

17 April 2018



NZD Positioning Signal Reads Overbought?

- **CFTC data show that over recent weeks net long speculative positions in the NZD have been building. When this indicator gets to extreme levels, it has historically provided a good short term sell signal for the NZD over the subsequent 4, 12, and 24 week period.**
- **We can't be sure that the current episode of building net long speculative positions is over. But, as a contrarian indicator, the warning signs have grown such that we now see skewed NZD risks to the downside hitherto.**
- **The downside risk aligns with our fundamental view on the NZD. Furthermore, net long NZD position building has come at a time when speculative accounts have moved towards short AUD and CAD positioning within the commodity currency space. We'd suggest this might be a good opportunity to take a contrarian view and lighten up on NZD/AUD and NZD/CAD exposure in particular.**

Each week the CFTC publishes data that provide a useful gauge on net speculative positioning in currencies and other financial market variables such as commodities and US Treasuries. We normally give the data a glance and then move on quickly. However, it piques our interest when positioning gets to extreme levels – the theory being that one-sided positioning might give a good contrarian signal for the outlook.

We've previously used this data to our advantage. Back in August last year¹ we noted that technical indicators were pointing to an overbought NZD and positioning in the NZD by speculators was extremely long. We noted that the NZD had always fallen from a point of extreme positioning. Sure enough, the NZD did indeed fall.

NZD Falls After Spec. Positioning Gets Extremely Long

Date of peak	No. of net long		Subsequent NZD % chg over:		
	contracts	NZD	4-wks	12-wks	24-wks
2-Aug-11	24126	0.8665	-1.5	-8.0	-7.6
21-Feb-12	24211	0.8340	-2.0	-7.8	-2.2
16-Apr-13	30808	0.8490	-3.5	-7.5	-2.5
6-May-14	20693	0.8740	-3.6	-2.7	-8.9
18-Jul-17	35981	0.7350	-1.5	-3.8	-3.3
10-Apr-18	22827	0.7360	?	?	?
Average NZD fall:			-2.4	-6.0	-4.9

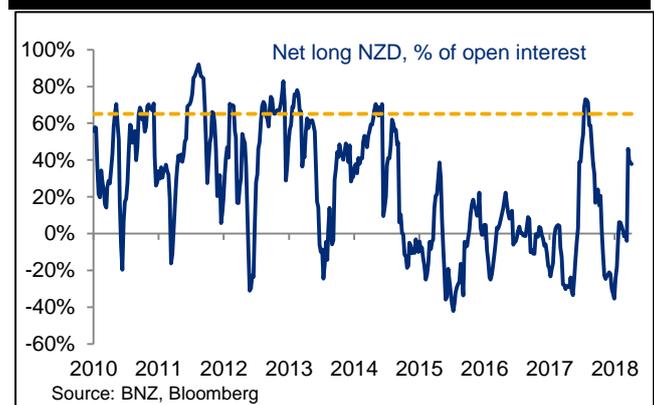
¹ BNZ Currency Research "Risks overhang NZD", 11 August 2017

Here's the Table again, showing the peak levels of net positioning since 2011 and subsequent falls in the NZD over 4, 12, and 24 weeks. We find the indicator useful when the number of net long contracts reaches over 20,000. On Friday, the latest CFTC data showed that the number of net long NZD contracts had increased from 18377 to 22827. Bingo.

Net Long NZD Spec. Positioning Gives Sell Signal...



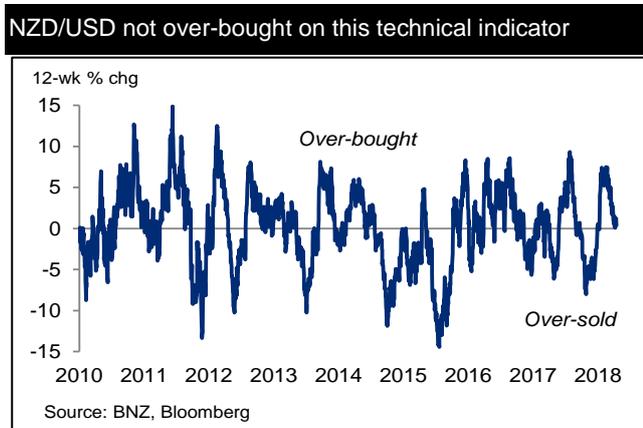
...Albeit Not Quite There Yet Using % of Open Interest



The indicator has a 100% track record in forewarning NZD falls over subsequent 4, 12, and 24 weeks. The only fishhook is that it helps if one knows if speculative positioning is at a peak. Historically, the indicator has peaked somewhere between 20.6k and 35.9k. In the current episode, we might still have another week or several weeks before speculative positioning peaks. We just don't know at this juncture.

For what it's worth we also looked at the indicator from the perspective of net long positioning as a percentage of open interest, which might be more appealing from a theoretical point of view. However, we found that the signal from this indicator wasn't quite as good and the analysis worked better using the raw contract data. We note that net NZD long positioning isn't as extreme when measured as a percentage of open interest, at present.

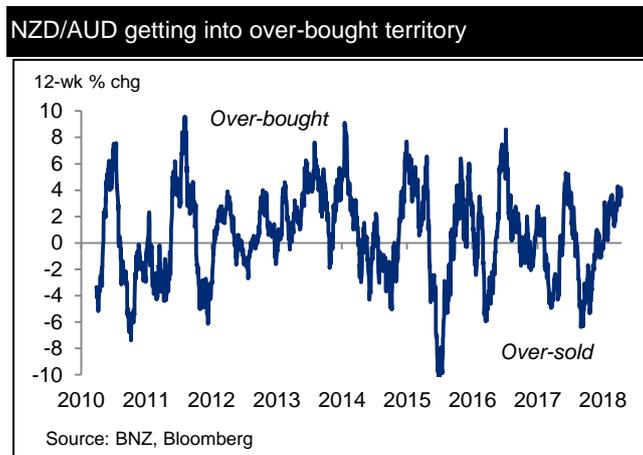
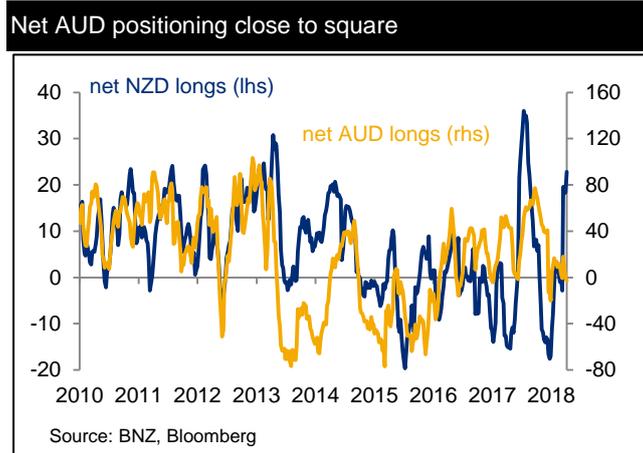
The other interesting thing about the current episode is that the NZD doesn't look over-bought on a technical basis. In four of the five previous periods of extreme net long NZD positioning, at the same time the NZD looked over-bought based on technicals (12-week % change of more than 5%). In the current episode, the NZD has been stuck in a range and therefore the 12-week % change indicator is barely positive.



Still, we think that the net speculative positioning indicator suggests skewed NZD risks to the downside over the short term.

It is also worth noting what is happening to AUD positioning. Net speculative AUD positioning has been falling over recent weeks to the point where the indicator is now slightly in negative territory. We might hypothesise that traders have recently preferred to take on board long NZD/AUD positions. Momentum has certainly been in favour of NZD/AUD as it has trended higher this year. Looking at 12-week percent changes, NZD/AUD looks somewhat overbought.

Combining the data on positioning in NZD/AUD alongside the overbought NZD/AUD conditions gives some weight to the view that this cross faces skewed risks to the downside. As it happens, this aligns with our fundamental view on the cross, with economic similarities between NZ and Australia suggesting that a range-trading cross is more appropriate than a rising NZD/AUD trend. At the end of March we highlighted the vulnerability to the NZD/AUD



cross as it approaches the top end of its long-established 0.90-0.96 trading range².

CAD positions have also recently moved from net long to net short. And, as for the AUD, fundamentally we continue to see downside risk to NZD/CAD as outlined in a recent note³.

A NAFTA resolution over the coming weeks looks likely and we think the Bank of Canada remains well placed for two more hikes this year with recent key Canadian data releases (higher CPI & strong jobs growth) favouring a move as early as May (BoC should stand pat this week and a May hike is only 44% priced). Meanwhile, RBNZ hikes remain a story for 2019 at the earliest. From a starting point of an over-valued NZD/CAD cross rate, fundamental forces should weigh on the cross.

In summary, the NZD has had a good run recently. We can explain some of this by fundamental factors. As we noted in our weekly, risk appetite reached a four-

² [BNZ Currency Research "NZD/AUD: Reverse Swing Ahead", 28 March 2018](#)

³ [BNZ Currency Research, "NZD/CAD: Canada \(Home and\) Dry?", 26 March 2018](#)

week high at the end of last week and this added 1 cent to our short-term NZD fair value estimate, albeit at 0.7150 this still sits a couple of cents below current spot. We can also explain some of the recent strength in NZD/AUD by outperformance of NZ commodity prices relative to Australia.

But in addition to fundamental forces, there also seems to be an element of speculative behaviour in driving NZD strength. Year to date, the NZD has outperformed AUD and CAD by 3½-4% and in our view this hasn't been entirely justified. We'd suggest this might be a good opportunity to take a contrarian view and lighten up on NZD/AUD and NZD/CAD in particular.

jason.k.wong@bnz.co.nz

Contact Details

BNZ Research

Stephen Toplis

Head of Research
+64 4 474 6905

Craig Ebert

Senior Economist
+64 4 474 6799

Doug Steel

Senior Economist
+64 4 474 6923

Jason Wong

Senior Markets Strategist
+64 4 924 7652

Nick Smyth

Interest Rate Strategist
+64 4 924 7653

Main Offices

Wellington

Level 4, Spark Central
42-52 Willis Street
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Toll Free: 0800 283 269

Auckland

80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Toll Free: 0800 283 269

Christchurch

111 Cashel Street
PO Box 1461
Christchurch 8011
New Zealand
Toll Free: 0800 854 854

National Australia Bank

Peter Jolly

Global Head of Research
+61 2 9237 1406

Alan Oster

Group Chief Economist
+61 3 8634 2927

Ray Attrill

Head of FX Strategy
+61 2 9237 1848

Skye Masters

Head of Fixed Income Research
+61 2 9295 1196

Wellington

Foreign Exchange +800 642 222
Fixed Income/Derivatives +800 283 269

Sydney

Foreign Exchange +61 2 9295 1100
Fixed Income/Derivatives +61 2 9295 1166

London

Foreign Exchange +44 20 7796 3091
Fixed Income/Derivatives +44 20 7796 4761

New York

Foreign Exchange +1 212 916 9631
Fixed Income/Derivatives +1 212 916 9677

Hong Kong

Foreign Exchange +85 2 2526 5891
Fixed Income/Derivatives +85 2 2526 5891

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