21 August 2017

NZD Corporate FX Update

- The NZD is well down from its late-July peak and our projections show further downside risk into early next year. Our forecast drop to a sub USD 0.70 level is contingent on a recovery in the USD. This requires a successful renegotiation of the debt ceiling and Fed rate hikes to come back into focus.

After a strong run through to the end of July, the NZD has significantly underperformed, driven by a confluence of factors. Net speculative positioning has been and remains net long NZD at elevated levels, setting the scene for a contrarian move downward. NZ commodity prices have softened over recent weeks. Soft inflation data have supported the RBNZ's policy stance to keep rates low for an extended period. Risk appetite has fallen on increased US-North Korea political tensions. And the NZ election race has become a closer call after a change in leadership from the main Opposition party, adding a measure of uncertainty to the outlook.

At the same time, the USD showed signs of bottoming out early this month, after a terrible run for much of this year. Recent US data have positively surprised but the market remains sceptical that the Fed will be hiking rates much more this cycle, with only 1½ more hikes priced in over the next two years.

We've nudged up our NZD/USD forecasts a touch, going across the grain of recent momentum, but our narrative remains the same, with the NZD expected to face further headwinds over coming quarters, seeing it return back below USD 0.70.

NZ election risk and the US debt ceiling negotiations overhang both the NZD and USD over the next couple of months, providing scope for knee-jerk reactions and trading opportunities. Trump's continuing run of "own-goals" is detracting from his policy agenda, which currently looks in tatters and adding to a USD-risk premium. If only he could change tack and get his pro-growth agenda underway – that would represent a key upside to the USD and downside to NZD/USD, but this currently looks a distant prospect.

Instead, the more likely source of downward pressure for the NZD stems from further falls in risk appetite during the historically eventful September-October period, alongside further possible headwinds for NZ commodity prices. Unchanged RBNZ monetary policy won't be a supporting factor for the NZ dollar as other major central banks head down the path of policy normalisation. We think that the market underprices the chance of a Fed hike in December.

There should be better opportunities ahead for exporters to take some cover over the months ahead.

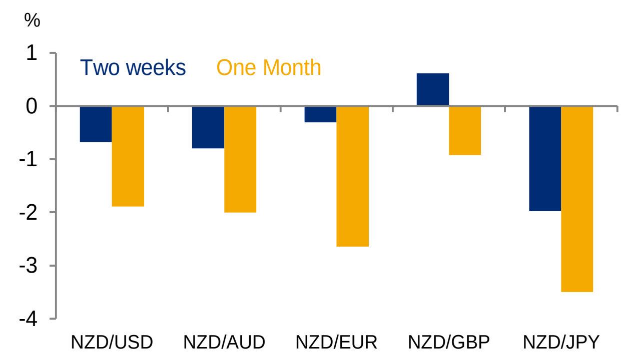
BNZ Foreign Exchange Forecast Summary

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	NZD/CNY
Current	*0.73*	*0.92*	*0.62*	*0.57*	*80*	*4.88*
Sep-17	0.72	0.92	0.61	0.56	81	4.90
Dec-17	0.70	0.93	0.60	0.55	81	4.77
Mar-18	0.69	0.93	0.59	0.54	81	4.70
Jun-18	0.69	0.95	0.58	0.54	81	4.70
Sep-18	0.70	0.95	0.57	0.54	83	4.73
Dec-18	0.70	0.96	0.58	0.56	84	4.75
Jun-19	0.72	0.96	0.61	0.58	85	4.85
Dec-19	0.73	0.95	0.62	0.59	85	4.86

	AUD/USD	EUR/USD	USD/JPY	GBP/USD	USD/CNY	TWI
Current	*0.79*	*1.18*	*109*	*1.29*	*6.67*	*77.2*
Sep-17	0.78	1.19	112	1.28	6.81	76.7
Dec-17	0.75	1.17	116	1.27	6.82	75.8
Mar-18	0.74	1.18	118	1.29	6.81	74.9
Jun-18	0.73	1.20	118	1.29	6.81	74.9
Sep-19	0.76	1.18	116	1.25	6.72	77.6
Dec-18	0.73	1.20	120	1.26	6.79	76.0
Jun-19	0.75	1.18	118	1.24	6.73	77.6
Dec-19	0.76	1.17	117	1.24	6.70	77.6

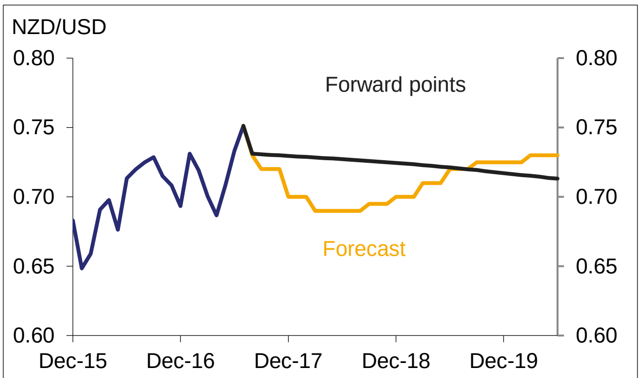
Source: BNZ, Bloomberg

NZD – Changes Over The Past Month



Source: BNZ, Bloomberg

NZD/USD: Downside Risk Next 3-6 Months



Source: Bloomberg, BNZ

The Crosses

NZD/AUD: We've toned down our projected uptrend for this cross, as expectations of RBNZ tightening get pushed out, nudging down our fair value estimates. Recent outperformance of hard commodities like metals over soft commodities like dairy has played a role in that revision as well. The March low around 0.91 could be threatened on a knee-jerk sell-off on NZ political risk, but even if we ignore that, on fundamentals we see anywhere in the low 0.90s as a reasonable level for exporters to hedge exposure. The cross has exhibited a strong tendency to range-trade over the past few years and we see that continuing. But we continue to see a modest upward trend in the range over the years ahead, based on preferred NZ economic fundamentals versus Australia.

NZD/GBP: It is five months into the Brexit negotiations and very little has been achieved so far. These negotiations will overhang GBP for a long time yet. The UK dataflow has turned negative over recent months and with high inflation eating into any income gains the economic backdrop is approaching one of a mini "stagflation". It's hard to see GBP performing well under these circumstances. That said, that negative fundamental backdrop is well acknowledged and GBP is very cheaply priced accordingly, which limits any further potential downside from here. 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 weaker NZD/EUR cross remains one of our highest conviction calls. ECB policy has been instrumental in holding down rates and the euro. While rate hikes are still a distant prospect, over coming months the ECB will be outlining its exit strategy from its quantitative easing programme. 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. Long EUR trades are a heavy consensus view so there will be times of choppy trading in this cross, but through to the end of this year and early next year we see it trending lower into the high EUR 0.50s. 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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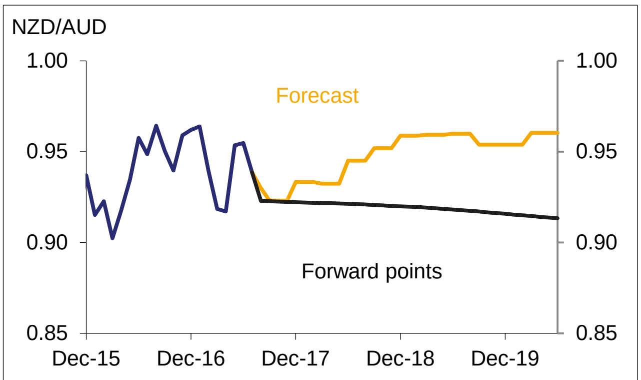
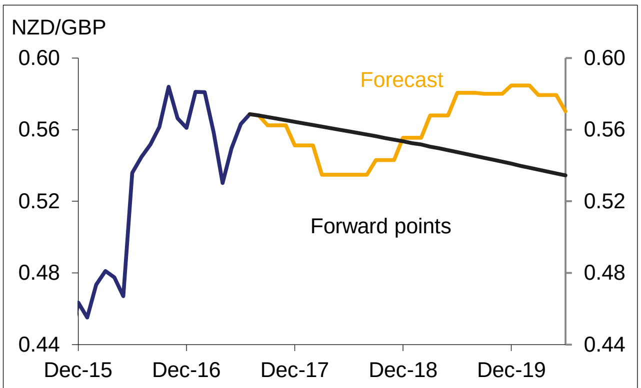
NZD/AUD: Flat with an Upside Bias Medium Term



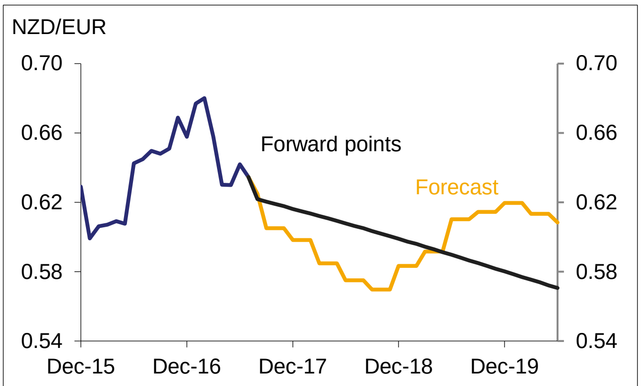
Source: Bloomberg, BNZ

NZD/GBP: Remaining At Elevated Historical Levels



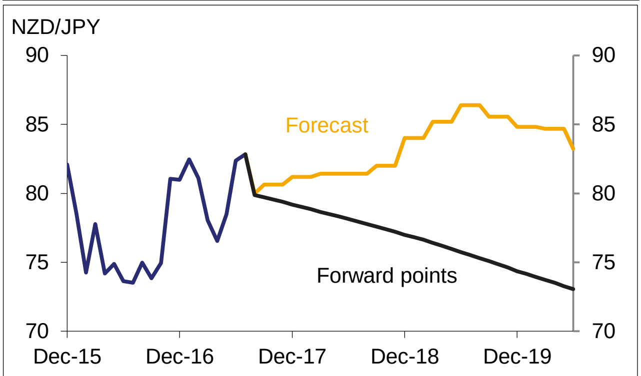
Source: Bloomberg, BNZ

NZD/EUR: Downwards as ECB Comes Into Play



Source: Bloomberg, BNZ

NZD/JPY: Consolidation around 80



Source: Bloomberg, BNZ

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