RESEARCH

Corporate FX Strategy

20 June 2018

NZD Corporate FX Update

- We've shaved a couple of cents off our Q3 target to 0.6850, the middle of the support zone seen over the past eighteen months. Our downgrade reflects a number of current global headwinds for the NZD.
- Our year-ahead forecasts remained pitched around the 0.70-0.71 mark.

We have become a bit more cautious about the near term outlook for the NZD. The USD recovery that began mid-April might have more legs, with the US economy showing more growth momentum, and we have increased conviction that the Fed will continue along its path of gradually raising the Fed Funds rate.

A stronger USD acts like a tightening in global financial conditions and this is having a negative impact on emerging markets, with some spillover into commodity currencies like the AUD and NZD. In China, a weaker credit impulse and signs of weaker growth momentum are also evident, hindering the outlook for commodity prices and currencies should these trends persist.

Stronger NZ commodity prices and still-high levels of risk appetite have supported a 0.71-0.72 range for our short-term fair value model estimate for much of this year, offsetting the negative impulse from higher interest rates in the US versus NZ. Those support factors could easily give way should the global growth outlook deteriorate. US-China trade tensions have escalated recently, with the imposition of import tariffs by the US and immediate retaliatory action from China. The direct impact of this on growth and inflation is negligible at this stage, but a further escalation of tensions would be a negative factor for the NZD.

The 0.68-0.69 support area in place for the past eighteen months looks vulnerable over the short term. As a result of the global factors above, we've shaved two cents off our end-Q3 target to the mid-point of the support zone at 0.6850 but left our year-end target at 0.70 at this stage. A break of support would open the floodgates to a bigger push lower, but that is more a risk than our central forecast.

Looking at domestic factors, RBNZ monetary policy remains unsupportive for the NZD, with core inflation remaining below target. Easier fiscal policy and higher farm incomes support GDP growth over the coming year.

Despite our near-term downgrade to the NZD, at a current bottom-of-the-range level, it would be prudent for exporters to add to cover for those who are under-hedged. Given our near-term outlook, for importers it looks a real stretch to see a quick return to levels seen earlier this year of above 0.72.

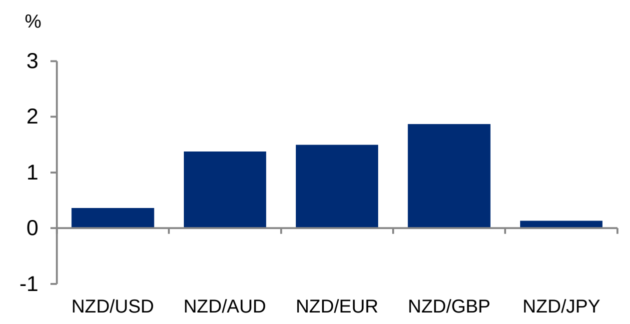
BNZ Foreign Exchange Forecast Summary

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	NZD/CNY
Current	*0.69*	*0.94*	*0.60*	*0.52*	*76*	*4.46*
Sep-18	0.69	0.94	0.60	0.52	75	4.45
Dec-18	0.70	0.93	0.59	0.51	77	4.48
Mar-19	0.70	0.93	0.57	0.48	76	4.34
Jun-19	0.71	0.94	0.58	0.48	75	4.42
Sep-19	0.71	0.94	0.57	0.46	74	4.42
Dec-19	0.70	0.93	0.54	0.45	71	4.37
Mar-20	0.70	0.93	0.53	0.45	70	4.38
Jun-20	0.69	0.93	0.52	0.44	68	4.32
Sep-20	0.69	0.93	0.51	0.43	68	4.33
Dec-20	0.68	0.93	0.49	0.43	67	4.27

	AUD/USD	EUR/USD	USD/JPY	GBP/USD	USD/CNY	TWI
Current	*0.74*	*1.16*	*110*	*1.33*	*6.44*	*73.7*
Sep-18	0.73	1.15	109	1.32	6.50	73.4
Dec-18	0.75	1.18	110	1.38	6.40	73.8
Mar-19	0.75	1.22	108	1.45	6.20	72.6
Jun-19	0.75	1.22	106	1.47	6.23	73.2
Sep-19	0.75	1.25	104	1.53	6.23	72.8
Dec-19	0.75	1.30	102	1.55	6.24	71.5
Mar-20	0.75	1.32	100	1.55	6.25	71.3
Jun-20	0.74	1.34	99	1.57	6.26	70.3
Sep-20	0.74	1.36	98	1.60	6.28	70.1
Dec-20	0.73	1.38	98	1.60	6.28	69.3

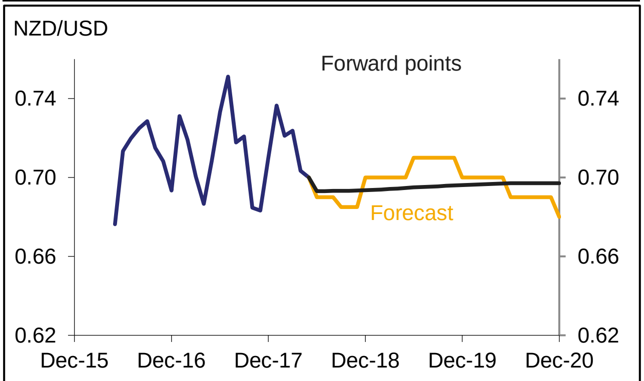
Source: BNZ, Bloomberg

NZD – Changes Over The Past Month



Source: BNZ, Bloomberg

NZD/USD: Flat, in line with forwards

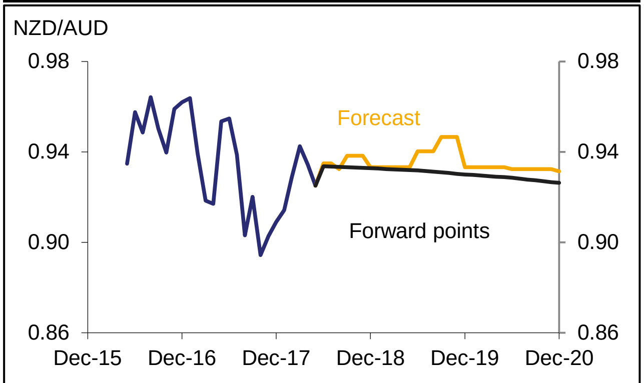


Source: Bloomberg, BNZ

The Crosses

NZD/AUD: We continue to see the cross rate anchored between 0.90-0.95 over the foreseeable future, presenting good opportunities for hedging currency risk near the ends of this range and during brief skirmishes outside the range. A projected 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. Oscillations in the cross are more likely to reflect short-term movements in relative commodity prices and short term gyrations when headlines appear about emerging market and China risks (e.g. US-China trade war developments), with the AUD more threatened by such negative headlines than the NZD.

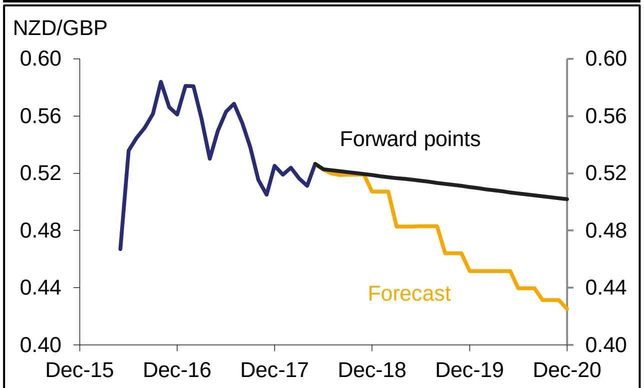
NZD/AUD: Range-Trading Around 0.90-0.95



Source: Bloomberg, BNZ

NZD/GBP: Brexit negotiations are not going well, not helped by a torn Conservative party. The first battle is for the UK government itself to agree on certain parameters, let alone get the EU on side and make progress on the exit. The Irish border issue remains a key stumbling block for progression. Ultimately we see common sense prevailing and a “soft” or delayed Brexit, and this argues for the discount still built into GBP being eventually eaten away, driving a lower NZD/GBP trend. BoE rate hikes should come back onto the radar later in the year when the soft patch in economic data passes, supporting GBP. Exporters can afford to keep hedging lighter than usual if we’re right.

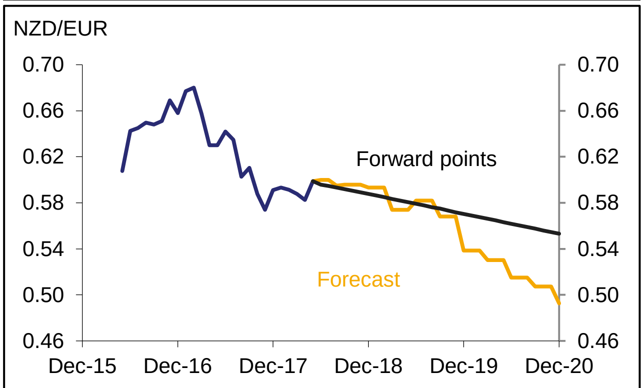
NZD/GBP: Medium-term Downward Pressure



Source: Bloomberg, BNZ

NZD/EUR: The ECB confirmed that the asset purchase programme will likely end this year but we were surprised to see that emergency policy rate settings, including the negative deposit rate, will remain in place until at least September 2019. This reduces our enthusiasm for EUR over the near term, delaying the renewed downtrend we previously saw for NZD/EUR. A pick-up in growth and inflation in the euro area would see sentiment for EUR improve, but to date economic momentum has been on the softer side of expectations. The range trading environment looks like continuing over the near term, but over the medium term we still see scope for the cross to revert to a downward trend.

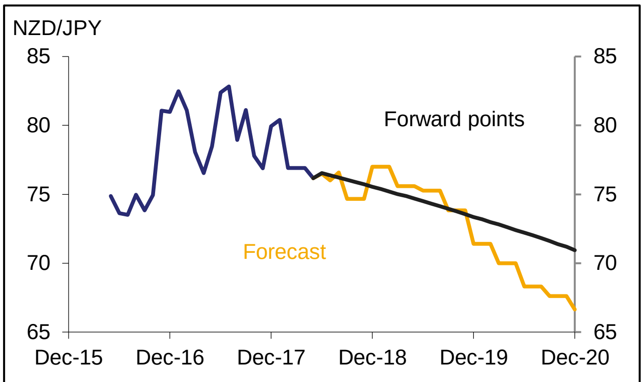
NZD/EUR: Range-Trade Before Downward Trend



Source: Bloomberg, BNZ

NZD/JPY: Our medium term outlook remains for a weaker NZD/JPY profile but strong support between 75-76 is proving to be a tough level to crack. We might have to wait until next year for a decisive, sustained, break lower. While the BoJ is doing less and less asset purchases, with inflation moving away from its 2% target the Bank seems committed to its super-easy policy stance, and is likely to be patient in reassessing its current yield curve control policy. This keeps the yen on the soft side, but periods of episodic strength when risk sentiment turns sour remain likely. While the timing of these are unpredictable, exporters and importers can take advantage of these swings when they occur.

NZD/JPY: Range-Trade Before Downward Trend



Source: Bloomberg, BNZ

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