

1 June 2018



### Events Round-Up

NZ: ANZ Activity Outlook, May: 13.6 vs. 17.8 prev.  
NZ: ANZ Business Confidence, May: -27.2 vs. -23.4 prev.  
CH: Manufacturing PMI, May: 51.9 vs. 51.4 exp.  
AU: Private Capital Expenditure (q/q%), Q1: 0.4% vs. 1% exp.  
EZ: Unemployment Rate, Apr: 8.5% vs. 8.4% exp.  
EZ: Core CPI (y/y%), May: 1.1% vs. 1% exp.  
US: Core PCE deflator (y/y%), Apr: 1.8% vs. 1.8% exp.  
US: Chicago PMI, May: 62.7 vs. 58.3 exp.

### Good Morning

Italian risks receded further last night, with the Five Star and League parties agreeing to form a government with a new choice of finance minister and two polls overnight showing Italians overwhelmingly favour the euro. Market focus has started to shift back to trade tensions, with the US imposing tariffs on aluminium and steel from the EU, Canada and Mexico and these countries promising to respond in kind - equity markets are a moderately lower in response. The NZD is back above 0.70 for the first time in almost a month.

The political risk in Italy appears to be receding, with the Five Star and League parties announcing they had reached an agreement to form a government, with Giuseppe Conte accepting the role as Prime Minister a short while ago. The coalition has chosen economics professor Giovanni Tria to be finance minister with Euroskeptic economist Paolo Savona responsible for the European affairs ministry. Last year, Tria called for a debate on whether the euro was right for Italy and Europe, but his comments imply he takes a far more balanced view than Savona. Two polls out overnight hammered home the message that Italians want to keep the euro currency – one poll showed 72% wanted to stay vs. 23% who wanted to leave while the second poll had the split at 60% vs. 24%, an overwhelming majority.

Italian bond yields have predictably fallen in response to the news overnight, with the 2 year yield down 60bps to 0.9%. The 2 year Italian yield has now completely reversed the vicious sell-off on Tuesday. Italian-German spreads are unlikely to completely compress back to the levels of a month ago given the new coalition is still an unknown quantity (and has shown it can flip-flop on

positions), their fiscal spending plans imply a higher debt/GDP profile that is likely to cause issues with both Brussels and the credit rating agencies. There wasn't too much spillover from the positive Italian developments into other markets, with most assets classes having already repriced the previous session.

Trade tensions have started to come back to focus, with the US announcing tariffs on steel and aluminum imports from Canada, Mexico and the EU. The tariffs were announced earlier this year but these countries were given temporary waivers at the time in the hope of finding a negotiated solution (which didn't eventuate). The three are responsible for 40% of US steel imports. The trade partners have said they will respond with retaliatory tariffs, with French finance minister Bruno Le Maire saying the EU was being forced to "enter a trade war". Separately, the US administration is looking into potential tariffs on imported autos, which would represent a further escalation in trade tensions if enacted. And this on the back of President Trump's decision earlier this week to levy \$50b of tariffs on Chinese imports. The Canadian dollar and Mexican peso are two of the big underperformers in FX markets on the back of the pick-up in trade tensions.

Equity markets have reacted negatively to the trade tensions, with the S&P500 down around 0.5% and the Dow Jones down almost 1%. Equity markets were also generally weaker in Europe, despite the more positive mood around Italy, with financials leading the way lower (likely influenced by reports that the FDIC had put Deutsche Bank's US subsidiary on its "problem banks" watch list).

The US 10 year Treasury yield is 2bps lower, at 2.83%, reflecting the decline in equities and increase in trade tensions. Fed Governor Brainard made some unusually hawkish comments a few hours ago, saying the "I am seeing more evidence that labour markets are tightening, and wages are accelerating, although at a measured pace" and the outlook suggests the Fed would need to raise rates "modestly beyond neutral." The market has pared back Fed rate hike expectations since the Italian political situation erupted, and now prices 2 hikes for the remainder of the year and 1.5 hikes for 2019. Payrolls tonight will be the key focus for the market.

In FX, the moves have been reasonably modest (outside of the Canadian dollar and Mexican peso). The euro is 0.2% stronger on the day, just below 1.17, helped both by

the improvement in the Italian political backdrop as well as a higher than expected Eurozone CPI release. As foreshadowed by the German and Spanish CPI releases yesterday, the Eurozone headline CPI jumped to 1.9% (vs. 1.6% expected) while core CPI also surprised on the upside slightly.

The NZD has reached 0.70 for the first time in also a month and is one of the outperformers in FX markets on the day. The weaker than expected ANZ Business Survey didn't have any lasting impact on the NZD and it drifted higher through most of the remainder of the session, tracking moves in the EUR.

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Coming Up

		Period	Cons.	Prev.	NZT
NZ	ANZ Consumer Confidence Index	May		120.5	10:00
NZ	Terms of Trade Index QoQ	1Q	-2	0.8	10:45
GE	Markit/BME Germany Manufacturing PMI	May F	56.8	56.8	19:55
EC	Markit Eurozone Manufacturing PMI	May F	55.5	55.5	20:00
UK	Markit UK PMI Manufacturing SA	May	53.5	53.9	20:30
US	Change in Nonfarm Payrolls	May	190	164	00:30
US	Unemployment Rate	May	3.9	3.9	00:30
US	Average Hourly Earnings YoY	May	2.6	2.6	00:30
US	ISM Manufacturing	May	58.2	57.3	02:00

Source: Bloomberg, BNZ.

Foreign Exchange					Equities				Commodities**		
Indicative overnight ranges (*)					Major Indices				Price		
	Last	% Day	Low	High		Last	% Day	% Year		Last	Net Day
NZD	0.7007	+0.3	0.6981	0.7024	S&P 500	2,704	-0.7	12.1	Oil (Brent)	77.59	+0.1
AUD	0.7568	-0.1	0.7555	0.7593	Dow	24,423	-1.0	16.3	Oil (WTI)	67.13	-1.6
EUR	1.1690	+0.2	1.1641	1.1724	Nasdaq	7,446	-0.2	20.1	Gold	1305.3	-0.1
GBP	1.3297	+0.1	1.3278	1.3348	Stoxx 50	3,407	-1.0	-4.2	HRC steel	924.0	+3.8
JPY	108.64	-0.2	108.39	109.00	FTSE	7,678	-0.1	2.1	CRB	202.8	-0.2
CAD	1.2959	+0.7			DAX	12,605	-1.4	-0.1	Wheat Chic.	543.0	+0.7
NZD/AUD	0.9259	+0.4			CAC 40	5,398	+0.3	2.2	Sugar	12.79	+1.5
NZD/EUR	0.5994	+0.1			Nikkei	22,202	+0.8	11.8	Cotton	91.64	+0.8
NZD/GBP	0.5270	+0.2			Shanghai	3,095	+1.8	-0.2	Coffee	123.7	+2.8
NZD/JPY	76.12	+0.0			ASX 200	6,012	+0.5	4.8	W/M powder	3270.0	-0.5
NZD/CAD	0.9080	+0.9			NZX 50	8,659	+0.1	16.2	<b>Australian Futures</b>		
NZ TWI	73.75	+0.2							3 year bond	97.855	0.02
									10 year bond	97.34	0.03

  

Interest Rates																				
	Rates				Swap Yields				Benchmark 10 Yr Bonds				NZ Government Bonds				NZ Swap Yields			
	Cash	3Mth	2 Yr	10 Yr		Last	Net Day		Last	Net Day		Last	Net Day		Last	Net Day				
USD	1.75	2.30	2.67	2.87	USD	2.82	-0.03	NZGB 6 05/15/21	1.99	-0.01	1 year	2.08	0.01							
AUD	1.50	1.98	2.08	2.84	AUD	2.67	0.02	NZGB 5 1/2 04/15/23	2.27	-0.01	2 year	2.21	0.01							
NZD	1.75	2.03	2.21	3.09	NZD	2.73	0.00	NZGB 2 3/4 04/15/25	2.54	-0.01	5 year	2.63	0.02							
EUR	0.00	0.06	-0.13	0.91	GER	0.34	-0.03	NZGB 4 1/2 04/15/27	2.73	0.00	7 year	2.86	0.02							
GBP	0.50	0.60	0.94	1.46	GBP	1.23	-0.03	NZGB 3 04/20/29	2.89	0.00	10 year	3.09	0.02							
JPY	-0.08	-0.01	0.05	0.26	JPY	0.04	0.01	NZGB 3 1/2 04/14/33	3.09	0.00	15 year	3.36	0.02							
CAD	1.25	1.17	2.24	2.59	CAD	2.22	-0.05	NZGB 2 3/4 04/15/37	3.25	0.00										

\* These are indicative ranges from 5pm NZT; please confirm rates with your BNZ dealer

\*\* All near futures contracts, except CRB. Metals prices are CME.

Rates are as of: NZT 06:57

Source: Bloomberg

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