

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.

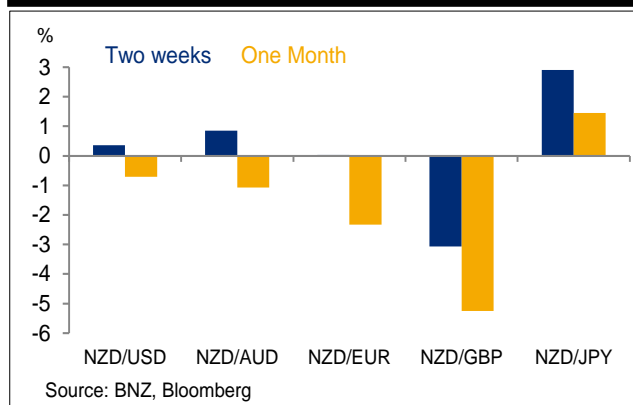
BNZ Foreign Exchange Forecast Summary

| | 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 |

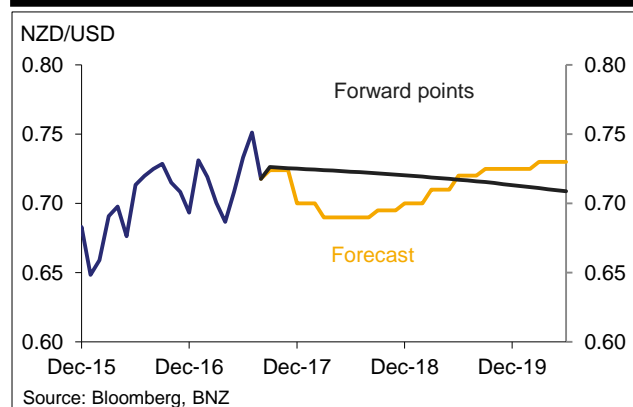
| | AUD/USD | EUR/USD | USD/JPY | GBP/USD | USD/CNY | TWI |
|---------|---------|---------|---------|---------|---------|------|
| Current | 0.80 | 1.20 | 112 | 1.35 | 6.58 | 76.0 |
| Dec-17 | 0.75 | 1.17 | 116 | 1.33 | 6.67 | 75.3 |
| Mar-18 | 0.74 | 1.18 | 118 | 1.30 | 6.64 | 74.5 |
| Jun-18 | 0.73 | 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



NZD/USD: Downside Risk Next 3-6 Months



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.

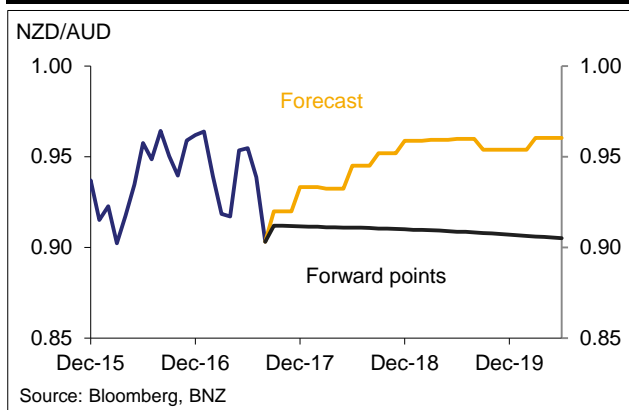
NZD/GBP: With high CPI inflation, the Bank of England recently signalled a possible policy rate increase over coming months. While that has given a boost to GBP, the reality is that economic growth momentum is slowing and real incomes are falling. Brexit negotiations are proceeding at a pedestrian pace 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 choppy, 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.

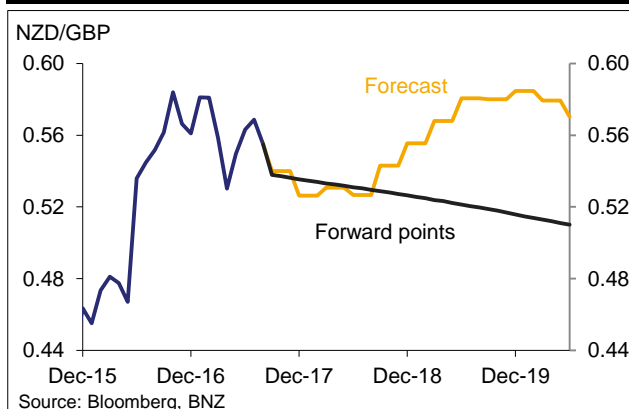
NZD/JPY: We fundamentally don’t like the yen as the BoJ is far, far away from meeting its inflation target. Even though the BoJ doesn’t need to purchase as many JGBs to maintain its 0.1% yield target for the 10-year rate, ongoing balance sheet expansion with no end in sight adds to the medium-term downward 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.

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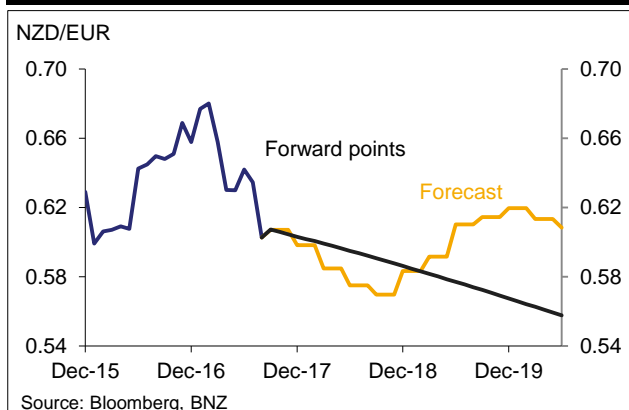
NZD/AUD: Currently Near the Bottom of a Range



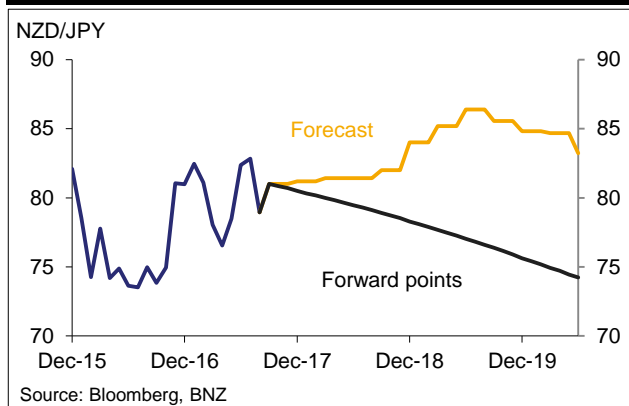
NZD/GBP: Remaining At Elevated Historical Levels



NZD/EUR: Downwards as ECB Comes Into Play



NZD/JPY: Consolidation around 80



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