7 May 2018

NZD Corporate FX Update

- In the near term we see the NZD sustaining the recent move lower and doing a bit of work in the 0.70-0.72 area. We've already seen dips below 0.70 and they should become more frequent as the year progresses alongside the continuing gradual rise in NZD headwinds.

The NZD has fallen sharply since mid-April, likely exaggerated by a shake-out of net long speculative positioning over a period in which sentiment for the USD has improved. After spending much of the year stuck in a tight 0.72-0.74 range, our central view would be for the range to be a couple of cents lower nearer 0.70-0.72 over the next few months. This also happens to be the range our short-term fair value model estimate has been stuck in over the past few months, driven by the ebb and flow of risk appetite and NZ commodity prices. Obviously, if sentiment for the USD happened to improve further, then that would see a more sustained move below the 0.70 mark. But strong technical support is in a range of 0.68-0.69 and we think that level might be tough to crack.

NZ monetary policy won't be providing any support to the NZD over the foreseeable future. Indeed, the NZD lost its high-yield status some time ago and as the Fed Funds rate rises alongside a flat NZ OCR, the cost of carry for the NZD will continue to rise, representing an ever-increasing headwind. Forward points are no longer in exporters' favour, and over the next year or two hedging will become even costlier. The flipside is that importers can now cover at more attractive levels and these will improve (relative to prevailing spot).

The argument for the NZD to return to its high this year above 0.74 is one that requires the negative structural USD story based on its rising twin deficits to regain the spotlight. While we wouldn't rule that out, we see conventional macro forces as negative for the NZD and an offsetting factor. These include the reduced relative interest rate support for the NZD mentioned above and our big picture view on the global economic outlook. 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.

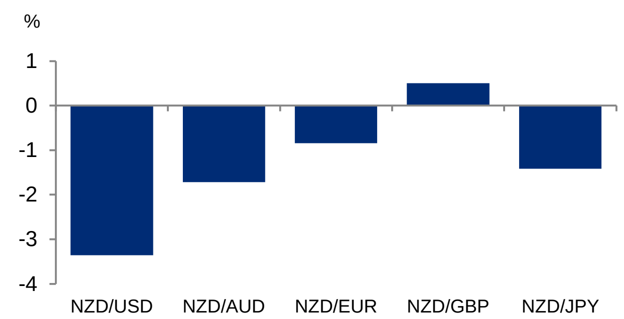
Our NZD/USD projections are fairly flat, reflecting these opposing dynamics. The recent stumble in the NZD provides an opportunity for exporters to top up on any hedging requirements. We see further such opportunities later in the year, but it would be prudent to take advantage of the recent dip. Importers would no doubt have topped up hedging at much better levels than present so can afford to wait for the next rally to sell into.

BNZ Foreign Exchange Forecast Summary

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	NZD/CNY
Current	*0.70*	*0.93*	*0.59*	*0.52*	*77*	*4.46*
Sep-18	0.71	0.92	0.58	0.50	78	4.40
Dec-18	0.70	0.93	0.56	0.48	76	4.33
Mar-19	0.70	0.93	0.56	0.47	74	4.34
Jun-19	0.71	0.94	0.56	0.47	74	4.42
Sep-19	0.71	0.95	0.56	0.46	72	4.42
Dec-19	0.70	0.93	0.54	0.45	70	4.37
Mar-20	0.70	0.93	0.53	0.45	69	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	66	4.27
	AUD/USD	**EUR/USD**	**USD/JPY**	**GBP/USD**	**USD/CNY**	**TWI**
Current	*0.75*	*1.20*	*109*	*1.35*	*6.36*	*73.5*
Sep-18	0.77	1.23	110	1.42	6.20	72.9
Dec-18	0.75	1.25	108	1.45	6.18	71.8
Mar-19	0.75	1.26	106	1.50	6.20	71.6
Jun-19	0.76	1.27	104	1.52	6.23	72.4
Sep-19	0.75	1.28	102	1.53	6.23	72.4
Dec-19	0.75	1.30	100	1.55	6.24	71.2
Mar-20	0.75	1.32	99	1.55	6.25	71.1
Jun-20	0.74	1.34	98	1.57	6.26	70.2
Sep-20	0.74	1.36	98	1.60	6.28	70.1
Dec-20	0.73	1.38	97	1.60	6.28	69.2

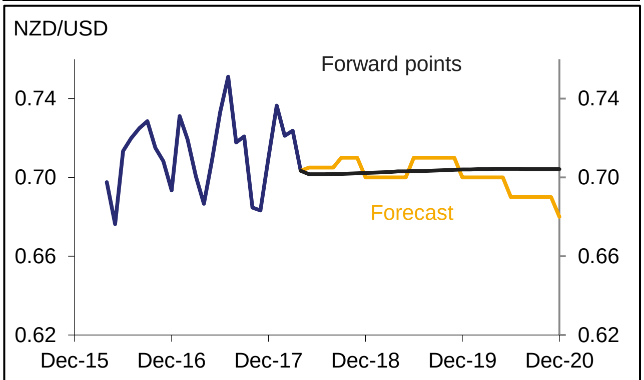
Source: BNZ, Bloomberg

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 0.90-0.94 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 China risks (recently US-China trade war developments), with the AUD more threatened by such negative headlines than the NZD.

NZD/GBP: GBP is expected to be in the driving seat, recovering from its depressed level when viewed in a medium-long term context. Brexit risks still seem to be pervading the headlines even though a transitional deal has been agreed in principle. But ultimately we see common sense prevailing and this argues for the discount still built into GBP being eaten away, driving a lower NZD/GBP trend. Expected BoE rate hikes have been nudged out after a weak patch of data, but should come back onto the radar later in the year, supporting GBP. Exporters can afford to keep hedging lighter than usual if we're right.

NZD/EUR: Despite some recent consolidation after last year's significant depreciation, 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: Our medium term outlook remains for a weaker NZD/JPY profile. 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. The cross also remains vulnerable to the downside on any major global risk-off event. A key support level is 76, which the cross has failed to convincingly break on at least six occasions over the past year or so. Our projections show a break of that level later in the year but the risk is that it comes sooner. Importers should lower target levels for hedging accordingly.

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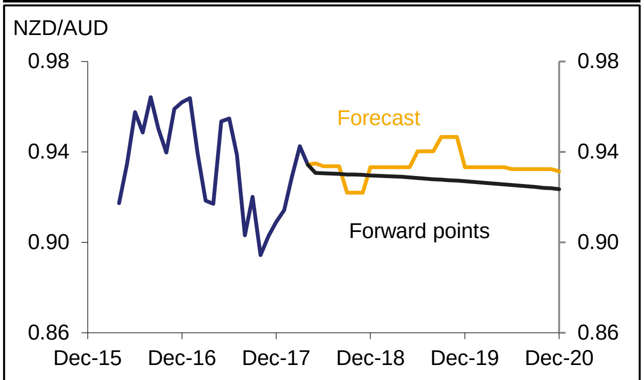
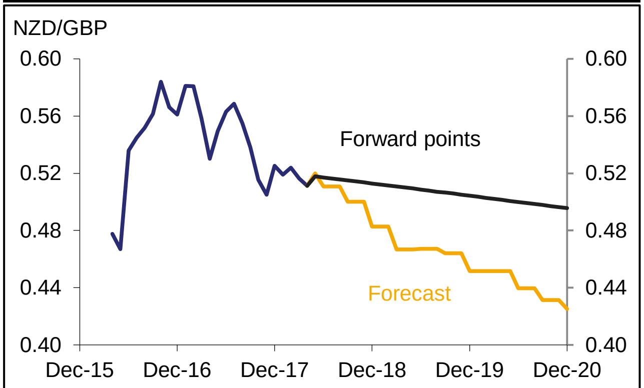
NZD/AUD: Range-trading Around 0.90-0.94



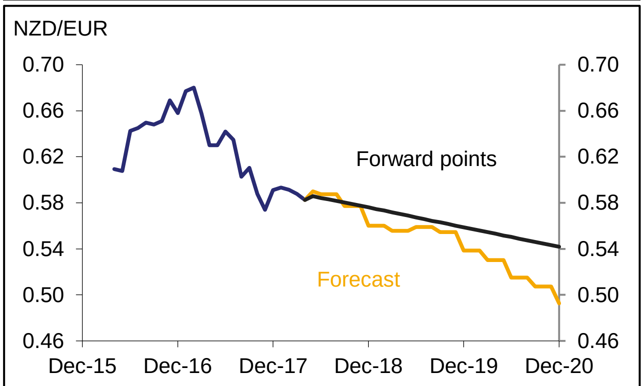
Source: Bloomberg, BNZ

NZD/GBP: Downward Trend to Continue



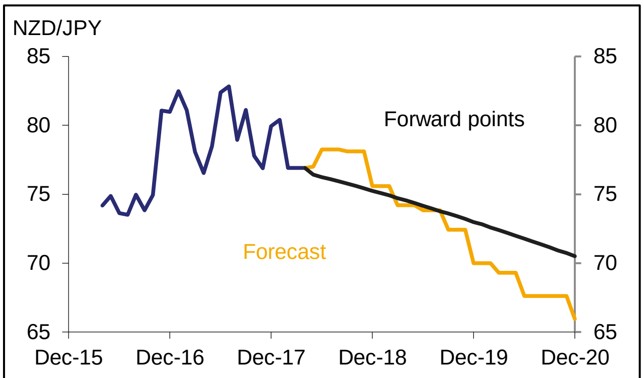
Source: Bloomberg, BNZ

NZD/EUR: Downward Trend to Continue



Source: Bloomberg, BNZ

NZD/JPY: Plenty of Downside Risk Ahead



Source: Bloomberg, BNZ

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