NZD Corporate FX Update

- The NZD continues to face near-term headwinds, driven by weaker economic momentum both globally and domestically. It’s too early to be optimistic on any potential US-China trade “deal”, with the recent handshake agreement seen at this stage to be not much more than symbolising a truce.

The NZD has trended mostly lower over recent months and headwinds are likely to continue over the near term, although based on our projections the NZD’s downturn might be drawing to a close.

The 13th round of US-China trade talks ended with a handshake and path towards an interim deal that might well curb any further ramp-up in punitive tariffs. However any rollback of existing tariffs and progress on thornier issues looks unlikely at this stage. A truce that sees the maintenance of the status quo might be enough to prevent further yuan weakness which hitherto has been instrumental in dragging down the value of the NZD.

The NZD inevitably performs poorly during economic downturns and global economic momentum remains to the downside. Easier global monetary policy currently underway and a trade war truce might be enough to stabilise growth and even engineer a modest recovery, which explains our more positive NZD outlook for next year. Despite the soft global backdrop, NZ commodity prices are holding up well and are NZD-supportive.

Domestic factors remain largely NZD-negative, with low levels of confidence widely evident and GDP growth on a weaker, sub-trend path. Further RBNZ rate cuts look inevitable, although these are well-priced.

Our 3-6 month target for the NZD remains at 0.6150, with two-sided risks, mainly emanating from the global economic outlook. If economic growth momentum remains to the downside and the trade war re-escalates then that would raise the chance of a sub-0.60 handle for the NZD seen typically under global recession-like conditions. On the positive side, more encouraging developments in the trade war and a turnaround in global growth would inject some life into the NZD and at the same time trigger a broadly-based reversal in the USD, adding to potential NZD/USD gains.

At current depressed levels exporters should be attune to locking in some forward cover. Importers should keep hedging short, ahead of potentially better NZD levels next year.

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BNZ Foreign Exchange Forecast Summary

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Source: BNZ, Bloomberg

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NZD – Changes Over the Past Month/Quarter

1-month 3-months

Source: BNZ, Bloomberg

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NZD/USD: Nearing a potential trough

Source: Bloomberg, BNZ
The Crosses

NZD/AUD:
Our current fair value estimate is around 0.93, which is where our projections through the next 12 months are anchored. Similarities between the NZ and Australian economies outweigh the differences, with both countries on track to experience a period of sub-trend growth and easier monetary policy. RBA policy moves likely form part of the RBNZ’s reaction function, keeping rate differentials in check. 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. Breaching that level again soon is looking like a stretch so importers should look to reduce target levels for any future hedging.

NZD/GBP:
The odds of really bad outcomes for GBP have reduced considerably and both the UK and EU are looking keen to lock in a Brexit deal, either by month-end or with a short delay. Given the recent volatility in GBP and range of permutations, we’ll await more clarity before changing our projections, but under a soft Brexit deal, our fair value estimate for the cross is in the high 0.40s. Exporters and importers need to continue to tread carefully until a final UK/EU agreement has been reached.

NZD/EUR:
The euro-area economy is under pressure, with Germany on the verge of economic recession. Rising speculation of some much-needed fiscal expansion is welcome, but isn’t expected to be timely or significant enough to materially change the outlook. That leaves the burden of stimulus on the ECB, which will deliver further policy easing, but is ultimately limited by the policy constraints it faces with its bloated balance sheet and already-negative deposit rate. That said, the weaker NZD has predominated and already driven the cross close to our target level of 0.56, so further downside is limited. Exporters shouldn’t be shy to lock in some cover with the cross near its 5-year low. Importers should take advantage of any rallies that take the cross close to 0.60.

NZD/JPY:
We don’t have a lot of conviction in our projections, which see a bit more downside potential over the short term before recovering. With the cross near multi-year lows, it would be prudent for exporters to take some cover. Swings in risk appetite and US Treasury yields can result in some whip sawing in the cross rate over the short-term. Importers might need to reduce target hedging levels, with a return to 73+ looking like a stretch over the short-term. The BoJ has hinted of further policy easing but its policy options are limited, with negative rates not particularly helpful for the trading banks and their incentives to lend.

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