

13 August 2018



## Events Round-Up

NZ: Manufacturing PMI, Jul: 51.3 vs. 52.8 prev.

NZ: Retail card spending (m/m%), Jul: 0.7% vs. 0.5% exp.

JN: GDP (q/q%), Q2: 0.5% vs. 0.3% exp.

UK: Industrial production (y/y%), Jun: 1.1% vs. 0.7% exp.

UK: GDP (q/q%), Q2: 0.4% vs. 0.4% exp.

CA: Unemployment rate, Jul: 5.8% vs. 5.9% exp.

US: CPI (y/y%), Jul: 2.9% vs. 2.9% exp.

US: CPI ex food & energy (y/y%), Jul: 2.4% vs. 2.3% exp.

## Good Morning

The worsening macroeconomic situation in Turkey escalated into an all-out currency crisis on Friday night, with the Lira falling 24% at one point. This triggered weakness in other emerging market currencies, broad-based strength in the US dollar and a pick-up in risk aversion. The NZD, which was already on the back foot after the MPS, has fallen further to below 0.66. NZ rates experienced another substantial fall on Friday as the market continued to digest last week's MPS and the subsequent comments from Assistant Governor McDermott.

The Turkish lira (TRY) moved into the spotlight on Friday night after experiencing a ginormous 24% intraday fall. Investors have been concerned about Turkey's economic imbalances for some time; the country has a large 6.5% current account deficit to fund from offshore, an overheated economy with high inflation (~15%), and a sizable stock of foreign currency denominated liabilities (which become more difficult to service when the lira falls). Additionally, President Erdogan has previously described interest rates as the "mother of all evil" and instilled his son-in-law to head the finance ministry, causing investors to question whether Erdogan and the central bank are willing to take the difficult steps needed (interest rate rises and fiscal tightening) to stem the crisis.

On Friday, shortly after the NZ market close, the FT reported that the ECB's banking supervisory arm had grown concerned about some European bank's exposures to Turkey (BBVA, Unicredit and BNP all own Turkish banks). While the ECB didn't see the situation as critical at this stage, the report triggered a swift 10% sell-off in the Lira and caused the EUR to break below 1.15. The lira came under further downward pressure as Erdogan stuck

to his defiant rhetoric in a scheduled speech, saying "Turkey will prevail in this economic war", followed by the finance minister disappointing the market with an outline for a "new economic model" that was short on detail. The intraday losses on the lira peaked at 24% after Trump then tweeted that he was doubling tariffs on Turkish steel and aluminium. There was some retracement of the lira's losses late in the session, to leave it down "only" 16% on the day, after Trump's lawyer said they were close to a resolution in the diplomatic row over Turkey's detention of a US pastor.

There were some signs of contagion from Turkey, with other emerging market currencies falling (South African rand - 2.7% and Russian Ruble -1.5%), global equity markets hit and core government bond yields falling. The Eurostoxx index was down around 2%, led by financials (BBVA and Unicredit fell ~5%). The S&P500 fell 0.7%, although it pared some of its earlier losses after the comments from Trump's lawyer. Meanwhile, the US 10 year Treasury yield declined 5bps to 2.87%, despite a slightly higher than expected US core CPI print.

While Turkey is in many ways an idiosyncratic case (many emerging market countries have been repairing their external imbalances over recent years), the risk remains that there could be further spill-over to other EM markets if the Turkish authorities don't take serious steps to stop the crisis. That probably entails significant interest rate hikes (despite Erdogan saying on the weekend that interest rates were a "tool of exploitation"), an IMF rescue package or even capital controls – all of which seem like unpalatable options for Erdogan for now. A significant further tightening of EM financial conditions, were it to occur, would be negative for global growth, especially coming at a time when there is the risk of a serious escalation in the US-China trade war. And in terms of FX, a broad-based EMFX decline would likely be associated with further weakness in the NZD given the prevailing correlation over the past year and the likely decline in risk appetite (EM bond spreads are included in our risk appetite index).

Currency moves on Friday reflected the risk-off tone permeating markets, with the USD, the yen and the Swiss franc the best performing of the majors. The EUR was down 1% on the day, and broke below key support at 1.15 when the FT article was published, to leave it at its lowest level since July last year. The break in the EUR led to corresponding weakness in the AUD which fell below 0.73 at one point to its lowest level since early 2017. On the

flip-side, the USD indices moved sharply higher, with the Bloomberg dollar index back to its highs of the year.

The NZD lagged the move in the EUR and AUD, and was down only modestly against the USD on the day, ending the week near 0.6580. Over the week, the NZD was still the worst performing currency (-2.3%) reflecting the dovish MPS and subsequent comments from Assistant Governor John McDermott. McDermott's comments that he wanted the market to understand rate rises were "off the table for the foreseeable future" and the RBNZ was closer to the "trigger point" of cutting rates saw another substantial fall in NZ rates on Friday. The 2 year swap fell 5bps to 1.99% while the 5 year rate fell 7bps (taking its two-day decline to almost 20bps). The market now prices 9bps of rate cuts into the OIS curve by June next year. The PMI on Friday added to the gloom over the NZ growth

outlook, with the index pointing to slow growth in the manufacturing sector.

Given Erdogan's fighting talk over the weekend, we would expect risk assets to start on the back foot this week. There's no major economic data over the next 24 hours, although the PSI and food prices are released locally.

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Coming Up

		Period	Cons.	Prev.	NZT
NZ	Performance Services Index	Jul		52.8	10:30
NZ	Food Prices MoM	Jul		0.5	10:45

Source: Bloomberg, BNZ.

Foreign Exchange						Equities				Commodities**				
Indicative overnight ranges (*)					Other FX		Major Indices				Price			
	Last	% Day	Low	High		Last	% Day			Last	Net Day			
NZD	0.6581	-0.3	0.6571	0.6618	CHF	0.9952	+0.2	S&P 500	2,833	-0.7	16.1	Oil (Brent)	72.81	+1.2
AUD	0.7302	-1.0	0.7281	0.7358	SEK	9.123	+1.3	Dow	25,313	-0.8	15.8	Oil (WTI)	67.63	+1.4
EUR	1.1413	-1.0	1.1388	1.1522	NOK	8.361	+0.5	Nasdaq	7,839	-0.7	25.3	Gold	1214.2	-0.1
GBP	1.2758	-0.5	1.2723	1.2827	HKD	7.850	+0.0	Stoxx 50	3,426	-1.9	0.6	HRC steel	869.0	+1.0
JPY	110.83	-0.2	110.51	111.14	CNY	6.847	+0.4	FTSE	7,667	-1.0	4.9	CRB	191.7	-0.4
CAD	1.3140	+0.7			SGD	1.373	+0.4	DAX	12,424	-2.0	3.4	Wheat Chic.	569.5	-2.9
NZD/AUD	0.9013	+0.4			IDR	14,478	+0.4	CAC 40	5,415	-0.4	7.0	Sugar	10.54	-2.5
NZD/EUR	0.5766	+0.5			THB	33.32	+0.2	Nikkei	22,298	-1.3	13.0	Cotton	85.86	-1.6
NZD/GBP	0.5158	-0.1			KRW	1,129	+1.1	Shanghai	2,795	+0.0	-12.9	Coffee	110.1	-0.5
NZD/JPY	72.94	-0.6			TWD	30.73	+0.3	ASX 200	6,278	-0.3	10.3	WM powder	2970.0	+0.0
NZD/CAD	0.8647	+0.3			PHP	53.16	+0.3	NZX 50	9,011	+0.8	16.7	<b>Australian Futures</b>		
NZ TWI	71.74	+0.1										3 year bond	97.96	0.03
												10 year bond	97.43	0.05
Interest Rates						NZ Government Bonds				NZ Swap Yields				
Rates		Swap Yields		Benchmark 10 Yr Bonds		Last				Last				
	Cash	3Mth	2 Yr	10 Yr	Last	Net Day								
USD	2.00	2.34	2.79	2.93	USD	2.87	-0.05	NZGB 6 05/15/21	1.74	-0.08	1 year	1.96	-0.02	
AUD	1.50	1.96	2.05	2.77	AUD	2.59	-0.06	NZGB 5 1/2 04/15/23	1.94	-0.08	2 year	2.00	-0.05	
NZD	1.75	1.92	2.00	2.87	NZD	2.41	-0.09	NZGB 2 3/4 04/15/25	2.23	-0.09	5 year	2.34	-0.07	
EUR	0.00	0.06	-0.15	0.88	GER	0.32	-0.06	NZGB 4 1/2 04/15/27	2.41	-0.09	7 year	2.59	-0.07	
GBP	0.75	0.81	1.06	1.52	GBP	1.24	-0.05	NZGB 3 04/20/29	2.58	-0.09	10 year	2.87	-0.06	
JPY	-0.06	-0.04	0.05	0.32	JPY	0.10	-0.01	NZGB 3 1/2 04/14/33	2.77	-0.09	15 year	3.12	-0.06	
CAD	1.50	1.17	2.43	2.67	CAD	2.30	-0.03	NZGB 2 3/4 04/15/37	2.92	-0.09				

\* 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 New York Close

Source: Bloomberg

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