Kiwi Falls 13% Against the USD!

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Compared with a year ago the Kiwi dollar has fallen against the greenback by about 13%. Is that worth writing about? Anyone exporting goods to the United States might think it is – but that would not be the Kiwi way. Pointing out how a sustained currency movement out of anyone's control was bringing one a benefit would sound like skiting and as Kiwis we don't do that.

However, if the Kiwi dollar rises by just over 7% from a year ago against the Aussie dollar we do think that is worthy of comment, admittedly mainly because of the "magic" number of 1:1 or parity involved – sort of like how all our lives were so much changed by the new millennium starting one and a half decades ago. In fact our fascination with parity is so strong I did numerous media interviews on the subject on Easter Monday and Tuesday this week. Why the biased interest in the NZD's smallish rise against the AUD from a year ago?

One reason will be because so much business commentary in New Zealand for perhaps over a century now has been couched in terms of what such and such means for exporters – not households or other businesses. Thus we have all been brought up on the mantra that a rising Kiwi dollar is bad and a falling Kiwi dollar is a great thing.

With nothing else changing a higher currency will be bad for exporters. But it will also be good for importers and households and it all depends upon what is causing our currency to move higher. In this case it is not actually our currency moving higher – it is the Aussie dollar moving lower. In fact compared with a year ago the AUD has dropped by 18% against the US dollar. Our currency has admittedly moved up by 10% against the Euro, but that reflects not anything happening here but instead the poor state of the Eurozone economy and commencement last month of money printing by the European Central Bank.

So the question to be answered here is not why has the NZD risen, because in fact on a trade weighted basis we have fallen 4% from a year ago – but why has the Aussie dollar fallen so much?

The decline in the AUD reflects a lot of negative factors all coming together at the same time.

- Iron ore is Australia's biggest export earner and prices are at a ten year low less than one-third their levels of four years ago.
- There are persistent concerns about immediate growth prospects for China bringing the risk of further declines in not just iron ore prices but coal prices also.
- The Federal Government is finding itself unable to pass legislation to get a deteriorating budget deficit track under control, bringing reduced confidence in the business sector.
- The Federal Government is also proving unable to undertake increasingly necessary economic reforms aimed at allowing productivity in Australia to overcome the complacency and inefficiencies generated by 23 years without having a recession.
- The retailing sector is struggling to adjust to online competition and consumer spending caution post-GFC.
- It is anticipated that there will be full closure of the motor vehicle assembly industry by the end of 2017. This and other factors are hitting the manufacturing sector hard.

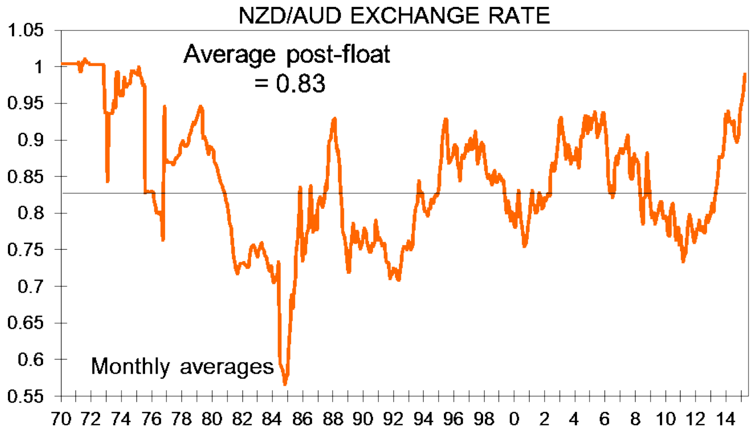
Investment in the important mining sector is plummeting, though there is some offset from improving residential construction assisted by record low interest rates.

As the Aussie dollar falls we have partly ridden on it's coat-tails – hence one reason for our decline against an independently rising US dollar. But we have not gone down as far as the AUD because our economy for now is in better shape. Our jobs growth has been a strong 3.5% the past year, GDP is up 3.2%, core retail volumes have grown 4.2%, business and consumer confidence are at above average levels, our commodity prices have fallen less than Australia's, and chances are very slim that our central bank will feel the need to cut NZ interest rates.

In fact our cash rate was increased 1% last year to 3.5% while Australia's has been cut to 2.25% - but not to the 2.0% level which the markets had near 75% factored in ahead of the RBA announcement at 2.30pm AEST Tuesday. You have to laugh sometimes. All my media interviews Monday and Tuesday for NZ outlets included discussion of the high probability of an RBA rate cut being likely to take the NZD above parity. But the interviews with Australian media outlets on Tuesday afternoon and evening were with knowledge of the absence of a rate cut and the Kiwi dollar having retreated back one cent to the lowly level of 98 cents.

That offers me a good opportunity to once again remind everybody that you cannot forecast exchange rates – and by you I mean me and every other economist I have ever met over three decades in this business. And before some uninformed person out there starts rubbishing us economists, if you are a rugby league fan remember you also can't forecast the outcome of a Bulldogs Rabbitohs match with less than two minutes on the clock, or the outcome of an Americas Cup race when NZ is 8:1 ahead. Cricket World Cup final – maybe a tad more predictable sad to say.

So now that the Kiwi dollar has settled back for a bit against the AUD, do we once again do as we did in 1988, 1995, 2003, and 2005 – cancel the sausage roll orders and moan that one should have shipped money into Aussie dollars near 94 cents back in those earlier times or near 98 cents this time?



Not at all. Take delivery and put them in the freezer. None of the factors on the list above explaining AUD weakness are going to reverse direction in the near future. Two weeks ago I said it was a 50:50 call whether we reach parity. Last week I said 75:25. This week I say 85:15.

If we do achieve parity, what then? No idea – read the bit above about not being able to forecast exchange rates. But at a pinch the fundamentals suggest to me that the Kiwi dollar will be strong against the AUD (you interpret what "strong" means) for the next couple of years. By late-2017 the migration cycle with Australia will almost certainly have turned, the Christchurch rebuild will be still underway but not as strong, dairy conversions and capital spending generally will be easing off, stimuli from lower interest rate and fuel price expectations will have washed out of the system, and we could be close to a correction occurring in one of the many bubble-like asset markets offshore being inflated by money printing and investors chasing yield in a low interest rate paradigm.

Sporadic is written by Tony Alexander, Chief Economist at the Bank of New Zealand. The views expressed are my own and do not purport to represent the views of the BNZ. It is a supplement to the monthly NZ Observer. Please sign up at www.tonyalexander.co.nz
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