

Delivering Sustainable Financial Performance

ASIA-PACIFIC

R I S K M A N A G E M E N T

## Strategy and tactics

Tuesday, 27 October 2009  
Weekly Report  
Published Tuesday 5.15pm

### New Zealand dollar market overview

**Please Note: This market report is confidential to our clients and must not be forwarded to third parties outside your company.**

Current spot rate: 0.7476  
One week ago spot rate: 0.7566  
One month ago spot rate: 0.7159

#### APRM's Central View

- Strength of NZD against USD has dislocated from fundamental indicators for domestic and global economy that do not justify as strong NZD v USD.
- Financial market pricing for recovery in global economy has been overdone impacted by overly stimulatory monetary conditions and liquidity; temporarily positive for NZD but negative over medium-term.
- Improved forward looking manufacturing surveys globally have supported growth sensitive currencies (such as NZD) but are now starting to level out.
- NZD to remain well supported versus USD until more conclusive signs central banks globally are close to tightening policy – timing getting closer.
- Ultimately widening USD versus EUR interest rates differential a negative for EUR and NZD over medium term.

#### Risks to Central View

- Upside Risk:** New Zealand domestic economy more resilient than expected (becoming less likely).
- Upside Risk:** US Federal Reserve maintains loose monetary policy for longer to keep USD weaker and aid US economic recovery.
- Downside Risk:** The USD is highly likely to remain the global reserve currency, therefore USD strength including against NZD.
- Downside Risk:** Stronger NZD itself risks removing expected New Zealand export led economic recovery; negative for longer-term NZD outlook (**occurring**).
- Downside Risk:** Central Banks pick up pace of removing emergency stimulus measures over coming months.

#### Exporter hedging recommendations (Generic)

- Existing clients with long-term forward cover in place should close down a portion of that cover with forward rates to run at least 10% above 10 year rolling average of 0.6590, i.e. above spot rate of 0.7100 (0.7345) for forward contracts maturing in 2 (3) years time, and replace with options. Clients should contact us for specific recommendations.
- New clients without long-term cover should ensure top ups to minimums of policy with options (out of the money purchased NZD calls) on any overnight dips focusing on 0 – 6 month forward exposures.

#### Importer hedging recommendations (Generic)

- 0 – 6 month payments = Policy maximums at current levels.**
- 6 – 12 month payments = Policy maximums at current levels**
- 12+ month payments = Stagger into forward cover 13 months to 24 months ahead from spot rate of 0.7100 and from spot rate of 0.7345 for 25 to 36 months.**

DISCLAIMER: The information contained in this letter/email is given in good faith and has been derived from sources believed to be reliable and accurate. However, neither Asia-Pacific Risk Management Limited nor any of its employees, directors or shareholders, gives any warranty of reliability or accuracy and shall not be liable (whether in contract, tort (including negligence), equity or any other basis) for errors or omissions herein, or any loss or damage sustained by any person relying on such information, whatever the cause of such loss or damage.

### Roger's Comments

#### **Time for some steel in the RBNZ Governor's back-bone?**

There are some early tentative signs that the Kiwi dollar surge upwards over the last six months may finally be running out of some steam. A marginal recovery in the USD globally and the failure of the Australian dollar to push-on higher to the mid-0.9000's against the USD have held the Kiwi back from

**Disclaimer:** The information contained in this newsletter is given in good faith and has been derived from sources believed to be reliable and accurate. However, neither Asia-Pacific Risk Management Limited, nor any of their employees or Directors or any affiliated companies, gives any warranty of reliability of accuracy nor accepts any responsibility arising in any other way (including by reason of negligence) for errors or omissions herein.

Asia-Pacific Risk Management Ltd  
Level 14, West Plaza  
Cnr Albert and Customs Street  
Auckland New Zealand  
Ph: (09) 913 4625  
Fx: (09) 913 4626

further gains above 0.7500/0.7600. Commodity price increase and global sharemarket gains have been two more important variables behind the dramatic appreciation of the NZD from 0.5000 to 0.7500 over the past six months as well. However, over recent weeks these markets have not been able to add substantially to their earlier increases. The US company reporting season produced profit results generally better than expected, however the Dow Jones Index has struggled to hold above 10,000 as the quality of the profits were more from historical cost-cutting than genuine sales revenue growth. It appears that these international drivers of the Kiwi dollar value may reduce in importance and intensity as the global forex markets start to wind-down ahead of the 31 December year-end. Certainly, the long-NZD position holders are more likely to be sellers of NZD's to close-down/reduce positions than aggressive NZD buyers to add to their positions at this time of year. The lead-indicators of copper prices and the Baltic Freight Index for shipping suggest that commodity prices (thus the AUD) are unlikely to push higher over coming months.

The upcoming RBNZ OCR review this week on 29 October and their full Monetary Policy Statement on 10 December stand to be more influential over the NZD/USD currency direction over coming weeks. RBNZ Governor Alan Bollard has been attempting to talk the Kiwi dollar down for several months, but rather disturbingly contradicted himself last week in front of the Parliamentary Finance and Expenditure Select Committee by stating that the high NZD did not necessarily prevent him from increasing interest rates if it was needed in response to a strong housing market and retail spending - arguably some rather poorly chosen and injudicious words from the Governor, which boosted the Kiwi dollar even higher in the FX markets for a day or two. The near term outlook for the Kiwi may now well be more centred on what the RBNZ say and do. The moneymarkets are pricing-in increases in the OCR from March 2010, rising rapidly to 4.50% from the current 2.5%. Bank economists and other economic forecasters are also staking claims that official interest rates have to increase much sooner in 2010 than the "late 2010" policy stance the RBNZ currently has. The economist view is that the housing market is back on the rise, this stimulates strong consumer spending and inflation automatically increases. Inflation has not come from excessive consumer demand in New Zealand for many years and the higher currency is in fact causing imported consumer goods to fall in price. The fears from these economists of inflation increasing in 2010 are misplaced. The significant rise in the Trade Weighted Index and NZD/USD exchange rate over the last six months have already tightened monetary policy from -1000 to +400 on the combined Monetary Conditions Index. Why would the RBNZ need to increase interest rates to tighten monetary policy even further when the inflation and growth forecasts for 2010 are subdued, at best?

Mr Bollard has the opportunity to influence the NZD lower for the benefit of the wider economy by not bowing to the current moneymarkets and economist pressure. There is no need to increase short-term interest rates at all for many months when the steep upward slope of the yield curve and the high NZD value already have monetary conditions considerably tighter than three or six months ago. The New Zealand economy desperately needs an export-led recovery based on real income growth, the appreciation of the NZD this year has destroyed that opportunity. The RBNZ require some steel in their backbone at this time to stick to their current monetary stance and not be swayed by the short-term, fickle and changeable views of the private sector economists. The RBNZ were bullied into tightening monetary policy at the wrong time in mid 2007 that caused the economic recession over 2008. They have the power to rectify a major problem for the export sector with the over-valued currency and thus should not make another policy mistake by pushing interest rates up too soon. The Canadian central bank is not raising their rates as they see problems for their export economy from an over-valued currency. The RBNZ here should follow their lead.

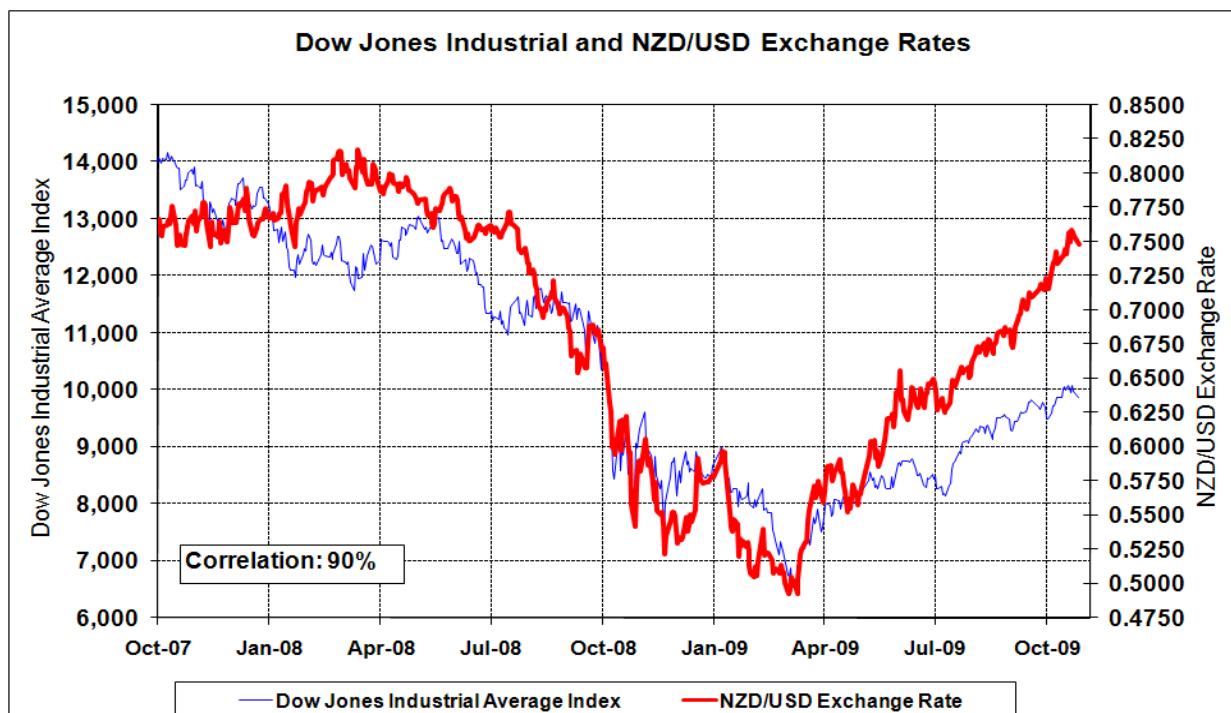
Annual inflation in Australia is forecast to increase to 3.5% in 2010 which contrasts starkly with New Zealand where inflation is forecast to remain between 1.0% and 2.0%. Our short-term interest rates are already 1.0% below those of Australia and could go up to 2.0% below as the Aussies tighten monetary policy much sooner than us in 2010. The NZ/Australian interest rate differential points to the NZD/AUD cross-rate falling from 0.8200 to 0.7700 as foreign investors pull funds out of NZ in favour of Australia.

<b>Contacts:</b>	<b>Roger Kerr</b>	<b>(09) 913 4628</b>	<b>roger.kerr@aprisk.com</b>
	<b>Stuart Henderson</b>	<b>(09) 425 0158</b>	<b>stuart.henderson@aprisk.com</b>
	<b>Brett Johanson</b>	<b>(04) 918 0008</b>	<b>brett.johanson@aprisk.com</b>
	<b>Chris Hedley</b>	<b>(09) 913 4629</b>	<b>chris.hedley@aprisk.com</b>
	<b>Duncan Shaw</b>	<b>(09) 913 4611</b>	<b>duncan.shaw@aprisk.com</b>
	<b>Jason Bligh</b>	<b>(04) 913 0001</b>	<b>jason.bligh@aprisk.com</b>

## Market Sentiment and Direction

### NZD remains elevated but off highs

The NZD reached a 15 month high above USD 0.7600 last week however has subsequently eased back to 0.7475. Initial NZD strength was related to the generally well performing global financial market environment including the Dow Jones Industrial Index above 10,000 before finishing the week at 9,870. Movements stronger in the NZD for much of last week also followed the weaker USD to below 75.00 on the USD Index measure before a better supported USD has subsequently seen the USD Index at 76.00 early this week.



### A dose of reality for the financial markets?

Standing back from the daily, weekly and even monthly noise, it just does not seem reasonable for the financial markets to have priced the extent of rebound in the likes of the NZD and AUD at current levels following the period of near disintegration of the financial system and fears of collapsing economic activity over the September 2008 to March 2009 period. Confidence and activity have been stabilised and are now improving following the unprecedented actions of the monetary and fiscal authorities however many of the structural problems and imbalances still remain. FOMC Chairman Bernanke has recently commented around potential imbalances remaining / worsening based on some assumed prospect of developments for a return to global economic growth led by US consumers borrowing to consume and Asian export growth being driven by under-valued currencies whilst US Federal Budget deficits remain exceedingly wide.

Even with the NZD and AUD having eased slightly off their highs of last week these remain around four-fifths of the way to the upper end of the 2008 and 2009 ranges, i.e. consistent with a largely 'thriving' global economy. Whilst economic Armageddon has been avoided for the time and a cyclical global economic recovery is underway, there has been little done to address the structural problems.

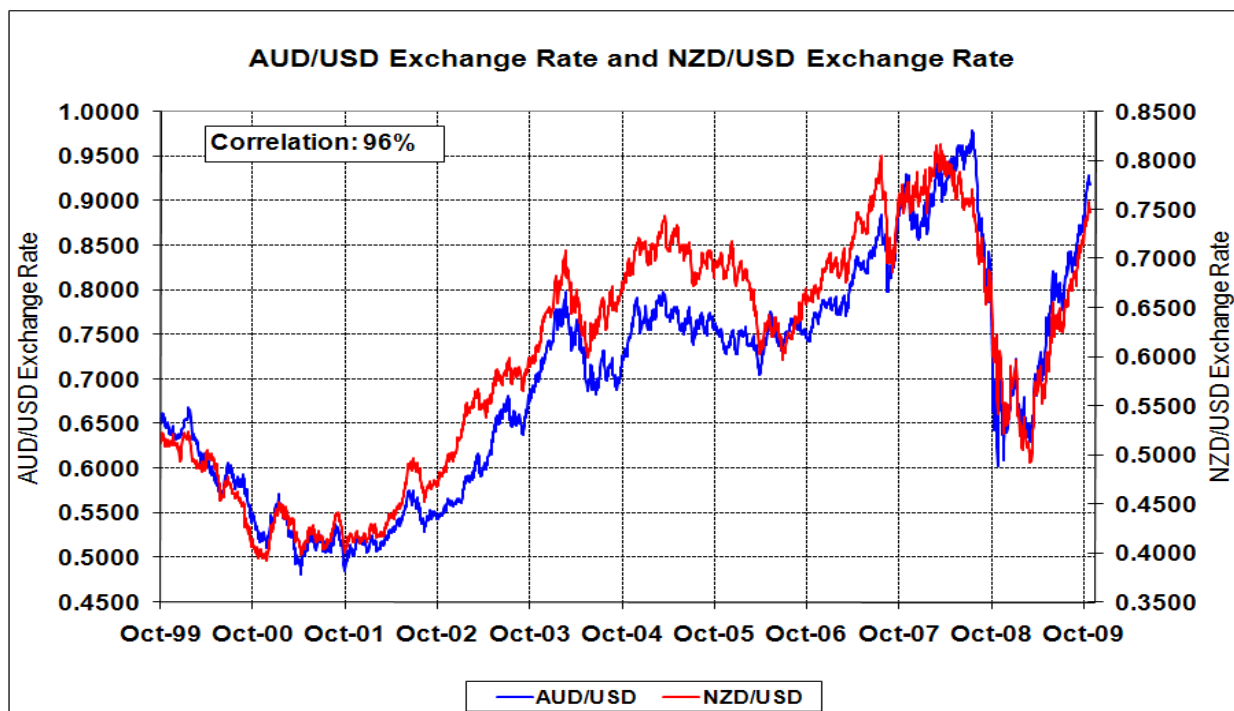
	NZD/USD Exchange Rate	AUD/USD Exchange Rate
2008/2009 high	0.8170	0.9795
2008/2009 low	0.4925	0.6025
Current spot rate	0.7475	0.9185
% of fall 'recovered'	79%	84%

#### Contacts:

Roger Kerr  
Stuart Henderson  
Brett Johanson  
Chris Hedley  
Duncan Shaw  
Jason Bligh

(09) 913 4628  
(09) 425 0158  
(04) 918 0008  
(09) 913 4629  
(09) 913 4611  
(04) 913 0001

roger.kerr@aprisk.com  
stuart.henderson@aprisk.com  
brett.johanson@aprisk.com  
chris.hedley@aprisk.com  
duncan.shaw@aprisk.com  
jason.bligh@aprisk.com



Following this near capitulation in financial market risk sentiment over the September 2008 to March 2009 period perceived risky asset markets have been underwritten by the commitments of governments and central banks to maintain artificially loose monetary and fiscal policy settings for some time further. The actions of central banks in setting near zero interest rates have not been able to differentiate between the underlying economic objectives and the financial market behaviours. A sizeable amount of the recovery in many financial assets has been justified based also on the previous sell down being too severe. However markets are now at risk of a sharp snap-back lower once timing of expectations for removal of the emergency monetary policy settings are nearer and the realisation becomes more tangible that the period of artificially stimulatory conditions will cease.

US Federal Reserve officials continue to communicate differing views on the likely need for ultimately removing the monetary policy stimulus. However, there is a growing expectation that over coming months there will be a revision to the wording of Fed statement that “the Committee...continues to anticipate that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period” such that the Fed has more flexibility and does not ‘shock’ the financial markets when the time eventually comes to signal removing the monetary policy stimulus.

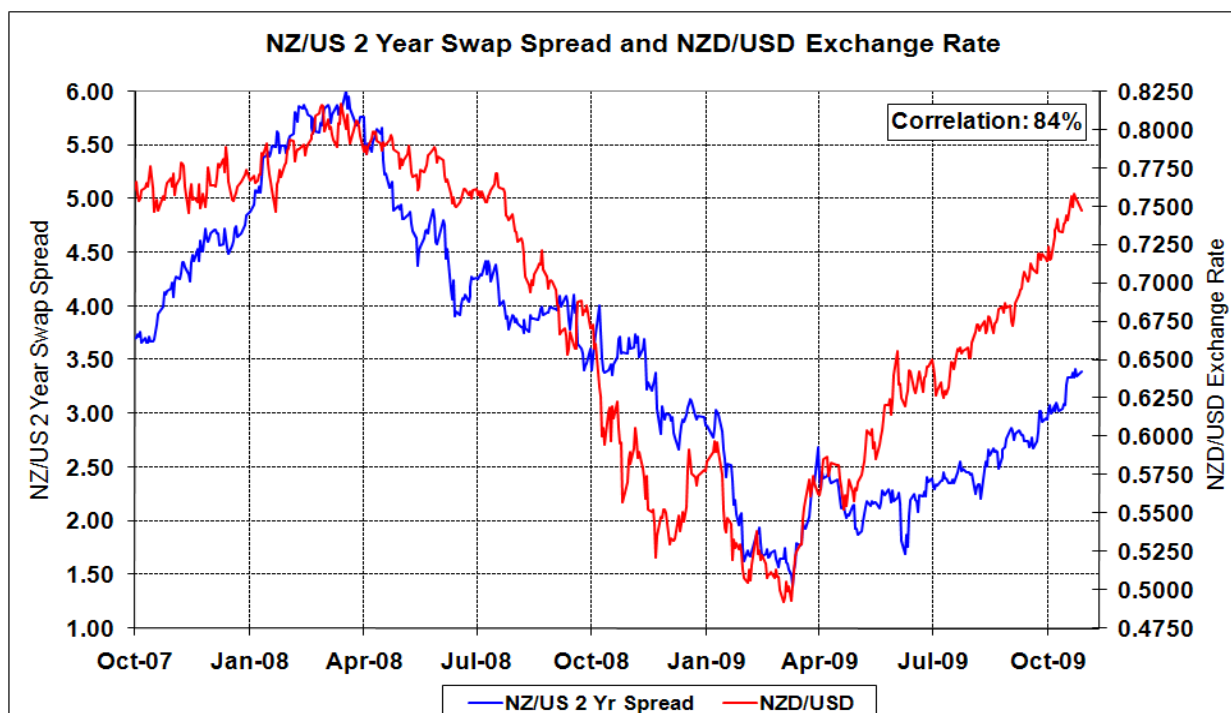
### **RBNZ unlikely to ratify interest rate market pricing**

Ahead of the 29 October OCR Review APRM believes the interest rate markets and foreign currency markets have moved too far ahead of the RBNZ reality. An RBNZ outlook that is not as hawkish as the financial markets have already priced means the risk is weighted towards a reaction of lower market interest rates and NZD foreign exchange rates post the OCR review announcement. Monetary conditions in New Zealand have now moved to a setting that is too tight in relation to the economic outlook in 18 months time, largely due to the impact of the highly valued NZD on the productive / exporting / new wealth generating sectors of the economy. There appears little motivation for the RBNZ to ratify market pricing that would likely only accentuate foreign exchange market and wholesale interest rate market pricing higher, with conditions in New Zealand already tighter than are needed.

The challenge for Governor Bollard is to word the OCR statement in a way that does not provide reason to buy the NZD from a domestic perspective, and indeed ideally to reduce support for the NZD. A period of moderate independent NZD weakness would in turn buy some time until an expected strengthening of the USD occurs based on the outlook for US interest increases to lead those of the other major central banks (i.e. Europe, UK and Japan).

<b>Contacts:</b>	<p>Roger Kerr Stuart Henderson Brett Johanson Chris Hedley Duncan Shaw Jason Bligh</p>	<p>(09) 913 4628 (09) 425 0158 (04) 918 0008 (09) 913 4629 (09) 913 4611 (04) 913 0001</p>	<p>roger.kerr@aprisk.com stuart.henderson@aprisk.com brett.johanson@aprisk.com chris.hedley@aprisk.com duncan.shaw@aprisk.com jason.bligh@aprisk.com</p>
------------------	--	--	--

The NZD/USD exchange rate is already out of line with the NZ / US 2 year swap rate differential. There is further potential for this swap rate differential to narrow as per above based on initially lower New Zealand swap rates and subsequently higher US swap rates. A weaker NZD/USD exchange rate would help bring about a more sustainable economic recovery in New Zealand at which point the RBNZ would have stronger reason to adjust the monetary policy (interest rate) setting at a later time.



### Strategy considerations for exporters and importers

For exporters with long-dated forward exchange contracts in place; forward rates to run that are around and above 0.6590 (i.e. 0.7100 spot for 2 year maturities, 0.7345 spot for 3 year maturities) being 10% above the 10 year rolling average remain triggered and clients should be closing down a portion of forward cover and entering NZD call options, or wide collar options. For importers, filters for 2 years forward are triggered from a 0.7100 spot rate and filters for 3 years forward are triggered from a 0.7345 spot rate. Clients should be staggering into hedging of forecast exposures in these periods. Clients should contact us directly for specific recommendations.

- Likely trading range next month:           **0.6800 – 0.7625 Bias: →**
- Likely trading range next six months:   **0.6200 – 0.7625 Bias: ↓**

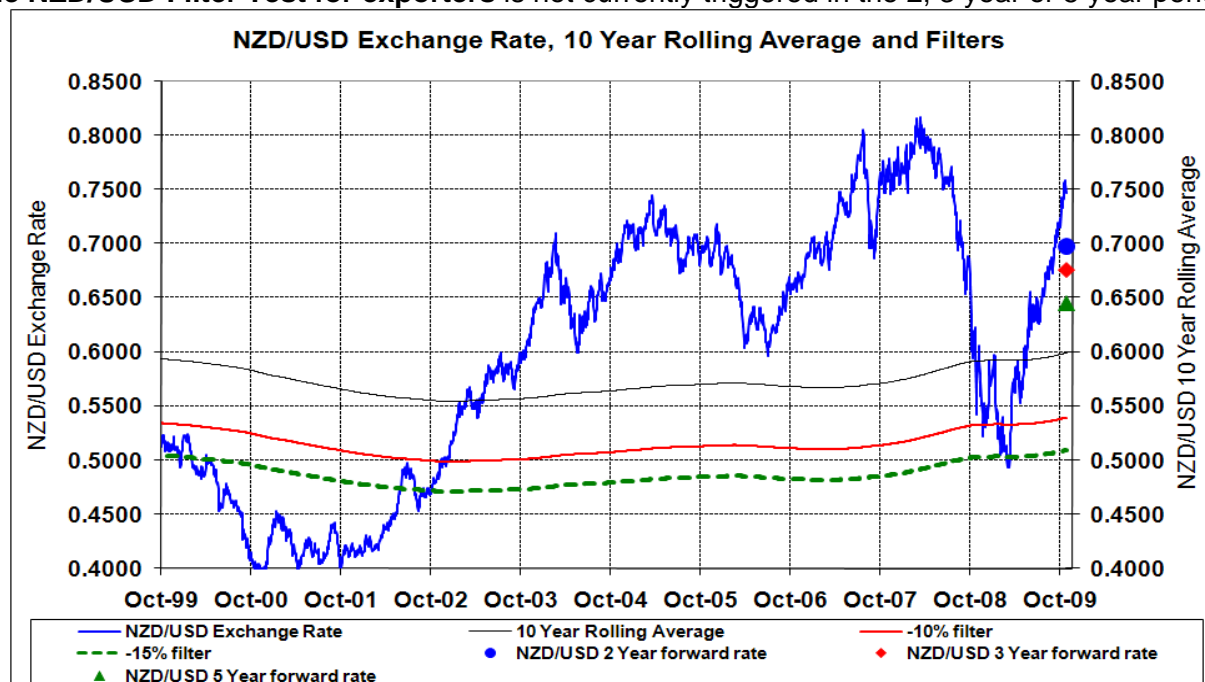
### Upcoming key economic data releases

Date (NZT)	Statistic	Previous	Deutsche Forecasts	Impact on NZD rates ↓↑
27/10	US Case Schiller House Prices (Aug)	-13.3%yoy	-11.8%yoy (consensus)	→
	US Consumer Confidence (October)	53.1	55	→
28/10	NBNZ Business Confidence (October)	49.1		→
	US Durable Goods Orders (Sept)	-2.4%mom/-20.2%yoy	+3.0%mom	→
	US New Home Sales (September)	0.7%mom	2.6%mom	→
29/10	RBNZ OCR Announcement	No change (2.50%)	No change (2.50%)	↓

<b>Contacts:</b>	<b>Roger Kerr</b> <b>Stuart Henderson</b> <b>Brett Johanson</b> <b>Chris Hedley</b> <b>Duncan Shaw</b> <b>Jason Bligh</b>	<b>(09) 913 4628</b> <b>(09) 425 0158</b> <b>(04) 918 0008</b> <b>(09) 913 4629</b> <b>(09) 913 4611</b> <b>(04) 913 0001</b>	<b>roger.kerr@aprisk.com</b> <b>stuart.henderson@aprisk.com</b> <b>brett.johanson@aprisk.com</b> <b>chris.hedley@aprisk.com</b> <b>duncan.shaw@aprisk.com</b> <b>jason.bligh@aprisk.com</b>
------------------	--	--	--

	NZ Merchandise Trade Balance (Sep)	-NZD725m	-NZD671m	→
30/10	NZ Building Permits (September)	+1.7%mom/-8.8%yoy	+5.0%mom/-15.1%yoy	→ / ↑
	US Real GDP Growth (Q3)	-0.7% annualised	4.0% annualised	→
31/10	Chicago PMI (October)	46.1	50	→ / ↓
	Michigan Consumer Confidence (Oct)	69.4	70.0	→

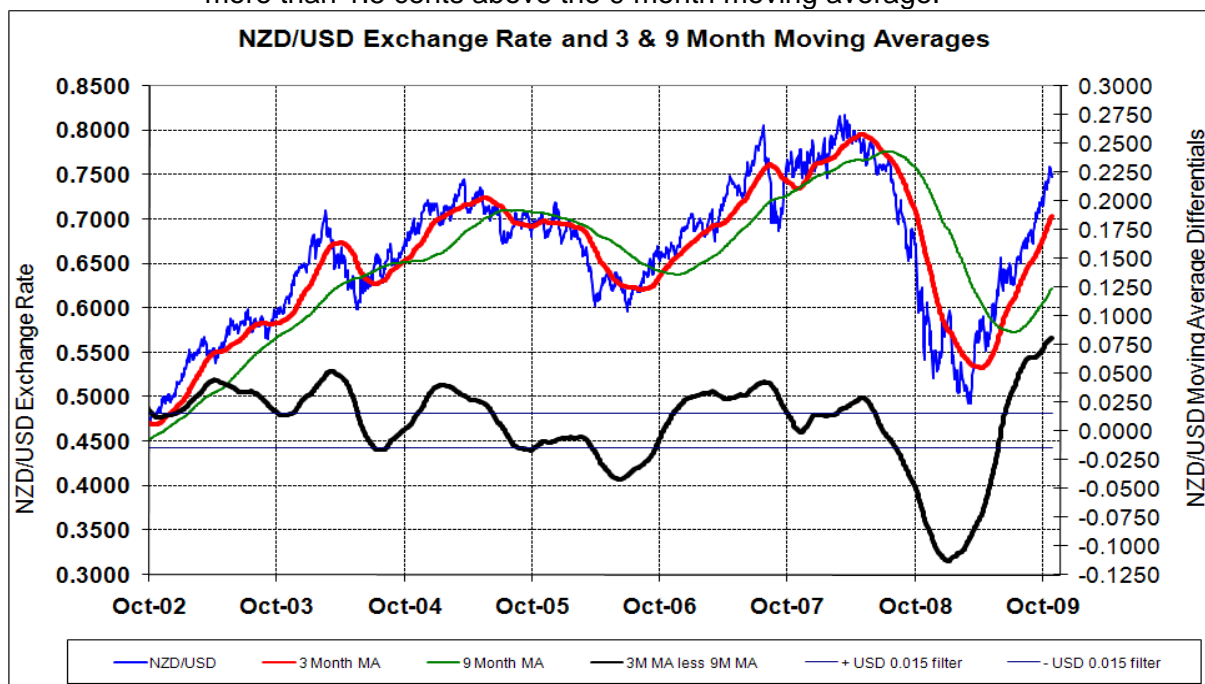
The NZD/USD Filter Test for exporters is not currently triggered in the 2, 3 year or 5 year periods.



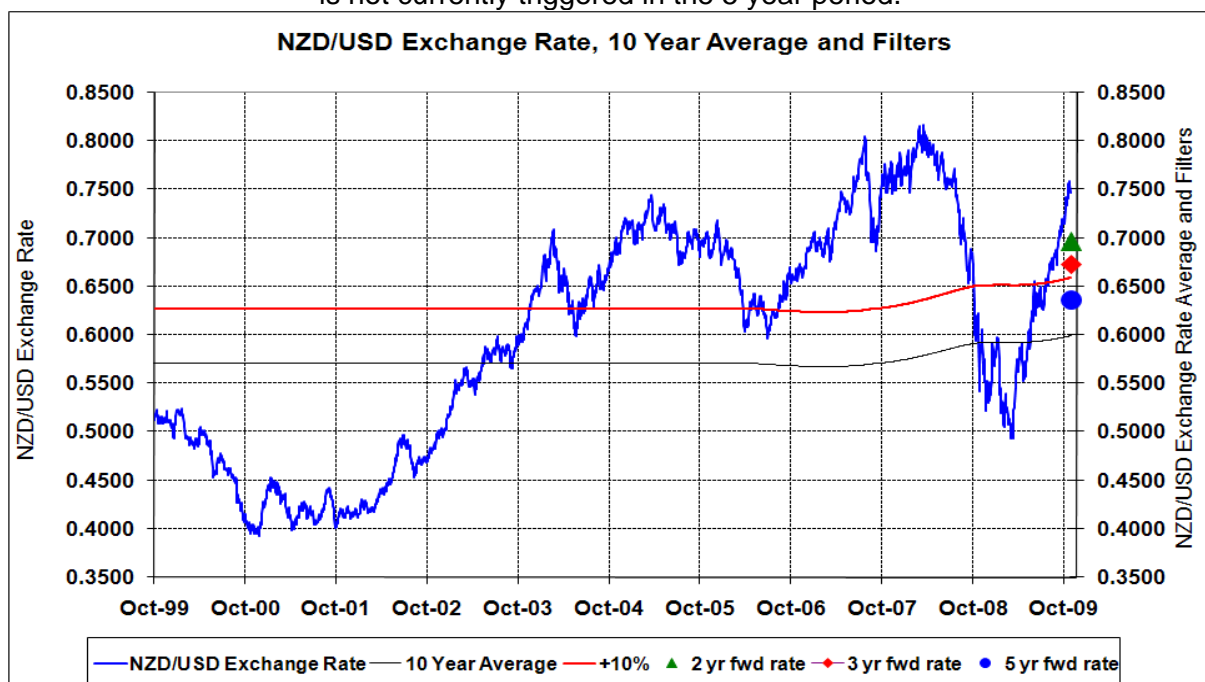
NZD/USD Filter Activation			
Filter Criteria	2 Year	3 Year	5 Year
Filter Criteria	10% below ave	10% below ave	15% below ave
<b>Current Spot (27 Oct 2009)</b>	<b>0.7476</b>	0.7476	0.7476
Forward Points (exporter)	-499.7	-716.0	-1027.0
Forward Rate	<b>0.6976</b>	<b>0.6760</b>	<b>0.6449</b>
10 year rolling average	0.5993	0.5993	0.5993
Filter activation level	0.5393	0.5393	0.5094
<b>Activated?</b>	<b>No</b>	<b>No</b>	<b>No</b>
<b>Necessary spot rate for activation</b>	<b>0.5893</b>	<b>0.6109</b>	<b>0.6121</b>
Further move needed	0.1583	0.1367	0.1355
Forward Rate relative to 10 year rolling average?	16.4%	12.8%	7.6%

<b>Contacts:</b>	Roger Kerr (09) 913 4628 Stuart Henderson (09) 425 0158 Brett Johanson (04) 918 0008 Chris Hedley (09) 913 4629 Duncan Shaw (09) 913 4611 Jason Bligh (04) 913 0001	roger.kerr@aprisk.com stuart.henderson@aprisk.com brett.johanson@aprisk.com chris.hedley@aprisk.com duncan.shaw@aprisk.com jason.bligh@aprisk.com
------------------	--	--

The NZD/USD Trend Test currently signals an ‘up-trend’ whereby the 3 month moving average is more than 1.5 cents above the 9 month moving average.



The NZD/USD Filter Test for importers is currently triggered in the 2 year and 3 year periods, and is not currently triggered in the 5 year period.



NZD/USD Filter Activation (Importer, and Exporter close-outs)	2 Year	3 year	5 year
Filter Criteria	10% above ave	10% above ave	15% above ave
<b>Spot (27 October 2009)</b>	<b>0.7476</b>	0.7476	0.7476
Forward Points (importer)	-510	-751	-1115
Forward Rate	0.6966	0.6725	0.6361
10 year rolling average	0.5993	0.5993	0.5993
Filter activation	0.6592	0.6592	0.6892
<b>Activated?</b>	<b>Yes</b>	<b>Yes</b>	<b>No</b>
<b>Necessary spot rate for activation</b>	<b>0.7102</b>	<b>0.7343</b>	<b>0.8007</b>
Further move needed	-	-	0.0531
Forward Rate Relative to 10 year rolling average?	16.2%	12.2%	6.1%

Contacts: Roger Kerr (09) 913 4628 roger.kerr@aprisk.com  
 Stuart Henderson (09) 425 0158 stuart.henderson@aprisk.com  
 Brett Johanson (04) 918 0008 brett.johanson@aprisk.com  
 Chris Hedley (09) 913 4629 chris.hedley@aprisk.com  
 Duncan Shaw (09) 913 4611 duncan.shaw@aprisk.com  
 Jason Bligh (04) 913 0001 jason.bligh@aprisk.com