

Strategy and Tactics

Tuesday, 20 October 2009
Fortnightly Report
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EUR & GBP market overview

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

	NZD/EUR	NZD/GBP
Current spot rate:	0.5034	0.4598
One fortnight ago:	0.4992	0.4615
One month ago:	0.4816	0.4359

APRM's Central View

- New Zealand monetary policy easing cycle now finished, but RBNZ in no hurry to raise interest rates
- NZD value has strengthened commensurate with more optimistic outlook regarding global economy, but now has likely gone too far on this basis
- Increases to US interest rates ahead of Europe to support USD versus EUR.
- Outlook for NZD/EUR stable-to-lower
- UK economy moving out of recession; whilst sentiment towards GBP remains very poor the next major trend in NZD/GBP can realistically only be lower.

Risks to Central View

- **Downside Risks (NZD/GBP):** Some potential for UK economic recovery to occur sooner than initially thought would support GBP.
- **Upside Risks (NZD/GBP):** Fiscal outlook for UK remains poor and weighs on value of GBP from an instability perspective (already priced)
- **Upside Risks (NZD/EUR & NZD/GBP):** Monetary and fiscal authorities maintain emergency settings in place for a time further supporting risky asset values such as NZD (has occurred and will risk reversing)

Exporter hedging recommendations (Generic)

EUR

- 0 - 12 months = Existing clients should be at maximums of policy consistent with previous recommendations. Policy midpoints for new cover.
- 12 month+ = Maximum of limits allowed for forward contracts consistent with previous recommendations (3 year filter below 0.5035 currently triggered, 2 year filter below 0.4875 - not currently triggered).

GBP

- 0 -12 months: Buy GBP put option versus USD and leave NZD leg open of split leg strategy.
- 12+ months: Exporters with long-term USD cover at attractive levels should consider converting a portion of these contracts to GBP. Clients should contact us directly for specific recommendations.

Importer hedging recommendations(Generic)

EUR

- 0 - 6 months = Policy maximums for new cover at current levels.
- 6 – 12 months = Policy midpoints for new cover at current levels.
- 12+ months = 0% for new cover.

GBP

- 0 – 12 months = Policy maximums for new cover at current levels.
- 12+ months = 2 year hedging triggered from 0.4135 spot (filter 0.3840), 3 year hedging triggered from 0.4260 spot. Stagger in to long-term hedging with filters triggered.

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.

EUR Market Sentiment and Direction

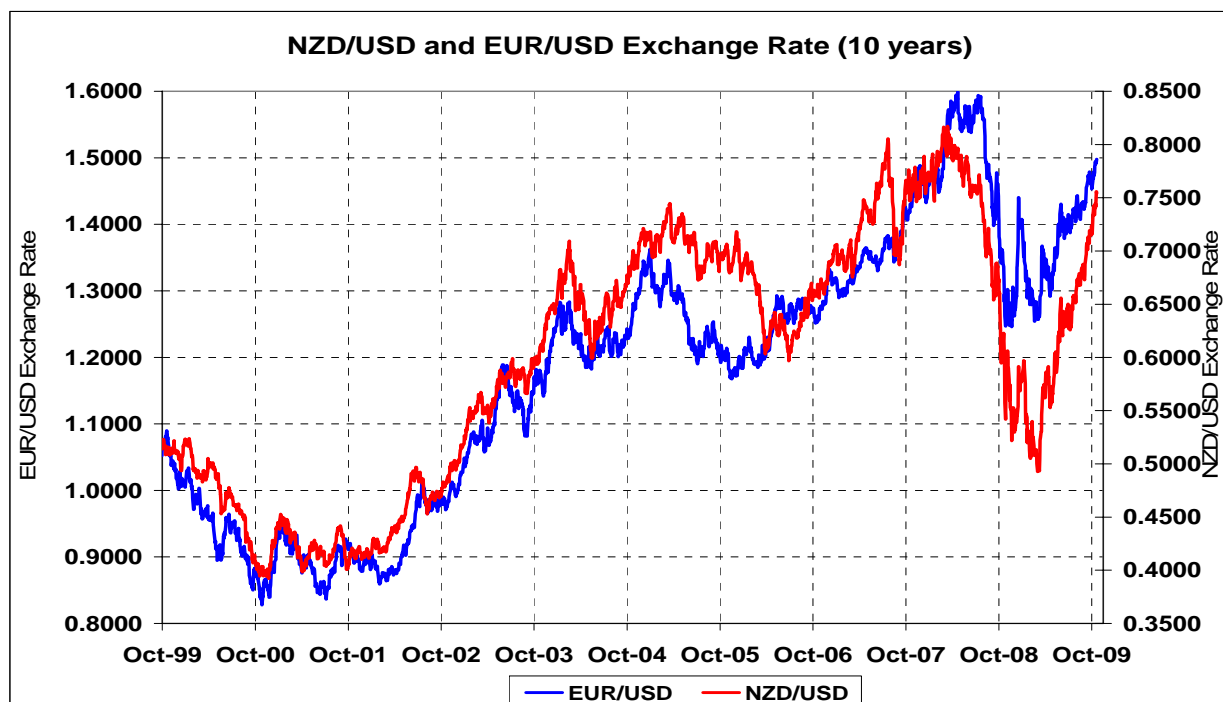
NZD strengthens back above 0.5000 versus EUR

The NZD has remained in a 0.4950 to 0.5050 range against the EUR over the last two weeks and is currently back towards the top of this range at 0.5035. The NZD and EUR have been generally well supported in global foreign exchange markets in an environment where the USD itself has remained under pressure for most of the last fortnight with a firming US equity market upon improved company

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earnings having generally supported perceived risky assets such as the NZD (and to a lesser extent the EUR) against the USD.



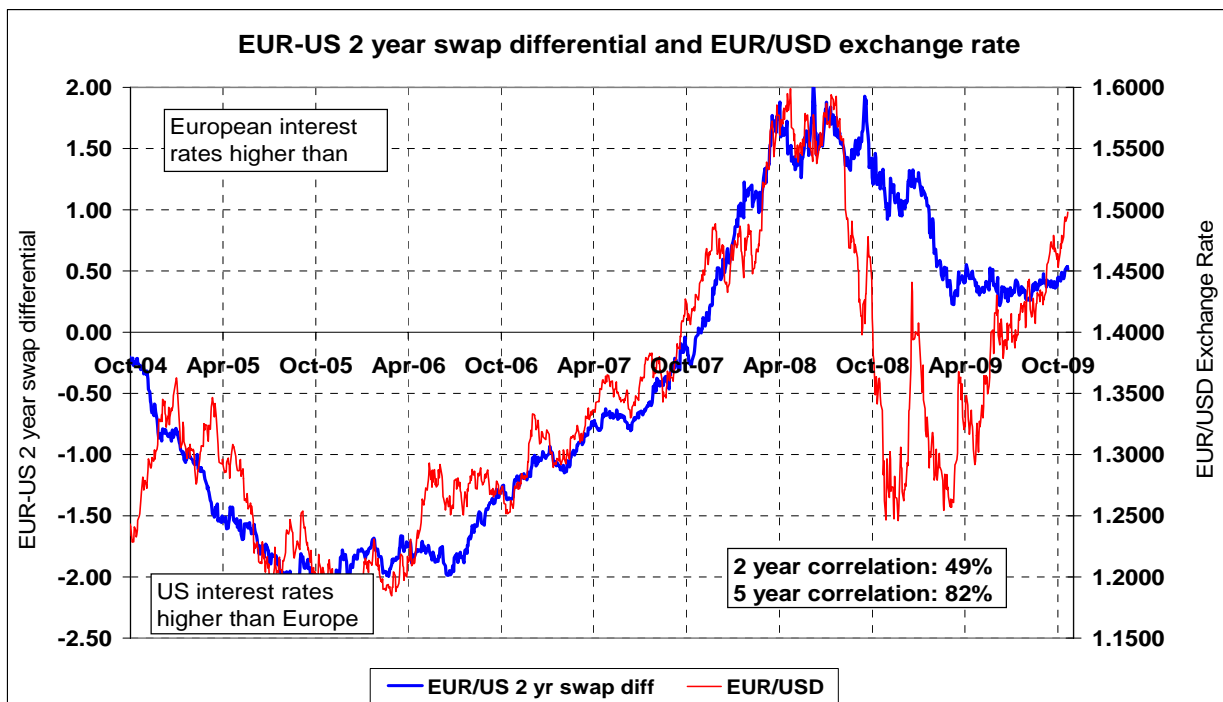
EUR (and NZD) has strengthened too far versus USD based on interest rates differentials

US industrial production grew by 0.7%mom in September to be 6.1% lower than a year ago being the smallest annual contraction since October 2008. US retail sales showed a 1.5% contraction in September (following a 2.2% increase in August) to be 6.0% below levels of a year ago. Excluding motor vehicles retail sales increased by 0.5% to be 5.3% lower than a year ago. US core CPI increased by 0.2%mom in September to be 1.5% higher than a year ago – up from 1.4%yoy in September and the first acceleration in the annual rate of core inflation since April.

European economic data over the last two weeks has been notable for some strength in industrial production at +0.9%mom in August albeit remaining 15.4% lower than a year ago. Forward looking indicators that have predicted some of the recent rebound in actual economic activity data such as industrial production appear now to be waning. The ZEW survey of economic sentiment eased to 56.9 in October from 61.2 previously. The European-wide trade balance showed a seasonally adjusted surplus of EUR1.0bn in August from EUR6.0bn previously. Retail sales remained negative at -0.2%mom/-2.6%yoy

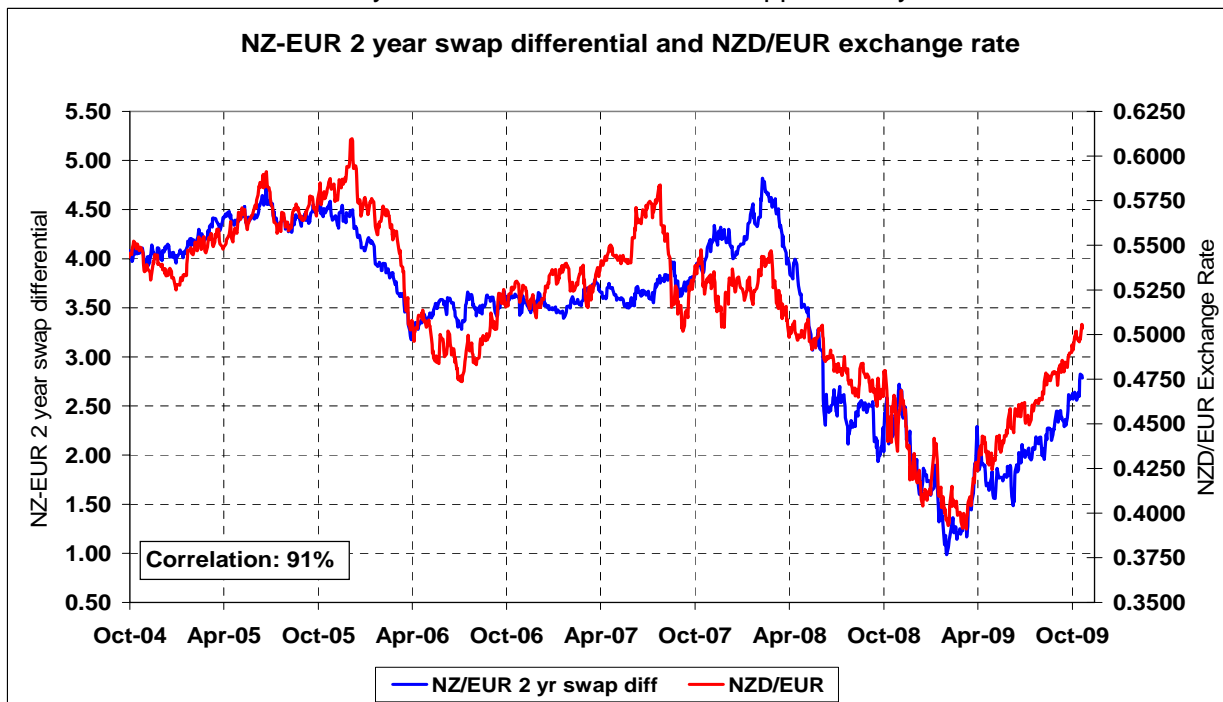
German factory orders were stronger than expected increasing by 1.4% in August albeit remaining 20.4% lower than a year ago. Industrial production expanded by 1.7% in August but to be 16.8% lower than a year ago. The German ZEW Survey of Economic Sentiment eased to 56.0 in October with the Current Situation Index easing to -72.2. The Trade Balance for August was weaker than expected at a surplus of EUR8.1bn versus EUR12.0bn expected.

At the current USD 1.4980 and indeed anywhere above USD1.4500 the EUR appears to have moved too high against the USD based on relative economic data and implications for interest rates. APRM expects the current 50 basis point differential between US 2 year swap rates (1.35%) and European 2 year swap rates (1.85%) will ultimately move in favour of the US as the US Federal Reserve moves to tighten monetary policy ahead of the European Central Bank.



New Zealand domestic economic data stronger but already priced into NZD value

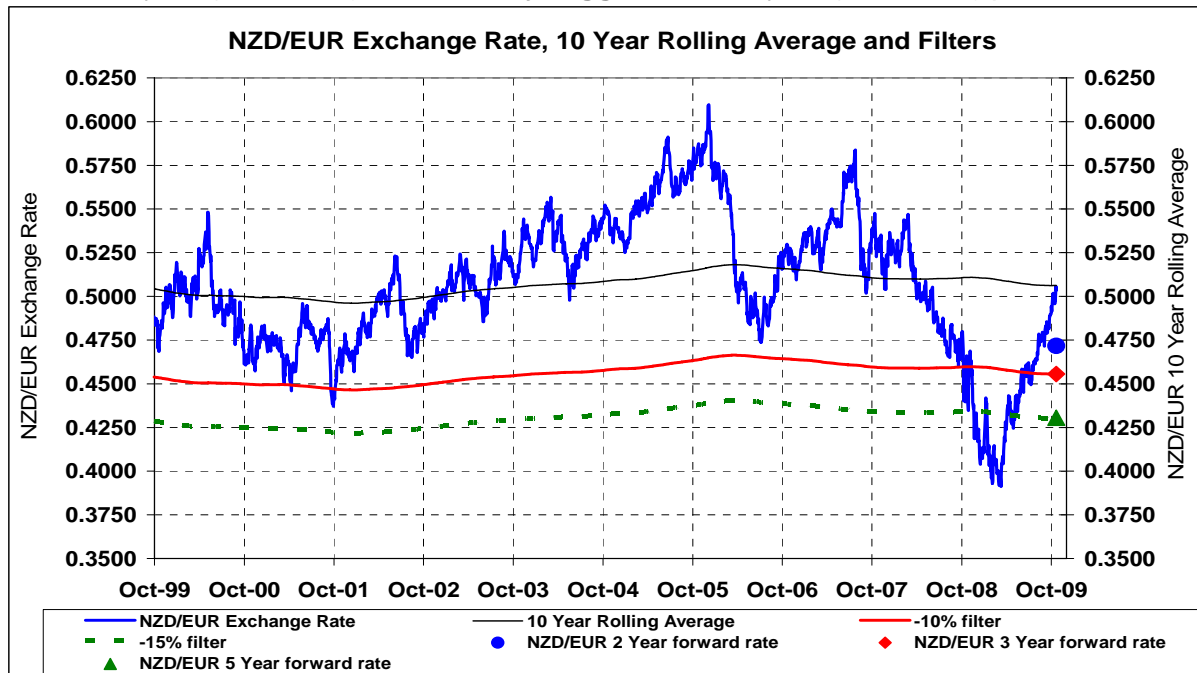
New Zealand retail sales increased by a seasonally adjusted 1.1%mom in August to be 0.7% lower than a year ago. REINZ median sales price of \$350k was the highest since November 2007 and up 6.1% on a year earlier. Developments in domestic economic data over the last three to four months have supported the NZD higher against all currencies including the EUR. Further increases in the NZD against the USD from current levels do not appear justified particularly in the instance of a stronger NZD value itself hampering the outlook for the productive sectors of the economy. A removal of the global monetary policy stimulus will likely see sentiment sour towards the NZD versus the USD but also support a stronger USD against the EUR such that a reasonably stable NZD/EUR cross rate outlook close to and modestly below current levels would appear likely.



- Likely trading range this month: EUR: 0.4850 – 0.5050 Bias: →
- Likely trading range next six months: EUR: 0.4800 – 0.5100 Bias: →

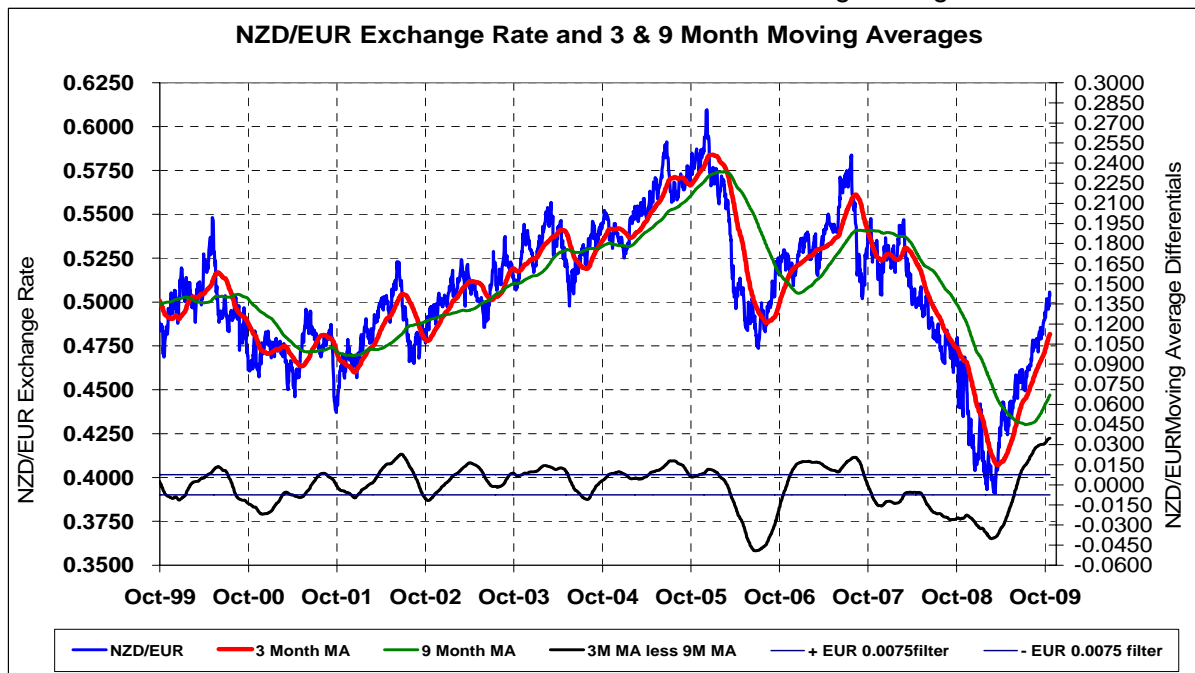
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The NZD/EUR Filter Test for exporters is **not triggered** in the 2 year (-10% filter), is **triggered** in the 3 year (-10% filter) and is **nearly triggered** and 5 year (-15% filter) periods.



NZD/EUR Filter Activation	2 Year	3 Year	5 Year
Filter Criteria	10% below ave	10% below ave	15% below ave
Current Spot (20 Oct 2009)	0.5034	0.5034	0.5034
Forward Points (exporter)	-318.1	-478.7	-728.9
Forward Rate	0.4716	0.4555	0.4305
10 year rolling average	0.5063	0.5063	0.5063
Filter activation level	0.4556	0.4556	0.4303
Activated?	No	Yes	No
Necessary spot rate for activation	0.4874	0.5035	0.5032
Further move needed	0.0160	-	0.0002
Forward Rate relative to 10 year rolling average?	-6.8%	-10.0%	-15.0%

The NZD/EUR Trend Test currently signals an 'up-trend' whereby the 3 month moving average is at least 0.75 cents above the 9 month moving average.

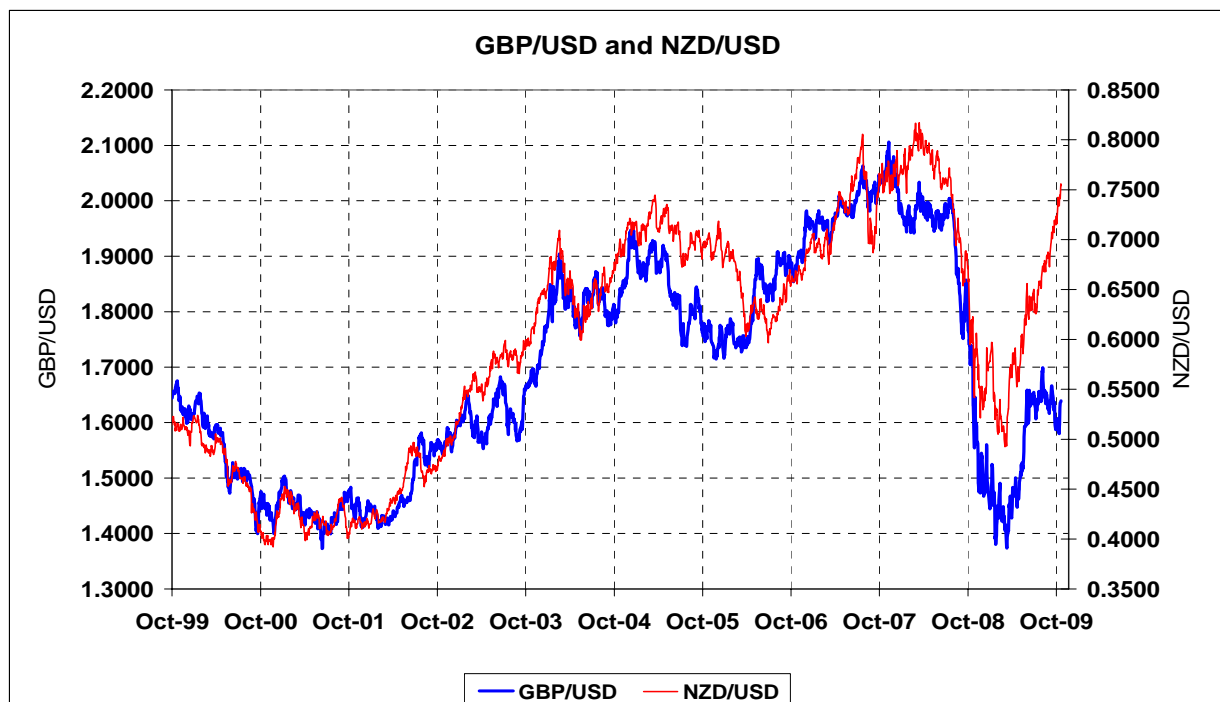


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GBP Market Sentiment and Direction

NZD remains within high 0.4500 to 0.4650 range against the GBP

The NZD has remained at the exceedingly elevated levels above 0.4500 against the GBP over the last fortnight albeit had appeared to be coming back towards and below 0.4500 late last week as the NZD lagged the movements higher in the major currencies against the USD at that time. More broadly it can be seen that the NZD has appreciated 53% against the USD since the 9 March 2009 low whereas the GBP has appreciated 19% against the USD over this period; the implementation of quantitative easing in the UK bringing about the weaker GBP value in global foreign exchange markets. More broadly the strengthening in the GBP from USD 1.5800 on 12 October to the current 1.6400 reflects the overall weaker USD environment but also some modestly improved sentiment towards the UK economy by way of moderately better optimism with regards to the UK economic outlook.



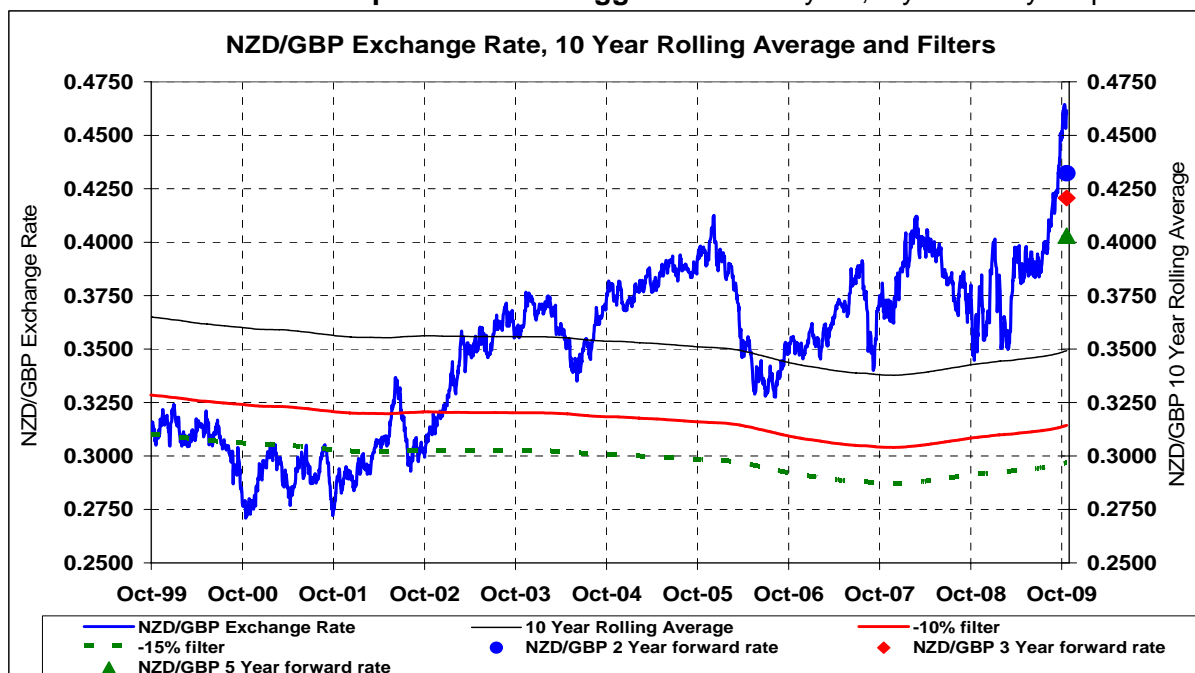
Bank of England maintains interest rates and size of QE programme unchanged in October

The Bank of England maintained the overnight interest rate at 0.50% per their October meeting and maintained the total size of the QE program unchanged at GBP175bn. Some UK economic data has shown more positive signs of late with the PMI Services Survey for September at 55.3 from 54.1 previously. The Halifax house price measure increased by 1.6% mom in September albeit remained 7.4% lower than a year ago. In contrast industrial production contracted by 2.5% in August to be 11.2% lower than levels of a year ago.

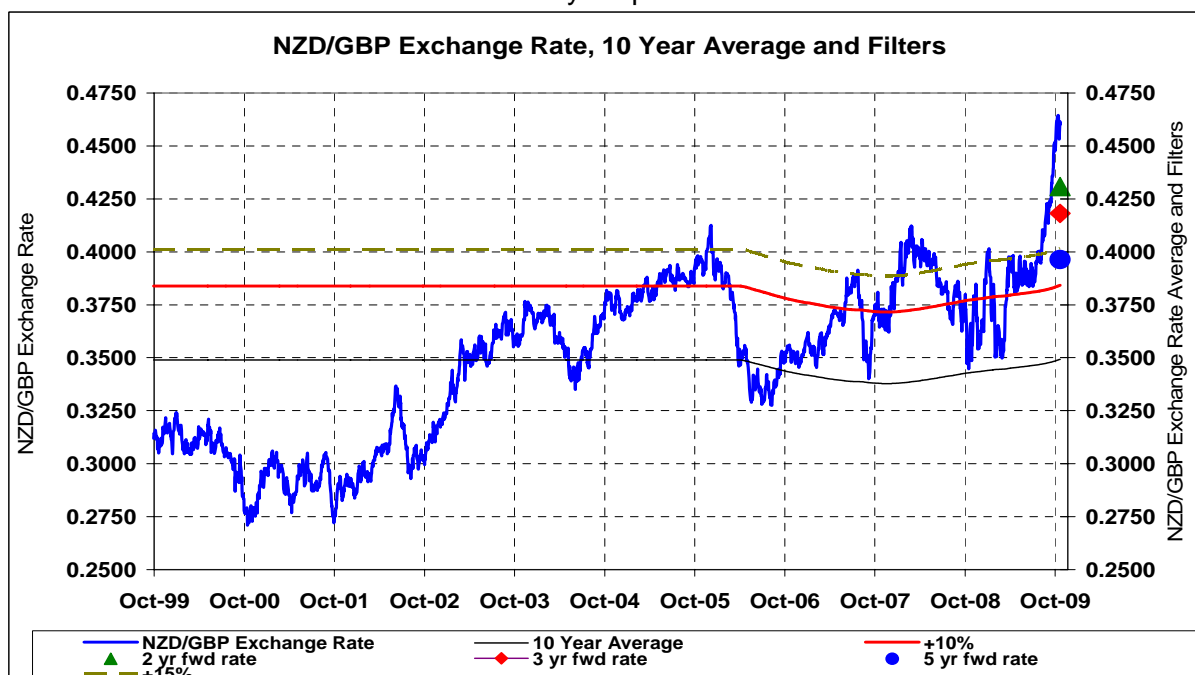
At 1.90% UK 2 year swap rates are 275 basis points below those in New Zealand. However even such a relatively wide interest rate differential does not justify the extent of strength in the NZD against the GBP. The last two times the interest rate differential was at similar levels to the current the NZD/GBP exchange rate was at 0.4000 (April 2008) and 0.3700 (October 2007).

A correction lower in the NZD/GBP appears justified however, among other factors, may require either an end and expectation for ultimately reversal to the QE program (supporting the GBP more broadly), or more likely firmer expectations that the extraordinarily stimulatory monetary policy conditions globally will be approaching an end therefore the likelihood of a correction lower in the likes of the NZD value. Under such a condition NZ / UK interest rate differentials would still suggest an NZD/GBP cross rate somewhere in the very high 0.3000's.

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



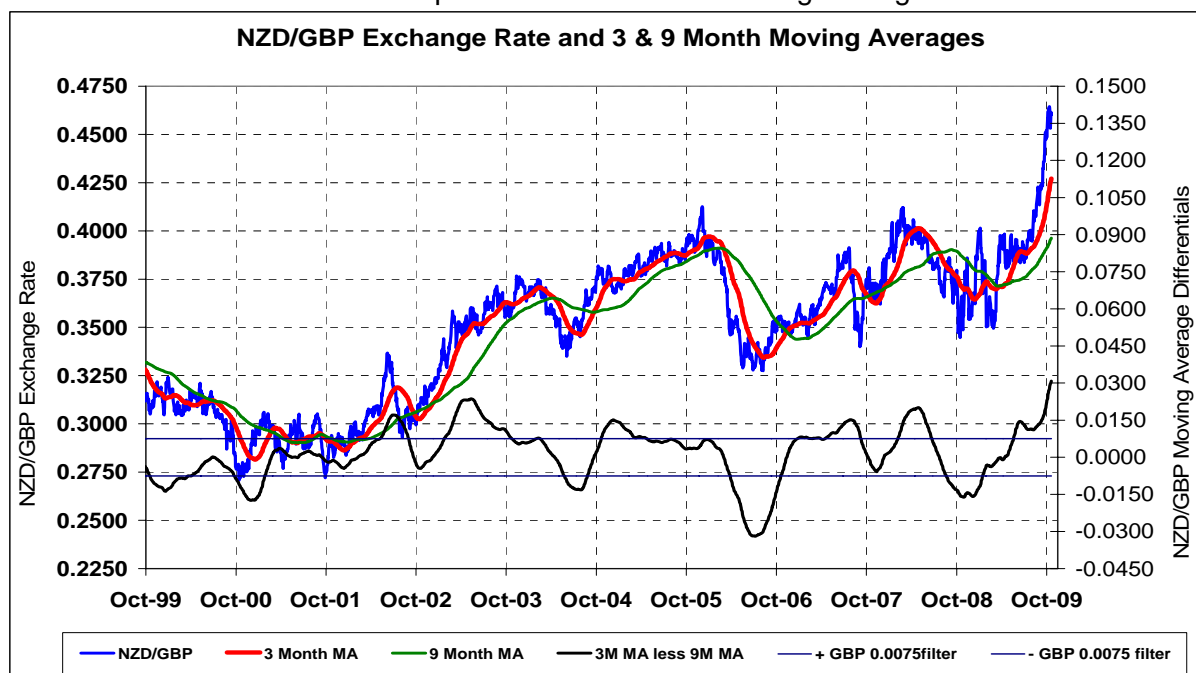
The NZD/GBP Filter Test for importers is triggered in the 2 year and 3 year periods but not quite the 5 year period.



NZD/GBP Filter Activation (Importer)	2 Year	3 year	5 year
Filter Criteria	10% above ave.	10% above ave.	15% above ave.
Spot (20 October 2009)	0.4598	0.4598	0.4598
Forward Points (importer)	-292.6	-420.0	-637.5
Forward Rate	0.4305	0.4178	0.3961
10 year rolling average	0.3493	0.3493	0.3493
Filter activation	0.3842	0.3842	0.4017
Activated?	Yes	Yes	No
Necessary spot rate for activation	0.4135	0.4262	0.4654
Move needed	-	-	0.0056
Forward Rate Relative to 10 year rolling average	23.3%	19.6%	13.4%

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The NZD/GBP Trend Test currently signals an 'up-trend' whereby the 3 month moving average is above 0.75 pence of the 9 month moving average.



CHF Summary

APRM's Central View

- CHF support globally as 'safe-haven' currency has diminished due to improved financial market sentiment.
- Limit to CHF weakness also now that there are many other alternative cheap funding currencies to CHF.
- Swiss National Bank selling of CHF in attempt to prevent strengthening of CHF.

Risks to Central View

- **Upside Risks:** New Zealand economic recovery before Switzerland leads to upward pressure on NZD/CHF cross rate (occurring).
- **Downside Risks:** Stronger NZD value too high too soon brings about ultimately weaker New Zealand economic outlook and NZD value.

Exporter hedging recommendations (Generic)

- 0 – 12 months = Existing clients should be at maximums of policy consistent with previous recommendations. Policy midpoints for new cover.
- 12 month+ = Maximum of limits allowed for forward contracts consistent with previous recommendations (filters 0.7670/0.8000).

Importer hedging recommendations (Generic)

- 0 – 6 month payments = policy mid points for new cover at current levels.
- 6 -12 months = policy mid points for new cover at current levels.

CHF Market Sentiment and Direction

NZD trading in upper part of recent range against the CHF

The NZD has traded in a CHF 0.7500 to 0.7650 range over the last two weeks and is currently trading towards the upper end of this range at 0.7620. A stronger NZD on the NZD/CHF cross rate has occurred as NZD strength to USD 0.7540 has outperformed the CHF currently trading at 1.0100 against the USD. There would appear limited prospect for a materially stronger NZD versus the CHF from current levels.

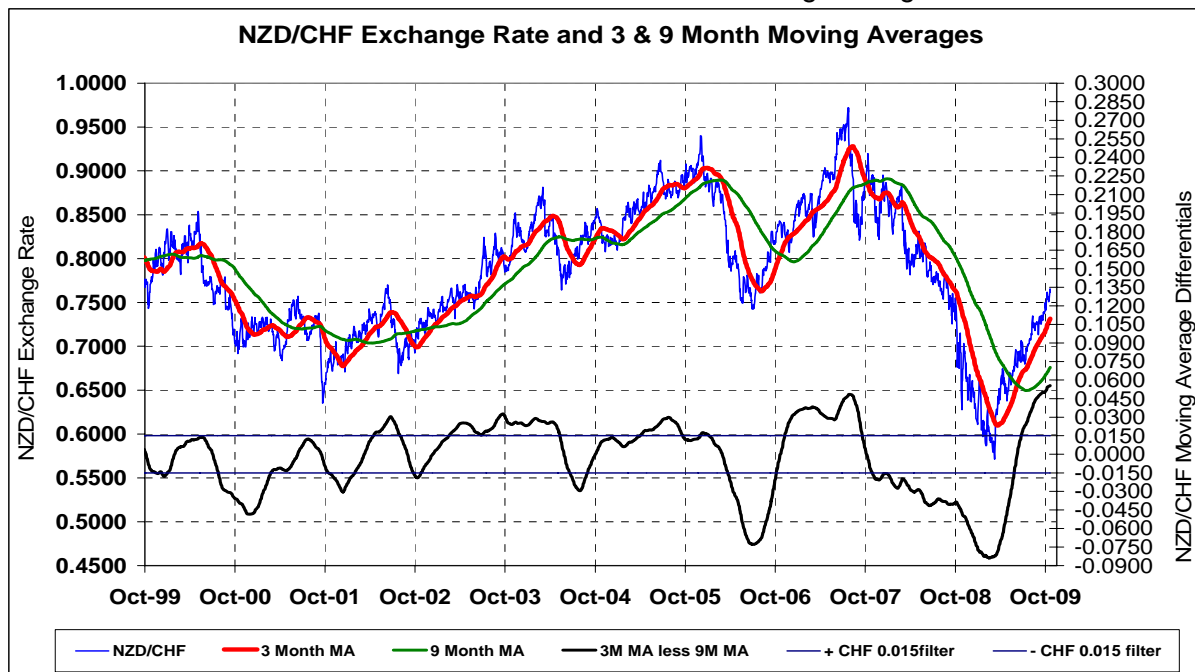
- **Likely trading range this month:** 0.7350 – 0.7700 Bias: →
- **Likely trading range next six months:** 0.7200 – 0.7800 Bias: →

Contacts:

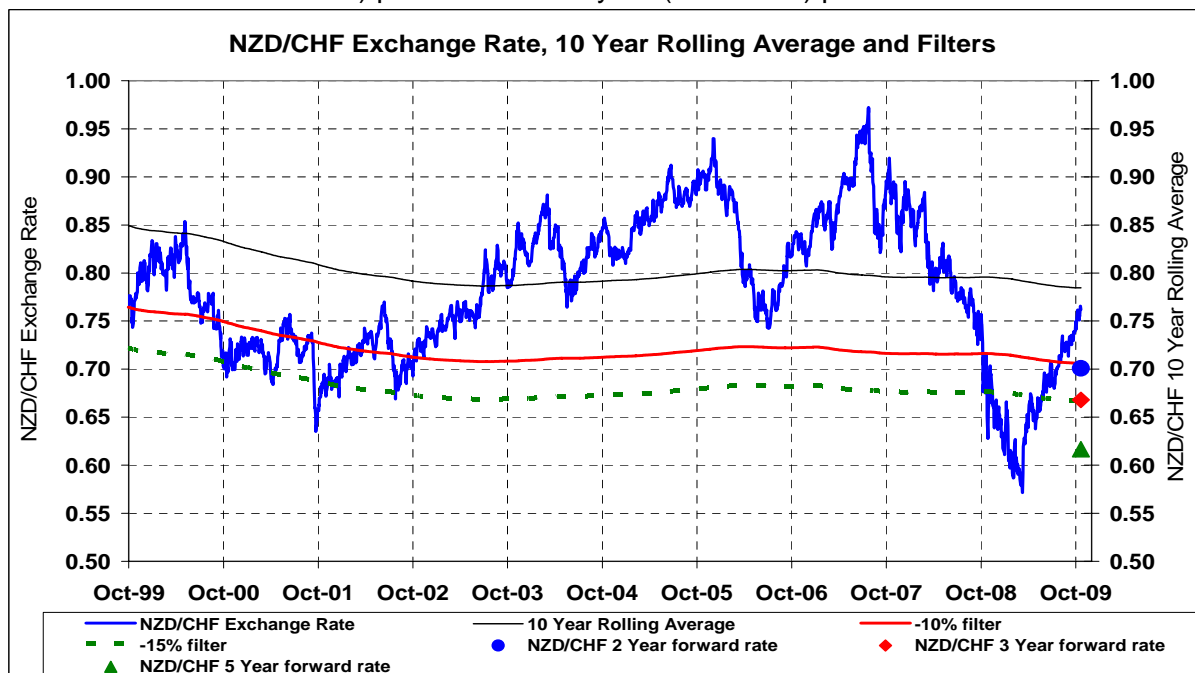
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The NZD/CHF Trend Test currently signals an 'up-trend' whereby the 3 month moving average is at least 1.5 cents above the 9 month moving average.



The NZD/CHF Filter Test for exporters is triggered in the 2 year (-10% filter) period, 3 year (-10% filter) period and the 5 year (-15% filter) period.



NZD/CHF Filter Activation	2 Year	3 Year	5 Year
Filter Criteria	10% below ave	10% below ave	15% below ave
Current Spot (20 Oct 2009)	0.7620	0.7620	0.7620
Forward Points (exporter)	-610.9	-940.1	-1453.0
Forward Rate	0.7009	0.6679	0.6167
10 year rolling average	0.7846	0.7846	0.7846
Filter activation level	0.7061	0.7061	0.6669
Activated?	Yes	Yes	Yes
Necessary spot rate for activation	0.7672	0.8001	0.8122
Further move needed	-	-	-
Forward Rate relative to 10 year rolling average?	-10.7%	-14.9%	-21.4%

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