

29 May 2018



Events Round-Up

No major economic data

Good Morning

Italian yields have skyrocketed again and the EUR weakened, as the market prepares for new elections in Italy, likely in Autumn. There remains relatively little contagion from Italy into other markets as yet, with S&P500 futures near unchanged and FX moves reasonably modest. It was a public holiday in the UK and US overnight and there was no major data released.

Italy remains front and centre of the market's attention. The market initially reacted positively to news yesterday that Italian President Mattarella had vetoed the Five Star/League coalition's choice of finance minister, the prominent Eurosceptic Paolo Savona. Rather than select a more 'euro friendly' finance minister, PM-elect Conte chose to give up on forming a coalition government. The EUR rose from 1.1650, where it ended the week, to almost 1.1730 by the end of the NZ trading day. The Italian government bond market initially reacted positively as well, with the 2 year Italy yield down 20bps shortly after the European open with the 10 year Italy yield down 10bps.

The positive sentiment didn't last long however, and Italian yields quickly exploded higher again and the EUR weakened. The President's decision to veto Savona met with a fierce backlash from Five Star and League politicians, with Luigi Di Maio, the Five Star leader saying "*last night was the darkest in the history of Italian democracy.*" The Italian President's choice of caretaker PM, Carlo Cottarelli, known as "Mr Scissors" for his cuts to public spending in Italy in the past, is likely to reinforce the perception among supporters of Five Star and the League that the President is obstructing the will of the people and siding with the EU. Both parties indicated they would vote against the care-taker PM, setting the stage for new elections, likely in September or October, and what is likely to be hostile (probably anti-EU) rhetoric on the campaign trail.

The 2 year Italian-German spread increased 50bps on the day to 160bps, its widest level since late 2013, towards the end of the Eurozone sovereign crisis. Likewise, the EUR quickly gave up its gains from the Asian trading session and dropped around 1% to new lows against the

USD, just above 1.16. The market has pushed the first (10bp) ECB rate rise out to October next year. Market movements (especially in bonds) may have been exaggerated by thin trading conditions amid the US and UK public holidays, so tonight's session will be closely watched.

The safe haven demand for German bunds spilled over into other major bond markets, with the US 10 year Treasury futures yield down 7bps (implying the 10y rate at 2.86%, its lowest level in over a month). The NZ 10 year swap rate fell 2.25bps yesterday to 3.135% and we should expect further falls today as the local market reflects these overnight moves.

So far, there has been limited fall-out in other asset classes from the situation in Italy, with S&P500 futures around flat on the session (the cash market is closed for Memorial day). The Euro Stoxx index is down just less than 1%, with the Italian index unsurprisingly 2% lower (and Italian bank stocks underperforming).

In FX, moves have been reasonably contained, despite the sharp rise in Italian yields. The JPY is one of the outperformers on the session, but is close to unchanged against the USD from the end of last week (hardly a sign of heightened risk aversion). The Norwegian Krone and Canadian dollars have underperformed on the back of another fall in oil prices.

The NZD followed the EUR higher during the local session yesterday as the market initially reacted positively to Italian political developments. The NZD reached a high of 0.6960 around 6pm NZT before fading to 0.6940 over the remainder of the trading day as Italian fears mounted and the EUR resumed its decline. The net result was that the NZD is around 0.3% higher on the day, the best performing G10 currency (as it continues to recover from its sharp decline between mid-April to mid-May).

There was little impact from the Government's decision late in the local session to eradicate *Mycoplasma bovis* at a cost of \$886m over 10 years (similar to estimates that had been floated). The eradication will lead to 152,000 cattle being culled (around 1.5% of the NZ total) and will have negative implications for production in the future. See the note from Doug Steel, *Macroeconomic Risks From NZ Cattle Disease* for more information.

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Coming Up

		Period	Cons.	Prev.	NZT
JN	Jobless Rate	Apr	2.5	2.5	11:30
US	Conf. Board Consumer Confidence	May	128	128.7	02:00
EC	ECB's Coeure Speaks at Roundtable Discussion in Paris				04:00

Source: Bloomberg, BNZ

Foreign Exchange					Equities				Commodities**		
Indicative overnight ranges (*)					Major Indices				Price		
	Last	% Day	Low	High		Last	% Day	% Year		Last	Net Day
NZD	0.6939	+0.3	0.6938	0.6960	S&P 500	2,721	-0.2	12.6	Oil (Brent)	75.30	-1.5
AUD	0.7544	-0.1	0.7543	0.7581	Dow	24,753	-0.2	17.4	Oil (WTI)	66.47	-2.1
EUR	1.1628	-0.2	1.1608	1.1728	Nasdaq	7,434	+0.1	19.7	Gold	1302.7	-0.5
GBP	1.3312	+0.0	1.3297	1.3341	Stoxx 50	3,483	-0.9	-2.7	HRC steel	875.0	-0.8
JPY	109.37	-0.0	109.24	109.61	FTSE	7,730	+0.2	2.4	CRB	203.3	-1.1
CAD	1.3003	+0.2			DAX	12,863	-0.6	2.1	Wheat Chic.	559.8	+2.3
NZD/AUD	0.9198	+0.4			CAC 40	5,509	-0.4	3.2	Sugar	12.46	+0.6
NZD/EUR	0.5967	+0.5			Nikkei	22,481	+0.1	14.2	Cotton	86.65	+1.3
NZD/GBP	0.5213	+0.3			Shanghai	3,135	-0.2	0.8	Coffee	120.4	-0.1
NZD/JPY	75.89	+0.3			ASX 200	6,004	-0.5	5.2	WM powder	3290.0	+0.3
NZD/CAD	0.9023	+0.6			NZX 50	8,645	+0.1	16.6	Australian Futures		
NZ TWI	73.14	+0.3							3 year bond	97.845	0.02
									10 year bond	97.30	0.05

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			
USD	1.75	2.32	2.68	3.00	USD	2.93	0.00	NZGB 6 05/15/21	2.00	-0.01	1 year	2.05	0.00
AUD	1.50	1.94	2.05	2.88	AUD	2.75	-0.03	NZGB 5 1/2 04/15/23	2.28	-0.01	2 year	2.20	0.00
NZD	1.75	2.00	2.20	3.14	NZD	2.72	-0.02	NZGB 2 3/4 04/15/25	2.55	-0.02	5 year	2.66	-0.01
EUR	0.00	0.06	-0.15	0.90	GER	0.34	-0.06	NZGB 4 1/2 04/15/27	2.72	-0.02	7 year	2.89	-0.02
GBP	0.50	0.61	0.97	1.52	GBP	1.32	-0.00	NZGB 3 04/20/29	2.89	-0.02	10 year	3.14	-0.02
JPY	-0.07	-0.03	0.05	0.27	JPY	0.04	0.00	NZGB 3 1/2 04/14/33	3.08	-0.02	15 year	3.41	-0.02
CAD	1.25	1.17	2.27	2.64	CAD	2.30	-0.05	NZGB 2 3/4 04/15/37	3.24	-0.02			

* 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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