31 October 2018

bnz

NZD Corporate FX Update

- **Our forecasts show the NZD hovering around 0.65 through the next six months, but we aren't confident enough to declare the downward trend of the past six months over. Much bad news is priced in but the global macro backdrop is challenging.**

The NZD has been in a downward channel since April, making fresh lows each month. The early-October low of 0.6425 had held but the NZD still isn't out of the woods yet, with threats to the downside still lingering.

On a positive note, the NZD has held up well recently considering the pummelling seen in global equity markets and the fall in risk appetite. At the end of last week, our risk appetite index fell to its lowest level in nearly two years, helping close the gap between spot and our fair value estimate (0.6660) to a statistically insignificant 2%. The NZD's resilience might reflect some closing of short positions, although there has been scant evidence of that in the weekly CFTC commitment of traders' reports, where short NZD positioning remains historically elevated. One might therefore be tempted to conclude that selling pressure on the NZD seen over the past six months has drawn to a close.

A more convincing explanation for reduced selling pressure on the NZD is the better support seen for emerging market currencies – the NZD has closely followed JP Morgan's emerging market FX index all year. We see the biggest threat to the downside for the NZD coming from a speculative attack on CNY, and increased capital outflows from China that spill over into a weaker NZD. A further round of tariff increases imposed by the US on Chinese imports from 1 January and the potential of more tariffs through 2019 would add to this risk for the yuan and NZD.

Domestic forces are mixed. NZ's terms of trade are weakening and NZ's current account deficit is on a path towards 4^{+}% of GDP, as import growth outstrips exports. More positively, there has been no corroborating evidence of weaker business confidence spilling over into actual weaker activity. On the contrary, hard economic activity data have positively surprised over the past month or so. Inflation is running stronger than the RBNZ previously projected, reducing the chance of any further rate cuts this cycle, not that we thought that likely anyway. Still, RBNZ rate hikes remain a distant prospect and NZ rates are falling further behind US rates as time goes on and this remains a clear headwind for the NZD.

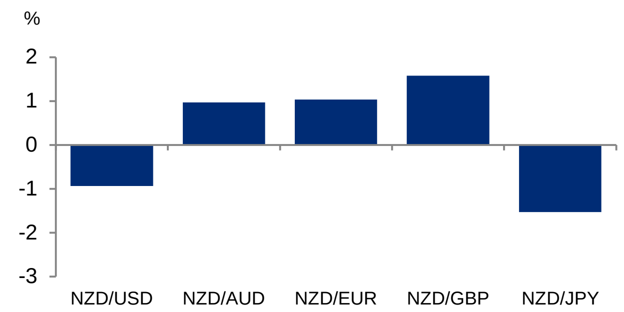
Our forecasts are consistent with a fairly steady NZD over the next six months. On our projections, importers are unlikely to see a return to more attractive hedging levels above 0.70 through the next 6-12 months. Exporters can afford to be patient in locking in forward cover.

BNZ Foreign Exchange Forecast Summary

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	NZD/CNY
Current	*0.66*	*0.93*	*0.58*	*0.52*	*74*	*4.57*
Dec-18	0.65	0.91	0.55	0.51	73	4.46
Mar-19	0.65	0.90	0.54	0.51	72	4.62
Jun-19	0.66	0.90	0.54	0.51	73	4.75
Sep-19	0.68	0.91	0.54	0.51	73	4.90
Dec-19	0.69	0.92	0.53	0.49	73	4.93
Mar-20	0.70	0.92	0.53	0.49	73	4.97
Jun-20	0.70	0.91	0.52	0.48	71	4.90
Sep-20	0.70	0.92	0.52	0.47	70	4.83
Dec-20	0.69	0.92	0.50	0.45	68	4.69
	AUD/USD	**EUR/USD**	**USD/JPY**	**GBP/USD**	**USD/CNY**	**TWI**
Current	*0.71*	*1.13*	*113*	*1.27*	*6.97*	*72.4*
Dec-18	0.71	1.18	112	1.26	6.90	70.8
Mar-19	0.72	1.20	110	1.28	7.10	71.4
Jun-19	0.73	1.22	110	1.30	7.20	72.6
Sep-19	0.75	1.25	108	1.34	7.20	74.1
Dec-19	0.75	1.30	106	1.40	7.15	74.5
Mar-20	0.76	1.32	104	1.43	7.10	74.9
Jun-20	0.77	1.34	102	1.46	7.00	74.0
Sep-20	0.76	1.36	100	1.49	6.90	73.5
Dec-20	0.75	1.38	99	1.52	6.80	72.1

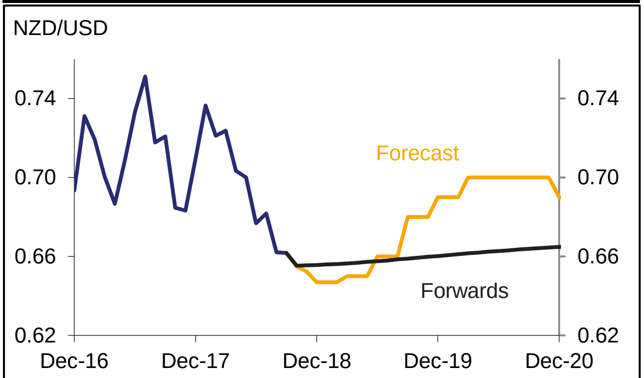
Source: BNZ, Bloomberg

NZD – Changes Over The Past Month



Source: BNZ, Bloomberg

NZD/USD: Anchored around 0.65 for Next 6 Months



Source: Bloomberg, BNZ

The Crosses

NZD/AUD: The near-term threat of moving sub-0.90 has evaporated, given the sharp reversal in oil prices downwards after a blistering run up. We're also detecting some increased attention on Australia's vulnerable housing market – the risk that lower house prices pose for households, given their high debt levels. With downside threat to the cross reduced, the 0.90-0.95 range will likely continue to hold. We have no strong view on the relative economic performance between the NZ and Australian economies, with both expected to grow close to trend, and both central banks keeping policy on hold for the foreseeable future. We still see dips close to 0.90 as good levels for exporters to buy cover while 0.93-0.94 is a good level for importers to add to cover.

NZD/GBP: We continue to see a lower NZD/GBP track over the medium term, but the near-term picture remains highly uncertain. The risk of a no-deal Brexit has increased, and this outcome would likely spiral the UK into recession and see the cross back up to 0.55+. The other risk factor in the same direction is a challenge to PM May's leadership which ends up in fresh elections and a change to a Labour government with socialist tendencies. At the other extreme, a negotiated withdrawal agreement by the end of November or early December would be GBP supportive and see the cross visit fresh lows into the high 0.40s. Given the near-term binary outlook it would be prudent for exporters and importers to hedge known cashflows and avoid open FX positions if possible.

NZD/EUR: Some softer economic data, Italian Budget woes and the lack of any Brexit withdrawal agreement have been recent headwinds for the euro. We see these factors as temporary and maintain our view that over the medium term the bias will be for the cross to drift down further. The ECB's asset purchase programme ends this year and through next year the focus will turn to the first post-GFC ECB rate hike, most likely towards the back end of the year. We see some value in importers taking forward cover around technical resistance in a 0.58-0.5850 zone. Exporters might have to wait until next year for fresh lows to be made.

NZD/JPY: The yen remains the cheapest currency of the majors and has safe-haven characteristics in a more uncertain world and these remain the key attractions of the yen when thinking about the outlook for the coming year. The BoJ remains successful in keeping interest rates suppressed and the yen cheap, but we harbour doubts that this policy can be kept permanently in place. Over the medium term we see downward drift in the cross. Exporters should take advantage of lurches down in the cross during times of weaker risk appetite. Strong technical support is in place at 72.25. Blips higher in the cross when risk appetite improves provide opportunities for importers to take cover. For importers it might be prudent to lower target hedging levels down to 75-76.

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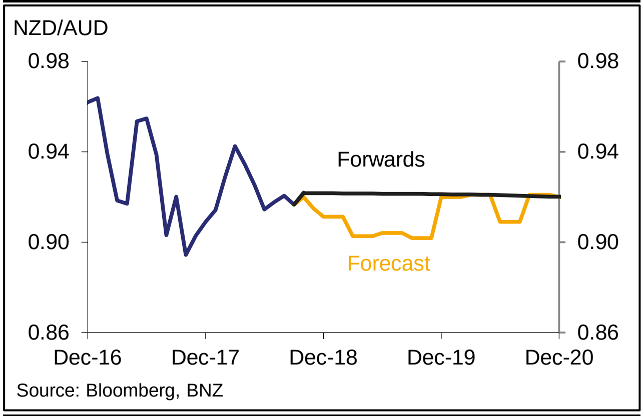
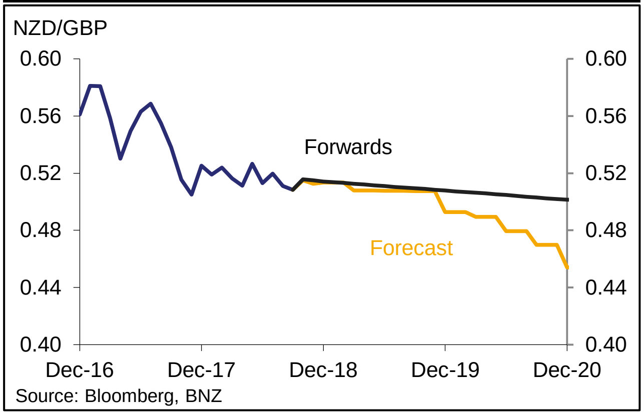
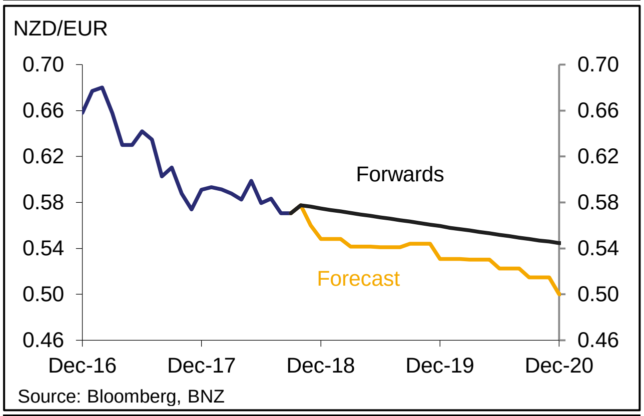
NZD/AUD: Range-Trading Around 0.90-0.94



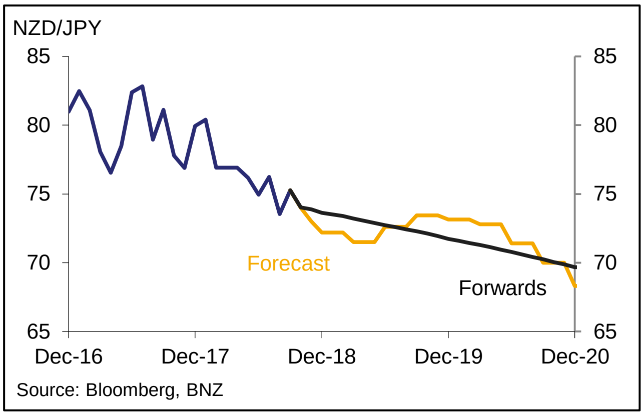
NZD/GBP: A Binary Near-Term Outlook; Bearish Med-term



NZD/EUR: Medium-term Downward Trend



NZD/JPY: A Downward Medium-Term Trend



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