bnz

21 November 2016

NZD Corporate FX Update

- Trump's victory in the US Presidential election was a surprise, but it lends weight to our base case for a stronger USD outlook. While the USD has recovered strongly, an earlier and more vigorous recovery in dairy prices along with prospects of a stronger-for-longer NZ economy have been partially offsetting forces for the NZD.
- Our NZD/USD projections are unchanged and show a moderate depreciation through the next 6-12 months. NZD/AUD projections are also unchanged but the surprise Trump victory has had more impact on EUR and JPY and those crosses have been revised higher.

For some time we've highlighted the opposing forces on the NZD – stronger domestic conditions applying upward pressure and global conditions applying downward pressure. The shock election of Trump as the next US President increases our confidence in the stronger USD story that has underlined our forecasts all year, but we find ourselves in no urgent need of revising NZD/USD forecasts. The reason is that the domestic forces on the NZD have been stronger than expected – including stronger NZ terms of trade – and the surprise Trump victory means we can sidestep another NZD upgrade that might otherwise have been on the cards.

Our projections see the NZD/USD remaining in a USD0.70-0.73 trading range over the next month or two (the NZD has a tendency to perform strongly into year-end from seasonal factors), with dips below that lower range over the very near term. Our projections show the NZD tracking sustainably lower through next year, targeting USD0.67 in the second half.

A December Fed tightening is expected to be followed by at least two more hikes next year. The Fed's projections have yet to incorporate a significant US fiscal easing under Trump, so that adds to the likely upward pressure on the USD. NZD will be affected by that direct impact as well as the second round effect – through weaker global risk appetite as emerging market currencies suffer and the stronger USD acts as a tightening in global financial conditions.

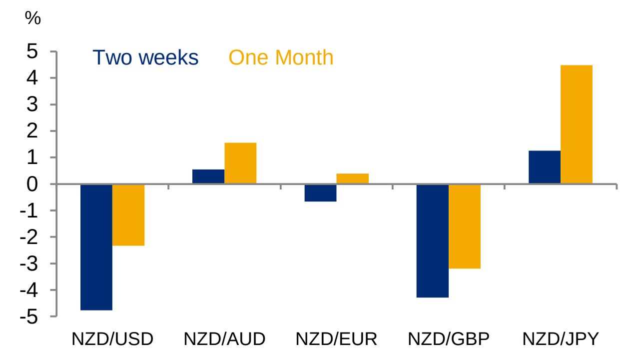
Our negative view on NZD/USD is tempered by the fact that the NZ economy continues to grow above trend and resource pressures are tightening. NZ monetary policy is expected to be on hold all through next year, but as headline and core CPI inflation recover, the market will increasingly focus on the timing of the first tightening. NZ-US rate spreads might contract, but other NZ-global spreads are likely to increase, a supportive factor for the NZD.

BNZ Foreign Exchange Forecast Summary

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	NZD/CNY
Current	*0.70*	*0.95*	*0.66*	*0.57*	*78*	*4.82*
Dec-16	0.72	0.96	0.70	0.58	79	5.00
Mar-17	0.70	0.96	0.71	0.58	78	5.04
Jun-17	0.68	0.94	0.68	0.57	78	4.92
Sep-17	0.67	0.96	0.66	0.56	76	4.81
Dec-17	0.67	0.96	0.64	0.56	75	4.80
Jun-18	0.68	1.00	0.64	0.56	74	4.87
Dec-18	0.69	1.00	0.63	0.57	74	4.91
Jun-19	0.71	1.00	0.63	0.57	75	5.06
	AUD/USD	**EUR/USD**	**USD/JPY**	**GBP/USD**	**USD/CNY**	**TWI**
Current	*0.73*	*1.06*	*111*	*1.24*	*6.89*	*77*
Dec-16	0.75	1.02	110	1.23	6.95	80
Mar-17	0.73	0.98	112	1.21	7.20	79
Jun-17	0.72	1.00	114	1.20	7.24	78
Sep-17	0.70	1.02	113	1.19	7.18	77
Dec-17	0.70	1.04	112	1.20	7.17	77
Jun-18	0.68	1.06	109	1.21	7.16	78
Dec-18	0.69	1.10	107	1.22	7.12	78
Jun-19	0.71	1.12	105	1.25	7.12	79

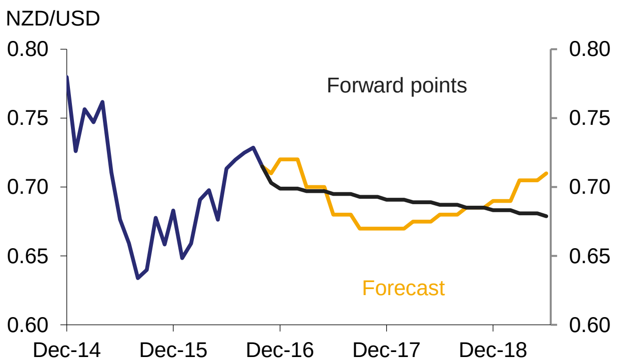
Source: BNZ, Bloomberg

NZD – Changes Over The Past Month



Source: BNZ, Bloomberg

NZD/USD: Mild Depreciation Through 2017



Source: Bloomberg, BNZ

The Crosses:

NZD/AUD: Our projections for the next year have the cross consolidating in a 0.93-0.96 range, so exporters should be looking to hedge exposure on any dips into the low 90s. We see NZ's cyclical outlook as more positive compared to Australia and this should be reflected in a tighter labour market, the development of higher relative inflationary pressure and support for the cross. The next move from the RBNZ is mostly likely to be a rate hike, while the market is still toying with the chance of the RBA possibly cutting again next year. Our longer term projections have an eventual move to parity, possibly sometime in 2018.

NZD/GBP: Trump's victory has taken some downward pressure off GBP as the vote for "anti-establishment" puts the spotlight on Europe's forthcoming elections and possibly a more conciliatory EU in dealing with Britain's eventual exit. The element of doubt around "hard" or "soft" Brexit is enough to contain selling pressure on GBP. Recent UK economic data have held up better than expected in the Brexit vote aftermath, but we think that it is just a matter of time before signs of weaker activity are forthcoming. The UK economy still faces a prolonged period of economic uncertainty and a large current account deficit to fund, which should prevent GBP recovering strongly from here. We see NZD/GBP hovering in the high 50s for some time yet, an historically elevated level.

NZD/EUR: Trump's surprise victory has been clearly negative for EUR ahead of a long list of upcoming elections/votes in Europe over the next year including the Italian constitutional referendum in December, the French Presidential vote in May and German Federal election less than a year away. These represent a key source of uncertainty and the period of maximum risk is seen to be over the next 3-4 months, leading to further EUR weakness. Thus, the Trump victory has resulted in a significant upgrade to near-term NZD/EUR projections and we recommend that exporters take on some extra cover ahead of this upcoming period of heightened risk for the region.

NZD/JPY: JPY has been significantly hit, a reflection of the stronger global bond yield dynamic as global inflationary pressures are likely to be higher under Trump's leadership. This works in favour of the BoJ, which has been struggling to meet its inflation target. Japan's economy remains soft and core inflation has been moving lower, not higher. The "yield curve control" policy adds to the pressure on the BoJ to print money to prevent Japan's 10-year bond rate from rising. This should keep downward pressure on the yen and over the next 12 months, NZD/JPY is no longer expected to fall, with our NZD/JPY projections revised higher. The best chance for a much weaker NZD/JPY is some sort of global shock, but these are unpredictable by definition.

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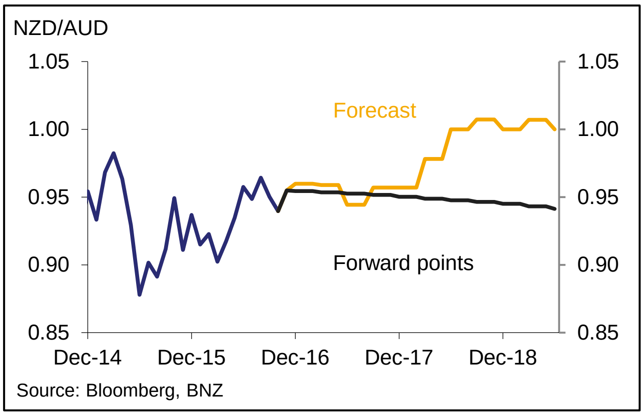
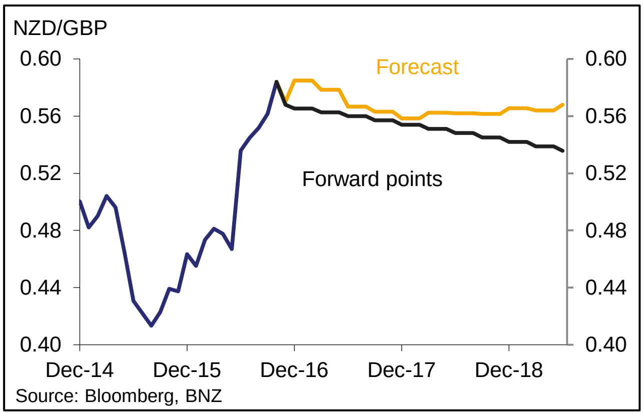
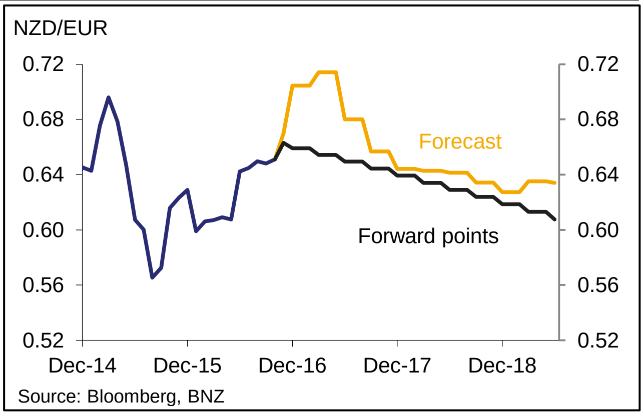
NZD/AUD: Consolidation Ahead; Upside For Medium-Term



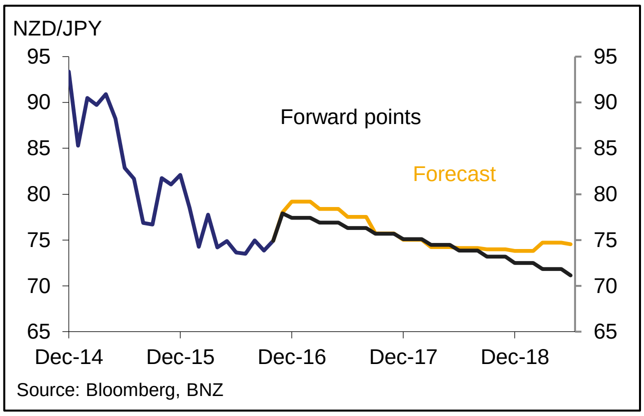
NZD/GBP: Consolidating at a Very Elevated Level



NZD/EUR: Heightened EUR Political Risk Near-Term



NZD/JPY: Upside Risk Next 6-9 Months



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