

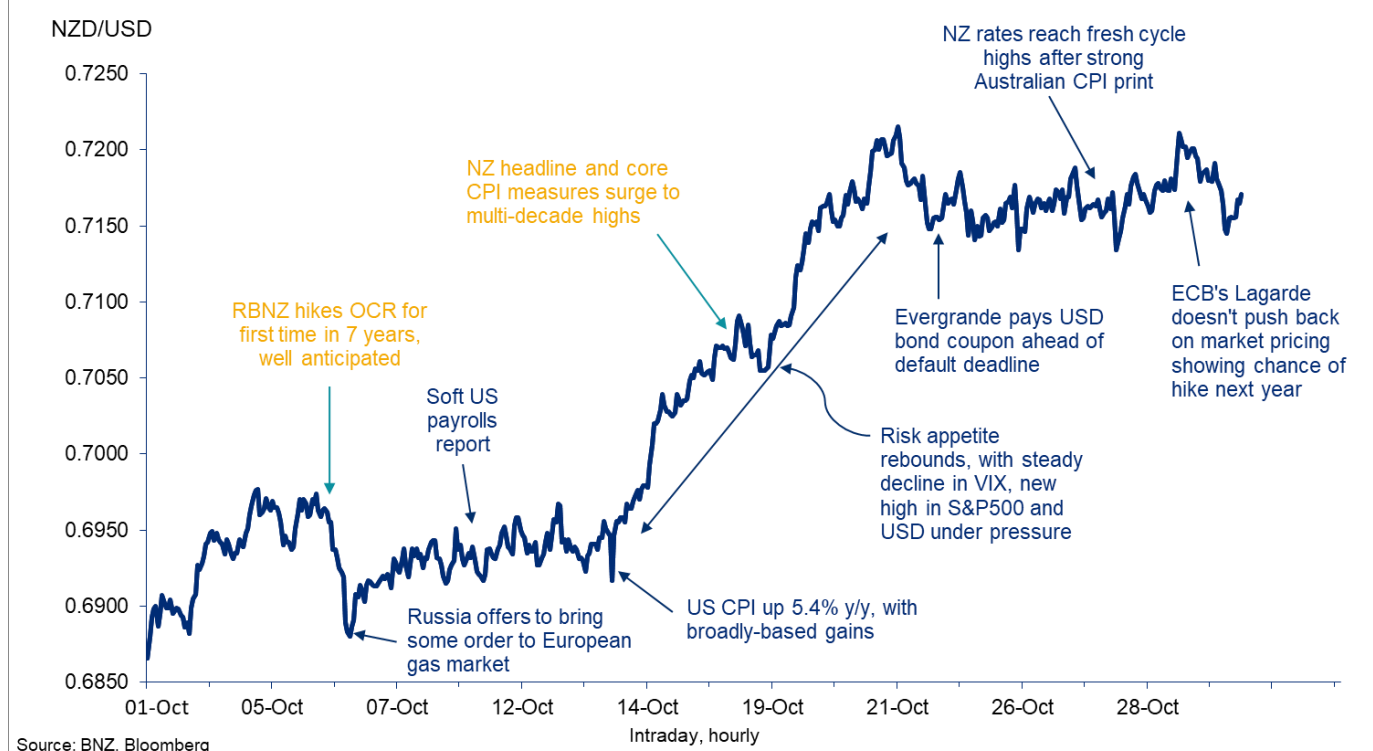
1 November 2021



## NZD rebounds in October

- The return of the global relation theme in October saw commodity currencies outperform
- Higher NZ, Australian and Canadian short-term rates supported the move. NZD/USD rose nearly 4%
- NZ rates surge across the whole yield curve; 5-year swap rate now up over 200bps for the year

### NZD/USD over October 2021



Quick Outlook		October ranges
<b>NZD/USD</b>	After the strong lift in October, a period of consolidation is due, particularly given that concerns about the global economic outlook remain, against a backdrop of strong inflationary forces and rising interest rates. Probably near the top of its likely trading range into year-end.	0.6880 – 0.7220
<b>NZD/AUD</b>	Trading close to the 0.95 mid-point of our near-term projections. Near-term, Australia's economy looks better placed coming out of COVID19 restrictions while NZ-AU rate spreads close to peaking. Risk is weighted towards some downside pressure into year-end.	0.9425 – 0.9600
<b>NZD/GBP</b>	Move up to 0.52 is in line with our projections, which show some consolidation around this level.	0.5060 – 0.5240
<b>NZD/EUR</b>	Expected to consolidate around the 0.60 mark. The lift to a four-year high takes it near the top of its trading range we expect into year-end.	0.5940 – 0.6200
<b>NZD/JPY</b>	After the surge in October, risks are now probably weighted to the downside, with some vulnerability to a shift back down in risk sentiment. Much higher NZ inflation versus Japan is reducing long-term fair value estimates for the cross.	76.4 – 82.5

The global reflation trade returned with a vengeance in October, evidenced by a strong rebound in global equity markets to fresh record highs, higher break-even inflation yields, broadly-based rises in commodity prices, and commodity currencies outperforming. The commodity currencies were enhanced by some big lifts in short-term rates, with the RBNZ, RBA and Bank of Canada seen to be ahead of others in leading the global policy tightening cycle. For NZ, the move in rates was brutal right across the curve.

In the September report we noted the risk-off theme that prevailed, with global growth potholes from supply chain issues, increased risk around China's economy with focus on the troubled property market, and rising inflationary pressure, not helped by surging energy prices. In October, these forces lingered, but for whatever reason, risk appetite perked up and risk assets recovered.

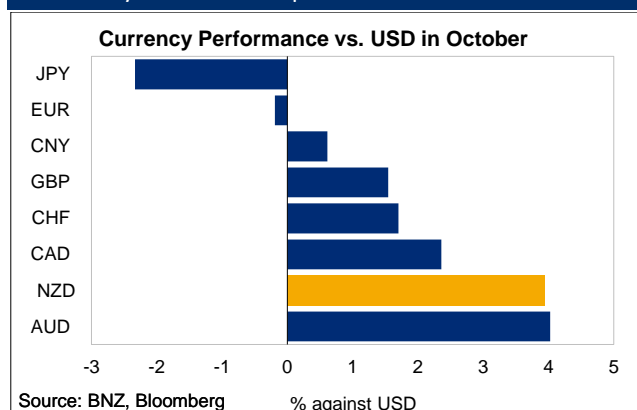
Inflation was a predominant theme for markets in October, but rather than spook equity markets, it didn't prevent a decent recovery in global equity markets. After the fall in September, the MSCI World Index surged by 5½% to a fresh record high, supported by a still-robust earnings backdrop. Most global bond markets weren't perturbed either, with a hefty lift in break-even inflation yields offset by falling real rates so that the rise in nominal 10-year rates was modest.

For the US, the 10-year nominal rate rose by just 7bps to 1.56%, after trading a 5-month high of 1.70%. Decomposing that nominal rate increase, the 10-year break-even rate rose by 21bps to 2.59%, while the real 10-year rate fell deeper into negative territory, down 15bps to minus 1.04%. Similar trends were evident in Europe, with the closely watched EUR 5y5y forward inflation swap breaking up through 2% for the first time since 2014.

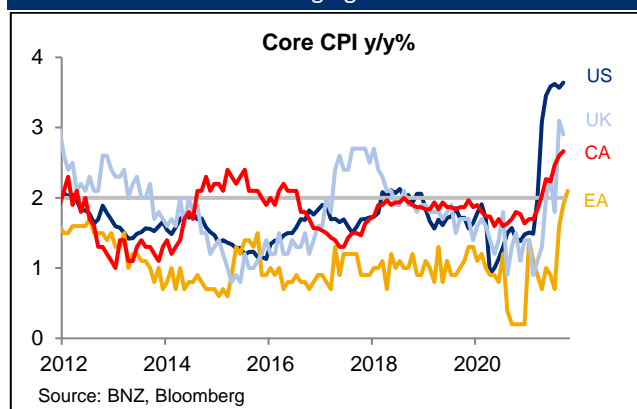
Commodity prices showed broadly based gains across the energy, metals, other industrials and agricultural sectors. Early in the month, European natural gas prices rose further to astronomical levels before some calm was returned, with forecasts of a warmer Northern Hemisphere winter and Russia offering to help stabilise the market. WTI crude hit a 7-year high over USD85 per barrel during the month. More relevant to NZ, ASB's NZ commodity price index rose to a record high in SDR terms, surpassing the 2013 peak. Dairy prices showed good gains for the month, seeing analysts and Fonterra revising up milk price forecasts, with NZX futures for FY22 settling around the \$8.60 mark.

Global CPI figures were generally higher, nudging up to 5.4% y/y in the US, surging to 4.9% y/y in NZ and consolidating at 3.0% y/y in Australia, but with signs of higher core inflationary pressure. Core euro area CPI inflation breached the 2% target for the first time since 2002. The surge in NZ inflation was shockingly high, with an average of Statistics NZ core measures showing core inflation of 4.1%, while the RBNZ's sectoral factor model estimate, which is slow-moving, exhibits low volatility and

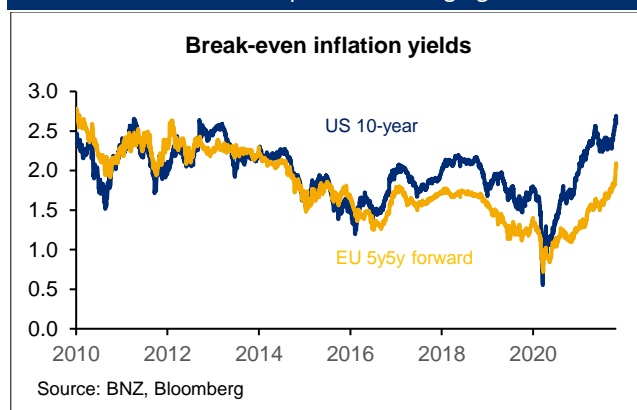
Commodity currencies outperform in October



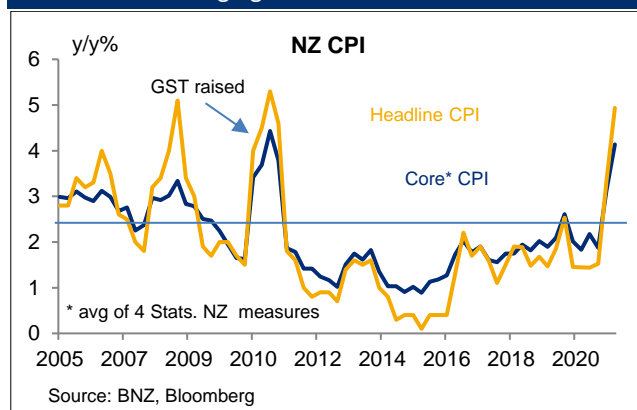
Global core CPI inflation surging ahead



Market-based inflation expectations surging ahead



NZ CPI inflation surging ahead



is very slow to pick up on new trends, showed a record-equalling lift of 0.3% in the annual increase to 2.7% alongside upward revisions to recent data.

As widely expected, the RBNZ kicked off the first rate hike cycle since 2014 with a 25bps lift in the OCR to 0.50%. The Bank noted that the medium-term outlook for inflation and employment had not materially changed since the August MPS, even with the current lockdown restrictions. The local COVID19 situation wasn't throwing the RBNZ off course with the Bank noting that cost pressures were becoming more persistent. The Bank also flagged the risk of current supply-side price shocks leading to more generalised price rises.

The combination of no change to the RBNZ's rates outlook despite local COVID19 lockdowns and the shockingly high CPI print, sent NZ interest rates surging ahead, with the 2-year swap rate closing the month up a massive 83bps to 2.26%. Liquidity conditions were poor at times, with a one-sided market, and some spillover from a big rise in Australian rates later in the month was an additional contributing factor. Rate increases were brutal across the curve, although curve flattening was evident, with the 10-year swap rate up 49bps to 2.74%. The 10-year NZGB rose 58bps to 2.58%, a much larger rate increase than seen in most other markets.

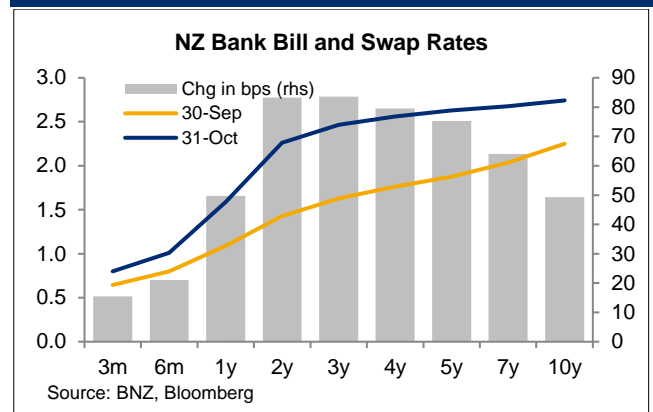
The spread of COVID19 in NZ gathered pace during the month, leading to an extension of lockdowns, including highly restrictive measures remaining in place in Auckland. This led to analysts downgrading growth assumptions for Q4, but progress in vaccination offered some light at the end of the tunnel, so this factor didn't have any significant impact on the market.

The global reflation theme supported outperformance of commodity currencies, with the NZD, AUD and CAD at the head of the leaderboard. This move also correlated with the re-pricing of rate hike expectations, with Jun-22 bill futures over the month showing the largest moves among peers (see table overleaf).

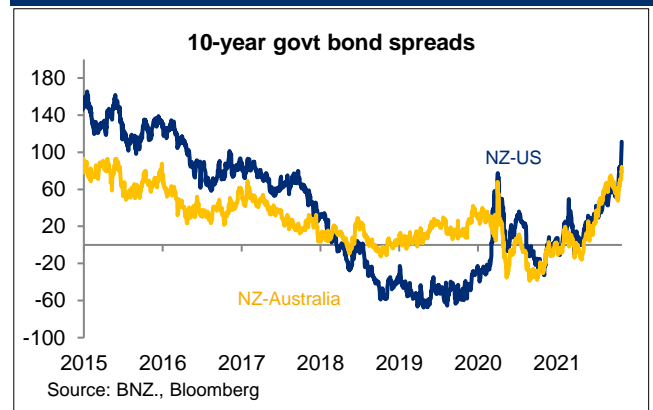
The NZD low for the month of 0.6877 was made on the first day of the month, and revisited on the 6<sup>th</sup>, before climbing as high as 0.7219 on the 21<sup>st</sup>, before consolidating around 0.7150, gaining just under 4% for the month.

The AUD showed a similar profile, seeing NZD/AUD flat for the month at 0.9540. Despite central bankers still claiming current inflation pressures were likely to be transitory, markets showed increasing doubts, and this was on public display in Australia. The market frequently tested the RBA's ill-fated yield curve control policy, designed as a forward guidance tool to give credibility to its view that the cash rate wouldn't need to rise until 2024. Through the month, the market increasingly brought forward its view of when Australia's tightening cycle would begin in 2022 and the rate move accelerated after core inflation printed much higher than RBA and market expectations.

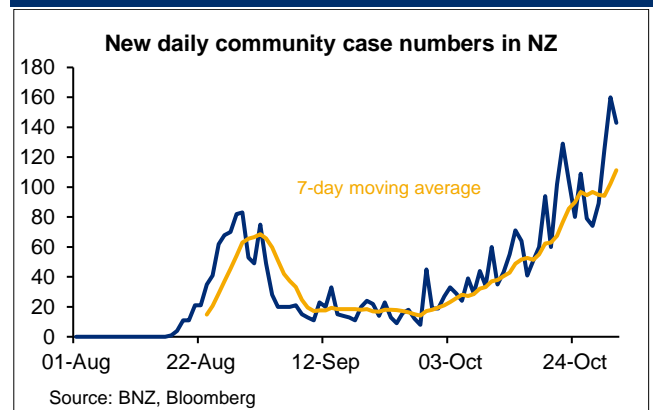
Brutal sell-off in NZ rates market



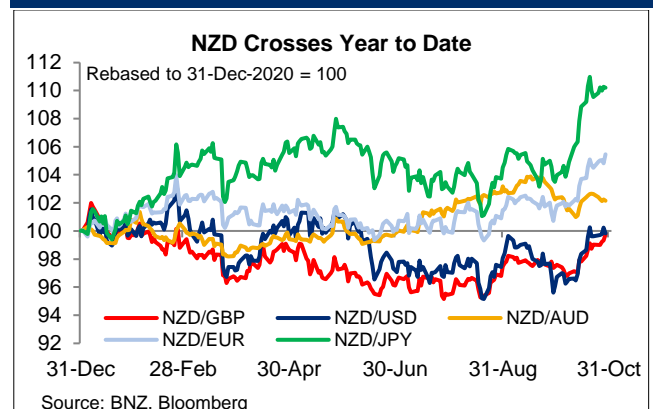
NZ-global 10-year spreads track higher



New COVID19 case numbers pick up in October



NZD now higher year-to-date on most crosses



The bringing forward of rate hikes was also evident for the US, UK and euro area, although on a lesser scale. The USD was well-bid early in the month, hovering close to its year-to-date high, before higher risk appetite saw some USD weakness, and the BBDXY index closed the month down 0.4%.

The positive risk appetite environment and higher NZ-global rate spreads resulted in chunky NZD rises on JPY, EUR and GBP crosses. NZD/JPY showed a particularly large appreciation of 6½%, printing a four-year high of 82.5. NZD/EUR rose over 4% and printed a four-year high of just

above 0.62. NZD/GBP was up about 2½%, revisiting levels seen earlier this year.

Of note, despite the massive surge in NZ rates this year (2- and 5-year swap rates in the order of 200bps), leading to higher NZ-global rate spreads; higher risk appetite (world equities up over 20%); and the record high NZ commodity price index, as at the end of October the NZD/USD was little changed (in fact down slightly) from the level at the start of the year, while the NZ TWI was up less than 1%.

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## Monthly Performance Table

	end-Oct	end-Sep	Change		end-Oct	end-Sep	Change
<b>Currencies</b>				<b>NZ Rates</b>			
NZD/USD	0.7171	0.6899	3.9%	OCR	0.50	0.25	0.25
NZD/AUD	0.9538	0.9547	-0.1%	NZ 90day BB	0.80	0.65	0.16
NZD/EUR	0.6201	0.5959	4.1%	NZ 2yr sw ap	2.26	1.43	0.83
NZD/GBP	0.5242	0.5121	2.4%	NZ 5yr sw ap	2.63	1.88	0.75
NZD/JPY	81.74	76.78	6.5%	NZ 10yr sw ap	2.74	2.25	0.49
NZD/CNY	4.593	4.446	3.3%	NZ Govt (4/25)	2.21	1.36	0.85
TWI	76.0	73.9	2.9%	NZ Govt (4/27)	2.35	1.62	0.74
AUD/USD	0.7518	0.7227	4.0%	NZ Govt (4/29)	2.48	1.85	0.63
EUR/USD	1.1558	1.1580	-0.2%	NZ Govt (5/31)	2.58	2.00	0.58
GBP/USD	1.3682	1.3474	1.5%	<b>Global 10 year bond rates</b>			
USD/JPY	113.95	111.29	2.4%	US	1.56	1.49	0.07
USD/CNY	6.41	6.44	-0.6%	Canada	1.72	1.51	0.21
USD/CAD	1.2388	1.2680	-2.3%	UK	1.03	1.02	0.01
USD BBDXY	1160.50	1165.12	-0.4%	France	0.27	0.15	0.12
Asia DXY	107.89	107.34	0.5%	Germany	-0.11	-0.20	0.09
<b>Equity Markets</b>				Italy	1.17	0.86	0.31
MSCI AC Wrld, loc.	1,878	1,789	5.0%	Spain	0.61	0.46	0.15
MSCI World, loc.	10,568	10,014	5.5%	Portugal	0.52	0.35	0.16
MSCI EM, USD	3,052	3,021	1.0%	Ireland	0.33	0.18	0.15
US S&P 500	4,605	4,308	6.9%	Japan	0.09	0.07	0.03
Euro STOXX 600	475.5	454.8	4.6%	Australia	2.09	1.49	0.60
Germany DAX	15,689	15,261	2.8%	<b>Commodities (USD)</b>			
France CAC 40	6,830	6,520	4.8%	WTI Crude	83.57	75.03	11.4%
UK FTSE 100	7,238	7,086	2.1%	Brent Crude	84.38	78.52	7.5%
Aust S&P/ASX 200	7,324	7,332	-0.1%	R/B CRB Index	237.7	228.9	3.8%
Japan Topix	2,001	2,030	-1.4%	Gold spot	1,783	1,757	1.5%
China CSI 300	4,909	4,866	0.9%	Silver spot	23.90	22.17	7.8%
NZX50	13,100	13,276	-1.3%	Copper	436.8	408.9	6.8%
Volatility: VIX	16.26	23.14	-29.7%	Iron Ore	105.18	115.93	-9.3%
<b>3-mth Bill Futures</b>				Thermal coal	223.45	218.00	2.5%
NZD Jun-22	97.81	98.53	-0.72	Corn	568.3	536.8	5.9%
AUD Jun-22	99.31	99.88	-0.57	Wheat	772.8	725.5	6.5%
USD Jun-22	99.56	99.80	-0.23	NZX Dairy WMP	3,925	3,780	3.8%
EUR Jun-22	100.39	100.49	-0.09	NZX Milk Payout '22	8.63	8.35	3.4%
GBP Jun-22	98.80	99.37	-0.57				
CAD Jun-22	98.60	99.21	-0.61				

Source: BNZ, Bloomberg

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