18 April 2017

NZD Corporate FX Update

- The NZD continues to consolidate after a significant fall in early March. While rising geopolitical risk is undoubtedly NZD-negative, a soft patch in US economic data sees the market trimming back Fed hike expectations. These two offsetting forces could see a relatively steady NZD over coming months.
- Our (unchanged) forecasts see the NZD hover around the USD 0.70 mark over the next 3-6 months, before headwinds re-emerge, resulting in a year-end target of USD 0.67.

A recent development is rising geopolitical risk, with a deterioration in US-Russia relations after the US bombed a Syrian airfield and Trump becoming more aggressive with North Korea, drawing in China to provide some back-up support. Reflecting these emerging risks, BNZ's risk appetite measure is now well down from its recent high and this has dragged our short-term fair value estimate down to a USD 0.72 handle.

A fall in risk appetite this year was always on the cards, but with geopolitical factors behind the move, possible outcomes have become more diverse. At one extreme, military action on the Korean peninsula or a marked escalation in US-Russia tensions in the Middle East add downside tail-risk to the NZD outlook. On the other hand, if this is all about Trump just trying to increase his approval ratings (it has worked so far) or boost his negotiating power around US-China trade relations, for example, then the market really shouldn't take much notice and recent trends should reverse. This would see a nudge higher in the NZD.

More fundamentally, a recent reversal of fortunes in US economic data sees reduced market pricing of Fed rate hikes ahead. Soft CPI data genuinely raise a question mark over the pace of rate hikes ahead. This theme could easily continue, which is positive for NZD/USD over the short-term, but ultimately we see this dynamic reversing.

NZ monetary policy remains a current neutral factor for the NZD, but ultimately positive next year. The RBNZ seems unconvinced that rising NZ inflationary pressure of late will be sustained. Its prolonged rates-on-hold view has been influential in containing NZ short rates and the NZD. This can work for a while longer, but we project that inflation pressures are greater than the RBNZ realises, which will require a policy response next year.

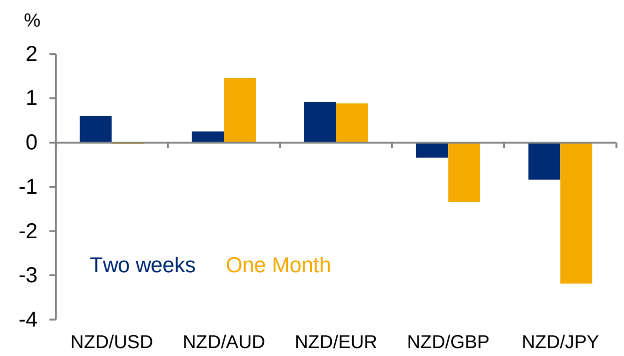
NZ commodity prices have stabilised this year and noteworthy has been a recent strong recovery in whole milk powder prices. Our view is that prices might have overshot fundamentals, although it looks like the market hasn't really bid up the NZD on this trend anyway.

BNZ Foreign Exchange Forecast Summary

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	NZD/CNY
Current	*0.70*	*0.93*	*0.66*	*0.56*	*76*	*4.83*
Jun-17	0.71	0.95	0.68	0.57	81	4.91
Sep-17	0.70	0.96	0.67	0.56	81	4.94
Dec-17	0.67	0.96	0.64	0.55	79	4.72
Jun-18	0.68	0.97	0.64	0.56	82	4.77
Dec-18	0.69	0.99	0.63	0.57	84	4.83
Jun-19	0.71	1.00	0.63	0.57	84	4.91
Dec-19	0.73	1.00	0.64	0.57	83	5.00
	AUD/USD	**EUR/USD**	**USD/JPY**	**GBP/USD**	**USD/CNY**	**TWI**
Current	*0.76*	*1.06*	*109*	*1.26*	*6.89*	*76.4*
Jun-17	0.75	1.05	114	1.25	6.92	78.5
Sep-17	0.73	1.04	116	1.24	7.05	78.7
Dec-17	0.70	1.04	118	1.22	7.04	76.1
Jun-18	0.70	1.06	120	1.21	7.01	76.7
Dec-18	0.70	1.10	122	1.22	7.00	77.2
Jun-19	0.71	1.12	118	1.25	6.92	78.7
Dec-19	0.73	1.14	114	1.27	6.85	79.0

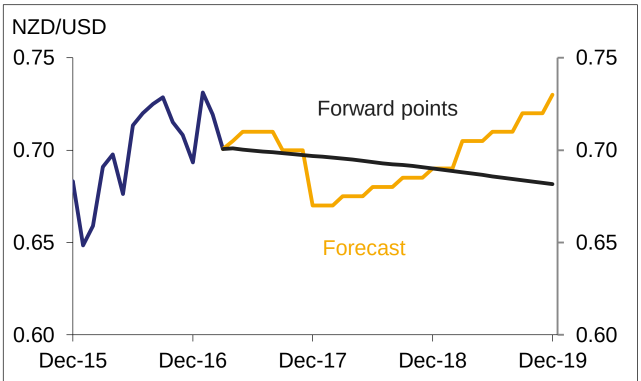
Source: BNZ, Bloomberg

NZD – Changes Over The Past Month



Source: BNZ, Bloomberg

NZD/USD: Consolidation Ahead of Weakness Late-2017



Source: Bloomberg, BNZ

The Crosses

NZD/AUD: The cross is now well up from mid-March lows, but for exporters a buy on dips strategy remains relatively attractive, with the currency trading below its annual average of just above AUD 0.94. The cross has barely reacted to the improvement in dairy prices during a time of much weaker iron ore prices and on that basis still looks a bit oversold on a short-term view. We still see the medium-term bias being one of upward pressure. This is based on our view that NZ faces increased capacity pressures in the economy relative to Australia, ultimately leading to the RBNZ tightening policy ahead of the RBA.

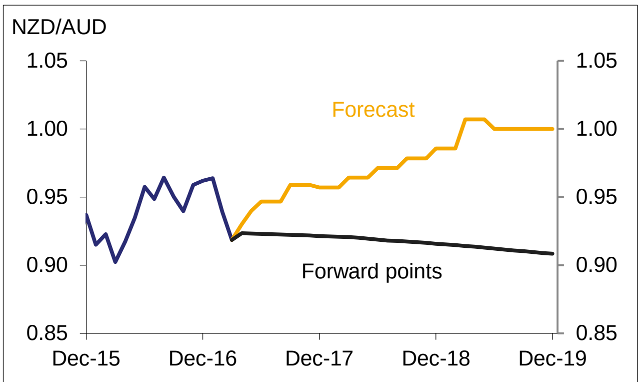
NZD/GBP: The Brexit process has officially begun and the UK faces a long road ahead before one can be certain about its future economic direction. There will be times when negotiations between the UK and EU turn ugly and create some GBP volatility as investors try to assess the ultimate outcome. Real wages in the UK are falling as the GBP collapse pushes up inflation, not a positive sign for consumer spending. Uncertainty should hold back investment. We see NZD/GBP spending much of this year in the high 0.50s, a historically elevated level. The only positive thing about GBP is that positioning is already significantly short, limiting upside risk in NZD/GBP from here.

NZD/EUR: The French presidential elections are a current focal point. Polls suggest a Macron victory with second round voting on 7 May, which would be EUR-positive, removing a source of downside risk. A Le Pen or Melenchon victory would be (significantly) EUR-negative. We judge Italian elections as the biggest source of political risk, but they are more likely to be held in early 2018 than 2017. After the French election, the ECB will likely become the most important factor for the euro and as time goes on the central bank should gradually harden up its stance on monetary policy, which currently remains highly stimulatory. Timing is the biggest uncertainty here, with recent inflation data shocking to the downside, which delays any ECB move. The balance of risk is weighted towards a much weaker NZD/EUR cross rate later in the year, after a period of near-term consolidation.

NZD/JPY: The yen has been well supported on the fall in global risk appetite. NZD/JPY is a good proxy for risk appetite and, as such, is difficult to forecast. Our projections assume that geopolitical risks fade and so the cross returns to around the 80 mark. The balance of risk is that geopolitical risks linger for longer. On fundamentals, the yen should be much weaker, as the BoJ is far, far away from meeting its inflation target, so any monetary policy normalisation remains a distant prospect. The cross around the mid-70s provides exporters an opportunity to hedge at attractive levels.

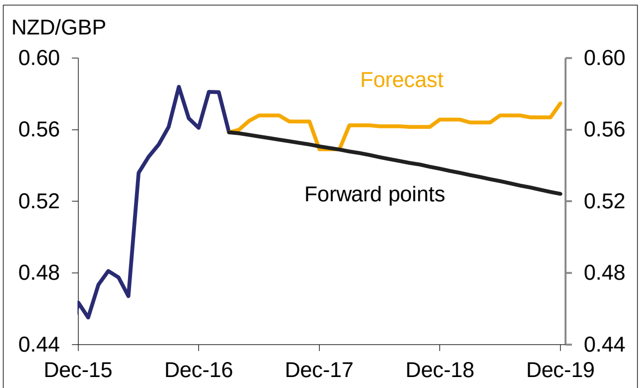
jason.k.wong@bnz.co.nz

NZD/AUD: Still Looks Oversold



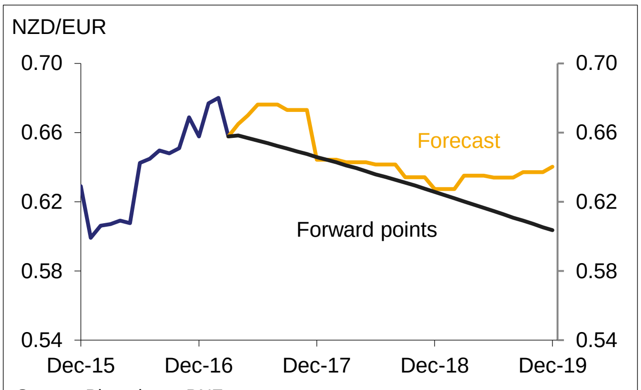
Source: Bloomberg, BNZ

NZD/GBP: Consolidating at a Very Elevated Level



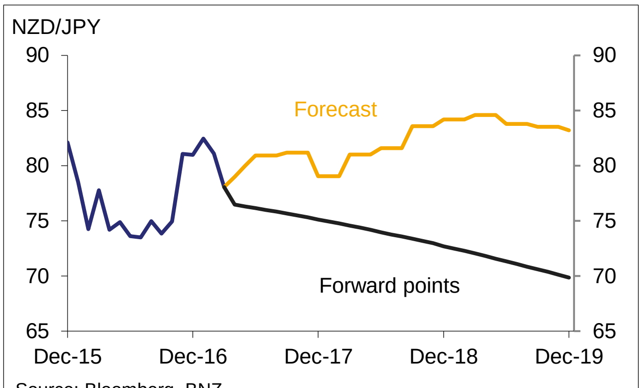
Source: Bloomberg, BNZ

NZD/EUR: Lower by Year-End as ECB Comes Into Play



Source: Bloomberg, BNZ

NZD/JPY: Hedging Opportunity on Lower Risk Appetite



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

Kymberly Martin
Senior Market Strategist
+(64 4) 924 7654

Jason Wong
Currency Strategist
+(64 4) 924 7652

Main Offices

Wellington
60 Waterloo Quay
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
Global Co-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