NZD/CAD

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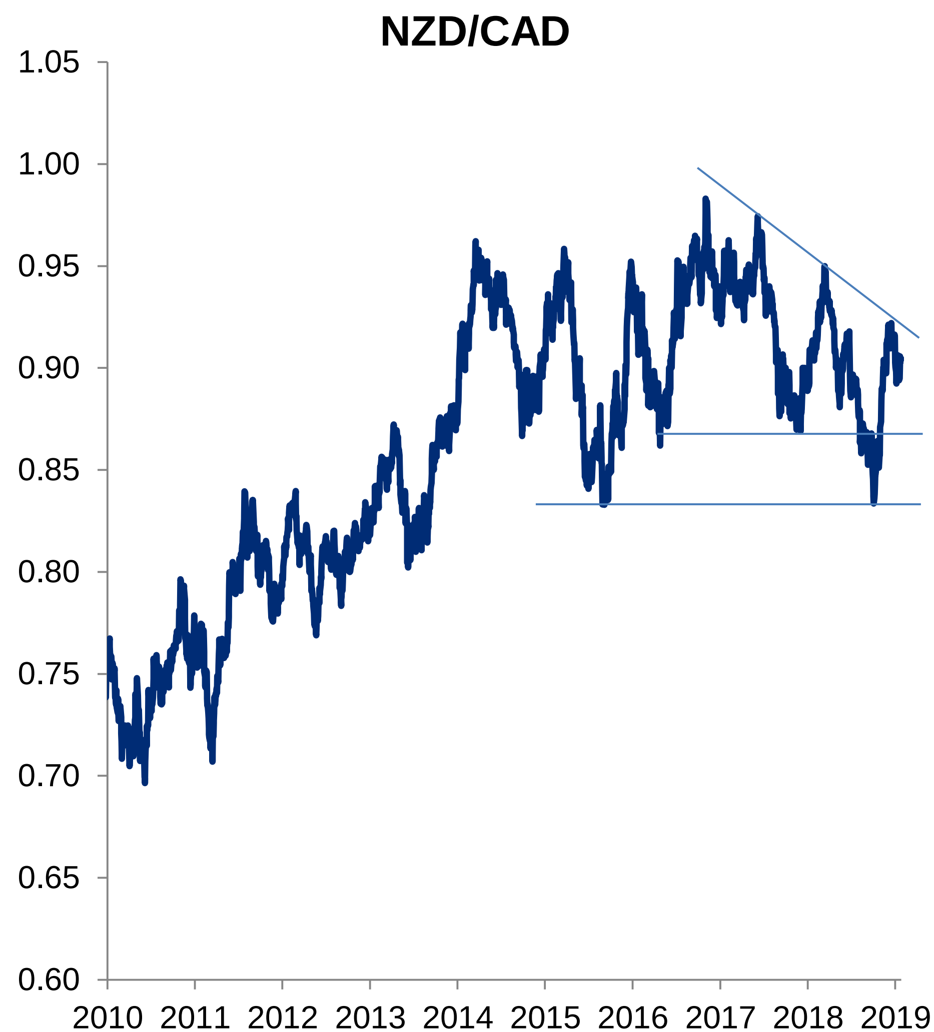
Summary

- The cross is currently near the middle of its 5-year trading range.
- On a multi-year view, we see more downside than upside pressure.
- We don't have strong conviction on the near-term outlook, with oil prices likely to be a key swing factor. Relative commodity prices are a much more important driver than interest rate differentials.
- Our forecasts show the cross spending more time in a 0.85-0.90 range than 0.90-0.95 range this year.

Technical picture

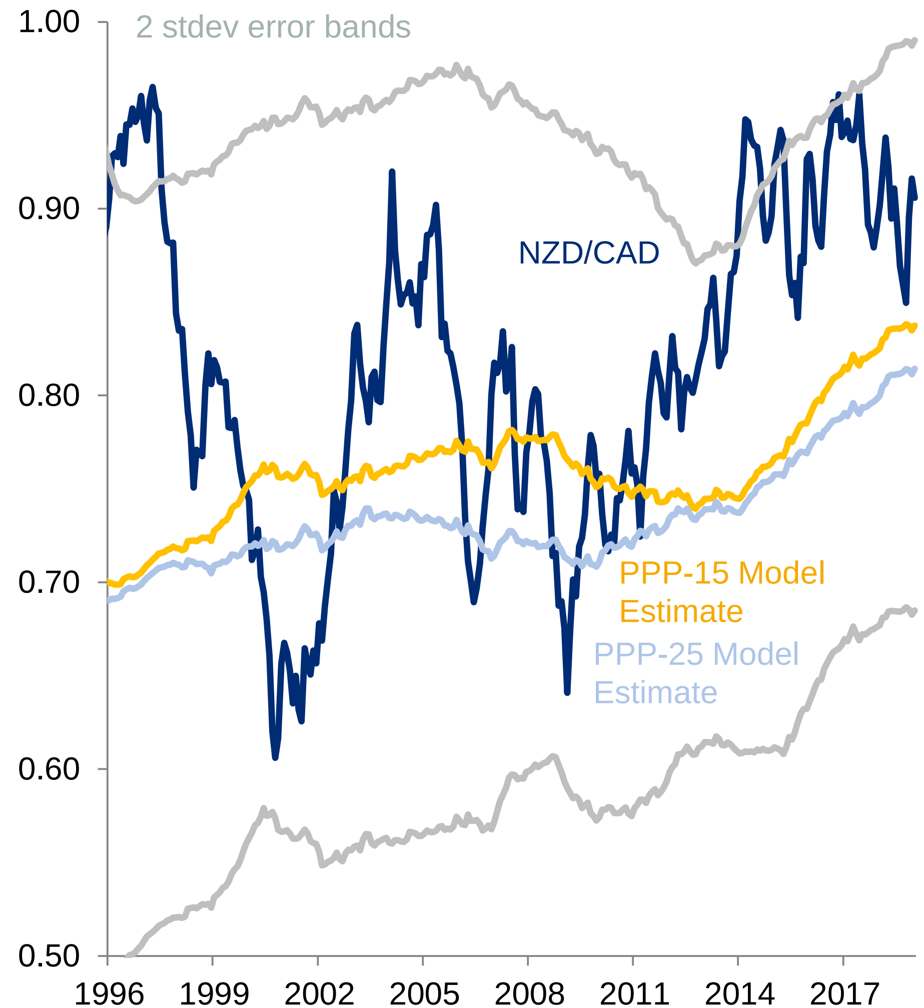
- The cross has traded sideways for much of the past five years, spending most of the time between 0.85-0.96 – with only brief excursions outside that range.
- A trend of lower peaks over the past couple of years is indicative of a possible downward trend in play. Trendline resistance is around 0.92.
- 0.87 is a key support level ahead of major support around 0.83-0.85.



Source: BNZ, Bloomberg

Long-term valuation model

- The cross has been trading above our long-term purchasing power parity estimates for the best part of 7-8 years, reflecting strong NZ relative terms of trade.
- Our PPP estimates are between 0.8100-0.8350.

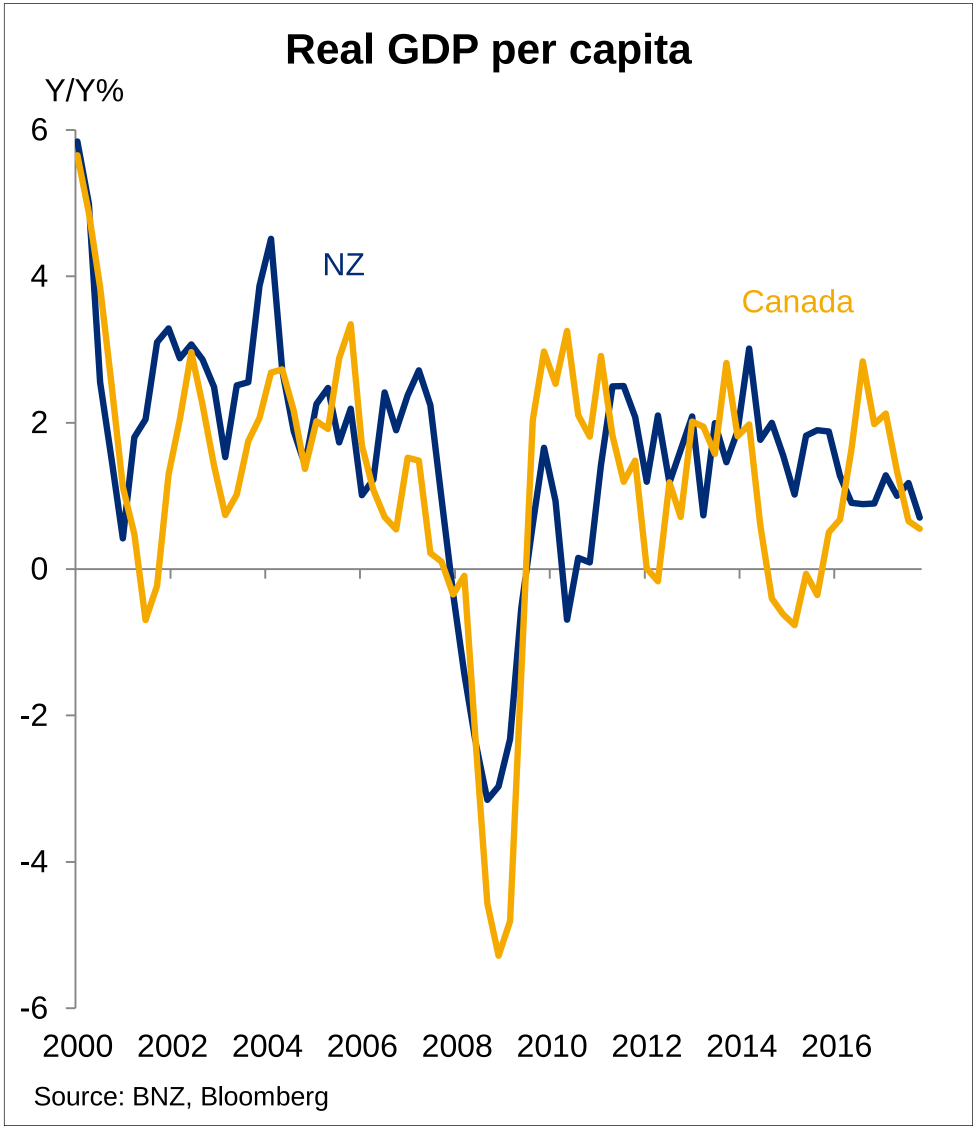


Source: BNZ, Bloomberg

* Our two PPP model estimates are based on 15-yr and 25-yr averages respectively

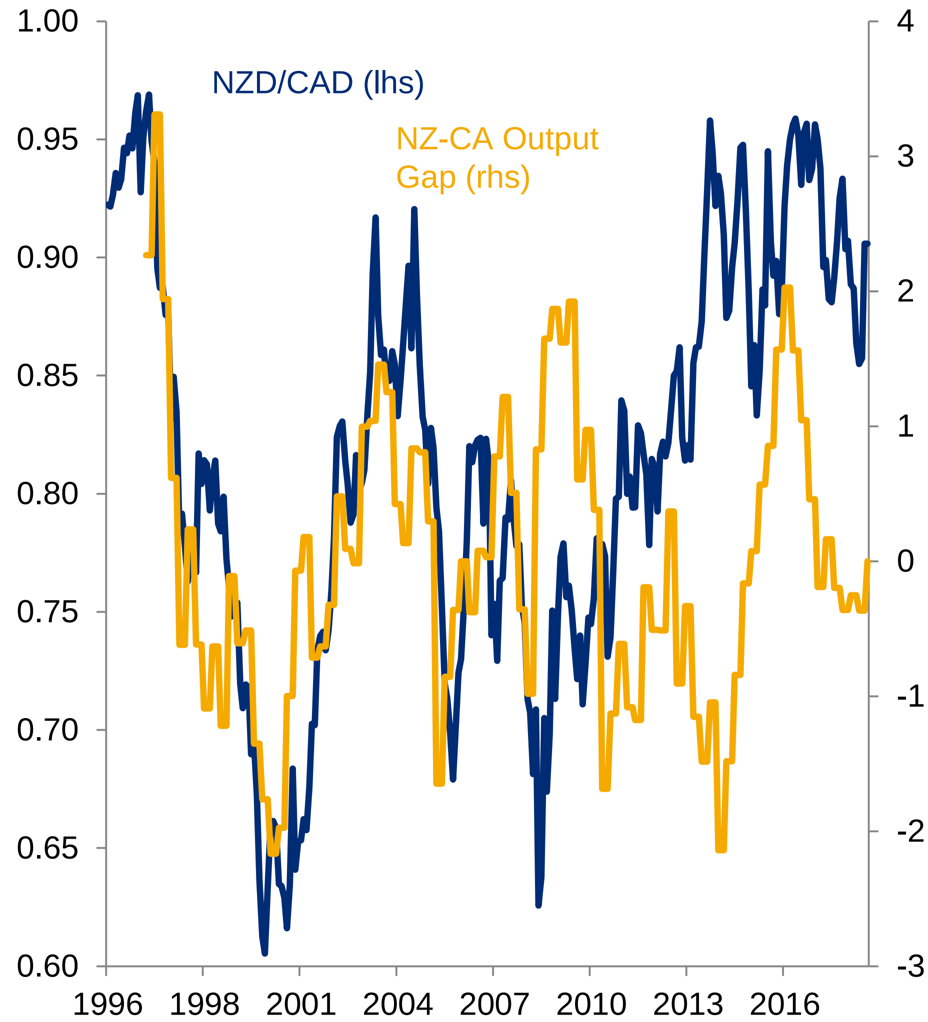
Economic Growth

- NZ and Canada GDP per capita growth rates are currently similar, both showing modest growth.
- Downward momentum has been greater in Canada over the past 18 months, but off a much higher base.
- Consensus forecasts suggest trend-like growth for both countries, with NZ having a slight edge for the year ahead.



Output Gap

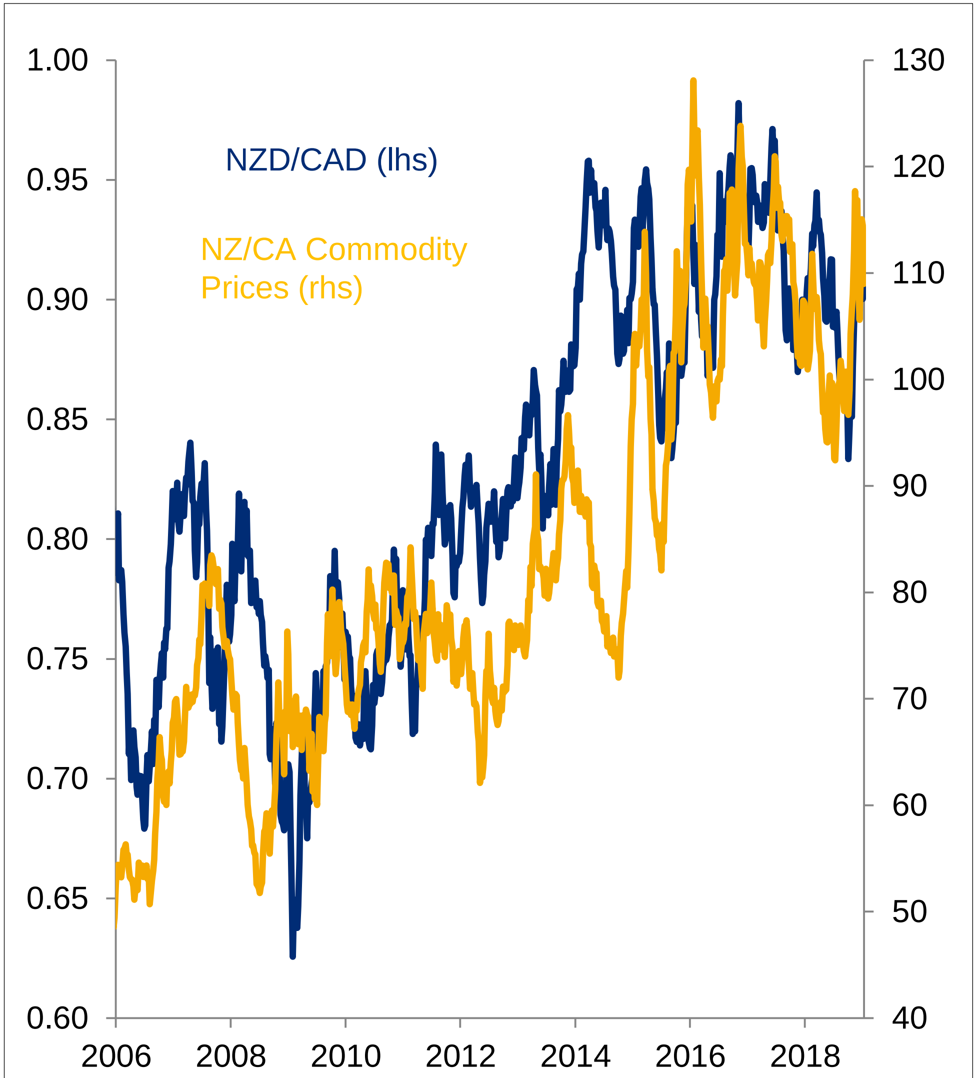
- Looking at relative output gaps, the Canadian economy's outperformance over the past couple of years has seen a closing NZ-Canada output gap, consistent with a weaker NZD/CAD.
- Consistent with the previous chart, there are hints that this performance gap has closed and, looking forward, this factor should be neutral for the cross.



Source: BNZ, Bloomberg

Relative Commodity Prices

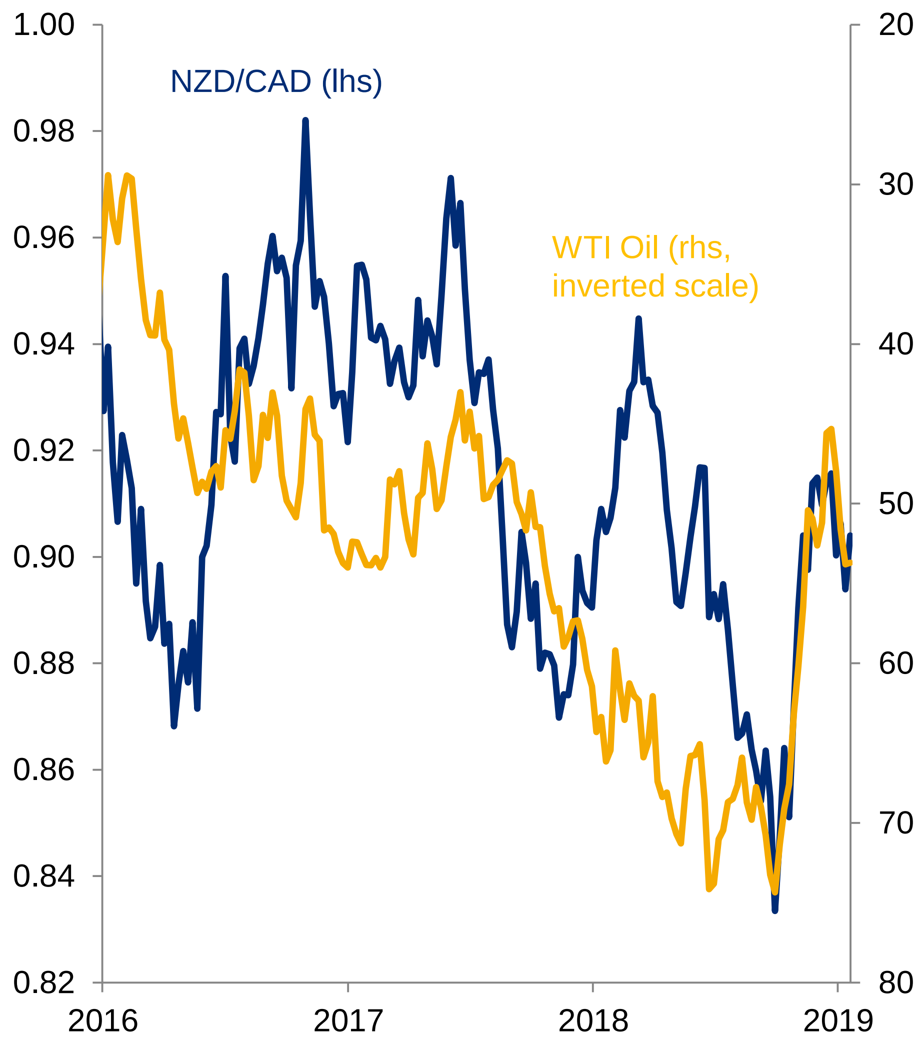
- The best indicator for the cross that we can find is relative commodity prices or terms of trade.
- Strength in NZ versus Canadian commodity prices and terms of trade can explain the strong cross over the past five years.
- Stronger dairy prices currently support NZ commodity prices.
- Oil prices – a big driver of Canada's terms of trade – are difficult to predict, and could be the key swing factor over the coming year.



Source: BNZ, Bloomberg

Oil Prices

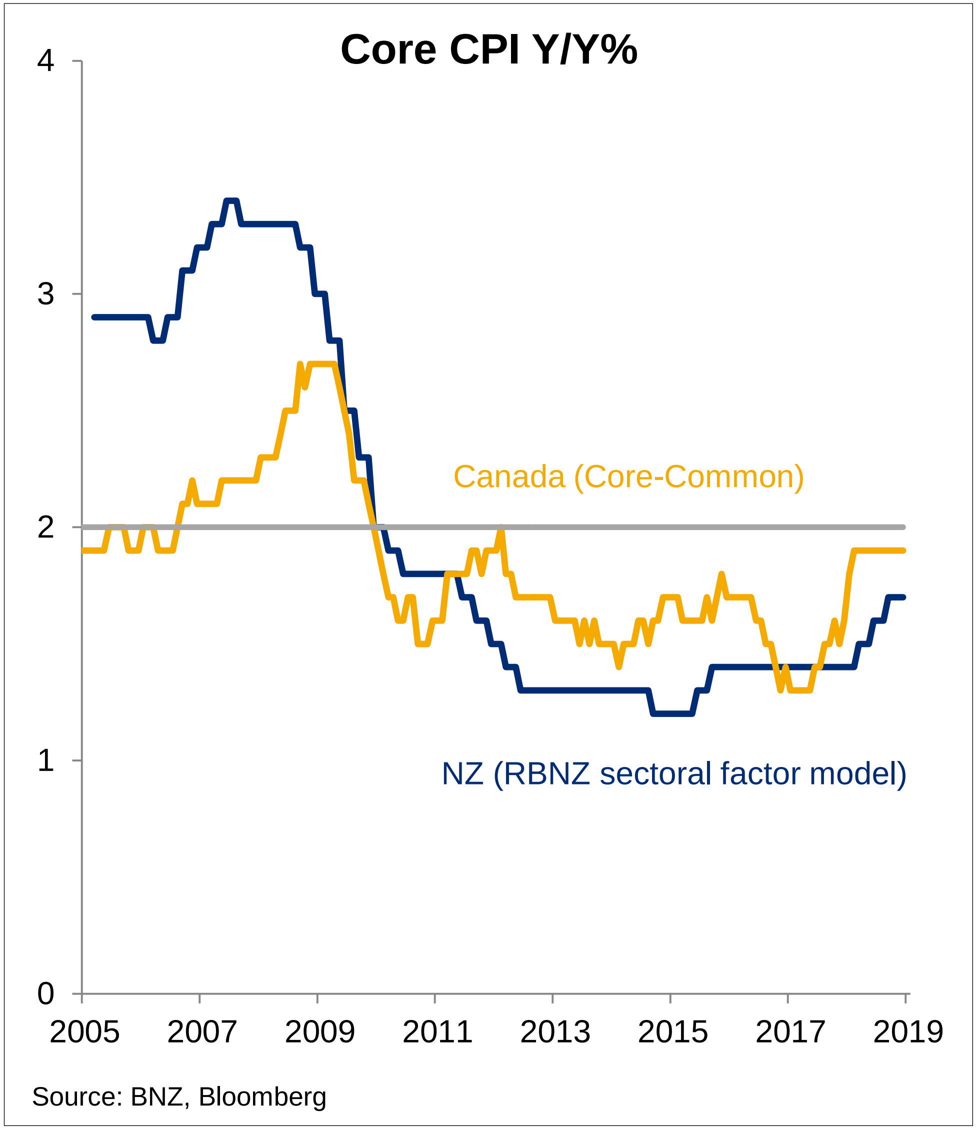
- The sharp fall in oil prices in Q4 can explain the sharp recovery in the cross from October 2018.
- If one takes the view that WTI oil prices will settle around the USD50-55 per barrel mark, then that would limit any further strength in the cross.



Source: BNZ, Bloomberg

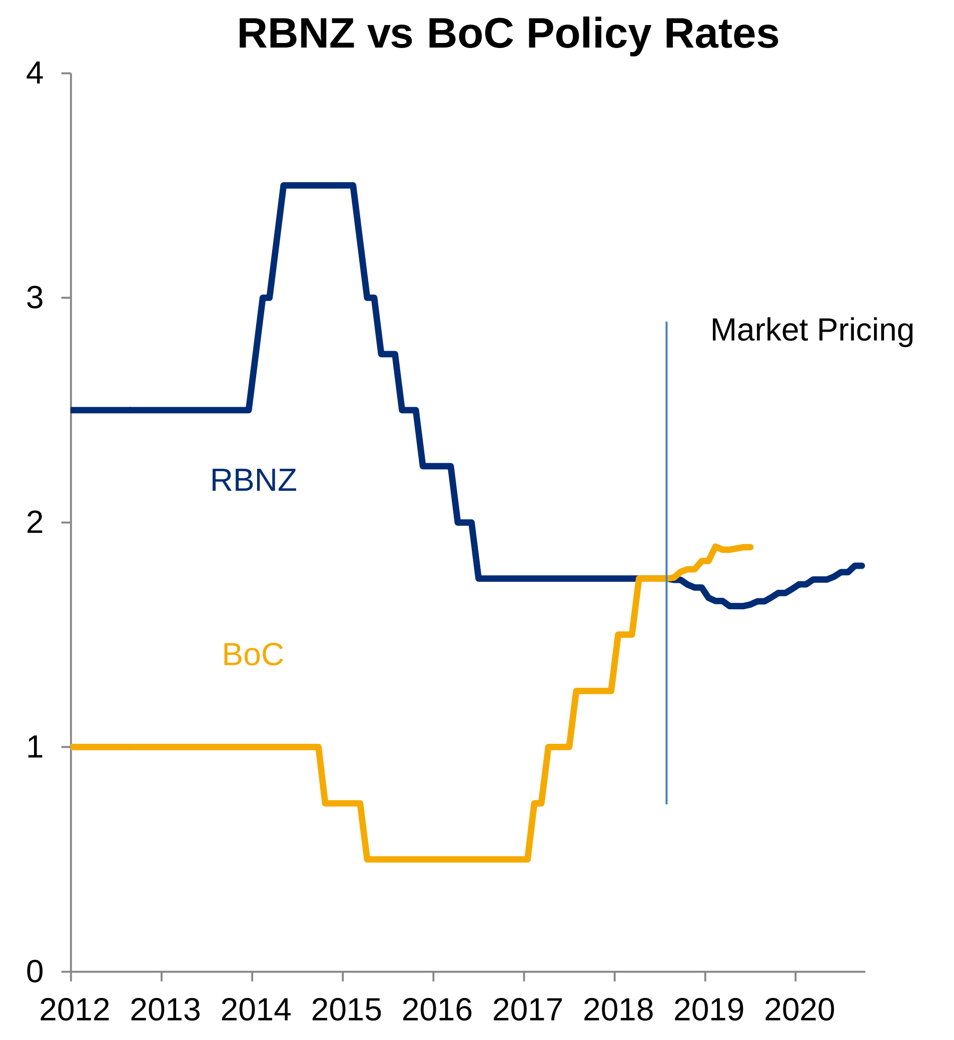
Inflation

- The Bank of Canada is closer to achieving its inflation target than the RBNZ.
- However, after 125bps of tightening since mid-2017, the Bank of Canada looks to be on hold this year. The Bank has a mild tightening bias but is monitoring a number of weak indicators at present.
- The RBNZ also looks to be on hold for an extended period, wanting to see more evidence of higher inflation.



Monetary Policy

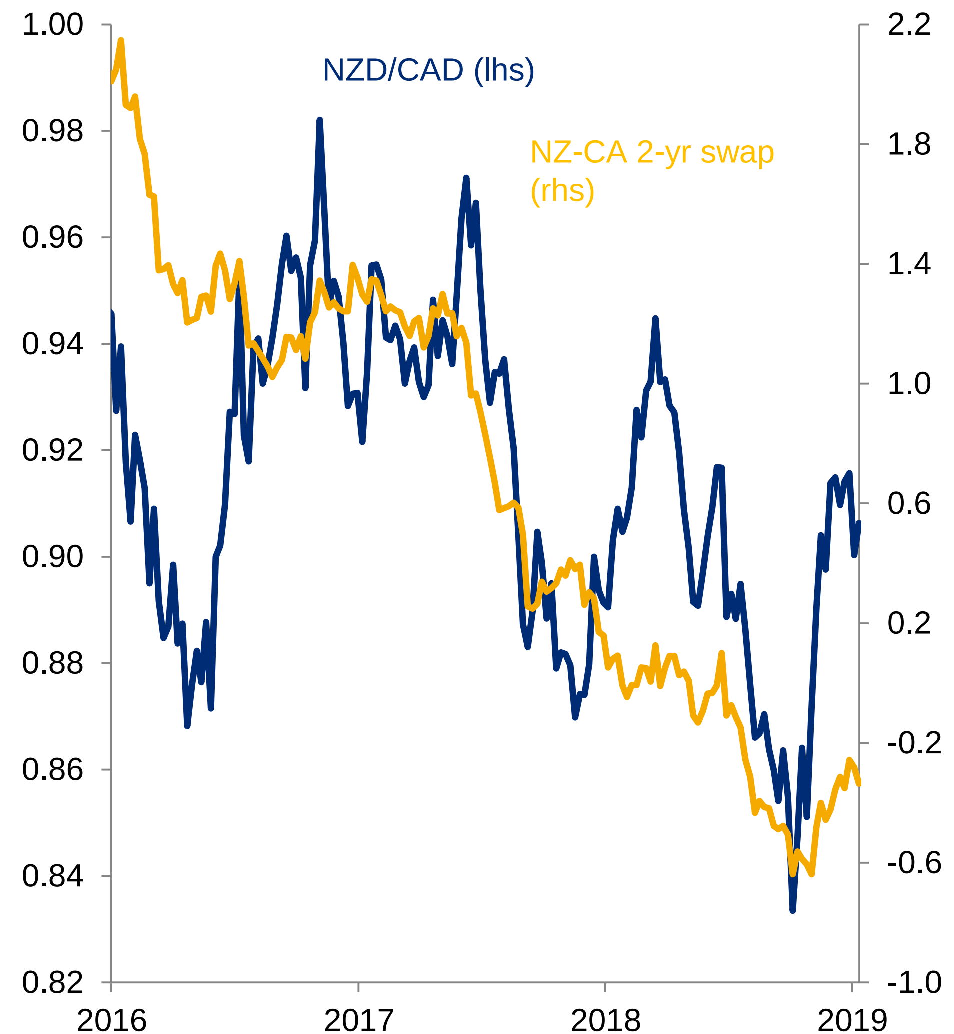
- The market sees a chance of the BoC raising rates this year and the RBNZ cutting rates this year, although a full hike/cut has yet to be priced.
- Another BoC hike would likely require oil prices to hold up, global risks and Canadian housing market risks to subside; and another Fed rate hike would be a supporting factor.
- We see an RBNZ rate cut this year as unlikely and requiring a big global negative shock to develop to support such a move.



Source: BNZ, Bloomberg

Rate Differentials

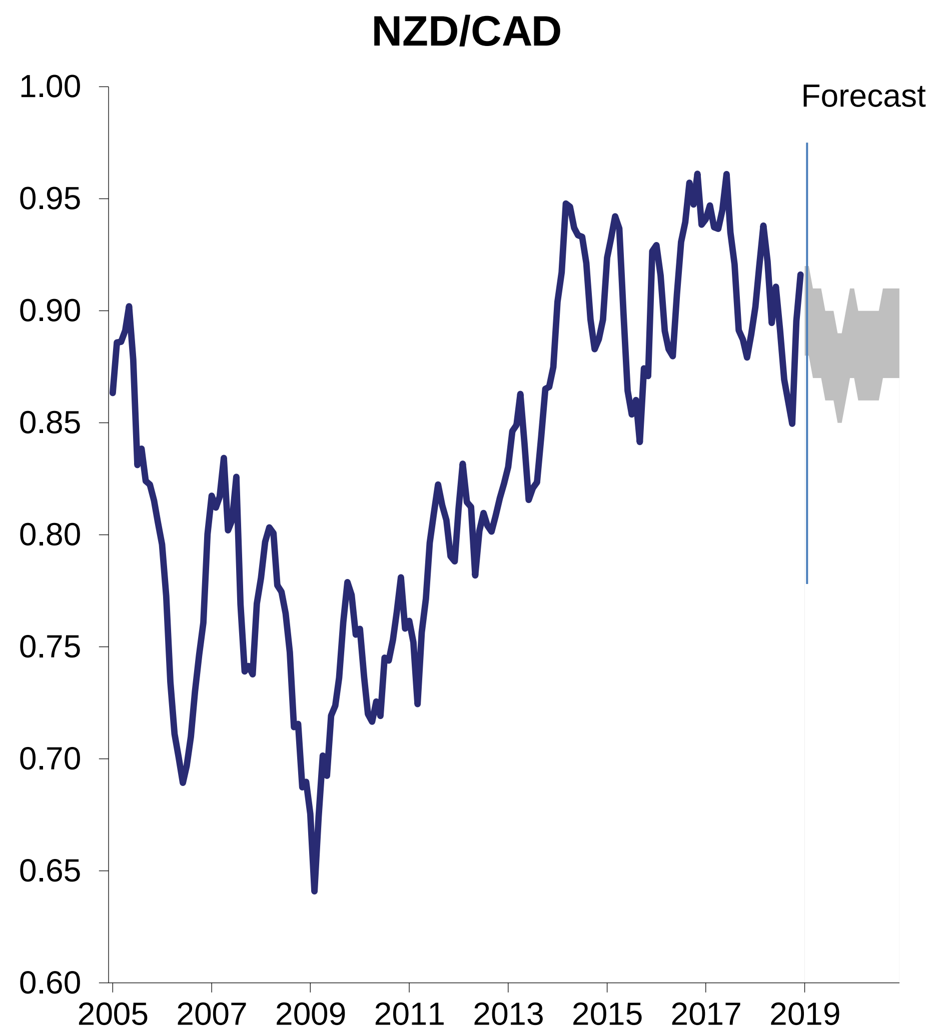
- Relative interest rates are only a secondary driver of the cross. Even over short-time periods the relationship isn't great, with commodity price gyrations much more significant.
- Rate hikes being priced out of the Canadian curve late last year has helped lift the NZ-Canada 2-year swap rate spread, a mild positive force on the cross recently.



Source: BNZ, Bloomberg

Forecasts

- We see opposing forces on the cross. The long-term model suggests a downward bias on a multi-year view.
- Oil prices are a key swing factor over the short term.
- Our forecasts are fairly flat with modest downside risk, thus show the cross spending more time in a 0.85-0.90 range than 0.90-0.95 range this year.



Source: BNZ, Bloomberg

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