NZD/AUD

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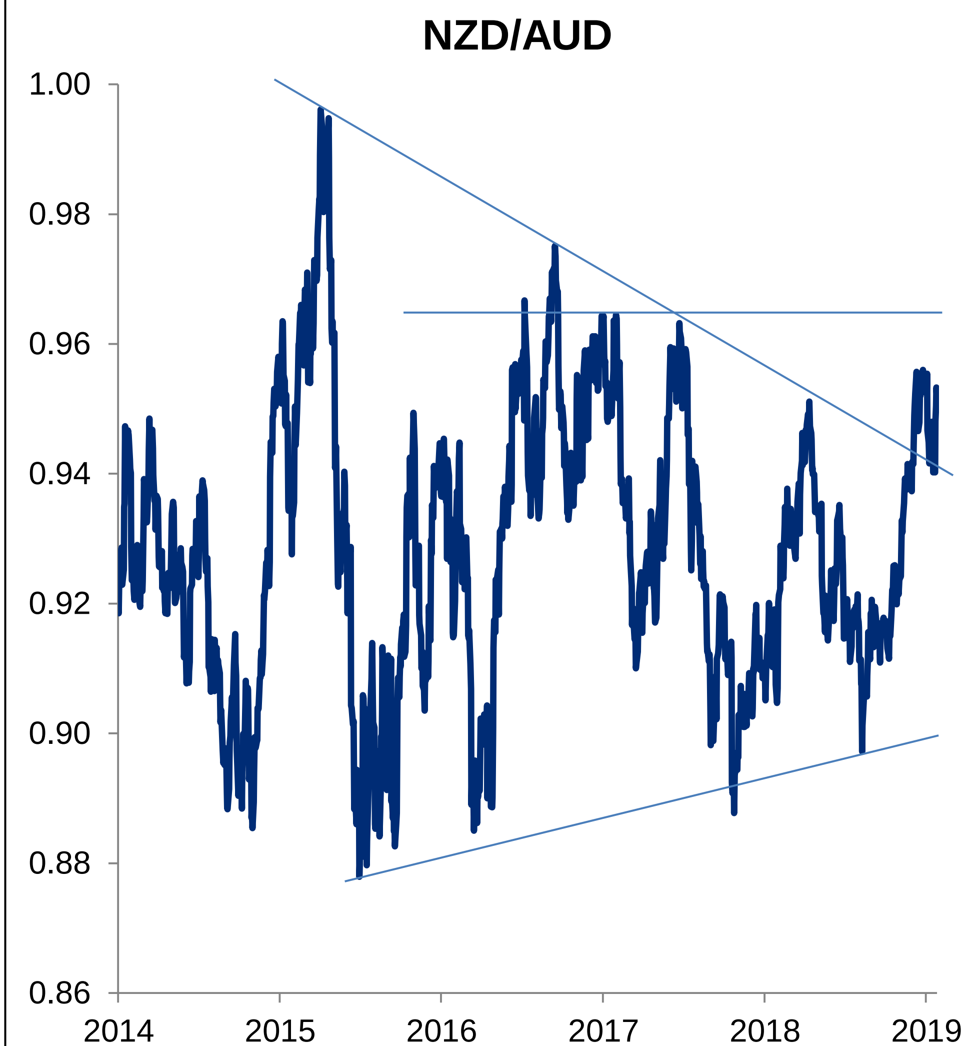
Summary

- NZD/AUD trades near the top end of its 5-year trading range, slightly above our LT and ST fair value estimates.
- We see this as justified, given some of the current negative forces that weigh on Australia, such as concerns about its housing market and closer ties to a slowing Chinese economy.
- We see the higher trading range for the cross being sustained through 1H19, with projections consistent with a 0.93-0.98 trading range, before the cross reverses course later in the year.

Technical picture

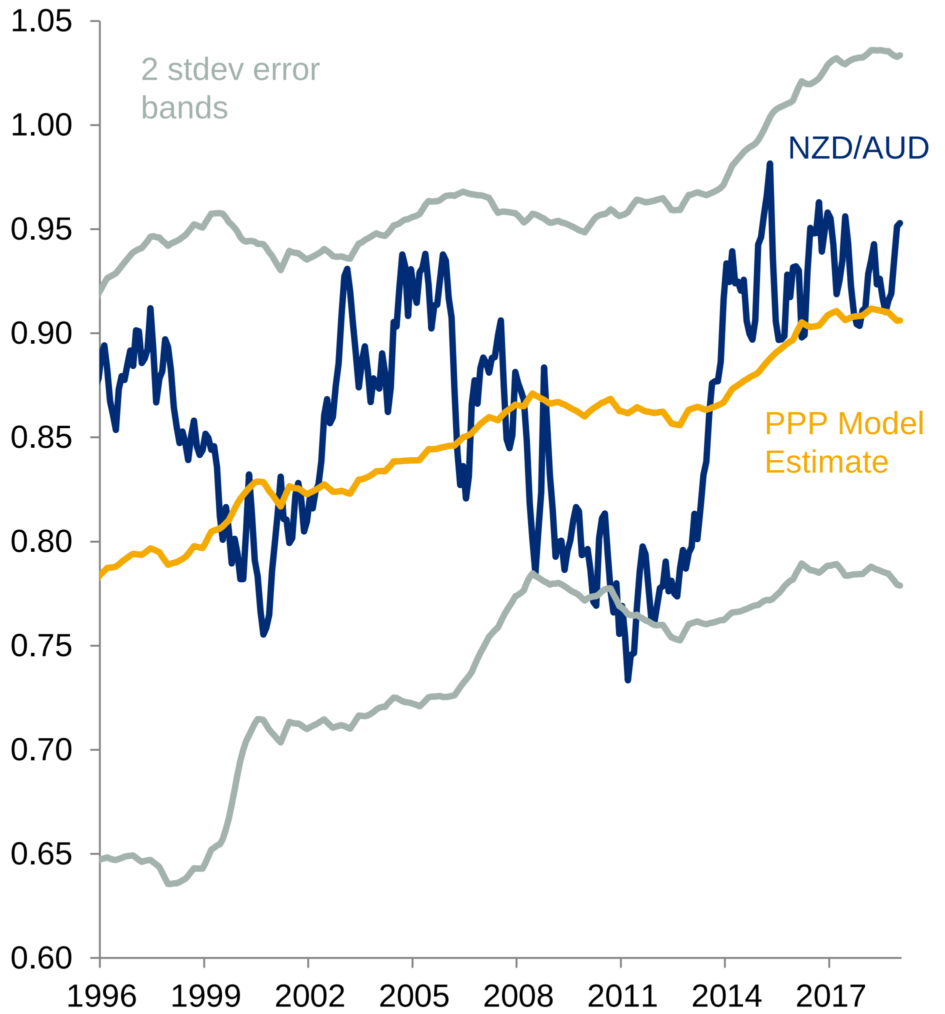
- The cross is trading near the top end of its trading range of the past five years.
- The downtrend of lower peaks was broken late-2018.
- Ignoring the 3-Jan flash crash, the cross has range-traded between 0.9370-0.9580 over the last six weeks.
- These represent short-term support and resistance levels.
- There's a lot of resistance between the 0.96-0.97 level.



Source: BNZ, Bloomberg

Long-term valuation model

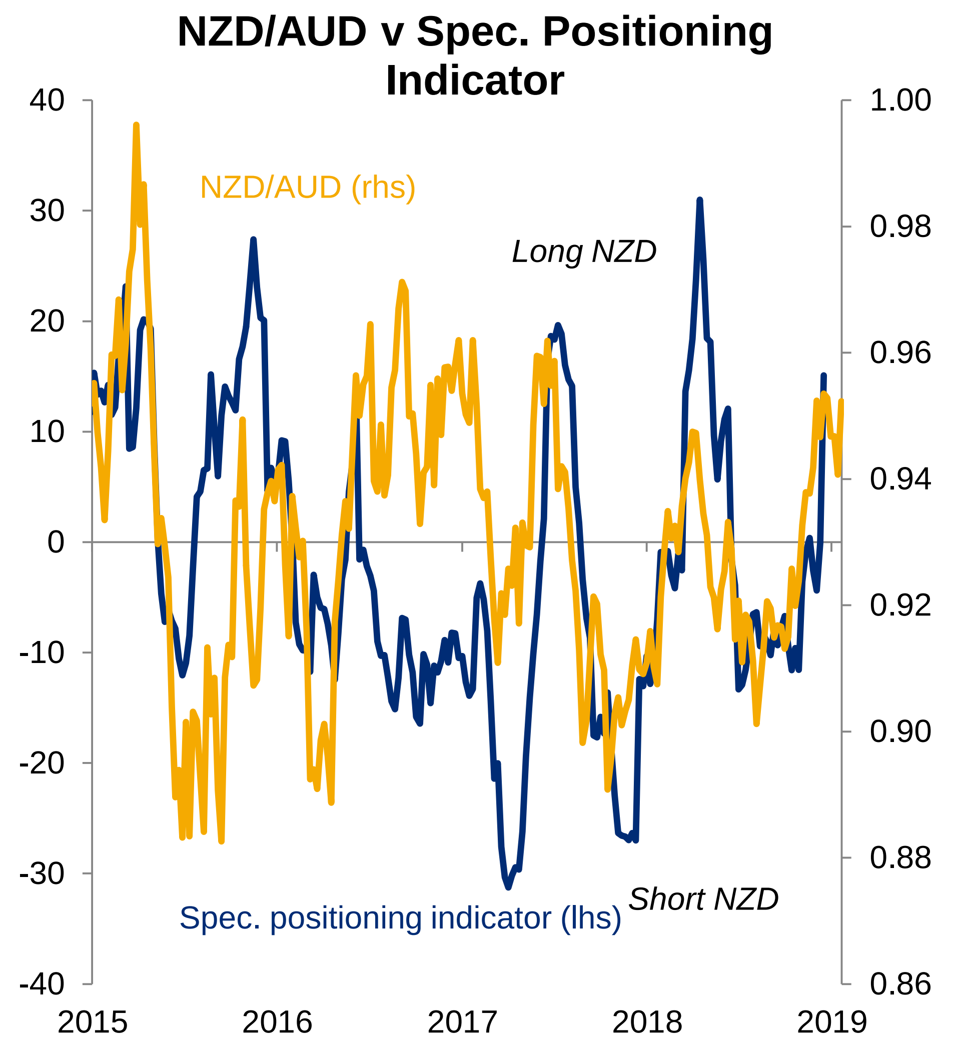
- Our long-term PPP model estimate has been around 0.90-0.91 for the past few years.
- Upward drift over decades reflects NZ’s lower inflation record than Australia, as per the lower central bank target.
- Current spot is above long-term fair value, but not significantly so.



Source: BNZ, Bloomberg

Speculative Positioning

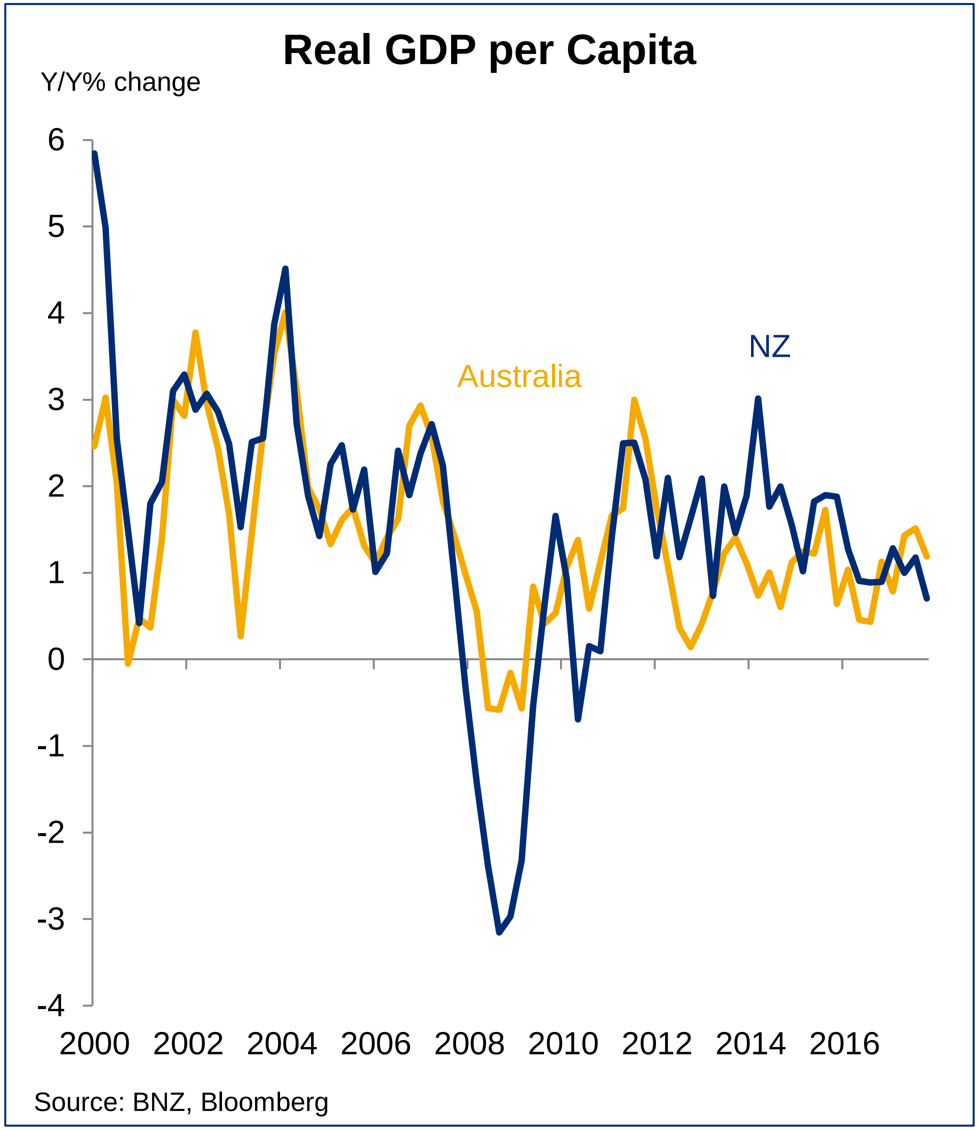
- The US government shutdown means CFTC spec. positioning data are only available through to just before Xmas.
- Our indicator, which scales the CFTC data appropriately, suggested modestly long NZD-AUD positioning late last year.
- Our “feel” is that long NZD-AUD speculative positioning still prevails.



Source: BNZ, Bloomberg

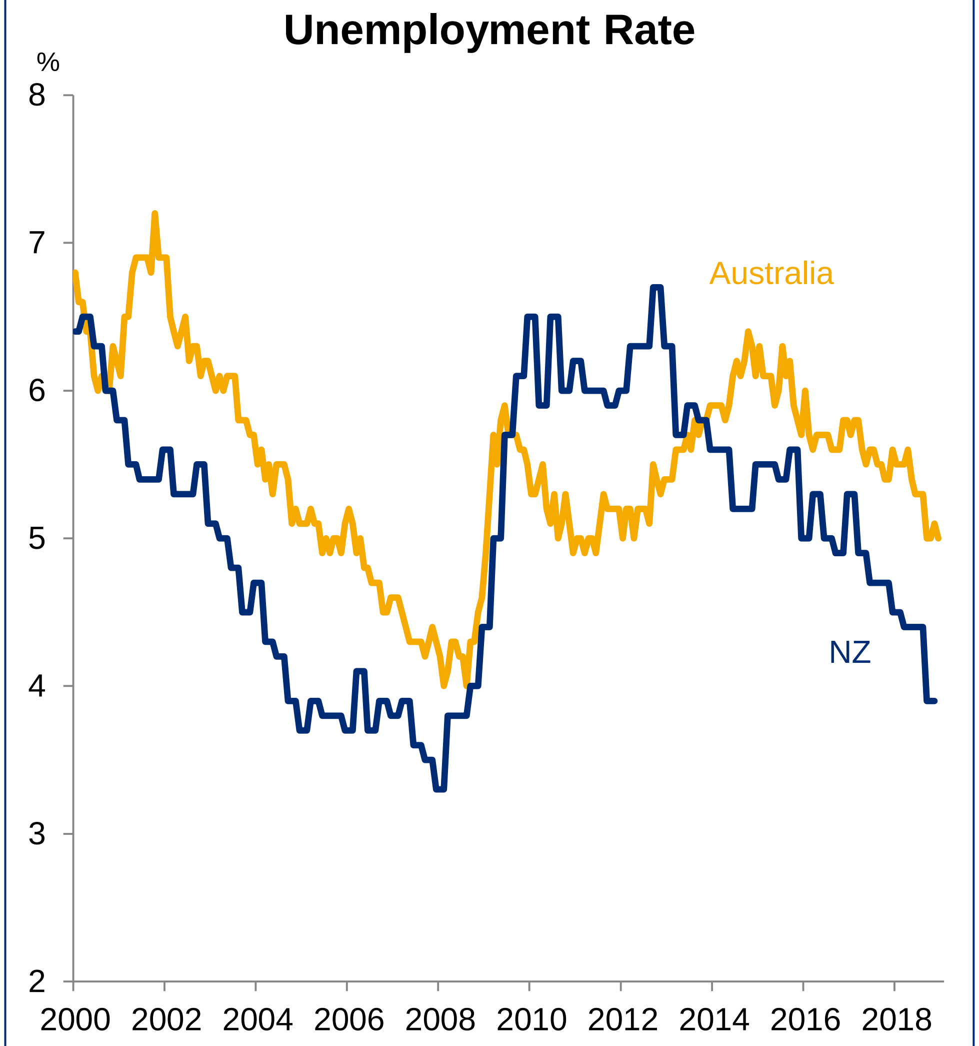
Economic Growth

- The NZ and Australian economic cycles are broadly in sync.
- Real GDP per capita growth was slightly weaker in NZ compared to Australia last year, but not significantly so.
- The growth outlook for both countries looks similar to us, with modest growth close to trend at best in both - certainly nothing spectacular.



Unemployment Rates

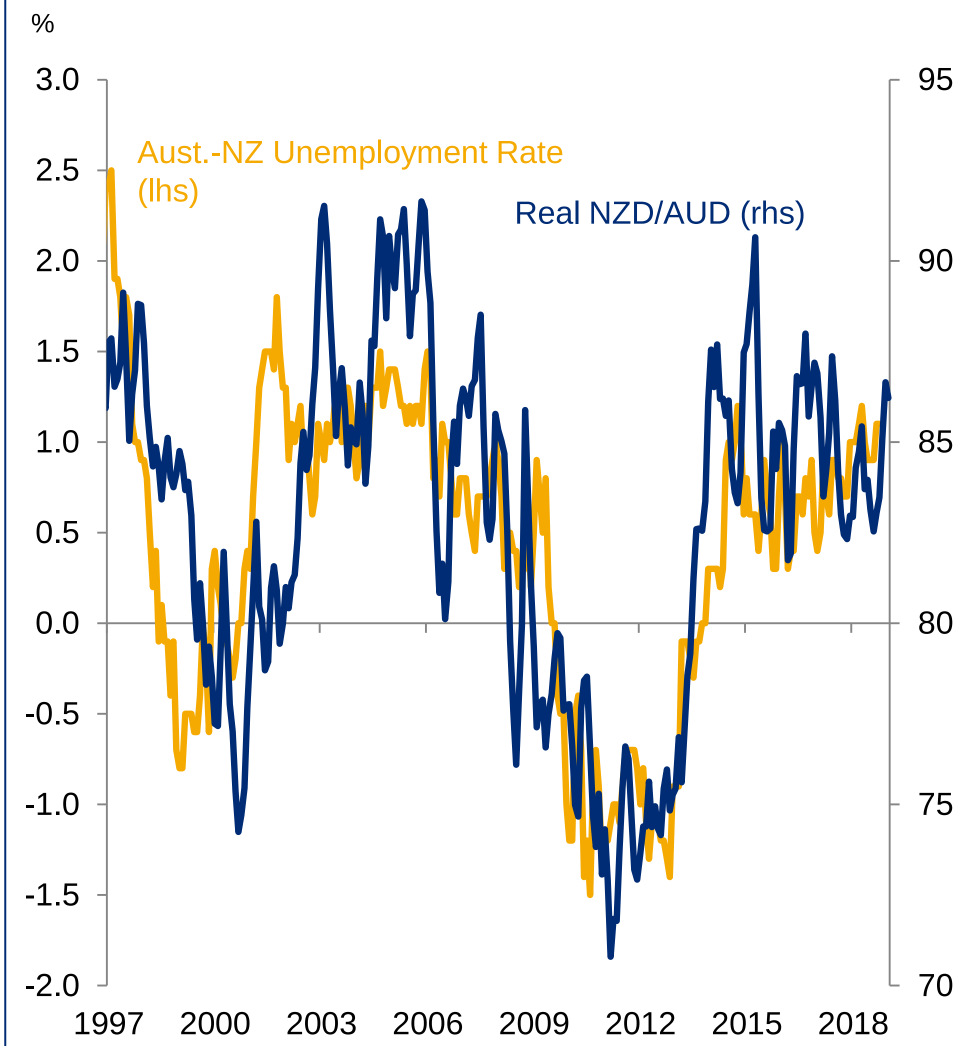
- The unemployment rate is our favourite indicator to monitor cyclical pressures on the cross rate – it summarises capacity pressures in the economy and pressures on interest rates.
- Over the past five years, NZ and AU unemployment rates have been falling at roughly similar paces.
- With very high labour force participation and a lower unemployment rate, we'd judge inflationary pressure from this source to be greater in NZ than Australia.



Source: BNZ, Bloomberg

Unemployment Rate Differential

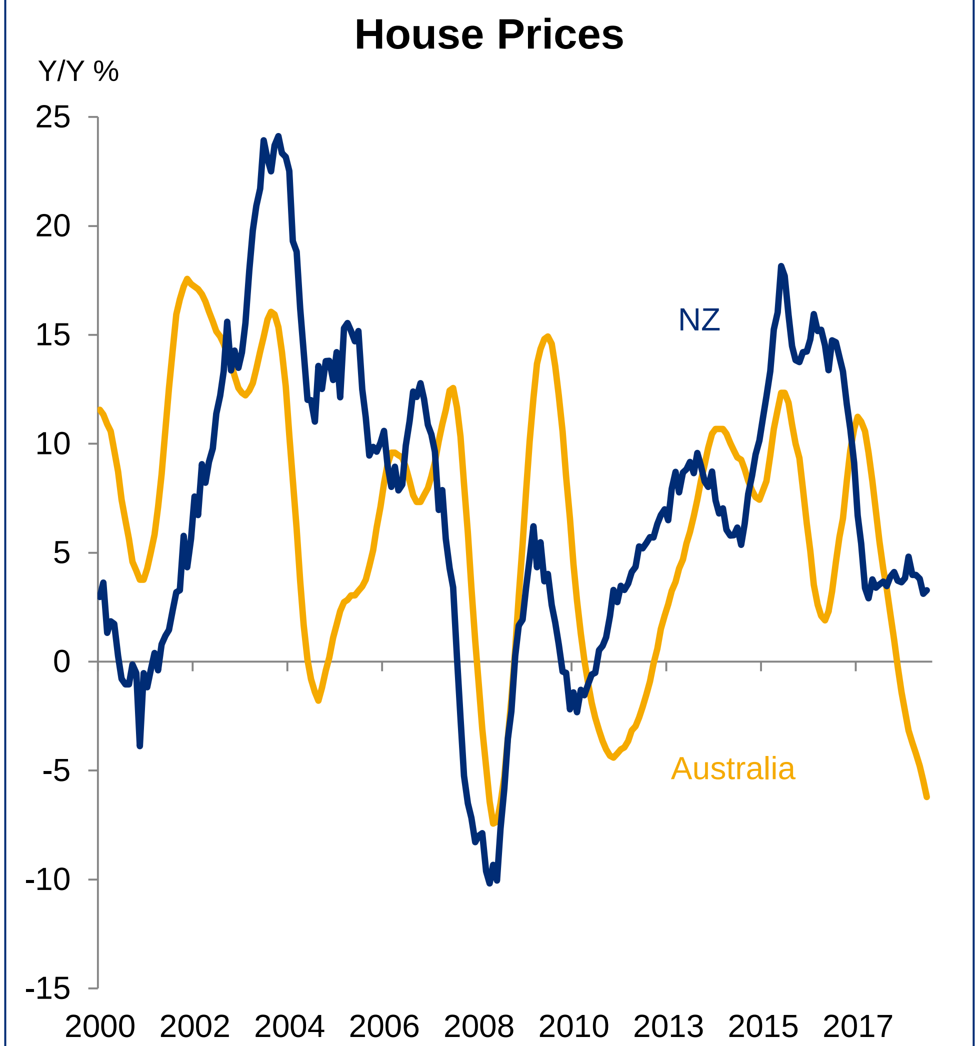
- The difference in unemployment rates can single-handedly satisfactorily explain broad NZD/AUD cycles over the past 20 years.
- A relatively steady unemployment rate gap can explain the trading range environment for the cross over the past 5 years.
- The indicator is currently consistent with the NZD/AUD near the top of its trading range.



Source: BNZ, Bloomberg

Housing Market

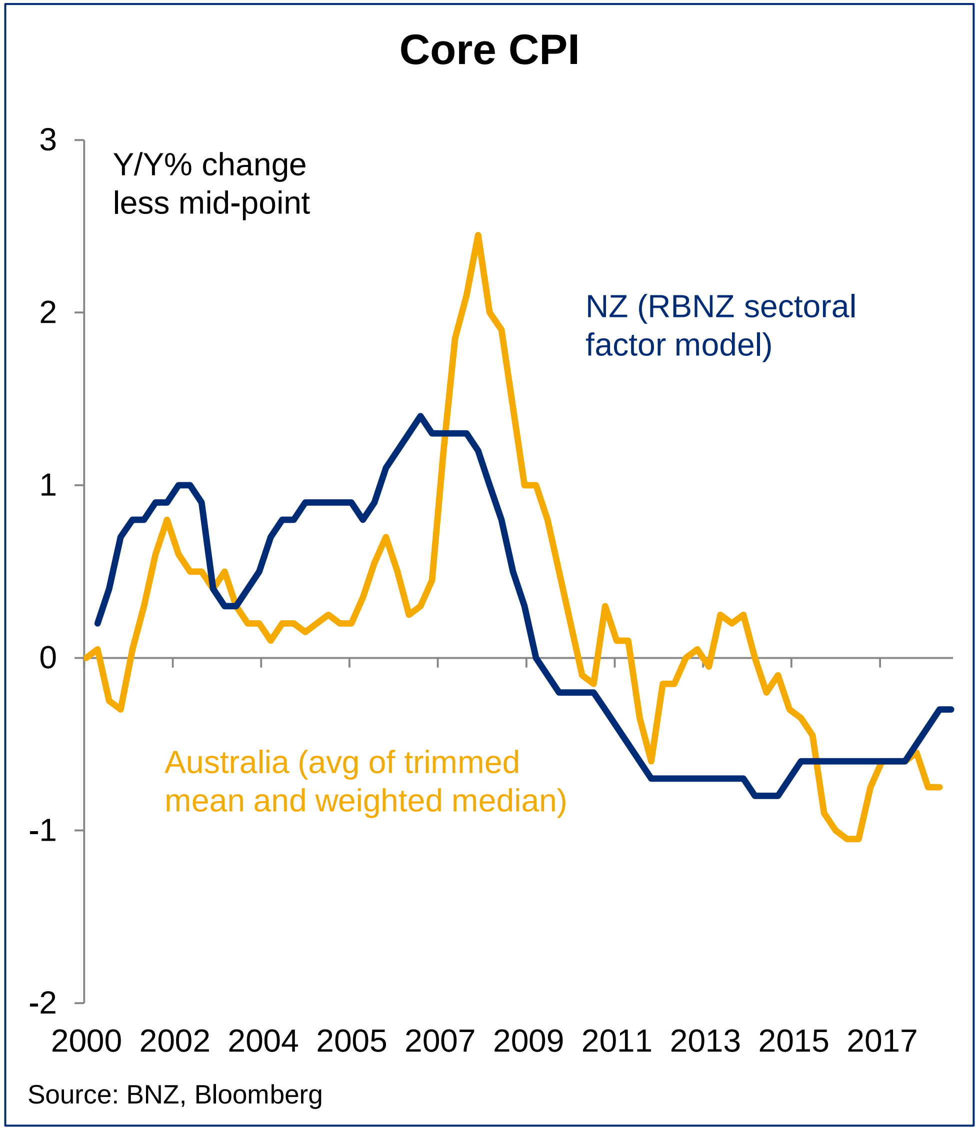
- The state of the housing market is a current point of difference between NZ and Australia.
- Australian house prices are being dragged down by big falls in Sydney and Melbourne.
- For now, this is AUD-negative but the risk is that the NZ market eventually follows Australia down.
- New proposed RBNZ capital requirements are likely to restrict NZ credit supply, albeit at a slow-burning pace over the next 5 years.



Source: BNZ, Bloomberg

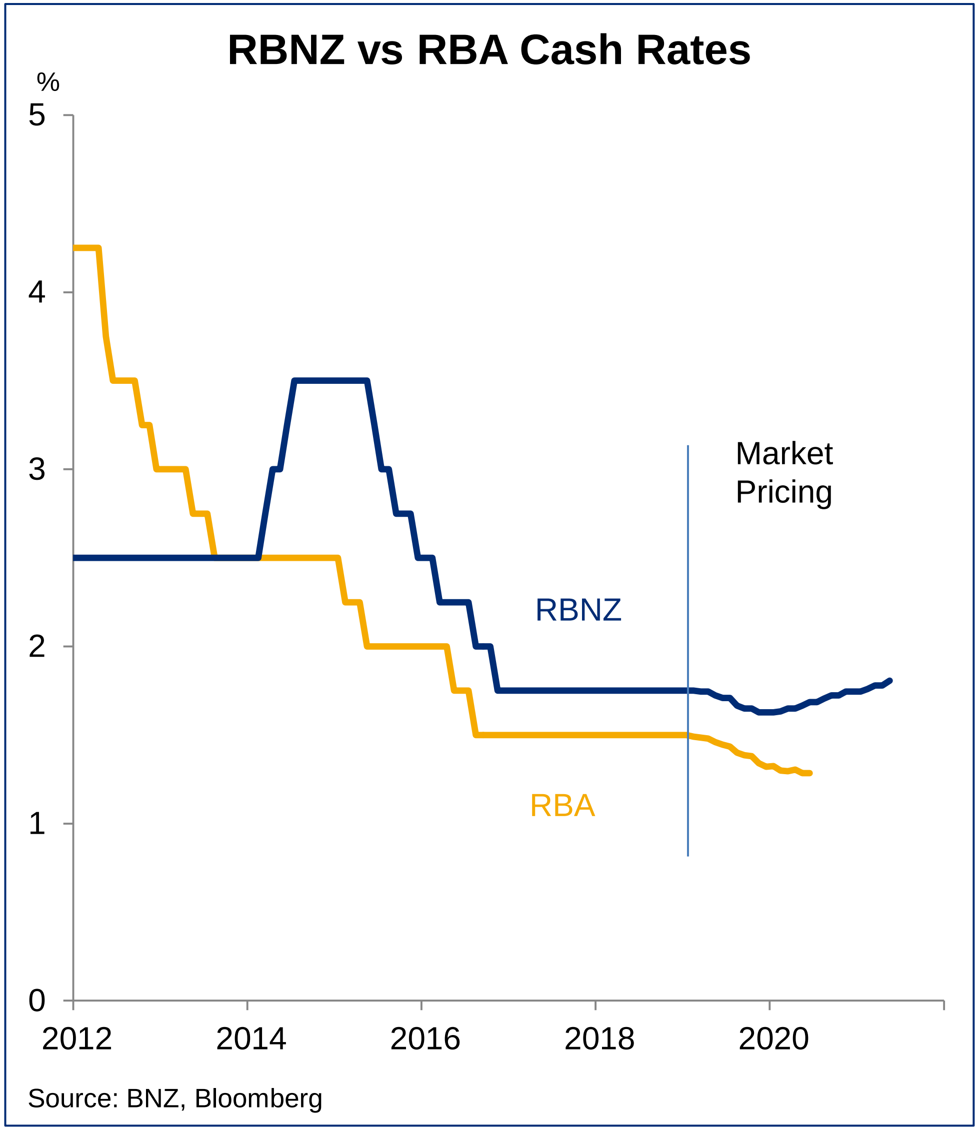
Inflation

- The RBNZ is currently closer to meeting its inflation target compared to the RBA.
- Other things constant, the RBNZ should be closer to normalising its policy rate (higher) than the RBA.
- In reality, neither central bank is likely to be in a hurry to change policy rates this year.
- Based on this chart the risk of a rate cut from the RBA to meet its inflation target is greater than the RBNZ.



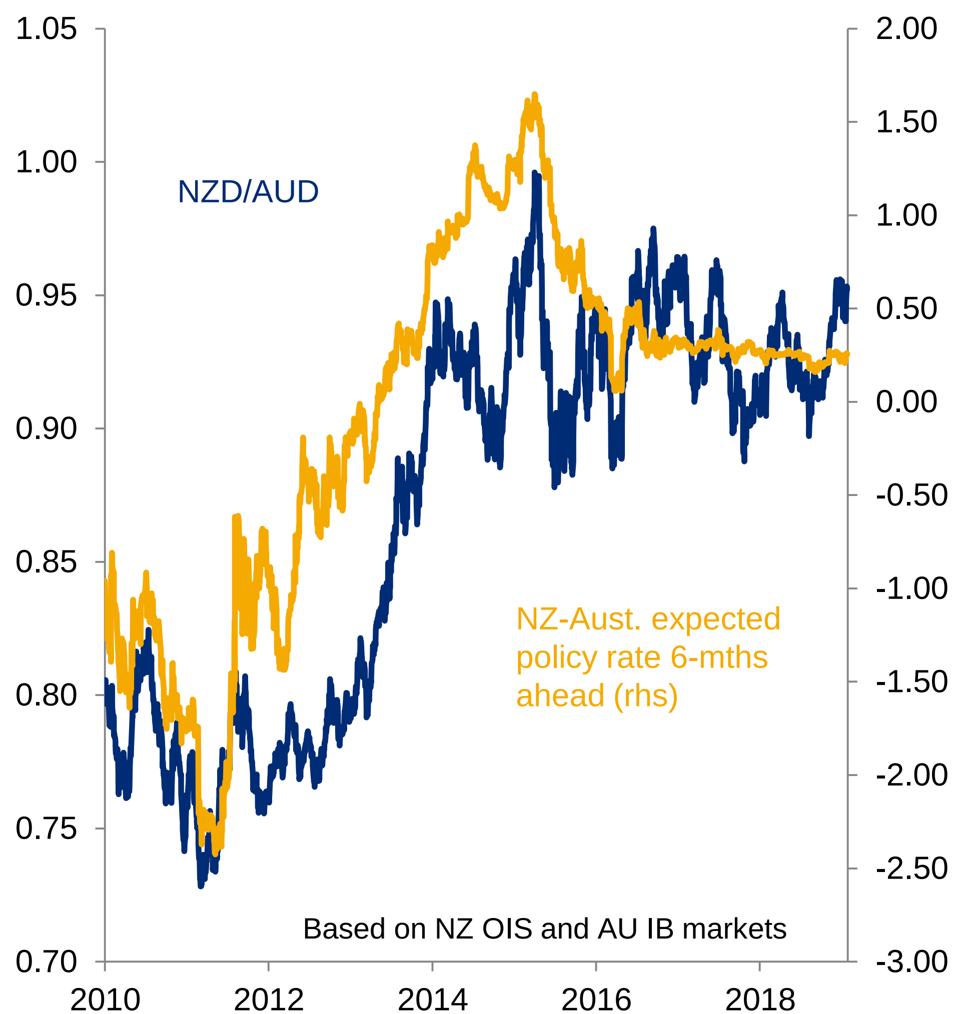
Monetary Policy (I)

- In both countries the market sees the near-term risk being one of possible rate cuts through 2019.
- But neither market has a full rate cut priced in.
- As per the inflation chart it seems fair that the market is more “dovish” on the RBA than the RBNZ.



Monetary Policy (II)

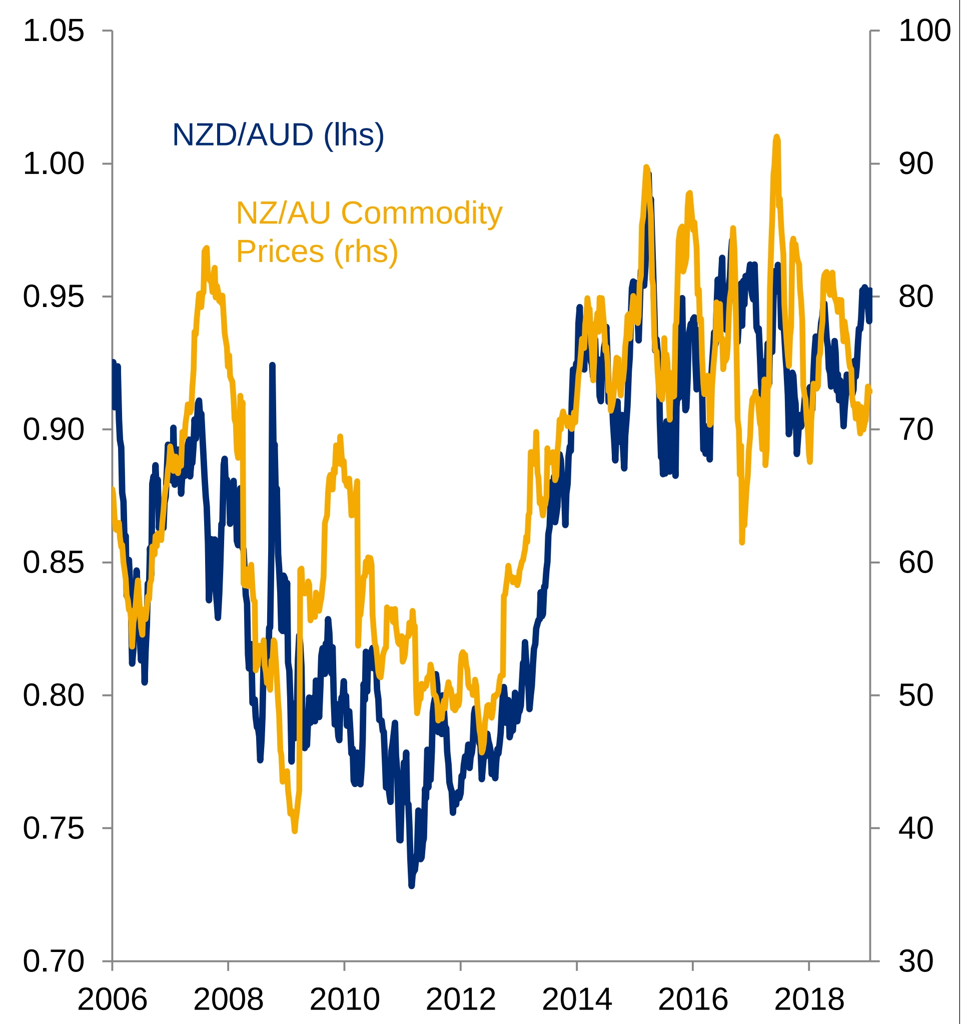
- Relative interest rates haven't been a key driver of NZD/AUD volatility over the past couple of years.
- Looking at the expected policy rate in six months time, the difference between NZ and Australian rates has shown little movement, with the 25bps gap in expected cash rates little changed.



Source: BNZ, Bloomberg

Relative Commodity Prices

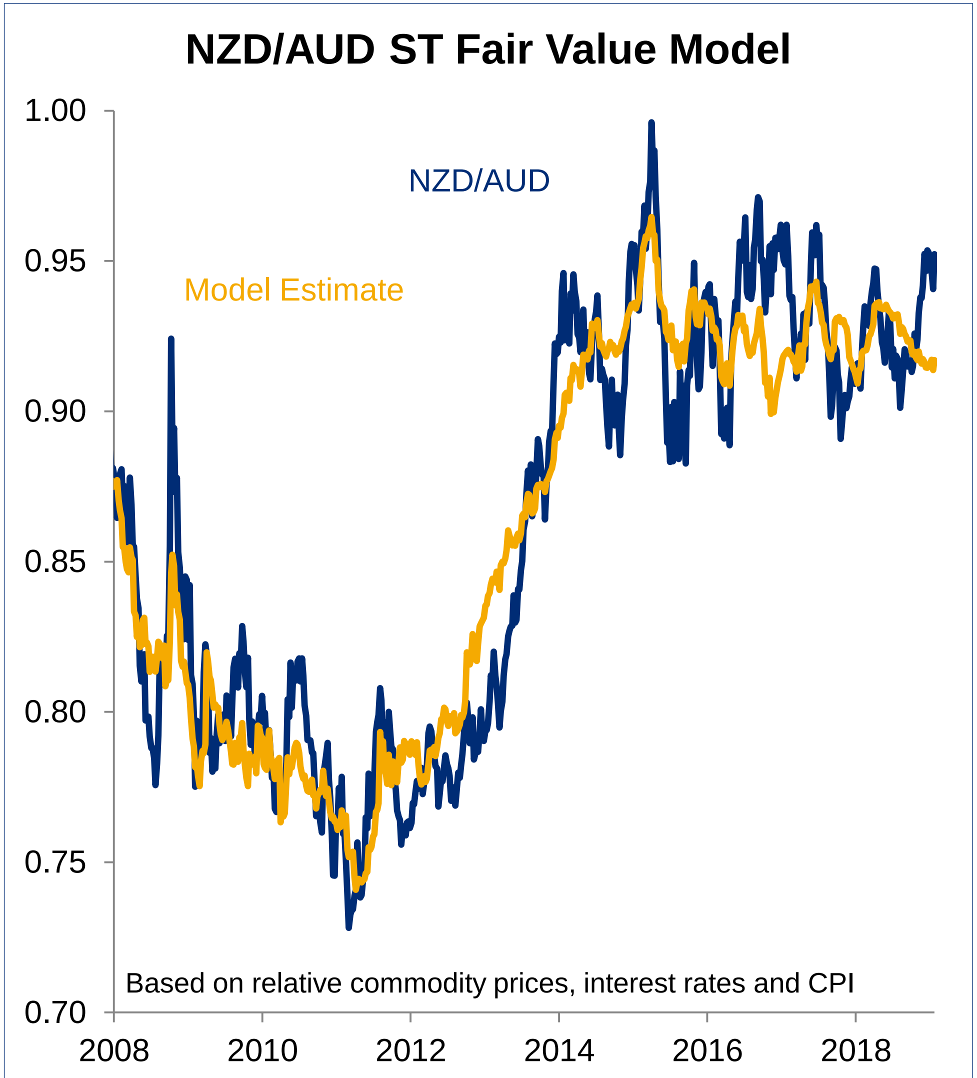
- Relative NZ/Australian commodity prices can kick around a bit and drive short-term variations in the cross rate.
- A recent recovery in dairy prices bodes well for the NZ commodity price index, while higher oil prices will be supporting the Australian index.
- In a global economic slowdown, we are more positive on NZ's "softer" commodities than Australia's "hard" commodities.



Source: BNZ, Bloomberg

Short Term Valuation Model

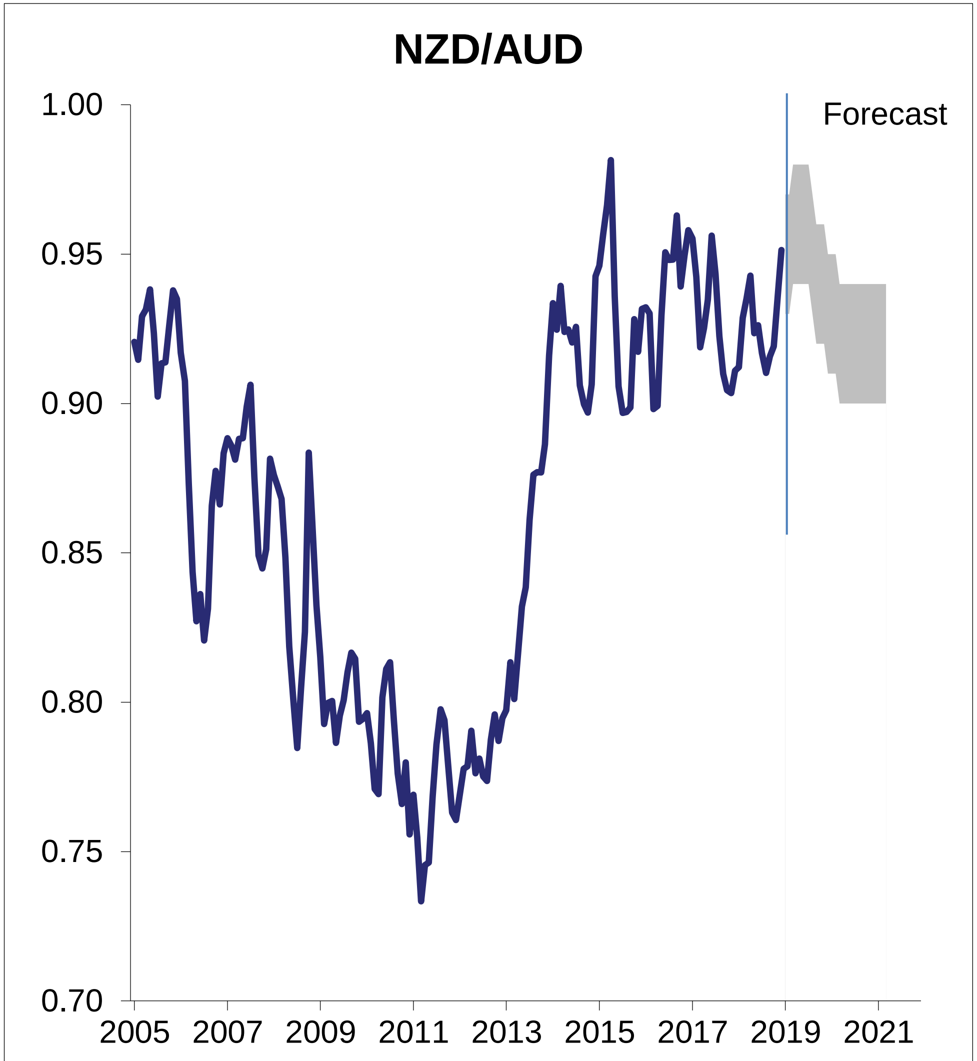
- Our ST FV model estimates sits around 0.91-0.92.
- Current spot is slightly higher, likely reflecting the negative factors not captured by the model – the concerns about the Australian housing market and political risk ahead of the May Australian Federal election.
- So the spot rate already captures some of the negative vibe around the AUD, limiting upside potential from here.



Source: BNZ, Bloomberg

Forecasts

- We see the higher trading range for the cross being sustained through the first half of 2019, with our forecasts consistent with a 0.93-0.98 range before reversing course.
- At the margin, NZ indicators are currently slightly more positive than Australia, supporting the cross.
- The Australian Federal election in May is an added risk factor in 1H19.



Source: BNZ, Bloomberg

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