Trade Idea – Foreign Exchange

Kiwi downtrend to prevail

21st October 2016

**Nzd decline pauses**

- Signs are emerging that the momentum that has sustained the yearlong rally in the NZD has started to take a marked turn. The trade weighted Kiwi has fallen 2.7% in the past six weeks as dovish domestic monetary policy and declining support from dairy prices has put the currency under pressure. In addition, the recent climb in developed market sovereign yields has tempered support for the NZD from carry trades, investments that profit from widening interest rate differentials between the NZD and other currencies (see Figure 1). While better than expected Q3 inflation numbers have provided the NZD/USD and NZD/EUR with a small boost, we still believe the downward trend is likely to continue, with current levels offering an attractive entry point for tactical investors. A further cut to the Reserve Bank of New Zealand’s (RBNZ) official cash rate at the monetary policy meeting in November could be the catalyst for the next leg lower for the NZD.

![Figure 1: International yields rise from trough](source: Bloomberg, ETF Securities)

**Bearish factors weigh in**

- At the latest monetary policy meeting, the Reserve Bank of New Zealand (RBNZ) refrained from cutting interest rates but made it clear that “further policy easing will be required”. The New Zealand economy has benefited from strong inward migration and healthy growth, but headline inflation remains at multi-decade lows, in part due to the strength of its own currency. As outlined in a speech by the RBNZ assistant governor, John McDermott, last week the central bank’s concern is that soft headline inflation figures will feed into “expectations of future inflation” and “weigh on future actual inflation”. While Q3 inflation of 0.2% impressed markets, on an absolute basis it remains lacklustre, so we expect the RBNZ to maintain its dovish inclination and cut interest rates at the upcoming meeting on the 9th November. Lower rates will weigh on the relative rate differential between the NZD and its developed currency counterparts and keep the NZD under pressure.

**Strong resistance to come**

- The NZD/USD is currently hovering between its recently established downward trend line at around the 0.721 level and its 100 day moving average (DMA) at 0.718. These levels have significance as they acted as key support points over recent months and will prove difficult for the currency pair to breach without a strong impetus. Should the currency pair turn lower it is likely to run into support at its July 25th low at around 0.696, 3.9% below current levels. For the NZD/EUR, the technical

*All figures quoted are sourced from Bloomberg unless stated otherwise.*
picture is less compelling at current levels but a further move to 0.66 would provide an attractive point to gain short exposure as this resistance has failed to be significantly penetrated since May of last year.

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