20 September 2018

NZD Corporate FX Update

- **The NZD might have found a floor around 0.65 over the near-term as Trump's move on tariffs was more moderate than feared. That said, the risk of further escalation of US-China trade tensions remains a real threat and there are enough headwinds to limit any significant NZD recovery.**

The NZD's trend over recent months has looked ominous, with fresh lows made in May, July, August and September. The most recent low near 0.6500 came ahead of President Trump's decision on further Chinese import tariffs, a threat that has overhung the NZD over the past couple of months. In the event, the more moderate than expected 10% tariff rate to be imposed on a further $200b of Chinese imports was less than half of the possible 25% mooted, and this has provided some near-term support for the NZD.

The immediate threat of a further lurch down to 0.63-0.64 has now past, although that could come back onto the radar early next year if Trump proceeds with the 25% tariff rate from 1 January and slugs the market with hefty tariffs on the remaining $250b+ of Chinese imports. The outcome of the early-November mid-term US elections and Trump's behaviour after Republicans (more likely than not) lose their majority in the House becomes the next key focus for the market, ahead of possible Xi-Trump talks in late November.

A slump in NZ business confidence this year got the market's attention and played a role in the RBNZ's more dovish than expected stance at the August MPS. However, Q2 GDP growth was the strongest in two years and provided no evidence to support the notion that the economy has hit a pothole. Weak business surveys might well indicate where the balance of risk lies regarding the economy but have so far proven to be an unreliable steer on actual activity.

An economy tracking much stronger than the RBNZ thought reduces the chance of rate cuts over the near-term, a probability we had already thought to be quite low. But the market still prices in a chance of rate cuts over the next year, and we'd expect this to be priced out of the curve over time. That said, a series of further Fed rate hikes will keep NZ-US rate spreads under pressure and remain a key headwind for any NZD recovery.

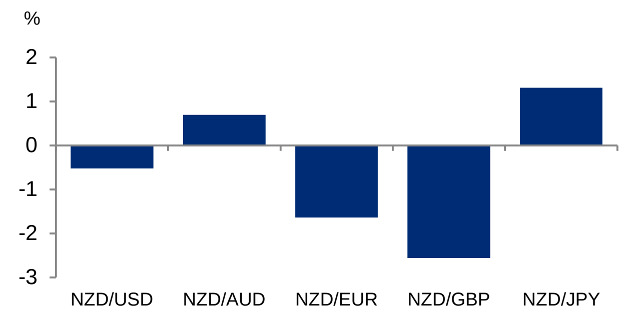
The NZD continues to trade at a discount to our short-term fair value model estimate, which recently slipped below the 0.70 mark. We expect fundamental forces to keep weighing on that model estimate and our NZ forecasts continue to be pitched around the 0.68 mark through the next six months. Another way of expressing this is to suggest that the NZD will remain anchored in a 0.65-0.70 zone until further notice.

BNZ Foreign Exchange Forecast Summary

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	NZD/CNY
Current	*0.66*	*0.92*	*0.57*	*0.51*	*75*	*4.55*
Dec-18	0.68	0.91	0.58	0.54	75	4.59
Mar-19	0.68	0.91	0.56	0.53	73	4.56
Jun-19	0.69	0.92	0.57	0.53	73	4.59
Sep-19	0.69	0.92	0.55	0.52	72	4.49
Dec-19	0.69	0.92	0.53	0.49	70	4.45
Mar-20	0.70	0.93	0.53	0.49	70	4.48
Jun-20	0.69	0.93	0.52	0.47	68	4.42
Sep-20	0.68	0.92	0.50	0.46	67	4.35
Dec-20	0.67	0.92	0.49	0.44	66	4.29
	AUD/USD	**EUR/USD**	**USD/JPY**	**GBP/USD**	**USD/CNY**	**TWI**
Current	*0.73*	*1.17*	*112*	*1.31*	*6.85*	*72.2*
Dec-18	0.75	1.18	110	1.26	6.75	72.9
Mar-19	0.75	1.22	108	1.28	6.70	72.1
Jun-19	0.75	1.22	106	1.30	6.65	72.6
Sep-19	0.75	1.25	104	1.34	6.50	71.9
Dec-19	0.75	1.30	102	1.40	6.45	71.3
Mar-20	0.75	1.32	100	1.43	6.40	71.9
Jun-20	0.74	1.34	99	1.46	6.40	70.9
Sep-20	0.74	1.36	98	1.49	6.40	69.6
Dec-20	0.73	1.38	98	1.52	6.40	68.7

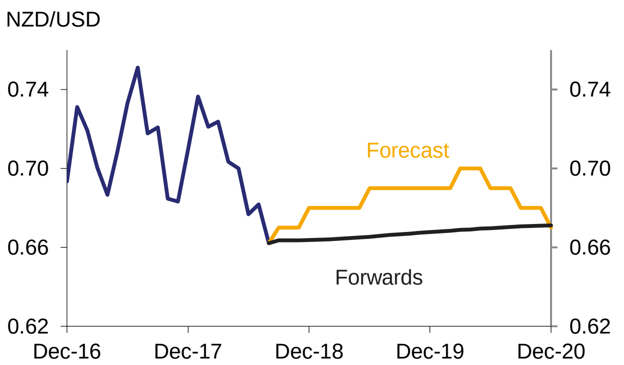
Source: BNZ, Bloomberg

NZD – Changes Over The Past Month



Source: BNZ, Bloomberg

NZD/USD: Forecasts Stuck in a 0.65-0.70 Zone



Source: Bloomberg, BNZ

The Crosses

NZD/AUD: We continue to see the cross rate anchored between 0.90-0.95 over the foreseeable future. Short-term gyrations are most likely to be caused by relative hard versus soft commodity price movements and sentiment prevailing over emerging market currencies and China, something the AUD is more glued to than the NZD. 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. This argues for a range-bound cross rate. We still see dips close to 0.90 and below as good levels for exporters to buy cover.

NZD/GBP: The market has recently taken a more optimistic view on Brexit negotiations that leaves our near-term GBP projections somewhat exposed, but there is still a lot of water to go under the bridge. A range of scenarios, encompassing a no-deal Brexit or soft-Brexit, remain entirely possible. Furthermore, a political and constitutional crisis with a fresh general election also cannot be ruled out. Given the binary outlook – which comes to a head over the next six months – it would be prudent for exporters and importers to hedge known cashflows and avoid open FX positions if possible. We see a lower NZD/GBP track over the medium term, but the near-term picture remains highly uncertain.

NZD/EUR: After recently reaching a multi-year low, we might see a relief rally over the short term. The 0.56 level might provide some near-term support and it would be prudent for exporters, who haven't done so already, to lock in some forward cover. That said, ultimately we see the cross continuing to trend lower. 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. If we do get a near-term bounce, importers shouldn't hesitate to take some cover, as it's probably a stretch to see the cross return to a 0.60 handle anytime soon.

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. At some stage global risk appetite is likely to move down and NZD/JPY is correlated to this dynamic. Thus, our medium term outlook remains for a weaker NZD/JPY profile. Exporters can afford to keep cover lighter than usual while importers should use any significant rallies, which pop up from time to time, to take cover.

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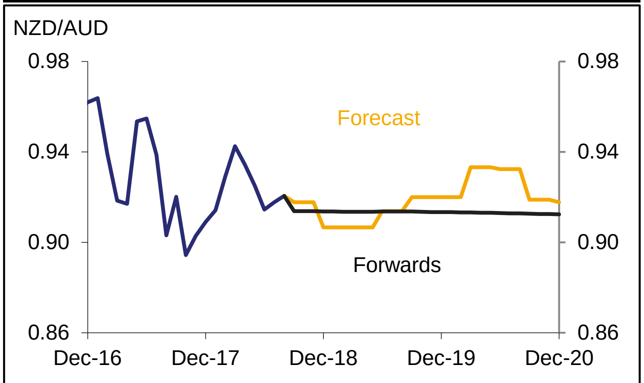
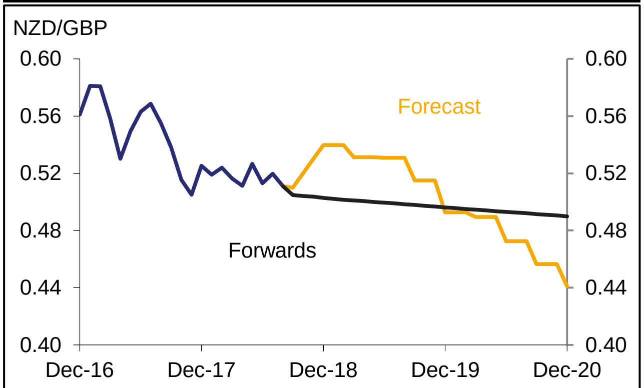
NZD/AUD: Range-Trading Around 0.90-0.95



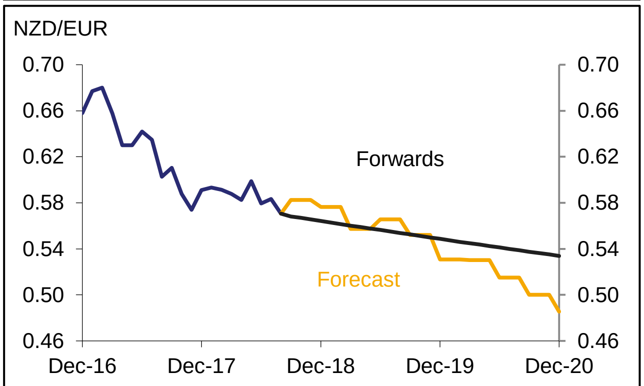
Source: Bloomberg, BNZ

NZD/GBP: Risk of Downward Trend Coming in Earlier



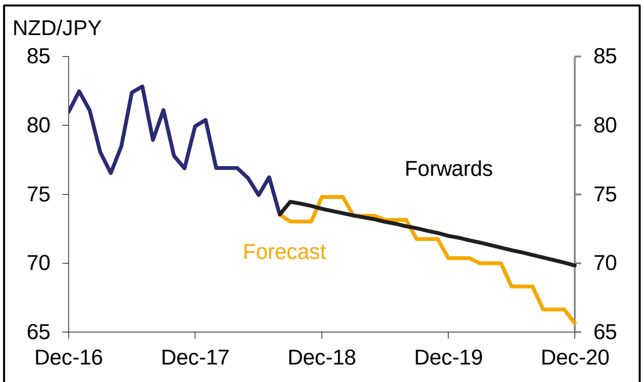
Source: Bloomberg, BNZ

NZD/EUR: Downward Trend Still in Play



Source: Bloomberg, BNZ

NZD/JPY: A Downward Medium-Term Trend



Source: Bloomberg, BNZ

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