Trade Idea – Foreign Exchange

Strong Kiwi threatens inflation outlook

5th August 2016

Rising NZD presents problem for RBNZ

- On Thursday 21st July, the Reserve Bank of New Zealand (RBNZ) released an economic update detailing the bank’s views on the current economic situation. The update revealed a marked shift in the bank’s stance towards a more pessimistic outlook for the country’s economic and inflation prospects, citing recent NZD strength as a key concern. The NZD has risen 3.6% since the start of June despite market expectations for an interest rate cut soaring during the same period. This has been largely due to investor demands for a safe source of yield at a time when foreign sovereign bond yields have been compressed. Next week, the RBNZ is scheduled to hold its August monetary policy meeting, where it will announce a decision on the current interest rate and release its quarterly monetary policy statement. We believe that the RBNZ will use this meeting to cut rates and outline a clear easing bias going forward, particularly to counteract increasingly harmful NZD strength. We therefore see a retracement ahead for the NZD, particularly against the US Dollar where there is the potential for US Federal Reserve actions to surprise on the hawkish side.

- The recent RBNZ economic update delivered nothing in the way of new forecasts, but did show a greater focus on NZD strength and its economic impacts. The statement explicitly stated that “the high exchange rate is adding further pressure to the dairy and manufacturing sectors and, together with weak global inflation, is holding down tradable goods inflation” (Source: http://www.rbnz.govt.nz/). Language also clearly stated that a decline in the NZD was “needed” in the future, rather than “expected”, which implies that the bank is willing to take greater steps going forward to limit currency strength. We expect these steps to be outlined in its upcoming monetary policy report which should spur markets to price in a more dovish easing path going forward. This should see the NZD come under pressure in coming weeks.

Figure 1: Falling global yields supports NZD

Source: Bloomberg, ETF Securities

Carry demand buoy NZD

- The NZD has been the beneficiary of carry demand, as investors aim to harvest yield from the relatively strong interest rates on offer in New Zealand (see Figure 1). The nation’s 10 year sovereign bond is the only one in the G10 currency complex that is offering a yield above 2%, which has become increasingly attractive as foreign alternatives have collapsed to zero. Going

*All figures quoted are sourced from Bloomberg unless stated otherwise.
forward, we believe that sharp increases in carry demand for the NZD will be less likely as the RBNZ demonstrates a greater willingness to implement further monetary stimulus and cut interest rates.

**Momentum wanes**

- The NZD/USD exchange rate has been trending higher since the start of June (strengthening 5.4%), but trading over this period has been choppy. The relative strength indicator (RSI), a popular indicator of momentum, has been moving steadily lower over this period, reflecting that the trend may be losing steam. Should the RBNZ meeting act as a catalyst for a movement lower in the NZD/USD exchange rate, the pair could fall towards its 100 daily moving average (DMA) at 0.694, a 3.8% fall from current levels.

**Investors wishing to express the investment views outlined above may consider using the following ETF Securities ETPs:**

- **Currency ETPs**
  - **EUR Base**
    - ETFS Long NZD Short EUR (EUNZ)
    - ETFS Short NZD Long EUR (NZEU)
  - **GBP Base**
    - ETFS Long NZD Short GBP (GBNZ)
    - ETFS Short NZD Long GBP (NZGB)
  - **USD Base**
    - ETFS Long NZD Short USD (LNZD)
    - ETFS Short NZD Long USD (SNZD)

The complete ETF Securities product list can be found [here](#).
Important Information

This communication has been provided by ETF Securities (UK) Limited ("ETF Securities") which is authorised and regulated by the United Kingdom Financial Conduct Authority (the "FCA"). The products discussed in this document are issued by ETF Foreign Exchange Limited ("FXL"). FXL is regulated by the Jersey Financial Services Commission. This communication is only targeted at qualified or professional investors.

The information contained in this communication is for your general information only and is neither an offer for sale nor a solicitation of an offer to buy securities. This communication should not be used as the basis for any investment decision. Historical performance is not an indication of future performance and any investments may go down in value.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

This communication may contain independent market commentary prepared by ETF Securities based on publicly available information. Although ETF Securities endeavours to ensure the accuracy of the content in this communication, ETF Securities does not warrant or guarantee its accuracy or correctness. Any third party data providers used to source the information in this communication make no warranties or representation of any kind relating to such data. Where ETF Securities has expressed its own opinions related to product or market activity, these views may change. Neither ETF Securities, nor any affiliate, nor any of their respective, officers, director, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this publication or its contents.

ETF Securities is required by the FCA to clarify that it is not acting for you in any way in relation to the investment or investment activity to which this communication relates. In particular, ETF Securities will not provide any investment services to you or advise you on the merits of, or make any recommendation to you in relation to, the terms of any transaction. Nor is ETF Securities authorised to behave in any way which would lead you to believe otherwise. ETF Securities is not, therefore, responsible for providing you with the protections afforded to its clients and you should seek your own independent legal, investment and tax or other advice as you see fit.

Short and/or leveraged exchange-traded products are only intended for investors who understand the risks involved in investing in a product with short and/or leveraged exposure and who intend to invest on a short term basis. Potential losses from short and leveraged exchange-traded products may be magnified in comparison to products that provide an unleveraged exposure. Please refer to the section entitled "Risk Factors" in the relevant prospectus for further details of these and other risks.

For qualified and professional investors only, not for public dissemination – Past performance does not guarantee future results.

ETF Securities
3 Lombard Street
London
EC3V 9AA
United Kingdom

t +44 (0)207 448 4330
f +44 (0)207 448 4366
e info@etfsecurities.com
w etfsecurities.com

The intelligent alternative