The Aerial View

Market Update

NZD Update

- Q1 GDP data may be influential in guiding expectations of the RBNZ
- A weakening AUD amid an RBA policy-reappraisal also has a role to play

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Amid speculation about the RBNZ’s current plans for policy after last month’s rate cut, tomorrow’s GDP report may have a big say this week on the NZD’s short-term performance as the currency trades just north of (near) four year trend support against the USD.

Certainly, a dovish FOMC could well lend the kiwi a hand both directly and indirectly (given the NZD’s 68% correlation with the CNY, relative to the USD, since 2010). But the bears have been in firm control of the NZD for a while now – a function of trade uncertainty and the USD’s ascent, of course, but the NZD’s diminishing lustre on the basis of yield cannot be ignored.

With the OCR at a record low, the NZD cedes 39 - 65bp to the USD across the (2-10) curve, and with the JPY-funded pick-up having halved in three years (to 140-178bp), even historical volatility (in NZD/JPY) at the lower end of its historical range becomes a bigger problem for the carry-trade in a ‘risk-on’ environment.

Anything that enhances the prospects of further RBNZ cuts therefore places more distance between the NZD and its status as a go-to yield enhancer – a fact that sheds light on the second largest daily move in NZD/USD this year (of -1.6%). This came on March 27th as RBNZ Governor Adrian Orr signalled that the “more likely direction of our
next OCR move is down”.

Of course, further cuts are by no means assured: early this month RBNZ assistant governor Christian Hawkesby suggested that rates could “remain broadly around current levels for the foreseeable future”. But Mr Hawkesby also noted the need to be “ready to adapt to changing conditions”, and it could certainly be argued that Mr Hawkesby’s stipulation is being met.

In fact, a forecast-matching 0.6% q/q print tomorrow may not be enough to deter the bears. PMI data have already shown that manufacturing activity slumped in May (the index posted the largest monthly drop since 2012) with a slide in new orders auguring badly for output. Inflation expectations as measured by ANZ, meanwhile, have dropped to their lowest in nearly two years.

Dairy too has done the NZD few favours of late with prices falling for the second consecutive auction a fortnight ago; and the NZD’s outlook cannot be seen in isolation from its neighbour given the historically close relationship between the two currencies. Certainly, the RBNZ is not indifferent to the outlook for the AUD/NZD cross.

At present, the AUD is in the grip of shifting expectations surrounding domestic monetary policy (the product of fresh assumptions about NAIRU) which has left the currency just a few pips above the 2016 low against the USD, below which there is limited technical support all the way down to the 2008 low, below 60 cents.

We mention this because since 2000, the NZD and AUD have put in the same directional daily performance against the USD 74% of the time and we note that the NZD’s largest move year-to-date (-1.72%) came on February 6 as RBA Governor Philip Lowe unveiled the Bank’s own shift in policy.


Please direct questions or comments to:

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