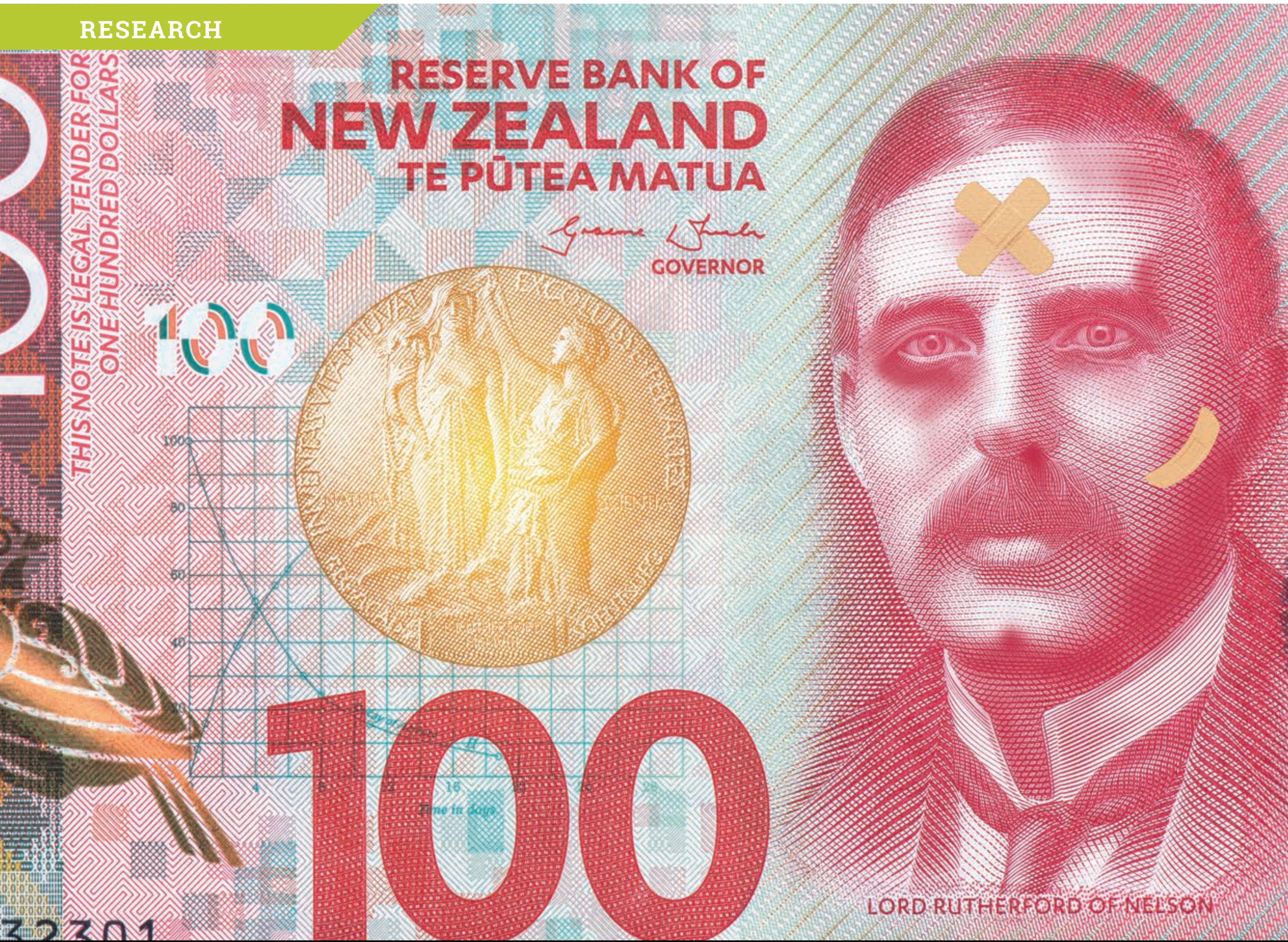
RESEARCH



DOWN BUT NOT OUT

Is a weak New Zealand dollar good or bad for New Zealand? International equities provide diversity through exposure to different economies and industries, and they're also proving to be very useful during the current period of weakness in the New Zealand dollar.

For New Zealand's consumers, a weak dollar means imported items cost more and when booking our next overseas holiday, it can dampen the holiday mood.

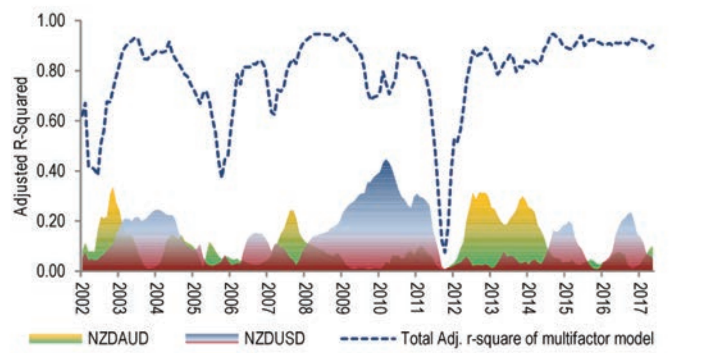
On the other hand, exporters should be happier, as the relative attractiveness of their goods would have improved. That's good news for the agricultural, horticultural and fishing sectors, which are New Zealand's largest exporters.

However, those benefits take time to circulate through the economy. And not everyone will benefit because food costs would also increase.

This is borne out by the New Zealand equity market's reaction to currency movements. The New Zealand equity market direction normally follows the direction of the currency movement.

The market tends to decline as our dollar weakens and rise as it strengthens. This was precisely the case in the early 2000's, just after the financial crisis, and we've seen it more recently. During these periods, currency accounted for between 20% and 40% of movement in the New Zealand equity market.

RELATIVE IMPORTANCE OF CURRENCY AS A DRIVER OF NZ EQUITY MARKET



Source: Forsyth Barr analysis, Thomson Reuters

Most of the time, currency impacts are benign, but the recent period demonstrates why it is handy to hold at least some investments internationally. Typicially, international equity currency exposure is unhedged in investment portfolios. In contrast, international bonds can be made to look attractive through the use of currency hedging tools and the differentials between local and domestic interest rates.

One of the reasons the New Zealand dollar has fallen in value against the US dollar is because these interest rate differentials have changed. For example, for as long as I can remember, New Zealand 2-year interest rates used to be +200bp higher than US rates.

Currently US 2-year rates are +100bp higher than New Zealand rates. To maintain yield attractiveness given the weaker New Zealand dollar, hedged international bond investment portfolios need to either extend their maturity profile, or increase their exposure to lower quality issues.

Another alternative investment strategy would be to increase exposure to New Zealand equities with exposure to offshore earnings. For the most part, the earnings of New Zealand companies are more exposed to Australia. There are however a number of companies whose earnings are exposed and sensitive to the NZD/USD exchange rate. The problem is the number is small and those expected to deliver positive returns even smaller.

NZ USD EARNERS SENSITIVE TO NZD USD

	USD	Sensitivity to USD (higher negative best)				Expected
	% Revenue	2004-2005	2009-2011	2015-2017	since 4/2018	12m return
Refining NZ	80%	-0.5	-0.6	-0.72	-0.46	15%
F&P Healthcare	47%	-0.58	-0.51	-0.48	-0.73	-13%
Tourism Holdins	44%	-0.38	-0.42	-0.58	-0.19	10%
Skellerup	27%	0.22	0.75	0.4	-0.75	13%
Mainfreight	23%	0.49	0.9	0.6	-0.79	-2%
Restaurant Brands	22%	-0.06	-0.8	-0.69	-0.59	-2%
Sanford	18%	-0.52	-0.19	-0.54	-0.53	12%

Source: Forsyth Barr analysis, Bloomberg

International equity exposure is therefore preferred over chasing the few NZ companies that may benefit from New Zealand dollar weakness.

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