

30 May 2018



Events Round-Up

JN: Unemployment rate, Apr: 2.5% vs. 2.5% exp.

US: Conference Board consumer confidence, May: 128 vs. 128 exp.

Good Morning

Last night saw an absolute meltdown in the front-end of the Italian bond curve and serious signs of capitulation. The 2 year Italy-Germany spread closed around 190bps (!) wider with the market concerned the upcoming Italian election will be seen as a de facto vote on the EU/euro. Signs of contagion have started to emerge with core bond yields down sharply in other markets, major equity indices down and the JPY and Swiss Franc strengthening.

We thought volatility over the past few sessions in Italy had been pretty crazy, but it was nothing compared to last night. The 2 year Italian yield increased 180bps on the day to over 2.6%, a larger one day move than was seen at any time during the Eurozone sovereign crisis. The spread between the Italian 2 year bond and German equivalent widened to 350bps, its widest since 2012 (for reference, this spread was 25bps a month ago). The moves look like complete capitulation, with market movements exaggerated by thin and worsening liquidity. There were reports of some price makers not making quotes on certain Italian and Spanish bonds overnight and some investors will need to de-risk their positions in light of the surge in volatility. The sharp flattening in the Italian curve is consistent with growing concern about credit risk/redenomination risk with Italy.

There was no real trigger for the brutal sell-off in Italy overnight, although there have been reports that new elections might come as soon as late July (rather than autumn). In a poll overnight, the League party had moved up to 27.5% support with Five Star at 29%, and media are reporting that parties are pushing for an earlier election date. There is concern that the President's decision to veto the coalition's choice of finance minister will further embolden the two anti-establishment parties to campaign on an anti-EU platform, which could be seen as a de facto referendum on EU membership (a survey of Italians by the Jacques Delors Institute earlier this year showed only 35% of citizens regarded EU membership as a good thing).

With the Italian election ahead, it's not obvious what the "circuit-breaker" is to reassure the market. The ECB's QE

certainly hasn't done much to stem the rout (the ECB's €4b of Italy purchases a month can be dwarfed by private sector flow).

The pressure on Italy has filtered through into other markets. Core bond yields have seen large moves lower amid a generalized flight to safety. The 10 year Treasury yield is down 15bps to 2.77%, its lowest level since March. The market still sees a June rate rise by the Fed as a near certainty (85+%) but it has scaled back rate hike expectations over the remainder of this year (the market now prices 37.5bps of hikes in total over the remainder of the year, including June). In other markets, 10 year UK gilts are down 13bps and 10 year bunds are down 8bps, to 0.25%. The stand-out move is the German front-end, where the 2 year yield fell 10bps to -0.8%, a clear sign of investors seeking safety and perhaps starting to worry about redenomination risk.

Other risk markets have started to show signs of reacting to the situation in Italy. The S&P500 is down over 1.5%, with financials leading the way lower, and the VIX has ticked up to around 18. Equity markets in Europe are also lower, led by the Italian index (-2.65%). Italian bank share prices closed down between 5 and 7%.

FX markets have moved predictably to the risk-off mood permeating markets. The JPY is around 1% stronger on the day, the best performing currency, with the Swiss franc not far behind. USDJPY fell from around 109.50 yesterday morning to as low as 108.11 a short while ago, although it has managed to bounce off that level to 108.45.

The EUR and Scandinavian currencies are the weakest on the day. The EUR fell to its lowest level since July last year, down almost 1% to 1.1525. The EUR has fallen almost 7% in the space of a month. The NZD and AUD have followed the EUR lower overnight, with the pick-up in risk aversion adding to the downward pressure. The NZD has fallen from 0.6940 this time yesterday to 0.6895 now, a fall of around 0.7%.

In the context of a significant pick-up in global risk aversion, the market will be particularly attuned to the RBNZ Financial Stability Report and comments from Governor Orr today. There is a lot of data out tonight, but it is likely to be very much second-order compared to the developing situation in Europe.

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Coming Up

		Period	Cons.	Prev.	NZT
NZ	RBNZ Publishes Financial Stability Report				09:00
NZ	Building Permits MoM	Apr		14.7	10:45
NZ	RBNZ's Orr at Parliament Select Committee on FSR				13:10
GE	Unemployment Claims Rate SA	May	5.3	5.3	19:55
GE	CPI EU Harmonized YoY	May P	1.8	1.4	00:00
US	ADP Employment Change	May	190	204	00:15
US	GDP Annualized QoQ	1Q S	2.3	2.3	00:30
US	Advance Goods Trade Balance	Apr	-71	-68	00:30
CA	Bank of Canada Rate Decision		1.25	1.25	02:00
US	U.S. Federal Reserve Releases Beige Book				06:00

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	0.6893	-0.7	0.6890	0.6939	CHF	0.9885	-0.4	S&P 500	2,680	-1.5	11.0	Oil (Brent)	75.28	+0.0
AUD	0.7500	-0.6	0.7499	0.7545	SEK	8.966	+1.6	Dow	24,285	-1.9	15.2	Oil (WTI)	66.69	-1.7
EUR	1.1530	-0.8	1.1510	1.1640	NOK	8.295	+1.2	Nasdaq	7,371	-0.9	18.7	Gold	1307.7	-0.1
GBP	1.3244	-0.5	1.3205	1.3323	HKD	7.846	+0.0	Stoxx 50	3,428	-1.6	-4.2	HRC steel	882.0	+0.8
JPY	108.44	-0.9	108.11	109.13	CNY	6.418	+0.3	FTSE	7,633	-1.3	1.1	CRB	201.8	-0.8
CAD	1.3026	+0.3			SGD	1.346	+0.2	DAX	12,667	-1.5	0.3	Wheat Chic.	553.5	-1.1
NZD/AUD	0.9191	-0.1			IDR	13,995	-0.9	CAC 40	5,438	-1.2	2.0	Sugar	12.46	-0.2
NZD/EUR	0.5978	+0.1			THB	32.10	+0.3	Nikkei	22,358	-0.5	13.6	Cotton	90.65	+4.6
NZD/GBP	0.5205	-0.2			KRW	1,077	+0.3	Shanghai	3,120	-0.5	0.3	Coffee	120.3	-0.3
NZD/JPY	74.75	-1.6			TWD	29.99	+0.2	ASX 200	6,014	+0.2	5.2	WM powder	3275.0	-0.5
NZD/CAD	0.8979	-0.5			PHP	52.69	+0.4	NZX 50	8,636	-0.1	16.5	Australian Futures		
NZ TWI	72.90	-0.4										3 year bond	97.895	0.05
												10 year bond	97.40	0.12
Interest Rates						NZ Government Bonds				NZ Swap Yields				
	Rates				Benchmark 10 Yr Bonds		Last			Last				
	Cash	3Mth	2 Yr	10 Yr	Last	Net Day								
USD	1.75	2.32	2.57	2.82	USD	2.78	-0.15	NZGB 6 05/15/21	2.02	0.02	1 year	2.05	0.00	
AUD	1.50	1.94	2.07	2.78	AUD	2.69	-0.07	NZGB 5 1/2 04/15/23	2.30	0.02	2 year	2.21	0.00	
NZD	1.75	2.02	2.19	3.07	NZD	2.74	0.02	NZGB 2 3/4 04/15/25	2.57	0.02	5 year	2.64	-0.01	
EUR	0.00	0.06	-0.14	0.86	GER	0.26	-0.08	NZGB 4 1/2 04/15/27	2.74	0.02	7 year	2.87	-0.02	
GBP	0.50	0.61	0.90	1.43	GBP	1.20	-0.12	NZGB 3 04/20/29	2.91	0.02	10 year	3.12	-0.02	
JPY	-0.07	-0.03	0.05	0.25	JPY	0.03	-0.01	NZGB 3 1/2 04/14/33	3.10	0.02	15 year	3.38	-0.02	
CAD	1.25	1.17	2.18	2.53	CAD	2.17	-0.13	NZGB 2 3/4 04/15/37	3.26	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 07:04

Source: Bloomberg

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