

# RESEARCH

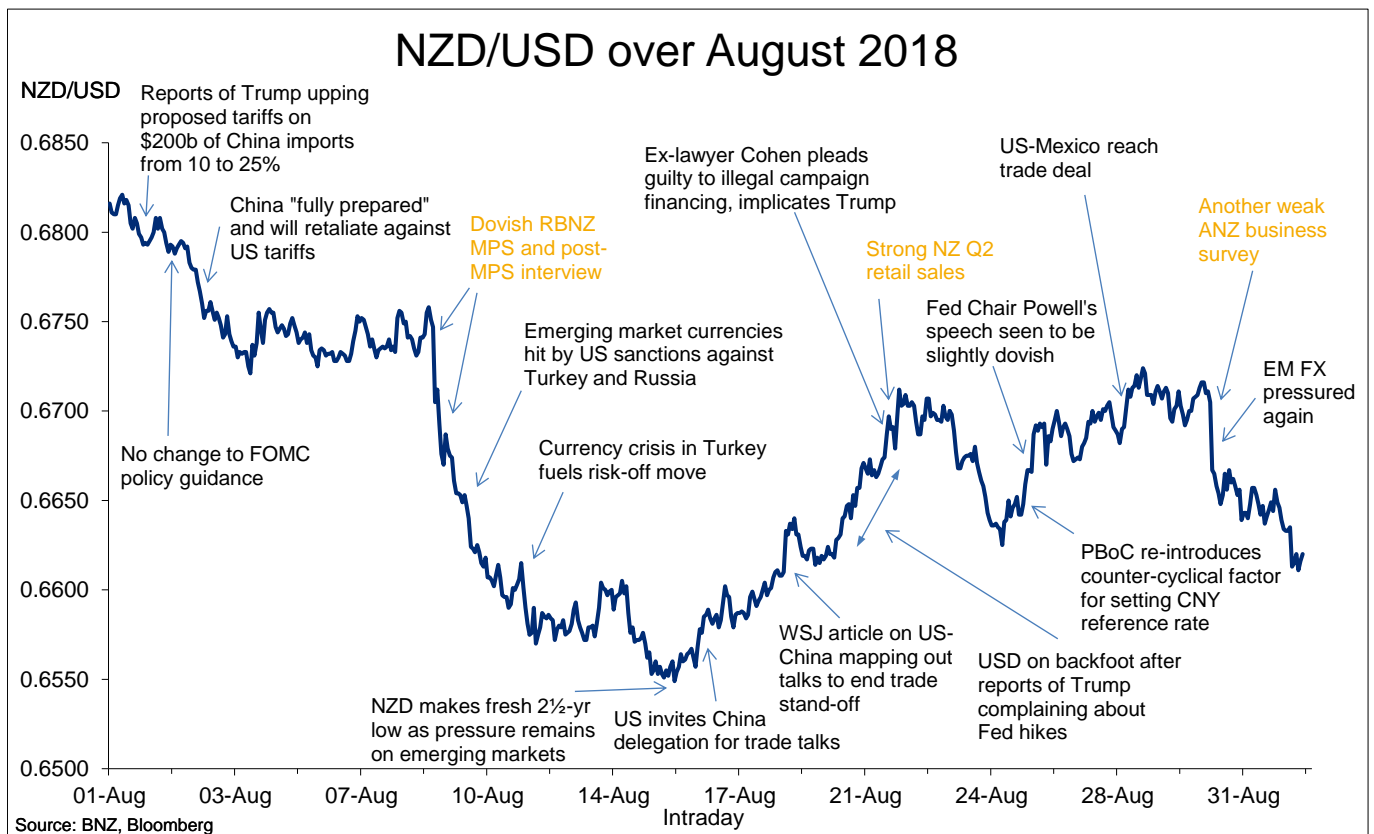
## FINANCIAL MARKETS WRAP

3 September 2018



### NZD and AUD underperform in August

- US-China trade tensions escalate; Emerging market currencies under pressure
- Global and domestic forces see NZD reach multi-year lows on some crosses
- Easier policy priced into NZ curve and NZ-global rate spreads narrow further



Quick Outlook		August ranges
NZD/USD	Binary near-term risk, ahead of Trump's decision on imposing additional tariffs on Chinese imports. Sub-0.65 easily achievable on a bad outcome that sees contagion across Asia-Pacific currencies. Modest rebound possible on a not-so-bad outcome.	0.6545 – 0.6820
NZD/AUD	Very close to fair value and near middle of the 0.90-0.94 range we see as an anchor through the year. More of the same, with similar economic outlooks and steady rates.	0.8950 – 0.9210
NZD/GBP	Brexit headlines will intensify over coming months and a range of outcomes from dire to good remain possible. Our assumption of a soft Brexit as the endgame means medium-term downside risk to the cross but volatility could increase ahead of that.	0.5100 – 0.5245
NZD/EUR	We continue to see the path of least resistance as one of further modest downside pressure over the medium term.	0.5685 – 0.5840
NZD/JPY	Medium-term pressure remains to the downside as the yen remains super-cheap and potentially more volatile markets into year-end would foster a lower near-term cross.	72.4 – 76.3
90-day BB	Flat, with little chance of monetary policy adjustment over coming months.	1.90% - 1.93%

The NZD underperformed in August and a fresh 2½-year low was reached mid-month. Both global and domestic factors were in play. On the global side, increased US-China trade tensions and ongoing weakness in emerging market currencies spilled over into a weaker NZD. On the domestic side, the RBNZ Monetary Policy Statement surprised the market with its more dovish than expected tone, while business confidence lurched lower.

The month got off to a bad start with reports coming through of President Trump upping his proposed tariffs on a further \$200b of Chinese imports from 10% to 25% during the period of public consultation. China showed no sign of capitulating to White House demands, saying it was “fully prepared” and will retaliate against US tariffs. Further tit-for-tat tariffs on \$16bn of trade were implemented by both countries, as previously announced, taking the total to \$50b. Public consultations on the next phase of tariffs on \$200bn of trade ends 6 September, before Trump can make his decision. This will keep the market on tenterhooks until we know the outcome. US-China trade talks late in the month showed little progress.

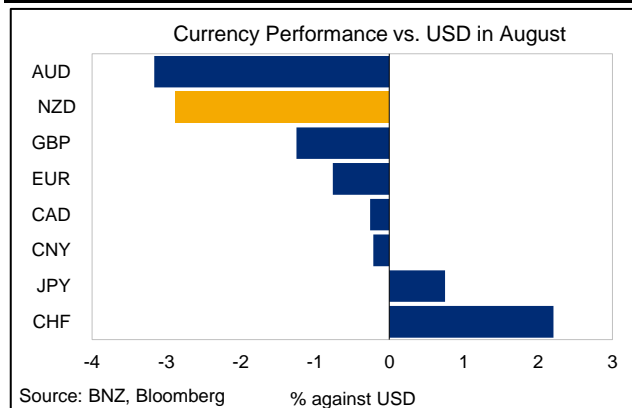
Turkey became another domino to fall regarding the pressure seen on emerging markets so far this year, although in this case it was very much self-inflicted, with the market losing confidence in President Erogan’s economic direction and a dispute regarding the imprisonment of a US pastor didn’t help. Turkey’s Lira fell by 25% for the month, and its demise spilled over into other emerging market currencies and the NZD, with the fresh low of 0.6545 coming near the time of maximum pressure on Turkey. Later in the month, Argentina’s peso came under attack and its currency fell over 25% for the month.

Ahead of Turkey’s drama, the RBNZ published a more dovish-than-expected Monetary Policy Statement. In a surprise move, the Bank put more weight on the risk of weaker growth than the recent lift in underlying inflationary pressure. This resulted in the Bank pushing out its first projected rate hike by about one year, with the Bank looking to keep policy steady for longer. The projections showed no sign of a rate hike until the second half of 2020. Governor Orr argued that the risks to the OCR outlook up or down were balanced, while Assistant Governor McDermott was more dovish than that, suggesting the chances of a rate cut had increased (“we’ve been pushed nearer to that trigger point”) and that the Bank would need to see core inflation above 2% to hike.

In the post MPS environment, the NZD became more sensitive to negative domestic economic releases. This was evident after the NZD fell again after the ANZ business outlook survey showed confidence lurching down further, to levels not seen since the global financial crisis.

The market priced in a much higher chance of easier policy over the next year. At month-end some 11bps of easing was priced into the OIS curve over the coming year. The NZ rates market continued to outperform other markets, with the 2-year swap rate ending the month down 16bps to 1.98%.

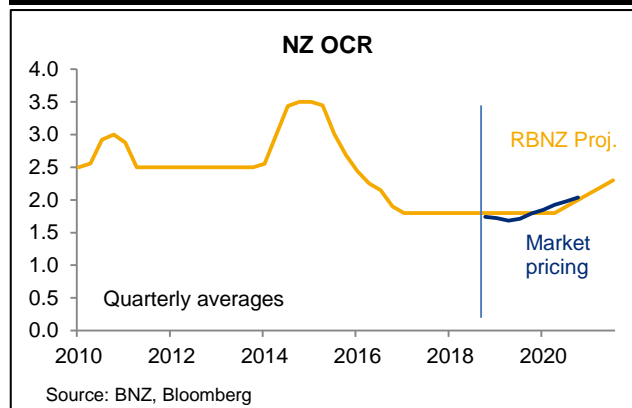
**NZD, AUD Clear Underperformers in August**



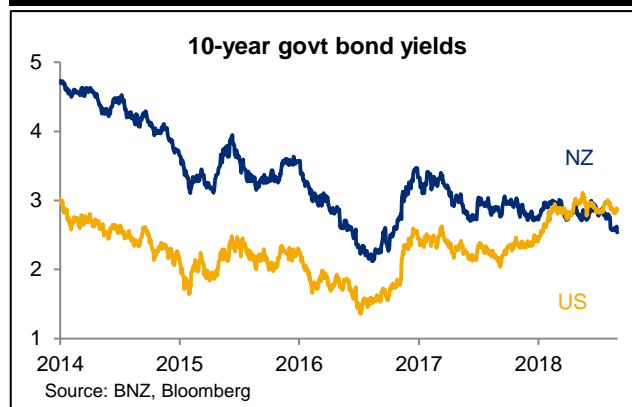
**US-China Tariffs – The Story So Far**

US Tariffs on China	
Tariff Imposition	Status
20-50% tariffs on washing mach./solar panels	In-place
Steel (25%) and aluminium (10%)	In-place
25% on \$50b China imports	In-place
25% on further \$200b of China imports	Consultation period ends 6 Sept
Tariffs on all \$500+b of China goods imports	Threatened
China tariffs on US	
Tariff Imposition	Status
25% on \$50b of US imports	In-place
5-25% on \$60b of US imports	"Subject to the actions of the US"

**Market Pricing Shows Increased Chance of OCR Cut**



**NZ Govt Yields Drift Further Below US**



NZ 5-10 year swap and government bond rates ended the month down in the order of 20-25 basis points, reaching their lowest levels in nearly two years. Lower NZ-global rate differentials were one factor in the softer NZD for the month, with the US 10-year rate down just 10bps to 2.86%.

The USD peaked around the time of maximum angst for emerging markets mid-month, reaching its highest level in more than a year on the various indices we monitor. Sentiment for the USD was softer in the second half, not helped by a run of weaker economic data, Trump lamenting Fed rate hikes since he appointed Fed Chair Powell, while the latter's address to the annual Jackson Hole conference was taken to be slightly more dovish than expected. The market focused attention on his comment "while inflation has recently moved up near 2%, we have seen no clear sign of an acceleration above 2%, and there does not seem to be an elevated risk of overheating."

The NZD fell to a mid-month nadir of 0.6545, before the turnaround in the USD. The AUD was the weakest of the majors, not helped by its close correlation with emerging market currencies. Monetary policy expectations were also a factor for the weaker AUD, with higher mortgage rates delivered by some banks seen to push out the timing of any possible RBA hikes. Political infighting within the governing Liberal party didn't help sentiment either. An ugly battle saw Turnbull ousted and colleague Morrison appointed as the fourth Prime Minister in just five years. NZD/AUD fell as low as 0.8948 in the aftermath of the dovish RBNZ MPS, but the cross rate recovered over the second half and ended slightly higher for the month near 0.92.

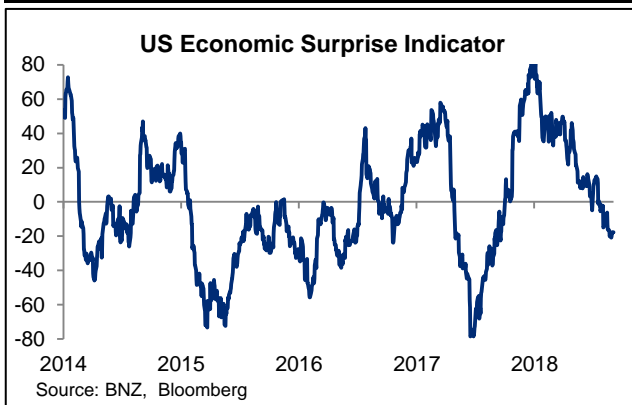
GBP underperformed as the probability of a no-deal Brexit appeared to increase, with the timetable for an agreement between the UK and EU slipping further. EUR/USD fell almost 1% for the month, but the weak NZD was the driver of NZD/EUR falling to its lowest level in nearly three years.

CNY remained in the spotlight. After USD/CNY marched on towards the psychological 7 level, the yuan finally found some favour, helped by the negative turnaround in the USD mid-month and reports of Chinese authorities taking steps to lean against further currency weakness. Towards the end of the month the PBoC reintroduced the "counter-cyclical factor" for setting the CNY reference rate, returning to the "smoke-and-mirrors" approach that has previously worked to reduce speculative activity in the currency. USD/CNY finished the month little changed around 6.83.

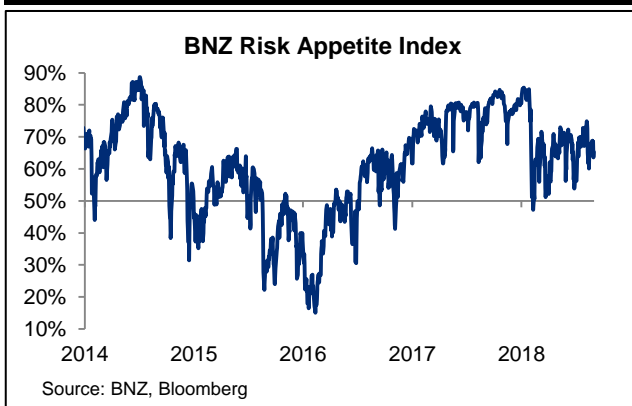
BNZ's risk appetite index for the month fell from 70% to 65%, driven by the wider emerging market credit spread indicator, while the VIX index was steady. This can explain why JPY and CHF were the two strongest major currencies. NZD/JPY was down by around 3½%. CAD performed well, broadly keeping pace with the USD despite other commodity currencies getting hit. The US and Mexico agreed to a new trade deal, but US-Canada tensions remained high and a self-imposed deadline to come to a NAFTA deal wasn't met by month-end.

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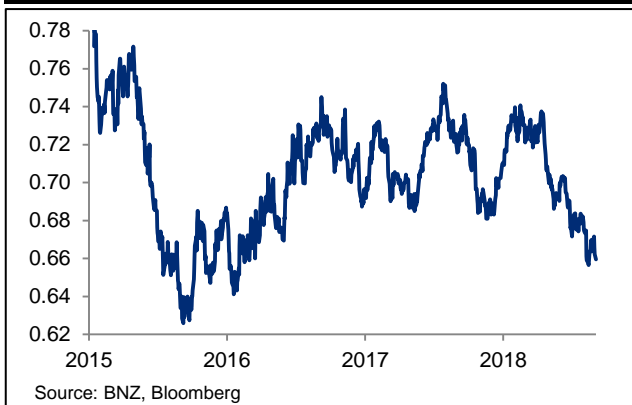
**US Economic Data Surprises Turn Negative**



**Risk Appetite Down in August But Still Above Average**



**A 2½ year low for NZD/USD**



**NZD/EUR Down to a 3-year Low**



### Monthly Performance Table

	end-Aug	end-Jul	Change		end-Aug	end-Jul	Change
<b>Currencies</b>				<b>NZ Rates</b>			
NZD/USD	0.6622	0.6818	-2.9%	OCR	1.75	1.75	0.00
NZD/AUD	0.9206	0.9178	0.3%	NZ 90day BB	1.91	1.91	0.00
NZD/EUR	0.5706	0.5832	-2.2%	NZ 2yr sw ap	1.98	2.14	-0.16
NZD/GBP	0.5109	0.5196	-1.7%	NZ 5yr sw ap	2.32	2.56	-0.24
NZD/JPY	73.54	76.25	-3.6%	NZ 10yr sw ap	2.83	3.04	-0.21
NZD/CNY	4.522	4.6439	-2.6%	NZ Govt (4/21)	2.37	2.61	-0.24
TWI	72.0	73.5	-2.0%	NZ Govt (4/23)	1.91	2.14	-0.24
AUD/USD	0.7189	0.7424	-3.2%	NZ Govt (4/27)	2.37	2.61	-0.24
EUR/USD	1.1602	1.1691	-0.8%	NZ Govt (4/29)	2.53	2.79	-0.26
GBP/USD	1.2960	1.3124	-1.2%	<b>Global 10 year bond rates</b>			
USD/JPY	111.03	111.86	-0.7%	US	2.86	2.96	-0.10
USD/CNY	6.83	6.82	0.2%	Canada	2.23	2.31	-0.08
USD/CAD	1.3040	1.3006	0.3%	UK	1.43	1.33	0.10
USD TWI major	117.22	116.66	0.5%	France	0.68	0.73	-0.05
Asia DXY	105.09	105.81	-0.7%	Germany	0.33	0.44	-0.12
<b>Equity Markets</b>				Italy	3.24	2.72	0.52
MSCI AC Wrlld, loc.	1,230	1,216	1.2%	Spain	1.47	1.40	0.07
MSCI World, loc.	6,788	6,695	1.4%	Portugal	1.92	1.73	0.19
MSCI EM, USD	2,347	2,412	-2.7%	Ireland	0.85	0.90	-0.04
US S&P 500	2,902	2,816	3.0%	Japan	0.10	0.06	0.04
Euro STOXX 600	382.3	391.6	-2.4%	Australia	2.52	2.65	-0.13
Germany DAX	12,364	12,806	-3.4%	<b>Commodities (USD)</b>			
France CAC 40	5,407	5,511	-1.9%	WTI Crude	69.80	67.63	3.2%
UK FTSE 100	7,432	7,749	-4.1%	Brent Crude	77.64	74.39	4.4%
Aust S&P/ASX 200	6,319	6,280	0.6%	R/B CRB Index	193.0	194.5	-0.8%
Japan Topix	1,735	1,753	-1.0%	Gold spot	1,204	1,224	-1.7%
China CSI 300	3,335	3,518	-5.2%	Silver spot	14.54	15.52	-6.3%
NZX50	9,313	8,922	4.4%	Copper	264.9	283.2	-6.4%
Volatility: VIX	12.86	12.83	0.2%	Iron Ore	66.03	67.75	-2.5%
<b>3-mth Bill Futures</b>				Coking coal	182.50	177.00	3.1%
NZD Jun-19	98.08	97.89	0.19	Thermal coal	118.00	117.55	0.4%
AUD Jun-19	98.05	97.93	0.12	Corn	365.0	386.5	-5.6%
USD Jun-19	97.14	97.06	0.08	Wheat	545.5	573.3	-4.8%
EUR Jun-19	100.25	100.25	0.00	NZX Dairy WMP	2,850	2,975	-4.2%
GBP Jun-19	98.95	98.92	0.03	NZX Milk Price 2019	NZD 6.51	NZD 6.61	-1.5%

Source: BNZ, Bloomberg

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