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12 August, 2020

The New Zealand noise may spread if the dollar keeps dropping

◆ The Reserve Bank of New Zealand expanded its quantitative easing saying, among other things, that the appreciation of the country's currency has offset export price gains.

◆ Central bank governors of nearly all the G10 economies could consider similar decisions as the dollar continues to drop.

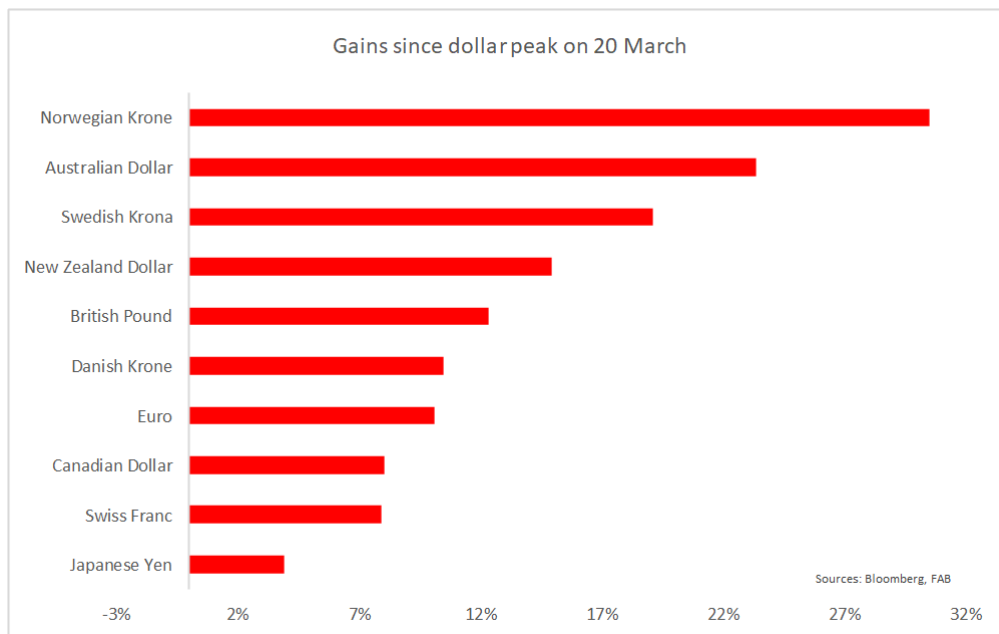
◆ If other central banks add quantitative easing it would buoy risk asset prices but would also support a higher US dollar.

◆ The caveat is that the Federal Reserve has done so much so fast, that the dollar continues to look overvalued.

◆ The FAB AAC remains underweight equities while favouring gold and investment-grade debt.

The Reserve Bank of New Zealand (RBNZ) has just said what most of its G10 peers are holding to themselves: the dollar weakening is starting to hurt. In a surprise move this morning, the central bank increased its asset purchase program by 100 billion New Zealand dollars (US\$65.4 billion) citing a number of downside risks to the economy and noting: "Prices for New Zealand's exports remain robust, but this has been partly offset by a rise in the New Zealand dollar exchange rate."

The same statement could have been issued from Norway, Australia or Brussels, with the single requirement of changing the country. The US dollar index, which is comprised mostly of the currency's rate against G10 peers, is down 2.9% this year so far, and almost 9% since 20 March, when it peaked.



The former ECB Chairman Mario Draghi made a similar decision to the RBNZ in 2018, when the common currency was trading higher than 1.21 dollars per euro. Then, he announced deeper negative rates helping the euro drop nearly 7% in a month. Similar actions were taken in 2008-2010, prompting people to say then that central banks were in a currency war.

So far, central banks have been generally well-behaved. They have not intervened directly or indirectly in their exchange rates even though many of the G10 currencies are already showing double digit gains since March. Yet, as the Reserve Bank of New Zealand showed, there is a limit.

The key one to watch is the European Central Bank (ECB). Its next policy meeting is a month away, but governors could start talking down the euro before that. If the ECB weighs on the currency, that would be particularly bad news for the US dollar bears.

The New Zealand central bank added quantitative easing as it tried to stem the kiwi gains

The euro and the British pound normally account for nearly two thirds of the moves in the dollar index. Hence, if the euro starts to depreciate again, the dollar index would immediately react. Usually that precedes the unwinding of carry trades which then strengthens the dollar overall.

The caveat to that, however, is that there is so much US dollar liquidity now that it will take plenty of quantitative easing by other central banks to make the dollar more attractive as an investment. Still, New Zealand may be the first sign. While this raises questions about the direction of the US dollar, it reinforces the case for risk assets. The more money everyone prints, the more attractive stocks and corporate bonds become.

Investment Strategy Update

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