17 December 2018

NZD Corporate FX Update

- A strong NZD recovery in November against a backdrop of weaker risk appetite and flat-to-softer NZ commodity prices, sees the currency looking rich on fundamentals, although not significantly so. We see global macro headwinds persisting over the next 3-6 months, suggesting more downside than upside risk for the NZD over that timeframe.

The NZD showed a strong recovery in November, breaking its prior six-month downward trend. Over recent weeks it has been trading slightly rich compared to our short-term fair value model estimate, which has hovered around 0.66-0.67.

Part of the NZD's recovery has reflected a more positive vibe on the US-China trade war. We see a good chance of some sort of trade deal being reached in early 2019, that won't necessarily address the multi-dimensional underlying tension between the two countries, but at least might get tariff threats away from the headlines.

We suspect that US-China trade issues will be much less of a currency driver next year, as already seems to be the case. However, a significant threat to NZD performance over the coming 3-6 months will be how the global economy fares. Global economic headwinds tend to be a negative force for the NZD and weaker growth dynamics currently in China and across Europe need to be monitored carefully.

Through the next year the outlook for US monetary policy is murkier. We are sympathetic to the view that the rate hike cycle will see a pause in early 2019, something the market now entertains. But the impact of a less aggressive rate hike cycle has had little impact on the USD so far, as the US economy outperforms. Still, the bias for NZ-US short-term rate differentials remains to the downside, as RBNZ rate hikes remain a distant prospect.

Weaker NZ dairy prices have been a negative force for the NZD over the past six months, but we are more constructive on the outlook and this, along with weaker oil prices, should support NZ's terms of trade.

Our forecasts for the next 3-6 months are pitched around a central forecast of USD0.67-0.68. Against a backdrop of a slowing global economy, we'd expect to see some resistance near 0.70 and importers should be looking to lock in some hedging on any positive rallies towards and above that level. Usual standard errors around forecasting mean that 0.65 is well within reach again and, at a stretch, the year-to-date low of 0.6425. On our view that the USD is likely to lose some cyclical support in the second half of 2019 when the Fed will be close to completing its tightening cycle, we'd see the mid-0.60s as a good level for exporters to lock in some longer-term hedging.

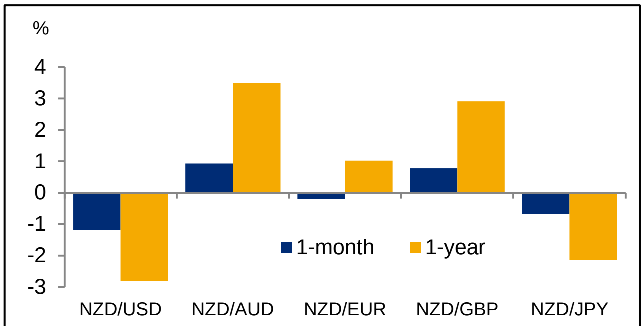
BNZ Foreign Exchange Forecast Summary

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	NZD/CNY
Current	*0.68*	*0.95*	*0.60*	*0.54*	*77*	*4.70*
Mar-19	0.68	0.96	0.58	0.50	77	4.83
Jun-19	0.67	0.96	0.57	0.48	76	4.82
Sep-19	0.69	0.94	0.57	0.48	75	4.93
Dec-19	0.70	0.93	0.57	0.48	76	5.01
Mar-20	0.70	0.92	0.57	0.48	75	4.97
Jun-20	0.71	0.92	0.57	0.48	75	4.97
Sep-20	0.72	0.92	0.56	0.49	75	4.97
Dec-20	0.73	0.92	0.56	0.49	74	4.96
Mar-21	0.72	0.92	0.55	0.48	73	4.90

	AUD/USD	EUR/USD	USD/JPY	GBP/USD	USD/CNY	TWI
Current	*0.72*	*1.13*	*113*	*1.26*	*6.91*	*74.8*
Mar-19	0.71	1.17	113	1.35	7.10	75.1
Jun-19	0.70	1.18	113	1.40	7.20	74.6
Sep-19	0.73	1.20	110	1.43	7.20	75.3
Dec-19	0.75	1.23	108	1.45	7.15	76.0
Mar-20	0.76	1.24	107	1.46	7.10	75.4
Jun-20	0.77	1.25	105	1.47	7.00	75.8
Sep-20	0.78	1.28	104	1.48	6.90	75.9
Dec-20	0.79	1.30	101	1.50	6.80	76.1
Mar-21	0.78	1.30	101	1.50	6.80	75.3

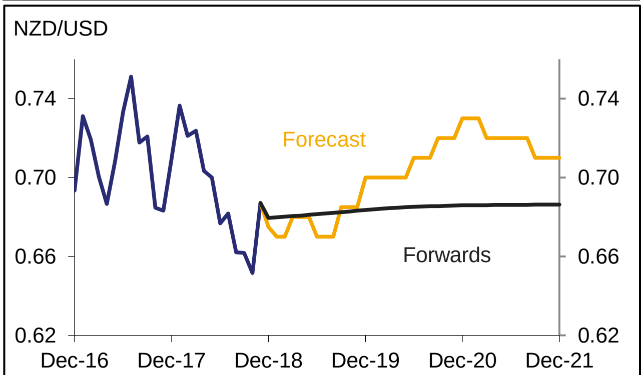
Source: BNZ, Bloomberg

NZD – Changes Over The Past Month/Year



Source: BNZ, Bloomberg

NZD/USD: Short-term downside risk



Source: Bloomberg, BNZ

The Crosses

NZD/AUD: With the cross near the top of the familiar 0.90-0.95 trading range we'd normally suggest importers lock in cover. For sure, that would be prudent, but the cross might hold up here for longer than usual and even test higher levels in first half of next year. There's a lot of focus on the weakening Australian housing market at present, which looks likely to continue. Furthermore, Australia has a Federal election to navigate by May, with associated political and economic uncertainty, particularly given a high chance of change to a Labour government. Slower global growth might also be expected to have a more detrimental impact on Australia's terms of trade compared to NZ.

NZD/GBP: The market has taken a dim view of the UK government's handling of a Brexit deal. A number of permutations remain possible but we see the odds of a destructive "no-deal" outcome as reduced. Through the fog, we are becoming more optimistic, with the most likely outcomes being a vote for PM May's soft Brexit plan, or an extension of the exit date that might include a second referendum. Exporters and importers still need to tread carefully, but if we're right then the cross could fall substantially – more than 10% – on a 3-6 month view. So we see risks heavily skewed to the downside for the cross.

NZD/EUR: A weaker GBP has spilled over into a weaker EUR, seeing a sharp upward move in the NZD/EUR cross. If our more positive view on Brexit is validated, then NZD/EUR should head back down. Again, exporters and importers need to tread carefully against this backdrop. European activity indicators have been on the soft side for several months now, holding back performance of EUR. It remains to be seen how temporary this pothole in growth will be, but we think some special factors have been in play, holding back economic performance. A fading of Italian budget concerns would remove one negative force that has held back EUR as well. Our projections for the cross show a downward bias.

NZD/JPY: The yen has been unusually weak during the recent bout of negative risk appetite which, along with better sentiment for the NZD, has seen the cross recently back up through 78. The rebound in the cross offers some attractive hedging levels for importers, as we see some resistance to any further recovery. On a long-term valuation perspective, the yen is super-cheap. No doubt exporters took plenty of advantage to buy cover during August-October on the frequent dips towards 72.5 and therefore can afford to wait for better levels before topping up. The BoJ will be concerned that meeting its inflation target remains elusive, but it has run out of policy options. The Bank's ultra-easy policy stance will continue, but further easing measures just aren't practical.

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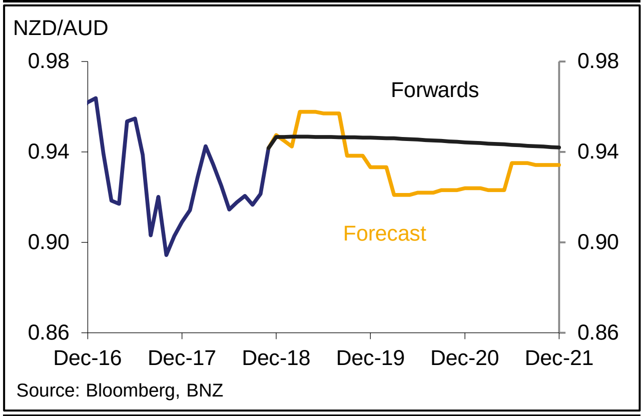
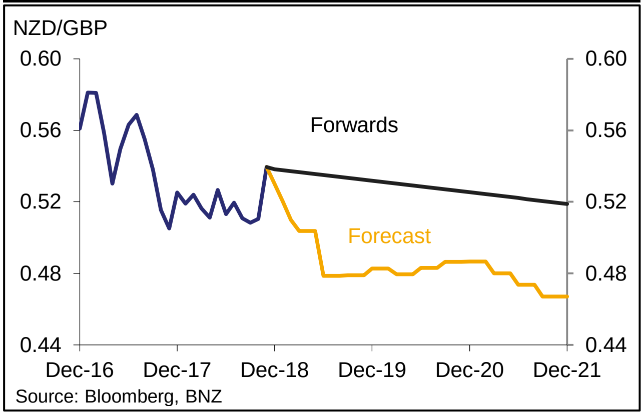
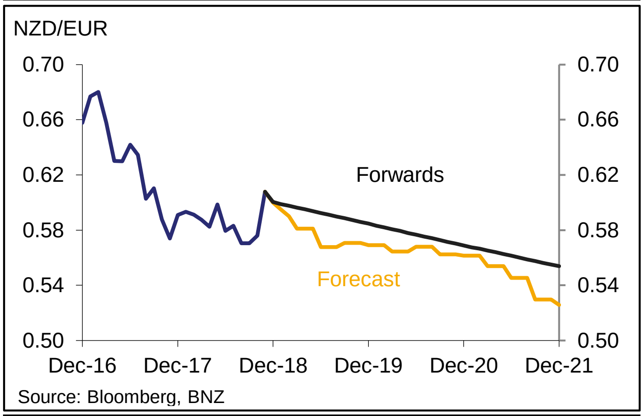
NZD/AUD: Holding Near Top-of-the Range Near-Term



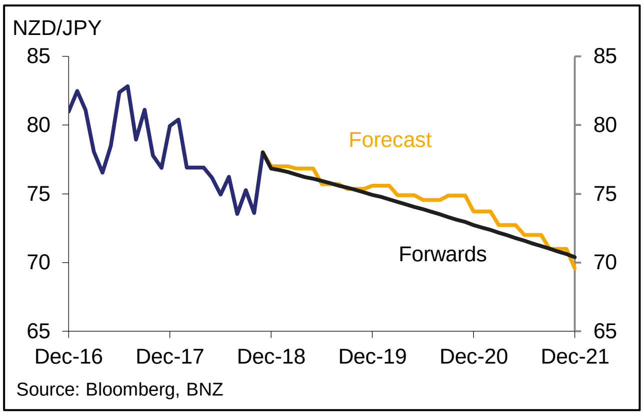
NZD/GBP: Bearish, Assuming Brexit Risks Fade



NZD/EUR: Downside, Assuming Brexit Risks Fade



NZD/JPY: A Downward Medium-Term Trend



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