Chinese currency popular, Trump a source of volatility

The ASB Kiwi Dollar Barometer tracks exporters', importers' and importer/exporters' exposures to foreign exchange risk, through surveying businesses with annual 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, as well as special questions on topical issues in the FX markets.

- **The NZD/USD is expected by businesses trading internationally to be around $0.70 in twelve months.**
- **Donald Trump's presidency is expected to be the main driver of FX volatility over the next 12 months.**
- **Trading in Chinese currency is considerably more widespread than expected.**

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

The special questions focused on FX volatility, trade in Chinese currency and how firms complete FX transactions. Donald Trump is expected to be the main driver of FX moves in the next 12 months. However, a surprisingly high percentage see European elections as the main FX driver, while not too much impact is expected from NZ's election. Trade in Chinese currency was surprisingly widespread with 54.5% of respondents having transacted. Importers/exporters were the most likely to trade Chinese currency, followed by exporters. However, when volumes are taken into account, only around 8.5% of all FX traded is in Chinese currency. Finally, we found phone calls and internet are the two most popular methods for completing FX transactions. As a general rule, the larger the firm, the more likely it is to use the internet.

Sources of FX volatility: Trump

With 2017 notable for a large number of potentially disruptive social, economic and political events ahead, we asked what respondents believed would be the main drivers of FX volatility. Unsurprisingly, **the top result was the presidency of Donald Trump,** with just-shy of half of all respondents picking that as the main potential source of volatility. **In second place are European elections**, on around 40%. The ranking of this option is not a surprise, but such a high response rate is, given the relative lack of local media attention. **In third place is Brexit**, despite its relatively limited impact on NZ. **In last place is the NZ election, at just 5%**. Voting is not until September, though, leaving it less time to impact 2017, while it is (almost) at the back of the line (German elections are around the same time). There is little difference in the breakdown when splitting the data by firm focus, but the size of the firm does matter in its outlook.

The $150m+ firms have the greatest response to the EU elections at 43% (Chart 1), vs 38% in the $30-150m and 35% for the $1-30mn firms. This may be due to greater EU exposure, with larger firms potentially trading with a larger number of countries. **The $1-30m group has a response rate for the NZ election of over 3 times more than the other two groups (8.9% vs 2.5% and 2.6%)** and placed this event above Brexit, the only group to do so. **This could be because small firms have fewer resources to cope with local changes than much bigger firms, so feel relatively more exposed to any changes that stem from NZ's election.**

Trading Chinese currency

A surprisingly high number of respondents to the NZD Barometer trade in Chinese currency. 54.5% said they trade it, although that may be skewed higher by some firms just making the odd small payment. Even so, the result is considerably higher than expected. However, multiplying the percentage of positive responses by the average volume share of Chinese FX trade (15.4%), **pegs Chinese FX trade at 8.4% of all FX volumes, on a weighted basis**. This is around the figure we expected.

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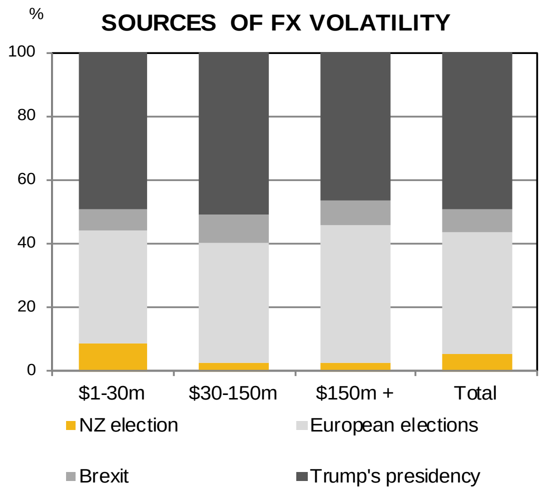

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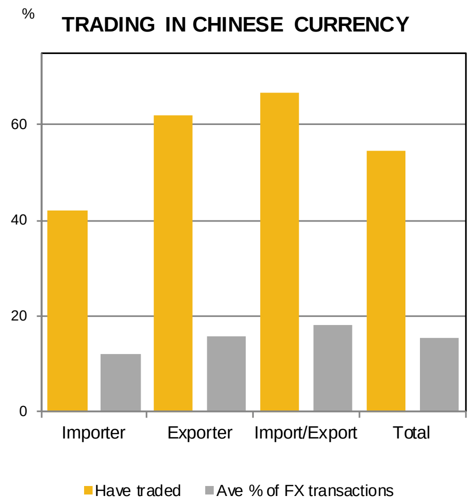

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Importer/exporters lead the way with 66.7% of firms trading Chinese FX, although such firms effectively have double the opportunity to trade the currency. However, exporters had a 62.1% response rate, much higher than expected, while importers were lower at 42.1% (Chart 2). **The size of the response rate had a positive correlation with the average percentage of current FX transactions conducted in Chinese currency.** The greater the propensity of a group to trade Chinese currency, the larger the share of FX turnover that the Chinese currency makes up.

There is also a loose correlation between the size of a firm and the percentage of FX transactions which are conducted in Chinese currency. Firms with turnover of $1-30m had the lowest percentage of those trading Chinese currency at 43.7% (Chart 3). However, the $30-150m segment saw 65.5% of firms engaging in Chinese currency trade. That only dipped a little to 60.7% for the $150mn+ group.

The $150mn+ group which trade Chinese FX saw a whopping 32.9% of FX transactions conducted in Chinese currency, almost 3 times as much as the $1-30mn group on 8.8%. That could be skewed by some large corporates doing a few major deals. Even so, it suggests a sizable trade link. The $30-150mn segment was closer to the smaller firms, at 12.2%.

Future Chinese FX trading

Of all firms that do not trade in the Chinese currency, 36.7% expect to do so in the next 2 years, while 51.1% are not sure, leaving just 12.2% which do not expect to trade (Chart 4). However, **of the larger firms, a massive 75% expect to start trading, while 40.0% of the $30-150m firms are looking to trade and just 18.5% of the smaller firms**. There is a chance many of the firms across all 3 size groups already trade with Chinese firms, but in USD rather than the Chinese currency.

When looking at firm focus it is little surprise to see importer/exporters are the most likely to begin trading in Chinese FX in the next 2 years (Chart 5). This group already has the highest percentage of firms which currently trade Chinese currency. Just under half of those which do not trade are expecting to, with only 6.8% not expecting to.

Methods of conducting FX transactions

Finally, we asked how firms choose to conduct FX transactions. **Unsurprisingly, the most popular options were phone conversations and internet. Over 80% of transactions went through these channels**, with a roughly even split between the two. **The customers' business focus seems to make little difference in the method of execution**, with importers just as likely to pick up the phone as exporters. **The size of the customer does make a difference.** Broadly, **firms with FX turnover of $1-30mn have a preference for using the phone** (43% of respondents – Chart 6). In our June edition of the Barometer, we looked at FX hedging policy and found 80% of firms in the same segment had no formal hedging policy. It could be this which encourages such firms to pick up the phone and seek some input, before transacting.

The firms with FX turnover of $150m+ selected the internet as the preferred method (59%). In June we found that 57% of the same group of firms said hedging decisions are based on a formal policy. Thus, it could be the policy is applied and the transaction executed, with less need for external input and, as such, the internet is a more efficient method.

Firms that sit in the middle, with FX turnover of $30-150mn, had responses roughly in the middle of the other two groups for all 4 methods.

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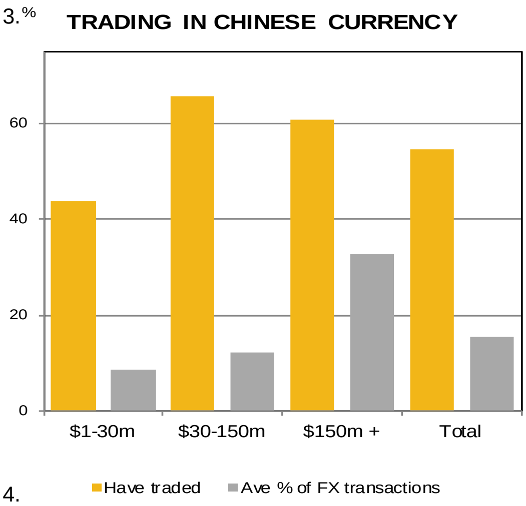

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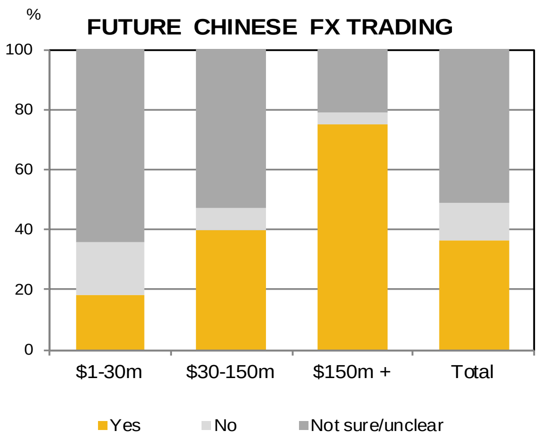

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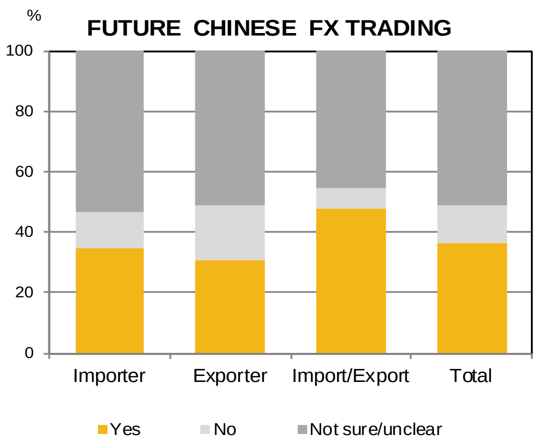

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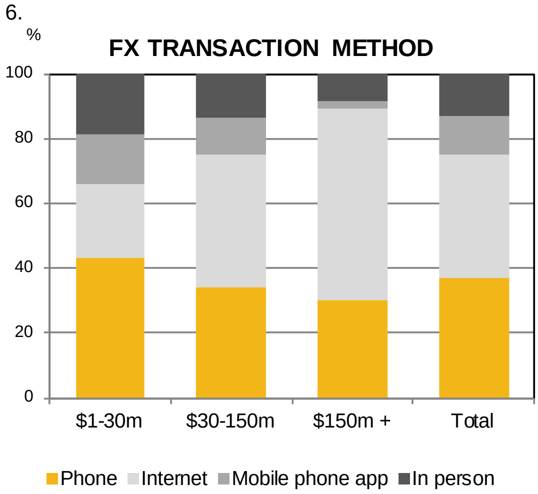

NZD forecast to gently depreciate vs the USD

Over the survey period (Jan 24-Feb 17) NZD/USD depreciated from 0.7250 to 0.7200. It did mark a high of around 0.7350, with the lack of US fiscal stimulus announcements and a focus on US immigration by the new President undermining the USD for a short time. **However, a promise from President Trump to soon deliver some "phenomenal" plans reassured the market**. The NZD also took a step back after the February MPS, when the RBNZ successfully tempered market expectations for an OCR hike this year.

The start point for all forecasts is at least a cent higher than ASB's June 2017 outlook. Importers have again retained the more upbeat view on the NZD, but all three groups look for the NZD to depreciate over the forecast horizon. Importers do see a very small appreciation of the NZD between June and September (0.7200 to 0.7220), but other than that, it is one-way traffic (Chart 7). Exporters see NZD/USD losing around 2 cents over the next 12 months, similar to ASB's 3 cent prediction. When splitting by firm size, the $1-30m group expects a slightly firmer NZD than the $30-150m and $150m+ categories, which have (more or less) the same outlook.

Overall though, the results show the NZD is expected to depreciate through to September/December, with the pace of depreciation then expected to slow a touch through to March next year.

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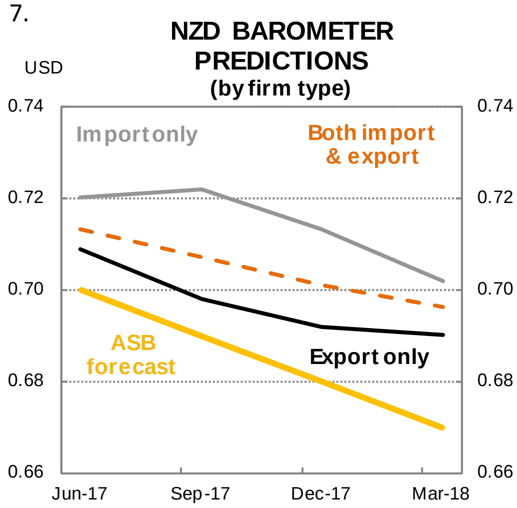

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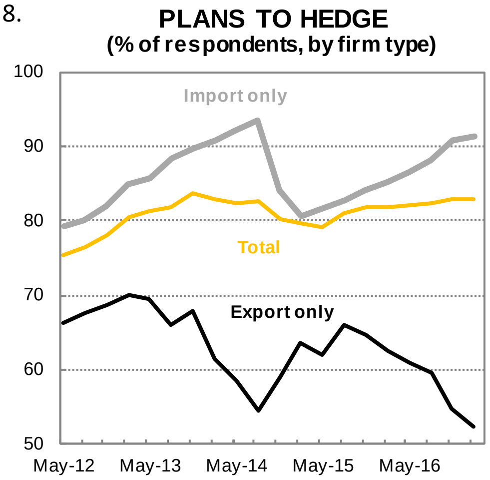


FX hedging plans over the next 3 months

Hedging intentions for the next 3 months continue the slow move higher, marking another high since Q1 2014 (Table 1). Once again, the percentage of exporters looking to hedge has dipped (Chart 8), and marked another low. Given relative NZD firmness over the period, that is no great surprise. **Importer hedging intentions have risen in line with the elevated NZD.** There is no change when assessing hedging intentions by firm size, with the larger firms still more likely to hedge.

FX turnover for the next year

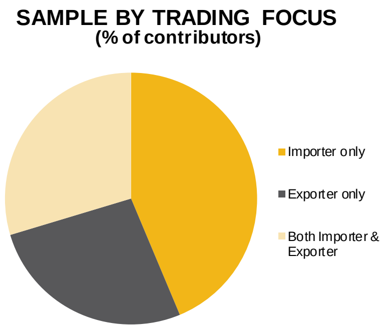
The overall percentage of respondents expecting an increase in FX turnover over the next 12 months has again risen compared to the prior survey, extending the recent trend. The exception is exporters, who expect to experience a small dip in FX turnover. By firm size, all groups expect higher FX turnover. **The average size of the increase in FX exposure rose a little, but remains around the two-year average of 5.5%**.

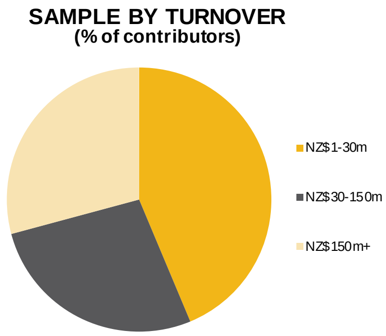
Table 1

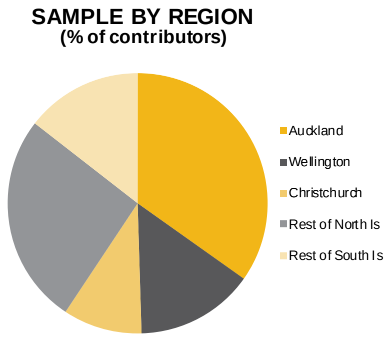
	Importers	Exporters	Import & export	$1-30m	$30-150m	$150+m	Total
Percentage of firms planning to hedge in the next 3 months							
Nov-16	90.7	54.9	93.1	65.6	94.7	98.4	82.9
Feb-17	91.3	52.4	94.7	68.2	91.4	98.4	83.0
If planning to hedge, what percentage of exposure							
Nov-16	88.8	95.5	96.8	81.2	98.0	99.4	92.6
Feb-17	89.6	91.6	97.1	81.9	97.8	99.5	92.5
Over the next year, do you expect FX turnover to increase vs. the last 12 months							
Nov-16	76.8	69.6	87.8	57.7	89.6	100.0	78.5
Feb-17	79.0	68.0	88.6	58.9	91.4	100.0	79.3
How much is FX turnover expected to increase by?							
Nov-16	2.9	7.0	6.8	3.3	5.9	6.0	5.1
Feb-17	3.5	7.4	7.0	4.0	5.8	6.6	5.5

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 430 businesses turning over at least NZ$1 million per year. Research fieldwork was conducted over a three week period ending 17 February 2016. Over this period the NZD traded between 0.7135 and 0.7375. 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. What percentage of your FX transactions are currently in Chinese Renminbi?
5. If zero, do you expect to begin trading in Chinese currency within the next two years?
   Yes / No / Not sure/unclear
6. What percentage of your business FX transactions are conducted by…?.
   Phone / Internet / Mobile phone app / In person
7. Which of the following political events do you think will be the biggest cause of FX volatility in 2017?
   The New Zealand election / The European elections / Brexit / Donald Trump's presidency

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