The global economy and the Fiji dollar

David de Garis
Senior Treasury Economist
Fiji, February 2005
Today’s talk

- The global economy
- Outlook for major currencies and interest rates
- Australia and New Zealand: two Fiji major trading partners
- Outlook for the Fiji dollar
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Global growth peaked in Q3 2004

World IP and the OECD leading indicator

OECD composite leading indicator, 4 months forward

LEI rose 0.2% in Dec but will keep falling in y-o-y terms for a while yet

World industrial production (3-mth moving average)

% change from year earlier

Global IP and purchasing manager sentiment

Global purchasing managers index 3 mths fwd (right scale)

PMI Perhaps stabilising

% change from year earlier

World industrial production (3-mth moving average)

Note: ‘IP’ is industrial production. The global PMI is constructed from PMIs for the US, Euro area, Japan, UK, Canada, Australia, HK & Singapore. Sources: OECD; Datastream; Economics@ANZ.
The US economy ended 2004 with reasonable growth momentum

**Purchasing managers’ (ISM) index**

- Net balance (%)
- PMI
- Mfg growth threshold
- Rose into year end but receded in Jan

**Retail sales**

- % change from previous month (excl. auto dealers and garages)
- Trend
- Actual

**Industrial production**

- % change from previous month
- Trend
- Actual

**Non-farm employment**

- Payroll employment change: 150k needed to hold U/E rate steady
- Jobless claims trending lower through Feb

**Sources:** Institute of Supply Management; US Commerce Department; Federal Reserve; Bureau of Labor Statistics.
China’s economy has slowed a bit, and lower inflation removes some pressure for higher rates

**Sources:** China National Statistics Bureau; People’s Bank of China.
Global growth outlook – more uncertainty than a year ago

United States: the mainstay

Japan: structural improvement?

China the powerhouse: slowing not stopping!

Europe: lagging
Oil prices and surrounding geopolitics remains a “thorn in the side” of the global economy

Crude oil prices

- **ANZ expects oil to average $45 this year**
  - which would encompass some pull-back
  - OPEC is now defending $40 as a base

- **Politics and oil are an ugly mix**
  - Iraq, the Middle East and political instability in some oil producing economies is keeping the market on edge
  - OPEC is meeting demand which is holding up. OPEC is closer to capacity limits but supply disruption cannot be ignored
  - the $9 average rise in oil prices this year has already cut 0.5% off world growth this year
Last year started strongly but then growth eased

World growth outlook

% change from year earlier

Sources: OECD; IMF; Economics@ANZ.
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The number one currency market issue: the US current account deficit

**US current account deficit and its financing**

**Net foreign purchases of US bonds and stocks**

*Note:* ‘equity investment’ includes corporate bonds.  *Sources:* US Bureau of Economic Analysis; Department of the Treasury.
The US dollar has already fallen significantly, if unevenly

Real effective exchange rates

US dollar

2000 avge = 100

30-year high (1985)

(Down 17% from Feb 02 peak)

30-year low (1974 & 1980)

Other currencies

2000 avge = 100

Euro (up 22% since Feb '02)

Weighted average of Asian currencies (down 3.7% since Feb '02)

Sources: JP Morgan; Economics@ANZ. Asian currencies are JPY, CNY, KRW, TWD, HKD, THB, MYR, SGD, IDR, PHP and INR, weighted by 2002 GDP at market exchange rates.
The US$ has had a mixed opening against ‘major floating currencies’ so far in 2005 ...

**EUR/USD**

US$ per € (inverted)

31-Dec 31-Mar 30-Jun 29-Sep 29-Dec 31-Mar

**GBP/USD**

US$ per £ (inverted)

31-Dec 31-Mar 30-Jun 29-Sep 29-Dec 31-Mar

**USD/JPY**

¥ per US$

31-Dec 31-Mar 30-Jun 29-Sep 29-Dec 31-Mar

**AUD/USD**

US$ per A$ (inverted)

31-Dec 31-Mar 30-Jun 29-Sep 29-Dec 31-Mar

*Note:* charts show daily data from 31 Dec 2003 onwards.

*Source:* Reuters.
The Federal Reserve will keep nudging rates to “neutral” (=>3%) but on a “measured” basis

- Chairman Greenspan’s Feb ’05 semi-annual testimony
  - the economy has entered 2005 at a reasonably good pace
  - Inflation is low even with “accommodative” monetary policy
- Inflation not (yet?) a threshold policy driver for the Federal Reserve
  - No doubt there are upstream commodity price pressures from oil, metals etc
  - And a lower US$ could have produced more consumer inflation
  - The Fed expects 1.5-1.75% for PCE inflation over 2005

Sources: US Federal Reserve; Datastream.
Outlook for the US$

- No doubt, the US economy, after China remains the global economy’s major growth spur and probably destination of choice.

- The US budget deficit has appeared on the US Administration’s radar with promises to halve the deficit by 2009 and accelerate economic and social security reforms.

- US interest rates are becoming attractive (2.5% cf ECB 2%; Japan 0%; UK 4.75%; Australia 5.25%; NZ 6.5%).

- We would not rule out one last phase of US$ decline, but we are approaching the end game of its demise; if it does decline further, a EUR/USD of 1.35-1.40 would likely be the Euro’s peak; USD/JPY of 100-103 and up to 2 for the GBP.
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The RBA has recently signalled that rates could rise over the next few months.

**Inflation**

- 'Headline'
- RBA inflation target band
- Excluding GST and 'volatile' items

**Interest rates**

- Cash rate
- 90-day bill yield

*Falling petrol prices and a rising A$ may force inflation temporarily below 2% this year*

*The RBA’s ‘tightening bias’ will be acted on at their March Board meeting (next week!) and likely again in April*

Sources: ABS; RBA; Economics@ANZ.
The RBA thinks the Australian economy is stronger than official figures

**Economic growth**

- Real gross domestic income
- Real gross domestic product

**Growth and NAB survey**

- NAB trading activity
- Real gross domestic income

Sources: ABS; NAB
The labour market is very strong, with many businesses reporting acute skills shortages.
Australian house prices rose faster than almost anywhere else in the world from 1997 to 2004

Sources: national statistical agencies and real estate institutes; Datastream; Economics@ANZ
Housing sector leading indicators stabilising

Housing finance commitments

Residential building approvals

1st home buyer finance

Home-buying sentiment

Sources: ABS; Westpac/Melbourne Institute; Economics@ANZ.
Financial intermediaries’ lending growth showing signs of stabilising

Housing credit

% change from year earlier

* incl. securitizations

Business credit

% change from year earlier

Other personal credit

% change from year earlier

Total credit

% change from year earlier

Source: Reserve Bank of Australia
Household debt and debt servicing are being closely watched by the RBA

Sources: Reserve Bank of Australia; ABS; Economics@ANZ estimates.
NZ economy: slowdown still not arriving!

Economic growth

Unemployment rate and
demand for skilled labour

Sources: ANZ National Bank, Statistics NZ
World commodity prices for NZ’s key commodity exports still strong

ANZ commodity price index

World prices declined for the first time in 18 months in December but edged higher in January.

Sources: ANZ National Bank
Any increase in ‘risk aversion’ on the part of global investors would also weaken the A$.

Measures of investor risk aversion and the A$

Equity market volatility

Credit market spreads

Note: The VIX index is a measure of US stock market volatility based on prices of options on S&P500 futures.

Sources: Datastream; Economics@ANZ.
Slower world growth and a narrowing rate spread to cap the A$’s rise

**Traditional ‘fundamentals’ and the A$**

**Commodity prices**

- RBA US$ commodity price index (right scale)
- A$-US$ (left scale)

Large rises in contract prices for iron ore and coking coal will boost this index from April ‘05

**Interest rate spreads**

- Australia-US 90-d interest rate spread (right scale)
- A$-US$ (left scale)

This narrowing spread trend will continue after the RBA lifts rates in March/April

Sources: Datastream; Economics@ANZ.
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Outlook for the Fiji dollar (FJD)

- **ANZ expectation of the A$/US$ breaching 0.80 in this half is coming to pass**
  - In part from a soft US$, but now:
    - Expectations of A$ rate rises and booming commodity prices also large A$ positives

- **The Fiji dollar is pegged to a basket of currencies with the A$/US$ the main key**
  - assuming a broadly unchanged FJD “effective” trade-weighted rate, on the above forecasts the FJD/USD could reach a peak of 0.65-0.66 by mid year
  - With the FJD/AUD easing from 0.77 to 0.75 by mid year as the A$ peak ...
  - ... before FJD/AUD recovering as the A$ falls later in 2005

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**Graph: Exchange rates: AUD & FJD**

- The Fiji dollar is pegged to a basket of currencies with the A$ having the largest weight

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**Note:**
- The exchange rates are represented on the graph with FJD/USD and AUD/USD axes.
- The graph shows the trend of the Fiji dollar (FJD) and its relationship with the Australian dollar (AUD) and United States dollar (US$) over the years 2000 to 2005.
Fiji dollar cross rates

FJ$ vs A$

FJ$ vs NZ$

FJ$ vs EUR

FJ$ vs JPY

economics@ ANZ
# Key FJD-related FX rates & drivers

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<td>US Fed funds rate (% pa)</td>
<td>2.25</td>
<td>3.25</td>
<td>3.75</td>
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<td>€ - US$</td>
<td>1.36</td>
<td>1.40</td>
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<td>US$ - ¥</td>
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<td>103</td>
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<td>A$ - US$</td>
<td>0.78</td>
<td>0.84</td>
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<td>RBA cash rate (% pa)</td>
<td>5.25</td>
<td>5.75</td>
<td>5.75</td>
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<td>Australian 10-year bond yield (% pa)</td>
<td>5.33</td>
<td>5.50</td>
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<td>RBNZ cash rate</td>
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<td>6.50</td>
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<td>6.00</td>
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<tr>
<td>FJD – US$</td>
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<td>0.63</td>
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<td>FJD – A$</td>
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<td>FJD – ¥</td>
<td>61.7</td>
<td>65.1</td>
<td>62.1</td>
<td>55.9</td>
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* actual
Summary

- Prepare for some slowing in the global economy
  - Watch oil prices; uncertainty in Europe and Japan

- The Fed is lifting rates gradually to around 3-4%

- The US$ has already declined significantly
  - Perhaps one “final phase” of US$ decline but not enduring

- Australian and New Zealand economic growth will struggle
  - Two RBA rate rises are in the pipeline; maybe one from RBNZ

- Spot FJD/USD is now appreciating with the A$; this rise could continue further (a “final US$ decline phase”) but then follow the A$ down
  - Under current arrangements with a managed FJD basket
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