19 September 2017

NZD Corporate FX Update

- The risk-loving environment provides near-term support for the NZD but our forecasts are predicated on this dynamic not lasting forever. A further Fed hike in December remains in our forecast, which supports a modest recovery in the USD and nudges the NZD down to 0.70 by year-end. The NZD is then projected to hover around that level through 2018.

The significant selling pressure we saw for the NZD during August has ended and the currency has consolidated through September. We see the general election as a red herring. The contest is a close one, but ultimately the NZD will be driven by global forces than political developments. We don't see much implication for the NZD on a sustained basis under the most probable coalition scenarios. We still see any knee-jerk reactions to the NZD from political noise as opportunities for exporters and importers to buy and sell at better entry levels. Depending on the election outcome, this could continue in the weeks ahead.

Our risk appetite index recently reached its highest level this year, supporting a move for our short-term fair value estimate to the 0.76 mark. The model this year has tended to overstate the actual spot rate, so we see the current spot around 0.73 as broadly fair. Our projections for a weaker NZD into year end and into earlier next year are based on the view that such high risk appetite is unlikely to be sustainable.

That view also relies on the Fed continuing along its path of rate normalisation, with another projected rate hike in December and more hikes through next year. We therefore see the market under-pricing the chance of Fed hikes through the end of next year. If we're right, then that sets the scene for a possible sub-0.70 move for the NZD next year. If we're wrong then easy US monetary conditions support higher levels of risk appetite and a stronger NZD than projected.

The RBNZ remains well out of the picture for now, but as other major central banks start or continue along their path towards monetary policy normalisation, the pressure will go on to the RBNZ to follow. Implications for the NZD will be moderated as long as the RBNZ doesn't stand out from the crowd, as we suspect. Our projection for the hiking cycle to begin August 2018 is far enough away and close enough to market pricing for local monetary policy to remain an immaterial factor for the NZD over coming months.

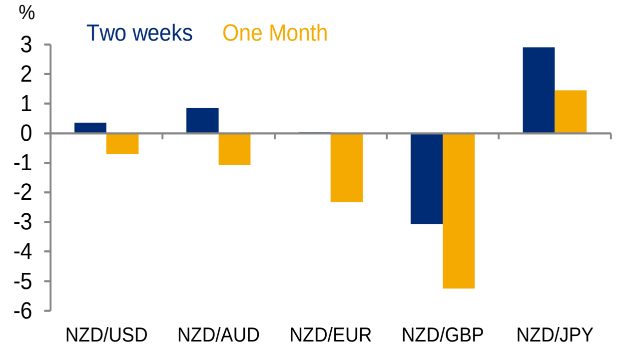
The NZD hasn't spent a lot of time sub 0.70 this year and, while our year-ahead projections are anchored around that level, it would be prudent for the exporters to increase cover as dips arise.

BNZ Foreign Exchange Forecast Summary

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	NZD/CNY
Current	*0.73*	*0.91*	*0.61*	*0.54*	*81*	*4.77*
Dec-17	0.70	0.93	0.60	0.53	81	4.67
Mar-18	0.69	0.93	0.59	0.53	81	4.58
Jun-18	0.69	0.95	0.58	0.53	81	4.58
Sep-18	0.70	0.95	0.57	0.54	82	4.60
Dec-18	0.70	0.96	0.58	0.56	84	4.66
Jun-19	0.72	0.96	0.61	0.58	86	4.79
Dec-19	0.73	0.95	0.62	0.59	85	4.79
Jun-20	0.73	0.96	0.61	0.57	83	4.78
	AUD/USD	**EUR/USD**	**USD/JPY**	**GBP/USD**	**USD/CNY**	**TWI**
Current	*0.80*	*1.20*	*112*	*1.35*	*6.58*	*76.0*
Dec-17	0.75	1.17	116	1.33	6.67	75.3
Mar-18	0.74	1.18	118	1.30	6.64	74.5
Jun-18	0.73	1.20	118	1.31	6.64	74.5
Sep-18	0.73	1.22	118	1.28	6.62	74.9
Dec-18	0.73	1.20	120	1.26	6.65	75.7
Jun-19	0.75	1.18	120	1.24	6.65	77.5
Dec-19	0.76	1.17	117	1.24	6.60	77.4
Jun-20	0.76	1.20	114	1.28	6.55	77.3

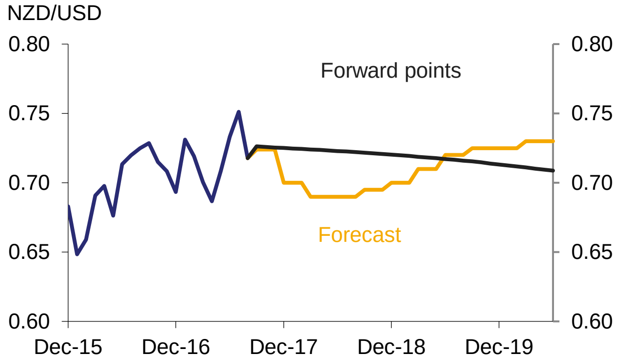
Source: BNZ, Bloomberg

NZD – Changes Over The Past Month



Source: BNZ, Bloomberg

NZD/USD: Downside Risk Next 3-6 Months



Source: Bloomberg, BNZ

The Crosses

NZD/AUD: A recent surge in “hard” commodity prices has been a key factor in driving down the cross from 0.95 to 0.90 over the past few months. We believe some of that increase in hard commodity prices has been speculative in nature and prices are vulnerable to reverse course. Demand might well have been (temporarily) ramped up ahead of expected China government shutdowns of pollution-billowing factories when winter approaches. A supporting and related factor has been a bringing forward of RBA rate hike expectations. NAB recently brought its expectations of the first RBA hike to August 2018, similar to the timing of our RBNZ rate call. We see a broad 0.90-95 range over the next year so any dips in the high-0.80s, low 0.90s look like good opportunities for exporters to hedge exposure.

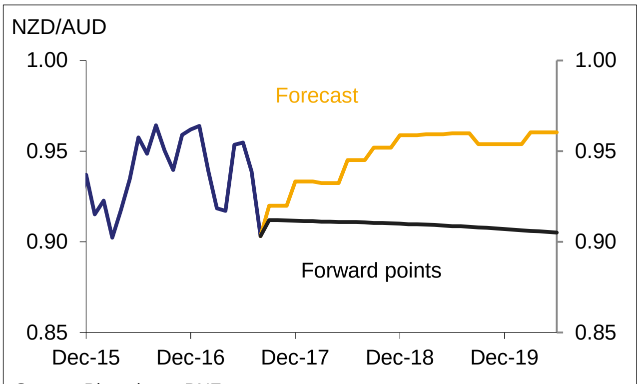
NZD/GBP: With high CPI inflation, the Bank of England recently signalled a possible policy rate increase over coming months. While that has given a boost to GBP, the reality is that economic growth momentum is slowing and real incomes are falling. Brexit negotiations are proceeding at a pedestrian pace and uncertainty about the outlook will linger for many years, even if the worst-case scenario of a cliff-like hit in March 2019 can be avoided. A rate hike or two might shake out some weak short positions in GBP but tightening monetary conditions will detract from growth. GBP is a very cheap currency but it deserves to be. Exporters should continue to budget for the historically high NZD/GBP cross rate continuing for an extended period and take advantage of any short-term dips to buy cover.

NZD/EUR: A pause is due in the strong downward momentum in this cross but we see further downside pressure over the coming year as the ECB’s QE programme draws to a close. Trading might become choppier, rather than one-way. Rate hikes are still a distant prospect but a turning point in ECB monetary policy, which was instrumental in keeping EUR depressed, has been reached. Against a strong euro-area economic backdrop, the ECB will be trying to contain enthusiasm for the euro as it begins the long process of policy normalisation. Exporters can afford to keep hedging cover lower than usual and of course the opposite applies for importers.

NZD/JPY: We fundamentally don’t like the yen as the BoJ is far, far away from meeting its inflation target. Even though the BoJ doesn’t need to purchase as many JGBs to maintain its 0.1% yield target for the 10-year rate, ongoing balance sheet expansion with no end in sight adds to the medium-term downward pressure on the yen. A return of US 10-year yields towards the higher end of this year’s range would help drive a softer yen. While our projections show a modest upward trend in the cross, there are likely to be opportunities to buy dips on spells of negative risk appetite, which the cross is highly sensitive to.

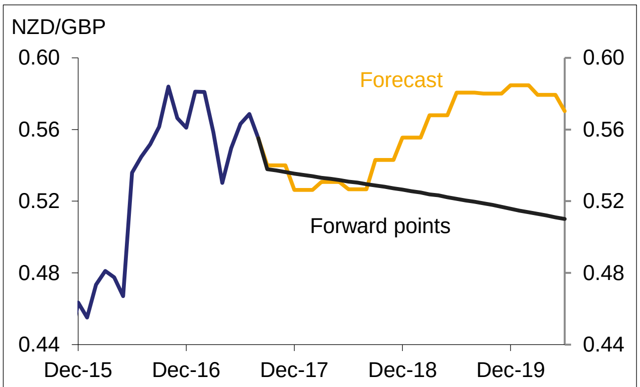
jason.k.wong@bnz.co.nz

NZD/AUD:Currently Near the Bottom of a Range



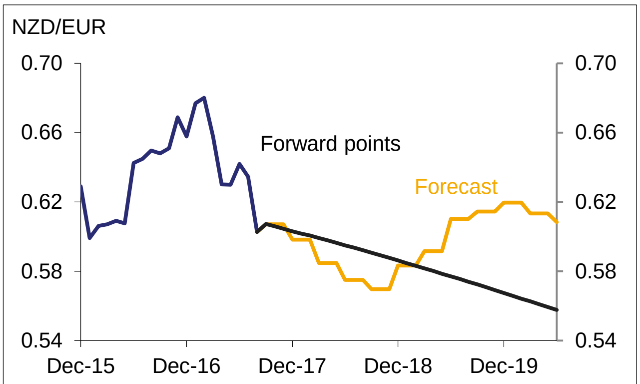
Source: Bloomberg, BNZ

NZD/GBP: Remaining At Elevated Historical Levels



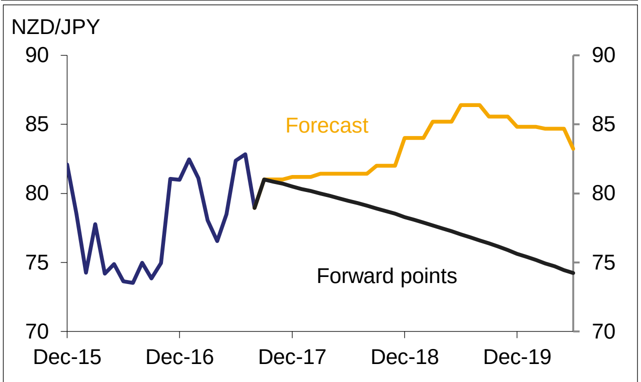
Source: Bloomberg, BNZ

NZD/EUR: Downwards as ECB Comes Into Play



Source: Bloomberg, BNZ

NZD/JPY: Consolidation around 80



Source: Bloomberg, BNZ

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

Main Offices

Wellington
42-52 Willis Street
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Phone: +(64 4) 473 3791
FI: 0800 283 269

Auckland
80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Phone: +(64 9) 976 5762
Toll Free: 0800 081 167

Christchurch
111 Cashel Street
PO Box 1461
Christchurch 8011
New Zealand
Phone: +(64 3) 353 2219
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 Interest Rate Strategy
+(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