Kiwi Dollar Barometer

September 2017

Turning of the tide

The ASB Kiwi Dollar Barometer tracks exporters', importers' and importer/exporters' exposures to foreign exchange risk, through surveying businesses with annual foreign exchange turnover of at least NZ$1 million. The Barometer also surveys businesses' expectations for the NZD/USD and businesses' hedging plans for managing foreign exchange risk. Our September edition includes questions on two special topics: the impact of the impending NZ general election on FX hedging/use of options, as well as the impact of the elevated NZD/AUD on respondents' selling prices.

Key "take-outs" from the September ASB Kiwi Dollar Barometer:

A clear turnaround in NZD sentiment was evident in the survey, with respondents having significantly revised up their NZD/USD outlook. Surveyed respondents now expect the NZD/USD to average 75.3 cents by Q3 in 2018, which compares to a 12-month outlook of just 65 US cents three months ago. The change in view has occurred in conjunction with the recent lift in the NZD/USD and was generally across the board, irrespective of the size or trade focus of enterprise.

FX turnover in the next 12 months is expected to be higher for 78.1% of respondents, with the 6.8% average increase in exposure the highest in close to three years.

Overall hedging intentions were broadly unchanged on the previous survey, with 83.4% of respondents planning to hedge in the next 3 months, which accounted for around 93% of their FX exposures.

This quarter's edition examines two topics. The first topic examined the impact of the forthcoming NZ General Election on September 23 on the extent of FX hedging cover. Among reporting enterprises, 44.5% already had increased their hedging activities, with a further 38.5% intending to increase hedging; only 17% cited the election as not having an impact. FX options were clearly the risk mitigation product of choice to managing election-related currency volatility, with 70.5% of enterprises having already increased or intending to make increased use of FX options. Intentions were the strongest for enterprises with large FX exposures and for exporters.

The second topic covered the impact of the persistently high NZD/AUD (above 90 Australian cents since last April) on selling prices for exporters and importers. About 40% of respondents had already passed on the impact of the persistently high NZD/AUD into selling prices, while close to 50% of enterprises had absorbed the impact on their margins. Results varied by enterprise size and type, with importers more likely to pass on the NZD/AUD impact onto customers (at the expense of margins not widening as much as they could have), whilst exporters mostly tend to absorb the high NZD/AUD impact on their margins.

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Please refer to the important disclosures at the end of this document.

The impact of the impending NZ general election on FX activities

Over the last couple of years, political events have triggered sharp exchange rate movements or periods of heightened volatility. The fortunes of the UK Pound following the Brexit vote and the UK general election are a timely reminder of their potential impact. **In this edition we asked respondents whether the forthcoming election would result in increased use of FX hedging or FX options.** For the purposes of this report, the responses are categorised by type of enterprise – importer/exporter only or both importer & exporter. The results are also categorised by size of enterprise and summarise responses received over the three weeks to August 4, 2017.

Election impact on FX hedging

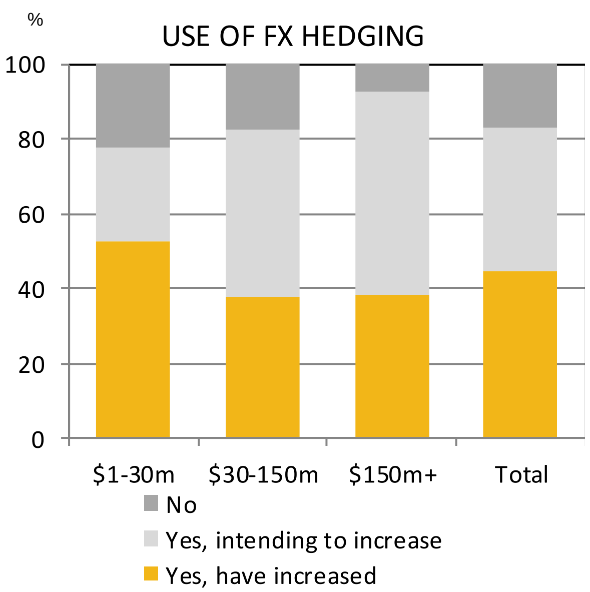
Overall: Around 44.5% of respondents had increased the extent of their FX hedging as a result of the election, with a remaining 38.5% intending to increase hedging and only 17% not changing their FX hedging (Chart 1).

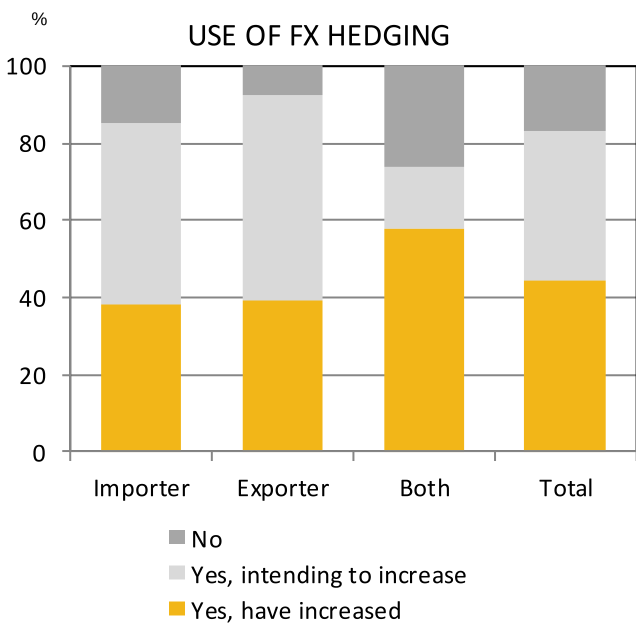
$1-30m: Of firms with turnover in this segment, 52.8% have increased the extent of FX hedging given the forthcoming election, the highest proportion reported by the size of enterprise. A further 24.8% of firms intend to increase hedging. This means that the remaining 22.4% of respondents in this segment were not intending to increase FX hedging, the highest proportion by firm segment.

$30-150m: Of this segment, only 37.8% have increased hedging, but 44.5% still intend to increase hedging. In total, 82.3% of firms have either increased or stated their intent to increase FX hedging due to the election.

$150m+: Just 38.5% of surveyed firms in this segment have increased hedging, but 54.1% are intending to do so. In total, a whopping 92.6% of firms have either increased or stated the intent to increase their FX hedging, with just 7.4% reporting no election impact on hedging. It is likely that firms of this scale typically have more complex or larger FX transactions that require FX hedges.

Type of Enterprise: There are a few notable points when splitting the data by type of enterprise. The survey results confirmed that exporters were the most likely to hedge, with 39.4% of respondents having already increased hedging, 52.9% intending to increase hedging and only 7.7% were not considering additional hedging. For importers, 38.4% had increased hedging with 46.6% intending to increase hedging. For importers/exporters (denoted as 'both' in the chart below), 57.7% had already increased hedges, a further 16.1% were intending to increase hedges, with the remaining 26.2% not contemplating additional hedging.





Election impact on FX options

FX options are a tool well suited for hedging against the outcomes of binary events, such as elections.

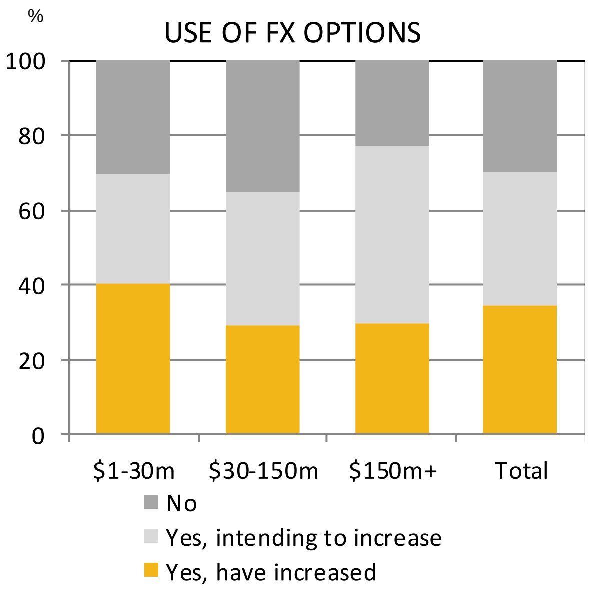
Overall: Respondents were also asked whether they had increased (or intended to increase) use of FX options given the impending NZ General Election. Whilst options are only a subset of the total hedging strategy, the trends by enterprise type and size were similar to that for overall hedging. For all enterprises surveyed, 34.4% had made increased use of FX options, 36.2% were intending to make more use of options, while the remaining 29.5% of enterprises were not contemplating increasing FX option use.

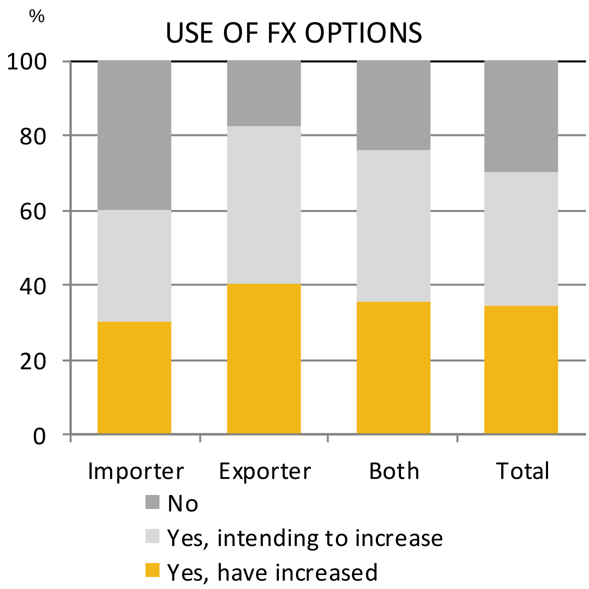
$1-30m: For enterprises with turnover in this segment, 40.4% had increased use of FX options, 29.5% were intending to do so, with 30.1% not having (or intending to) increase purchases of FX options.

$30-150m: Only 29.4% had made increased use of FX options, although a further 35.5% were intending to purchase FX options prior to the election. This leaves 35.5% of enterprises that did not intend to increase use of FX options.

$150m+: 29.5% of surveyed enterprises had already made increased use of FX options and 47.5% were still intending to increase options. Just 23% of enterprises in this segment were not going to change their FX option strategy due to the election.

Type of Enterprise: The survey results revealed some key differences by enterprise type. The survey results confirmed that exporters had generally made increased use of FX options (40.4% versus 30% for importers and 35.8% for importer/exporter). A higher proportion of exporters were also intending to increase cover (42.1% versus 30% and 40.1% respectively). The largest proportion intending *not* to increase additional FX options were importers (40%), followed by importers/exporters (24.1%) and exporters (17.3%).





Summary for FX hedging and options

The forthcoming General Election has resulted in (or is likely to result in) increased FX hedging activity, with 83% of surveyed enterprises having increased or showed the intention to increase hedging. About 70% of firms surveyed had either increased or intended to increase the use of FX options. A higher proportion of enterprises with smaller turnover had already increased hedging and use of options, whilst a higher proportion of larger enterprises were intending to increase FX hedging/use of options. Hedging was more commonplace for exporters, with cover being put in place (or sought) for around 92% of enterprises, with 83% in the form of options. About 85% of importers had (or were considering) increased hedging cover, but only 60% of this cover was via options. About three quarters of exporter/importers were contemplating more FX cover.

NZD/AUD Impact on selling prices

Overall: The sustained high level of the NZD/AUD had been passed onto customers of 39.6% of firms surveyed. Close to half of all firms surveyed (49.8%) noted that the impact of the high NZD has been absorbed in their margins. The remaining 10.6% were not exposed or experienced no impact from the high NZD/AUD.

Importers: 53.4% of firms surveyed had passed on the high NZD impact to customers (most likely in the form of lower prices), whereas 26.9% of firms had not passed on the change to their customers. 19.7% of firms did not experience a NZD/AUD impact.

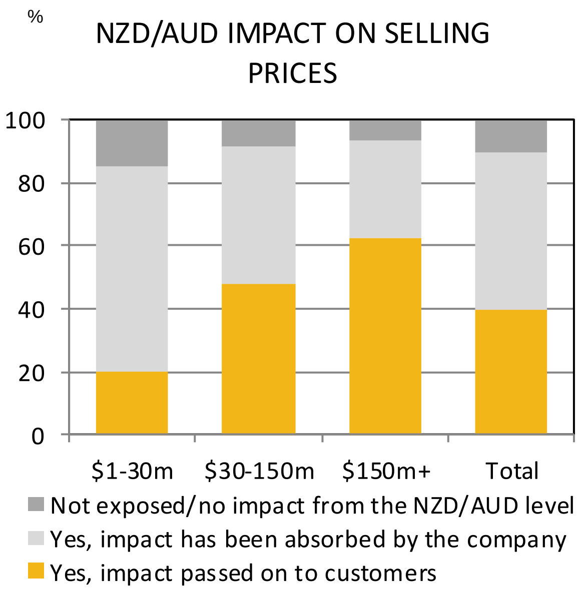
Exporters: The high NZD impact was only passed on by 13.5% of surveyed exporters, with 82.5% of surveyed exporters absorbing the impact in their margins. Less than 4% of surveyed exporters did not feel the impact of the high NZD/AUD.

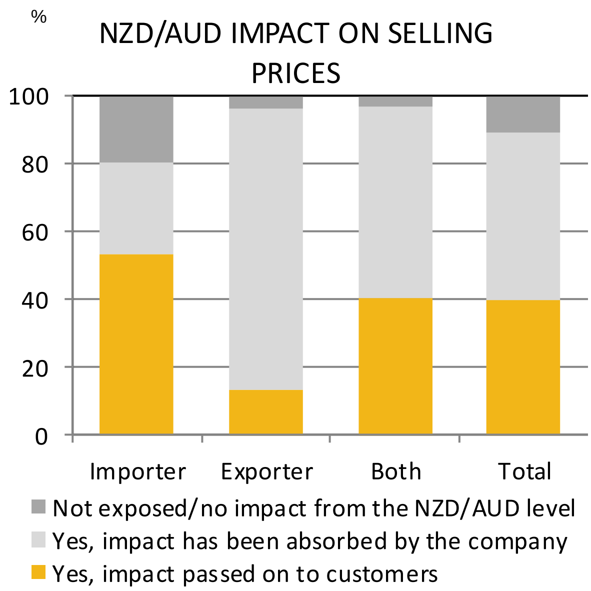
Importer/Exporters: Results for this group were somewhere in the middle. For this group, 40.1% of surveyed firms have passed on the high NZD impact, 31.1% have absorbed the high NZD impact in their margins, with just 3% reporting no impact of the high NZD/AUD.

The NZD impact varied according to firm size: Enterprises with more than $150m in turnover were more likely to pass on the impact of the high NZD/AUD onto their customers (62.3%), with 31.1% of enterprises in this segment absorbing the impact. For enterprises with turnover between $30-150m, 47.9% reported that they had passed on the impact to customers, with 43.7% absorbing the impact. Enterprises with between $1-30m in turnover were more likely to absorb the high NZD impact in their margins (65.3%), with only 20.3% being able to pass the impact onto consumers.

Summary

Our survey suggests that only about 40% of respondents have passed on the impact of the high NZD/AUD onto their customers. The degree of responsiveness varies by type of enterprise, with importers more likely to pass on exchange rate impacts, whilst exporters were more likely to absorb the impact in their margins. Enterprises with larger turnover were also more likely to pass on the NZD/AUD exchange rate impact to customers, with smaller enterprises more likely to absorb the exchange rate impact into their margins.

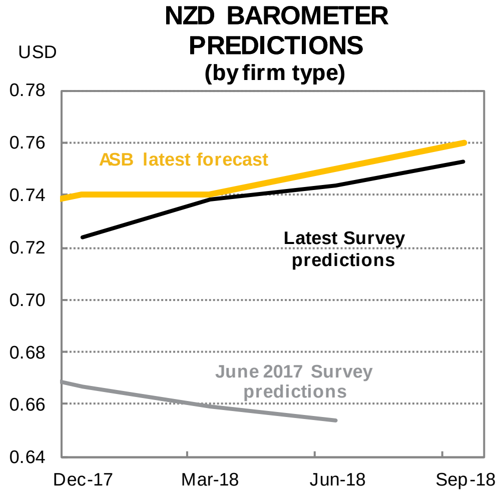


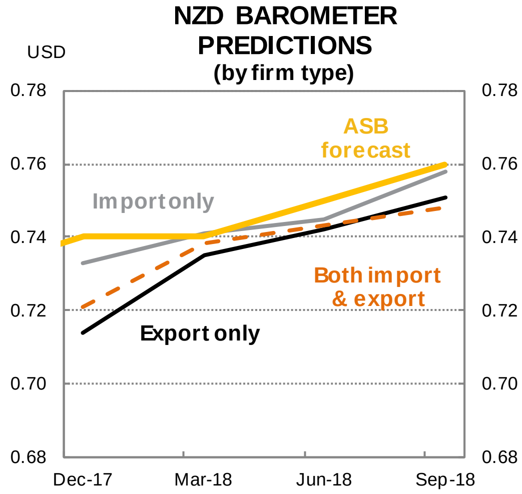


NZD outlook: holding up

Over the survey period (3 weeks ended August 4) the NZD/USD traded in a 0.732 to 0.752 range, averaging 0.743. This compared to a 0.6850 to 0.7060 range in the May survey. The major driver of the move was the concerted weakening of the USD, with the US dollar index falling by approximately 6% from the start of May to the start of August, although there have been signs of USD stabilisation of late. Linked to the lower USD has been reduced optimism that the stimulus and tax reform agendas proposed by President Trump will be quickly passed. Increased risk aversion towards the end of the period and the 'on hold for longer' message from the RBNZ have seen the NZD pare back some of the recent gains.

The change in view from survey respondents bring the NZD/USD outlook from the Barometer more into line with ASB's forecasts (see chart). Our view is that prospective additional US fiscal stimulus will be a long way off, with supportive domestic factors (including the elevated terms of trade and prospective OCR hikes) likely to support the NZD. The stronger for longer NZD view in the Barometer responses marks a shift from the last few surveys in which the general expectation had been for NZD depreciation to varying degrees.





FX hedging plans over the next 3 months

Hedging intentions for the next 3 months were steady at around 3½ year highs. While overall intentions were steady, the quarter saw declining intentions for importers and import/exporters balanced by an increase for exporters. Given the recent strengthening of the NZD/USD, the pullback in exposures for importers was perhaps not surprising, as was the increase in planned hedging for exporters. Export hedging intentions were well below historical averages (54.8% versus 61.9%), while import hedge intentions were above them (89.6% versus 86.5%). As the table shows, firms with larger turnover continued to show higher percentages for hedging intentions. **For those enterprises that plan to hedge, the cover is equivalent to 92.8% of FX exposures, down slightly from the June result but still the second highest on record.**

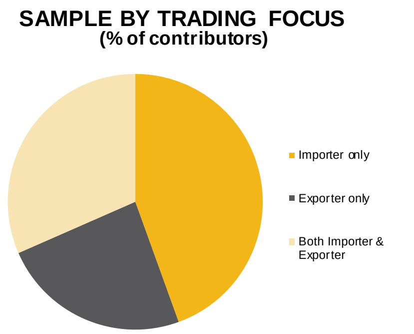
FX turnover for the next year

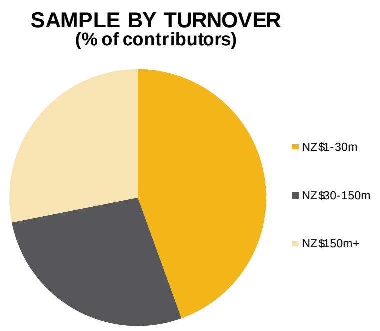
The overall percentage of respondents expecting an increase in FX turnover over the next 12 months rebounded from the previous survey, rising to 78.1% from 76.5% in June. However, this was still the second-lowest reading in 18 months. Whilst both importers and importers/exporters expected to increase turnover, expectations for exporters (67.3) fell to their lowest level in two years. **The average increase in FX exposure (6.7%) was the highest in close to three years.**

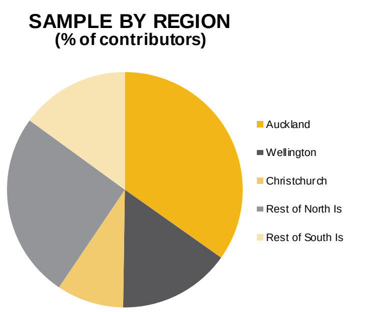
	Importers	Exporters	Import & export	$1-30m	$30-150m	$150+m	Total
Percentage of firms planning to hedge in the next 3 months							
Jun-17	92.4	50.5	95.5	65.5	97.4	98.4	83.4
Sep-17	89.6	54.8	96.4	65.8	96.6	98.4	83.4
If planning to hedge, what percentage of exposure							
Jun-17	91.3	88.9	97.3	86.1	94.4	99.2	93.1
Sep-17	88.8	93.3	97.7	84.0	95.6	99.4	92.8
Over the next year, do you expect FX turnover to increase vs. the last 12 months							
Jun-17	69.5	73.8	88.8	56.2	85.5	100.0	76.5
Sep-17	75.1	67.3	90.5	59.1	86.6	100.0	78.1
How much is FX turnover expected to increase by?							
Jun-17	3.5	7.7	7.3	4.9	5.0	6.4	5.5
Sep-17	6.0	6.2	7.7	7.3	7.0	5.9	6.7

About the Kiwi Dollar Barometer

The ASB Kiwi Dollar Barometer is prepared every three months based on a survey conducted by East & Partners. East & Partners is a market research and advisory firm. For the latest edition of the ASB Kiwi Dollar Barometer, East & Partners interviewed 434 businesses turning over at least NZ$1 million per year. Research fieldwork was conducted over a three week period ending 4 August 2017. Over this period the NZD/USD traded between 0.732 and 0.752. Businesses were asked a range of questions about their exposure to and views about the NZD. The Charts provide information on the survey sample.







The specific questions asked were:

1. What approximate NZD/USD exchange rate level do you expect to see in: End June 2017? End September 2017? End December 2017? End March 2018?
2. What percentage of your FX exposures are you planning to hedge in the next 3 months?
3. Relative to the last 12 months, over the next 12 months by how much do you forecast your FX turnover to change?
4. In response to the impending NZ General Election, have you increased or do you intend to increase the extent of your hedging/your use of FX Options?
5. Has the sustained level of the NZD/AUD had an impact on your selling prices?

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