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Global

FX Insight

NZD - Rising Risks of Short Squeeze

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NZD Near Lower Bound of Model; Short Positions Stretched

Our fair value model shows that NZD spot is close to testing our model's lower bound of 0.66 levels (1 standard deviation of fair value estimate of 0.73 levels). Historically NZD spot has hardly trade outside of our lower bound and our model implies that downside could be limited, barring external shocks (i.e. full-blown trade war). In addition, we note that CFTC positioning report saw modest reduction of NZD short positions from unprecedented levels. Further reduction in short position from overstretched levels is expected to expose NZD to the upside in the interim. Bias to initiate opportunistic buy on dips at 0.67 for a move towards 0.6850 (targeting 2% profit or so). SL below 0.6650 (risk of 0.7%).

RMB (Trade War), Dairy Prices, RBNZ to Drive NZD Direction

Given that NZD is highly sensitive to RMB, re-escalation in trade war tensions between US and China will have a negative bearing on the NZD. But the reverse is also true - moments of relief in the RMB on the back of China's measures could help to support the NZD. Divergence between dairy prices and Fonterra's farmgate forecast typically do not last and should correct. We think GDT (dairy) prices could rise given dry weather conditions in Northern hemisphere and that could weigh on supply and support dairy prices (potential positive for NZD). Upcoming GlobalDairyTrade (GDT) auctions on 21 Aug and 4 Sep should deserve some attention.

Will RBNZ's Dovish Rhetoric Shift?

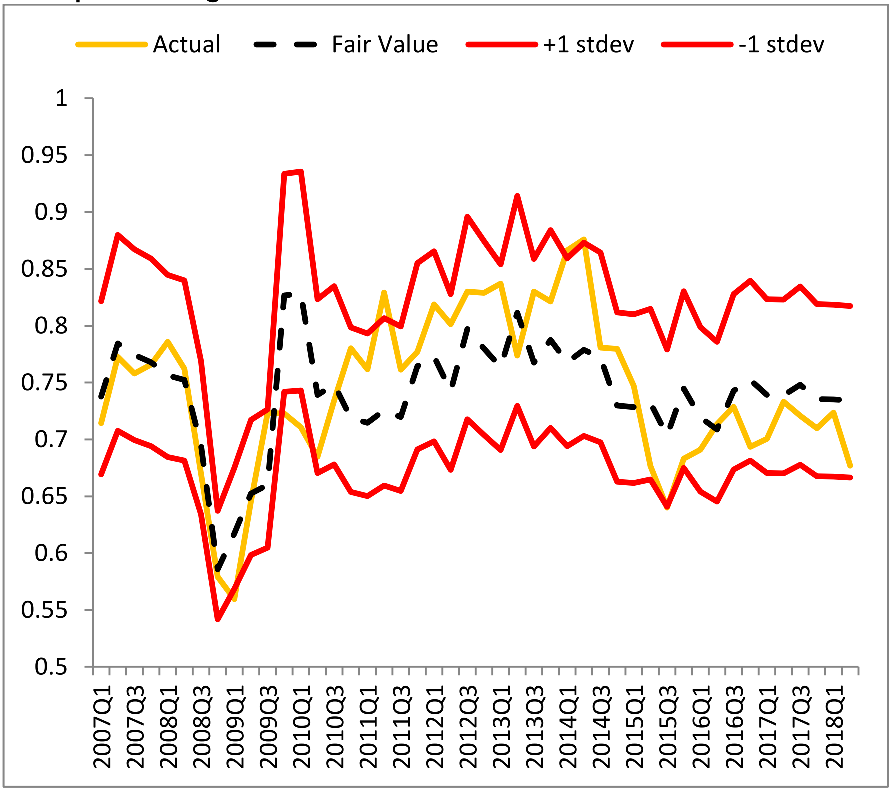
RBNZ is widely expected to keep Overnight Cash Rate on hold at 1.75% at its upcoming Monetary Policy Committee meeting tomorrow (5am SG/KL time on 9 Aug) amid cautious inflation outlook, signs of moderation in global activity and ongoing trade war concerns between US and China. The release of quarterly MPS (on the same day) and Governor Adrian Orr's press conference are also worth focusing on, especially after the recent slippage in both services and manufacturing PMIs for Jun as well as the surprised rebound in inflation. In particular we will be watching for potential change in wordings on the MPS in relation to "above-trend pace of growth" and if RBNZ Governor Orr flags the possibility of higher price pressures amid higher energy prices – the latter (surprise element) could shift market expectations for an earlier than expected RBNZ rate hike and is supportive of the NZD.

SEE PAGE 9 FOR IMPORTANT DISCLOSURES

Fair Value Model Suggests NZD Spot is Near Stretched Lower Bound

Our fair value model (estimated using OLS on quarterly data starting 1Q 2007) which takes into account 3 cyclical factors - the 10Y yield differentials between NZ and US adjusted for inflation, current account to GDP ratio differentials and a reflation variable (proxy by changes in World equities to World Government bond) puts NZD/USD fair value estimate at 0.73 levels, with a lower bound of 0.66 and 0.81 (1 standard deviation from fair value estimate).

NZD Spot Nearing 1 Standard Deviation of Our Fair Value Estimate



Source: CEIC, Bloomberg, Eviews, Maybank FX Research & Strategy

Some observation could be made from the historical performance of our fair value model: (1) Our NZD fair value estimate has been relatively stable at 0.73 levels over the past 6 quarters with the exception of 1 quarter; (2) deviation of NZD spot from fair value estimate is not uncommon but it hardly trades out of our fair value model's lower bound; (3) NZD spot typically do not spend more than 2 quarters languishing at the lower bound; (4) NZD spot tends to rebound sharply upon testing the lower bound.

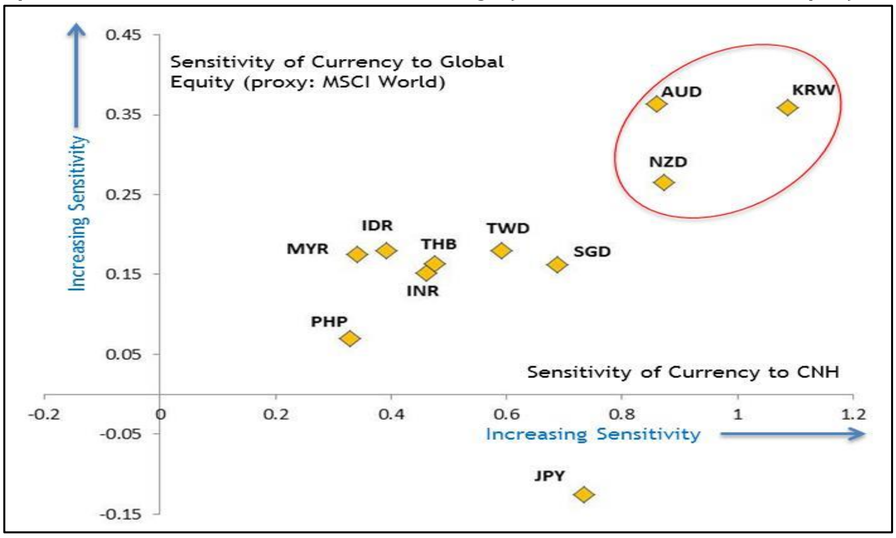
Barring external shocks (i.e. full blown trade war), we think NZD downside may be limited towards 0.66 levels as implied from our model.

That said it may be too soon to call for sustained NZD strength as NZD still lack catalysts from within (unless dairy prices turned higher and/or RBNZ shifts into hawkish bias) and the current external environment remains unfavourable (concerns of trade wars inflicting damage to world trade and world growth could hamper a meaningful recovery in the NZD).

NZD highly Sensitive to Changes in RMB and Risk Sentiment

We did a study on the sensitivity of various currencies in Asia Pacific to changes to independent variables including RMB (as proxy for trade war) and MSCI World Index (as proxy to risk sentiment). Our study shows NZD is highly sensitive to movements in RMB and stock market.

Apart from KRW and AUD, NZD is Also Highly Sensitive to RMB and Equity



Note: X axis: Beta of XXX currency to CNH as independent variable; Y axis: Beta of XXX currency to MSCI World Index as independent variable based on daily change data YTD 11 Jul 2018
Source: Bloomberg, Maybank FX Research & Strategy

While we acknowledge that trade war tensions between US and China are far from over (US to impose 25% tariff on $16bn of China imports on 23 Aug; could increase tariff rate from 10% to 25% on another $200bn worth of Chinese imports (as early as 5 Sep); China said it is ready to retaliate, US public hearings on 20 – 23 Aug, etc.) and should continue to exert downside pressure on the RMB, we do not rule out moments of relief in the RMB on the back of China's measures:

- PBoC was said to ask banks to prevent "herd behaviour" and momentum chasing moves in the currency market in a Monday morning meeting. Bloomberg news reported that any pressure building on the RMB will need to be released in a timely manner and China will not work against market forces… PBoC has plenty of tools to stabilise the market, will keep RMB flexible and allow it to move in both directions. CNH rose nearly 1% in the past 2 days. [6 Aug 2018]

- PBoC announced it will reintroduce the 20% reserve requirement ratio for forward sale of RMB (up from zero), wef. 6 Aug. In the words of PBoC, this move was aimed at preventing macro financial risks and promotes prudent operation of financial institutions, but the markets took the move as a hint that authorities are growing uncomfortable with the pace of RMB depreciation and the one-way move and are taking steps to slow the pace of decline. The CNH rose 1.2% vs. USD last Fri. [3 Aug 2018 announcement]

- PBoC eased bank capital rule to support lending as authorities sought to mitigate rising risks to the domestic economy from US-China trade war. CNH appreciated by more than 1% vs. the USD then [25 Jul 2018]

A temporary relief for RMB or upside gains in risk assets could help to support the NZD.

RBNZ to Retain Dovish Tilt but Surprise Element Not Ruled Out

RBNZ is widely expected to keep Overnight Cash Rate (OCR) on hold at 1.75% at its upcoming Monetary Policy Committee (MPC) meeting on Thu (5am SG/KL time) amid cautious inflation outlook, signs of moderation in global activity and ongoing trade war concerns between US and China.

> *"OCR will remain at 1.75% for some time to come…the direction of our next move is equally balanced, up or down…only time and events will tell"*
>
> *10 May 2018 MPS*

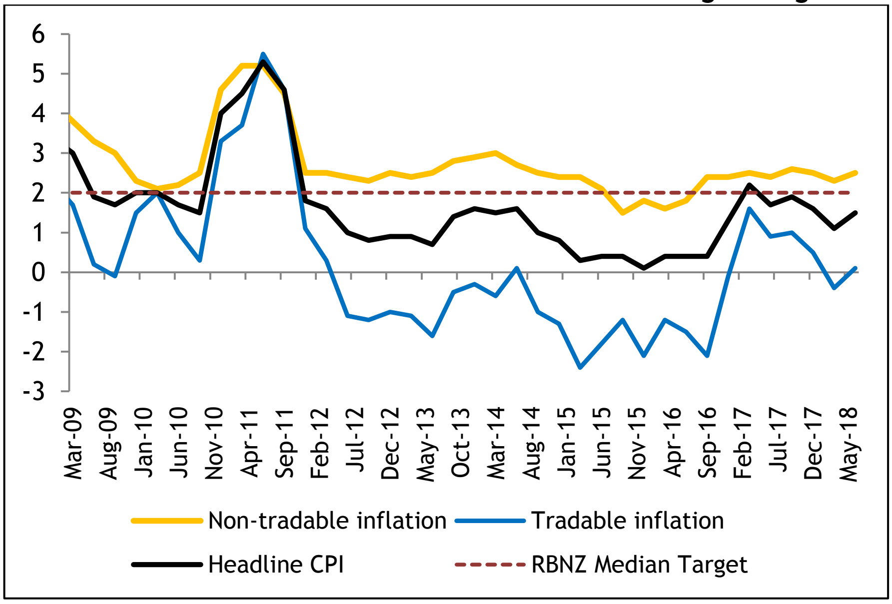
> *"the OCR will remain at 1.75 percent for now. However, we are well positioned to manage change in either direction - up or down - as necessary"*
>
> *28 Jun 2018 MPS*

The RBNZ is also expected to retain a dovish tilt in its Monetary Policy Statement (MPS), taking the lead from Governor Adrian Orr's dovish tone in his previous comments in previous MPC meetings (in May and Jun) and downward pressure on home prices across NZ. He may also be perceived to prefer a softer currency as he did mention that "the fall in NZD after the RBNZ meeting (in May) was a good thing".

We believe the release of quarterly MPS (on the same day) is worth focusing on, especially after the recent slippage in both services and manufacturing PMIs for Jun as well as the surprised rebound in inflation.

In particular we will be watching for potential change in wordings on the MPS in relation to "above-trend pace of growth" and if RBNZ Governor Orr acknowledges the recent decline in Kiwi and if he flags the **possibility of higher price pressures amid higher energy prices - the latter (surprise element) could shift market expectations for an earlier than expected RBNZ rate hike and is supportive of the NZD.**

Inflation could return to the Middle of RBNZ's 1 - 3% Target Range

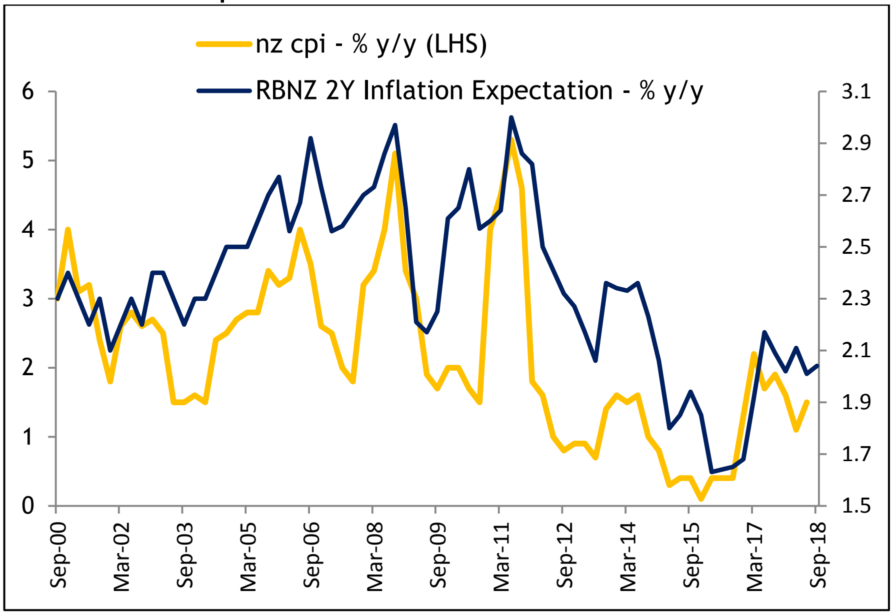


Source: Bloomberg, Maybank FX Research & Strategy

Headline CPI rose to 1.5% y/y in for 2Q, up from 18-month low of 1.1% in 1Q. The rise was due to higher prices for household energy (subcomponents including electricity, gas and solid fuels), transport (higher petrol prices), food, actual rentals and dwelling insurance. Both tradable and non-tradable inflation rose in 2Q.

Headline CPI now comes close to the middle of RBNZ's inflation target range of 1 – 3%. Our internal projection also shows inflation possibly rising towards RBNZ's median target of 2% in early 2019. RBNZ quarterly survey of inflation expectation for 3Q also showed a modest rise to 2.04% y/y. Inflation expectations tend to have implication on inflation, OCR and the NZD.

RBNZ Inflation Expectation Rose



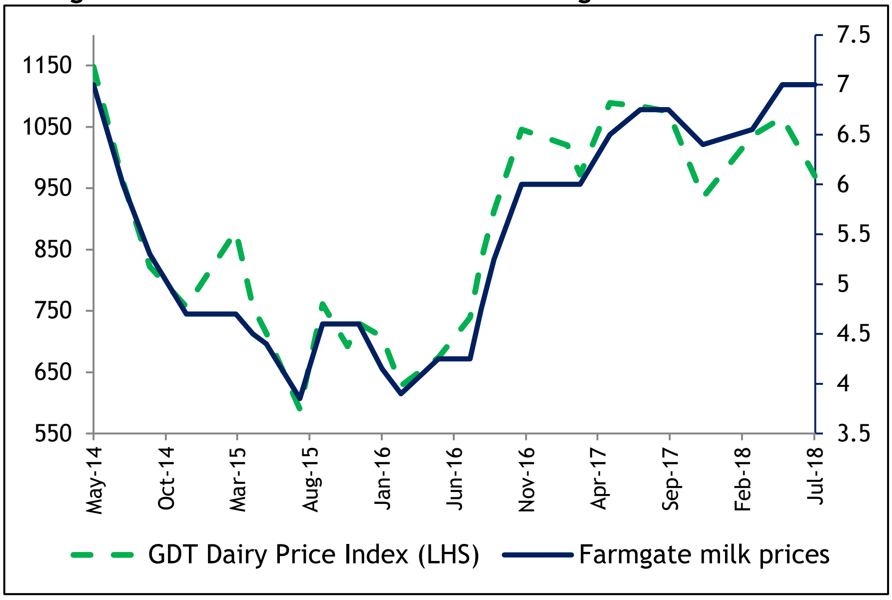
Source: Bloomberg, Maybank FX Research & Strategy

Potential fiscal impulse and further minimum wage increase (minimum wage could be further raised to NZ$20/hour by 2020; has already been raised to NZ$16.50 on Apr-2018) could support consumer spending and result in faster pick-up in inflation.

GDT Auctions Closely Watched

We believe upcoming GlobalDairyTrade (GDT) auctions on 21 Aug and 4 Sep should deserve some attention, given the divergence between dairy prices (decline in dairy prices since Jun's auction) and farmgate forecast (Fonterra upgraded farmgate milk prices to $7/kg for 2018/19, up from $6.55/kg). Such abnormality typically does not last long and this should correct. Issue remains if Fonterra downgrades forecast (possible negative for NZD) or GDT prices play catch-up and rebound from recent lows (could lend a boost to NZD).

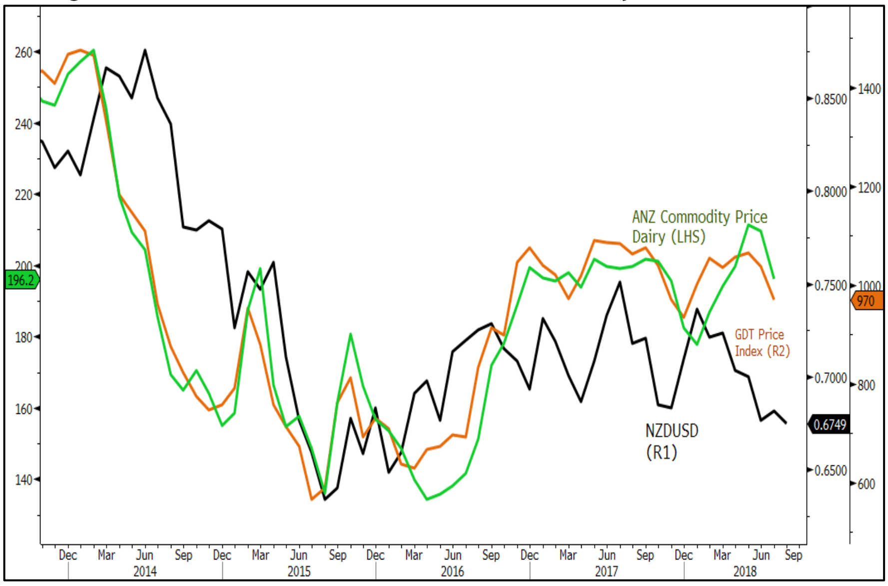
Divergence between GDT and Fonterra's Farmgate Forecast



Source: Bloomberg, Maybank FX Research & Strategy

Movements in dairy prices will impact the NZD, given its strong positive correlation (dairy sector contributes 3.5% to NZ GDP while dairy exports is nearly 30% of NZ merchandise exports). Dry weather conditions (due to summer season) in the Northern hemisphere could result in lower supply in coming months while previous auctions (although prices fell) saw no decline in demand from Chinese buyers. These factors could be supportive of dairy prices and could support the case for NZD upside.

Strong Positive Correlation between NZD and Dairy Prices



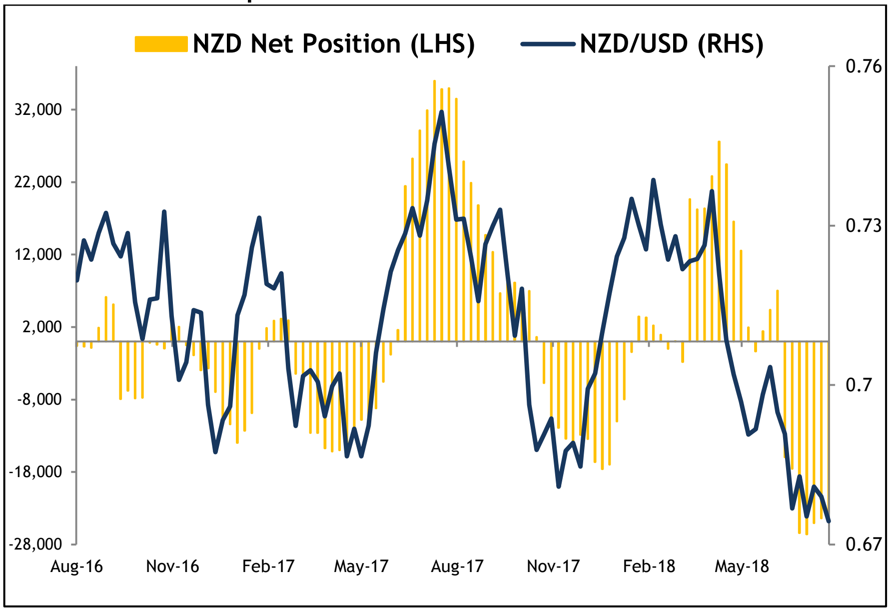
Source: Bloomberg, Maybank FX Research & Strategy

NZD Short Positions Over-Stretched and At Risk of Short Squeeze

Non-commercial CME CFTC positioning (proxy for leveraged funds typically speculative flow in nature) saw modest reduction of NZD short positions from unprecedented levels. Further reduction in short position from overstretched levels is expected to expose NZD to the upside in the interim.

To add, most of the negativities (such as RBNZ's dovish rhetoric, soft dairy prices, cautious inflation outlook, etc.) are already priced in; surprise twist in events, including a temporary recovery of RMB (NZD highly sensitive to; see next page) or less dovish than expected RBNZ could be some of the contributing factors for NZD short positions to unwind.

NZD Shorts near Unprecedented Levels with NZD Near 2Y Lows



Source: Bloomberg, CFTC, Maybank FX Research & Strategy

NZD (Daily Chart) - Downside Risks but Tactical Bias to buy Dips

Source: Bloomberg, Maybank FX Research & Strategy

NZD was last seen at 0.6740 levels. Mild bullish momentum is waning while stochastics is falling. Further downside risks not ruled out in the near term. Support at 0.6720, 0.6690 levels. Resistance at 0.6780 (21 DMA, 23.6% fibo retracement of Jun high to Jul low), 0.6830 (38.2% fibo) and 0.6870 levels (50% fibo). An extended move higher towards 0.6910 (61.8% fibo) should not be ruled out. **Bias to initiate buy on dips at 0.67 for a move towards 0.6850 (targeting 2% profit or so). SL below 0.6650 (risk of 0.7%).**

NZDSGD - Cautious on Decisive Break Below 0.9180

Source: Bloomberg, Maybank FX Research & Strategy

NZDSGD was last seen at 0.9205 levels. Underlying momentum remains bearish bias. Key support at 0.9180 (2017 low). We are cautious especially on the break below that as that could pave way for further downside towards 0.9040 levels (76.4% fibo retracement of 2015 low to 2017 high). Resistance at 0.93 (50 DMA, 61.8% fibo), 0.9430 (200 DMA).

NZDMYR (Daily) – Potential Interim Base in the Making

Source: Bloomberg, Maybank FX Research & Strategy

NZDMYR was last seen at 2.75 levels. Momentum is showing tentative signs of turning bearish on the daily chart – an indication of some short term downside pressure but mild bullish momentum (as seen from weekly chart) remains intact. We do not rule out downside pressure in the near term but price action suggests possible interim bottom in the making around 2.70 – 2.72 levels. Resistance at 2.7750 (100 DMA) before 2.8170 (200 DMA).

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