CURRENT DEVELOPMENTS IN EUROMARKETS

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The purpose of this presentation from my point of view is to describe recent developments in the Euromarkets with particular reference to the New Zealand experience in these markets. With this in mind I propose to divide my talk into three sections:

(1) Recent developments generally;

(2) The experience of New Zealand borrowers in the Euromarkets; and

(3) The development of the New Zealand dollar sector of the Euromarkets.

Firstly, one must appreciate the sheer size of the Euromarket. In extensive ball park terms, one can guesstimate that Eurobonds have been placed in an amount of something over US$200 billion per annum, over the last three or four years, with syndicated loans, commercial paper and committed facilities being placed in these markets at a rate of between 200 and 250 billion per annum during the same period.

To bring that into the Australian and New Zealand perspective, in terms of Eurobonds the Australian currency last year alone contributed 151 Australian dollar deals totalling A$10.5 billion and its small cousin New Zealand currency 18 New Zealand dollar deals totalling more than NZ$1 billion.

Australasian borrowers participating in all the major currency sections of the Euromarket over the last twenty years have raised over 600 Eurobond issues, being around 480 deals for Australian names and 120 for New Zealand names.

1. RECENT DEVELOPMENTS GENERALLY

The recent development in terms of the product which has caused the greatest stir has been the explosion of the Japanese equity warrant market. We have seen more than US$25 billion issued into this sector during 1989 to date; with issue sizes of up to US$1.5

billion as in the recent Mitsubishi Corporation deal. Deals still to come to the market are Toyota Motor Corp and Sumitomo Realty & Development, each which will raise US$1.5 billion. Sumitomo Corp, Nippondenso, C Itoh and Marubeni Corp are also due to the market soon with deals of $1 billion.

A steadier and probably more sustainable growth has been witnessed in the fields of Euro-Commercial paper and Euro-Medium term notes (MTNs). MTN programmes are effectively tap issues, where a borrower has the flexibility to issue paper over a very broad range of maturities to meet particular investment demand. It is noteworthy that many of the Australian banks and semi-governments and the stronger New Zealand State Owned Enterprises have established ECP programmes in the recent past to take advantage of what would seem to be a rapidly maturing market. We would estimate, that there is currently in excess of US$50 billion in Euro-CP outstanding, a volume that continues to provide issuers with confidence in regard to future prospects for the market. A considerably lower volume of Euro-MTNs has been issued to date, but given the cost advantages of a tap programme over straight Eurobonds, it would seem fairly clear that Euro-MTNs have much to offer.

A number of Australian borrowers, both semi-government and corporate have been quick to establish such programmes and have gained withholding tax exemptions for all notes issued under the facility.

Other new products seen in the market of late are many and varied. Among them are mortgage and other asset backed securities, the first of which to be secured against solely new Zealand assets emerging two months ago, this being United Building Society mortgage backed bonds.

One, probably brief, phenomena has been the expansion of the dual currency sector wherein investors are asked to write a currency option in favour of the borrower in respect of receiving a cosmetically very high coupon, with a recent Australian Yen issue, for example, yielding 30 per cent.

Areas of concern have also developed, the most recent being the declining profitability of the markets for intermediaries due to excessive competition. Issue volumes have been hit by concerns over country risk, and for corporates, nervousness over event risk, although the burgeoning development of the Japanese equity warrants market has mitigated the effect on volume to some extent. The most recent example of corporate event risk is the massive deterioration of the credit worthiness of RJR Nabisco, as a result of the Kohlberg Kravis Roberts takeover at the end of last year, resulting in US$14 billion of new debt on the books and a down grading of credit rating. Similarly a very recent example is the death of a majority shareholder in Campbell's Soups two weeks ago resulting in a fall in the price of outstanding bonds of the company because this event may open up Campbell's as an LBO target. Withholding tax has caused problems most recently for German borrowers. Rising interest rates over the last couple of years, especially in terms of Australian dollar issuers, have led to some large losses on the books of over aggressive underwriters. These and other problems have given the Euromarkets some pause for thought with regard to the development path they will take. However it is clear that the role of the Euromarkets will remain a vital one, and that it will continue to be so - always provided that external regulation can continue to remain benign, and that the markets remain allowed to develop in the direction best suited to serve those that provide its raison d'etre, that is, the borrowers and the investors.

2. EXPERIENCE OF NEW ZEALAND BORROWERS IN THE EUROMARKETS

New Zealand borrowers have played an active role (even if only small in the greater scheme of things), in the development of the Euromarkets since the early days. The tapping of the Euromarkets by the New Zealand Government and New Zealand corporates, mostly in non-New Zealand currency, has been going on since the late 1960s on a regular basis through a variety of the different sectors in the Euromarkets. As a result, Euro investors have become reasonably familiar with the New Zealand name and as an on-going source of country risk across the whole range of Euro instruments such as - Euro Bonds, Euro Commercial Paper, syndicated loans and private placements.

Historically by far the most frequent borrower to the Euro Bond market out of New Zealand has been the New Zealand Government. In more recent times, many New Zealand corporates have had a hidden role in the Euromarkets by taking New Zealand dollar swaps off the back of the Euro Kiwi issues.

Figure 1 (attached at then end of this paper) is a pie chart showing New Zealand borrowers in the Euromarkets broken down into government issues and corporate issues from 1966 through to 1989.

The New Zealand Government's experience

The New Zealand Government's frequency to the Euromarkets is a direct reflection of its frequent need for certain currencies and a clear confirmation on the New Zealand Government's confidence of the efficiency of the Euromarkets in providing for those currency needs at attractive levels. Historically the government borrowed directly in the currency which suited its payment profile, however more recently the government debt office has shown a greater willingness to access those markets and currencies in which the investor demand is more apparent and allows them with swaps to maximise the pricing advantage which that investor demand creates.

A recent example of this is the one year Australian dollar offering by the New Zealand Government through Commerzbank two weeks ago, which was swapped into sub-Libor deutschmarks, at a level I understand around Libor minus 80 - thus providing the New Zealand Government with a cost effective liability in a currency which was, at the time, closed to borrowers due to excessive interest rate volatility.

The New Zealand corporates' experience

New Zealand corporates have been able to access the Euromarkets to fund both their offshore operations and to some extent domestic operations. These offerings have been accorded a varying reception and, to date, have been largely targeted towards institutional investors in US dollars, Swiss francs and other institutional favoured currencies.

The application of New Zealand withholding tax on all offshore borrowings by New Zealand residents, has been an extremely limiting factor in terms of developing a broader investor base for New Zealand corporate names. However, the Euromarkets for those who have been able to access it, have provided an ideal opportunity to access occasional arbitrages out of the domestic bond markets or bank borrowings.

Another factor which New Zealand borrowers have suffered from, is lack of name recognition among European retail and institutional investors. This is getting better with the advent of corporates such as Brierleys now with a presence in the UK and featuring in the European news, and publicity around New Zealand state owned enterprises (not all of it being positive, however publicity just the same) and with state owned enterprises now being responsible for their own funding, the Euromarket investors are slowly becoming more familiar with NZ names such as Rural Banking and Finance Corporation, Wool Board, Dairy Board, Housing Corporation, Telecom Corporation of New Zealand, Electricity Corporation - just to name a few. Road shows such as that recently completed by Fletcher Challenge and Electrocorp prior to launch of their Euro Commercial Paper programmes and similarly with Telecom Corporation of New Zealand's road show later this month prior to the launch of its Euro Commercial Paper programme, are essential to actually create institutional interest.

Perhaps of interest is that New Zealand country risk is still not widely approved for sizeable holdings amongst institutional portfolios. This is not necessarily a reflection on the creditworthiness of the New Zealand corporate names, rather another reflection of the lack of constant exposure to the Euromarkets by New Zealand borrowers and geographical distance - although adverse publicity surrounding Equiticorp and the plight of some other investment companies in New Zealand may not help the situation in the short term.

3. DEVELOPMENT OF THE NEW ZEALAND DOLLAR SECTOR OF THE EUROMARKETS

I would like now to address specifically the development of the New Zealand dollar or Euro-Kiwi sector. The next graph (Figure 2 - attached at the end end of this paper) shows the volume of issuance in New Zealand dollars from 1982 through to 1989. The New Zealand currency is a fairly recent arrival in the portfolios of Euro investors and to date has been largely limited to the fixed rate bond market. The backbone within this fixed rate bond market for New Zealand dollar paper is with retail investors, particularly in Germany, Belgium and the Netherlands, (commonly referred to in the market as "Belgium dentists").

The market was initiated in 1984 and 1985 by Fay Richwhite as a means of accessing fixed rate New Zealand dollar for Kiwi corporates at levels considerably below where the government was borrowing domestically at the time. Initial issuers were to name a few, New Zealand Forest Products, New Zealand Breweries, Rural Bank, and Fletcher Challenge. Six or seven issues were placed in these early stages of the market, however, with the advent of global currency swap markets, European investment banks started to bring their own European clients to the sector to take advantage of the attractive borrowing levels. As a result, during the last three or four years the market has been completely dominated by non-Kiwi banking and corporate names, as European names are generally better credits and more familiar to the retail investors. New Zealand banks, semi-government corporations and straight corporates have however, still participated and benefited by taking the swaps from these institutions still at levels which were attractive compared to the domestic rates.

The chart on Figure 3 (attached at the end of this paper) reflects the highly opportunistic nature of the New Zealand dollar market being dominated by bank names and the fleet-footed corporates which are traditionally more receptive to offers of attractive sub-Libor US dollars from any source.

The most important recent development in terms of the New Zealand dollar sector from Fay Richwhite's point of view has been the emergence of Fay Richwhite as a committed market participant. The additional competition seems to have been welcomed by all players, and is likely to lead to an increase in the number of natural users of fixed rate New Zealand dollars entering the market, due to keener pricing levels and a reduced willingness to pay away currency swap spreads.

The most surprising recent development in the New Zealand dollar Euromarket has been the comparative buoyancy of the sector over the last year or eighteen months. During much of the last four or five years, the standard retail currency has been the Australian dollar, with the New Zealand dollar largely of interest as an alternative, due to the New Zealand dollar coupons being three or four per cent higher than the Australian dollar coupons. However, recently this position has been reversed with the Australian dollar deals offering coupons of up to or around 16.75-17 per cent and New Zealand coupons showing only 13.5-14 per cent. Nevertheless, retail interest has remained, (albeit at a slightly reduced level) due to an increasing sophistication amongst the European retail base, which is focusing more and more on comparative economic fundamentals, and which is therefore better placed to take a view on the prospects for the currencies during the life of the deals it is offered.

The New Zealand dollar Eurobond sector seems able to take approximately NZ$1-2 billion of produce in each year despite the relative attractiveness of the Australian dollar currency and Australian dollar coupons.

It must be stated, however, that the New Zealand dollar market is a thin market with little liquidity and so is highly retail oriented from the demand side. Deal sizes are typically 50 million to 60 million New Zealand dollars and 80 per cent to 100 per cent of each transaction is taken by the retail investor. In order to expand the market further, New Zealand borrowers would be wise to pay close attention to the need of institutional investors for liquidity.

It is very firmly our conviction that the New Zealand dollar market will not be viewed as anything other than an opportunistic sector, until such time as the market is regularly tapped by natural users in New Zealand dollars. Clearly this is going to be fairly difficult to achieve, given the seeming reluctance of the New Zealand Government to issue offshore in their own currency, and the constraints placed upon corporates by non-resident withholding tax upon the accessing of the offshore markets. Nevertheless, it is an end towards which we should devote some energy, not only because this is vital for the perceived maturity of the New Zealand dollar sector as a whole, but also because as we put more New Zealand dollar product into the market of a nature that is acceptable to institutional and retail investors alike, New Zealanders are forcing that market to pay greater attention to the New Zealand economy as a whole, with the obvious long term advantages this entails for New Zealand's profile internationally.

Figure 1

NEW ZEALAND BORROWERS IN THE EUROBOND MARKET

BY TYPE OF BORROWER 1966 - 1989

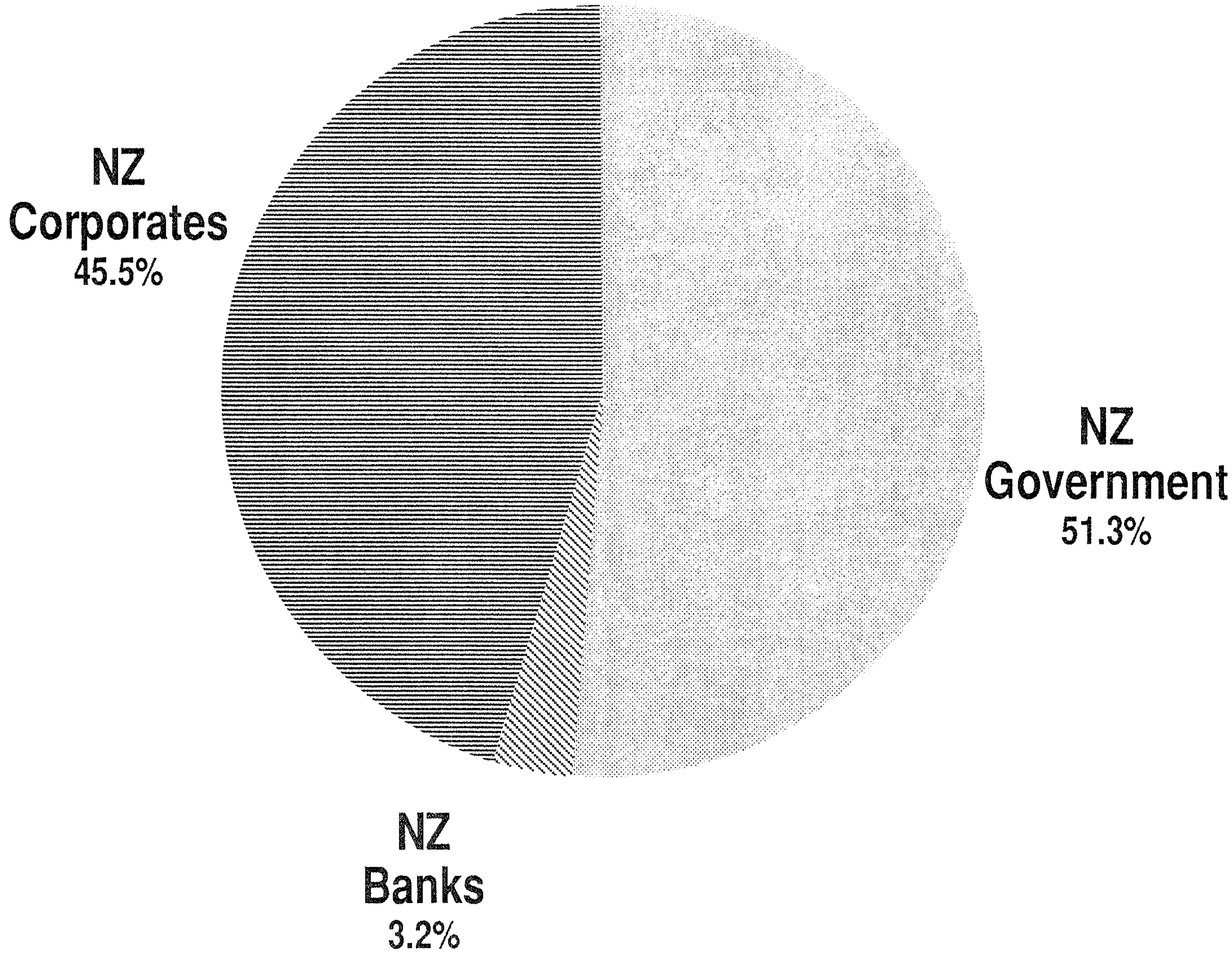

Figure 2

NZ$ FIXED RATE EUROBONDS
ANNUAL ISSUE VOLUME 1982 - 1988

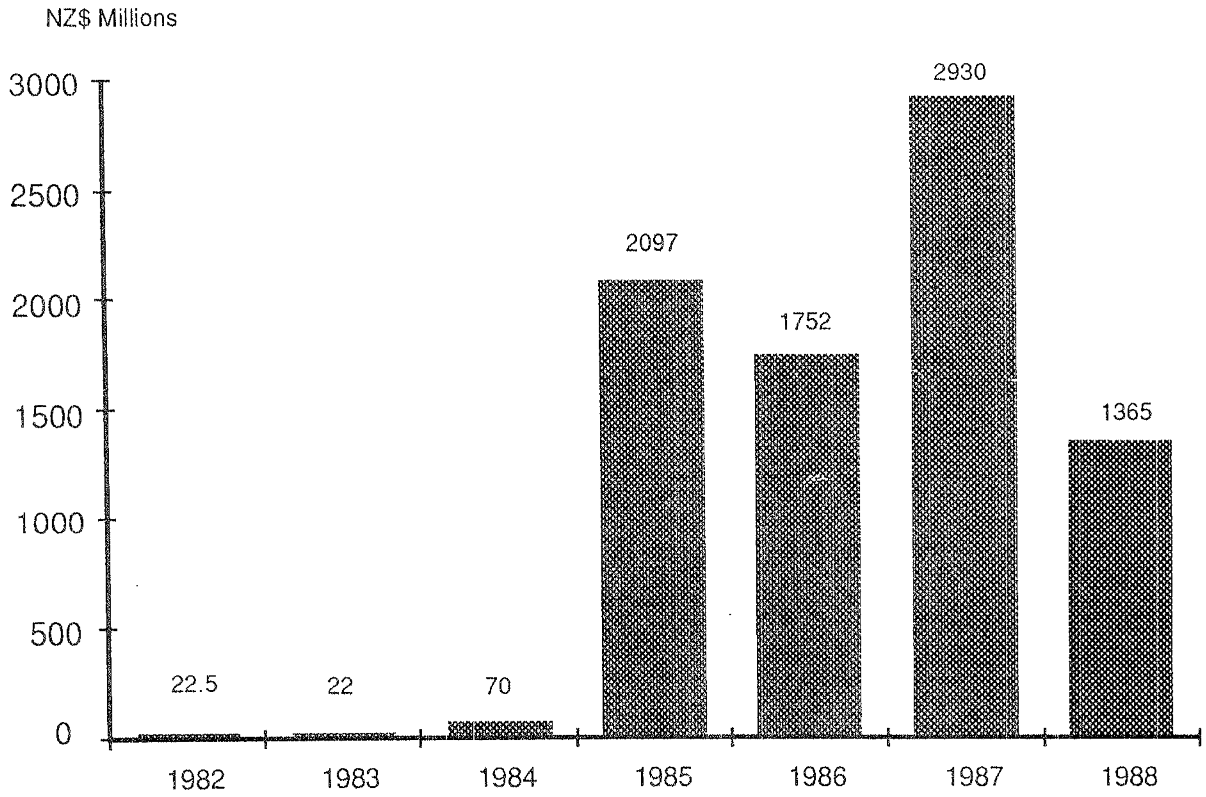

Figure 3

THE NZ$ EUROBOND MARKET
BY TYPE OF BORROWER 1982 - 1989