

Expectations of NZD depreciation see divergence in hedging interest

- The ASB Kiwi Dollar Barometer tracks exporters', and 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.
- Businesses generally expect the NZD to peak in March 2014 and then depreciate against both the USD and AUD over the coming year.
- Overall, businesses' interest to hedge continues to increase, driven by an increase in the proportion of importers planning to hedge. An overwhelming majority of importers are expecting their FX exposures to increase in the coming months. However, a smaller proportion of exporters intend to hedge.
- However, businesses have shortened the duration of their hedging in response to the recent decline in the NZD and greater uncertainty about the outlook.

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

The results from the Kiwi Dollar Barometer indicate businesses are generally expecting the NZD to peak in March next year, before easing steadily thereafter. These expectations of a decline in the NZD (and also the recent fall) appear to be driving increased interest amongst importers to hedge. As was the case in previous quarters, while a higher proportion of importers indicated intentions to hedge, of the exporters that intended to hedge they planned to hedge a higher proportion of their FX exposures.

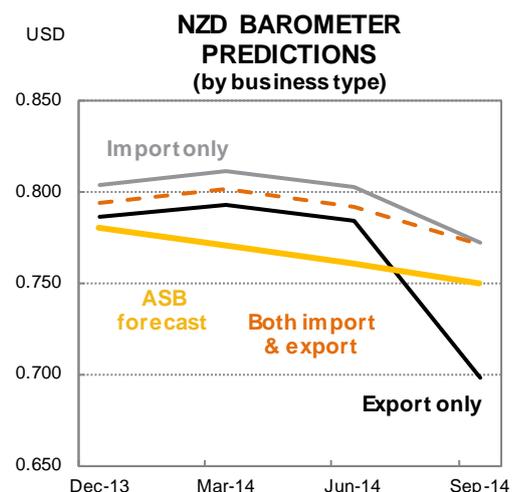
The Barometer finds just over 90% of businesses surveyed indicated they had shortened the duration of their hedging in response to recent shifts in the NZD, with importers shortening the duration of their hedging by a smaller amount of time. This move to shorten the duration of hedging likely reflects the large degree of uncertainty over the direction of the NZD for the coming year. The re-emergence of volatility in recent months also means a higher cost for taking out options, and this is likely to deter businesses from hedging too far out with this tool.

Importers generally indicated an increase in selling margins as a result of the recent appreciation in the NZD/AUD, while exporters indicated an increase in selling margins as a result of the recent depreciation in the other key NZD crosses. These results suggest many businesses are choosing not to fully hedge their foreign exchange exposure, and are not fully passing on the effects on costs (whether higher or lower) onto their customers.

Businesses expect NZD to depreciate over the coming year

The ASB Kiwi Dollar Barometer indicates businesses on average expect the NZD/USD to peak at 0.803 in March 2014, before falling steadily to reach 0.753 by September 2014. Importers continue to be more bullish on the NZD, with the divergence in NZD expectations between importers and exporters very wide for September 2014. This survey was taken over the period 23rd July to 2nd August, during which the NZD/USD traded a wide range. The NZD/USD edged up above 81 cents in late July before steadily depreciating towards 77 cents in early August. The depreciation largely reflected USD strength as positive US data supported market expectations the Federal Reserve will begin tapering its asset purchase programme in September.

- Importers, on average, expect the NZD/USD to peak at 0.811 in March next year, before easing steadily over the year to reach 0.772 by September next year. While exporters also expect the NZD/USD to peak in March 2014, it is expected to be at a slightly lower level of 0.793. Thereafter, exporters expect a relatively sharp depreciation to 0.698 by September next year.



ASB Economics in mid-July revised down its outlook for the NZD/USD, largely reflecting expectations of a stronger USD. We now expect the NZD/USD to gradually ease from 0.78 at the end of this year to 0.75 by September 2014.

Businesses also expect the NZD/AUD to peak in March 2014 before easing steadily. While importers are also more bullish relative to exporters on the NZD/AUD, the divergence in expectations is narrower relative to the diverging expectations on the NZD/USD. This likely reflects the smaller range the NZD/AUD traded in during the survey period.

- Importers, on average, expect the NZD/AUD to peak at 0.881 in March 2014, before steadily falling to 0.854 by September 2014.
- Meanwhile, exporters expect the NZD/AUD to peak at 0.868 in March 2014 and reach 0.844 by September next year.
- In contrast, ASB Economics expects a lower NZD/AUD in the near term, before rising to 0.87 by June 2014 and holding around that level for the following months.

Diverging interest to hedge

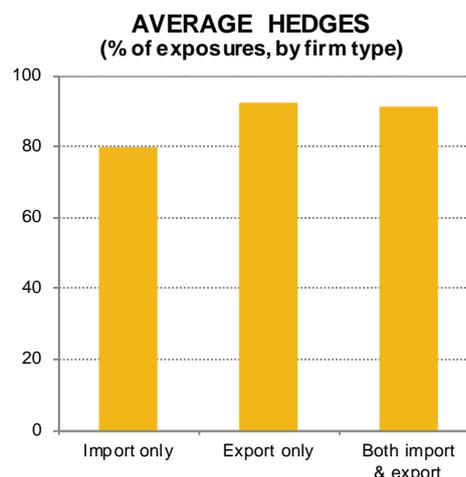
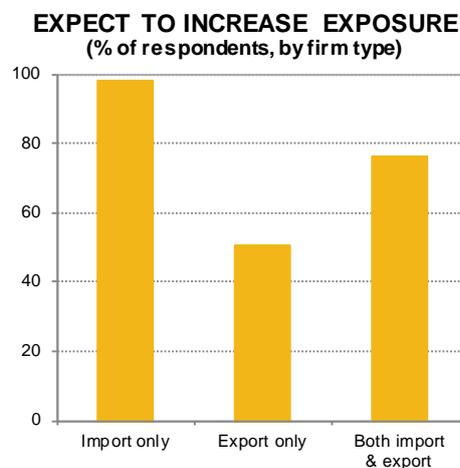
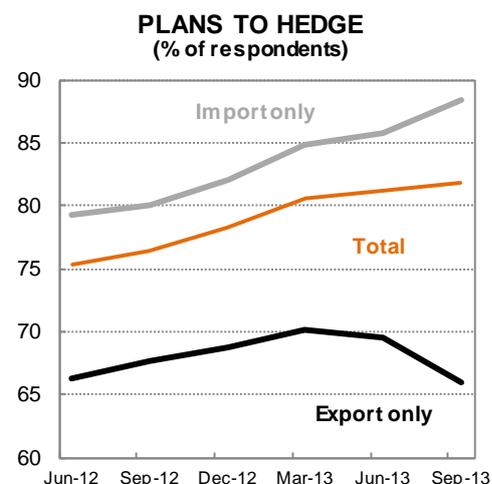
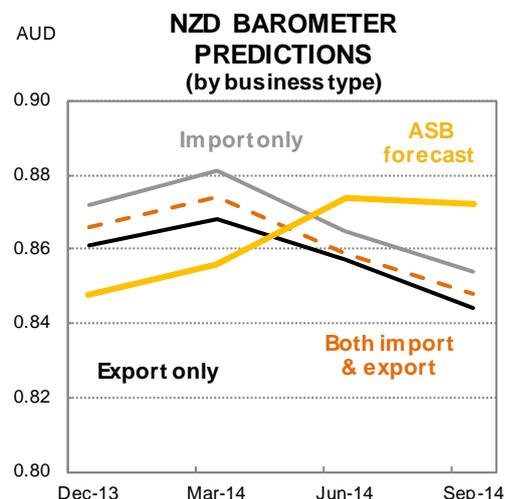
Overall interest to hedge FX exposures continues to rise amongst businesses, driven by an increasing proportion of importers planning to hedge over the coming months. In contrast, the proportion of exporters planning to hedge over the coming months has declined. Exporters appear to be trimming back intentions to hedge, likely a reaction to the recent depreciation in the NZD (with any further depreciation a benefit to unhedged exposures).

- 88.3% of importers surveyed intended to hedge over the next three months, up from 85.8% of importers in the previous quarter.
- However, only 66.0% of exporters surveyed intended to hedge over the next three months, a drop from the 69.5% of exporters in the previous quarter.

The majority (79.5%) of businesses surveyed expected that their foreign exchange exposures would increase over the coming months. In particular, almost all importers surveyed indicated they expected their FX exposures to increase. The 98.2% of importers expecting larger FX exposures is in contrast to only 50.5% of exporters expecting increased FX exposures. Of the businesses that both import and export, 76.1% indicated they expected an increase in FX exposures.

As in previous quarters, despite the higher proportion of importers indicating intentions to hedge, the exporters that intended to hedge indicated plans to hedge a higher proportion of their FX exposures. Across the businesses that intended to hedge, there was an increase in the proportion of FX exposures planned to be hedged relative to the previous quarter.

- The Kiwi Dollar Barometer finds that of the importers that planned to hedge, on average they intended to hedge 79.3% of their FX exposures. This is an increase from the 76.6% of FX exposures indicated by importers in the previous quarter.
- The proportion of FX exposure planning to be hedged by exporters edged up slightly. On average, exporters plan to hedge 92.2% of their FX exposures, up from the 91.1% in the previous quarter.



Businesses shorten duration of hedging

This quarter, we were interested in whether recent movements in the NZD have affected the duration of hedging done by businesses. The Barometer finds an overwhelming majority of businesses surveyed indicated they had shortened the duration of their hedging in response to recent shifts in the NZD. However, there was a difference between importers and exporters regarding the amount of time they changed the duration of their hedging by, with importers tending to shorten the duration of their hedging by a fewer number of months.

- 63.6% of importers surveyed indicated they had shortened the duration of their hedging by up to three months, while 29.1% of importers surveyed indicated they had shortened the duration by more than three months.
- Of the exporters surveyed, 59.4% indicated they had shortened the duration of their hedging by more than three months, while 29.7% indicated they had shortened the duration by up to three months.

Across the businesses, just over 90% have shortened the duration of their hedging in response to the recent shifts in the NZD. This may reflect businesses' uncertainty over the direction of the NZD over the coming year in light of the relatively wide trading range recently. There are many events over the coming months which will likely have a key influence on the NZD, with a large degree of uncertainty over the outcome. These events include whether the Federal Reserve will begin the tapering of its asset purchase programme in September; how the RBNZ will respond to continued pressures in the housing market; and how the global recovery will evolve.

Meanwhile, the re-emergence of volatility in recent months has seen the cost for taking out options increase (as measured by implied volatility, which is markets' expected future volatility of an exchange rate from now till the maturity date of an option). The recent increase in implied volatility will likely deter businesses from hedging with options too far out in time.

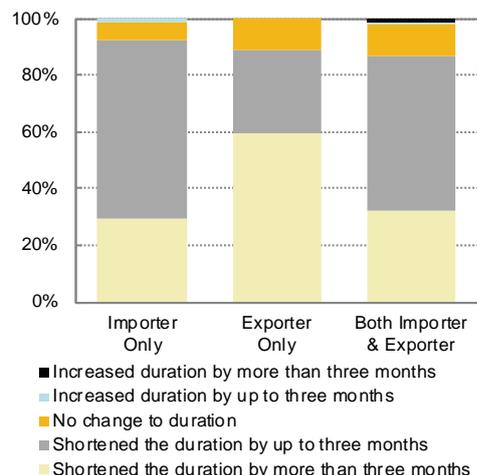
Business margins affected by NZD movements

We were also interested in how recent movements had affected businesses' selling margins, both in regards to the appreciation in the NZD/AUD and the depreciation in the NZD against the other major currencies. A high NZD tends to be beneficial to importers, given it reduces their costs in NZD terms and hence allows them to be more competitive on the NZ market. In contrast, a high NZD is detrimental to exporters, given it reduces their NZD returns and makes them less competitive in overseas markets.

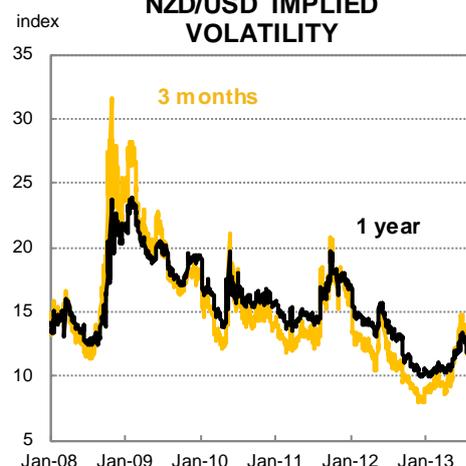
Hence it is unsurprising to find the majority (62.6%) of importers surveyed indicated an increase in selling margins as a result of the appreciation in the NZD/AUD, while the majority (60.8%) of exporters surveyed indicated a decrease in selling margins.

Conversely, the recent depreciation in the NZD against the other major currencies (USD, EUR, GBP and JPY) has seen a decrease in selling margins for the majority (66.7%) of importers surveyed. A majority (58.8%) of exporters surveyed indicated the recent depreciation in the other major NZD crosses has increased their selling margins.

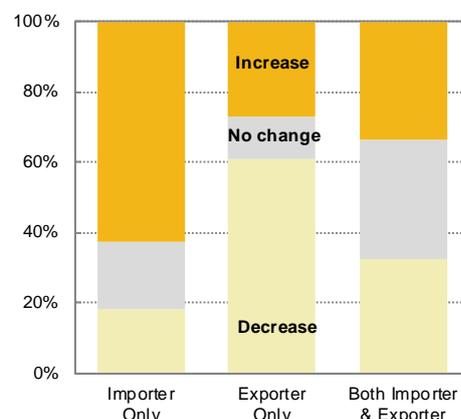
EFFECT ON DURATION



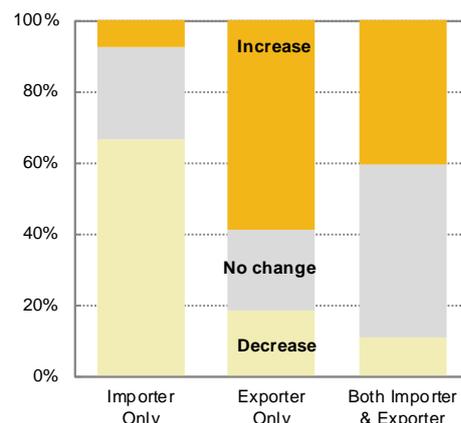
NZD/USD IMPLIED VOLATILITY



EFFECT OF APPRECIATION IN NZD/AUD ON SELLING MARGINS



EFFECT OF DEPRECIATION IN NZD ON SELLING MARGINS



Of the businesses surveyed which were both importing and exporting, most saw no change to their selling margins, particularly in regards to the recent depreciation in the major NZD crosses. These businesses are likely to have some degree of natural hedges, with the increased costs of importing from a depreciation in the NZD largely offset by the increased export returns.

The fact that the movement in key NZD crosses affected many of the businesses' selling margins suggests many are not fully hedging their foreign exchange exposure, and are not (yet) fully passing on the effects on costs onto their customers.

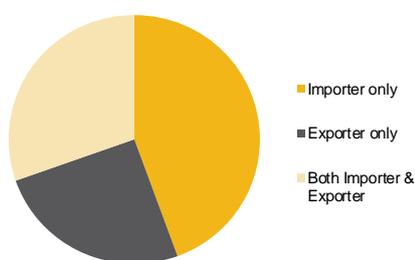
There appears to be scope for businesses to become more engaged with managing their foreign exchange risk, in order to minimise the reduction in selling margins which adverse movements in the NZD may bring.

About the Kiwi Dollar Barometer

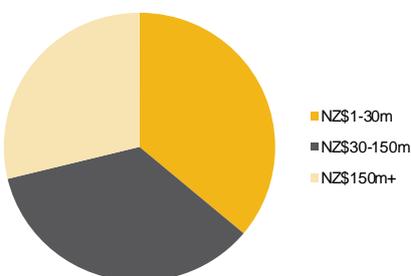
The ASB Kiwi Dollar Barometer is prepared every three months based on a survey conducted by East & Partners. East & Partners is a market research and advisory firm.

For the September 2013 edition of the ASB Kiwi Dollar Barometer, East & Partners interviewed 385 businesses turning over at least NZ\$1 million per year. The interviews were conducted between 23rd July to 2nd August. Businesses were asked a range of questions about their exposure to and views about the NZD. The charts below provide information on the survey sample.

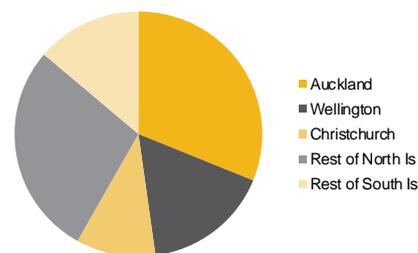
SAMPLE BY TRADING FOCUS
(% of contributors)



SAMPLE BY TURNOVER
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The specific questions asked were:

1. What approximate NZD/USD exchange rate level do you expect to see in:
 - end-December 2013
 - end-March 2014
 - end-June 2014
 - end-September 2014
2. What percentage of your FX exposures are you planning to hedge in the next 3 months?
3. By what percentage are you expecting your foreign currency exposure to change over the next 3 months?
4. How has the recent appreciation in the NZD/AUD affected your selling margins?
 - Increased our margins
 - No change to our margins
 - Decreased our margins
5. How has the recent depreciation in the NZD against the USD, EUR, GBP and JPY affected your selling margins?
 - Increased our margins
 - No change to our margins
 - Decreased our margins

6. By how much have recent shifts in the NZD changed the duration of your hedging?
- Shortened the duration by more than three months
 - Shortened the duration by up to three months
 - No change to duration
 - Increased duration by up to three months
 - Increased duration by up to three months
7. What approximate NZD/AUD exchange rate level do you expect to see in:
- end-December 2013
 - end-March 2014
 - end-June 2014
 - end-September 2014

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