16 June 2017

NZD Corporate FX Update

- The strong recovery in the NZD against all the majors over the past month corrects the pricing anomaly seen earlier in the year. A period of consolidation is now due.
- Our projection for the NZD to head down to USD 0.67 over the next 3-6 months is contingent on a rebound in US inflation that keeps the Fed on course to normalise policy.

What a difference a month makes. After earlier puzzling over NZD weakness in the face of strong fundamentals such as high risk appetite and rising NZ commodity prices, the NZD has staged a strong recovery. It remains below our short term fair value model estimate of USD 0.75 but we aren't banking on the NZD making further gains. The NZD is close to key technical resistance levels and we think some consolidation is now due.

Our projection of the NZD falling to 0.67 over the next 3-6 months relies heavily on a positive turnaround in the US data flow, namely higher inflation. Over the past few months the NZD has proven to be highly correlated with US Treasury yields and less correlated with the usual drivers. Stronger US data would keep the Fed on track to raise rates further and support a recovery in the USD. This in turn acts like a tightening in global financial conditions, reducing the global growth outlook, risk appetite and commodity prices, all NZD-negative factors.

US inflation indicators and the Fed are expected to be the key drivers of the NZD outlook for the rest of the year. Recent soft US inflation data challenges our view that the USD will soon recover, but it's a view we're still sticking with at this juncture.

By contrast, NZ monetary policy will take the back seat, with the RBNZ's clear policy guidance that rates won't be changing for a long time. A story of potentially higher NZ rates will likely have to wait until next year.

Looking at the technical picture, the NZD struggled to break 0.7500 in September. After falling, it then struggled to break 0.7400 in November. After falling, it then struggled to break 0.7350 in February. And after falling again, it only briefly breached 0.73 this week before settling lower. Despite the recent recovery, we see the NZD as being still in the midst of a downward trend this year.

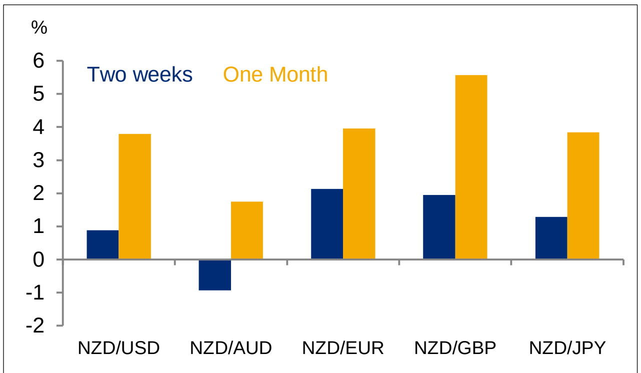
Importers should actively consider hedging around current levels. Exporters likely topped up cover through March-May when the NZD was under pressure and can afford to be more patient and await better re-entry opportunities over the next few months.

BNZ Foreign Exchange Forecast Summary

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	NZD/CNY
Current	*0.72*	*0.95*	*0.65*	*0.56*	*80*	*4.90*
Sep-17	0.67	0.94	0.60	0.54	78	4.66
Dec-17	0.67	0.96	0.59	0.54	79	4.67
Mar-18	0.68	0.96	0.59	0.54	81	4.73
Jun-18	0.68	0.97	0.59	0.54	82	4.79
Dec-18	0.69	0.99	0.58	0.57	84	4.88
Jun-19	0.71	1.00	0.59	0.57	84	4.98
Dec-19	0.73	1.00	0.59	0.57	83	5.04
	AUD/USD	**EUR/USD**	**USD/JPY**	**GBP/USD**	**USD/CNY**	**TWI**
Current	*0.76*	*1.11*	*111*	*1.28*	*6.80*	*77.8*
Sep-17	0.71	1.11	116	1.23	6.96	75.1
Dec-17	0.70	1.13	118	1.25	6.97	75.3
Mar-18	0.70	1.15	120	1.26	7.00	75.7
Jun-18	0.70	1.15	120	1.25	7.05	75.7
Dec-18	0.70	1.19	122	1.22	7.07	76.7
Jun-19	0.71	1.20	118	1.25	7.02	78.3
Dec-19	0.73	1.23	114	1.27	6.90	78.8

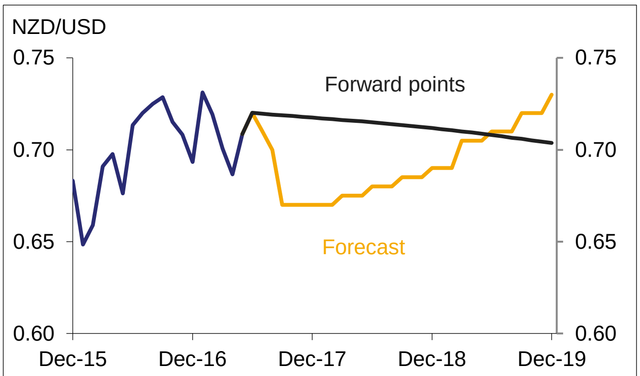
Source: BNZ, Bloomberg

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 strong NZD recovery sees the cross now more in line with our short term fair value model estimates of AUD 0.94-95. Our projections show the cross hovering around the 0.95 level for the rest of the year, so for exporters a buy on dips strategy remains appropriate. We still see the medium-term bias being one of upward pressure. This is based on our view that NZ faces increased capacity pressures in the economy relative to Australia, ultimately leading to the RBNZ tightening policy ahead of the RBA. Furthermore, we prefer the outlook for soft commodities over hard commodities and that should support the cross over the next 1-2 years.

NZD/GBP: The UK election result of a hung Parliament was a shock and only adds to the uncertainty about the outlook, with a weak minority government an added risk. That said, the pursuit of a "softer" Brexit stance by the new government has given hope for some that come March 2019 there'll be no cliff-like scenario on trade policy. Still, 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. We still expect a hard line to be pursued by EU negotiators. Real wages in the UK are falling as the weak GBP pushes up inflation, not a positive sign for consumer spending. Uncertainty should hold back investment, adding to a weak economic backdrop. Exporters should continue to budget for the historically high NZD/GBP cross rate continuing for an extended period.

NZD/EUR: With euro-area political risk no longer in the spotlight and ECB policy at a turning point, we are bullish on EUR, and expect NZD/EUR to face some downside pressure. ECB policy has been instrumental in holding down rates and the euro, so a gradual backing away from this policy stance is significant. Rate hikes are still a distant prospect, but within a few months we expect the ECB to outline plans to taper its asset purchase programme. Some sort of euro-area "taper-tantrum" can't be ruled out sometime over the next six months. Our forecasts show a sub EUR 0.60 rate later in the year, although the usual caveats apply around timing. Next year, Italian elections become a source of significant political risk and could disrupt our view, but at this stage we just flag this risk.

NZD/JPY: We fundamentally don't like the yen as the BoJ is far, far away from meeting its inflation target. Any monetary policy normalisation remains a distant prospect. Money printing required to keep rates at zero might well slow, but should still be ample enough to keep the yen depressed, particularly if we're right that global bond yields face upward pressure. Exporters should be looking to buy on dips in the cross in the high-70s.

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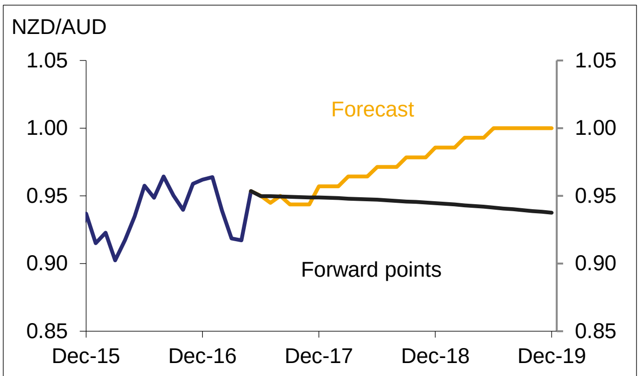
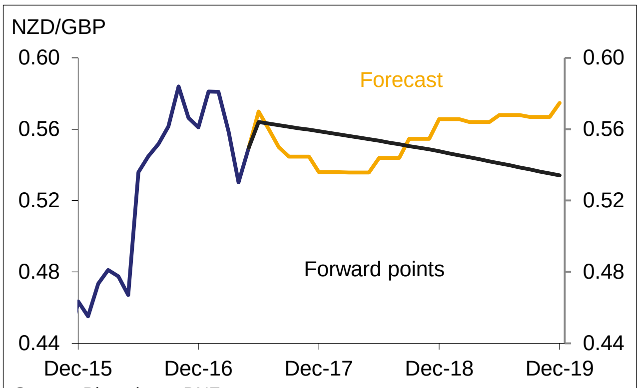
NZD/AUD: Flat, Before Upside Bias Resumes



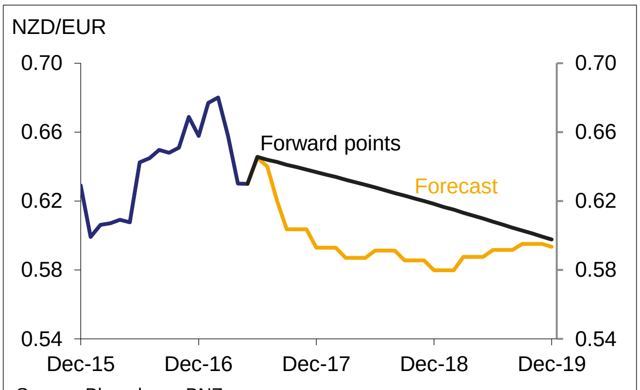
Source: Bloomberg, BNZ

NZD/GBP: Remaining At Elevated Historical Levels



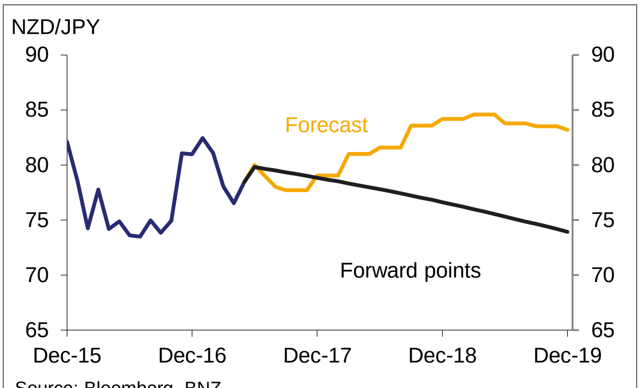
Source: Bloomberg, BNZ

NZD/EUR: Lower by Year-End as ECB Comes Into Play



Source: Bloomberg, BNZ

NZD/JPY: Flat, with an Upside Bias



Source: Bloomberg, BNZ

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