

Strategy and Tactics	Tuesday, 10 th November 2009 Fortnightly Report Published Tuesday 12.45 pm							
	<table border="1"> <tr> <td></td> <td style="text-align: right;">NZD/JPY</td> </tr> <tr> <td>Current spot rate:</td> <td style="text-align: right;">66.90</td> </tr> <tr> <td>Fortnight ago:</td> <td style="text-align: right;">65.30</td> </tr> <tr> <td>One month ago:</td> <td style="text-align: right;">65.90</td> </tr> </table>		NZD/JPY	Current spot rate:	66.90	Fortnight ago:	65.30	One month ago:
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APRM's Central View

- New Zealand monetary policy has been loosened too far but no urgency from RBNZ to consider raising interest rates
- Financial market pricing for recovery in global economy appears to have been overdone in short-term.
- Japanese domestic economy weak, JPY value around 110 versus USD based on fundamentals. External lead recovery subject to sustainability of global recovery.
- Current NZD/JPY exchange rate represents increasing optimism that an economic recovery is underway, appears valid but large question over sustainability once stimulatory monetary conditions are removed. Central banks outside of Japan are moving towards some form of tightening.
- Japanese economic recovery likely to lag that in New Zealand (and US) therefore fundamental outlook for weaker JPY. NZD to remain supported against the JPY

Risks to Central View

- **Downside Risk (NZD/JPY):** Data surprises may move from positive to negative in short-term consistent with some temporary weakness in NZD/JPY, likely to be influenced by lagged job & demand data
- **Downside Risk:** Stronger NZD itself risks delaying New Zealand export led economic recovery; negative for longer-term NZD outlook.
- **Upside Risk:** New Zealand and global monetary policy emergency setting slow to be removed meaning NZD moving to unsustainably higher level in short-term not fully warranted by economic fundamentals.
- **Upside Risk:** New Zealand economy more resilient than expected (becoming less likely)

Exporter hedging recommendations (Generic)

- 0 - 12 months = Existing clients should be at maximums of policy consistent with previous recommendations. Maintain policy maximums.
- 12 month+ = Maximum of limits allowed for forward contracts consistent with previous recommendations (filters below 69.0 for 3 years). Maintain policy maximums whilst filter levels remain triggered.

Importer hedging recommendations (Generic)

- 0 - 6 months = Policy midpoints for new cover at current levels
- 6 - 12 months = Midpoints for new cover above 66.5
- 12+ months = 0% for new cover.

The strategy described above represents our view of risk management actions which may, as at the date of this report, be appropriate for a range of borrowing and investing (importing and exporting) clients. The strategy is necessarily general and should not be pursued by individual clients without specific reference to us for consideration of the client's particular circumstances. Our opinions as expressed in this strategy and tactics report are subject to change at any time as variations in market circumstances occur.

JPY Market Sentiment and Direction

The NZD broadly supported at the 65.00 level against the JPY

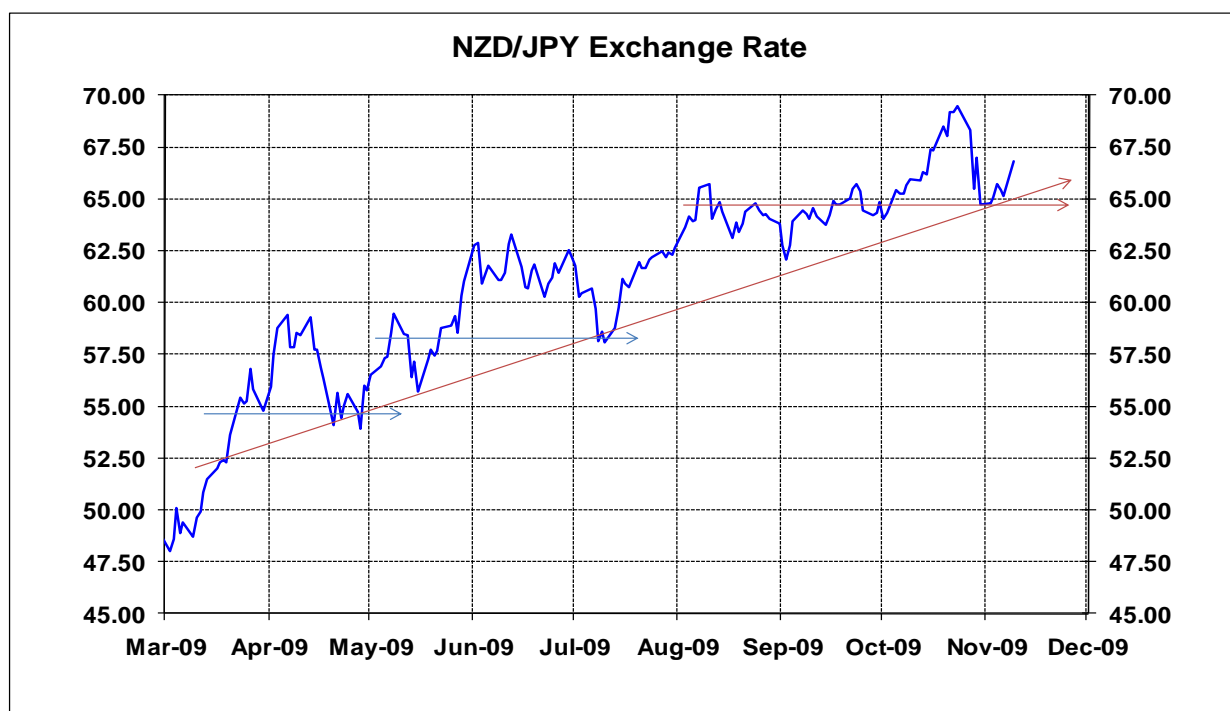
It has been a turbulent time for the NZD in foreign exchange markets the past two weeks, whilst some of this has been influenced by offshore movements, the majority of weight has come domestically. Prior to the 29 October interim OCR review the NZD/JPY exchange rate had appreciated to 69.50, the disappointment in foreign exchange markets following Governor Bollard's more dovish statement in

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which he explicitly stated market pricing was in contrast to policy and that the OCR will be maintained until the latter half of 2010 propelled the NZD lower to 65.30. This was followed again later in the week with Bollard's speech on why New Zealand is not Australia. The NZD weakened further to 64.70. Despite this the NZD has been unable to move lower even as domestic data printed poorly for Q3 with NZ employment growth weaker than expected and the unemployment rate rising to 6.5%.

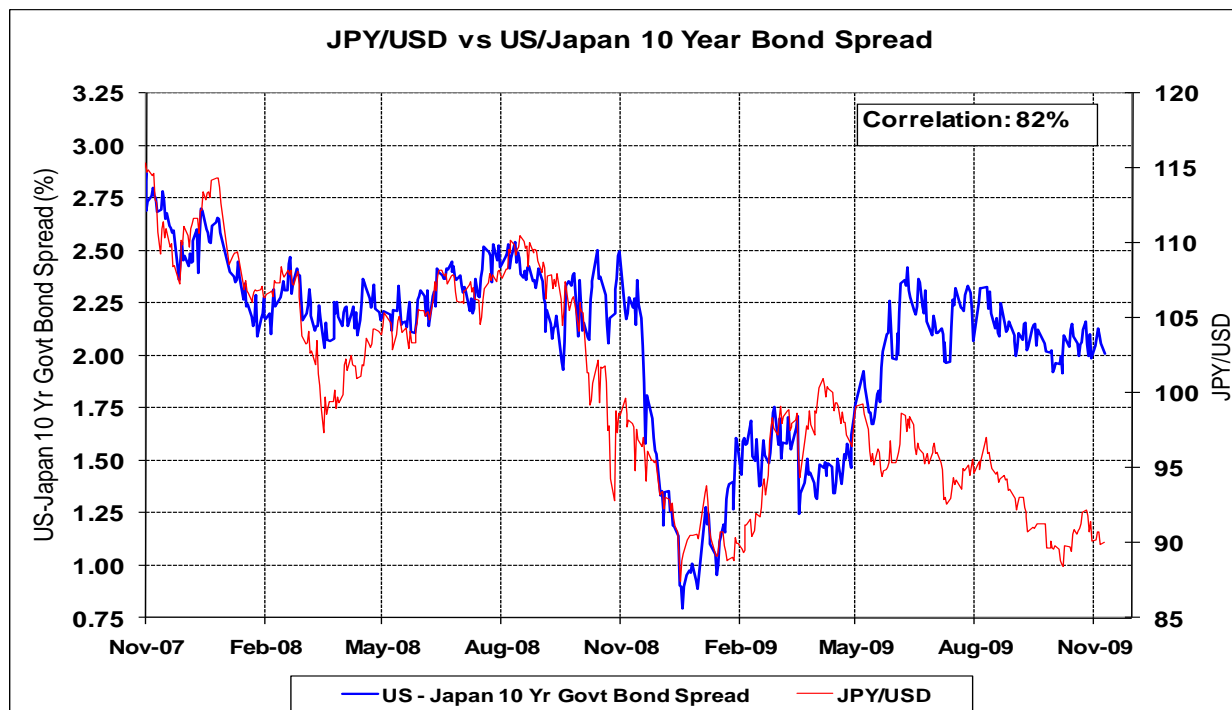
Such weakness in the NZD/JPY exchange rate has appeared short lived having found support around the 64.70 to 65.00 level. Indeed, over the past 4 months 65.00 has been a key level of support for the NZD with the appreciation above 67.50 appearing to be driven by speculative flows. This week's announcement of an increase in the 2009/2010 Fonterra milk solids payout to NZD6.05/kg (previously NZD5.10/kg) and renewed risk appetite following better US productivity (despite poor US employment data late last week) has supported the NZD higher on improving sentiment, currently the NZD/JPY exchange rate has strengthened to 66.90. In terms of an immediate outlook, whilst there remains the chance of a weaker NZD on risk aversion and acceptance in financial markets that New Zealand's recovery will likely be subdued (despite the Fonterra payout), the levels in which the NZD/JPY exchange rate is finding support has been gradually rising from 55.00 (March-May), 58.00 (May-July), to a current 65.00. This is reducing the likelihood of the NZD/JPY spot exchange rate revisiting the levels of 60.00 and lower.



Movements in the JPY/USD exchange rate from November 2007 to May 2009 have largely been consistent with movements in the US versus Japan 10 year government bond yield differential. In turn this has predominantly been driven by movements in the US 10 year government bond yield that were predominantly driven by risk sentiment considerations. Over the September to December 2008 period US 10 year government bond yields plummeted from 3.8% to 2.1% as USD treasury bonds were strongly bought. This period was also associated with selling of other risky assets that had been funded in cheap JPY therefore resulting in a sharply strengthening JPY/USD value as JPY had to be bought back. Note that these developments were driven by investor attitudes in global financial markets and not necessarily related to US economic developments. The January 2009 to May 2009 period had seen some scaling up of US 10 year government bond yields from 2.1% back to 3.9% as much of these previous flight to safety flows have been unwound and investors have moved back to a more neutral risk outlook consistent with a weaker JPY value. Since June 09 to November 09 the US/Japan bond spread has remained broadly range traded from 2.25% to 2.00% at an average of 2.14% as both the US Fed and Bank of Japan continue to signal a holding pattern with the of exceptionally low setting of monetary policy. In contrast the value of the JPY/USD exchange rate has

strengthened causing the divergence seen in between the value of the JPY and the bond spread as foreign exchange markets continue to look unfavourably on the USD and quantitative easing programme of the Fed.

At current levels the JPY/USD exchange rate appears undervalued based on this metric and is likely to continue to do so until the Fed signal timing for an end to QE and ultimately higher US interest rates. It is the view of APRM that some form of economic recovery in the US is occurring and that this will be more profound than any form of economic recovery in Japan. Furthermore, there has become an increased likelihood that in a now more stable financial market environment, developments in relative economic strengths and implications for (ultimately) higher interest rates may become more fundamental determinants of currency values again. Based on these merits the USD is likely to strengthen against the JPY over the next 12 to 18 months.

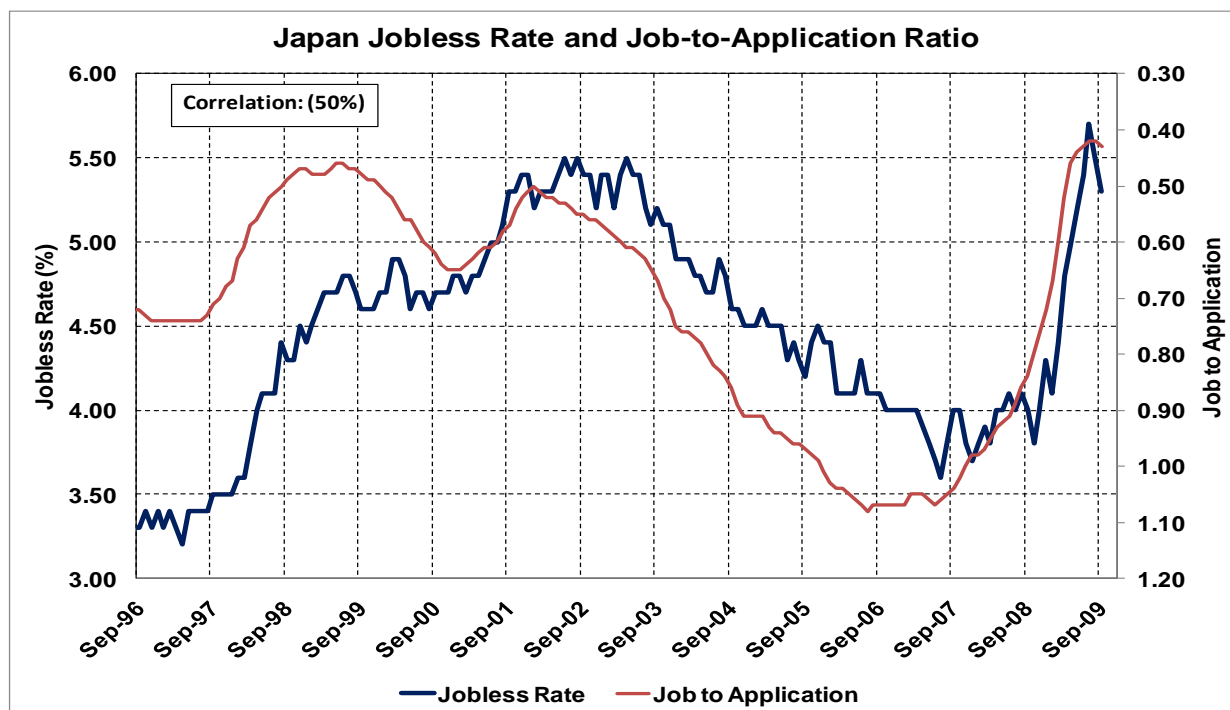


Japan's domestic economic situation underpinned by weak employment growth

Economic data in Japan has continued to show ongoing signs of improvement in the productive areas (related to the global economic recovery) and some tentative signs of improvement in the domestic area. The preliminary release of September industrial production showed production grew by 1.4%mom from 1.6%mom prior strengthening in annual terms to -18.9%yoy from -19.0%yoy. This remains consistent with the rise in the October manufacturing Purchasing Managers' Index (PMI) to 54.3 from 54.5. Domestically, there has been signs of improving demand, September housing starts and construction orders strengthened to -37%yoy and -14%yoy respectively from -38.3%yoy and -25.2%yoy, albeit at such levels are hardly supportive of internal growth. September retail trade surprised on the high side at 0.9%mom/-1.4%yoy above expectations of 0.2%mom/-1.6%yoy, dampening gains in demand continues to be employment growth and the job security. September jobless rate however slightly improved to 5.3% from 5.5% but remains close to the peak of unemployment at 5.7% in July (all time high), the job-to-applicant ratio was marginally higher at 0.43 (previously 0.42).

The significant hurdle continuing to face the BoJ to contemplate higher official interest rates has been the disinflationary impact of benign demand. Such continues to be the status quo in Japan at present evidenced in both the Nationwide and Tokyo measures of CPI inflation. September Nationwide headline CPI inflation was flat at -2.2%yoy, excluding food & energy was marginally stronger at -2.3%yoy from -2.4%yoy prior. The timelier released October Tokyo headline measure was weaker at -

2.4%yoy from 2.0%yoy prior, the inflation excluding food & energy was flat at -1.4%yoy. As such the BoJ elected at the 30 October meeting to leave the target rate unchanged at 0.1%.



Exporter recommendations, filter tests still activated beyond 3 years

Having now established a level of support around the 65.00 level, filter test activation for hedging into the 2 year time band is becoming less likely given the rising support level. A spot rate of 65.80 is required to achieve filter test activation into this time band. Large forward point differentials remain for hedging into both the 3 and 5 year time bands, the significant forward point benefit continues to provide attractive hedge rates below JPY60.00 for JPY exporters into these maturities. APRM continues to recommend maximums of policy whilst filters are triggered.

- Likely trading range this month: JPY: 65.00 – 68.50 Bias: → / ↑
- Likely trading range next six months: JPY: 63.00 – 70.00 Bias: → / ↑

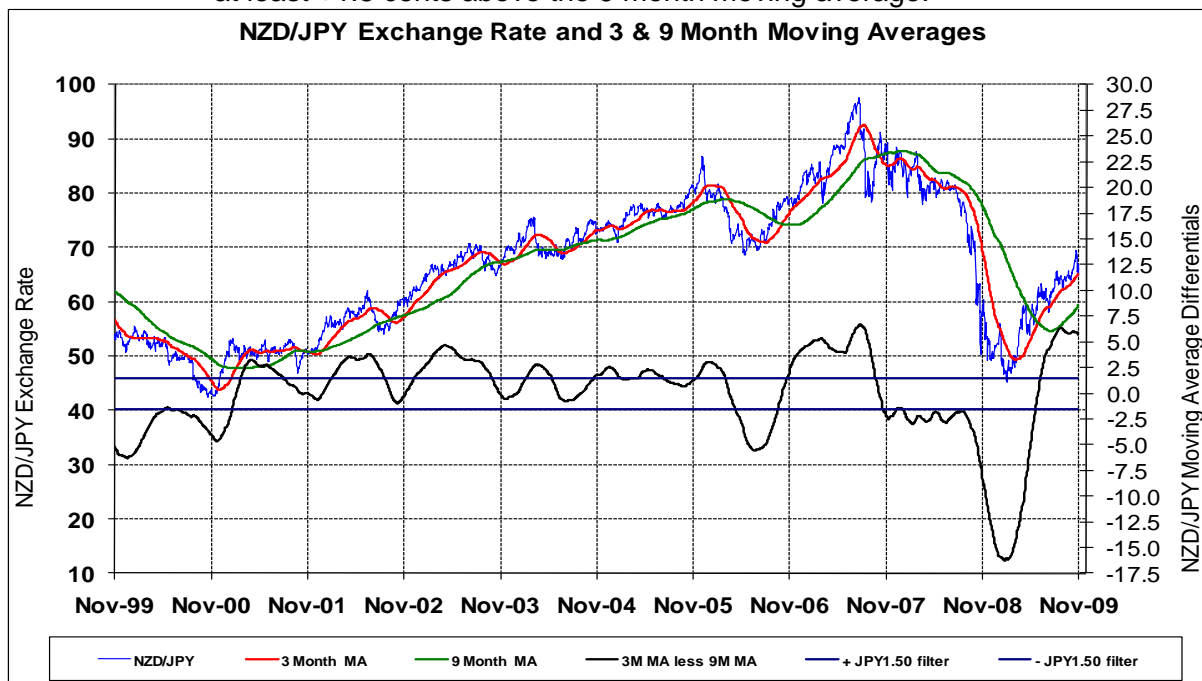
Upcoming key economic data releases

(NZT)	Statistic	Previous	Bloomberg Forecasts	Impact on NZD ↓↑
11/11	JPY Current Account (Sep)	JPY1,171bio	JPY1,510bio	→↓
	JPY M3 (Oct)	2.2%yoy	2.3%yoy	→
12/11	JPY Machine Orders (Sep)	-26.5%yoy	-26.2%yoy	→
14/11	JPY Consumer Confidence (Oct)	40.7	40.5	→
17/11	JPY GDP (SAAR) (Q3 prelim)	2.3%	2.9%	→↓

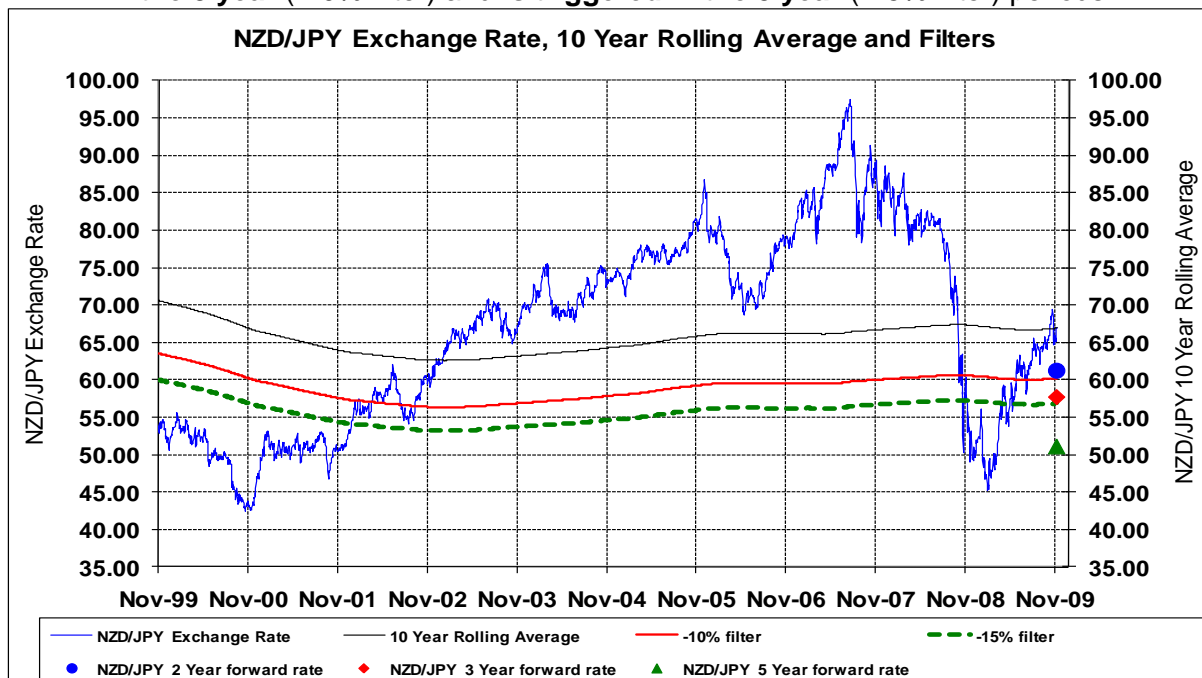
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The NZD/JPY Trend Test now currently signals an 'up-trend' whereby the 3 month moving average is at least +1.5 cents above the 9 month moving average.



The NZD/JPY Filter Test for exporters is now not triggered in the 2 year (-10% filter), is triggered in the 3 year (-10% filter) and is triggered in the 5 year (-15% filter) periods.



NZD/JPY Filter Activation		2 Year	3 Year	5 Year
Filter Criteria		10% below ave	10% below ave	15% below ave
Current Spot (10 Nov 2009)		66.90	66.90	66.90
Forward Points (exporter)		-567.0	-922.0	-1582.0
Forward Rate		61.23	57.68	51.08
10 year rolling average		66.88	66.88	66.88
Filter activation level		60.19	60.19	56.72
Activated?		No	Yes	Yes
Necessary spot rate for activation		65.86	69.41	72.54
Further move needed		1.04	-	-
Forward Rate relative to 10 year rolling average?		-8.4%	-13.8%	-23.6%

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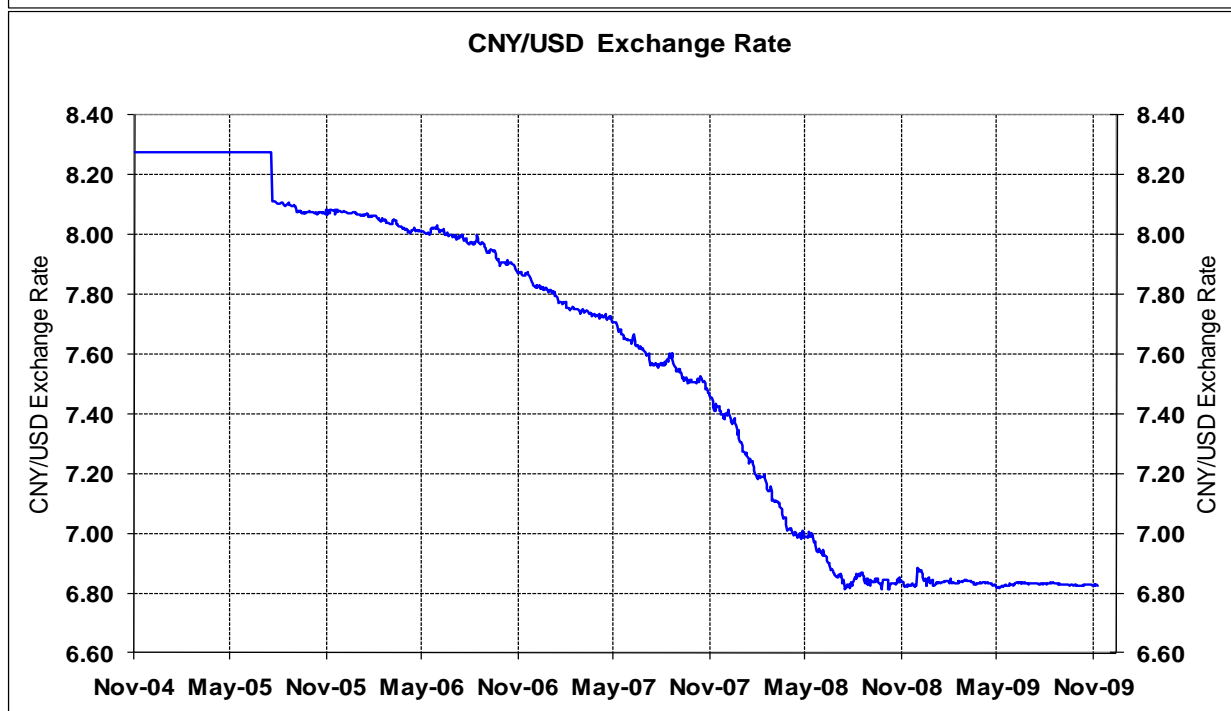
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China Market Sentiment and Direction

There has been limited Chinese economic data over the past fortnight for financial markets to infer any direction from. China's Manufacturing PMI (Purchasing Managers Index) showed an increase in October to 55.2 from 54.3 in September and has remained in expansionary territory (over 50) for the past quarter. It appears the Chinese economy is in the process of maintaining its growth trend following the sharp improvement over Q3 to 8.9%yoy. From this point onwards however there is some concern as to the sustainability of an ongoing Chinese economic recovery given the excessive accommodative levels of monetary policy, ease of credit and fiscal stimulation. Despite these concerns the Shanghai Index has appreciated to above 3,000 to a current 3,175. Positive sentiment following the G20 communiqué at the start of the week in continuing to emphasis support for the current level of monetary policy stimulus (especially in the US) has been a positive factor for equity markets; eventually this will have to be removed and ultimately test the resolve of financial markets.



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Korean Won Market Sentiment and Direction

The KRW has appreciated against the USD over the past fortnight to return to similar levels seen a month ago. At 1,160 the recent appreciation in the KRW was reflected favourable sentiment towards the Korean Won. South Korean economic data over this period has shown stronger than expected growth. The Q3 preliminary release of GDP growth showed the economy expanded by 2.9%qoq/0.6%yoy from 2.6%qoq/-2.2%yoy in Q2 and well above market expectations for 1.9%qoq growth. Growth in South Korea has been supported by China and whether such momentum can be maintained will be closely scrutinised over the coming quarters. Other measure of production showed expansion, September manufacturing production grew at 11.3%yoy (previously 1.0%yoy), the overall industrial production measure grew 5.4%mom/11.0%yoy from -1.3%mom/1.2%yoy in August.

Conversely, the NZD/KRW exchange rate weakened from 900 to 850, following independent NZD weakness. The NZD/KRW exchange rate may potentially remain under downward pressure given the directive of the RBNZ that monetary policy setting in NZ will be maintained at the current setting of 2.50% until the latter half of 2010. Presently the BoK has maintained official interest rates at 2.0% but given the ongoing improvement in the economy (and support from China) the chances of interest rates rising in Korea before that in NZ is increasing.

