5 February 2018

NZD Corporate FX Update

- Surprising strength in the NZD this year largely reflects bearish sentiment pervading the USD. The big question is how long can this continue? Our core view is that the NZD and AUD struggle to make further gains against the greenback on the back of weaker risk appetite and softer terms of trade for both countries. Other NZD crosses decline as the USD loses further ground to EUR, GBP and now JPY.

The year has begun with bearish sentiment overhanging the USD which saw the NZD push up to fresh highs above 0.74. We have recently been fretting about USD weakness and wondering how much longer this would be sustained. But currency markets are now at an interesting crossroads. A chunky increase in US Treasury yields has spooked markets. A much higher VIX index and wider credit spreads has seen our risk appetite index plunge from 85% to 70%, giving a taste of what might be in store for 2018, namely increased market volatility. A question mark hangs over whether the USD will continue to lurch downwards.

Lower risk appetite is a factor we've been highlighting for some time as a potential headwind for the NZD. Thus our core view remains that the NZD will face some headwinds this year, based on the assumption that tighter global monetary policy will eventually lead to some doubts about the sustainability of global growth and result in even weaker risk appetite. This would support a revival of the USD, at least against commodity currencies like the NZD.

We've lifted our NZD forecasts, but more so at the short term horizon (3-9 months ahead) than the medium-term. Our central forecast of 0.72 through to mid-year reflects a middle ground between two opposing views – the possibility of the USD continuing to track lower through the next six months taking the NZD higher, or the possibility that the USD has been oversold, and a near-term correction ensues. Our year-end target is unchanged at 0.70.

Lower NZ-US interest rate spreads through the year should act as a headwind for the NZD. We pushed out the expected timing of the first RBNZ rate hike to February 2019 following much weaker than expected Q4 NZ CPI and the stronger than expected NZD. NZ-US short term rate spreads have already pushed into negative territory and the risk points to further narrowing across the curve.

We think that the NZD at USD 0.73 and above is a good level for importers to be taking cover. For exporters, it might pay to be a little patient before adding cover.

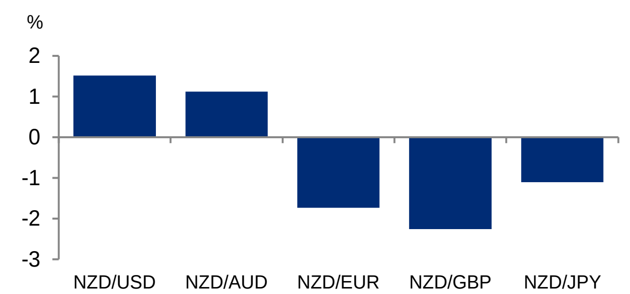
BNZ Foreign Exchange Forecast Summary

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	NZD/CNY
Current	*0.73*	*0.92*	*0.59*	*0.52*	*80*	*4.59*
Mar-18	0.72	0.92	0.58	0.50	80	4.55
Jun-18	0.72	0.92	0.56	0.50	79	4.50
Sep-18	0.71	0.92	0.55	0.48	77	4.40
Dec-18	0.70	0.93	0.54	0.47	76	4.33
Mar-19	0.70	0.93	0.55	0.48	76	4.34
Jun-19	0.71	0.93	0.56	0.49	76	4.42
Sep-19	0.71	0.94	0.56	0.49	75	4.42
Dec-19	0.70	0.93	0.54	0.48	74	4.37
Mar-20	0.70	0.93	0.53	0.48	74	4.38
Jun-20	0.69	0.93	0.52	0.47	71	4.32
Sep-20	0.69	0.93	0.51	0.47	70	4.33
Dec-20	0.68	0.93	0.49	0.46	68	4.27

	AUD/USD	EUR/USD	USD/JPY	GBP/USD	USD/CNY	TWI
Current	*0.79*	*1.24*	*110*	*1.41*	*6.30*	*74.8*
Mar-18	0.79	1.25	110	1.44	6.28	73.9
Jun-18	0.78	1.28	110	1.45	6.25	73.3
Sep-18	0.77	1.30	109	1.47	6.20	72.1
Dec-18	0.75	1.30	109	1.48	6.18	71.4
Mar-19	0.75	1.28	108	1.46	6.20	71.6
Jun-19	0.76	1.27	107	1.45	6.23	72.5
Sep-19	0.76	1.28	106	1.45	6.23	72.6
Dec-19	0.75	1.30	105	1.46	6.24	71.6
Mar-20	0.75	1.32	105	1.47	6.25	71.5
Jun-20	0.74	1.34	103	1.48	6.26	70.6
Sep-20	0.74	1.36	102	1.47	6.28	70.5
Dec-20	0.73	1.38	100	1.48	6.28	69.6

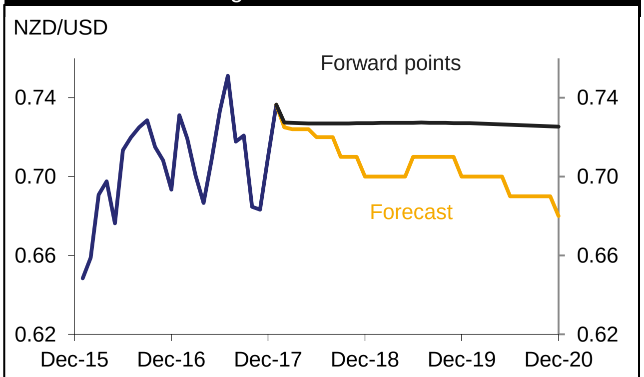
Source: BNZ, Bloomberg

NZD – Changes Over The Past Month



Source: BNZ, Bloomberg

NZD/USD: Flat through 2018



Source: Bloomberg, BNZ

The Crosses

NZD/AUD: This cross has tracked sideways for the past four years and our projections show more of the same, with the currency expected to trade within a 0.90-0.94 zone and brief skirmishes outside of that range likely. Our current short-term fair value model estimates sit within this range. A directionless cross rate reflects no strong view on the relative economic performance between NZ and Australia. We see relative interest rates remaining fairly steady alongside this view, with both the RBA and RBNZ content in being patient regarding future tightening in monetary policy.

NZD/GBP: GBP is expected to be in the driving seat, recovering from its depressed level when viewed in a medium-long term context. This sees the cross trending down further. We expect a transitional deal on Brexit to be agreed over the next couple of months, which might extend the current trade arrangements for two years or even longer. This would provide the UK with some much needed breathing space, boosting business confidence and lead to increased pricing of future BoE rate hikes. Exporters can afford to keep hedging lighter than usual if we're right. The risk to our view is that political infighting leads to a general election and a significant short-term hiccup to our view.

NZD/EUR: We continue to see potential for a lower cross rate, with a more towards 0.50 over the medium term. Behind this view is a strong euro-area economy relative to trend, fuelled by highly stimulatory monetary policy. The ECB's gradual move away from quantitative easing and expectations of an eventual removal of the negative deposit rate are likely to drive EUR higher. The significant depreciation last year was off a very high base so the spot rate still trades well above our medium-long term fair value estimates near the mid-0.50s. Importers should look to hedge exposure in the high 0.50s and exporters can afford to be patient with their hedging operations.

NZD/JPY: We've revised our JPY outlook significantly, so rather than seeing the cross range-bound, the balance of risk favours a lower NZD/JPY cross rate from here. While the BoJ remains far away from meeting its inflation target and is likely to keep policy unchanged for some time yet the dynamics of currencies has changed and near-term monetary policy matters less. The strength of EUR last year, despite negative rates, highlights how sometimes the market is prepared to take a longer term perspective, and on that note JPY remains by far the cheapest of the majors. Recent wobbles in risk appetite support safe-haven flows into JPY and to the extent that these continue, then the bias would be to the downside for the cross. It might pay for importers to consider hedging exposure above a cross of 80.

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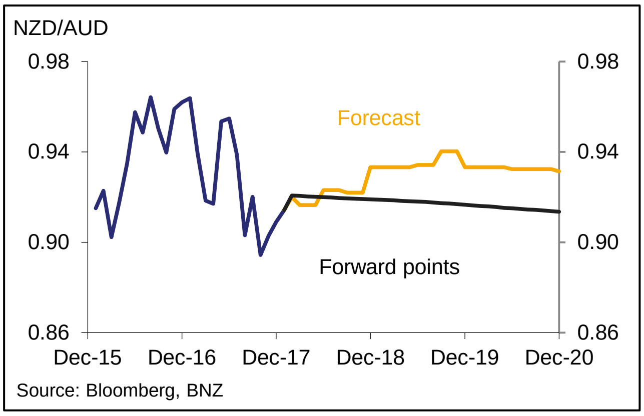
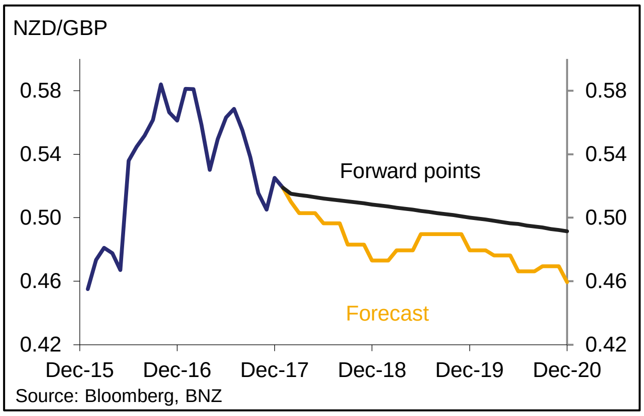
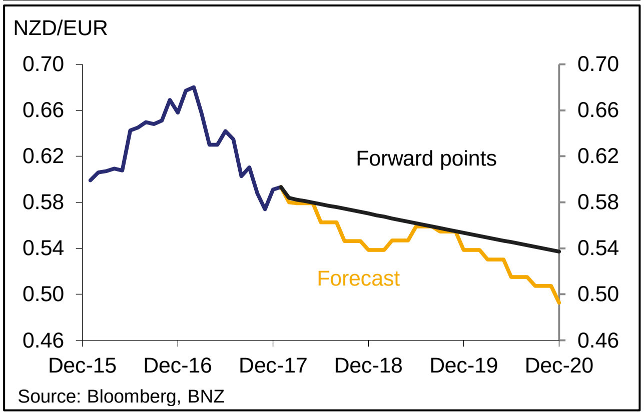
NZD/AUD: Range-trading around 0.90-0.94



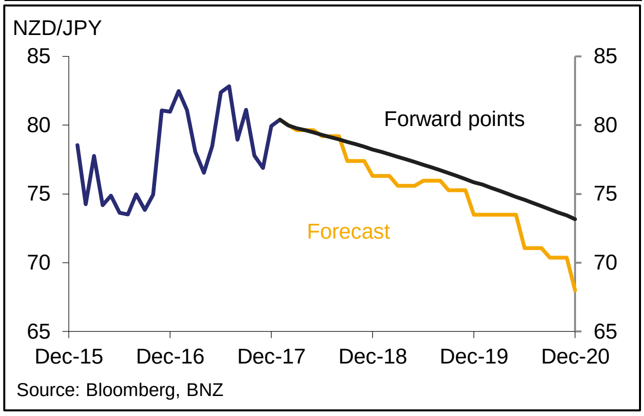
NZD/GBP: Downward Trend to Continuue



NZD/EUR: Downward Trend to Continue



NZD/JPY: Downside Bias



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