

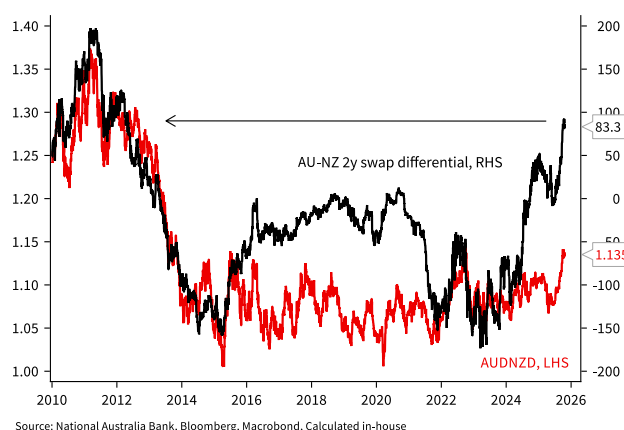
AUD/NZD – Macro conundrums and the cross-rate outlook

- While the widening of the 2-year AU-NZ swap spread suggests the AUD/NZD could trade above 1.25, if we incorporate the AU-NZ term structure and commodity indices to the analysis, the upside for the cross looks more limited
- Similarly, despite supportive short-term rate differentials and a wide AU-NZ unemployment gap, other macro variables—such as New Zealand’s improving current account, potential for a NZ growth rebound which may have begun in Q3, and relative terms of trade—suggest further AUD/NZD gains from here are less certain
- Our outlook for AUDN/ZD sees the cross stabilizing in a 1.13-1.15 range over coming quarters. Our modelling and macro assessment suggest the near-term risk is for a range overshoot while later next year the risk could flip to an undershoot

Following our FX forecast Update, [published](#) last week, we have been fielding several questions on our outlook for AUD/NZD with many colleagues and clients wondering why we are not more bullish on the cross. One common factor triggering the discussion has been the big widening in the 2-year AU-NZ swap spread, which now trades at levels not seen since mid-2012. On its own the spread suggests that the cross could easily trade above 1.25.

Instead, in our outlook we suggest the cross is likely to stabilise around the 1.13-1.15 area with excursions above or below this range likely but not seen as sustainable.

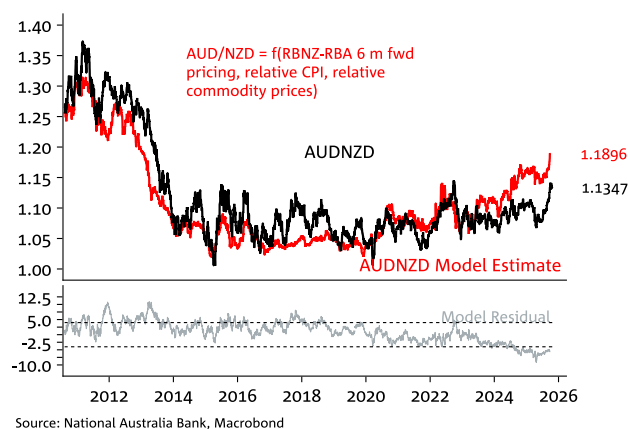
Chart 1: Crikey mate, check this out



Looking at our “old school” model (Chart 2) which estimates the fair value of the cross based on relative CPI inflation, relative commodity prices and relative short-term interest rates (6-month rates), at first glance a higher forecast for the cross would seem easy to justify.

But a closer at the model and its residual, suggests that something isn’t quite right. Ideally, over time we want to see deviations between spot and the model estimate (i.e. the residual) to converge towards 0. But this has not happened for quite some time. Indeed, this is not a recent phenomenon, with the model estimate spending much of its time above spot in the decade between 2010 and 2020. More recently, the residual has been drifting below 0 (since late 2023) and has yet to return to a positive reading.

Chart 2: Old school AUD/NZD model says ~1.20



Short term rates vs the relative term structures

Since the post GFC era and even more so since the post Pandemic era, modelling currencies against short term spreads has evolved to include relative term structures (using mid to long dated spreads as well as relative curves and slopes). In the past we have published notes explaining how we use this approach and indeed the [RBA AUD TWI model](#) uses the whole term structure.

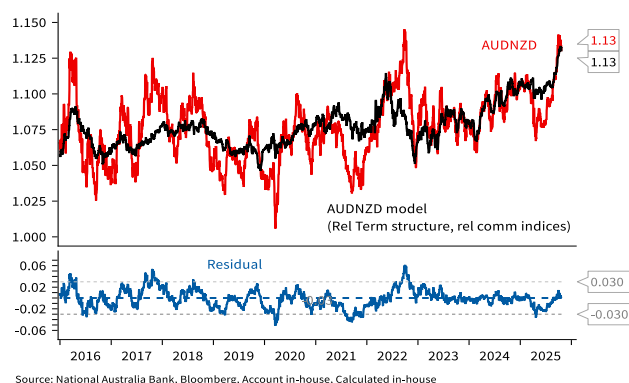
As central banks took cash rates towards their zero bound (and printed lots of money), front-end spreads lost some of their explanatory power for FX with mid to long-term spreads becoming more relevant, while studies also show that the shape of the curve could have explanatory powers (and leading relationships).

Bearing the above in mind, we build an experimental model using relative term structures (AU-NZ) plus the difference

between AU and NZ commodity indices. Using this approach the AUD/NZD cross no longer looks severely undervalued. Instead, the model is suggesting the cross is currently doing what it should, with spot and the model estimate not too far from each other.

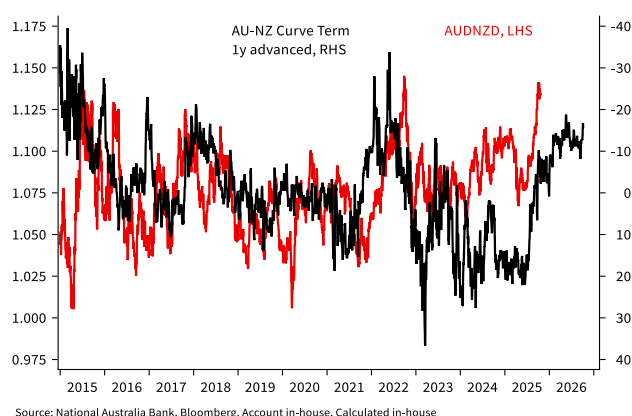
More importantly from a modelling perspective, the behaviour of the model residual is more reassuring. The residual tends to converge back to zero with few signs of drift. Furthermore, looking at the residual over the whole modelling period, the cross can overshoot, but encouragingly the cross has a strong tendency to head back towards the model's estimate (as opposed to the model estimate heading back towards spot). Indeed, the helpful aspect of the model is the (reversing) signal you get when the residual shoots through +/-3 cents (see Chart 3).

Chart 3: A term structure AUD/NZD model



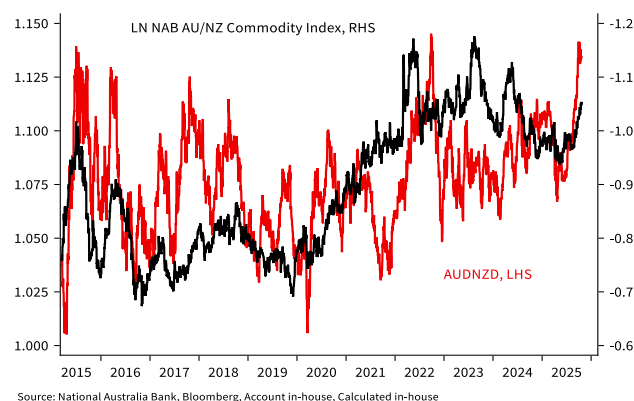
Looking at the model variables in more detail, the AU-NZ relative curve, which has a leading relationship with the cross, is not only suggesting the current spot level looks fair, but it is also suggesting a range trading environment should be expected over coming months.

Chart 4: Relative AU-NZ curve spread. Steady ahead



The model also includes a variable capturing the difference between an AU vs NZ commodity index. While there is a clear relationship between the cross and the commodity variable, the degree of influence varies over time. That said, the relative commodity variable is currently not arguing for higher AUD/NZD levels.

Chart 5: AUD/NZD vs AU- NZ commodity indices



We like models but we are not married to them

As noted at the start of this note, models often work – until they don't. So, while we like using models as part of our framework for thinking about currencies, we are not married to them. Indeed, since the onset of the pandemic we have also been forced to de-empathise the signals from our various AUD/USD valuation models.

Thus, in addition to our models, when we think about the AUD/NZD's fair value and its outlook, we also consider various other macro factors.

Beware the NZ growth rebound

Chart 6: AUD/NZD 1y rolling return vs AU-NZ economic surprises



As keen readers of our research would know, NAB's research colleagues across the ditch have been saying that the NZ economy isn't in nearly as parlous a state as the reported 0.9% contraction in Q2 GDP would otherwise have you believe. Some bounce-back is expected in Q3, and once we take into account base effects, plus the cumulative effect of the aggressive RBNZ easing to date, the hurdle for annual NZ GDP growth to spring back is very low. Annual growth should turn positive in Q3, and the coming 12 months could very well see it recover to between 2-3%, so matching or even exceeding Australia.

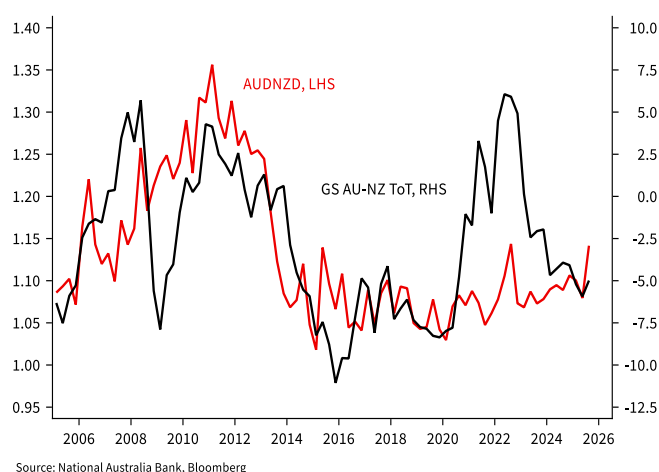
As per chart 6, the AUD/NZD 1 year rolling performance tends to have a strong relationship with relative AU-NZ economic surprises. If we are right in that there is a good chance New Zealand data start surprising to the upside over coming quarters, then the cross may have to start reflecting this tilt in relative economic performance.

Relative terms of trade, improving NZ current a/c

Current account balances show marked differences. Three years ago, NZ's current account deficit was running close to 10% of GDP on an annualised (seasonally adjusted) quarterly basis while Australia was close to balance. By the June 2025 quarter, NZ's current account deficit had shrunk to 3.2%, while Australia's balance had moved to a deficit of 2%. NZ's strong terms of trade and soft domestic demand backdrop have been instrumental in NZ's improving external accounts.

The relative AU-NZ term of trade index is now trending downwards. An extension of this trend suggests the cross could soon be facing some headwinds.

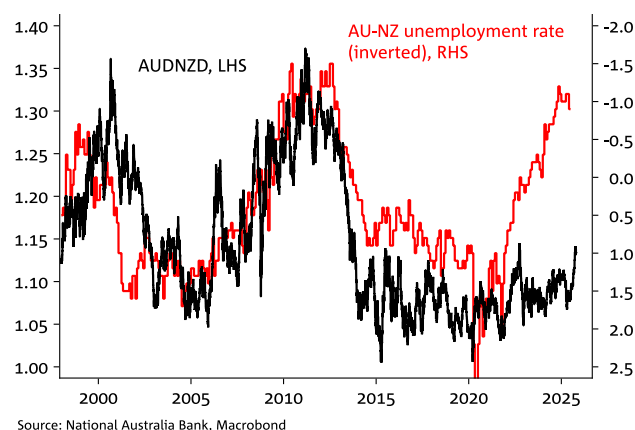
Chart 7: AUDNZD vs AUD-NZ ToT



AU-NZ unemployment gap supportive of higher levels, but turning signs are emerging

NZ's unemployment rate, which historically tracks below Australia, broke above Australia's rate early last year and the gap is now unusually large. This relativity along with wider short end rate spreads go a long way justifying the view for higher AUDNZD levels. That said, we think higher AU-NZ interest rate differentials already reflect this macro dynamic –highlighting excess capacity pressures in NZ compared to Australia. Based on our projections, the gap in unemployment rates should slowly start to close.

Chart 8: AUD/NZD vs NZ-AU unemployment rates



In short, the April-to-date run up in the AUD/NZD cross is justified by most AU-NZ macro variables and modelling. Yet looking ahead, our assessment of these variables suggests that further significant AUD/NZD appreciation looks more challenging than suggested simply by reference to short term rates spreads and the AU-NZ unemployment gap.

Consistent with our experimental AUD/NZD term structure fair value model, our AUD/NZD outlook - which is based on our expectations for another 25bps RBNZ rate cut before the Bank's current cycle is complete alongside one further RBA cut - sees the cross stabilising in the 1.13-1.15 area over much of the coming year. More aggressive RBNZ or RBA policy changes than assumed here would in turn change this risk either in favour of stronger gains or a somewhat larger pull-back in the cross.

Using the historical residual of the above term structure model, this does suggest a good chance the cross can test levels above 1.15, but we don't envisage such moves as likely to prove sustainable. Certainly, we would regard moves towards the 1.17 area as attractive levels for those looking at the inherent mean reversion properties of currencies and prepared to take a longer-term view. This is especially so given our wariness about the potential for the NZ economy to start outperforming next year.

To conclude, we think the AUD/NZD faces two-sided risk, rather than just upside. Near term, there is probably more risk for the cross to overshoot, i.e. test levels above 1.15, and then if we are right about NZ potential growth rebound, then next year the cross is at risk of facing a more pronounced downturn.

In the above mentioned we show point forecasts for AUD/NZD of 1.15 for end Q1/Q2 2026 - so allowing for moves to as high as 1.1750 - before easing back to 1.11 by early 2027, permitting for time to be spent back below 1.10.

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