Say Oui-Oui To The Kiwi

Some years ago my assistant came very close to booking me on a flight to Monterey, California, when I needed to go to Monterrey, Mexico. I relayed this story to the gate agent (this being in the pre-remove-your-shoes era), who told me a similar story about someone who was sent to San Jose, California, instead of San Jose, Costa Rica. The pot was taken, however, by the person behind me, though, who knew a fellow sent to Auckland, New Zealand, when he really wanted to go to Oakland, California.

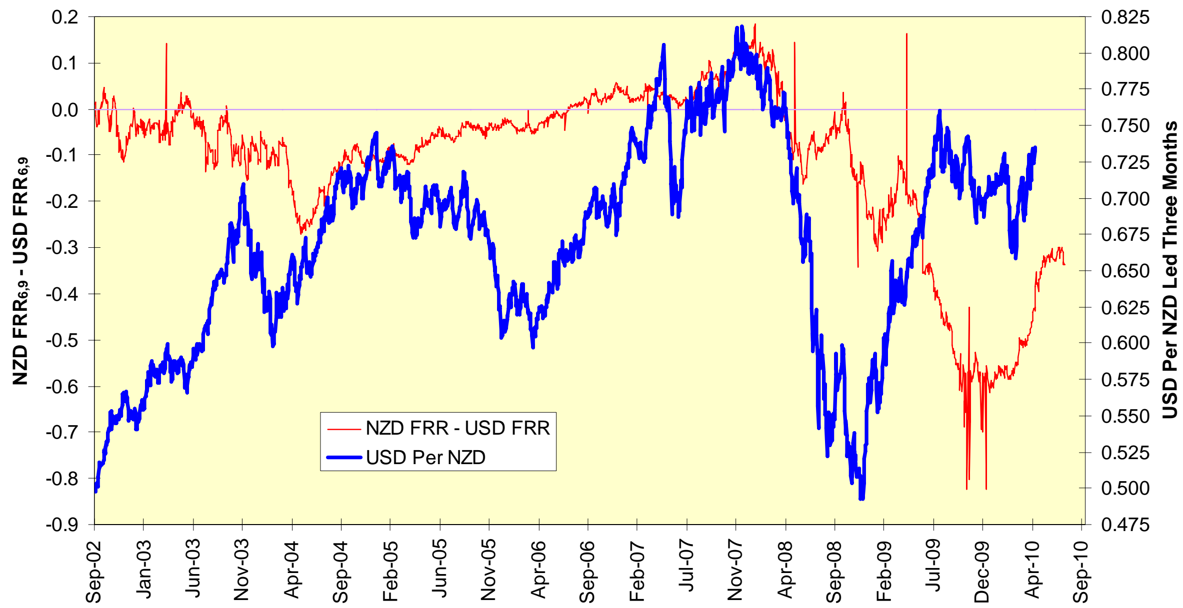
Speaking of New Zealand and its New Zealand dollar, (NZD, known affectionately as the "kiwi") it is one of those countries who have been raising interest rates while we have been searching high and low for ways to keep ours at zero and maybe even go a little lower. As such, they have been creating an interest rate gap between themselves on one hand and the Japanese and us on the other. Whenever such an interest rate gap opens, can carry traders be far behind?

The answer, clearly, must be "No;" otherwise we would not have asked it. Let's first map the excess carry return on borrowing three-month yen and lending into three-month kiwis against the USD per NZD rate. These two markets always moved in parallel, but the relationship has been especially close for the past decade. The logical interpretation here is the kiwi is being pushed higher by carry traders. Anyone who wishes to climb aboard this trade can do so via the BNZ exchange-traded fund.

New Zealand Dollar Rally Linked To Yen Carry After October 2000

If we switch the basis of comparison from a yen carry trade to the expected interest rate differentials between New Zealand and the U.S., the answer remains the same. We can measure this differential by comparing the forward rate ratios between six and nine months ($FRR_{6,9}$) for the two currencies. These represent the rates at which we can lock in borrowing for three months starting six months from now, divided by the nine-month rate itself. The differential has been in favor of the USD once we started to steepen our yield curve in 2008. That differential is closing now, and as it tends to lead the kiwi by three months, we should expect further support for the New Zealand dollar.

NZD Reclaiming Its Interest Rate Expectation Advantage Vs. USD



This pattern is going to be repeated throughout the Asia-Pacific region as non-Japan Asia is growing faster than either the U.S. or Japan. You can access this region en masse via the EPP exchange-traded fund. Until and unless both the U.S. and Japan kick into gear and start raising their short-term interest rates, their monetary ease is going to fuel other Pacific Rim economies, stock markets and currencies.

Please notice how I did not say “fuel both the U.S. and Japan.” The reason is simple: It will not. Free money here fuels growth elsewhere.