NZD/USD: Ready for another leg lower

The trade war will probably keep striking the battered and bruised New Zealand dollar and the dovish central bank of New Zealand is unlikely to provide any solid armour. We think NZD/USD may soon edge below 0.6500

RBA and Fed a good framework for the RBNZ

In the midst of recent market turmoil, the Reserve Bank of Australia kept rates on hold at 1% yesterday, while Governor Philip Lowe reiterated his recent rhetoric in favour of an 'extended period of low-interest rates' to support sluggish inflation.

In broad terms, the central bank has kept its forward guidance aligned with the Federal Reserve's 'openness to further rate cuts if necessary'. Turning to New Zealand's central bank meeting tomorrow, markets will scrutinise whether Governor Adrian Orr will align his forward-looking language in line with the Fed and RBA. In fact, guidance will drive the market's reaction to the rate announcement, given that a 25bp rate cut is fully priced in (100% implied probability) – and is our call too.

We don't necessarily see a weaker-NZD reaction right after

> *the announcement, but expect forward guidance to confirm the rate outlook will continue to be unsupportive for the currency*

The rate cut is expected in spite of the constructive 2Q labour data released overnight and is probably warranted given the negative dataflow (in particular, weaker business activity and confidence indicators) and price growth still below the central bank's target. We believe these factors along with trade-war-related risks (New Zealand is highly dependent on exports to China) will leave no choice for Governor Orr other than paving the way for more easing ahead.

We forecast another RBNZ cut in 2019, in line with market pricing of about 50bp of total easing. Given markets expectations, we do not necessarily see a weaker-NZD reaction right after the rate announcement but expect the forward guidance to confirm that the outlook will continue to be unsupportive for the currency.

0.64 NZD/USD

4Q19 Forecast

Trade tensions to keep fuelling downside risk

It's been a tough start of the month for risk assets, and the New Zealand dollar hasn't been spared in the tariff-induced risk-off turn.

The lower than expected USD/CNY fixing by the People's Bank of China at 6.9683 has averted another round of sell-off in risk-sensitive assets for now, but the risk appetite remains muted. In such an environment, the New Zealand dollar is unlikely to see any rays of sunshine anytime soon, especially given the unsupportive rate outlook and the prospects that trade tensions have more room to escalate further rather than subside in the short term.

Therefore, we believe the balance of risks for NZD is heavily tilted to the downside and we would not be surprised to see NZD/USD edge below 0.6500 in the coming weeks and head towards 0.6400 in autumn.

The recovery may be long and painful

In the longer term, we expect trade tensions to start abating in 4Q19 as both China and the US move closer to a trade deal. This would likely drain up the downward pressure on NZD, but we expect - differently from AUD – weaker economic fundamentals to make the recovery in NZD/USD quite lengthy and suspect the pair may need to wait until 2Q20 to climb back above 0.6600.

This implies that AUD/NZD could well reach 1.08 as early as in 1Q20.

Author

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

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