Kiwi Dollar Barometer

December 2017

A new dawn

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 December edition includes questions on three special topics: the impact of NZ general election outcome on the NZD, how the reduction in NZD forward points has impacted hedging duration, and what are the next potential catalysts for NZD FX volatility.

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

A clear turnaround in NZD sentiment was evident in the survey, with respondents having significantly revised down their NZD/USD outlook. Surveyed respondents now expect the NZD/USD to average 65.9 cents by Q4 in 2018, which compares to a 12-month outlook of 75 US cents just three months ago. Respondent groups have a similar outlook, irrespective of their trade focus or size of operation. The 6 US cent fall in the NZD since the August survey partly explained the change in view, but the change in government (see below) and offshore factors are likely to be influential. It is also in contrast to our published forecasts, which have the NZD strengthening to 75 US cents by the end of next year.

Given recent NZD volatility, it was little surprise to see an increase in hedging intentions, **with the 84% of respondents planning to hedge exposures** the highest in the close to four-year history of the survey. There were differences by trade orientation, with the lower NZD reducing hedging intentions for exporters (52.4%), increasing intentions for importer/exporters (at 97%, the highest on record), with those for importers steady at around 90%. **For those enterprises that plan to hedge, the cover is equivalent to 93.7% of FX exposures, the highest on record.**

This quarter's edition examined three special topics. **The first topic examined the impact of the NZ General Election result on the NZD outlook. More than 80% of respondents believed there had been an election impact**, with around three quarters believing the outcome had weighed on the NZD. We caution that there are likely to be other factors also impacting on the NZD. **The second topic asked whether the narrowing in NZD forward points had an impact on hedging duration**. **For close to 80% of respondents the answer was yes.** The impact on duration varied by the trade orientation of respondent, with proportionately more importers (which are facing lower costs) intending to increase duration. By contrast, more than half of the exporters surveyed said that they intended to shorten duration. **The final topic asks respondents on what would be the next potential catalyst for FX volatility. More than one-third of respondents (35.6%) felt that the next bout of FX volatility would be the result of Donald Trump and subsequent US trade policy and protectionist sentiment.** Trump was the most likely source of volatility for exporters and importers, whereas for more than one third of importer/exporters domestic politics is seen as likely to be the catalyst.

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

The impact of the NZ general election outcome on the NZD

Over the last couple of years, political events have triggered sharp exchange rate movements or periods of heightened volatility. NZD volatility and subsequent weakness around the recent NZ election are a case in point, in which the NZD has traded in a 7 US cent range over the past 5 months and has moved from around 73½ US cents just prior to the election to around 69 US cents by early November. **In this edition we asked respondents whether the election outcome had an impact on the NZD. More than 80% of respondents believed it had, with around three quarters believing the outcome had weighed on the NZD.** We caution that there are likely to be other factors also impacting on the NZD. Narrowing NZD interest-rate differentials have coincided with the weaker NZD, whilst the Australian dollar has gone through a similar cycle against the USD in recent months.

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 November 3, 2017.

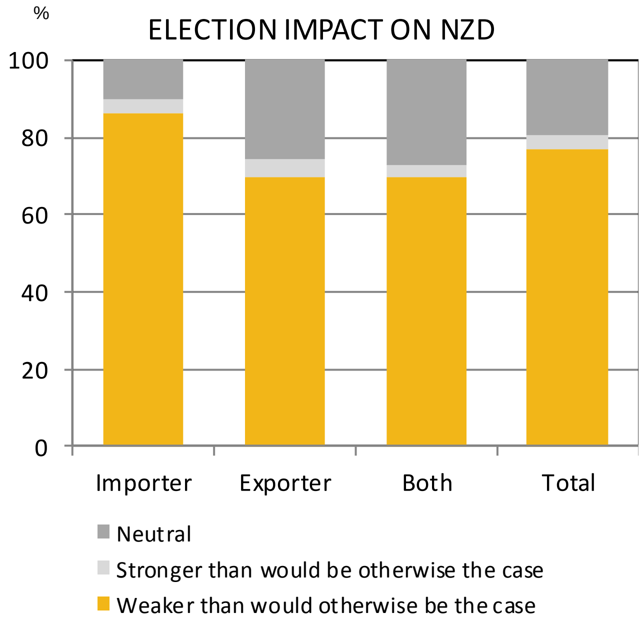
Election impact on FX hedging

Overall: Around 77.1% of respondents felt that the election outcome had weakened the NZD by more than would otherwise have been the case, only 3.7% felt it had strengthened NZD prospects, with the remaining 19.2% feeling the election had a neutral impact on the NZD (Chart 1). The results are not surprising given the post-election related dip in the NZD, part of which occurred during the sample period of the survey.

Importer Only: A larger proportion of respondents (86.5%) felt the election of the new coalition government has weakened the NZD, whilst 9.9% felt it had a neutral impact and only 3.6% felt it had strengthened the NZD.

Exporter Only: Of this segment, 69.5% see the NZD as weaker due to the election outcome, 25.7% felt it had a neutral impact, with 4.8% believing the election outcome had strengthened the NZD.

Importer/Exporters: Close to 70% (69.6%) or respondents see the NZD as being lower than would otherwise be the case, 27.4% believed the election result had a neutral impact, whereas just 3.7% felt the NZD was stronger.



Reduction in NZD forward points on hedging intentions

The narrowing in NZD interest rate differentials relative to our key trading partners has resulted in the reduction of NZD forward points. This, in turn, has affected hedging costs, by making it relatively cheaper for importers but relatively more expensive for exporters to hedge.

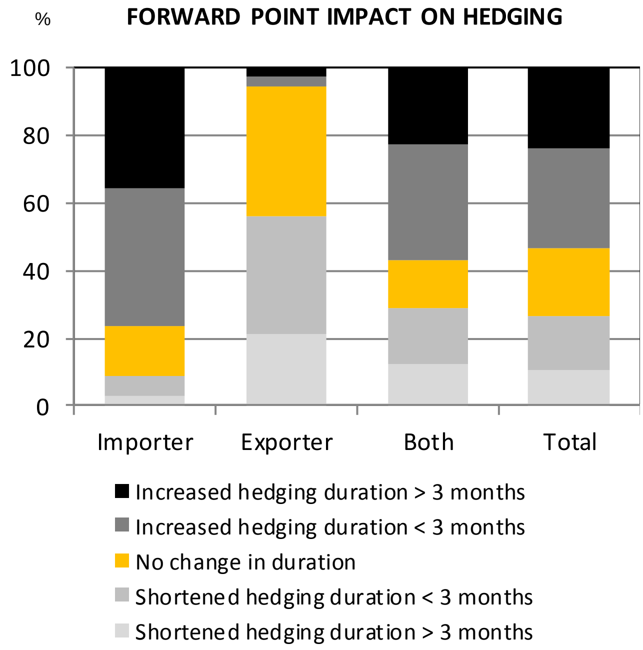
Overall: Around 20.1% of respondents reported that the reduction in NZD forward points had not affected their intended hedging duration. 29.4% had increased their hedging duration by up to 3 months, whereas a further 23.8% had increased their hedging duration for longer than 3 months. 10.4% had shortened their hedging duration by more than 3 months, with 16.2% shortening duration by up to 3 months.

As was to be expected, the results depended on the trade orientation of enterprise with most importers (which are facing lower costs) intended to increase duration, while most exporters intended to shorten duration.

Importer: The reduction in NZD forward points has resulted in more than three quarters of importers in our survey increasing their hedging duration: 40.6% intended to increase hedging duration by up to 3 months, with 35.9% increasing heading duration beyond 3 months. 14.6% of respondents noted that it would not impact their hedging duration, 5.7% cited they would shorten duration up to 3 months, with 3.1% shortening duration beyond 3 months.

Exporter: More than half of respondent exporters intended to shorten the duration of their hedging. 35.2% intended to shorten duration by up to 3 months with 21% reducing duration by more than 3 months. 38.1% cited no impact on hedging duration. Less than 6% were intended to increase hedging duration, with 2.9% increasing duration up to 3 months and the same portion increasing duration beyond that.

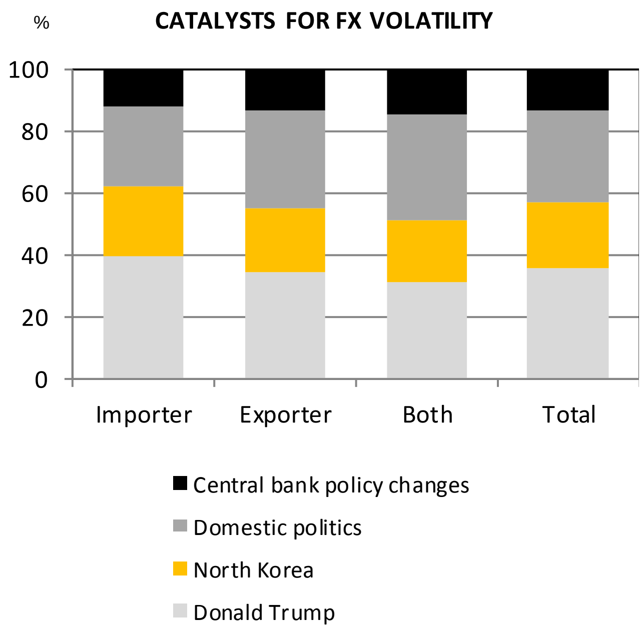
Importer/Exporter: Interestingly, the lower forward points encouraged enterprises in this segment to expand hedging duration. 34.1% intended to increase hedging duration by up to 3 months, and 23% intended to extend duration beyond that. For 14.1% there was no intent to change duration, with 16.3% of respondents intending to shorten hedging duration by up to 3 months and 12.6% intending to shorten duration by more than 3 months.



Next potential catalysts for FX volatility

Since the August survey, the NZD has been through a period of considerable volatility, trading in a 7 US cents range over the past 5 months. The NZD TWI has moved within a 10% range, having touched an 18-month low in mid-November. This special question in the survey asked respondents for their views on what could be the next potential catalyst that would trigger future FX volatility.

Overall: More than one-third of respondents (35.6%) felt that the next bout of FX volatility would be the result of Donald Trump and subsequent US trade policy and protectionist sentiment. The President's unpredictable nature and trade protectionist bent – the US withdrew from the Trans-Pacific Partnership free trade agreement in March 2017 – was an obvious concern for respondents. Another factor related to the US administration – North Korea – also scored highly, with a further 21.3% of respondents citing North Korea as the source of increased FX volatility. Domestic politics attracted close to 30% (29.9%), a reflection of the wariness the business community are likely to feel over the new, but incompletely defined, policy direction of the new coalition government. Central bank policy changes only attracted 13.2%, a relatively low share, with the forward guidance used by most central banks likely to be a factor in mitigating volatility due to central bank actions.



Importers: Close to 40% (39.6%) cited the Trump administration as the next catalyst for FX volatility, followed by domestic politics (26%), North Korea (22.4%), and central bank policy changes (12%). Offshore-dominated factors were adjudged to have a greater likelihood of causing FX volatility than domestically-generated ones, both in an absolute sense and relative to the other groups within the sample.

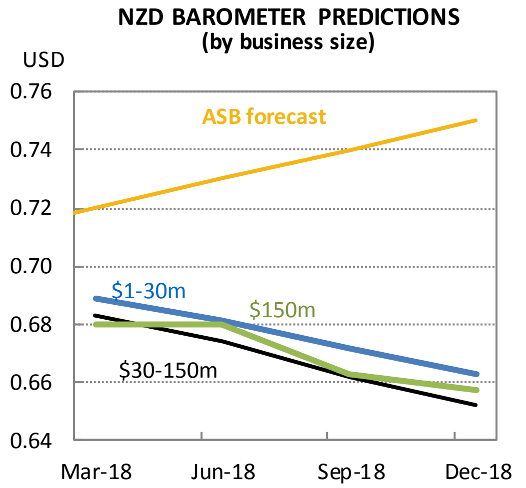
Exporters: The Trump administration (34.3%) took the top spot, followed by domestic politics (31%) and North Korea (21%), with central bank policy changes coming in a distant fourth (13.3%).

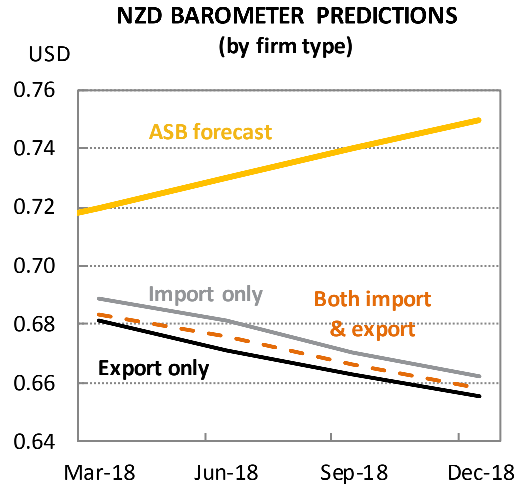
Importer/Exporters: Results for this group suggest that domestic politics could be an area to watch, with this adjudged to the greatest potential catalyst for NZD volatility (34.1%). This was closely followed by Donald Trump (31.1%) and North Korea (21.3%), with central bank policy changes (13.2%) further back in the pecking order.

NZD outlook: post-election dip expected to persist

The NZD TWI fell roughly 6% between the most recent survey in November and the August survey and was down by a similar margin in USD terms. Over the survey period (3 weeks ended November 3) the NZD/USD averaged 69.8 cents (0.682 to 0.720 range), as compared to the 74.3 US cent average in the August survey (0.732 to 0.752 range).

The key take out from this survey is that respondents expect the recent bout of NZD weakness to persist. Surveyed respondents expect the NZD/USD to ease from the close to 70 US cents average over the survey period to 68.5 cents by next March, 67.9 cents by June, 66.7 cents by September and 65.9 cents by the end of the year. As the charts in this section show, there is a reasonable degree of uniformity of responses, irrespective of firm size and trade focus. Exporters (65.5 US cents) and firms in the $30-150m bracket (65.2) are the most pessimistic regarding NZD prospects, whereas importers and smaller size firms are the most optimistic.

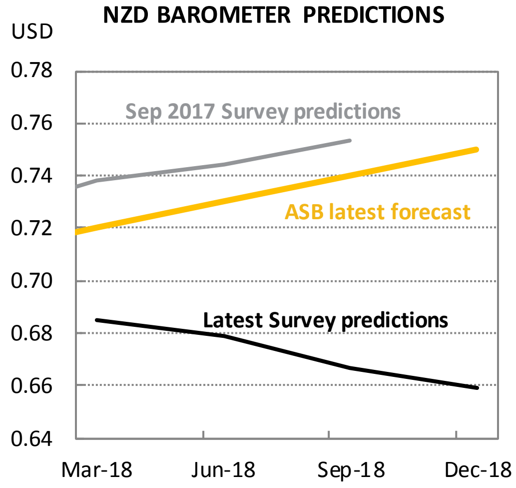




Expectations from the November survey are a marked change compared to the previous survey, in which the NZD was expected to gradually strengthen to around 75 US cents by the second half of next year. **The change in view from survey respondents is in contrast to the stronger for longer NZD view contained in ASB's forecasts (see chart)**, although ASB's NZD forecasts of late have been marginally pared back. We remain positive on the NZD outlook given the support provided by high outright NZD yields, the elevated NZD Terms of Trade and export commodity prices.

The weakening NZD view from the Q4 survey represents a return to normality of sorts, with most of the Barometer surveys tending to expect the NZD to soften in the period ahead. The Q3 Barometer result, in which gradual NZD appreciation was expected from historically-high levels, looks to be the outlier.

As the results from the special questions infer, part of the less optimistic view for the NZD could reflect the change in government. This is consistent with the observed 4 US cent fall in the NZD in the 2 weeks following NZ First's October 19 announcement**. There are other likely catalysts behind the weaker NZD, however.** NZD interest rate differentials with major trading partners have narrowed, whilst dairy prices have eased. Early August to early November coincided with a period of generalised USD strengthening, with the USD rising more than 4% against the Australian dollar (AUD) over that timeframe.



FX hedging plans over the next 3 months

Given recent NZD volatility, it was not surprising to see an increase in surveyed hedging intentions. **Hedging intentions for the next 3 months touched a new record high, with 84% of respondents planning to hedge exposures.** The lower NZD likely contributed to declining intentions for exporters (52.4%), which offset the proportionate increase in importer/exporters planning to hedge exposures (at 97%, the highest on record). It was perhaps surprising that given recent NZD weakness, hedging intentions for importers were steady at 89.6%, the lowest in 15 months. 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 93.7% of FX exposures, the highest on record.**

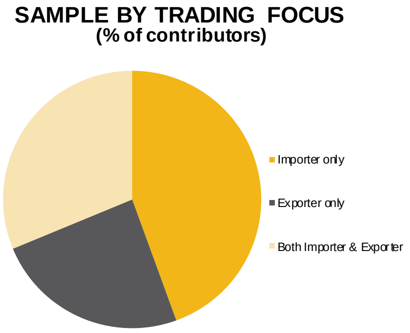
FX turnover for the next year

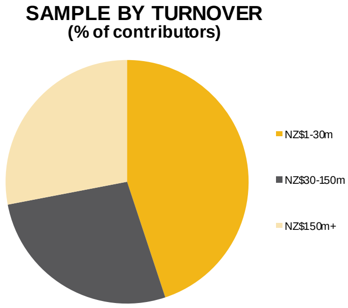
The overall percentage of respondents expecting an increase in FX turnover over the next 12 months rose to a 3-year high, rising to 79.7% from 78.1% in September. Whilst both importers and importers/exporters expected to increase turnover (to 80.2% and 91.1% respectively), expectations for exporters (64.8) fell to their lowest level in two years. **The average increase in FX exposure (7.5%) was the highest on record, driven by an increase in exposures for importers (8.7%) and for firms with smaller turnover.**

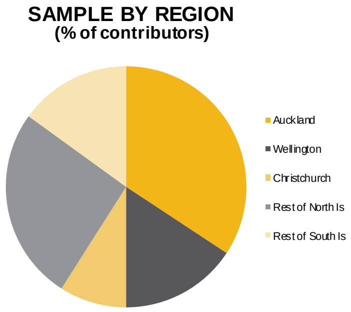
	Importers	Exporters	Import & export	$1-30m	$30-150m	$150+m	Total
Percentage of firms planning to hedge in the next 3 months							
Sep-17	89.6	54.8	96.4	65.8	96.6	98.4	83.4
Dec-17	89.6	52.4	97	66.5	97.4	99.2	84.0
If planning to hedge, what percentage of exposure							
Sep-17	88.8	93.3	97.7	84.0	95.6	99.4	92.8
Dec-17	88.8	93.5	98	88.8	94.0	99.5	93.7
Over the next year, do you expect FX turnover to increase vs. the last 12 months							
Sep-17	75.1	67.3	90.5	59.1	86.6	100.0	78.1
Dec-17	80.2	64.8	91.1	64.4	84.6	100.0	79.9
How much is FX turnover expected to increase by?							
Sep-17	6.0	6.2	7.7	7.3	7.0	5.9	6.7
Dec-17	8.7	5.8	7.0	7.7	7.4	7.2	7.5

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 432 businesses turning over at least NZ$1 million per year. Research fieldwork was conducted over a three week period ending November 3 2017. Over this period the NZD/USD traded between 0.682 and 0.720. 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 March 2018? End June 2018? End September 2018? End December 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. As a result of the New Zealand election outcome, is the NZD, weaker, stronger or no different to what otherwise would be the case?
5. Has the reduction in NZD forward points had an impact on the duration for which you intend to hedge?
6. What is the next potential catalyst for FX volatility?

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