NZD Corporate FX Update

- Our forecasts remain unchanged, with the NZD expected to be anchored around 0.67-0.68 over the second half of the year. An assumed US-China trade deal paves the way for some appreciation next year, albeit there remain fat tail risks skewed to the downside.

The NZD has trended higher over the past month from the sub-USD0.65 levels touched in May/June – moving from an oversold level to one more in line with our fair value model estimate.

The ongoing US-China trade war is a reason to remain cautious about the NZD outlook. On the economic front, global economic momentum is still softening, and the ratcheting up of tariffs in May is still working its way through the system, likely delaying any prospect for a rebound in global growth. On the domestic side, the monthly PMI and PSIs point to NZ GDP growth running closer to 1% than the 2½% projected, suggesting skewed risks to the downside.

Further RBNZ rate cuts are projected, but probably no more than currently priced in by the market, which sees a terminal OCR of around 1%. The same can be said for the US, so we don’t really see relative monetary policy as a key driver of the NZD.

Our year-end target remains at 0.68, assuming that the global and NZ economies don’t slow much more from here and US-China trade relations don’t deteriorate further. Our projections show the NZD pushing on higher through next year as a US-China trade deal eventually gets brokered well ahead of the US Presidential election late next year.

The risks around this constructive outlook remain to the downside at this juncture. Many risks still overhang the global and NZ economy, which the NZD is sensitive to. Any deterioration in US-China trade relations would see CNY under pressure again, and the NZD has been closely linked to CNY since the trade war began last year.

Exporters will no doubt have topped up hedges at lower levels to current spot and can afford to wait for any fresh dips below 0.67. Seasonally, the NZD has been strong in July and weak in August over the past decade. Importers should take the opportunity to top up hedges at levels above 0.67. Over coming months, the NZD is likely to face some resistance at 0.69.
The Crosses

NZD/AUD:
The cross has trended higher over the past three months and current spot around 0.96 represents a good level for importers to hedge FX exposure. Our projections and current fair value estimates are closer to the 0.93-0.94 mark. RBA policy easing is already showing visible signs of improvement in housing market indicators, removing a key threat to the Australian economic outlook that was overhanging in the first half. We therefore don’t see ongoing bearishness towards the AUD as warranted. Exporters can wait for better levels to hedge exposure at 0.94 and below.

NZD/GBP:
The election of Boris Johnson as PM increases the risk of some GBP unfriendly outcomes. His election pitch was that he will take the UK out of the EU on 31 October, deal or no deal. We fear that his desire to push for this could precipitate an early general election, where a number of outcomes are possible, including new governments run by either Jeremy Corbyn or Nigel Farage – either scenario could see GBP materially weaker. Our central view remains that the Brexit date will be pushed out (again) and no election will take place, but the overhanging risk of unfriendly outcomes will keep GBP under pressure. Our projections show the cross moving up to 0.56 but tail risks on both sides of the ledger around this are large. Exporters and importers should continue to tread carefully and cover known cashflows.

NZD/EUR:
There has been little spillover of a weaker GBP into EUR over recent months, which is a positive sign, although a hard UK Brexit remains a euro-negative risk factor. The ECB has recently acknowledged that monetary policy probably needs to do more of the heavy lifting in driving growth and inflation higher, even though easier fiscal policy would be the more appropriate move. Unfortunately political barriers hold back any substantial moves on this front. The cross has moved higher, with slightly more force than expected, but the bias remains to the upside. Exporters should use any dips to cover FX exposure.

NZD/JPY:
The cross turned higher mid-June and our projections are anchored closer to the mid-70s than low-70s, suggesting an upward bias remains – although dependent on our constructive outlook for global growth and US-China trade relations to play out. As always, short-term hiccups in risk appetite offer opportunities for exporters to cover FX exposure at better levels and these should always be on the radar.

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