TECHEMYNT

OCT 2022

NEW ZEALAND DOLLAR MARKET REPORT

In relation to the New Zealand Dollar Stablecoin (NZDS)

TECHEMY GROUP PROPRIETARY RESEARCH 2022

Dated 13th October 2022. Author: Aditya Das

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Executive Summary

Techemynt and the New Zealand Dollar Stablecoin

Today, the New Zealand dollar is the world's tenth most-traded currency. As a blockchain-based stablecoin, the $NZDS stablecoin combines the stability and value of the New Zealand dollar with the intrinsic utility of cryptocurrency to allow arbitrage, remittance, and payments in the global digital asset economy.

Issuer Techemynt is a New Zealand registered Financial Service Provider (FSP). The $NZDS is backed one-for-one with physical New Zealand dollars in a cash and cash-equivalent treasury. It was deployed on the Ethereum blockchain by Blockchain Labs, using the robust FiatToken framework developed by Centre.

Led by Techemynt executive director Fran Strajnar, the $NZDS was in development for over a year to make sure a gold standard in regulatory compliance was achieved. Potential users include forex and crypto traders, crypto funds, investors, and eventually merchants and everyday consumers.

The NZ Dollar and its position as global currency

The New Zealand Dollar is the official currency and legal tender of New Zealand, the Cook Islands, Niue, the Ross Dependency, Tokelau, and the Pitcairn Islands.

Between 1840 and 1933, British coins and currency were used as legal tender in New Zealand. In 1933, distinctive New Zealand coinage was introduced based on a fractional system. The new coins used the same denomination, weight, and size as British coins. In 1935, New Zealand introduced its own unique coinage, and in doing so, became the last and most remote of the British colonies to do so.

In 1967, New Zealand transitioned from the Imperial British standard (pounds, shillings and pence) to the decimal dollar-based coinage that is still used today.

In the most recent Bank of International Settlement (BIS) Triennial Central Bank Survey, conducted in 2019 - Foreign Exchange Turnover, the New Zealand dollar ranked as the tenth most traded currency globally. The NZD has held the number ten position since 2010. The survey reports that New Zealand's foreign exchange market handled an average of US$9.5 billion per day in April 2019.

Discussing the ranking at the time, Reserve Bank Assistant Governor and General Manager of Economics, Financial Markets, and Banking, Christian Hawkesby, said New Zealand has been able to maintain a high FX turnover to GDP ratio because non-residents are able to freely trade directly in the currency as well as in New Zealand Dollar-denominated financial instruments.

New Zealand's popularity as a foreign currency has grown steadily in the last 20 years. When the same survey was conducted in 1998, NZD was the 17th most traded currency in the world.

This report aims to explore the performance of the New Zealand Dollar, the asset that underpins the New Zealand Dollar stablecoin, in the last year, with particular reference to the US Dollar. It will cover the current state of the global economy and how this is affecting forex markets.

To begin this report we will first scope out and look at the dominant US dollar because all global forex currencies are currently at the Hegemon's mercy.

The US Dollar Behemoth

The US Dollar is currently dominating international currency markets. The greenback has been on a relentless rise this year. It rose on the back of interest rate hikes, and expectations of interest rate hikes, for most of the last year. In an uncertain bearish market, a high-yielding USD is in high demand.

The Fed Funds rate, the rate at which commercial banks borrow and lend their excess reserves to each other overnight, has risen to 3.00%-3.25%, a rate not seen since the 2008 global financial crisis. This rate affects the rate at which business loans, mortgage rates, and term deposits are set.

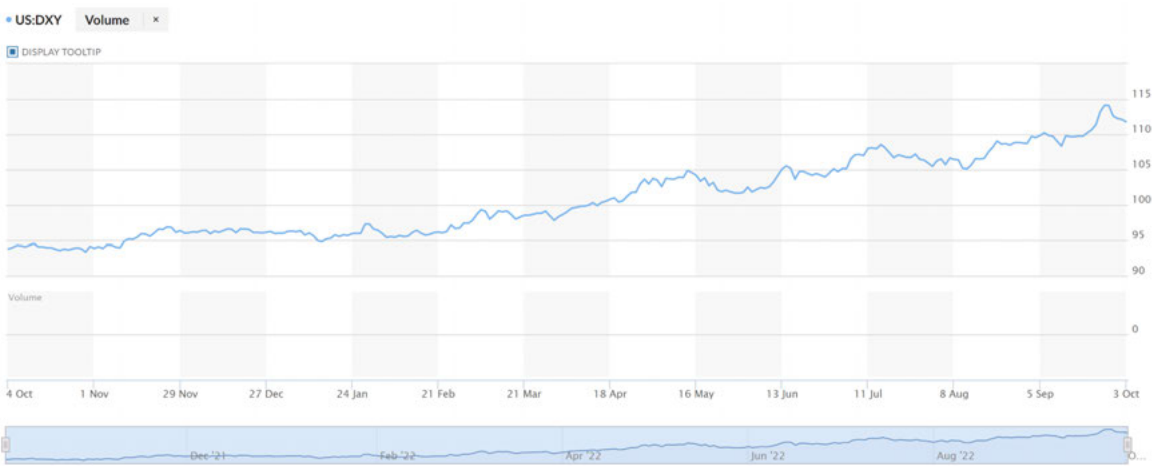
Source: Tradingeconomics.com and the Federal Reserve

The rate has ballooned because of three consecutive 75bps (0.75%) interest rates rises. This was a shock to a market that has been accustomed to low-interest rates and loose monetary policy for the last 10 years.

The Fed has been motivated to push aggressive monetary policy because of surging, historically high inflation in the United States. In a recent press conference, Fed Chairman Jerome Powell stated that, “We have got to get inflation behind us. I wish there were a painless way to do that. There isn’t.”

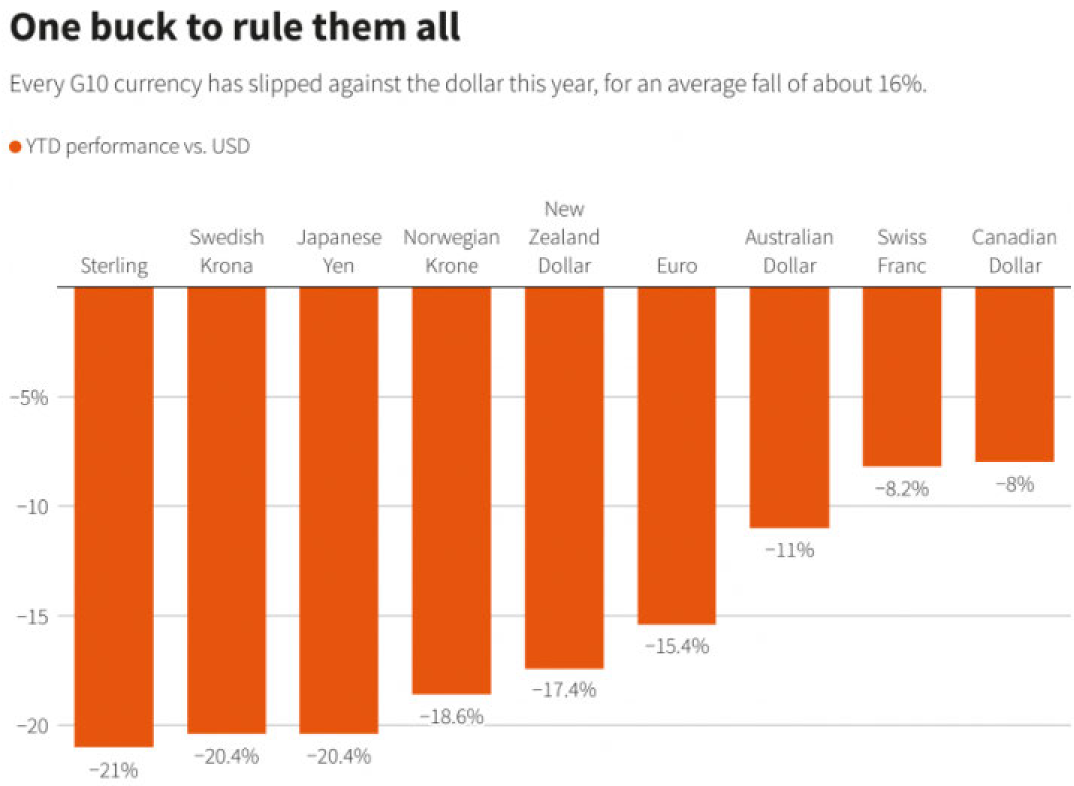
The consequence of the higher interest rates has been a rise in demand for saving as compared to investment. Investors are backing dollars not because of long-term faith in the US economy, but rather because they think the US economy will continue to raise rates to manage inflation.

The US central bank isn't isolated in this strategy. In the UK, Europe, New Zealand, Australia, and many other countries, central banks are raising rates to combat spiking inflation that hasn't been generated by strong economic performance. In this topsy turvy global economy, the market is turning to the US Dollar as its de-facto safe haven asset during a period of volatility.



The Dollar Index (DXY). Source: Marketwatch

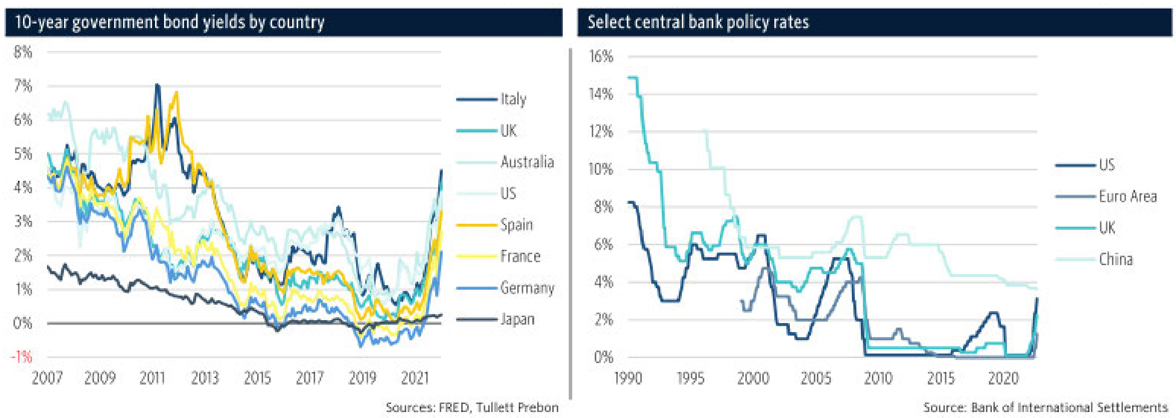
There are a number of factors for why the US Dollar is outperforming other global currencies.



Source: Refinitiv Eikon, Reuters

A tougher Central Bank

In July, economist Kenneth Rogoff said the US dollar was rising in large part, because the Federal Reserve was on track to raise interest rates faster than other countries.



Source Pitchbook

In late September, the British pound dropped to new lows against the US dollar after the UK government announced a package of tax cuts. The £45 billion tax cut package would have likely led to heavy long-term borrowing. Concerns about how the tax cut would be financed led to the heavy selling of British assets and fixed-income products.

In response, the Bank of England (BoE), the UK's central bank, announced that it was suspending the planned start of selling UK government bonds, known in the market as gilts. They would instead begin a new bond buying program. Bond purchasing is associated with quantitative easing, a shift by policymakers to inject newly 'printed' money to stimulate the economy during downturn periods.

The negative market reaction to tax cuts led to the BoE deciding to become a 'market maker of last resort' to prevent complete disaster. It stepped in and printed money, a decision that will lead to more inflation and a weaker sterling, to accommodate its economy and financial markets. Additionally, many are suggesting that the tax cuts will be funded through borrowing and therefore there may be pressure on the BoE to keep medium-term interest rates low.

In terms of its tactics for curbing inflation, the US Federal Reserve has been stronger and more consistent than the BoE, the Central Bank of one of the largest economies in the world, and the market has decided to dump sterling against the US dollar. A steady stream of selling became a flood after the BoE's bond purchasing order.

Source: Google Finance

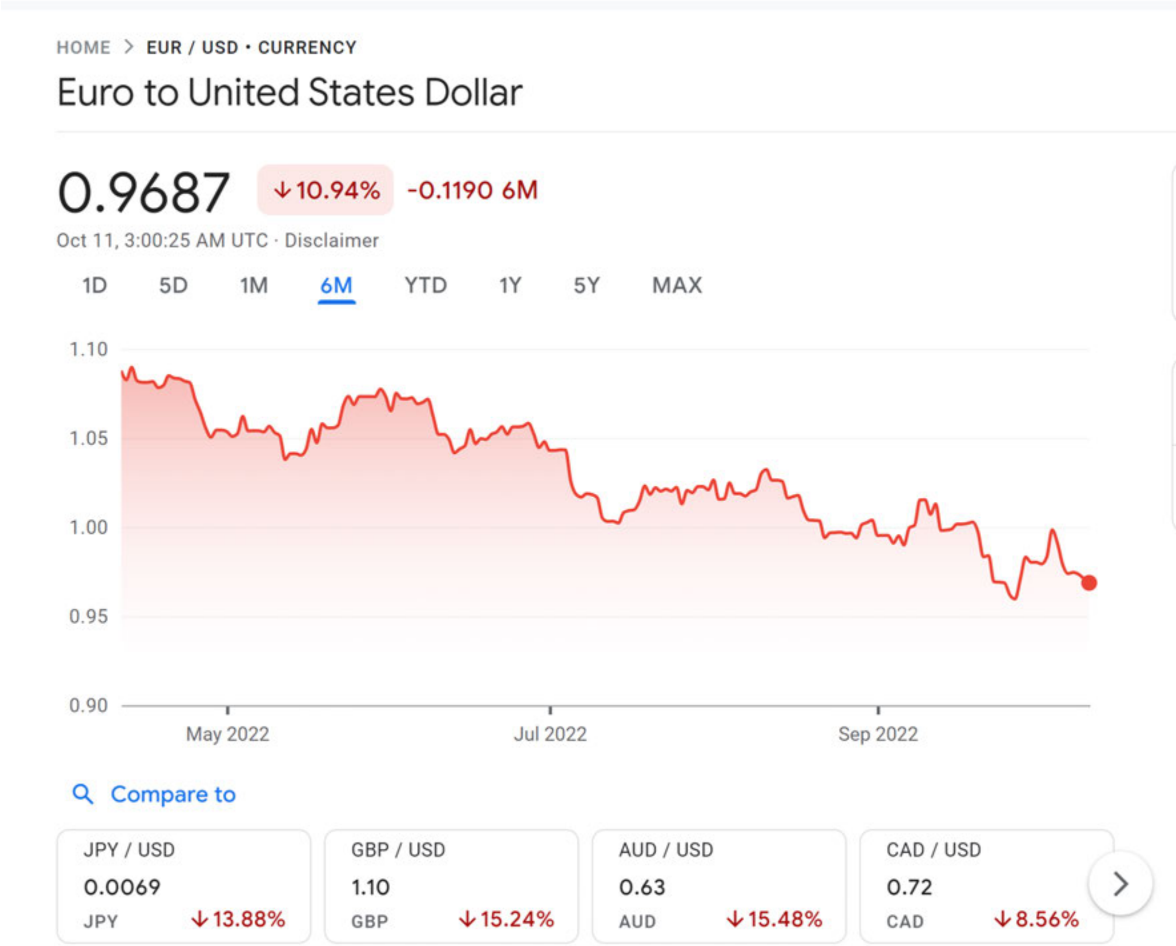
Other central banks also appear to be flinching in the face of recession concerns. The Reserve Bank of Australia, for example, elected to slow the pace of interest rate rises in October. The latest increase was just 0.25% (25 basis points) lower than the expected 0.5%. In his post-meeting notes RBA governor Phillip Lowe said the decision was made to slow down contractionary monetary policy and take stock. "The cash rate has increased substantially in a short period of time," he said.

Source: *Google Finance*

Europe battles with high energy prices

The ongoing military conflict between Russia and Ukraine has created an isolated economic strain on countries in Europe. Natural gas from Russia, prior to the current conflict, was a key part of the European energy mix.

Russia accounted for over 39 percent of all extra-EU gas imports in 2021 (Statista), with natural gas being a key part of the European energy strategy following plans to phase out nuclear energy in recent years. With sanctions now placed on Russian energy supplies and the Nord Stream pipelines out of action, the cost of energy has soared in the continent.



Source: Google Finance

There is a general view across the market that headwinds such as the upcoming European winter, mean the point of maximum pain is yet to be reached.

The US Dollar Hegemon

The US Dollar also acts as a safe haven during this most chaotic period for the world economy because of its position as a hegemon. The term monetary hegemony is described in Michael Hudson's Super Imperialism.

In Hudson's view, the US dollar has an asymmetric relationship with replacing gold as the hegemonic asset of the global economy. This position was supported by the emergence of entities like the International Monetary Fund and the World

Bank, which facilitated US dollar loans for countries in the developing world and thereby made them conduct international trade in the currency.

Economies that have an excess of US dollar-denominated loans are forced to continually buy the dollar at higher and higher rates to repay debts. Investors also pick up on this and because of the risk that these bonds may default, they swap them out for US government bonds.

The US dollar, since the fall of the gold standard, has and continues to underpin the world economy. It is the key currency for the medium of international exchange, a unit of account (the price of commodities and assets like Bitcoin), and a unit of storage (treasury bills and bonds).

The global economic downturn, as opposed to the alpha US economic performance, perhaps, is a more likely reason for why the US dollar is dominating international forex and savings markets. It is the currency that everyone must turn to when all else fails.

This tailwind is also tied to the Dollar Milkshake Theory, as coined by Brent Johnson, the CEO of investment advisory firm Santiago Capital. The theory uses the metaphor of a milkshake in a glass where the white froth represents assets like equities, housing, crypto-assets, and foreign currencies/investment. The milk, sugar and cream are money or dollars. The straw represents the monetary policy and the ability of the Fed to control the assets, or value in the glass.

When the Fed lowers rates and uses a monetary expansion policy, the dollar milkshake theory suggests that milk, cream, and sugar is being added to the glass and raising the asset froth. When inflation runs hot and the glass is close to overflowing, the Fed raises rates and pulls money out of the economy, sucking liquidity up through the straw. The level of froth eventually lowers and the focus shifts back to the US dollar, the milk, cream, and sugar.

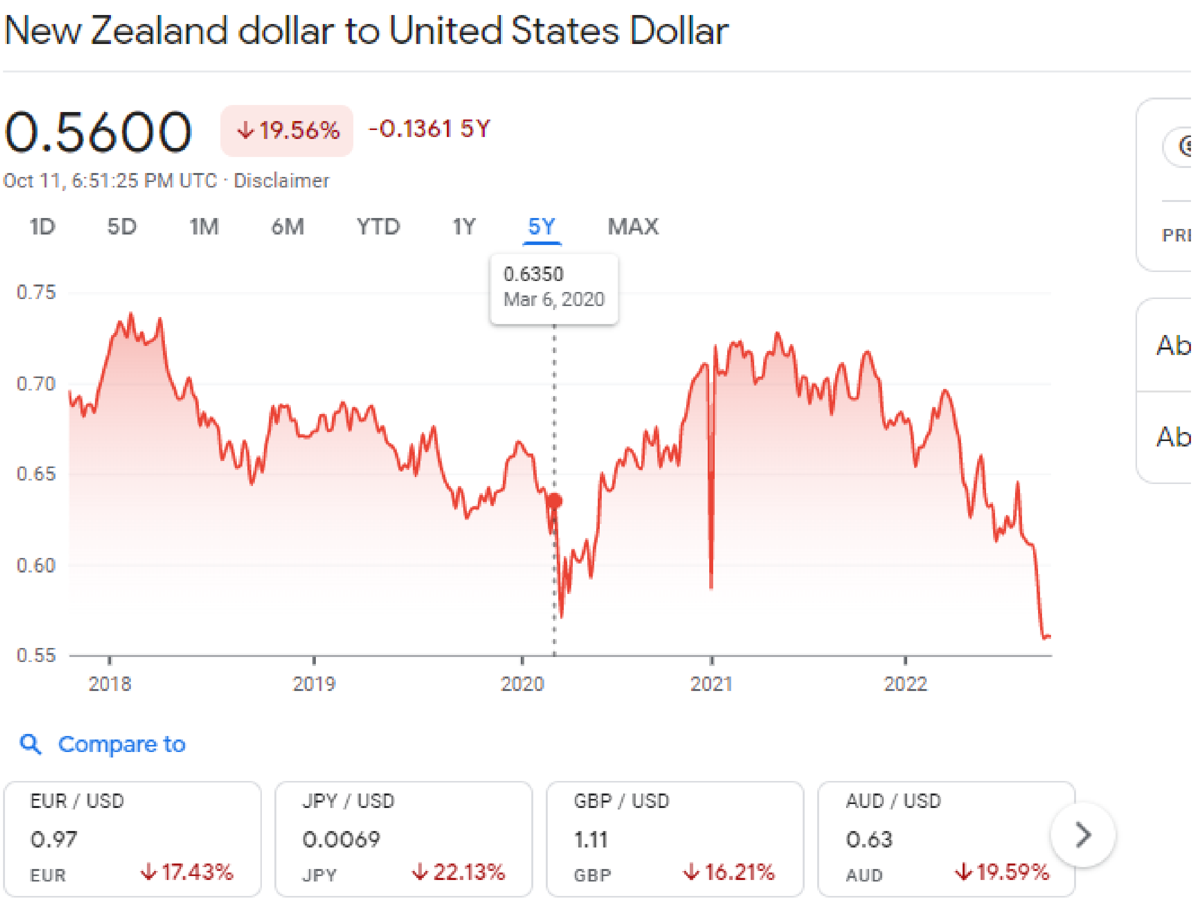
The increasing rates also lead to another driver of a flow of money away from other economies into the US. With the current 10-year rate in the US being higher than Japan, Germany, France, Switzerland, Netherlands, and Spain, why would an investor own any other government bond when the 10-year treasury bond of the world's largest economy offers 3.93%?

	Major10Y	Yield
	United States	3.9347
	United Kingdom	4.4390
	Japan	0.2500
	Australia	4.0180
	Germany	2.3080
	Brazil	11.8400
	India	7.4260
	Canada	3.4760
	Italy	4.6850
	France	2.8890
	Switzerland	1.4870
	Mexico	9.7700
	Netherlands	2.6300
	New Zealand	4.5000
	Portugal	3.3910
	Spain	3.4690
	Greece	4.9580

The 10-year yield rates. Source: Tradingeconomics.com

The New Zealand Dollar: A difficult position but potential for turnaround

At the beginning of October, the price of NZD (known as the Kiwi by FX traders) in USD terms hit a new 5-year low. Like many other global currencies, the Kiwi has collapsed in value against the dominant American dollar.



Source: [Google Finance]

Forecasts and state of the New Zealand Economy

The Real GDP growth of New Zealand was 5% in 2021. The OECD forecasts that growth number will slow to 3% in 2022 and 2% in 2023.

According to an OECD Economic Output report released in June, New Zealand's economic growth "will slow but remain solid as pent-up demand during the surge in COVID-19 infections in early 2022 is unleashed and the gradual reopening of the border allows the tourism sector to recover."

There is a general view from NZ-focused economists, at institutions like the Reserve Bank of New Zealand, ANZ, and ASB — that the growth of the NZ economy in 2021 was unexpectedly strong. This growth is, however, expected to wane because of high-interest rates designed to combat surging inflation.

In ANZ's Economic Forecast in August 2022, the bank's economist writes, "Our forecasts have the NZ economy avoiding recession, but that's only because we've penciled in a strong recovery in net exports." It notes that, "If international tourism and education don't pick up as quickly as we're hoping, the whole economy could easily slip into recession."

ASB's quarterly economic forecast from August 2022 does suggest that in NZ, headline inflation has likely peaked but more 'firefighting' using rising interest rates is set to occur.

In its latest monetary policy decision, the Reserve Bank of New Zealand announced that it would be raising the Official Cash Rate by 0.5% to 3.5%. It is the 5th consecutive rise of this percentage in a row, as the RBNZ continues to attempt to control an inflation rate in the country that has reached 7.3%.

What perked market interest at the time were suggestions from RBNZ that the rate rise could easily have been 75 basis points. "Some members [of the committee] highlighted that a larger increase in the OCR now would reduce the likelihood of a higher peak in the OCR being required," the RBNZ said.

What some observers find encouraging is the New Zealand central bank's commitment to taming inflation which may help the NZD maintain higher appeal than assets like the AUD. While the Australian Central Bank is slowing rate rises because of short-term fears, its neighbor is thinking with a long-term view and is ready for some pain in the short term.

Higher rates for the Kiwi may also mean it is less likely to be sold so quickly for the high-yielding US dollar.

The Kiwi - A high-beta Forex icon

While the economic outlook is not especially positive, a key factor in why the NZ economy is performing so poorly against the US Dollar is likely because of its position as a high-beta Forex currency. A currency that outperforms the baseline during global booms and underperforms during global recessions.

Source: [Google Finance]

What is notable in the long-term NZD/USD performance, is the New Zealand dollar's tendency to do poorly during worldwide economic crises. Notably during the Asian Financial Crisis in 1997 and the Global Financial Crisis in 2008.

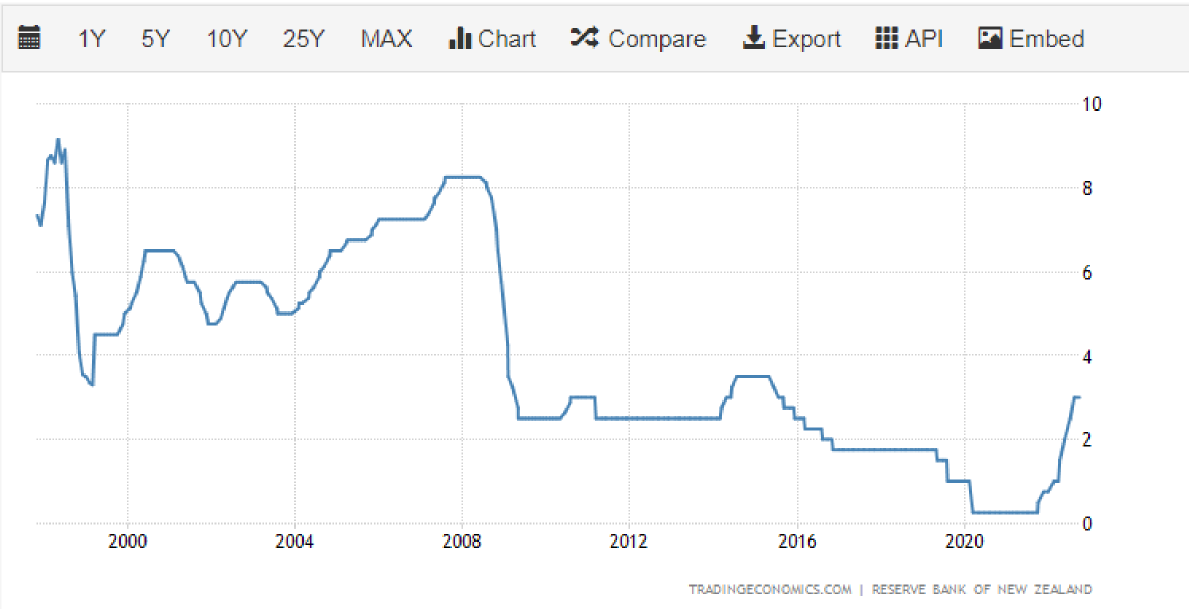
The Asian financial crisis was particularly brutal for the NZD. While Asian economies like Japan, refound their footing and rose against the US Dollar, the New Zealand dollar continued to falter and lose value against the US dollar until early in the year 2000.

The other extreme collapse of the NZD in recent years occurred in 2008 during the GFC. It is notably sharper and less of an extended drawdown than the period between 1997-2000. This sharp fall was because of the Kiwi's popularity as a carry trade currency.

Carry trading is a trading style that originated from Forex but it has now spread to other financial instrument trading markets. During a traditional Forex carry trade, a low-interest rate currency is obtained, generally by borrowing, and then traded for a currency with a higher rate of interest.

The New Zealand Dollar has historically been very popular as a tool for international Forex traders to do carry trades. It is a currency that has often offered high yields, particularly in comparison to low-yield but heavily traded currencies like the Swiss Franc and Japanese Yen.

Additionally, it has more stability than many high yielding Asian/developing economy currencies. Alongside the Australian dollar and the South African Rand, it has a goldilocks, delta-neutral appeal within Forex markets.



The Official Cash rate of New Zealand. Source: [Tradingeconomics.com]

The short-term interest rate of Japan. Source: Tradingeconomics.com

As the charts above indicate, there has historically been a much higher interest rate between New Zealand and Japan. In the early to mid-2000s, because of this, the Kiwi became a darling to Japanese retail and margin forex traders.

Margin trading positions of the NZD/JPY pair rose steadily during 2007-08, with Japanese traders gleefully taking advantage of the interest rate differentials between the two currencies. During the chaos of the global financial crisis in 2008, however, Japanese traders began to unwind their long Kiwi positions and this led to a sharp tumble in the NZD against the Yen and other currencies.

Source: Google Finance

On July 13th 2007, 1NZD=95.7194JPY. By February 6th, 2009 1NZD=48.6624. Reuters reported in May 2008, that the most dogged margin trade buyers of the Kiwi in Japan during the early-to-mid 2000s were retail traders, “typically Japanese office workers known as salarymen and housewives who make their bets online.”

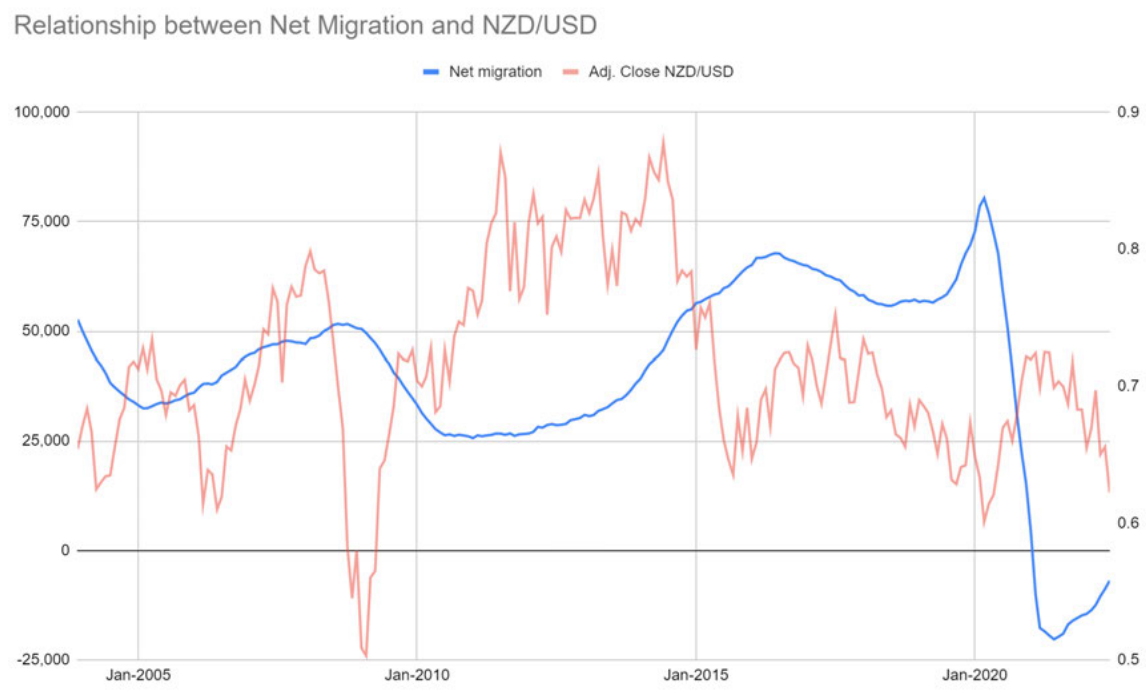
The same report noted that data from Gaitame.com, Japan’s biggest currency margin trading broker by the number of accounts, revealed a huge surge in buying interest in the lead-up to the collapse of the Kiwi, with traders also making bets on the NZD on its way down hoping to ‘catch the falling knife’. Koji Fukaya, a senior currency strategist at Deutsche Securities in Tokyo, told Reuters at the time that forex margin traders were becoming more cautious with their NZD bets.

On the flip side of the Kiwi's tendency to collapse during global market downturns, it has shown an ability to succeed when there are positive tailwinds circulating through the global economy.

HSBC chief economist for Australia and New Zealand, Paul Bloxham, famously described New Zealand "as the rockstar economy of 2014". Around the same time, Kathy Lien, managing director of BK Asset Management, said the New Zealand dollar was the "hottest" currency of 2014.

Factors for why market observers were so bullish about New Zealand included — construction spending on the Canterbury area post-earthquake rebuild, a housing boom fueled by low-interest rates, strong net immigration, and rising dairy export prices driven by surging demand from China.

The final two points are key. New Zealand is an export-led economy. What tends to push the price of the Kiwi is external demand. When the world does well and the global economy and consumption is rising, the NZD becomes more utilized.



Sources: Stats NZ, Yahoo finance, prepared by *Brave New Coin*

The chart above compares the net migration of New Zealand every month with the price of the NZD/USD pair at the start of each month. What it appears to show is a delayed reaction of price to net migration. Net migration is the number of immigrants minus the number of emigrants. Essentially the difference between economic agents entering, minus the number leaving.

Net migration rises initially and a few months later the NZD rises in value against the US Dollar. This is not always the case - in the period between the middle of 2010 to the middle of 2011. The value of the NZD rose rapidly while net migration stayed around the 25,000 level. Eventually, though, net migration did begin to rise.

Currently, we are observing a pattern where the net migration is starting to flip towards a positive number but the NZD/USD price is dropping rapidly.

In June 2021, during the COVID-19 pandemic and border restrictions, net migration hit a trough of -20,291. So, there were 20,291 more emigrating out of New Zealand than immigrating into it. As of June 2022, this number has reached -6680. As of the latest records in June, there were still more people leaving New Zealand than entering. Over this period of falling net migration, the price of NZD in US Dollar terms dropped sharply.

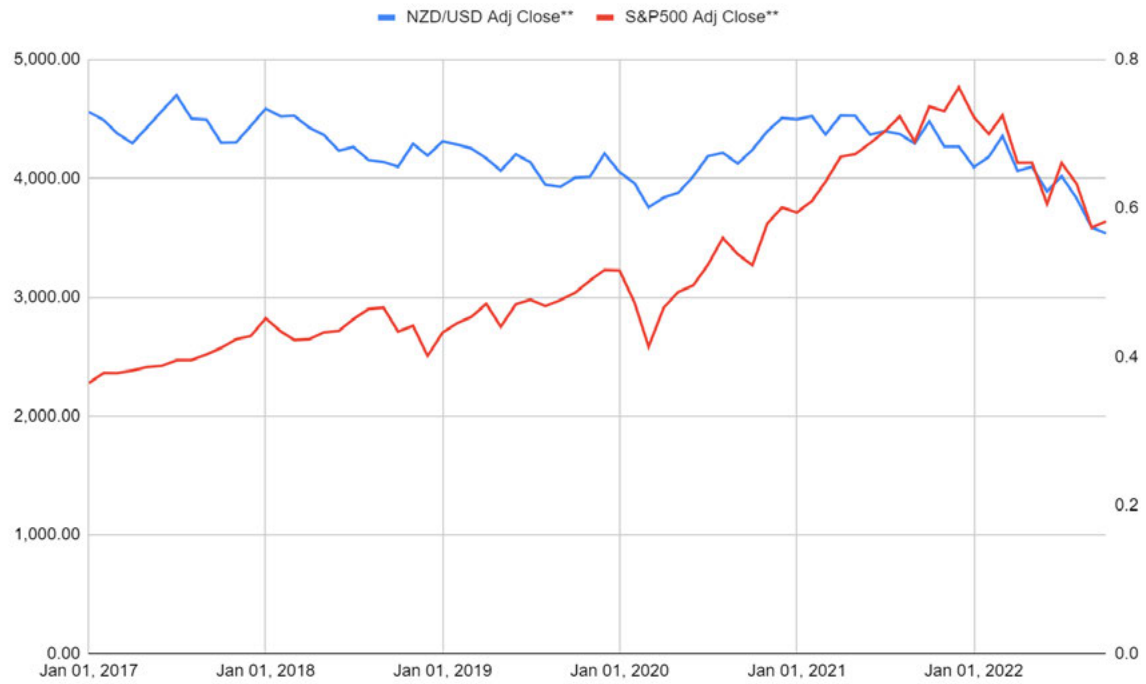
This is somewhat unexpected. With net migration improving this would suggest more incoming spenders of New Zealand Dollars and an improving NZD against the global baseline currency, the US Dollar. It is an historical pattern, however, that there has been a delayed reaction from the pair when net migration in New Zealand improves. If historical patterns repeat and net migration continues to move toward a positive value, then there may be an expectation that the value of NZD against USD will start to improve.

What is important to note again, however, is that there are factors not accounted for in this model that may be driving the price of NZD down against the USD.

A bleak global macro outlook

A key factor in why the NZD has performed so poorly against the US dollar in the last six months is a bleak global economic environment. As an economy that is export-led, there is more demand for the Kiwi when consumers in countries like China are spending more.

Additionally, as a darling of Forex traders, the currency does well when the global risk appetite is high. It is often the purveying thought amongst global traders that long Kiwi positions succeed with alpha, in macro bull capital markets. When investors are risk-averse due to factors like rising global rates or geopolitical tension the opposite attitude is held, and risk is adjusted by winding down Kiwi positions.



Source: Yahoo Finance, prepared by [Brave New Coin]

The correlation between the NZD/USD and stock is high particularly between January 2020 and up until October 2022. NZD/USD is trading like a risk asset, and will be considered as such until some of the negative geo-political tailwinds permeating through the global economy eases, the NZD may not fully be able to 'trade like itself'.

The Kiwi's medium-term value against the greenback will be tied to the performance of the world economy. There is currently a sense of fear and apprehension about the state of the global economy. The latest World Economic Outlook published by the International Monetary Fund in July 2022, suggests that the state of the world economy is 'Gloomy and more uncertain'. The report explains that this is because global output contracted in the 2nd quarter of 2022, owing to downturns in Russia and China, and lower-than-expected consumer spending in the USA.

The report notes that there are still major headwinds, yet to clear, that are affecting the ability of global output and the economy to function effectively. They are:

- Higher than expected inflation worldwide - especially in the United States and major European economies. This is triggering a response of higher interest rates and more expensive capital.
- A worse-than-expected slowdown in China driven by COVID-19 outbreaks and lockdowns.
- The spillover and production disruption from the war in Ukraine.

It will be difficult for the NZD to break its bearish trend against the US dollar until some of these headwinds pass. Broadly, it appears that they will not clear quickly. We have covered inflation but let's look briefly at the other two.

The Russian and Ukraine War heats up but how long can it be sustained?

The conflict between Russia and Ukraine continues to be volatile. On the 8th of October a massive explosion brought down sections of the Crimea Bridge. The 19km bridge is one of the longest in Europe. It is Russia's only bridge to Russian-annexed Crimea and has become a key piece of Russia's civil infrastructure. Russia has also used the bridge to move military equipment, ammunition, and personnel from Russia to battlefields in Southern Ukraine.

Russian Premier Vladimir Putin has accused Ukraine of carrying out the attack and has described it as an act of terrorism. This is the most recent example of rising tensions, alongside the air raids and Lviv strikes, emerging during the conflict. Russia recently began a conscription drive and has threatened a nuclear response.

There is a possibility of a ceasefire and more serious attempts to sit down at the negotiating table soon. Both sides will have some view to limit the cost and disruptions of the conflict, and a cease-fire may be reached because of these factors. However, the continual lobbies from both sides and the apparently escalating tensions suggest that the fires from the tension still burn hot.

Strict COVID-19 lockdown measures slow growth in China

China continues to separate itself from the rest of East Asia by implementing some of the world's strictest COVID-19 measures. South Korea has lifted its outdoor mask mandate and mandatory testing for inbound travelers. In Japan, there will be an end to pre-departure testing for travelers who have received at least one vaccine booster, and it is set to fully reopen its borders for the first time since 2020.

China, as of the 2nd week of October, in contrast, is doubling down on a "zero-COVID" strategy. The country continues to maintain tight border controls, close contact isolations, airport and public space closures, and snap lockdowns of neighborhoods.

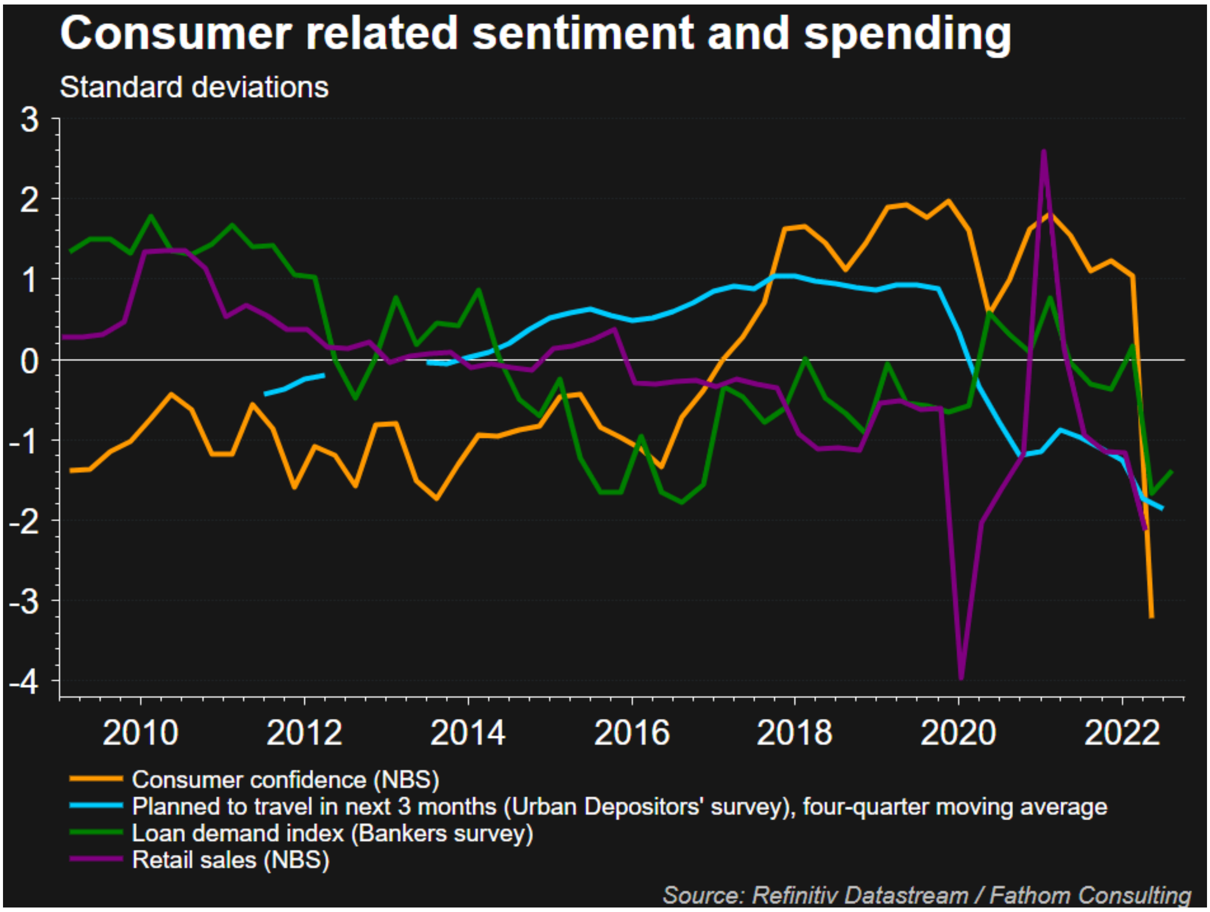
A factor in why this rigidity is being maintained is the importance of the upcoming 20th National Congress of the Chinese Communist Party (CCP) which is set to open on October 16th. There are expectations that, at the conference, an extension of President Xi Jinping's 10-year rule will be announced. It is being reported that in an effort to avoid the potential PR embarrassment of a COVID-19 outbreak in the lead-up to the mega-event, Chinese officials are taking extra precautions to control the disease.

This may be one headwind that could ease up in the coming months given the high cost and disruption of China's ongoing COVID-19 containment strategy, and the country's neighbors loosening their own pandemic control policy.

Recently, the Asian Development Bank said economic growth in China is set to be slower than the rest of developing Asia for the first time in 3 decades. The Manila-based bank announced in late September that it had lowered its growth forecast for China for 2022 from 5.2%, the rate it predicted in April, to 4.3%.

Excluding China, the rest of developing Asia is expected to grow by 5.3 percent in 2022 and 2023, the bank said. It points to the continuing "Zero COVID" policy as a key factor for the forecast change.

The ADB forecasts have had a negative effect on the Aussie and Kiwi Dollars and combined with plunging consumer confidence in China, are affecting the forex market's view of the two currencies. China has been a strong bilateral trade partner for both countries and in New Zealand, as mentioned earlier, Chinese demand for New Zealand dairy products is a key component of the export-driven economy.



Source: Refinitiv, prepared by Richard Snow

Conclusion

A mixed-bag outlook for the New Zealand Dollar

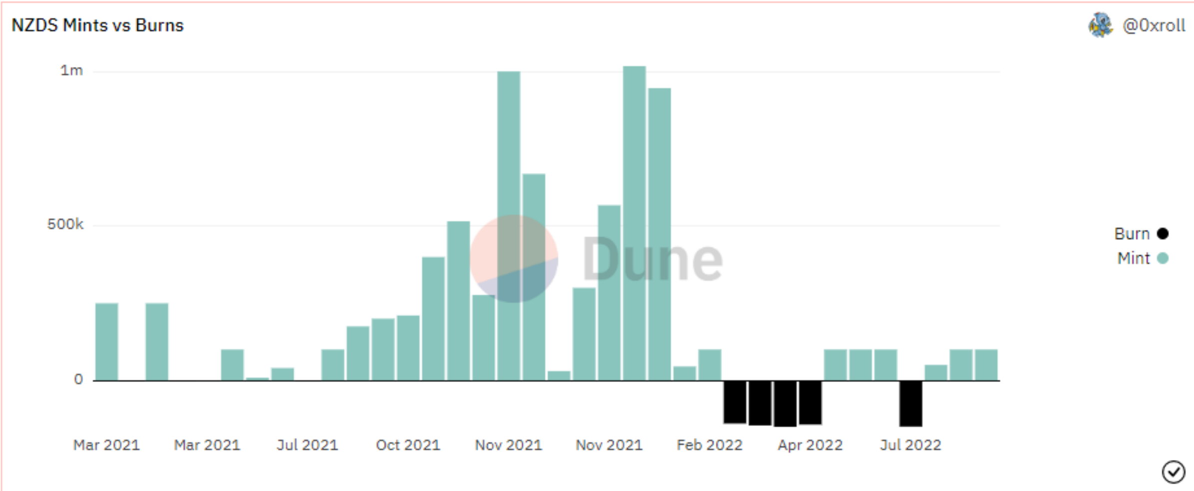
The New Zealand Dollar has performed bearishly so far this year. It is down year-to-date against the US Dollar, Euro, Swiss Franc, and Canadian Dollar. What this report has attempted to do is explain the key reasons why, which go beyond a 'weak New Zealand' economy.

New Zealand, in the global currency markets, is a high beta buy. It is a currency that is picked up by a rising global economy and consumer confidence. In the last year, with concerns about the state of the global economy rising, and markets leaning towards the dollar and 'safer' investments, the Kiwi has lost some steam. Specific factors like the particularly constrained Chinese economy have not helped.

There are, however, signals that the NZD may be due for a comeback. The Reserve Bank in NZ is showing a much stronger will to control inflation with interest rates than some other OECD nations, like the USA, and this could materialize into value growth. Additionally, net migration is beginning to reverse toward a positive level and this is set to create more demand for the New Zealand dollar.

These factors may not matter if the Kiwi's biggest enemy doesn't clear - uncertainty. Will China ease up on its "Zero COVID" policy? Will Russia and Ukraine agree to a ceasefire? Will the US Fed slow down on interest rate hikes because dollar debt is becoming too difficult to service?

As issuers of the leading New Zealand Dollar stablecoin, Techemynt is studying the shifting tides in markets. Within our ecosystem, there has been more demand to switch NZD to NZDS than to redeem, suggesting at least for some NZD holders, digitization, not dollarization, is the right option.



Source: *Dune Analytics*

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Aditya is a market analyst & digital asset researcher, with a focus on fundamental analysis and factors affecting the inherent value of digital assets. His analysis and opinions have been featured in MarketWatch, Reuters, The Globe and Mail, and Coin Telegraph.

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