19 July 2017

NZD Corporate FX Update

- From the current NZD/USD level at a year-to-date high, we see the balance of risk weighed to the downside over the rest of the year. However, a return to a sub-0.70 level is contingent on the (over-sold) USD staging a recovery, after its steady broadly-based decline over recent months.

The NZD has some fundamental support at the current spot rate, given the backdrop of very high risk appetite and record NZ terms of trade. Our short-term fair value model estimate has had a USD 0.75 handle for the past eight weeks running.

But our working assumption continues to be that the USD will stage a recovery. Its recent downward trend against all major currencies this year has gathered momentum over recent months, given a soft-spot in US data and the political shambles that is preventing any fresh policy initiatives from the Trump administration. Our USD trade-weighted index model suggests that it is oversold by 6%, the largest value gap over its 7-year history.

With speculative accounts broadly speaking short USD and long NZD (the largest net long position in four years for the latter), the hurdle rate for a reversal of fortunes is fairly low. In other words, it wouldn't take much of a "surprise" to see NZD/USD head back south.

The key triggers for a reversal would be some positive news on the US fiscal front – perhaps US Republicans making a concerted effort to push ahead with tax reform to get some "runs on the board" after the failed health care bill. Or a better run of data to help improve the odds of the US Fed continuing along its path of policy normalisation. Just one more rate hike this year (likely in December) would represent a positive factor for the USD, given beaten-down expectations.

RBNZ monetary policy won't be a supporting factor for the NZD this year. It is unlikely to join the chorus of other central banks in giving a nod to less policy accommodation. Soft Q2 CPI data and an inflation track that looks to be running below the RBNZ's last projections should leave the Bank decisively neutral.

NZ's general election on 23 September is looking to be a tight contest, with a number of unknown variables. Confidence could well dip ahead of the election date and as post-election negotiations get underway.

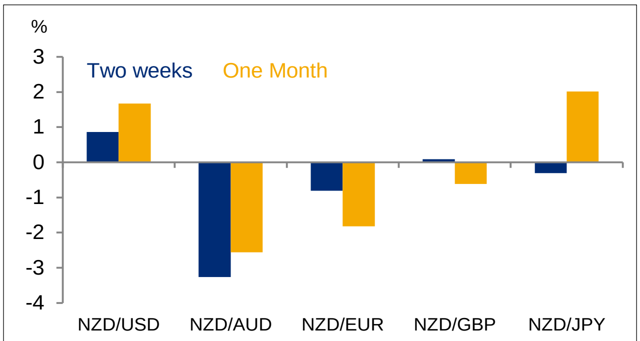
Importers should actively consider hedging around current levels. Exporters can afford to be more patient and await better re-entry opportunities over the next few months.

BNZ Foreign Exchange Forecast Summary

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	NZD/CNY
Current	*0.73*	*0.93*	*0.64*	*0.56*	*82*	*4.96*
Sep-17	0.71	0.97	0.61	0.56	81	4.84
Dec-17	0.68	0.97	0.59	0.54	80	4.64
Mar-18	0.68	0.96	0.58	0.53	81	4.60
Jun-18	0.68	0.97	0.58	0.53	82	4.63
Sep-18	0.69	0.98	0.57	0.54	84	4.66
Dec-18	0.69	0.99	0.56	0.55	84	4.69
Jun-19	0.71	1.00	0.57	0.55	84	4.78
Dec-19	0.73	1.00	0.58	0.56	83	4.89
	AUD/USD	**EUR/USD**	**USD/JPY**	**GBP/USD**	**USD/CNY**	**TWI**
Current	*0.79*	*1.15*	*112*	*1.30*	*6.75*	*78.0*
Sep-17	0.73	1.17	114	1.28	6.81	77.0
Dec-17	0.70	1.15	118	1.27	6.82	75.0
Mar-18	0.70	1.17	120	1.28	6.81	74.4
Jun-18	0.70	1.18	120	1.28	6.81	74.7
Sep-19	0.72	1.25	116	1.32	6.72	77.2
Dec-18	0.70	1.23	122	1.25	6.79	75.5
Jun-19	0.71	1.25	118	1.30	6.73	76.7
Dec-19	0.73	1.27	114	1.31	6.70	77.7

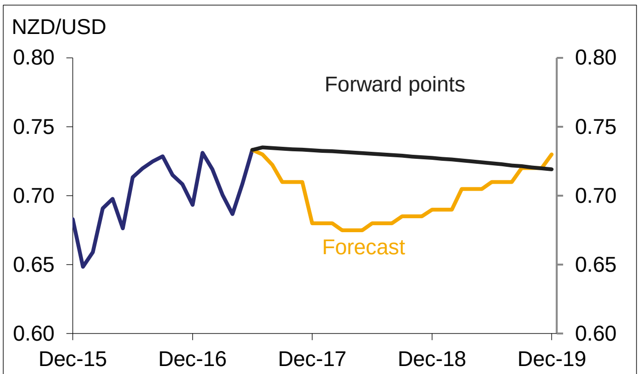
Source: BNZ, Bloomberg

NZD – Changes Over The Past Month



Source: BNZ, Bloomberg

NZD/USD: Downside Risk Next 3-6 Months



Source: Bloomberg, BNZ

The Crosses

NZD/AUD: The cross has plunged by over 3 cents over the last couple of weeks on a resurgent AUD. We don't think it has been entirely justified. As we saw earlier this year, the 0.91-0.93 range represents a good level for exporters to take on extra cover. Our current fair value estimates range about 0.94-0.95 and our medium term track still has an upward bias, albeit more so for next year than the rest of 2017. On a scorecard that compares NZ to Australian economic factors, NZ looks better placed when considering relative terms of trade, fiscal policy and capacity pressures and that should ultimately lead to the RBNZ raising rates next year ahead of the RBA. These factors lie behind our more positive medium term view.

NZD/GBP: GBP is more unpredictable than usual at the moment, given the inherent uncertainties as Brexit negotiations get underway and with the weakened UK government position after the shock election result. The Bank of England Monetary Policy Committee members have adopted a more hawkish tone, but the dataflow doesn't look flash, with the long-awaited post referendum slowdown now finally underway. EU leaders hold all the ace cards at the negotiating table and the UK faces a long road ahead before one can be certain about its future economic direction. Real wages in the UK are falling with the weak GBP pushing up inflation, not a positive sign for consumer spending. 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 is one of our highest conviction calls. ECB policy has been instrumental in holding down rates and the euro, so the recent nod towards reducing policy accommodation is significant. Rate hikes are still a distant prospect, but over coming months we expect the ECB to outline plans to taper its asset purchase programme. It will be hard for the ECB to contain enthusiasm for the EUR as policy normalisation plays out. However, long EUR trades are a heavy consensus view so it won't be straight line down to our projected level of EUR 0.56 by the end of next year. One potential hiccup is Italian elections likely early next year becoming a source of significant political risk. At this stage we just flag this as a risk to our view. 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. The BoJ recently signalled that it wasn't ready to modify its target for 10-year JGB yields in the face of pressure stemming from higher global rates. Any monetary policy normalisation remains a distant prospect. That said, the cross has had a steaming run recently and is due for a period of consolidation. Exporters should look to add to cover on any dips into the high 70s.

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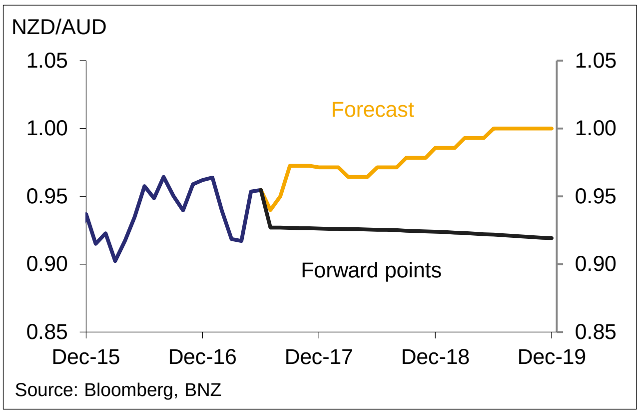
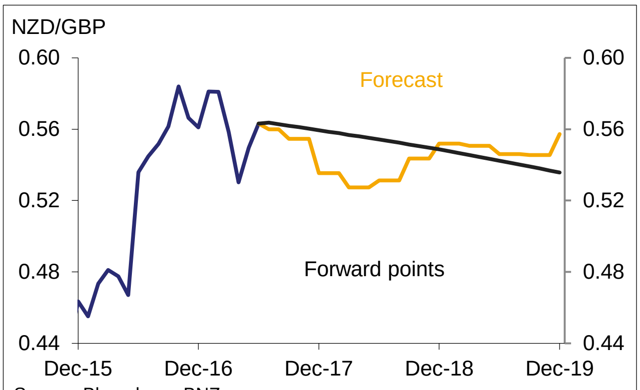
NZD/AUD: Flat with an Upside Bias



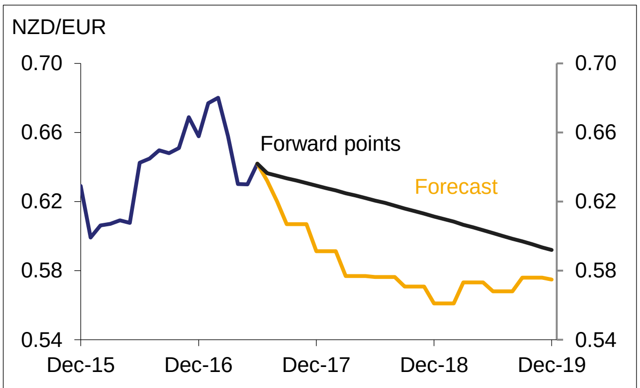
Source: Bloomberg, BNZ

NZD/GBP: Remaining At Elevated Historical Levels



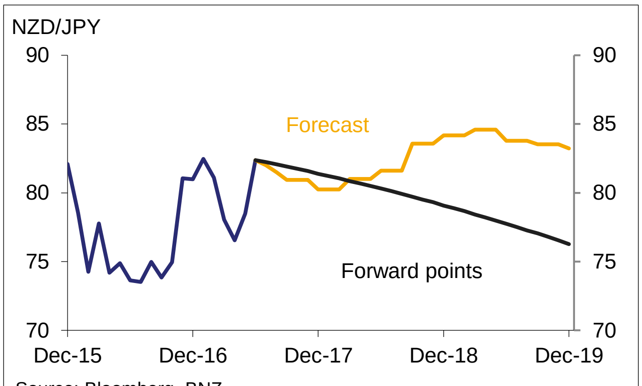
Source: Bloomberg, BNZ

NZD/EUR: Downwards as ECB Comes Into Play



Source: Bloomberg, BNZ

NZD/JPY: Due for some consolidation



Source: Bloomberg, BNZ

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