

FX Outlook 2018

Group Economics
Macro & Financial Markets
Research

1 December 2017

NZD to outperform the euro

Georgette Boele
Senior FX Strategist
Tel: +31 20 629 7789
georgette.boele@nl.abnamro.com

- The New Zealand dollar (NZD) was the weakest G10 currency in 2017
- The NZD will probably outperform the euro in 2018...
- ...as the central bank will move slowly towards tightening policy
- NZD will continue to underperform the US dollar though
- 2019 should be a positive year for New Zealand dollar

2017 was a weak year for New Zealand dollar

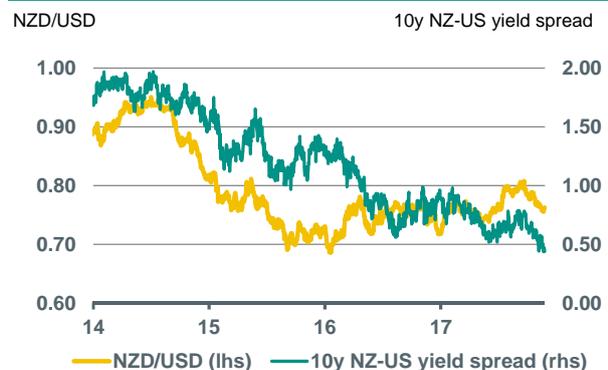
The New Zealand dollar was completely out of favour in 2017. It has declined by 12% versus the euro and 1% versus the US dollar making it the worst-performing G10 currency in 2017. Why? First, yield spread has moved against the New Zealand dollar have weighed on the currency. Second, weakness in dairy prices has also been negative for the New Zealand dollar as this is one of its main export products.

Dairy prices...



Source: Thomson Reuters Datastream, Bloomberg, ABN AMRO Group Economics

...and yield spreads to drive the New Zealand dollar



Source: Bloomberg, ABN AMRO Group Economics

Third, election uncertainty in New Zealand has also acted as a headwind. There is a complete change in the political landscape. Labour formed a coalition with Nationalist New Zealand First and signalled an abrupt change in policy compared to the past. The new government has communicated that it aims at supporting economic growth without a deterioration in government finances. It promised to cut migration, which has given considerable support to growth in the past. Moreover it said that it will ban foreigners from buying houses in New Zealand. In addition, it stated that it will review and reform the Central Bank Act. Labour said in its election campaign that it would like to add full employment to its existing sole mandate of price stability. These developments have

concerned investors and this has weighed on the New Zealand dollar sentiment. Has the New Zealand dollar seen the bottom? We try to answer this question in this report.

Mixed in 2018 and upside in 2019

We expect some upside for New Zealand dollar versus the euro as the Reserve Bank of New Zealand (RBNZ) will slowly but surely move towards tightening monetary policy. This is because positive growth momentum and above-trend growth will probably result in some upward pressure in inflation. The RBNZ has a 1-3% range for inflation but would like to keep inflation close to 2%. We expect a 25bp rate hike while financial markets have priced in a probability of 50% of such a hike. The RBNZ has signalled barely one 25bp rate in the coming two years. We think that this is too bearish. Expectations for a rate hike should support the NZD versus the euro but not versus the US dollar as we also expect more Fed rate hikes than market consensus.

For 2019, we have pencilled in a total of two 25bp rate hikes which is more hawkish than market consensus and the projections by the RBNZ. This should provide strong support to the kiwi in 2019 even if market focus is also on ECB rate hikes. We expect the overall commodity index (CRB) to rise and investor sentiment to be constructive in 2018 and 2019. These developments will be supportive for New Zealand dollar. All in all, the New Zealand dollar will be mixed in 2018 but we expect it to appreciate in 2019 on the back of central bank tightening and a positive investor sentiment.

In the alternative scenario, if the housing market and the economy were to slow down considerably, then it is unlikely that the RBNZ will hike and therefore the New Zealand dollar will probably decline.

Our NZD forecasts

New forecasts in red/bold

	01-Dec	Q1 18	Q2 18	Q3 18	Q4 18	Q1 19	Q2 19	Q3 19	Q4 19
EUR/USD new	1.1913	1.1800	1.1700	1.1600	1.1500	1.1800	1.2000	1.2300	1.2500
EUR/USD old		1.1500	1.1700	1.2000	1.3000				
NZD/USD new	0.6829	0.6900	0.6850	0.6800	0.6750	0.6800	0.7000	0.7200	0.7400
NZD/USD old		0.7600	0.7800	0.8000	0.8200				
EUR/NZD new	1.7444	1.7101	1.7080	1.7059	1.7037	1.7353	1.7143	1.7083	1.6892
EUR/NZD old		1.6100	1.6000	1.5900	1.5900				

Source: ABN AMRO Group Economics

Find out more about Group Economics at: <https://insights.abnamro.nl/en/>

DISCLAIMER

This document has been prepared by ABN AMRO. It is solely intended to provide financial and general information on economics. The information in this document is strictly proprietary and is being supplied to you solely for your information. It may not (in whole or in part) be reproduced, distributed or passed to a third party or used for any other purposes than stated above. This document is informative in nature and does not constitute an offer of securities to the public, nor a solicitation to make such an offer.

No reliance may be placed for any purposes whatsoever on the information, opinions, forecasts and assumptions contained in the document or on its completeness, accuracy or fairness. No representation or warranty, express or implied, is given by or on behalf of ABN AMRO, or any of its directors, officers, agents, affiliates, group companies, or employees as to the accuracy or completeness of the information contained in this document and no liability is accepted for any loss, arising, directly or indirectly, from any use of such information. The views and opinions expressed herein may be subject to change at any given time and ABN AMRO is under no obligation to update the information contained in this document after the date thereof.

Before investing in any product of ABN AMRO Bank N.V., you should obtain information on various financial and other risks and any possible restrictions that you and your investments activities may encounter under applicable laws and regulations. If, after reading this document, you consider investing in a product, you are advised to discuss such an investment with your relationship manager or personal advisor and check whether the relevant product—considering the risks involved—is appropriate within your investment activities. The value of your investments may fluctuate. Past performance is no guarantee for future returns. ABN AMRO reserves the right to make amendments to this material.

© Copyright 2017 ABN AMRO Bank N.V. and affiliated companies ("ABN AMRO")