NZD downtrend expected to continue

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 will decline further over coming year.**
- **Nonetheless, the interest amongst importers to hedge continues to decline.**
- **But for businesses that are hedging, a greater percentage of FX exposure is being covered.**

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

The latest ASB Kiwi Dollar Barometer indicates businesses are confident the NZD will moderate further over the coming year. For a change, there is very little difference between the expectations of importers or exporters. Interestingly, despite the widely-held expectation of further depreciation in the NZD, importers' interest to hedge their foreign exchange exposure declined noticeably for the second quarter. Meanwhile, the percentage of exporters hedging their exposures has increased for the second quarter. The ASB Kiwi Dollar Barometer has consistently shown big businesses hedge almost all their FX exposures; these changes are driven by small and medium sized businesses.

In sum, a slightly smaller percentage of businesses are planning to hedge FX exposures now compared to earlier surveys. But of those businesses that do plan to hedge, the proportion of FX exposure being covered continues to lift. Exporters who hedge on average are covering a greater percentage of their exposure relative to importers, but both groups are coving more of their FX exposure than in earlier surveys.

Businesses were fairly convinced that the NZD/AUD exchange rate had peaked when the survey was conducted. The survey took place in early February (2nd to 13th), and the Reserve Bank of Australia cut the cash rate on 3rd February. We were surprised that all businesses either thought the cross rate had peaked, or if it went any higher this year, it wouldn't get above 0.97. In early April the NZD/AUD has traded above 0.99, and we think there is a good chance the cross rate will reach parity.

Businesses expect NZD depreciation to continue

The ASB Kiwi Dollar Barometer shows a widespread expectation amongst businesses that the NZD will ease further over the coming year (chart 1). Forecasts of a steady NZD/USD depreciation have been a consistent theme of the last three quarterly ASB Kiwi Dollar Barometer surveys.

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 0.7230 by the end the year, and 0.7180 by March 2016.

Since the inception of the ASB Kiwi Dollar Barometer, importers' expectations for the NZD were higher than exporters. This Barometer is no exception, but the differential is now very narrow. The two groups' forecasts are within a cent of each other for the forecast horizon. In earlier ASB Kiwi Dollar Barometer surveys the difference between the two groups' predictions has been as wide as 7 cents.

ASB Economics forecasts a further depreciation in the NZD over the coming year. We expect the NZD/USD to trade slightly lower than both importers and exporters are expecting over the year ahead, and have a year-end forecast of 0.7000.

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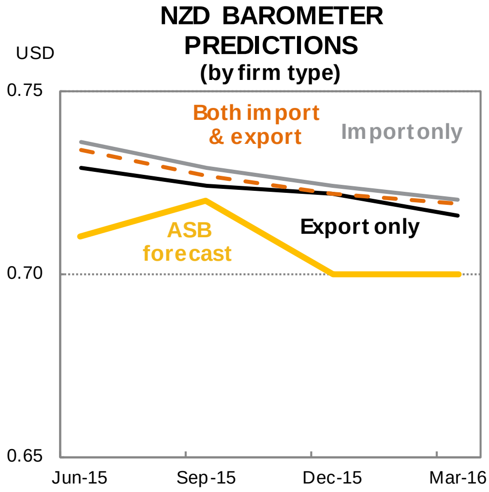

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Most businesses think NZD/AUD has peaked.

Businesses actually appeared fairly convinced that the NZD/AUD exchange rate had peaked when surveyors asked about the outlook for the cross rate over the year.

The survey was conducted in early February (2^{nd} to 13^{th}), and the Reserve Bank of Australia cut the cash rate on 3rd February, which caused the AUD to weaken. Given the backdrop, we were surprised that all businesses either thought the cross rate had peaked, or if it went any higher this year, it wouldn't get above 0.97.

Over the past five years NZD/AUD has traded from as low as 0.72 to above 0.99. In fact the pair was setting fresh record highs in late March and early April, after the ASB Kiwi Dollar Barometer survey was conducted.

In recent days the NZD/AUD has traded above 0.9970, and we think there is a good chance the cross rate will reach parity.

Adaptive Expectations and foreign exchange forecasting

"Adaptive Expectations" is an economic theory which focuses on how people are influenced by past events in predicting future outcomes. A common example is people's process of predicting inflation. Adaptive expectations suggest that if inflation increased last year, people will project that experience into their expectations, and predict higher rate of inflation in the coming year.

Foreign exchange forecasters can be heavily influenced by adaptive expectations, too. When a currency is going up, forecasters feel confident to forecast it will keep going up, and the same when it comes down. People also refer to past record highs in currency pairs when considering how high cross rates can trade in the future, and refer to long-run averages when considering if a currency is "high" or "low". Sometimes these reference points can be valid, but long-run averages, and historical highs and lows can have serious pitfalls when important economic variables are changing, and economies are undergoing significant structural changes such as a Terms of Trade shock. Nonetheless, the fact that the NZD has fallen fairly steadily since mid-2014 means we shouldn't be surprised by the expectation of steady depreciation revealed in this ASB Kiwi Dollar Barometer survey. And indeed our own NZD/USD forecasts point in the same direction: down.

What does surprise us are some of the hedging responses, when we take into account the currency forecasts that survey respondents provide.

Exporters and importers are both expecting the NZD to fall over the year ahead, as discussed earlier. For exporters, that's good news if the expected currency depreciation continues. Even though exporters think the NZD will go lower, a greater proportion are planning to hedge, and those firms are hedging a greater proportion of their exposures than recorded in any previous ASB Kiwi Dollar Barometer surveys.

Exporters appear to see the recent depreciation in the NZD as an opportunity to protect themselves against any potential rebound in the NZD. 63.6% of exporters intend to hedge their foreign exchange exposure, a marked increase from the 54.5% of exporters six months ago (chart 3). Of these exporters, they are also intending to hedge a slightly greater proportion of their foreign exchange exposure. The ASB Kiwi Dollar Barometer has shown a steady increase on the percent of FX exposures hedged by exporters since late 2012 (chart 4).

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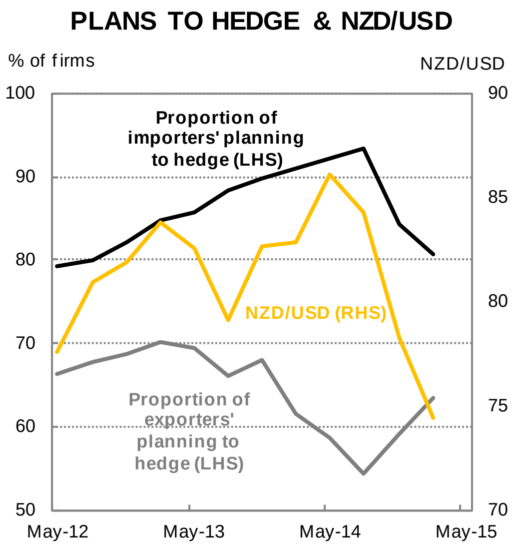

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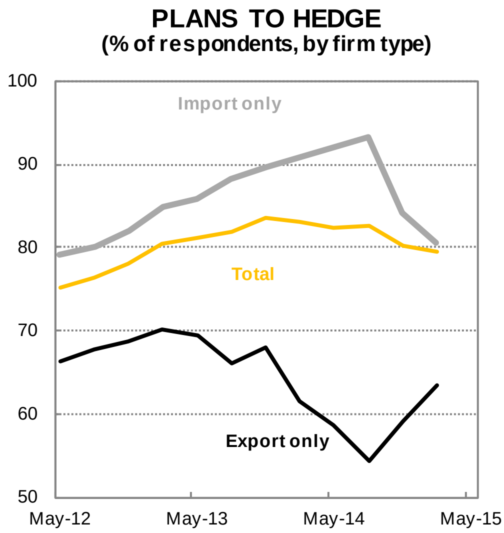

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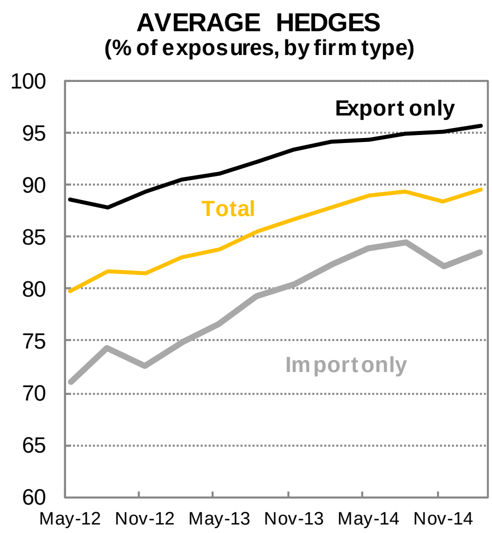

NZD depreciation works against importers

For importers, the higher the NZD, the better. But importers are not forecasting a wishful outlook, they are forecasting the NZD to keep moving against them, and head lower. So we are surprised that significantly fewer importers want to lock in their currency exposures now, before the NZD gets even weaker, as they are forecasting. As we saw last quarter, it appears that, although importers are reasonably confident the NZD will continue to depreciate, there is uncertainty about how much they should protect themselves against this expected adverse shift in the currency. In addition, importers may be uncertain about their business outlook, and this may be making them reluctant to lock in hedging that they may not need.

Since the first ASB Kiwi Dollar Barometer back in May 2012, every survey has shown that at least 90% of all businesses in the $150 million plus segment hedge almost all their FX exposure. Accordingly, it is worth noting that the variation in hedging decisions we are discussing for importers and exporters is driven by the smaller businesses in the $1-150 million turnover categories (charts 5 and 6).

Another factor behind this apparent inconsistency for importers is we have focussed the FX forecasting questions on the NZD vs. the USD and AUD, but importers may be considering a number of cross rates when thinking about their FX hedging decisions and survey answers.

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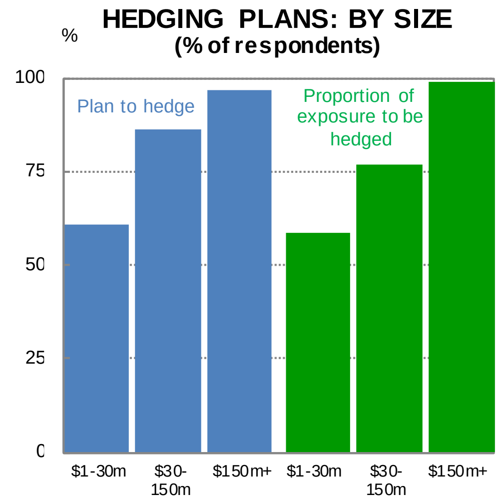

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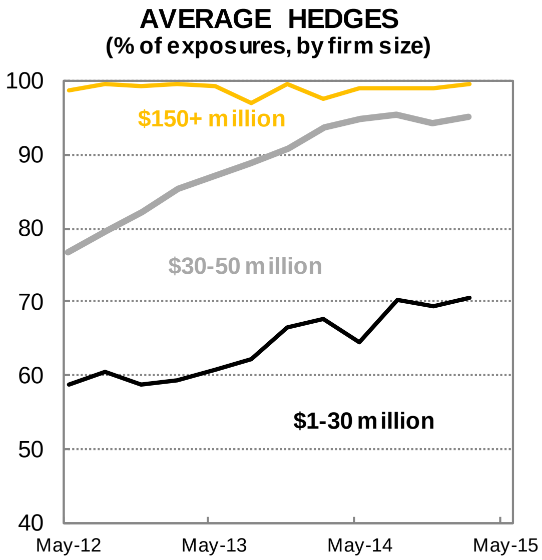


What else drives foreign exchange decisions?

In this ASB Kiwi Dollar Barometer we wanted to drill into the drivers of hedging and trading decisions further. We asked businesses to tell us the main influence on amount of NZD/USD traded and hedged over the past quarter. In a nutshell, the reasons vary a lot, and depend on the size of the business. Cash flows were the dominant driver for smaller businesses. Some 53.5% of businesses in the $1-30 million turnover segment said this was the dominant influence. In contrast, no businesses in the $150m plus turnover segment citied this as a reason, consistent with the fact that big businesses hedge almost all their FX exposure. The change in the level of the NZD was the second greatest influence for businesses in the $1-30 million turnover segment.

But the$150m plus customer segment said the level of the NZD was the dominant influence on trading and hedging decisions. With what we know about big businesses hedging almost all their cash flows, the level of the NZD is clearly important in implementing those hedging strategies. Volatility, an important factor in options pricing was important influence for big businesses, less so for smaller businesses. Likewise, expected future NZD movements were more influential to large businesses than small businesses in terms of trading and hedging decisions. Big businesses are keen on the NZD outlook, in order to help them implement the correct hedging strategies. Smaller businesses are interested in the NZD outlook too, of course. But because business cash flows are a key determinant of when they make FX transactions, small businesses may have less ability to exploit NZD movements.

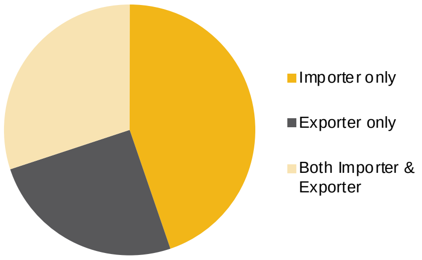
A broad conclusion from the ASB Kiwi Dollar Barometer's latest findings is that cash flows are the dominant influence for small businesses, and generally they hedge a lot less than big businesses. At the other end of the scale big businesses hedge almost all of their cash flows, so their decisions are more influenced by the key inputs into hedging strategies such as volatility, the NZD level and expected future movements.

The results for this question are tabled on the following page

Over the past quarter the amount of NZD/USD you traded and hedged was mainly influenced by:

	% of Enterprises				% of Enterprises			
	Importer Only	Exporter Only	Both Importer & Exporter	TOTAL	$1-30m Customer Segment	$30-150m Customer Segment	$150m plus Customer Segment	TOTAL
Change in the level of the NZD/USD	26.7	30.8	35.8	30.5	21.3	26.9	47.0	30.5
Change in the volatility of the NZD/USD	6.4	11.2	11.4	9.1	5.8	7.6	15.4	9.1
Expected future NZD movements	16.6	24.3	26.0	21.3	13.5	19.3	34.2	21.3
Not significantly changed the NZD volume trad	5.9	4.7	1.6	4.3	5.8	3.4	3.4	4.3
Business cash flows	44.4	29.0	25.2	34.8	53.5	42.8	0.0	34.8
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

SAMPLE BY TRADING FOCUS
(% of contributors)



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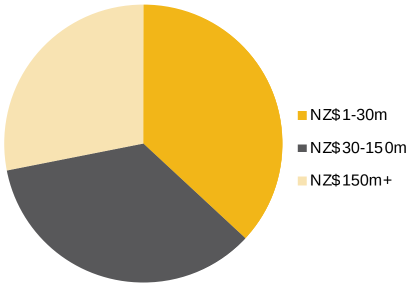

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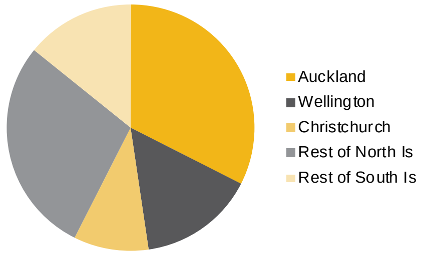

The specific questions asked were:

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. Relative to the last 12 months, over the next 12 months by how much do you forecast your FX turnover to change?

4. The NZD/USD has eased over 14c from its 0.88c high in July last year – how has that depreciation affected your pricing intentions?
   - Increased chance of raising prices
   - Decreased chance of raising prices
   - No impact on pricing intentions

5. Over the past quarter the amount of NZD/USD you traded and hedged was mainly influenced by:
   - Change in the level of the NZD/USD
   - Change in the volatility of the NZD/USD
   - Expected future NZD movements
   - Business cash flows
   - Not significantly changed the NZD volume traded

6. NZD/AUD reached a post float high of 0.9657 in early January – how high do you expect the cross rate to trade over the remainder of the year?
   - Lower, it has already peaked
   - Above 0.9657; lower than 0.9700
   - 0.9700 to 1.00
   - 1.00 or higher (parity plus).

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