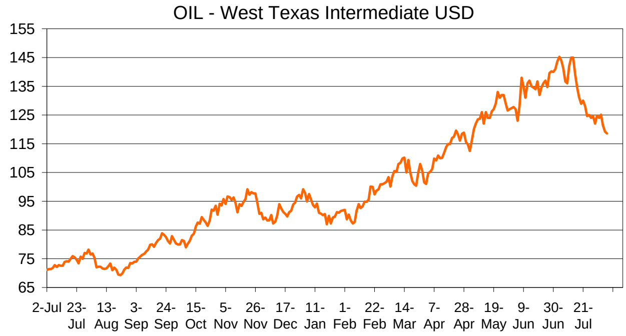
It's been another good week for New Zealand exporters with the Kiwi dollar consolidating just below 72.0 against the US dollar and falling on most of the cross rates. Downward pressure has come about in response to the New Zealand Treasury stating they believe the economy is in a recession, and the Reserve Bank Governor repeating his comments that plenty of scope exists for interest rates to decline. The general drift in the Kiwi dollar is downward and in fits and starts investors overseas are factoring that drift into the level of the exchange rate they are willing to accept in order to take a fresh exposure to the Kiwi dollar.

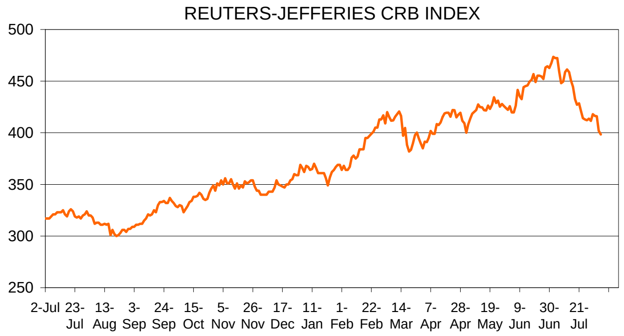
The NZD has however risen against the Aussie dollar to end near 78.9 from 77.8. This gain reflects a fall in the AUD in response to two factors. First the RBA have strongly signalled they are likely to cut interest rates very soon and we expect 0.5% worth of cuts before the end of the year and another 0.75% over 2009. Second, export commodity prices have also fallen away. The gold price overnight has ended near $887 from $912 last week while oil prices are near $118 from $124 last week.

In addition the CRB index which measures changes in prices of a range of commodities has fallen to just below 400 overnight for the first time since April.

BNZ OFFSHORE OVERVIEW



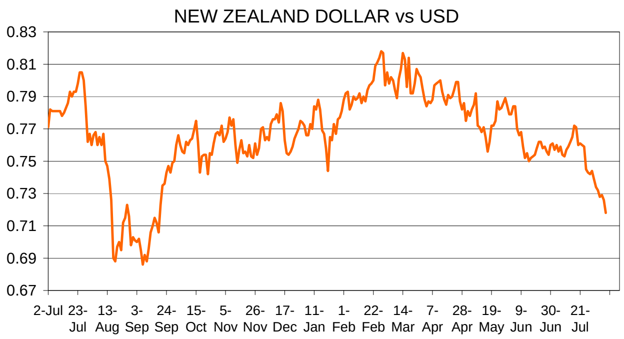


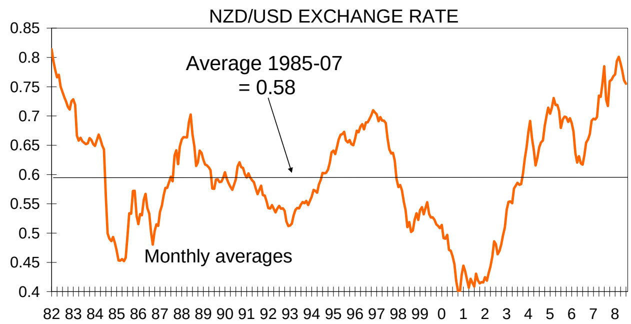


As we have been noting for an extremely long period of time, the Kiwi dollar is now firmly in the downward part of its cycle and it has now decreased over 10.0 cents from its peak against the US dollar above 82.0 cents back in March. What we have been saying since late last year has been that the next time the Kiwi dollar had a 10.0 set decline we expected the fall would stick as it were. There were declines exceeding 10.0 cents in 2004, 2006, and 2007 but because monetary policy was not embarking on an easing cycle the Kiwi dollar bounced right back up again.

That is not the case this time around and the Reserve Bank have said repeatedly that they plan to cut interest rates as long as there is not an excessive decline in the Kiwi dollar. We are we go from here for our currency is still broadly downward. The Reserve Bank is likely to cut the official cash rate 2% in the coming year from its current 8% level and for the next few months economic data releases are still likely to look quite poor even though there will be occasional signs of a rebound in activity such as the July housing data fall Auckland from Barfoot and Thompson.

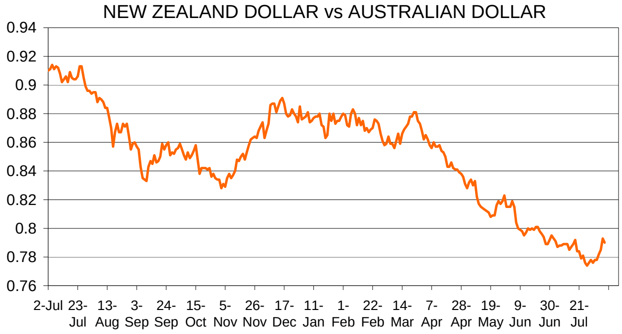
This afternoon the Kiwi dollar has ended against the greenback near 71.9 cents from 73.4 cents last week.

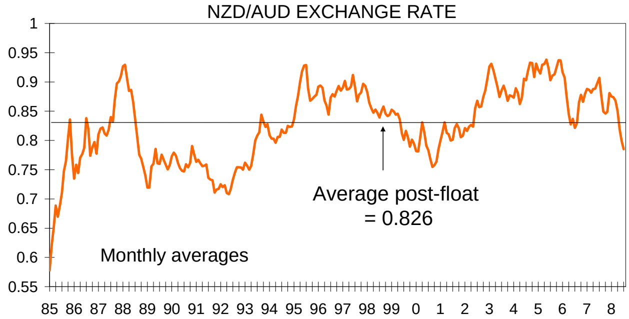




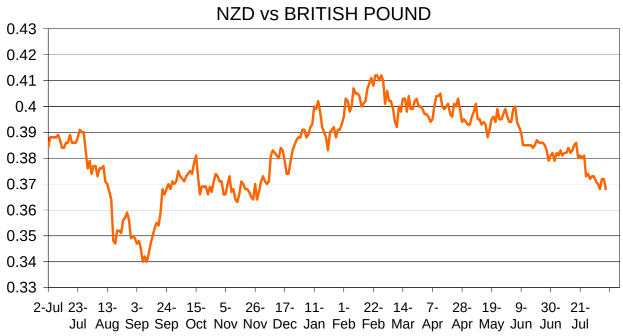
Against the Australian dollar we have risen to end near 78.9 cents from 77.8 last week.

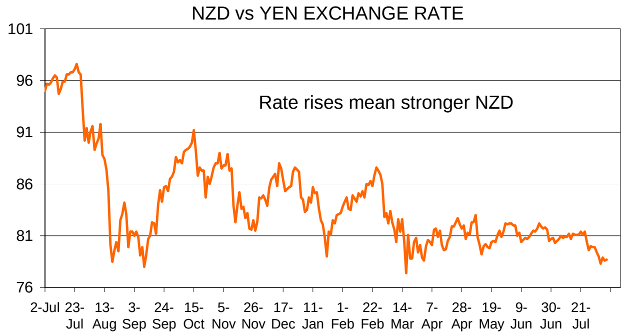
BNZ OFFSHORE OVERVIEW

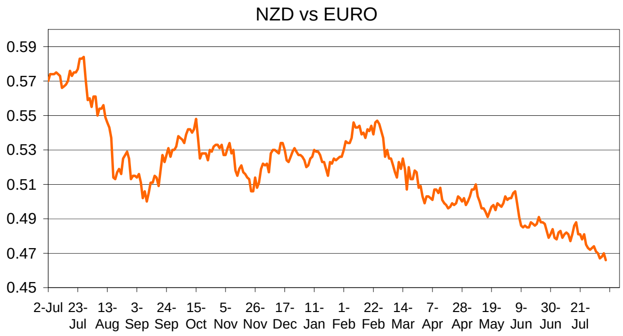


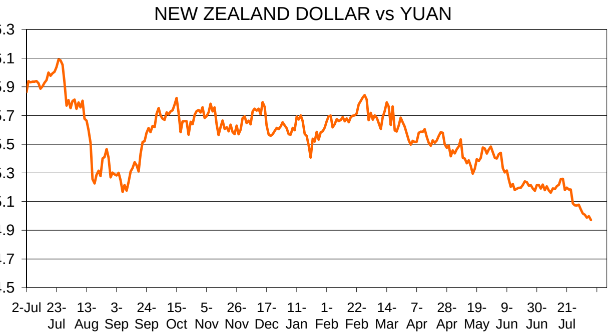


Against the British pound we have ended unchanged just below the 37 pence level while against the Japanese yen we have fallen to near 78.7 from 79.4. Against the euro we have fallen to near 46.6 cents from just over 47.0 cents last week.









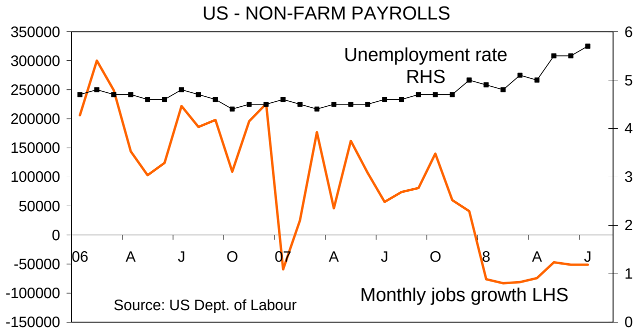
BNZ OFFSHORE OVERVIEW

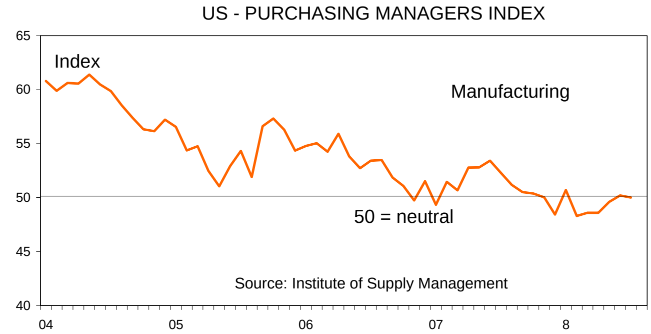
THE WEEK'S MAIN OFFSHORE EVENTS

United States

GDP +1.0%, CPI +5.0%, funds rate 2.0%, 9% of NZ visitors & 12% of exports, $10.5b FDI in NZ, 21% global GDP. NZ exports to US -12.7% year to May, tourists -2.2%.

Each month the most important piece of data to be released in the United States is the non-farm payrolls report. It shows the number of people employed outside the farming sector. In July in seasonally adjusted terms employment fell by 51,000 people for the second month in a row. This was actually less than the 75,000 fall the markets were expecting but reaction in the financial markets was not positive because the number of hours worked in July fell 0.4%. The average length of the working week was at its lowest level since the early 1960s and this is being read as a signal that economic growth has weakened off quite sharply in the early part of the second half of 2008 after holding up in the first half.

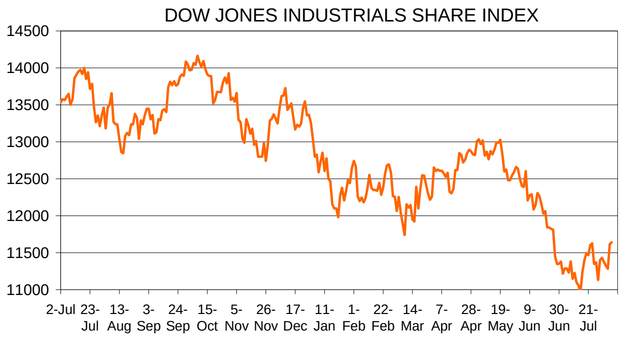


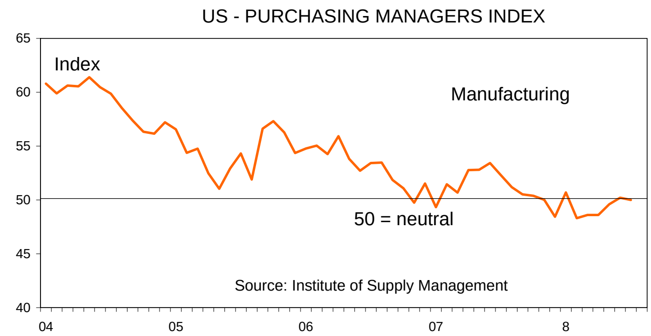


We learnt this week that the US economy grew at an annualised rate of 1.9% during the June quarter of this year which was less than the 2.3% expected but nonetheless still well away from zero and up from 0.9% in the March quarter and a revised 0.2% fall during the 2007 December quarter. Growth in the June quarter was assisted by the tax rebates package plus the smallest trade deficit in seven years as exports were boosted by the low dollar.

Adding to the growing concern that woe in the US housing market is nowhere near ending were comments from the former Federal Reserve Chairman during the week. Alan Greenspan said house prices are "…nowhere near the bottom…".
http://www.bloomberg.com/apps/news?pid=20601068&sid=aaZkP.moXYUY&refer=economy

And expectations of a weak outlook were reinforced by the Federal Reserve this week when they did as expected and left the funds rate unchanged at 2% but noted "Tight credit conditions, the ongoing housing contraction, and elevated energy prices are likely to weigh on economic growth." The next change in their key interest rate is likely to the upward but probably not for quite some time given the strength of worries about weakness in the United States economy. Reduced market expectations of the Federal Reserve raising its interest rate in the near future help account for some of the rebound in the US sharemarket over the week while the fall in oil prices explains a lot of the rest of the rise.





Activity certainly remained muted in the manufacturing sector in July with the Institute of Supply Management Performance of Manufacturing Index falling to a reading of 50.0 from 50.2 in June. A reading of 50 is considered neutral with no growth or shrinkage in the manufacturing sector and the fact that parts of the sector are being boosted by the lower dollar indicates other parts are being heavily suppressed by weakness in the domestic economy.

But perhaps the strength in exports is evident in the value of orders placed with manufacturers rising by a reasonably firm 1.7% in July after rising 0.9% in June. Orders were 5.5% ahead of the year earlier.

With the US sharemarket rising over 200 points during the week and falls in energy costs the US dollar has recovered further over the week to end against the Japanese yen at an eight-month high just over 109.6 from 108.2 last week. Against the British pound it has ended near $1.95 from $1.978 last week, and against the euro the US dollar has ended near $1.54 from $1.56 last week.

An occasional visitor to the United States this week sent in the following observations which readers may find interesting.

As I travelled around Silicon Valley, one could immediately see the affects of the financial meltdown on the high tech sector. There are literally hundreds of thousands sq. ft. of office space vacant (some of it Grade A which made me cringe given how hard it is to find good office space in Wellington!), but the large companies such as Cisco are building more office blocks on their campus. (Cisco's Campus would easily cover the area of Wellington's CBD and Te Aro districts combined.) In speaking to people, companies with established markets overseas are doing well mainly due to the weak US dollar but there is no venture capital for start-ups in the valley and therefore newly established companies moving into the cheaper, older space. A lot of older office space had notices out front saying that they were being demolished and residential would be constructed to replace this space but even this activity had stopped.
Any venture capital available is going into renewable energy such as huge solar farms being constructed out near the Mojave Desert.
http://money.cnn.com/2008/07/07/technology/woody_solar.fortune/index.htm?postversion=2008071104

The price of a gallon of gasoline ranges from $4.49 (NZD1.65 per litre) in California to $3.85 (NZD(1.39 per litre) in Texas although the range in prices within an area is quite startling. http://www.gasbuddy.com/

Has this stopped America's love affair with the car? No. We travelled on the I-10 outside New Orleans on a Sunday and in both directions, traffic was bumper to bumper. I was just as the busy as the motorway coming into Wellington on a weekday morning.
On the other hand, flying over car lots as we came into land in Dallas (Love Field) also showed new vehicles bumper to bumper. I was surprised to read that Ford had hired Toyota US's marketing boss and they going to start regional marketing campaigns instead of running them out of Detroit, however the main thrust of the article they could now promote the F-150 pickup in Texas over the smaller vehicles that Ford have!
http://www.dallasnews.com/sharedcontent/dws/classifieds/news/automotive/latestnews/stories/072608dnbusfordmarketing.3bfceec.html

Having been in San Jose and Dallas, I used their Light Rail systems keeping in mind that this is being advocated in Wellington and Auckland is building one. Both Dallas http://www.dart.org/ and San Jose are expanding their systems at incredible cost but they appeared to have very little impact at present. The most successful light rail link was the Trinity Rail Express link between Dallas and Fort Worth which had huge parking lots at each station and these were full during the day. So to be successful, as we know in other parts of Wellington, rail has to be used in conjunction with the motor vehicle not as a total replacement.

New Orleans is still a basket case. Three years after Katrina, the tourists have come back but not the former residents. Houses remained boarded up in the flooded districts and downtown there appeared to be many promises to start the construction of commercial real estate e.g. Donald Trump http://www.trumptowerneworleans.com/ but it appears that the city is broke. A great deal of effort has gone into removing the flood marks from the property and infrastructure seen by the tourists. While we there, the Mississippi River was closed to river traffic due to a major oil spill and I read later that the impact on the local economy was over USD1 billion. The flooding further up the river basin has also had its impact.

We have flown Southwest Airlines for all our internal flights to date and their planes have been packed. This isn't a surprise given that Southwest have the cheapest flights due to a fuel hedging strategy but all the airlines appear busy and airports packed. Southwest's total operational model is very unique and would succeed in NZ if implemented – yes we can have three carriers. For many people there appears to be no signs of a recession but the effects of minimum wage rises, and increasing food and fuel costs is having its impact on businesses. Bennigan's Restaurant chain closes:
http://news.yahoo.com/s/ap/20080729/ap_on_bi_ge/bennigan_s_bankruptcy_filing
Hotels appear to be fully booked and a hotel operator told me yesterday that most have increased their room rates this year by 10%.

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

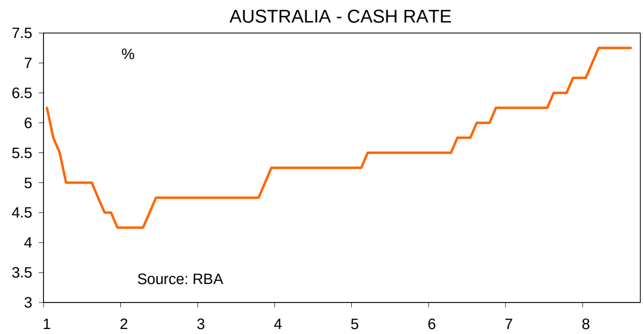
Australia

GDP +3.9%, CPI +4.5%, 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 23.4% (oil) year to May, tourists 5.5%.

As had been widely expected the Reserve Bank of Australia left it's cash rate unchanged at 7.25% this week having raised it 1% between August last year and March this year. What was not expected however was the explicit shift by the reserve bank of Australia to an easing bias with the statement

"Nonetheless, with demand slowing, the Board's view is that scope to move towards a less restrictive stance of monetary policy in the period ahead is increasing"

Evidence of demand slowing is easy to see. For instance last week it was reported that retail spending fell by a relatively strong 1% in June and indicators for the housing market are generally weakening while business and consumer sentiment levels are extremely low.

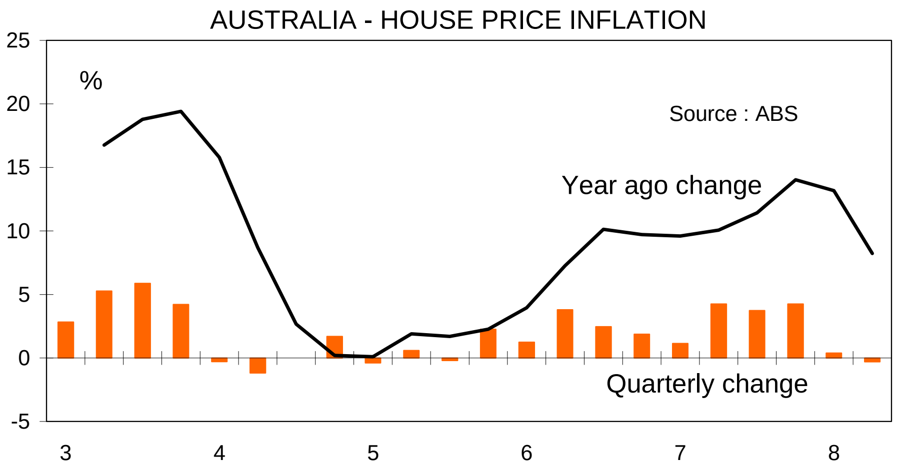


We expect the RBA will cut its cash rate 0.5% before the end of this year and come the end of 2009 the current 7.25% rate is likely to be at 6%. This reduction in interest rates will go a long way toward insulating the Australian economy against negative factors such as rising food, raw materials, and energy costs along with slowing trading partner growth and the effects of the international credit crisis. In particular widespread expectations of interest rate cuts will mitigate the decline in the housing sector.

Last week we noted that there is a downturn underway in the Australian housing market but not necessarily a large one. This is roughly the conclusion one could draw from the quarterly house price index released by the Australian Bureau of Statistics which fell 0.3% in the June quarter after rising 0.4% in the March quarter.

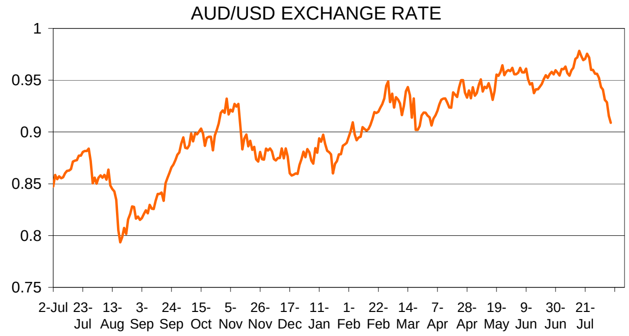
BNZ OFFSHORE OVERVIEW

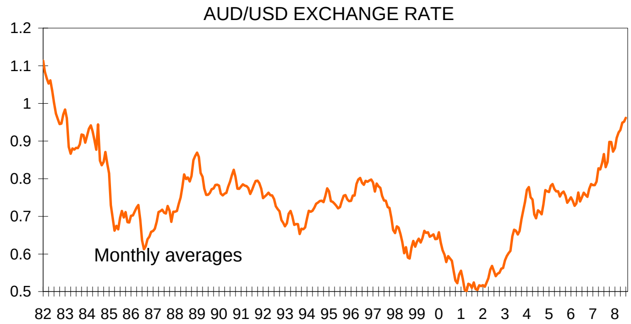
Average house prices across the eight major Australian cities were ahead 8.2% from a year earlier compared with 13.2% inflation in the March quarter and 10.1% a year earlier. This is the slowest rate of average house price gain since the first half of 2006. The graph below shows something we have referred to before regarding the Australian market having a pullback about three years ago so not being as vulnerable to current woe as other markets such as New Zealand, the United Kingdom, Ireland, Spain, and the United States.



Having said that, data released yesterday showed a sharp 3.7% seasonally adjusted fall in the number of owner occupied loans issued so borrowing for housing purposes is falling away quite sharply now.

The Aussie dollar has been pushed lower over the week depressed by falls in commodity prices associated with declines in industrial production around the world, weak economic data, and a shift to an easing bias by the Reserve Bank of Australia boosting market expectations of an interest-rate cut before the end of the year. The Aussie dollar has ended this afternoon near a four-month low against the US dollar down almost four cents from a week ago at 91.0 cents.





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http://www.nzte.govt.nz/section/11728.aspx
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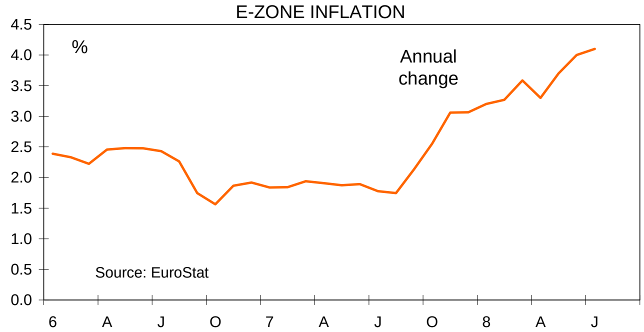
BNZ OFFSHORE OVERVIEW

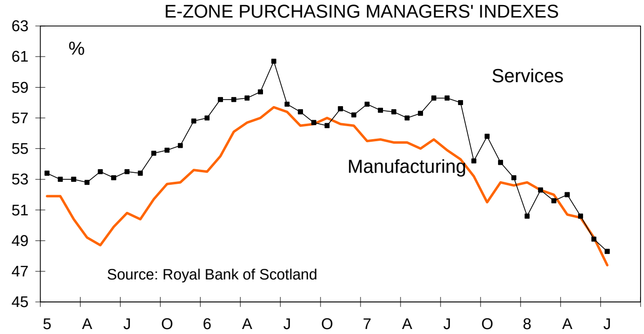
Euro-Zone

GDP +2.4%, CPI +4.0%, cash rate 4.25%, 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%.

In Europe the picture remains one of a continuing string of weaker than expected economic data. For instance this week Europe's biggest economy, Germany, reported that factory orders unexpectedly fell for the seventh month in a row in June, and there was a very weak retail sales report for July released earlier in the week. In fact for the entire Euro area retail sales in June fell a seasonally adjusted 0.6% from May and were down a whopping 3.1% from a year earlier.

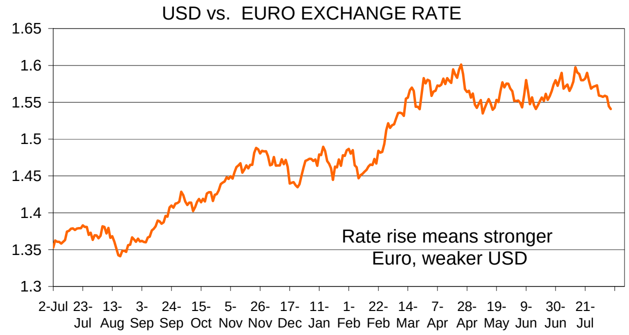
Inflation rose further in July to hit 4.1% from 4% in June and 1.8% a year ago. The ECB's target is 2% and comments from various officials have made it clear that tolerance of inflation so far away from 2% is extremely low even if the blame can mainly be laid at the door of higher petrol and food prices. And it is those higher petrol prices along with increased prices for raw materials, worries about the credit crisis and the impact on exports of a strong euro which would help account for the European manufacturing sector falling away. The monthly Purchasing Managers Index declined to a relatively low reading of 47.4 in July from 49.2 in June where a reading of 50 is neutral. This is the lowest reading since early 2003 and again builds into the picture of a weakening European economy. The services index also fell further in July.

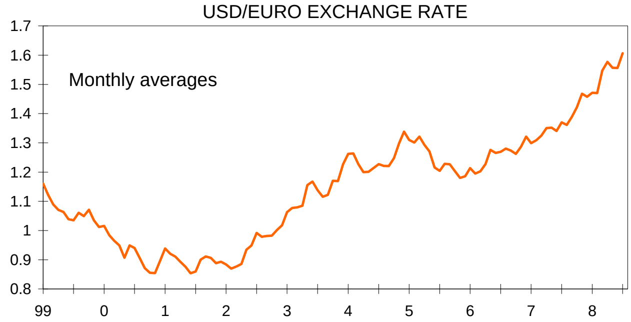




The jump in raw materials prices was clearly seen this week with the producers price index for the euro area rising 0.8% in June after rising 1.2% in May and 0.9% in April. Producer input costs are now on average 8% higher than they were a year earlier. This is the highest such rate of inflation since the series started in 1990.

With the US dollar generally firming assisted by falling oil prices the euro has weakened to a five-month low against the US dollar near $1.54 from $1.56 last week.





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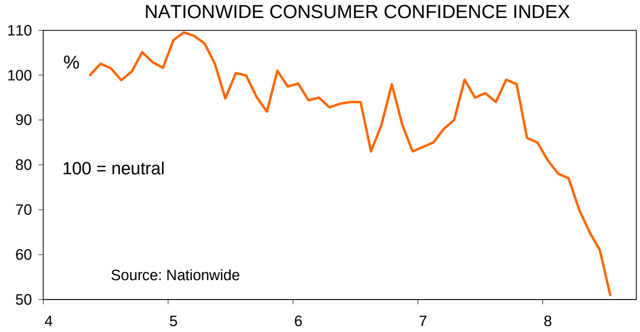
BNZ OFFSHORE OVERVIEW

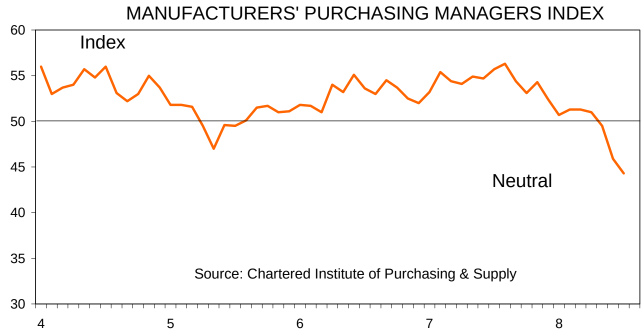
United Kingdom

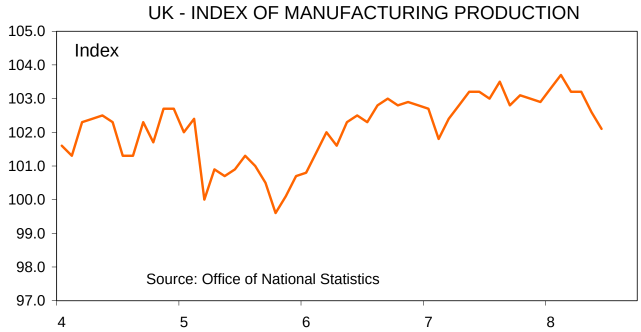
GDP +3.0%, CPI 3.8%, base rate 5.00%, 12% of NZ visitors & 5% of exports, $4b FDI in NZ, 3.3% global GDP. NZ exports to UK -4.7% year to May, tourists -3.6%.

The picture remains bad currently and in the near future for the UK economy with recession looking likely. This is most horribly seen in the monthly Nationwide index of consumer sentiment falling a whopping 11 points to a reading of 51 in July. It now sits at a four-year low in response to falling house prices and strong growth in the cost of living in the low reading signals only weakness should be expected for the retailing sector in the near future.



The manufacturing sector in the United Kingdom has been hit by a sharp increase in raw materials and energy costs, rising labour costs, and falling demand. This weakness was abundantly evident in the performance of manufacturing index released this week which fell to its lowest level in almost 10 years at 44.3 from 45.9 in June. In fact manufacturing output fell 0.5% in July after falling 0.6% in June and now sits1.1% down from a year earlier.



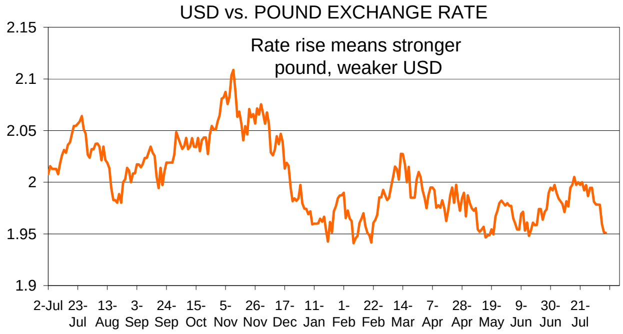


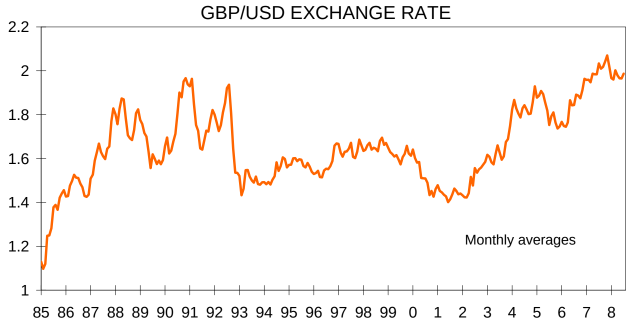
There is now widespread belief that the UK economy is probably in recession with manufacturing sector weakness reinforced by appallingly low levels of business and consumer confidence, the domestic impact of the global credit crisis, and the worst correction in the housing sector since the early 1990s.

This weakness was abundantly evident in the performance management index for the construction sector released this week which fell to an 11 year low of 36.7 in July from 38.8 in June where a reading of 50 is considered neutral.

With the factory output measure unexpectedly falling during the week, consumer confidence plummeting, and in light of the raft of other weak economic releases recently the pound has fallen to end this afternoon against the greenback near $1.95 from $1.98 last week.

BNZ OFFSHORE OVERVIEW





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

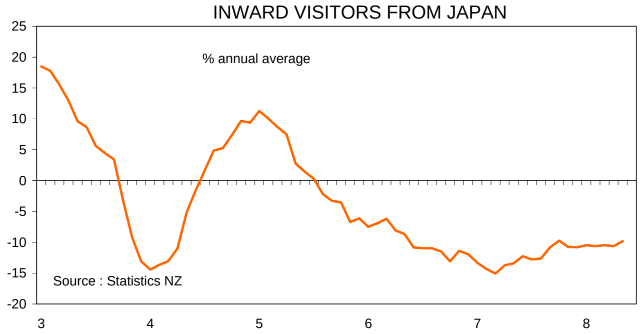
Japan

GDP +2.0%, CPI 0.8%, cash rate 0.5%, 5% of NZ visitors & 10% of exports, $1.8b FDI in NZ, 6.6% global GDP. NZ exports to Japan -7.1% year to May, tourists -9.8%.

According to the head of business statistics in the Cabinet office “ there is a high possibility the economy has entered a recession,…”
http://www.bloomberg.com/apps/news?pid=20601068&sid=agPMgTnteJP0&refer=economy

His comments come in response to a continuing deterioration in economic indicators in response to the global credit crisis, strong rises in prices for raw materials, food, and fuel along with a deteriorating fiscal situation and the inability of the Bank of Japan to respond as some other central banks have done by cutting interest rates.

Recent data releases have shown job numbers down 0.6% from a year earlier, appallingly low levels of consumer confidence, and faltering growth in exports. Given the still deteriorating global situation and the inability of the authorities to take practically any corrective measures to slow Japan's deterioration it would not seem reasonable for New Zealand exporters generally to expect firm trading conditions in Japan over the coming 12 months. It is likely we will see a continuing decline in the number of Japanese visitors to New Zealand in particular.

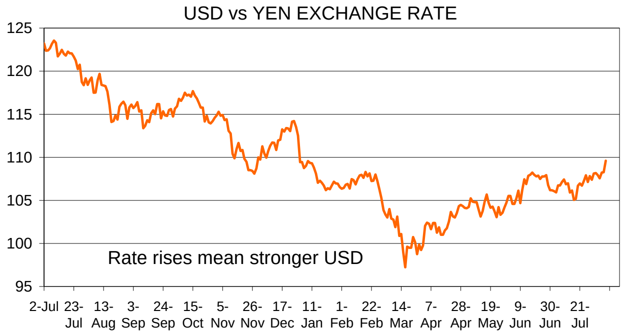


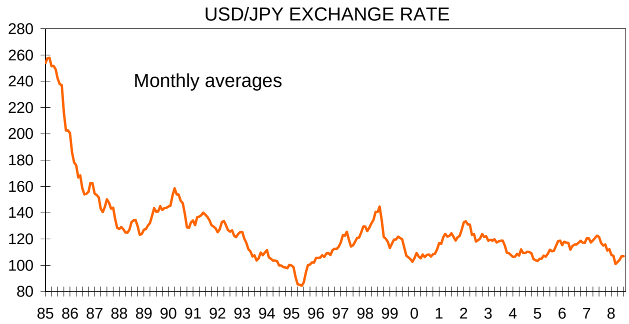
Reinforcing the poor fiscal situation in Japan the newly appointed ministers for Finance and the Economy see that they can't rely upon growth alone to meet the goal of balancing government's budget by 2011. This means either the goal is going to get pushed aside as was hinted at a few weeks ago or measures will be taken to improve the fiscal situation. This could mean cuts in spending or another move to boost the consumption tax. http://www.bloomberg.com/apps/news?pid=20601068&sid=aad.5rPVpFvY&refer=economy

This is one reason consumers remain cautious about their spending. There are concerns growth in the economy will be slowed by tightening fiscal policy in the next few years and that this could be one of the factors keeping the labour market on the weak side.

BNZ OFFSHORE OVERVIEW

Over the week the Japanese yen has continued to fall further against the US dollar to end this afternoon in the vicinity of 109.6 from 108.2 last week. This is the weakest level for the Japanese yen since the second week of this year.





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

China

GDP 10.1%, CPI +7.1%, 5% of visitors & 5% of exports, 11% global GDP. NZ exports to China +8.8% year to May, tourists +8.5%

In spite of the closure of some factories ahead of the Olympic Games and the impact of a rising currency China's manufacturing sector still appears to be in good heart with the monthly CLSA purchasing managers index holding steady in July at 53.3. A reading of 50 is considered neutral.
https://www.clsa.com/public/media/index.cfm?id=29&content=1&press_id=121&lang=en

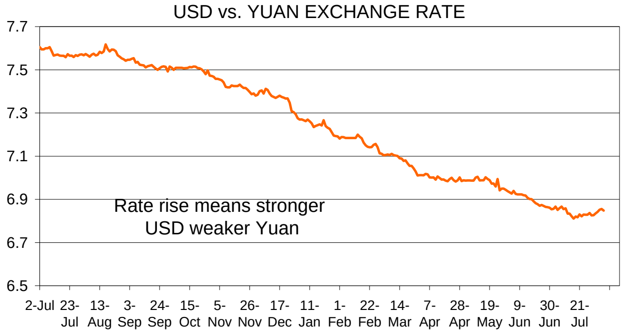
in fact in the absence of issues associated with the subprime crisis in the United States but with long-term underlying growth in consumer spending occurring the Chinese economy continues to chug along at a pace close to 10%. Slowing growth in activity is expected to occur however with export growth dented by the rising Yuan and weakness in trading partners along with increased shipping costs and raw materials prices. Inflation remains a big problem and it will be interesting to see if the authorities take stronger actions to get inflation under control once the Olympics are out of the way.

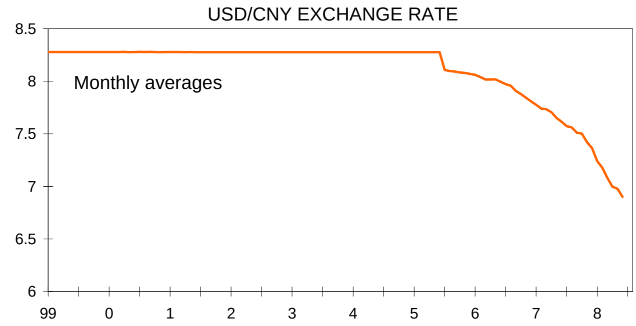
Here is a good article looking at the fact that China's financial institutions have been little affected by the global credit crisis in contrast to the appalling situation in Europe and the United States.
http://www.bloomberg.com/apps/news?pid=20601068&sid=aPAyYwJYe.Mg&refer=economy

The appreciating Yuan and rising costs are having a profound effect on exports from many parts of China. This article notes the impact in the strongly export-focussed eastern part of China.
http://www.bloomberg.com/apps/news?pid=20601089&sid=aYkipLQT8vaM&refer=china

BNZ OFFSHORE OVERVIEW

With the US dollar firming over the week in the markets going through periodic bout of concern that the authorities may not want the Yuan to rise quite so rapidly we have seen the Yuan lose ground against the greenback over the week. It is ended just below 6.85 against the US dollar from just above 6.83 last week





Want to find out about exporting to China? Start here.
http://www.nzte.govt.nz/section/11728.aspx
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