

20 August 2018



## NZD Corporate FX Update

- We have nudged down by 1-2 cents our NZD forecasts for the coming year, largely a reflection of negative domestic forces. Trump's next move on Chinese import tariffs represents a key risk event (up or down) for the NZD next month.

Global and domestic forces have recently driven the NZD down to a 2½-year low. Globally, the persistent downward pressure on emerging market currencies has spilled over into a weaker NZD. A stronger USD, escalating US-China trade tensions, and concern about the global growth outlook, amongst other factors, have been in play. Domestically, business confidence has fallen to a decade-low, other activity indicators have softened and the RBNZ has adopted a more dovish-than-expected policy stance.

NZ's GDP growth is stagnating at around trend, at best. Slowing population expansion is acting as a significant moderating factor and is already playing a part in slowing private consumption and employment growth. Weak business sentiment, if sustained, will also prove problematic with anecdotal evidence suggesting investment decisions are being postponed.

It was this focus on the softer growth outlook that triggered the RBNZ to adopt a more dovish-than-expected policy stance in its recent Monetary Policy Statement. This view came about despite evidence of rising inflationary pressure, with the Bank's previously-preferred measure of core CPI inflation reaching a seven-year high of 1.7%. We have pushed out our expectation of the first tightening in monetary policy to later in 2019, still a year away.

These changes in outlook on both domestic growth and rates, alongside a slightly softer terms of trade outlook, have resulted in a 1-2 cents shaving in our outlook for the NZD. We see it persisting in the high 0.60s now, rather than averaging around 0.70 over the next 12 months.

That said we could have easily made a more significant revision (to the downside) but that seems futile ahead of President Trump's next move on Chinese tariffs. After public consultation ends on 5 Sept., Trump will decide whether to (i) impose tariffs on \$200bn in Chinese imports, which China would retaliate against, and open up the possibility of tariffs on all Chinese imports, a much greater threat to the global outlook, or (ii) keep tariffs unchanged and focus on negotiating with China.

Scenario one could easily see the NZD lurch down further, with 0.63-0.64 entirely plausible. The second scenario could easily see the NZ recover some recent losses. Our central forecast assumes the more positive outcome, but we are not confident in that call.

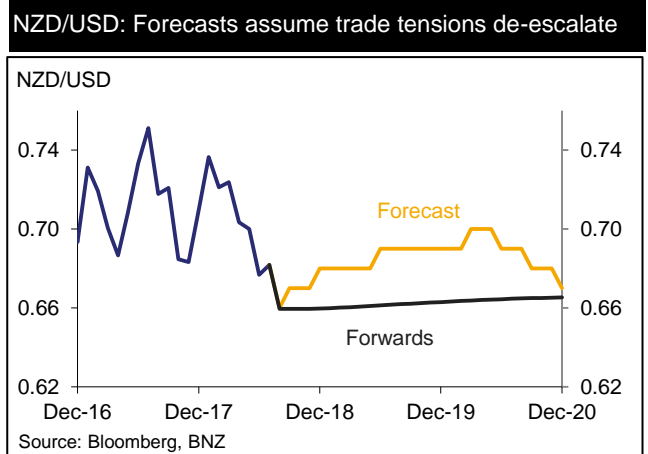
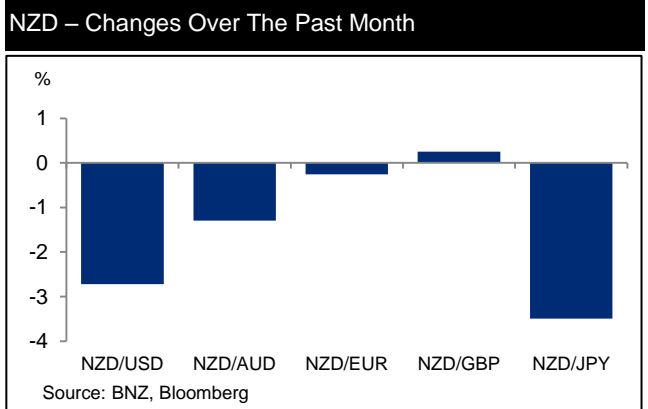
We can only hope that US businesses currently feeling the wrath of tariffs imposed to date – and there are many small businesses in that boat – get in the ear of President Trump. We await the next 4-6 weeks with trepidation.

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	NZD/CNY
Current	0.66	0.91	0.58	0.52	73	4.54
Sep-18	0.67	0.92	0.58	0.54	73	4.56
Dec-18	0.68	0.91	0.58	0.54	75	4.59
Mar-19	0.68	0.91	0.56	0.53	73	4.56
Jun-19	0.69	0.92	0.57	0.53	73	4.59
Sep-19	0.69	0.92	0.55	0.52	72	4.49
Dec-19	0.69	0.92	0.53	0.49	70	4.45
Mar-20	0.70	0.93	0.53	0.49	70	4.48
Jun-20	0.69	0.93	0.52	0.47	68	4.42
Sep-20	0.68	0.92	0.50	0.46	67	4.35
Dec-20	0.67	0.92	0.49	0.44	66	4.29

	AUD/USD	EUR/USD	USD/JPY	GBP/USD	USD/CNY	TWI
Current	0.73	1.14	111	1.27	6.86	72.0
Sep-18	0.73	1.15	109	1.25	6.80	72.6
Dec-18	0.75	1.18	110	1.26	6.75	72.9
Mar-19	0.75	1.22	108	1.28	6.70	72.1
Jun-19	0.75	1.22	106	1.30	6.65	72.6
Sep-19	0.75	1.25	104	1.34	6.50	71.9
Dec-19	0.75	1.30	102	1.40	6.45	71.3
Mar-20	0.75	1.32	100	1.43	6.40	71.9
Jun-20	0.74	1.34	99	1.46	6.40	70.9
Sep-20	0.74	1.36	98	1.49	6.40	69.6
Dec-20	0.73	1.38	98	1.52	6.40	68.7

Source: BNZ, Bloomberg



**The Crosses**

**NZD/AUD:** Even with a modest downgrade to NZD projections, we continue to see the cross rate anchored between 0.90-0.95 over the foreseeable future, albeit perhaps more time at the lower than upper end over coming months as the market toys with a chance of the RBNZ easing by mid-next year – something we don't expect to be delivered. We see both central banks keeping policy on hold through the next year. We have no strong view on the relative economic performance between the NZ and Australian economies, with both expected to grow close to trend. This argues for a range-bound cross rate. We still see dips below 0.90 as good levels for exporters to buy cover.

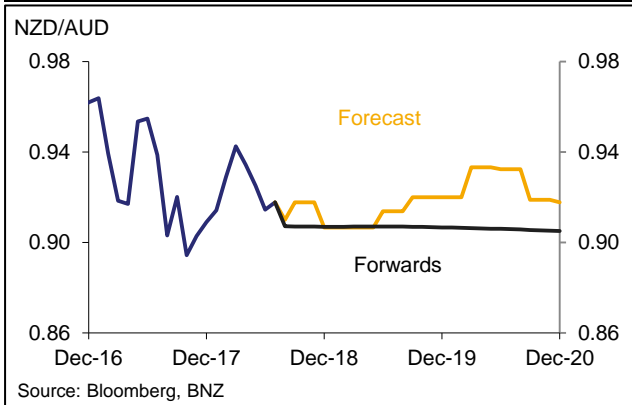
**NZD/GBP:** Brexit negotiations are not going well, not helped by a torn Conservative party so the government itself can't agree on what to present to the EU to negotiate, let alone get the EU on side and make progress on the exit. The risk of a no-deal Brexit come March 2019 has increased and this is reflected in the softer GBP of late and seen us push out our view for the next leg of NZD/GBP depreciation. A number of permutations remain possible ranging from dire to our end-game assumption of a soft-Brexit, the best possible outcome bar a fresh referendum. Given the binary outlook – which comes to a head over the next six months – it would be prudent for exporters and importers to hedge known cashflows and avoid open FX positions if possible.

**NZD/EUR:** This cross has been range-bound for the past ten months and our projections show more of the same over coming months ahead of a renewed depreciation trend through 2019. The Italian budget situation is laying the groundwork for a political spat over coming months that might well cap EUR, but ultimately we expect a positive resolution. The ECB's asset purchase programme should almost certainly end this year and through next year the focus will turn to the first post-GFC ECB rate hike, likely towards the back end of the year. Importers might look to reduce target levels, with some doubt that the 0.60 handle will be revisited, while exporters can afford to keep hedging lighter than normal.

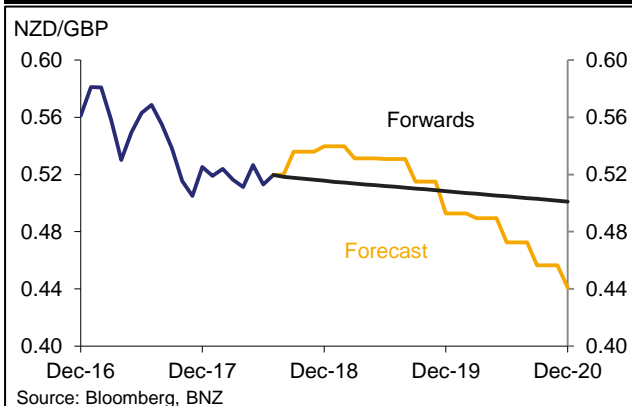
**NZD/JPY:** The yen remains the cheapest currency of the majors and has safe-haven characteristics in a more uncertain world. Our medium term outlook remains for a weaker NZD/JPY profile. The BoJ's last policy decision at the end of July was an attempt to extend the period of its super-easy policy stance. The widening of the tolerance band around the 0% JGB 10-year yield target was a practical measure in this regard – a clever attempt at taking its foot off the accelerator without engineering a stronger yen. But the reality is that its current inflation target of 2% makes little sense and the same can be said for its "continuous powerful monetary easing". Regardless of BoJ policy, as the global outlook becomes more uncertain, the pressure will be for the yen to strengthen over time, supporting a lower NZD/JPY cross.

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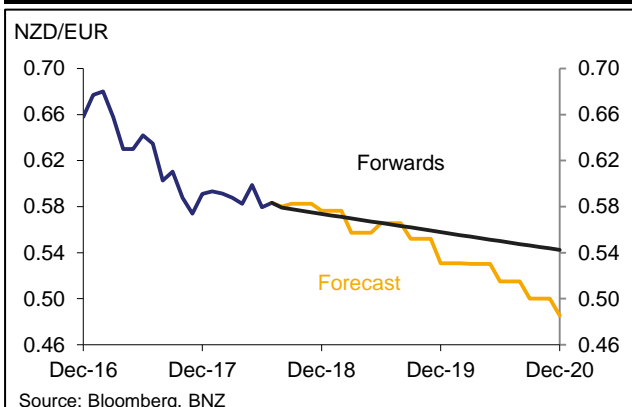
**NZD/AUD: Range-Trading Around 0.90-0.95**



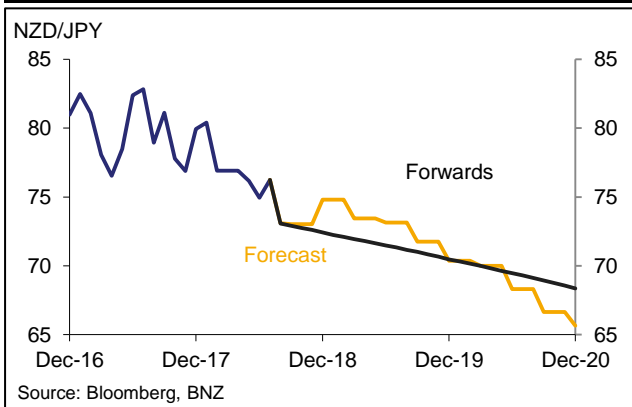
**NZD/GBP: Near-term Binary; Long-term Downward**



**NZD/EUR: Range-Trade Before Downward Trend**



**NZD/JPY: A Downward Medium-Term Trend**



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