19 March 2018

NZD Corporate FX Update

- **Our view that the NZD is on a medium-term depreciation path on most of the major crosses remains. Tighter global monetary policy is expected to ultimately lead to a softer global growth dynamic, lower commodity prices and weaker risk appetite, creating a slow-burning headwind for the NZD. Our year-end target remains at USD 0.70.**

Through 2018 so far, the NZD has met some resistance around 0.7440, with weaker risk appetite recently driving the NZD back down to 0.72, in line with our end-Q1 and Q2 targets set earlier this year. Trade protectionism has reared its ugly head again, following President Trump's imposition of import tariffs on various products including steel and aluminium. This theme is likely to continue into the second quarter, with Trump targeting a $100bn reduction in the US trade deficit with China. We have yet to see other countries retaliate, but if Trump continues down this path then some backlash seems inevitable. However, we still don't think that a full-on global trade war is likely and we see the real economic impact of what we would call tweaks to trade policy as limited.

While US trade policy is negative for market sentiment and by implication the NZD, the key macro factor behind our weaker NZD view for 2018 is a more fundamental shift down in risk appetite, as global monetary policy tightens and the world economic growth outlook moderates, albeit from a strong base. We still think this is a slow-burning headwind for the NZD through 2018.

NZ-US interest rate spreads remain on a declining path. Further Fed tightening still remains well on track, with upside risk to market pricing, while the RBNZ seems content to keep policy unchanged. The lack of any interest rate support for the NZD is likely to continue for some time yet.

The key risk to our negative NZD view is that a weaker USD trend re-emerges based on the significant deterioration in the US fiscal and current account outlook, the so-called twin deficits. Our underlying assumption is that NZD-negative forces dominate the negative USD-forces. If we're wrong, then the NZD could revisit and exceed last year's high of 0.7558 before the bigger global macro forces underlying our forecast kick in and send the NZD on a weaker path.

Based on our core view, we still think that an NZD above 0.73 would represent a good level for importers to be taking cover. The chance of dips below 0.70 might increase in the second half, but given our alternative scenario we wouldn't necessarily wait, and exporters should be actively looking at opportunities to take cover on any dips.

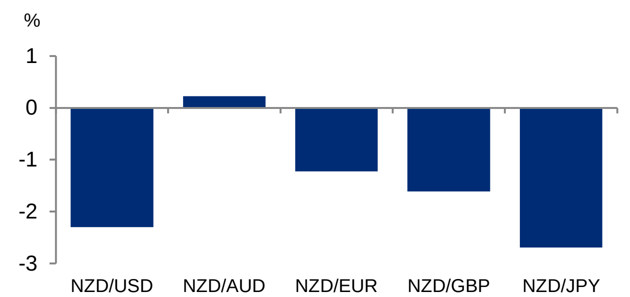
BNZ Foreign Exchange Forecast Summary

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	NZD/CNY
Current	*0.72*	*0.94*	*0.59*	*0.52*	*76*	*4.57*
Jun-18	0.72	0.92	0.56	0.50	75	4.50
Sep-18	0.71	0.92	0.55	0.49	73	4.40
Dec-18	0.70	0.93	0.54	0.48	71	4.33
Mar-19	0.70	0.93	0.55	0.48	71	4.34
Jun-19	0.71	0.93	0.56	0.49	71	4.42
Sep-19	0.71	0.94	0.56	0.49	71	4.42
Dec-19	0.70	0.93	0.54	0.48	69	4.37
Mar-20	0.70	0.93	0.53	0.48	69	4.38
Jun-20	0.69	0.93	0.52	0.47	68	4.32
Sep-20	0.69	0.93	0.51	0.47	68	4.33
Dec-20	0.68	0.93	0.49	0.46	66	4.27

	AUD/USD	EUR/USD	USD/JPY	GBP/USD	USD/CNY	TWI
Current	*0.77*	*1.23*	*106*	*1.39*	*6.34*	*74.6*
Jun-18	0.78	1.28	104	1.43	6.25	73.1
Sep-18	0.77	1.30	103	1.45	6.20	71.9
Dec-18	0.75	1.30	102	1.46	6.18	71.2
Mar-19	0.75	1.28	101	1.46	6.20	71.3
Jun-19	0.76	1.27	100	1.45	6.23	72.2
Sep-19	0.76	1.28	100	1.45	6.23	72.4
Dec-19	0.75	1.30	99	1.46	6.24	71.3
Mar-20	0.75	1.32	99	1.47	6.25	71.3
Jun-20	0.74	1.34	98	1.48	6.26	70.4
Sep-20	0.74	1.36	98	1.47	6.28	70.4
Dec-20	0.73	1.38	97	1.48	6.28	69.5

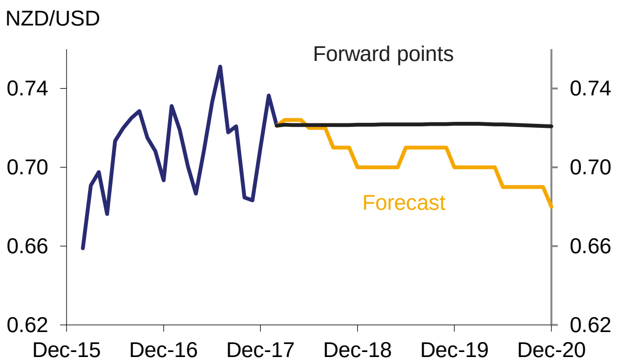
Source: BNZ, Bloomberg

NZD – Changes Over The Past Month



Source: BNZ, Bloomberg

NZD/USD: Modest Downside Risk



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. Relative commodity price movements (that oscillate and are difficult to predict) and sentiment ebbing and flowing with regards to a US trade war with China (negatively affecting AUD more than NZD) might well explain the week to week movements in the period ahead. 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.

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 soon, 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.

NZD/EUR: We continue to see potential for a lower cross rate, with a move 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: After upgrading our view on JPY earlier this year, we've made another significant upgrade, which takes our NZD/JPY forecast on an even more convincing downward path. Our thesis is that the yen remains super cheap in a long-run historical context. BoJ monetary policy has all but reached its physical limits. Going forward we expect the yen to be more influenced by economic fundamentals – such as growth relative to trend and its large current account surplus – than by BoJ policy. 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. Importers should consider lowering their target hedge levels to account for the possibility of a much weaker cross than accustomed to over the past 12 months.

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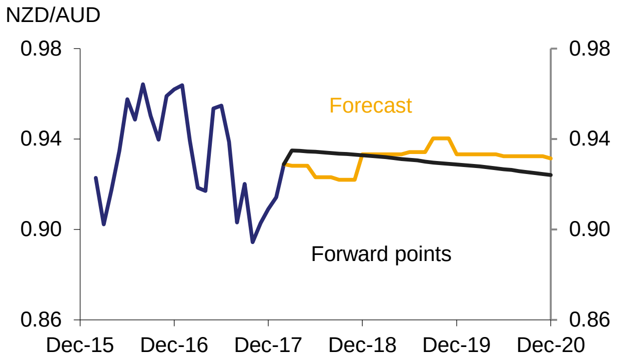
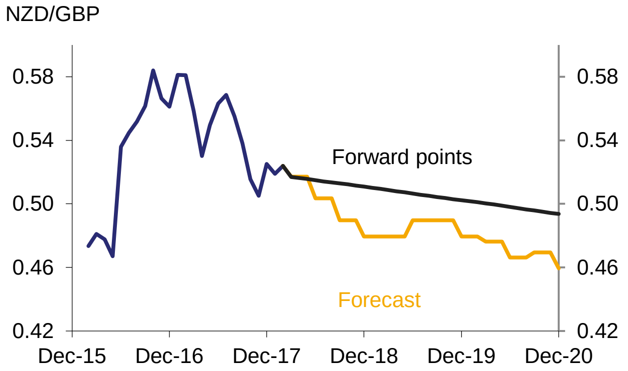
NZD/AUD: Range-trading Around 0.90-0.94



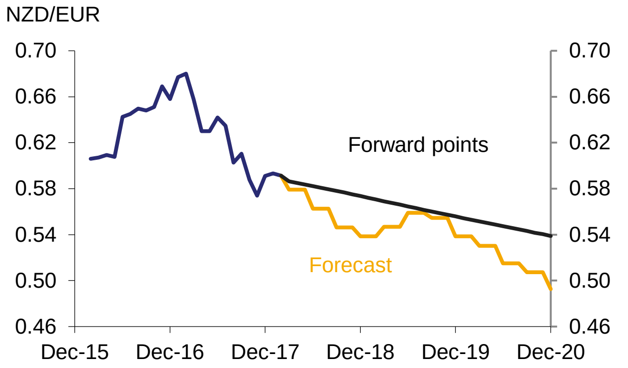
Source: Bloomberg, BNZ

NZD/GBP: Downward Trend to Continuue



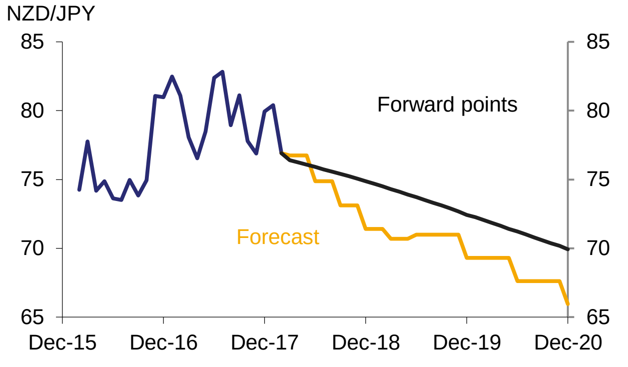
Source: Bloomberg, BNZ

NZD/EUR: Downward Trend to Continue



Source: Bloomberg, BNZ

NZD/JPY: Plenty of Downside Risk Ahead



Source: Bloomberg, BNZ

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