

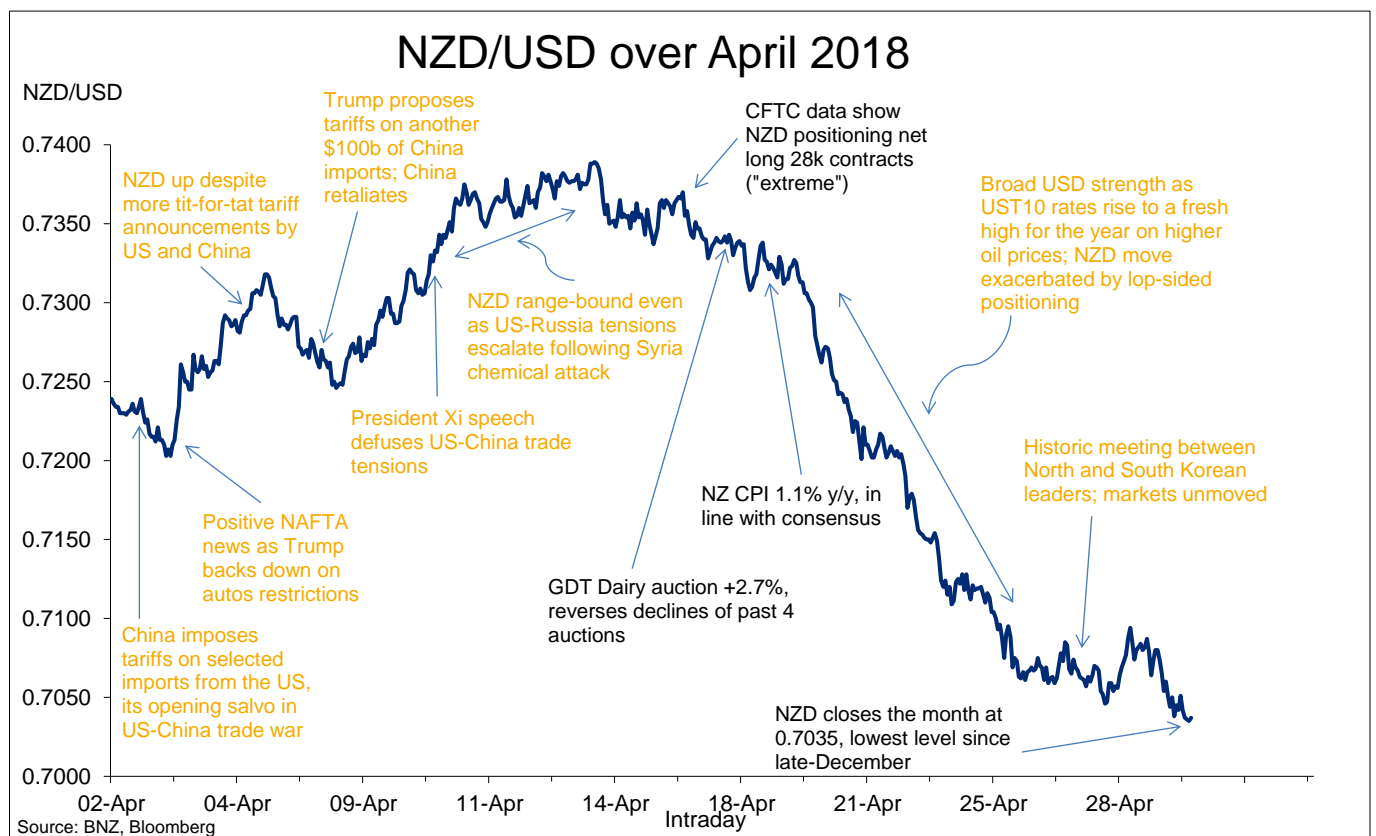
RESEARCH FINANCIAL MARKETS WRAP

1 May 2018



NZD Slumps in April

- NZD closes the month at its lowest level since late-December after a 3-cent slump
- USD broadly stronger, breaking out of a range
- UST 10 year yields reach a four year high; NZ-US rate spreads continue to narrow



Quick Outlook		April ranges
NZD/USD	After a quick 3-cent tumble, due for some consolidation, with large net long positions now likely cleaned out and fair value close to the 0.72 mark. Much will depend on whether the USD can continue to recover further after its range break-out.	0.7035 – 0.7395
NZD/AUD	Further modest downside risk after a break of its unjustified upward trend through to mid-April.	0.9320– 0.9535
NZD/GBP	We haven't got to the point where Brexit risks disappear from the headlines so still a bit jumpy for GBP until they do, but medium term bias for the cross to the downside.	0.5060 – 0.5215
NZD/EUR	Has been tightly range-bound recently, but bigger picture is one of further downside risk ahead, supported by further subtle shifts in ECB policy that support EUR.	0.5795 – 0.5995
NZD/JPY	Strong support near 76 but the risks of a sustained downward break increase as the year progresses on likely weaker risk appetite and fully exhausted BoJ policy.	76.2 – 79.6
90-day BB	Flat, with little chance of monetary policy adjustment over coming months.	1.96% - 2.06%

After a volatile period through February and March, risk appetite improved during the month, reflected in a recovery in global equities and higher global bond yields. Currency markets played to a different tune, with broadly based weakness in the NZD going against that force.

US trade wars continued to dominate the headlines, at least during the first half of the month as China proposed tariffs in retaliation to the proposed US tariffs. Not to be outdone, Trump instructed his administration to consider imposing tariffs on a further \$100b of China imports, in addition to the original \$50b of proposed tariffs. However, markets were encouraged by President Xi's keynote address at an Asian economic forum. Xi struck a conciliatory tone and allayed some market fears of the current verbal trade war between US-China morphing into an actual trade war.

US-Russia tensions escalated after President Trump warned that he was willing to challenge Russia directly in launching a military strike against Syrian President Bashar al-Assad's forces over an alleged chemical-weapons attack. Soon following, the US, UK and France launched missile strikes on Syrian chemical weapons facilities. However, the market took this in its stride and there was little overall impact.

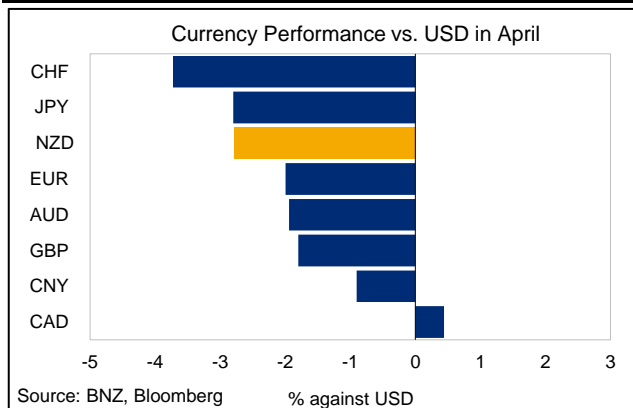
Near the end of the month Kim Jong Un became the first North Korean leader to step foot into South Korean territory since the end of the Korean War. At the historic meeting, Kim called for "a new history of peace and prosperity" and the two leaders agreed to move towards formally ending the war and pursue "complete denuclearisation" of the Korean peninsula. There was little impact on the market given that a risk premium on North Korean risks was priced out some time ago.

The USD was broadly stronger for the month, staging a recovery of 2½% in the second half of the month, breaking out of a range and taking it to its highest level since January. A shakeout of positioning goes a long way in explaining the recovery in the USD. Short positions in the USD were becoming uncomfortably expensive as USD short term rates (LIBOR) climbed higher and higher. A positive US economic dataflow, going against a backdrop of softer global indicators, particularly in Europe, can also explain improved sentiment for the USD.

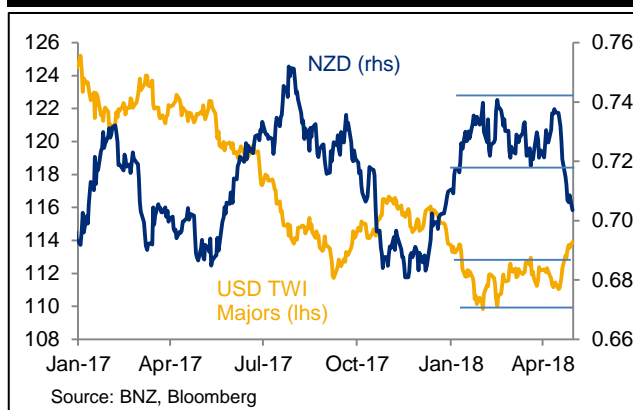
The NZD had a month of two halves, gradually rising through much of the first half on the better risk appetite backdrop before stumbling over the second half. Wrong-footed positioning likely exacerbated the sell-off, with net long positioning in the NZD inexplicably moving towards a historically high level at the same time as AUD and CAD positioning moved net short. Once sentiment for the USD turned positive, the NZD fell away sharply, losing over three cents within a couple of weeks and closing the month at 0.7035, its lowest level since late December.

The weaker NZD came even as dairy prices trended higher through the month, with NZX whole milk powder futures rising by 8% for the month and futures contracts for the milk payout rising by 1½% to \$6.66 for FY2018 and 8% to \$6.60 for FY2019.

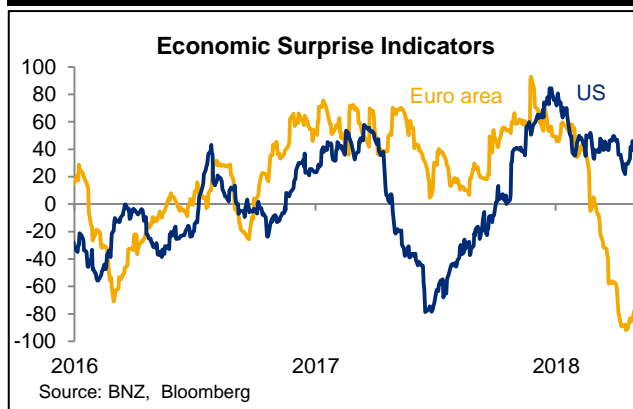
Broadly based USD strength in April



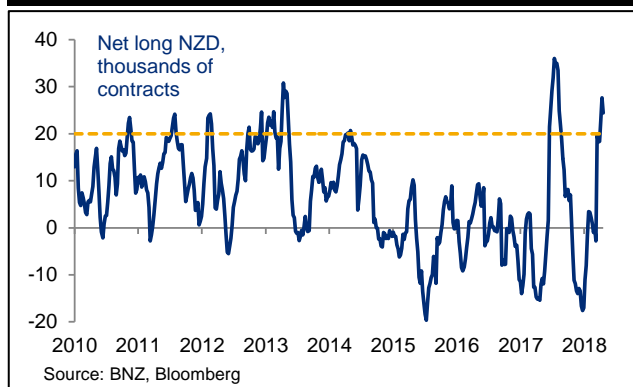
NZD breakdown; USD breakup



US dataflow better than Euro area recently



NZD positioning long & wrong ahead of mid-month slump



Within the commodity space, oil prices performed strongly as some balance was restored to the market, with the OPEC+ supply cuts eating away at inventory levels amidst strong demand. Brent crude reached its highest level in three years, surpassing USD 75 per barrel.

Higher oil prices and increased optimism that a new NAFTA deal would soon be signed supported CAD, which nudged out the USD as the strongest major currency for the month.

NZD/AUD pushed up through 0.95 and reached its highest level since July last year before the mid-month slump in the NZD. For the month, the NZD was lower on all the other crosses apart from the yen. The pre-eminent safe haven CHF and JPY currencies underperformed as risk appetite improved. In the case of JPY there was a pullback after exuberance for the currency over the first quarter.

After the UK and EU reached a transitional agreement for Brexit in March, some uncertainty followed, including whether or not the UK would actually leave the customs union. This seemed to reduce sentiment for GBP alongside softer activity and inflation indicators that reduced expectations for a May rate hike by the Bank of England.

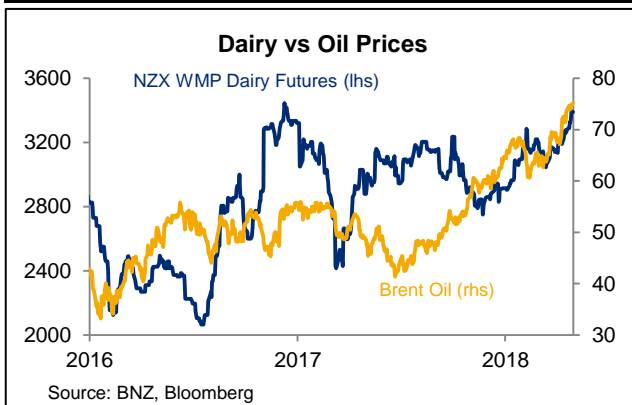
The broad-based recovery in the USD and the prevailing (extreme) net long positioning in EUR did no favours to the common currency. After the ECB meeting President Draghi acknowledged "some moderation in growth" but noted the economic recovery was still solid and supportive of inflation (eventually) getting to target. Bizarrely, Draghi admitted that the monetary policy outlook wasn't even discussed, seemingly indicating that the ECB remains nervous about the possible market reaction to when the ECB's quantitative easing programme finally ends.

US rates trended higher through the month and the 10-year rate breached the 3% mark for the first time since January 2014, driven by break-even inflation rates moving higher on the back of higher oil prices and real rates moving higher on increased confidence of further Fed tightening. After peaking at 3.03%, the 10-year rate ended the month at 2.95%, up 21bps for the month.

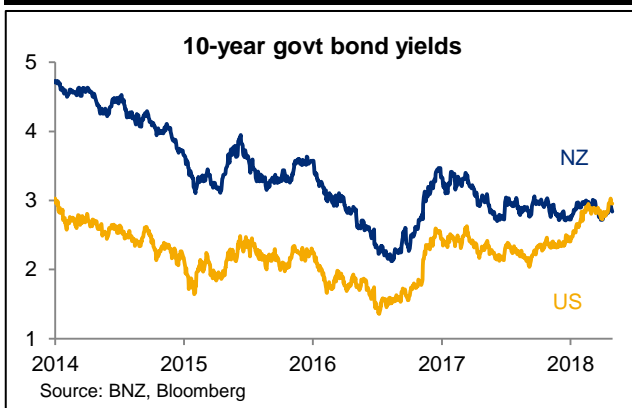
This dynamic dragged up global yields, although NZ's 10-year rate rose by "only" 12 bps to 2.84%, continuing the downward pressure on NZ-US rate spreads we have seen for some time. NZ monetary policy expectations remained little changed. The Q1 CPI increase of 1.1% y/y was in line with market expectations and is likely to be the low in the cycle, with higher oil prices seen to date likely to push inflation back to the mid-point of the target range by the end of the year. Newly installed RBNZ Governor Orr gave a wide range of media interviews during the month on a range of topics. Besides reiterating the Bank's continued forward-looking focus on the 2% CPI mid-point, he didn't give too much away on his monetary policy intentions.

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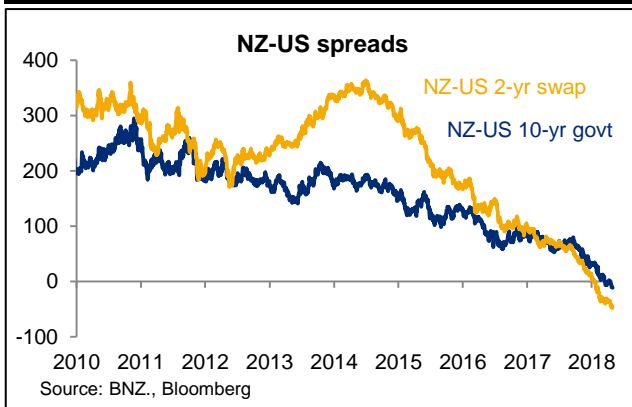
Dairy and oil prices higher



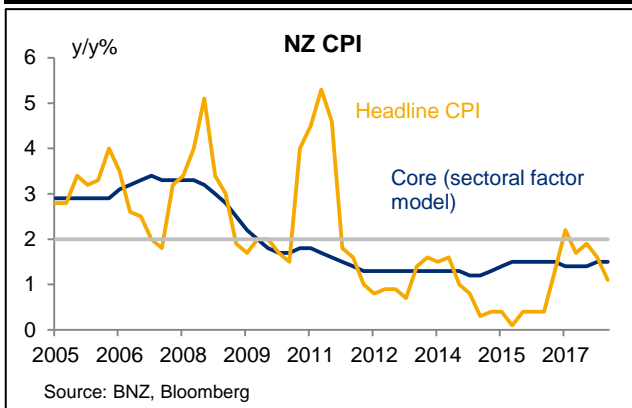
US rates reach a fresh high



NZ-US rate spreads still narrowing



Inflation pulse remains subdued



Monthly Performance Table

	end-Apr	end-Mar	Change		end-Apr	end-Mar	Change
Currencies				NZ Rates			
NZD/USD	0.7035	0.7237	-2.8%	OCR	1.75	1.75	0.00
NZD/AUD	0.9344	0.9426	-0.9%	NZ 90day BB	2.02	1.96	0.06
NZD/EUR	0.5825	0.5876	-0.9%	NZ 2yr sw ap	2.27	2.22	0.05
NZD/GBP	0.5112	0.5164	-1.0%	NZ 5yr sw ap	2.73	2.62	0.11
NZD/JPY	76.91	76.91	0.0%	NZ 10yr sw ap	3.21	3.06	0.15
NZD/CNY	4.456	4.5547	-2.2%	NZ Govt (4/21)	2.84	2.72	0.12
TWI	73.4	74.5	-1.5%	NZ Govt (4/23)	2.37	2.29	0.08
AUD/USD	0.7530	0.7679	-1.9%	NZ Govt (4/27)	2.84	2.72	0.12
EUR/USD	1.2078	1.2324	-2.0%	Global 10 year bond rates			
GBP/USD	1.3763	1.4015	-1.8%	US	2.95	2.74	0.21
USD/JPY	109.34	106.28	2.9%	Canada	2.31	2.09	0.22
USD/CNY	6.33	6.28	0.9%	UK	1.42	1.35	0.07
USD/CAD	1.2843	1.2900	-0.4%	France	0.78	0.72	0.07
USD TWI major	113.89	112.19	1.5%	Germany	0.56	0.49	0.06
Asia DXY	110.87	111.84	-0.9%	Italy	1.79	1.79	0.00
Equity Markets				Spain	1.27	1.16	0.12
MSCI AC Wrld, loc.	1,169	1,147	1.9%	Portugal	1.66	1.60	0.06
MSCI World, loc.	6,379	6,253	2.0%	Ireland	0.96	0.90	0.05
MSCI EM, USD	2,548	2,559	-0.4%	Japan	0.05	0.04	0.01
US S&P 500	2,648	2,641	0.3%	Australia	2.77	2.60	0.17
Euro STOXX 600	385.3	370.9	3.9%	Commodities (USD)			
Germany DAX	12,612	12,097	4.3%	WTI Crude	68.57	64.87	5.7%
France CAC 40	5,521	5,167	6.8%	Brent Crude	74.69	68.85	8.5%
UK FTSE 100	7,509	7,057	6.4%	R/B CRB Index	202.0	195.4	3.4%
Aust S&P/ASX 200	5,983	5,759	3.9%	Gold spot	1,315	1,325	-0.8%
Japan Topix	1,777	1,716	3.6%	Silver spot	16.33	16.37	-0.2%
China CSI 300	3,757	3,899	-3.6%	Copper	305.3	302.6	0.9%
NZX50	8,444	8,319	1.5%	Iron Ore	65.65	63.79	2.9%
Volatility: VIX	15.93	19.97	-20.2%	Coking coal	186.00	189.50	-1.8%
3-mth Bill Futures				Thermal coal	99.40	96.40	3.1%
NZD Dec-18	97.84	97.85	-0.01	Corn	400.8	396.3	1.1%
AUD Dec-18	97.98	98.04	-0.06	Wheat	510.5	468.5	9.0%
USD Dec-18	97.36	97.51	-0.15	NZX Dairy WMP	3,390	3,145	7.8%
EUR Dec-18	100.31	100.30	0.01	NZX Milk Price 2018	NZD 6.66	NZD 6.56	1.5%
GBP Dec-18	99.07	98.92	0.15	NZX Milk Price 2019	NZD 6.6	NZD 6.1	8.2%

Source: BNZ, Bloomberg

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