Businesses confident the NZD has turned – what to do now?

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.

- **Broad-based belief amongst businesses the NZD has peaked, and will decline further over coming year.**
- **But declining interest amongst importers to hedge.**
- **Majority of businesses have shortened the duration of their hedging in response to recent depreciation in the NZD.**

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

The latest ASB Kiwi Dollar Barometer indicates businesses are fairly confident the NZD has peaked and will moderate further over the coming year. Interestingly, despite the widely-held expectation of further depreciation in the NZD, importers' interest to hedge their foreign exchange exposure declined noticeably.

The majority of businesses, including importers, have shortened the duration of their hedging in response to the recent depreciation in the NZD. Despite the widespread expectation amongst businesses, including importers, of a further moderation in the NZD, it appears importers are less certain about whether to lock in the exchange rate at current levels. There looks to be scope for importers to gain a greater understanding of the use of hedging tools, including the use of FX options, to protect themselves from a further depreciation in the NZD.

The strengthening in the USD has been the key influence behind the recent depreciation in the NZD. This quarter, we were interested to find out what businesses saw as the key driver of this recent USD strength. "Interest rate expectations" were seen as the leading factor behind the USD strength, with "relative economic performance and outlook" a distant second. The results indicate a high level of awareness amongst businesses that the Federal Reserve will increase the Fed Funds rate sometime over 2015.

Overall, businesses seem pretty savvy about what is going on with exchange rates. The challenge is in how businesses can utilise hedging tools to most effectively mitigate any adverse effects on their business from sudden changes in the NZD.

Businesses expect further depreciation in the NZD

The ASB Kiwi Dollar Barometer shows a widespread expectation amongst businesses that the NZD will ease further over the coming year. Businesses' expectations for the NZD/USD over 2015 were fairly close across the business types. On average, businesses expect the NZD/USD to ease to 0.7360 by the end of next year.

Since the inception of the Kiwi Dollar Barometer, importers' expectations for the NZD were higher than exporters, although the differential was relatively narrow. This Barometer is no exception. Importers on average expect the NZD/USD to reach 0.7610 by mid-2015 and 0.7410 at the end of next year. This is slightly above the 0.7520 in mid-2015 and 0.7300 at end-2015 expected by exporters.

Similarly, ASB Economics forecast a further depreciation in the NZD over the coming year. We expect the NZD/USD to reach 0.7600 in mid-2015 and 0.7300 at the end of next year.

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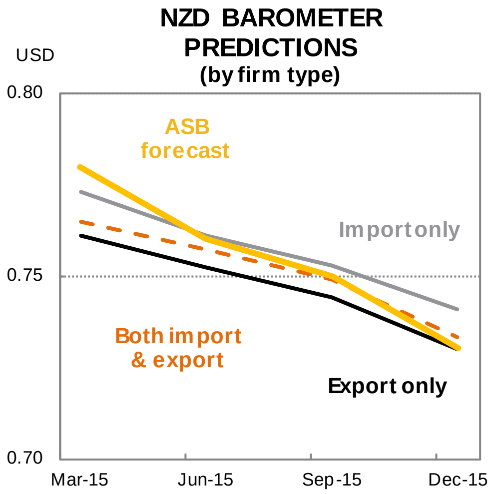

Businesses see Interest Rate Expectations as key USD driver

USD strengthening has emerged as a dominant influence in foreign exchange markets in recent months, and has been a key factor behind the depreciation in the NZD. This quarter, we were interested to find out what businesses saw as the key driver behind USD strength.

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Regardless of size or business type, "interest rate expectations" was seen as the leading factor behind the USD strength, as named by 56% of businesses surveyed. Coming a distant second was "relative economic performance and outlook", with 19.3% of all businesses surveyed seeing that as the key factor behind the recent USD strength.

There has been growing market focus on when the Federal Reserve will raise its policy rate in 2015, in light of ongoing improvement in the US economy. This increase in interest rate expectations has underpinned the strengthening in the USD in recent months. By contrast, signs of benign NZ inflation have led markets to expect the Reserve Bank will keep the OCR on hold over much of 2015. These diverging interest rate expectations have reduced the yield advantage of the NZD.

Have importers missed the boat?

Despite expectations of further depreciation in the NZD, there was a decline in the proportion of importers intending to hedge this quarter (Chart 3). It appears that, although importers are reasonably confident the NZD will continue to depreciate over the coming year, there is uncertainty about how much they should protect themselves against this expected adverse shift in the currency.

This trend is also reflected in the declining proportion of foreign exchange exposure importers intend to hedge (Chart 4). Importers are likely to have pared back on hedging plans given the recent NZD depreciation, and increased foreign exchange volatility more recently would have raised the cost of options and FX forwards.

This quarter, we were also interested to find out whether the recent depreciation in the NZD had prompted businesses to change the duration of their hedging. Over 85% of businesses surveyed shortened the duration of their foreign exchange hedging in response to the recent NZD depreciation. This trend was consistent across all business types and sizes.

Noticeably, 87% of importers shortened the duration of their foreign exchange exposure. Importers appear less committed to using foreign exchange hedging to protect themselves against further adverse movements in the currency, despite the widespread belief that the NZD will indeed fall further.

One possible explanation for this result is that although importers may believe the broader trend over the coming year will be a depreciation in the NZD, importers are nevertheless hoping for some short-term rebound in the NZD along the way which will allow them to hedge at more attractive levels.

Previous ASB Kiwi Dollar Barometers had found greater than half of importers' decisions over foreign exchange were driven by the timing of cash flows or were purely discretionary. It is possible a number of (small) importers were caught out by the recent depreciation in the NZD. Consequently, any hedging would be transacted at less attractive levels. In the absence of a formal treasury policy, some of these importers may be hoping for a rebound in the NZD allowing them to hedge at better levels.

Last quarter's ASB Kiwi Dollar Barometer found less than 9% of importers' foreign exchange transactions were through FX options, with 70.5% through FX forwards. There is scope for importers to increase the use of FX options to protect themselves against any further depreciation in the NZD, while capturing the benefits of any NZD rebound along the way. The increased use of FX options and adoption of a formal treasury policy would make importers better prepared to ride out sudden adverse moves in the currency. However, the recent increase in foreign exchange volatility has made FX options more expensive.

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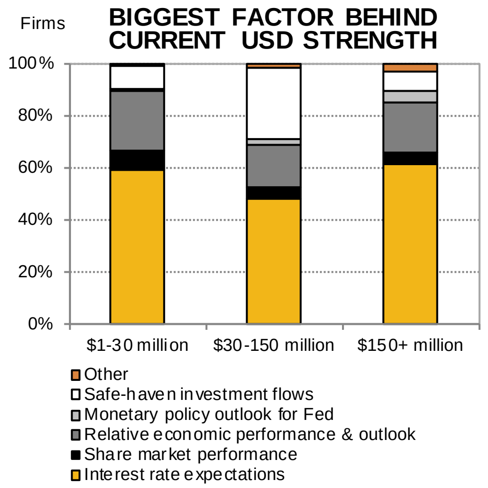

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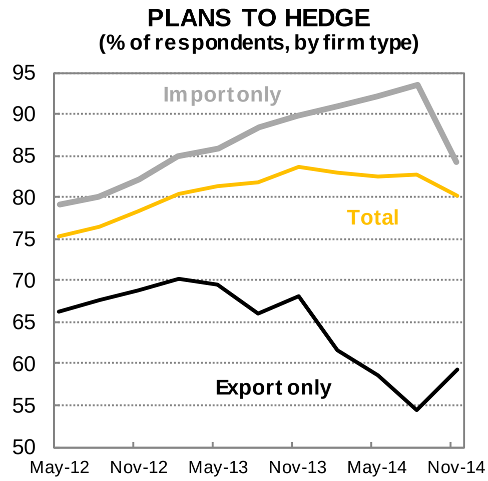

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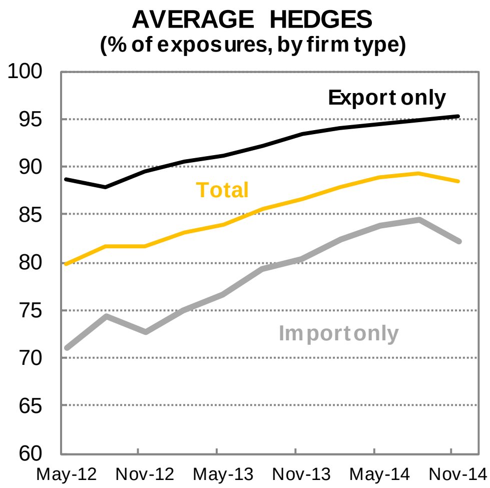

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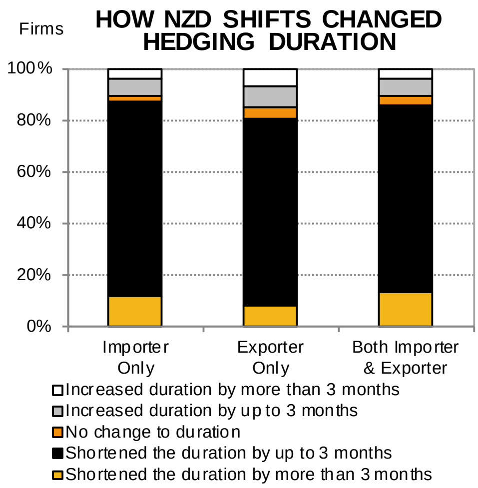
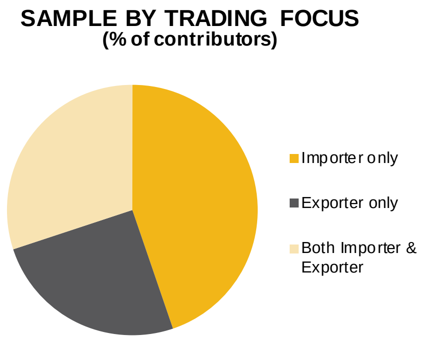
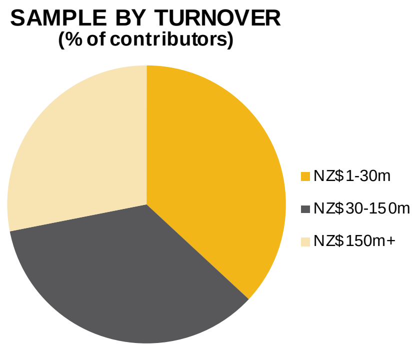


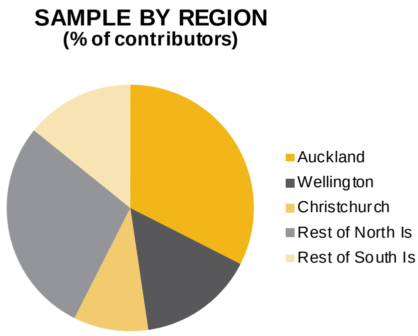
NZD depreciation provides opportunities for exporters

Exporters appeared to see the recent depreciation in the NZD as an opportunity to protect themselves against any potential rebound in the NZD. The proportion of exporters intending to hedge increased, as did the proportion of exposures exporters intended to hedge. 59.2% of exporters intend to hedge their foreign exchange exposure, a marked increase from the 54.5% of exporters in the previous quarter. Of these exporters, they are also intending to hedge a slightly greater proportion of their foreign exchange exposure.

80.3% of exporters shortened the duration of their foreign exchange exposure in response to the recent depreciation in the NZD. This result is fairly intuitive, suggesting the majority of exporters are looking to reap the benefits of an expected further depreciation in the NZD.







The specific questions asked were:

1. What approximate NZD/USD exchange rate level do you expect to see in:
   - end March 2015
   - end June 2015
   - end September 2015
   - end December 2015

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 turnover to change over the next 12 months?

4. What do you see as the biggest single factor behind the current period of USD strength?
   - Interest rate expectations
   - Sharemarket performance
   - Relative economic performance and outlook
   - Monetary policy outlook for the Federal Reserve
   - Safe-haven investment flows
   - Other

5. By how much have recent shifts in the NZD changed the duration of your hedging?
   - Shortened the duration by more than 3 months
   - Shortened the duration by up to 3 months
   - No change to duration
   - Increased duration by up to 3 months
   - Increased duration by more than 3 months

6. NZD/AUD has averaged 0.9110 over the Q3 2014 – what NZD/AUD level does your business expect over the 4 quarters to Q3 2015?
   - end December 2014
   - end March 2015
   - end June 2015
   - end September 2015

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