Kiwi Dollar Barometer

June 2016

NZ dollar expected to gently decline, hedging attitudes evolving

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 just above $0.65 in twelve months.**
- **Only those which both import and export see a drop in FX turnover in the next 12 months and even then only 0.1%.**
- **Firms with a turnover of $30-150m have seen a significant shift in FX hedging attitudes.**

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

The latest ASB Kiwi Dollar Barometer indicates businesses expect NZD/USD to be 0.6520 at the end of June 2017.

There has been a massive shift in attitudes to FX hedging, most notable in firms with a turnover of $30-150m.

The importance of cash flow as a driver of hedging decisions has diminished, with firms now making active decisions.

For all firms surveyed, the level of focus by senior management on FX hedging has increased in the last year.

More NZD weakness seen ahead

Since the last NZD Barometer the NZD/USD has moved higher, with the RBNZ's decision to hold rates in June spurring much of the move. Prior to that the NZD had instead drifted lower, although there were a few steps towards 0.70. It could be these steps that encouraged respondents to the survey, taken in the four weeks ending 2 May 2016, to temper estimates of NZD depreciation relative to the previous survey. Still, the latest **ASB Kiwi Dollar Barometer shows businesses are, on average, looking for NZD/USD to depreciate to 0.6520 over the next 12 months.**

Three months ago, respondents were forecasting NZD/USD around $0.663 by end June. Currently the rate is firmer, but a lower trend was in evidence. Given the continued, but soft, depreciation for the NZD in the sample period, respondents held onto expectations of a downward trend for the 12 months ahead, though reigned in the extent expected.

Importers are now less pessimistic on the NZD, with the 12-month outlook still down but now lifted 0.655 from 0.641. Exporters have gone the other way, dropping to 0.647 from 0.650. Importers/exporters have lifted their outlook to 0.651 from 0.647, which ties with the large turnaround in the view of importers and only small change from exporters.

When splitting by firm size, the general trend of a depreciating Dollar is seen over time. As firm size increases, the outlook for Dollar deprecation strengthens, a slight change to March when the $30-150m set had the weakest outlook.

Meanwhile, ASB Economics has revised its NZD forecasts. Rather than the mild depreciation expected by respondents, we expect NZD/USD to move higher. This despite our view the RBNZ will keep dropping the OCR. However, we have tempered the pace of appreciation compared to our March 2016 estimates. Since the Barometer survey was taken, it has become increasingly clear US interest rates will rise only very gradually over the next couple of years.

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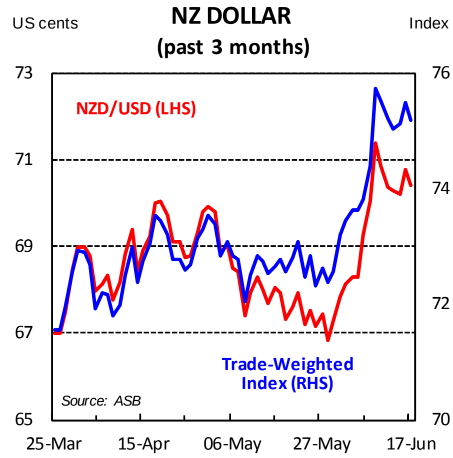

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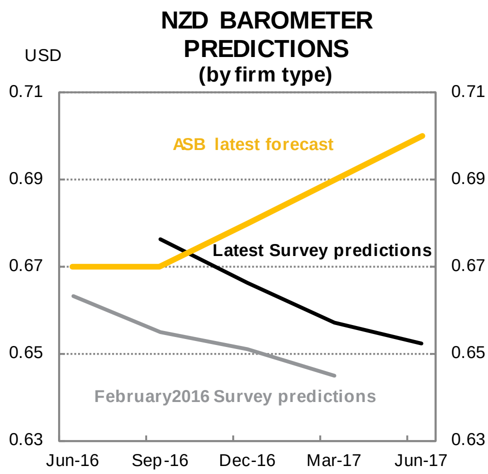

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Please refer to the important disclosures at the end of this document.

The changing face of FX hedging

The latest edition of the ASB Kiwi Dollar Barometer shows a significant shift in FX hedging drivers and policies compared to May 2014 when we last asked these detailed questions. This is particularly pronounced in the $30-150m firm size. Differences can also be seen between importers and exports over time. The level of focus applied to FX hedging also varies greatly between firm size and import/export activities.

$30-150m segment

Firms in the middle segment of the sample have seen a fundamental shift in attitudes towards hedging FX exposure over the last 2 years. The most prominent change is the driver of hedging decisions (Chart 3). Just 7.7% of firms now say the timing of cash flows is the main deciding factor, all the way down from 43.1% in 2014. Alongside this has been a huge growth in discretionary decision making, to 73.2% from 17.3%. Taken together this suggests more firms are thinking about what and when to hedge, rather than just reacting as-and-when cash flows dictate.

The impulses behind those decisions look to have been brought in-house. Decisions based on external input have declined to 11.3% from 24.5%. The rigour of those internal decisions appears to have strengthened, with the number of firms in this segment having no formal policy and no intention of introducing one in the next year declining to 61.3% from 69.1% (Chart 4). This has been accompanied by an almost doubling in the percentage of those firms looking to get a formal treasury policy within the next year, to 31.0% from 15.8%.

In a new question, we asked about the level of focus FX hedging has received from senior management over the prior 12 months (Chart 5). The $30-150m segment showed a massive 94.4% of respondents have seen focus increase significantly or slightly. This compared to just 5.6% where it has decreased or remained constant.

Overall this segment of the market is clearly thinking more about FX hedging and how to achieve it, while also bringing the process in-house.

$150m+

Those firms with annual turnover greater than $150m are also adjusting attitudes to hedging, albeit slightly more subtly. Nevertheless, those firms which base hedging on external decisions have declined to 19.0% from 43.4% (Chart 6). Instead a discretionary treasury policy is favoured, up to 50.4% from 29.2%, with decisions being made in-house but within a broad framework.

Those with no formal treasury policy have more than halved, to 17.4% from 40.7% (Chart 7). Some of those still without a policy do intend to get one in the next year (up to 25.6% from 19.5%). A total of 57.0% have some sort of policy, up from 39.8% just 24 months ago.

Finally only 5% of large firms have seen a drop in focus on hedging over the last 12 months. Taken together this result mirrors the evolution in attitude seen in the $30-150m group, a greater percentage is further along the path to having, and acting within, a formal policy.

$1-30m

The changes over the last 2 years for this group have been less pronounced, but still bear examination. The timing of cash flows has actually increased in as a key driver, albeit only to 67.7% from 63.3%. This is to the cost of discretionary decisions, down 7.9%pts to 22.0%. In addition now 8.5% of firms in this segment now have a formal policy of some sort, compared to zero 2 years ago.

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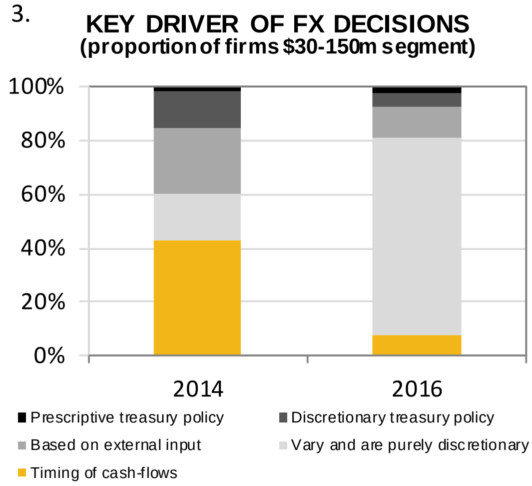

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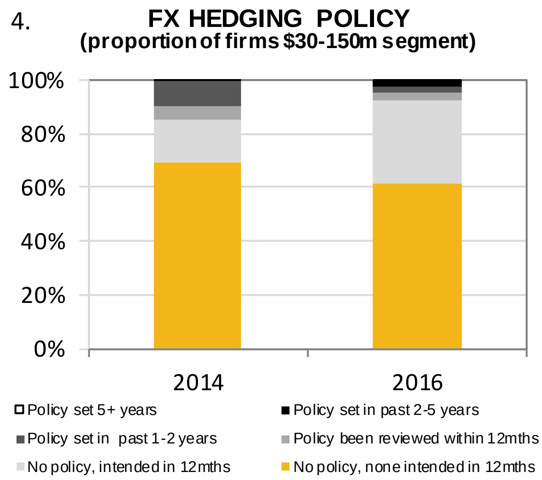

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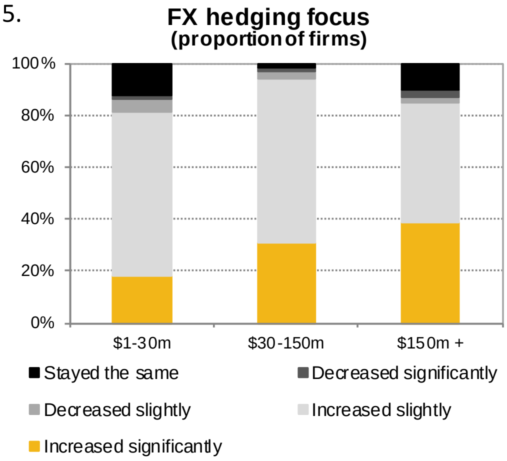

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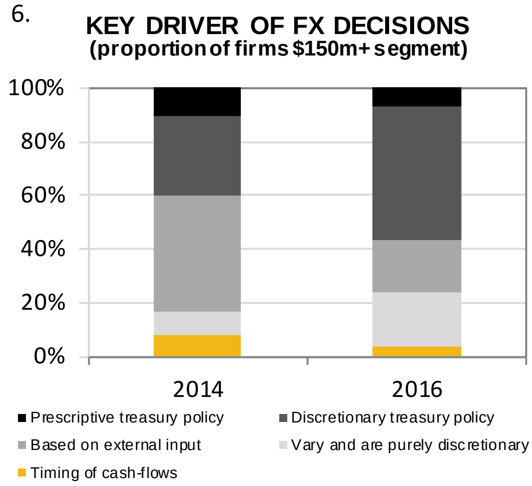

Imports & Exporters

Splitting by FX activity underlines the evolution seen above. The difference is particularly pronounced in those firms which export and import. Here the timing of cash flows is now only a driver from 9.5% of respondents' vs 39.7% in the 2014 poll. Discretionary hedging is the main growth area, up to 36.5% from 13.2%. Exporters show a similar trend, as do importers, albeit to a lesser extent.

The same is true of the reliance on external input, which has again decreased across all three activity focuses. Hedging policy has also shifted. The percentage of those with no formal policy is declining, no matter what the FX activity is.

Turning to the level of focus on FX hedging (Chart 8), around 80% of exporters have seen an increase of some sort in the focus on hedging. That is actually the smallest of three strands. Unsurprisingly those which both import and export have seen the biggest increase in focus, at 92.9%.

FX hedging plans over the next 3 months

Hedging intentions have increased vs the Q1 survey, to 82.2% from 81.1% (as a percentage of those planning to hedge). Within that there is some variation. Only 60.9% of exporters are planning to hedge, a low since August 2014 and down from 62.5% last time out (Chart 9). Given exporters are expecting the currency to fall this is no great surprise. It also suggests that, at the margin, decisions are rate sensitive. There is a corresponding increase in importers looking to reduce risk, to 86.6% from 85.3%. Of those which do plan to hedge, around 92% of exposure is expected to be covered. When cutting by firm size, again the general trend of the bigger the firm, the more likely to hedge, is reaffirmed.

FX turnover for the next year

The expected change in FX exposures is expected to increase for the third quarter in a row. On top of this, the size of the increase, 1.9 percentage points, is the largest since this survey began in Q2 2012. No matter if splitting by firm size or FX focus, only one group expect to see less FX exposure and even then only just (importers/exporters, down just 0.1%pt) (Chart 10).

Those which are expecting to see greater exposure are predicting an average of increase of 6%. That's a high since June 2015 and the third highest on record.

Taken together these responses underline the increased exposure of New Zealand business to foreign exchange and the risks that come with it. Some firms are taking action on this, as seen above but some are still hanging back, leaving them exposed.

What next for FX hedging?

Given the evolution in firms' attitudes to managing FX risk and expectations of future FX turnover and FX hedging intentions, more attention than ever is being placed on this activity. This is underlined by the development in focus being placed on hedging by senior management. In addition, New Zealand's relatively small, open, economy is likely to continue seeing strong foreign exchange flows. This could generate even more demand for hedging. The most likely group to see growth is the $1-30m segment, given this group only plan to hedge around 80% of exposure and there is scope for this to lift over time.

However, this depends on the NZD's behaviour over the coming months. Should the NZD weaken, as respondents generally expect, exporters will have little incentive to increase cover. Should the NZD evolve as ASB forecasts outline, there could be a significant increase in exporters hurrying to seek cover.

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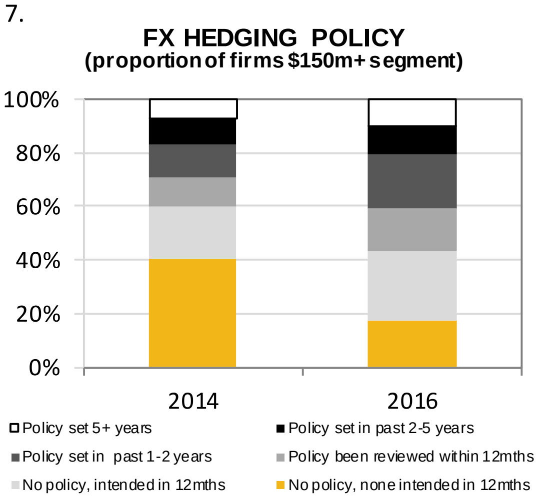

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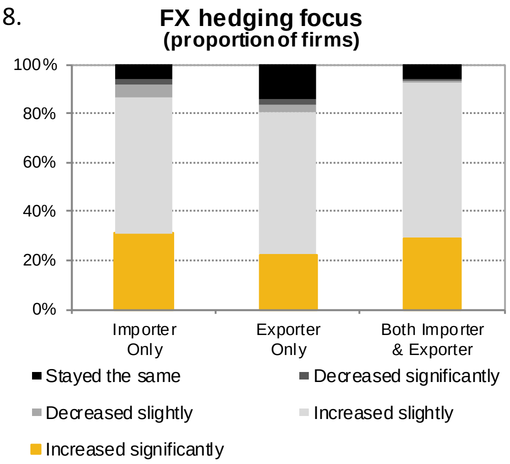

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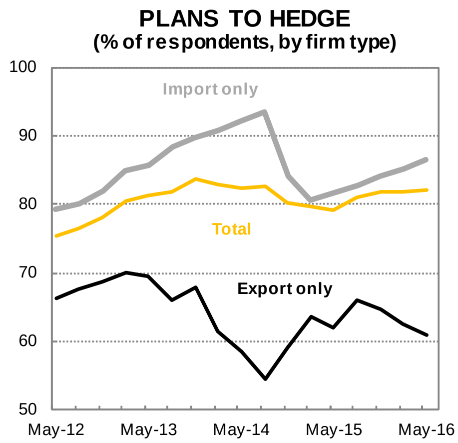

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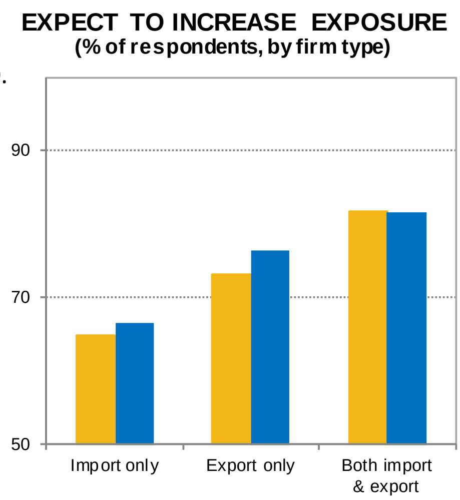
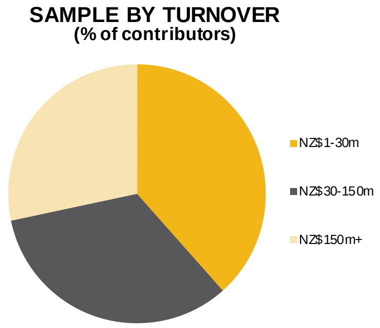
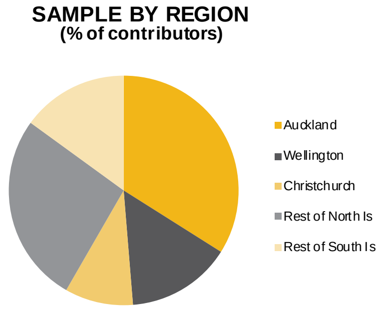


About the Kiwi Dollar Barometer

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 427 businesses turning over at least NZ$1 million per year. Research fieldwork was conducted over a four week period ending 02 May 2016. Over this period the NZD traded between 0.6780 and 0.7050. 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 September 2016? End December 2016? End March 2017? End June 2017?
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. At senior management level, as the focus on FX hedging for your business in the last year…?
   Increased significantly / Increased slightly / Decreased slightly / Decreased significantly / Stayed the same?
5. What is the key driver of your FX decisions?
   Timing of cash flows / Hedging decisions can vary and are purely discretionary / Hedging decisions are based on external input / Hedging decisions are based on formal treasury policy, with discretion / Hedging decisions are based on a formal treasury policy, with prescriptive guidelines?
6. Which of the following best describes your FX hedging policy?
   No formal policy, none intended in coming year / No formal policy, intend to have one within the coming year / Formal policy has been reviewed within the past year / Formal policy has been set in the past 1-2 years / Formal policy has been set in the past 2-5 years / Formal policy set over five years ago?

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