

4 July 2017

Events Round-Up

JN: Tankan confidence, large manuf., Q2: 17 vs. 15 exp.
AU: Building approvals (m/m%), May: -5.6 vs. 1.3 exp.
CH: Caixin PMI manufacturing, Jun: 50.4 vs. 49.8 exp.
EZ: Markit manufacturing PMI, Jun F: 57.4 vs. 57.3 exp.
EZ: Unemployment rate (%), May: 9.3 vs. 9.3 exp.
US: ISM Manufacturing, Jun: 57.8 vs. 55.2 exp.
US: Construction spending (m/m%), May: 0.0 vs. 0.3 exp.

Good Morning

Markets have begun the second half of the year on a positive note, supported by positive economic indicators. The Euro Stoxx 600 was up 1.1% while the S&P 500 index closed a shortened session before the Independence Day holiday up 0.2%. Global bond rates continued to nudge higher, while the USD was stronger across the board.

A range of business surveys pointed to the global economic recovery extending. Japan's Tankan survey showed improved confidence among large manufacturers for a third straight quarter, driven by exports. In the euro area, the final PMI estimate was slightly upgraded from the flash estimate to a 6-year high, while the unemployment rate remained at an 8-year low. The US ISM manufacturing index was much higher than the consensus, reaching an almost 3-year high, backed by strong new orders and employment components. The only exception to the positive vibe was the UK manufacturing PMI falling by more than expected to a 3-month low, as Brexit negotiations get underway.

The USD major currency index is up 0.5% with gains on all the major crosses. At the end of the June quarter, our USD model suggested that the currency on a TWI basis was oversold by over 5%. This was the most extreme level in over five years, suggesting the USD is well overdue for a recovery.

The yen has continued to underperform, as global bond rates tick higher, with USD/JPY up 0.9% to 113.40. In Tokyo's elections over the weekend, the ruling LDP party put in a poor performance, not a good sign for the continuation of "Abenomics". The vote was seen as a barometer of opinion as Japan faces a general election by the end of 2018. NZD/JPY is up to its highest level since January at 82.7.

EUR and GBP are both about 0.6-0.7% weaker to 1.1360 and 1.2940 respectively, with the strong USD in the driving seat. Yves Mersch, a member of the ECB's executive board, noted that "we need to have patience" with its accommodative policy stance but added that "we don't necessarily have to wait for prices to reach 2 percent before adjusting monetary policy." This followed the Bundesbank's Weidmann commenting on the positive economic backdrop and suggesting that the ECB "lift one's foot off the gas a little."

The NZD has fallen to around 0.73 against a stronger USD backdrop. Over the past week or so the currency has found it difficult to break through 0.7350 and we see the balance of risk through Q3 as weighed towards the downside as better US data support a USD recovery. NZD/AUD has largely tracked sideways around 0.9530, with AUD/USD down to around 0.7650. Eyes will be on the RBA later this afternoon as it releases a policy update. Markets will be focused on whether the language in the Statement follows the seemingly coordinated hawkish comments by central banks recently. In our view the RBA is unlikely to adopt a hawkish tone, given still elevated labour market slack and subdued inflation. But given the recent chorus of other major central banks, the market will be looking for hints of a hawkish tilt even if that isn't the RBA's intention.

Global bond rates continue to lift, with Germany's 10-year rate up a modest 1bp to 0.47% and the US 10-year rate up a more substantial 5bps to 2.35%, following the stronger ISM release. Further curve steepening was evident, with the 2-year rate up 3bps to 1.41%. In our weekly yesterday we noted the case for still-higher rates over the coming quarter. The air of complacency around the bond market should finally be put to rest, following the coordinated major central bank change in policy guidance recently, and a more volatile period for the rates market could well prevail over coming months. Brace for impact. We wouldn't be counting on any quick reversal of last week's substantial sell-off.

NZ's rates market has remained one-sided, with the 2-year swap rate up 4bps to 2.37% and the 10-year rate up 7bps to 3.41%. The move has been entirely driven by offshore forces and in actual fact the NZ rates market has underperformed the likes of the US and Germany. The 16bps rise in the 2-year rate over the past week has come soon after the RBNZ reiterated its neutral policy statement. That said, we have no issue with the market pricing in a rate hike as soon as May next year as that

aligns with our own expectation, some 18-months ahead of RBNZ guidance. NZ's 10-year bond rate rose by 6bps to 3.035%, and is now up a significant 31bps over the past four trading sessions.

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Coming Up

	Period	Cons.	Prev.	NZT
NZ QSBO business confidence	Q2		17	10:00
AU Retail sales (m/m%)	May	0.2	1.0	13:30
AU RBA cash rate target (%)	Jul	1.5	1.5	16:30
UK Markit construction PMI	Jun	55.0	56.0	20:30
NZ GDT dairy auction avg. winning price			3434	
EC ECB's Praet speaks in Rome				00:30
NZ QV house prices (y/y%)	Jun		9.7	05:00

Source: Bloomberg, BNZ

Foreign Exchange					Equities				Commodities**					
Indicative overnight ranges (*)					Other FX		Major Indices			Price				
	Last	% Day	Low	High	Last	% Day	Last	% Day	% Year		Last	Net Day		
NZD	0.7297	-0.5	0.7273	0.7323	CHF	0.9641	+0.6	S&P 500	2,429	+0.2	15.5	Oil (Brent)	49.68	+1.9
AUD	0.7653	-0.5	0.7645	0.7678	SEK	8.495	+0.7	Dow	21,479	+0.6	19.7	Oil (WTI)	47.09	+2.3
EUR	1.1358	-0.6	1.1355	1.1415	NOK	8.371	+0.3	Nasdaq	6,110	-0.5	25.7	Gold	1220.6	-1.7
GBP	1.2937	-0.7	1.2932	1.3023	HKD	7.811	+0.0	Stoxx 50	3,492	+1.5	21.1	HRC steel	638.0	-0.3
JPY	113.40	+0.9	112.46	113.46	CNY	6.800	+0.3	FTSE	7,377	+0.9	12.2	CRB	176.2	+0.8
CAD	1.3006	+0.3			SGD	1.383	+0.5	DAX	12,475	+1.2	27.6	Wheat Chic.	555.0	+5.5
NZD/AUD	0.9535	-0.1			IDR	13,368	+0.1	CAC 40	5,196	+0.1	21.6	Sugar	13.92	+0.8
NZD/EUR	0.6425	+0.1			THB	34.01	+0.2	Nikkei	20,056	+0.1	27.1	Cotton	73.69	-2.2
NZD/GBP	0.5640	+0.2			KRW	1,147	+0.2	Shanghai	3,196	+0.1	6.9	Coffee	127.7	+1.6
NZD/JPY	82.75	+0.4			TWD	30.43	+0.0	ASX 200	5,684	-0.6	7.6	W/M powder	3000.0	-0.5
NZ TWI	78.54	-0.1			PHP	50.65	+0.4	NZX 50	7,588	-0.3	9.3	Australian Futures		
Interest Rates					NZ Government Bonds				NZ Swap Yields					
Rates		Swap Yields		Benchmark 10 Yr Bonds		Last		Last		Last				
	Cash	3Mth	2 Yr	10 Yr	Last	Net Day								
USD	1.25	1.30	1.64	2.32	USD	2.35	0.05	NZGB 3 04/15/20	2.31	0.05	1 year	2.11	0.02	
AUD	1.50	1.71	1.94	2.91	AUD	2.67	0.07	NZGB 6 05/15/21	2.43	0.05	2 year	2.38	0.04	
NZD	1.75	2.00	2.38	3.42	NZD	3.04	0.06	NZGB 5 1/2 04/15/23	2.72	0.05	5 year	2.94	0.06	
EUR	0.00	0.06	-0.13	0.92	GER	0.48	0.01	NZGB 2 3/4 04/15/25	2.93	0.06	7 year	3.18	0.07	
GBP	0.25	0.31	0.68	1.33	GBP	1.26	0.01	NZGB 4 1/2 04/15/27	3.04	0.06	10 year	3.42	0.07	
JPY	-0.04	0.00	0.05	0.26	JPY	0.09	0.00	NZGB 3 1/2 04/14/33	3.37	0.06	15 year	3.67	0.07	
CAD	0.50	1.17	1.43	2.08	CAD	1.76	0.06	NZGB 2 3/4 04/15/37	3.59	0.06				

* 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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