NZD Corporate FX Update

- We upgrade our NZD forecasts, now seeing it drift higher, rather than lower, and anchored around 0.65 through to the middle of next year.

The NZD has been in a consolidation phase over the past couple of months, with support/resistance defined by 0.6200-0.6455. In recent research we have suggested the makings of a recovery are there for the NZD, given the reduction in global risks overhanging the market. We have modestly upgraded our projections for the NZD through the next 12 months to reflect the improving balance of risks.

Our previous forecasts had imbedded an ongoing US-China trade war and USD/CNY heading up to 7.40. The move towards a “Phase 1” agreement on US-China trade has seen the yuan supported and we no longer see the threat of further yuan depreciation. Given the strong link between NZD/USD and USD/CNY since the trade war began early last year, a stronger yuan assumption naturally flows through into an upgraded NZD outlook. Rather than see the NZD drift lower, our new projections over the next few quarters are anchored around 0.65.

The market is rightly sceptical that the Phase 1 trade agreement won’t necessarily end the US-China trade war, but a prolonged truce removes a key negative force overhanging the market. Reducing risks of a no-deal Brexit and the US yield curve (2s10s) steepening are two additional global factors that ought to support risk currencies like the NZD.

Global economic momentum indicators such as PMIs point to tentative evidence that global growth might be at an inflexion point and the worst is over. The NZD is sensitive to the global growth cycle and if global growth is truly past its nadir, then the low in the NZD might also have passed.

Further encouraging us to upgrade our NZD outlook is that the currency is looking rather cheap on our short-term fair value model. Our model estimate bottomed around 0.65 in August and has pushed up to above 0.68, driven by higher risk appetite and higher NZ commodity prices. We don’t expect a complete bridging of the gap, but the model tells us how much bad news is already priced into the NZD.

The forecast upgrade does not change our thoughts on hedging. At current low NZD levels, exporters should be attune to locking in some forward cover while importers should keep hedging short, ahead of potentially better NZD levels.

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The Crosses

NZD/AUD:
With a similar upgrade to AUD projections, we haven’t changed our view on the cross, seeing it anchored around 0.93-0.94, close to our current fair value estimate. Similarities between the NZ and Australian economies outweigh the differences, with both countries on track to experience a period of sub-trend growth. With risks around monetary policy the same, we expect interest rate differentials to remain range-bound. Exporters should look to lock in some cover on any forays below 0.92. Importers have had ample opportunity to lock in cover above 0.95 this year and any move towards that level should attract some forward cover.

NZD/GBP:
The odds of really bad outcomes for GBP have reduced considerably and focus now turns to the 12 December election. Our base case is that Boris Johnson wins enough seats to push through with a soft Brexit before the new 31 January Brexit date. However, other scenarios are possible, including another referendum and no Brexit. We think GBP can make further gains, keeping downside pressure on the cross. But exporters and importers still need to tread carefully as there are still a number of permutations, even if many suggest GBP can recover further.

NZD/EUR:
The worst might well be over for the euro-area economy, even if the growth outlook still looks fairly sluggish. It remains to be seen how new ECB President Lagarde approaches the role and what her bias is towards negative interest rates and quantitative easing, creating some uncertainty at the next mid-December ECB meeting. We see EUR benefiting from positive GBP spillover effects. Improving sentiment for both NZD and EUR sees the cross rate fairly stable through the next year on our new projections. With the cross near the bottom of its 5-year range, exporters should look to lock in some cover at 0.57 or below, while we don’t see much scope for a return to above-0.60 levels that importers might hope to see.

NZD/JPY:
After a prolonged downturn, our new projections are consistent with the low point in the cross having already passed. With the cross still near multi-year lows, it would be prudent for exporters to continue to take cover and enjoy sub-70 levels while they last. Swings in risk appetite and US Treasury yields can result in some whipsawing in the cross rate over the short-term. Our projections are consistent with a sustained move back above 70, so importers might like to keep hedging cover light at present.

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