New Zealand dollar strategy and tactics report

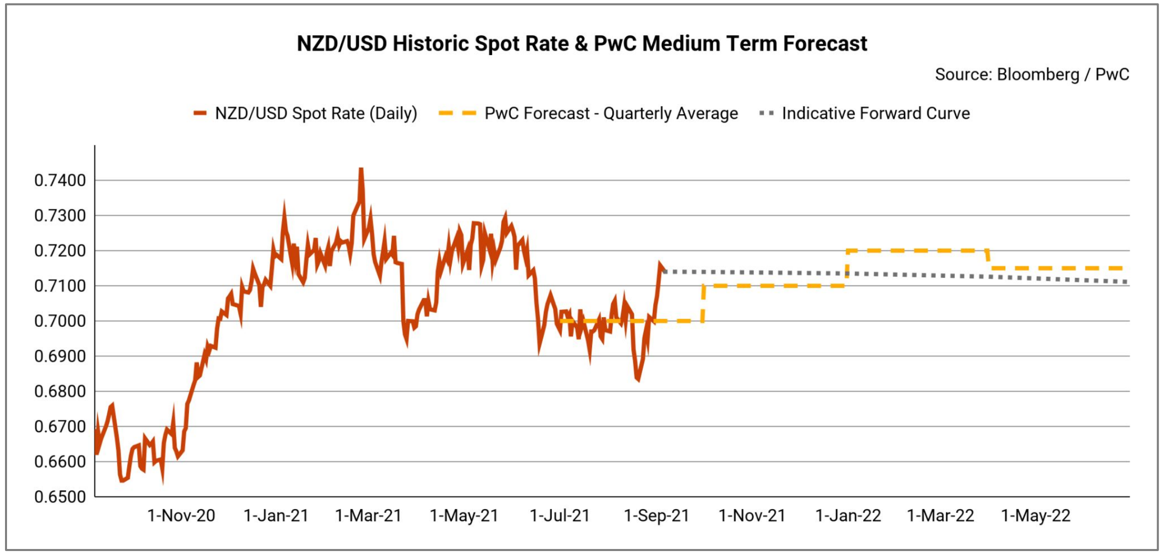
PwC Treasury Advisory | Rangatōpū Rawa

6 September 2021

Table of contents

NZD/USD: Recommendations and forecasts

Current Spot: 0.7140



The domestic Covid environment poses an additional complication for clients with both import and export related NZD/USD exposures. While the focus of risk management should be proactivity rather than reactivity, the evolving situation will likely present short-term challenges and opportunities. General recommendations may not suit all circumstances. Please discuss specifics with your principal advisor.

Core NZD/USD exchange rate views

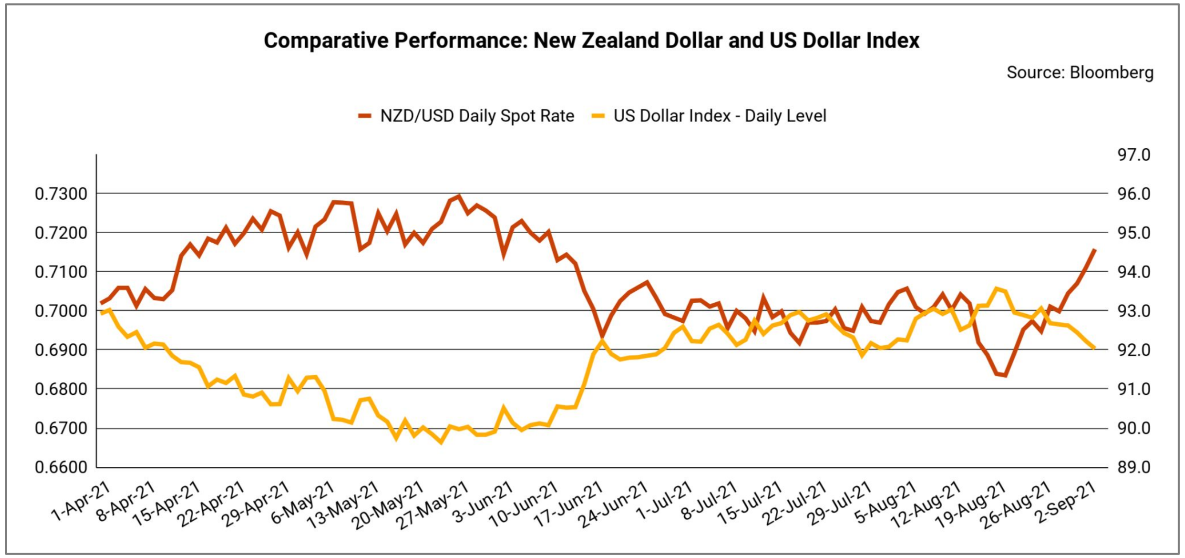
We retain our core expectation for a general increase in the NZD/USD over the coming quarters. While the stated intentions of the RBNZ argue for a move to the upside, the momentum will be slowed by ongoing uncertainty regarding the spread of the Covid variant(s) and US dollar volatility.

The NZD/USD extended its upward advance last week, climbing above 0.7150 for the first time since early June. Expectations of RBNZ action and a short lockdown were domestic drivers of the move. From an offshore perspective, a continuation of the weakening trend in the US dollar index provided NZD/USD an additional upside boost. Soft US employment data on Saturday was a notable contributor to the declining US dollar, the data calling into question the ability of the Federal Reserve to reduce Covid-era stimulus in the near term. We view 0.7100 as interim support, with 0.7200, if tested, slowing topside advances.

Exporter hedging recommendations	
0-12 months	The recent break below 0.6900 should have elevated hedging to maximums. Reinstate staggered orders from 0.6950 as required to maintain policy maximums.
12-24 months (no filters)	Recent break of 0.6910 and run towards 0.6800 should have lifted hedging levels to at halfway between mids and max. Maintain orders near 0.6910 with a view to sustaining that level of cover. A mix of collars and forwards remains our hedging instrument preference.

Importer hedging recommendations	
0-6 months	Last week's advance above 0.7150 should have triggered orders, elevating hedging levels toward Policy midpoints. Establish new orders from 0.7180 with a view to achieving hedging levels that are half-way between mid and max of Policy by 0.7250.
6-12 months	The advance above 0.7150 presents an opportunity to elevate hedging from Policy minimums. Layer fresh orders from 0.7180 with a view to achieving midpoints of Policy by 0.7250. Please get in touch as needed for specific recommendations.

Insight: Central bank binaries - lefty-loosey or righty-tighty



The central bank bonds of unity formed during the initial response to Covid-19 are showing signs of breaking. In one camp are the handful of banks eager to unwind emergency policy settings (and maybe layer a little bit of tightening on top). In the other camp are the banks looking to maintain current policy support for a while longer. The Reserve Bank of New Zealand (RBNZ) are arguably the poster child for camp one, having whipped the title away from the Bank of Canada (BoC). The steadfast Reserve Bank of Australia (RBA) dominate camp two with the US Federal Reserve (Fed) arguably in their ranks. Straddling the fence at present, with a foot in both camps, is the European Central Bank (ECB) and the Bank of England (BoE). From an NZD/USD perspective, divergence between the RBNZ and the Fed would appear to be the central bank aspect most consequential to currency sentiment. The noted impact of general US dollar strength / weakness in recent months on NZD/USD suggests another central bank could be exerting influence over the relative value of our local currency.

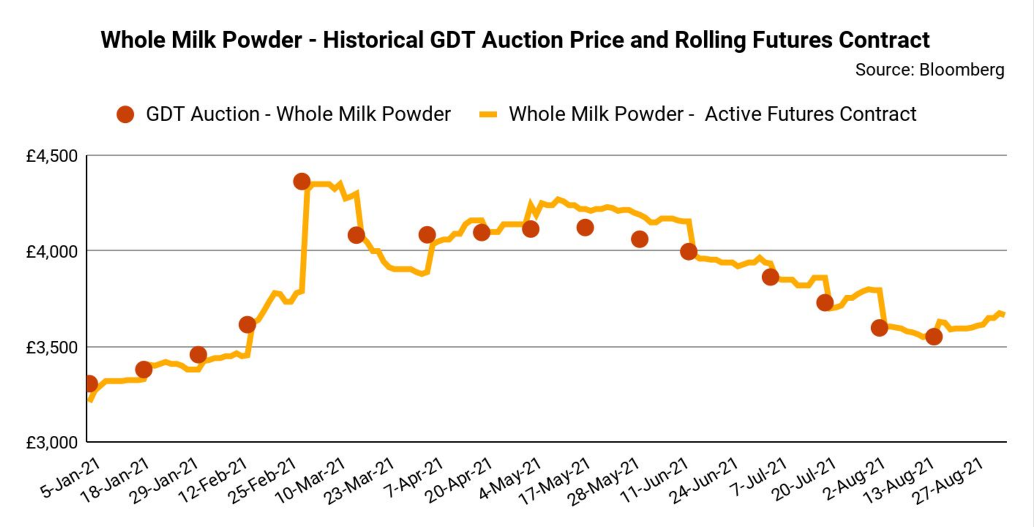
An aggressive RBNZ and a comparatively less aggressive Fed should make for a rapid ascension in the NZD/USD. Higher domestic base interest rates will certainly serve to boost the relative value of the NZD, but there is more moving the USD than just the presumed and evolving tightening intentions of the Fed.

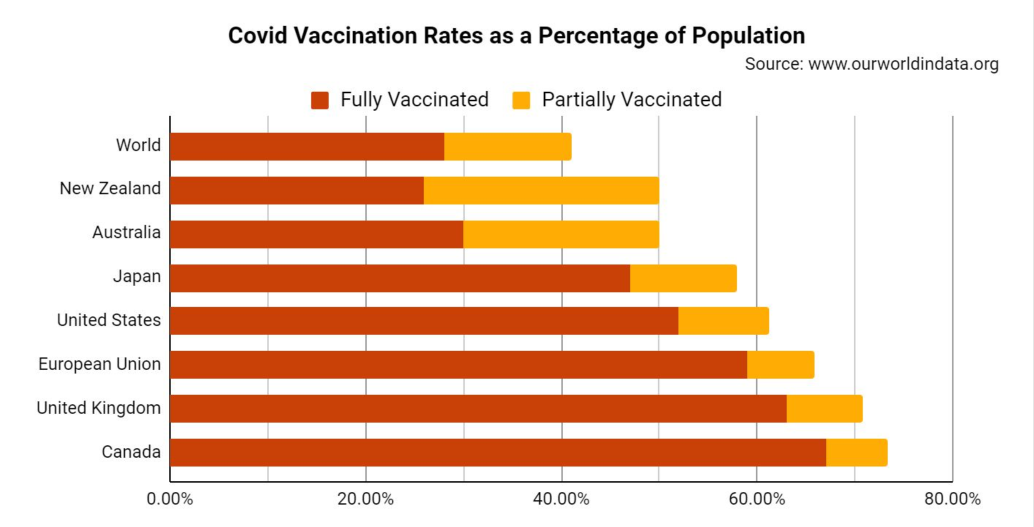
Prior to September, the NZD/USD had struggled to maintain a significant break beyond 0.7000. That tough topside played out in an environment where expectations of RBNZ tightening action were increasing while the market perception of the Fed tightening policy settings was a little up in the air. Outside of the dueling central bank narrative is the overarching theme of US dollar sentiment. Broad US dollar strength, as measured by the US dollar index (DXY), served to limit the advance of the NZD/USD. While the recent NZD/USD advance owes a fair bit to RBNZ interest rate expectations and the domestic Covid response, US dollar weakness has also played a crucial role. Some of that weakness stems from Fed expectations (expectations that took a knock over the weekend following employment data falling shy of consensus forecasts), but risk sentiment and relativity also play a part. Setting aside *flight to safety* trades, potentially the largest driver of US dollar sentiment this week will be the ECB's policy announcement.

Across the past week, a number of ECB officials have publicly expressed a desire to discuss tentatively tightening policy settings at the next scheduled meeting (Thursday). Those expressions have given Eurozone sovereign bond yields a mild lift and, more importantly, granted the EUR/USD a modest boost. EUR/USD chews up almost 60% of the DXY - where the EUR/USD goes, the DXY will go, to varying degrees, the other way.

Should the ECB talk down (or even fail to acknowledge) the prospect of winding back a proportion of Covid-response monetary policy settings, the recent moves higher in the EUR/USD will likely retrace. Such an outcome would serve to indirectly take some of the near-term winds out of the NZD/USD sails.

Key drivers of the NZD/USD exchange rate outlook





Domestic event risk

Once again, the domestic data diary is fairly light this week. A Global Dairy Trade (GDT) auction may impact the NZD/USD. Futures markets currently suggest yet another benign auction event, implying that any GDT related impact will likely be of the marginal variety. As the week progresses, positioning ahead of next week's Q2 GDP release may become evident, but again is likely to be marginal.

Case counting

On the Covid side of the equation, case counts and the pace of vaccination will also continue to exert mild influence over the NZD/USD. The assumption that the current lockdown will prove to be relatively short and will be followed by a splurge of spending (economic activity) is heavily factored into the current level of NZD/USD. Headlines or data that serve to challenge those assumptions offer the potential for a rapid (albeit partial) retracement of the recent advance.

Looking beyond the near-term, relative vaccination rates will continue to hold economic sway. Markets are increasingly looking past 2nd-jabs as a precursor to a return to economic normality and focusing upon the possible need for ongoing booster shots as the key.

Offshore event risk

As discussed in the prior slide, the words of the ECB may well prove to be of more relevance to the NZD/USD this week than economic data from either New Zealand or the United States. To be fair, notable market-moving US data is limited over the coming days. As a result, general US dollar sentiment will likely serve as the primary driver of magnitude and direction in NZD/USD.

Also on the central bank radar this week is the RBA and BoC. Despite geographic proximity, it is unlikely that anything coming from the RBA will impact the NZD/USD. The BoC however does have potential to influence at the margin. Further tightening-talk from the BoC should it occur, would illustrate that the RBNZ has 'friends', potentially improving market-implied odds of RBNZ action and providing a modicum of support to NZD/USD.

Get in touch with us.

Brett Johanson
Partner
+64 21 771 574
brett.a.johanson@pwc.com

Alex Wondergem
Partner
+64 21 041 2127
alex.j.wondergem@pwc.com

Tom Lawson
Director
+64 27 421 0733
tom.f.lawson@pwc.com

Mike Shirley
Associate Director
+64 27 480 9770
mike.c.shirley@pwc.com

Rajeev Verma
Senior Analyst
+64 21 024 86011
rajeev.c.verma@pwc.com

Samuel White
Senior Analyst
+64 21 0236 9953
samuel.j.white@pwc.com

Cameron Scott
Analyst
+64 21 831 796
cameron.b.scott@pwc.com

Keegan Robbins
Analyst
+64 21 823 739
keegan.g.robbins@pwc.com

Stephanie Blackwell
Analyst
+64 21 181 0008
stephanie.z.blackwell@pwc.com

Grace Lewis
Analyst
+64 21 859 614
grace.h.lewis@pwc.com

Hamish McCarroll
Analyst
+64 21 859 901
hamish.d.mccarroll@pwc.com

pwc.co.nz/services/treasury-and-debt-advisory