

28 May 2018



Events Round-Up

JN: Tokyo CPI ex-fresh food, energy (y/y%), May: 0.3% vs. 0.3% exp.

GE: IFO Business survey, May: 102.2 vs. 102 exp.

US: Durable goods orders (m/m%), Apr: -1.7% vs. -1.3% exp.

US: Durables ex-transportation (m/m%), Apr: 0.9% vs. 0.5% exp.

Good Morning

Oil prices fell sharply Friday after Saudi Arabia said it was "likely" OPEC and Russia would boost production. The decline in oil prices in turn pushed down core bond yields and energy stocks. Focus remains on European politics, with both Italy and Spain potentially set for new elections. Italy's President vetoed the Eurosceptic choice of Finance Minister a short while ago, leading PM-elect Conte to give up on forming a government. The market has taken the news positively, with the EUR moving higher this morning.

Oil prices took centre stage on Friday after Saudi Arabia's Energy Minister said he understood "*consuming countries' anxiety and concerns over potential supply shortages*" and said it was "*likely*" OPEC and Russia would boost production in the second half of the year. Brent crude oil, which had almost reached \$80 per barrel earlier in the week, fell over 3% in response to the comments, to below \$76. According to media reports, OPEC members are considering increasing output by between 300,000 to 1m barrels per day, to make up for production declines in member countries such as Venezuela and Iran (after the reinstatement of US sanctions). OPEC and Russia meet on June 22nd to decide on what action to take, and the potential for a supply response should help keep oil prices reasonably contained in the meantime.

The decline in oil prices helped push down core bond yields and depress inflation expectations. The 10 year Treasury yield fell 5bps to 2.93%, its lowest level in three weeks, while 10 year US inflation expectations fell 3bps to 2.10% (a six week low). Yields also fell in Germany (-5bps) and the UK (-8bps), assisted by safe haven buying stemming from European politics.

The European periphery is firmly back in the market's focus, with both Italy and Spain potentially set for new

elections. A short while ago, PM-elect Giuseppe Conte said he could not form a government because Italian President Mattarella had vetoed the coalition's Eurosceptic choice of finance minister. In response, the leader of the League called for new elections. The market will likely take the collapse of the anti-establishment coalition and the President's willingness to stand up to anti-euro cabinet choices as positive, even in the face of new elections. Frequent elections and political paralysis are nothing new for Italy but the prospect of an anti-establishment, Eurosceptic coalition seemingly on a collision course with Brussels was highly unsettling for the markets. On Friday, the 2 year Italian-German bond spread widened almost 50bps intraday (it closed up "only" 25bps wider), a sign of serious stress creeping in to the market.

Meanwhile, in Spain the opposition Socialists party called a vote of no confidence in the government after former members of the ruling Popular Party (PP) were found guilty of fraud in a long-running court case. The leader of centre-right Ciudadanos, which has backed the PP since the 2016 election, said PM Rajoy's position was "unsustainable" and called for fresh elections. The risk of an anti-establishment government in Spain is remote, with market-friendly Ciudadanos currently leading in the opinion polls and far-left Podemos in fourth place. Nevertheless, the Spanish-German 10 year spread widened to over 100bps, up 15bps on the day, although it remains well below the levels reached last year in the run-up to the French election.

So far, there has been minimal fallout from the European political situation to other risk markets. The Italian and Spanish bourses were down almost 2% on Friday, but the S&P500 was only down around 0.2% (led by falls in energy stocks). Reports over the weekend that the Trump-Kim summit might be back on shouldn't provide any more than fleeting support to risk assets.

The European political backdrop has weighed on the EUR, which fell to its lowest level since November, around 1.1650, although we note the EUR has since popped higher this morning after the news of the collapse in the Italian coalition. The decline in the EUR from the late European morning on Friday had mirrored the widening in spreads between Italian and German bonds. There was little reaction to reports that the ECB still intended to stop QE this year, and hadn't ruled out adjusting its forward guidance next month (rather than July).

Against a backdrop of broad USD strength on Friday, the NZD has outperformed. The NZD ended the week at 0.6915, around 0.1% lower than the NZ close on Friday, as it continues to consolidate after the sharp fall between mid-April and mid-May. In the week ahead, the RBNZ Financial Stability Report is released this Wednesday with comments from Governor Orr at the press conference likely to attract attention. We are also be interested in the government's decision, expected Monday, about how the animal disease Mycoplasma bovis will be tackled, with eradication seemingly the favoured option over containment.

Today is a public holiday in the US and UK so markets are likely to be quieter than usual. There is no major data in the session ahead, with European politics likely to remain at the forefront of attention.

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Coming Up

No major economic data

Foreign Exchange							Equities				Commodities**			
Indicative overnight ranges (*)					Other FX		Major Indices				Price			
	Last	% Day	Low	High		Last	% Day			Last	Net Day			
NZD	0.6917	-0.1	0.6906	0.6936	CHF	0.9910	-0.1	S&P 500	2,721	-0.2	12.6	Oil (Brent)	76.44	-3.0
AUD	0.7548	-0.4	0.7543	0.7590	SEK	8.768	+0.1	Dow	24,753	-0.2	17.4	Oil (WTI)	67.88	-4.5
EUR	1.1651	-0.6	1.1647	1.1734	NOK	8.174	+0.9	Nasdaq	7,434	+0.1	19.7	Gold	1309.0	-0.3
GBP	1.3309	-0.5	1.3306	1.3378	HKD	7.846	-0.0	Stoxx 50	3,515	-0.2	-1.8	HRC steel	875.0	-0.8
JPY	109.41	+0.1	109.13	109.60	CNY	6.392	+0.2	FTSE	7,730	+0.2	2.4	CRB	203.3	-1.1
CAD	1.2973	+0.7			SGD	1.342	+0.2	DAX	12,938	+0.6	2.7	Wheat Chic.	559.8	+2.3
NZD/AUD	0.9164	+0.2			IDR	14,125	-0.1	CAC 40	5,543	+0.0	3.9	Sugar	12.46	+0.6
NZD/EUR	0.5937	+0.4			THB	31.94	-0.2	Nikkei	22,451	+0.1	14.0	Cotton	86.65	+1.3
NZD/GBP	0.5197	+0.4			KRW	1,078	-0.2	Shanghai	3,141	-0.4	1.0	Coffee	120.4	-0.1
NZD/JPY	75.68	+0.0			TWD	29.95	+0.1	ASX 200	6,033	-0.1	4.9	WM powder	3280.0	+1.4
NZD/CAD	0.8973	+0.5			PHP	52.59	+0.1	NZX 50	8,638	+0.6	16.1	Australian Futures		
NZ TWI	72.88	+0.1										3 year bond	97.83	0.05
												10 year bond	97.25	0.06
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		Last		Last		
USD	1.75	2.32	2.71	2.97	USD	2.93	-0.05	NZGB 6 05/15/21	2.01	0.00	1 year	2.05	-0.00	
AUD	1.50	1.94	2.06	2.93	AUD	2.79	-0.02	NZGB 5 1/2 04/15/23	2.30	-0.00	2 year	2.20	0.00	
NZD	1.75	2.00	2.20	3.15	NZD	2.74	-0.03	NZGB 2 3/4 04/15/25	2.57	-0.01	5 year	2.66	0.01	
EUR	0.00	0.06	-0.15	0.92	GER	0.41	-0.07	NZGB 4 1/2 04/15/27	2.74	-0.03	7 year	2.91	0.01	
GBP	0.50	0.61	0.97	1.52	GBP	1.32	-0.08	NZGB 3 04/20/29	2.91	-0.04	10 year	3.16	0.01	
JPY	-0.07	-0.02	0.05	0.26	JPY	0.04	-0.01	NZGB 3 1/2 04/14/33	3.10	-0.03	15 year	3.43	0.01	
CAD	1.25	1.17	2.30	2.69	CAD	2.35	-0.06	NZGB 2 3/4 04/15/37	3.26	-0.03				

* 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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