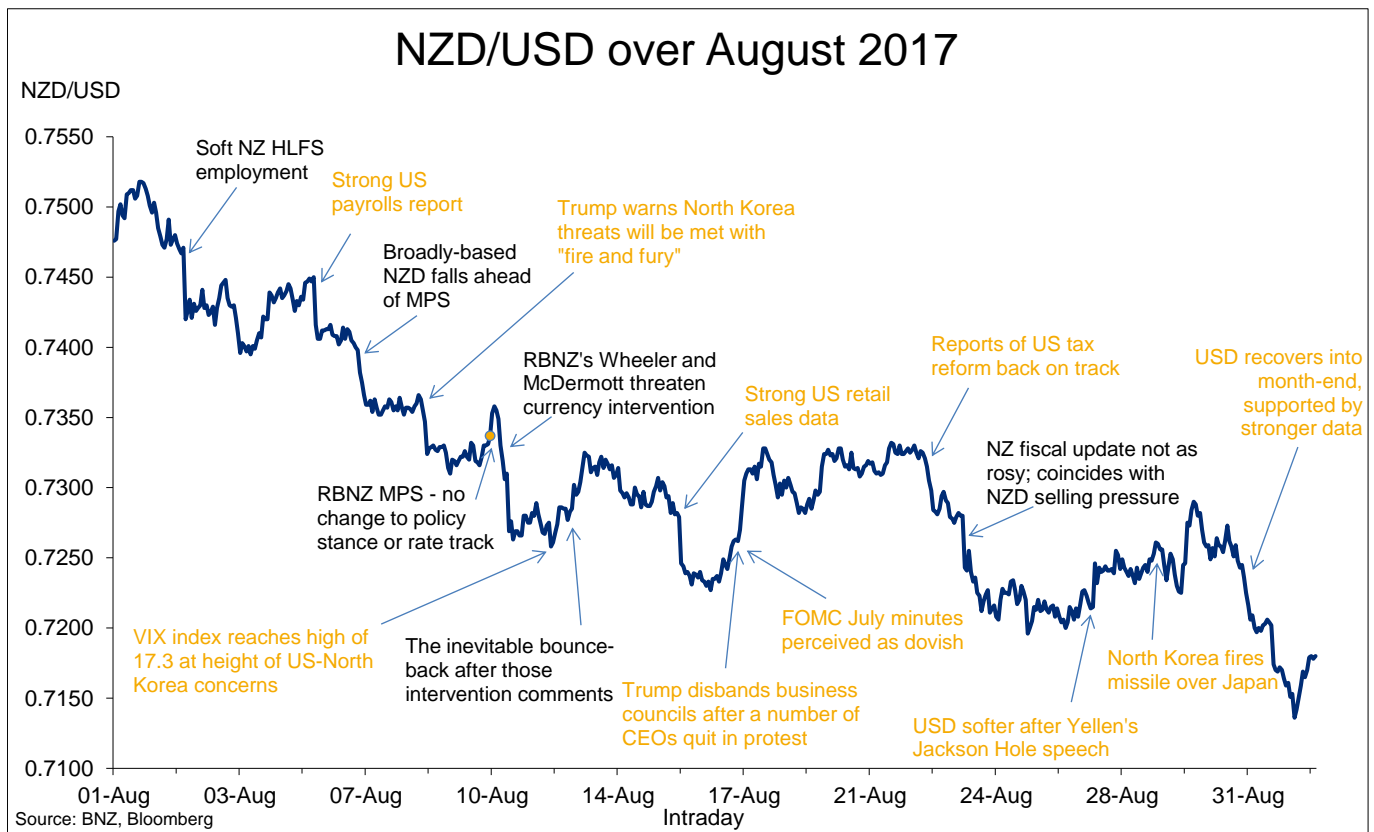


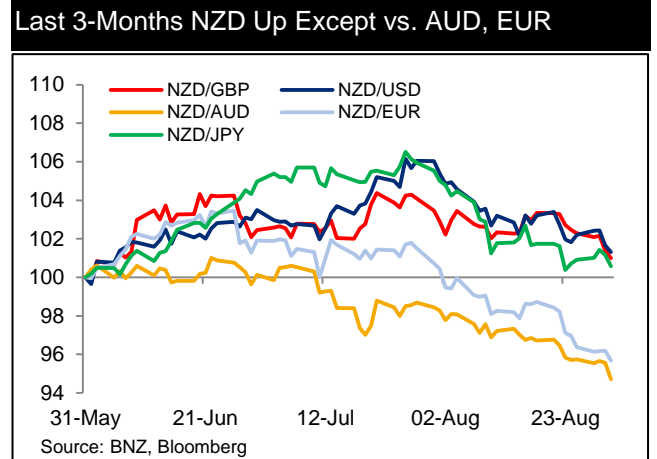
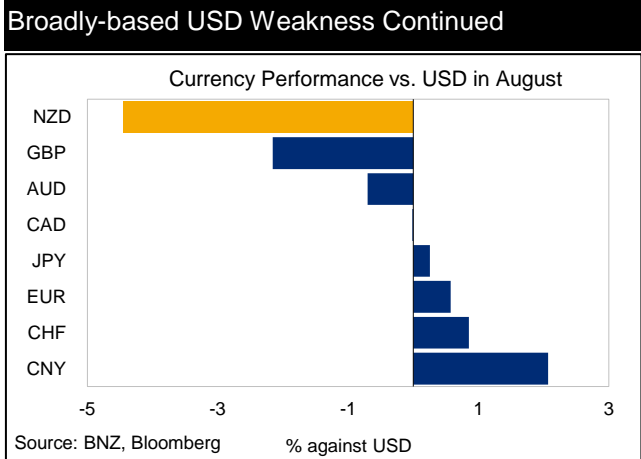
1 September 2017

August sees a strong downtrend in NZD

- NZD significantly lower, near 5% on many crosses
- Unwinding strength over recent months
- Speculators wrong-footed



Quick Outlook		August ranges
NZD/USD	After the pummelling in August, a period of consolidation ahead perhaps? Plenty of event-risk in September, with FOMC and debt ceiling angst negative for USD while NZ election and North Korea headlines are negative for NZD.	0.7130 – 0.7525
NZD/AUD	A fair cross in the low 0.90s given the recent strong rally in metal prices. Knee-jerk fall to 0.89 possible, but on fundamental grounds, due for some consolidation.	0.9025 – 0.9390
NZD/GBP	Brexit talks are moving at a pedestrian pace against a backdrop of a sluggish UK economy. Cross to remain range-bound over the foreseeable future.	0.5530 – 0.5705
NZD/EUR	We still see a move into the high 0.50s as inevitable, driven by the ECB's move towards ending QE, but after the 11% fall over the past six months a near-term break in the downtrend wouldn't surprise.	0.6010 – 0.6365
NZD/JPY	Correlated with UST yields so on our view that the 10-year rate moves higher into year end, the pressure on the cross would be towards the upside, but sensitive to risk sentiment	78.3 – 83.0
90-day BB	Flat, with little chance of monetary policy adjustment over coming months.	1.94% - 1.97%



A poor August for the NZD

The NZD was a clear under-performer during August, falling against all the major currencies we closely follow. We don't think there was any one specific driver behind this performance – we think it probably reflects the combination of poor trader positioning at the start of the month and the cumulative impact of a number of slightly NZD-negative forces.

Extreme long positioning can explain the move

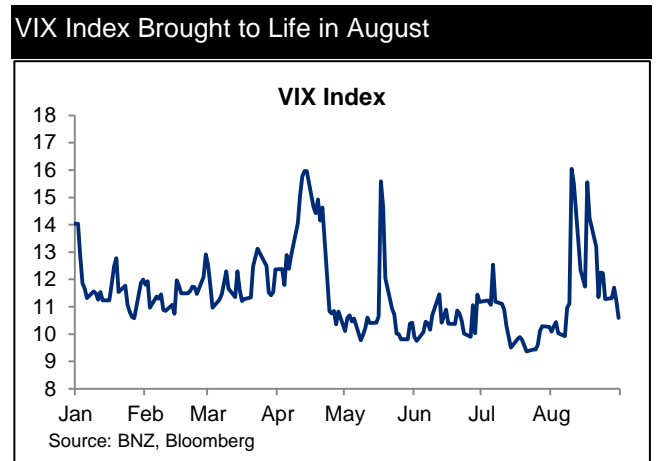
At the beginning of the month, CFTC data showed that net speculative positioning was extremely long NZD, with the number of net long contracts at a near-record level. At extremes, this indicator has proved to be a great contrarian indicator, and that was the case for August. In terms of the more fundamental forces that might explain NZD downward pressure over the month, we can point to volatility in risk appetite, softer NZ export commodity prices, an RBNZ that held its ground in projecting an unchanged OCR for an extended period, weaker-than-expected NZ employment data, a less rosy fiscal outlook than expected and the NZ election campaign heating up, and throwing a few curveballs.

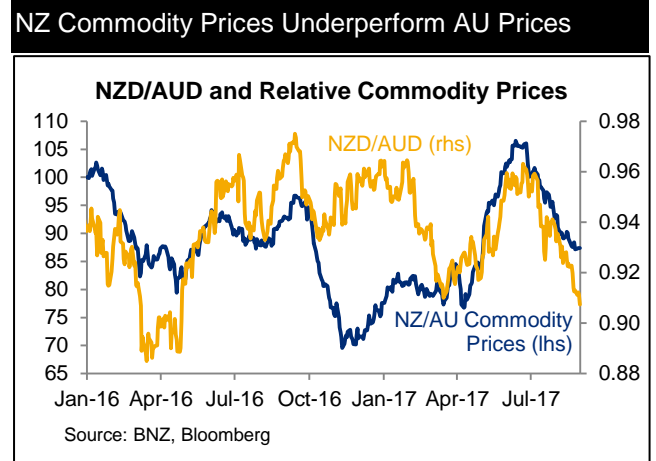
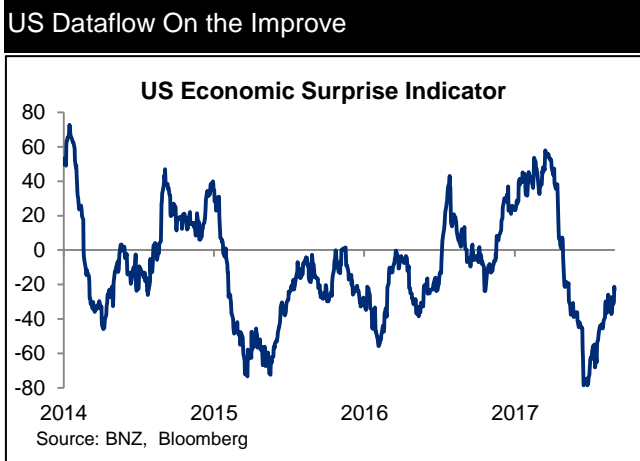
VIX a bit more volatile in August

While trading activity was typically quiet during the Northern hemisphere summer trading period there were three notable risk events that took the VIX index up through 14, something we haven't seen much of this year. Risk appetite temporarily soured after a war of words by US and North Korean leaders, with the sabre-rattling including a comment from Trump that North Korean threats would be met with "fire and fury". Late in the month, North Korea fired a missile high into the atmosphere over Japan, a provocative move that caused another temporary blip in risk appetite. Trump was in the headlines a lot, particularly after his lame response to racial violence in Charlottesville, Virginia. A number of politicians and business leaders tried to distance themselves from Trump, adding to the view that his policy agenda remained well off track.

USD flat despite positive dataflow

The USD managed to hold its ground for the month, with the TWI-majors index closing flat, but that and other key USD indices remained close to key technical support levels after heavy selling pressure through much of this year. The US economic dataflow improved, including strong employment data and GDP for Q2 revised up to 3%. Citigroup's US economic surprise indicator showed a rising trend through the month after free falling over the previous four months. Still, the message from a number of FOMC speakers was that they would need to see evidence of rising inflation, after its recent shift down, before voting to raise rates again. The market continued to price further Fed tightening out of the curve. By month end, another full 25bp hike wasn't priced in until the beginning of 2019.





Chunky falls on NZD crosses

The NZ TWI ended the month down a chunky 4½%, with falls of 4-5% against the USD, AUD, EUR and JPY. NZD/USD closed the month around 0.7180, unwinding the surge over the second half of July. NZD/AUD fell to 0.9030, a 16-month low. Supporting the move lower in NZD/AUD were higher interest rate spreads in Australia’s favour (Australian 2-year swap rate up 5bps, NZ 2-year swap rate down 2bps) and “hard” commodities significantly outperforming soft commodities. A number of metal prices made multi-year highs, driving Australia’s commodity price index higher, while NZ’s commodity price index drifted lower throughout the month.

PBoC happy with CNY strength

Of the major currencies, CNY was the strongest, with the PBoC seemingly happy to engineer a stronger currency against its reference basket, well ahead of the National People’s Congress in mid-October. The signal from the government seems to be that it is done presiding over a weaker CNY basket since late 2015 and is confident enough in the outlook to halt that trend. NZD/CNY fell by over 6% for the month.

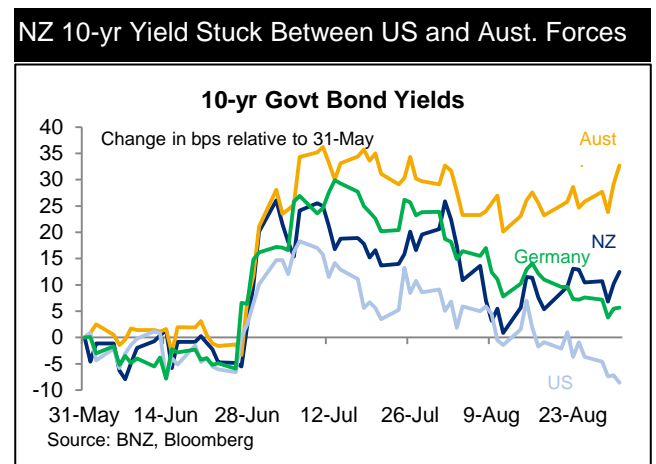
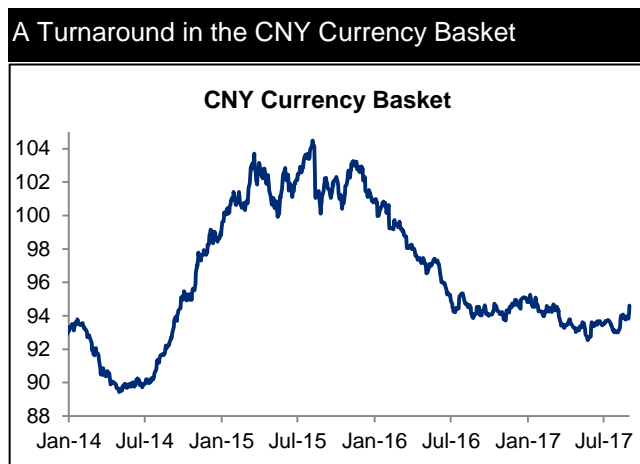
NZD/EUR has taken a hammering last 6 months

NZD/EUR continued along its downward trend, seeing the cross reach its lowest level in fifteen months. The 5% fall during the month took the cumulative fall since the end of February to over 11%. Euro-area economic indicators remained strong, with expectations that the ECB would announce an unwinding of its asset purchase programme (QE) at either its September or October meeting. EUR/USD stretched all the way to above 1.2050, its highest level since the start of 2015, but that was a step too far, and a turnaround in the USD saw the cross back to around the 1.19 mark.

Little progress on Brexit

GBP was on the soft side of the ledger. There was little sign of any real progress on Brexit talks between the UK and EU five months into the process. EU President Juncker said that the UK discussion papers were “unsatisfactory”. Chief EU Brexit negotiator Barnier said that he wanted the UK to come clean and say how much it is prepared to pay to leave the EU, still a major pre-condition from a European standpoint before any trade deal can be discussed, let alone settled. NZD/GBP fell by “only” 2½%.

USD/JPY found plenty of support below the 109 mark and ended the month fairly flat at 110. Movements were well correlated with US-year Treasury yields until late in the month, when the two diverged, with a higher cross going against the tide of falling US rates.



Global bond yields lower

Global bond rates were generally lower over the month, with Australia going against the grain and showing higher rates. The US 10-year rate ended the month down 18bps to 2.18%, with the market becoming less convinced that US monetary policy would tighten much further with a backdrop of soft inflation. After North Korea fired a missile over Japan, the 10-year rate reached an intra-day low of 2.08%, its lowest level for the year. NZ's 10-year bond rate was torn between the downward pressure of lower US rates and the upward pressure from Australian rates (chart on previous chart highlights this). The April-2027 bond closed the month down 8bps at 2.91%. The pressure from lower global rates caused a flattening of the yield curve, as a steady NZ monetary policy outlook kept the short end of the curve underpinned.

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Monthly Performance Table							
	end-Aug	end-Jul	Change		end-Aug	end-Jul	Change
Currencies				NZ Rates			
NZD/USD	0.7178	0.7512	-4.4%	OCR	1.75	1.75	0.00
NZD/AUD	0.9032	0.9388	-3.8%	NZ 90day BB	1.96	1.96	0.00
NZD/EUR	0.6027	0.6346	-5.0%	NZ 2yr sw ap	2.20	2.22	-0.02
NZD/GBP	0.5551	0.5686	-2.4%	NZ 5yr sw ap	2.67	2.76	-0.09
NZD/JPY	78.94	82.82	-4.7%	NZ 10yr sw ap	3.16	3.28	-0.13
NZD/CNY	4.734	5.0509	-6.3%	NZ Govt (4/20)	2.03	2.10	-0.07
TWI	75.3	79.0	-4.7%	NZ Govt (4/23)	2.49	2.57	-0.09
AUD/USD	0.7947	0.8003	-0.7%	NZ Govt (4/27)	2.91	2.99	-0.08
EUR/USD	1.1910	1.1842	0.6%	Global 10 year bond rates			
GBP/USD	1.2930	1.3215	-2.2%	US	2.12	2.30	-0.18
USD/JPY	109.98	110.26	-0.3%	Canada	1.85	2.05	-0.21
USD/CNY	6.59	6.73	-2.0%	UK	1.03	1.23	-0.20
USD/CAD	1.2482	1.2480	0.0%	France	0.66	0.80	-0.14
USD TWI major	113.69	113.80	-0.1%	Germany	0.36	0.54	-0.18
Asia DXY	107.97	107.14	0.8%	Italy	2.05	2.09	-0.05
Equity Markets				Commodities (USD)			
MSCI AC Wrld, loc.	1,084	1,079	0.4%	Spain	1.55	1.48	0.07
MSCI World, loc.	5,919	5,907	0.2%	Portugal	2.81	2.85	-0.04
MSCI EM, USD	2,355	2,302	2.3%	Ireland	0.68	0.83	-0.15
US S&P 500	2,472	2,470	0.1%	Japan	0.00	0.08	-0.07
Euro STOXX 600	373.9	377.9	-1.1%	Australia	2.71	2.68	0.04
Germany DAX	12,056	12,118	-0.5%	Commodities (USD)			
France CAC 40	5,086	5,094	-0.2%	WTI Crude	47.23	50.26	-6.0%
UK FTSE 100	7,431	7,372	0.8%	Brent Crude	52.82	52.87	-0.1%
Aust S&P/ASX 200	5,715	5,721	-0.1%	R/B CRB Index	180.9	182.6	-1.0%
Japan Topix	1,617	1,619	-0.1%	Gold spot	1,321	1,269	4.1%
China CSI 300	3,822	3,738	2.3%	Silver spot	17.58	16.83	4.5%
NZX50	7,817	7,694	1.6%	Copper	307.9	289.2	6.5%
Volatility: VIX	10.59	10.26	3.2%	Iron Ore	78.91	73.70	7.1%
3-mth Bill Futures				Coking coal	207.00	171.50	20.7%
NZD Dec-17	98.03	98.00	0.03	Thermal coal	95.30	93.20	2.3%
AUD Dec-17	98.23	98.26	-0.03	Corn	357.8	384.8	-7.0%
USD Dec-17	98.59	98.55	0.03	Wheat	434.5	499.8	-13.1%
EUR Dec-17	100.33	100.32	0.01	NZX Dairy WMP	3,250	3,260	-0.3%
GBP Dec-17	99.64	99.59	0.05	NZX Milk Price 2018 NZD	6.76	NZD 6.7	0.9%

Source: BNZ, Bloomberg

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