NZD Corporate FX Update

- We’ve trimmed our NZD optimism for the second half, given the escalation of US-China trade wars. We see the NZD as largely confined within 0.65-0.69, but with downside risk still lingering over the short-term.

Our NZD projections have been unusually stable, being unchanged over the past six months, even as we have recently highlighted some prevailing downside risk. We trim 1½-2 cents off our 2H19 projections, taking the average down to 0.6750, consistent with a view that the NZD largely trades within a 0.65-0.69 range.

Our projections for an NZD recovery over the second half, originally formulated late last year, were predicated on a generalised downturn in the USD alongside an easing in US-China trade tensions. We now abandon our assumption that US-China trade wars will be settled anytime soon.

The greater risk is that Trump imposes tariffs on the remaining $325bn of Chinese imports than removing recently imposed tariffs, to which China would respond with further retaliation. Since the trade war ramped up in Q2 last year, NZD performance has been closely linked to CNY. If the PBOC allowed USD/CNY to break above 7 – not currently part of our central view – then the NZD could easily sustain a clear break of USD0.65, putting last year’s low of 0.6425 under threat.

Risks here though are not entirely one-sided for commodity currencies like the NZD, as China’s government has been vocal in offering support for the economy to achieve its growth objectives. Furthermore, the USD has its own issues, as we’ve seen over recent weeks, with a notable fall as expectations of the Fed easing policy have ratcheted up against a backdrop of softer economic data and acknowledgement of an easing bias by FOMC officials. The risk of a series of US rate cuts has been instrumental in breaking the USD’s upward trend.

Against these global forces, domestic factors seem like a second order risk. Beside a backdrop of increasing global risks, at least one more RBNZ rate cut is likely, although rate cuts are currently well priced, with a terminal cash rate priced around 1.10% by early next year. Another factor hosing down our optimism for the NZD over 2H19 is our view that dairy prices have likely peaked, with the strong positive run in GDT auctions since November ending. We expect a 10% fall in international dairy prices through to the end of the year – a restraining force on NZ’s overall terms of trade, which remain close to a record high.
The Crosses

NZD/AUD:

With the risk of the Australian Federal election out of the way and more clarity on RBNZ and RBA policy stances, the outlook for the cross looks less interesting than it did at the beginning of the year. We’re back to seeing more similarities than differences between the Australian and NZ economic outlooks, which should see a range-bound cross. If anything, the cross could slip from above-average current levels, with relatively weaker NZ commodity prices one possible factor. With both NZD and AUD downgraded slightly, our cross projections remain unchanged, anchored around 0.93-0.94 in the second half.

NZD/GBP:

We have become more negative on GBP, with a likely Brexiteer to win the Tory leadership. The risk of a no-deal Brexit becomes alive again, despite a lack of Parliamentary support for such a move. The risk of a collapse in government and fresh elections also comes back into the frame. It’s hard to see the market taking a positive view on GBP until some certainty returns and the greater risk is that GBP comes under renewed pressure, even if ultimately we think the most likely scenario is some further delay to the Brexit process into 2020. Building some of these risks into our central forecast now sees a higher cross, towards the mid-0.50s in the second half.

NZD/EUR:

A weaker GBP on yet-more Brexit uncertainty would likely spill over into a weaker EUR. Aside from that risk, Germany’s economy is highly exposed to global trade and further escalation of US-China trade wars would be a drag on the euro-area economy and currency. Meanwhile the ECB doesn’t have many bullets left in its arsenal to support growth. The region is crying out for easier fiscal policy as a tool to be used to support growth, but there are political barriers to anything substantial in this area. The risk then is that the cross recovers some lost ground as these issues weigh on EUR. For exporters, current levels seem attractive enough to hedge some exposure.

NZD/JPY:

The escalation of trade wars and lower US Treasury rates have fed through into a much stronger yen and fall in the cross to fresh multi-year lows. Despite not seeing a speedy resolution to US-China economic relations it would be prudent for exporters to take advantage of the lower cross and hedge yen exposure. A lot of bad global news is already reflected in the price of the yen and US Treasuries safe-havens, restraining further yen strength from here. Indeed, the greater risk is some sort of normalisation in risk appetite which sees the cross drifting higher into year-end.
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