

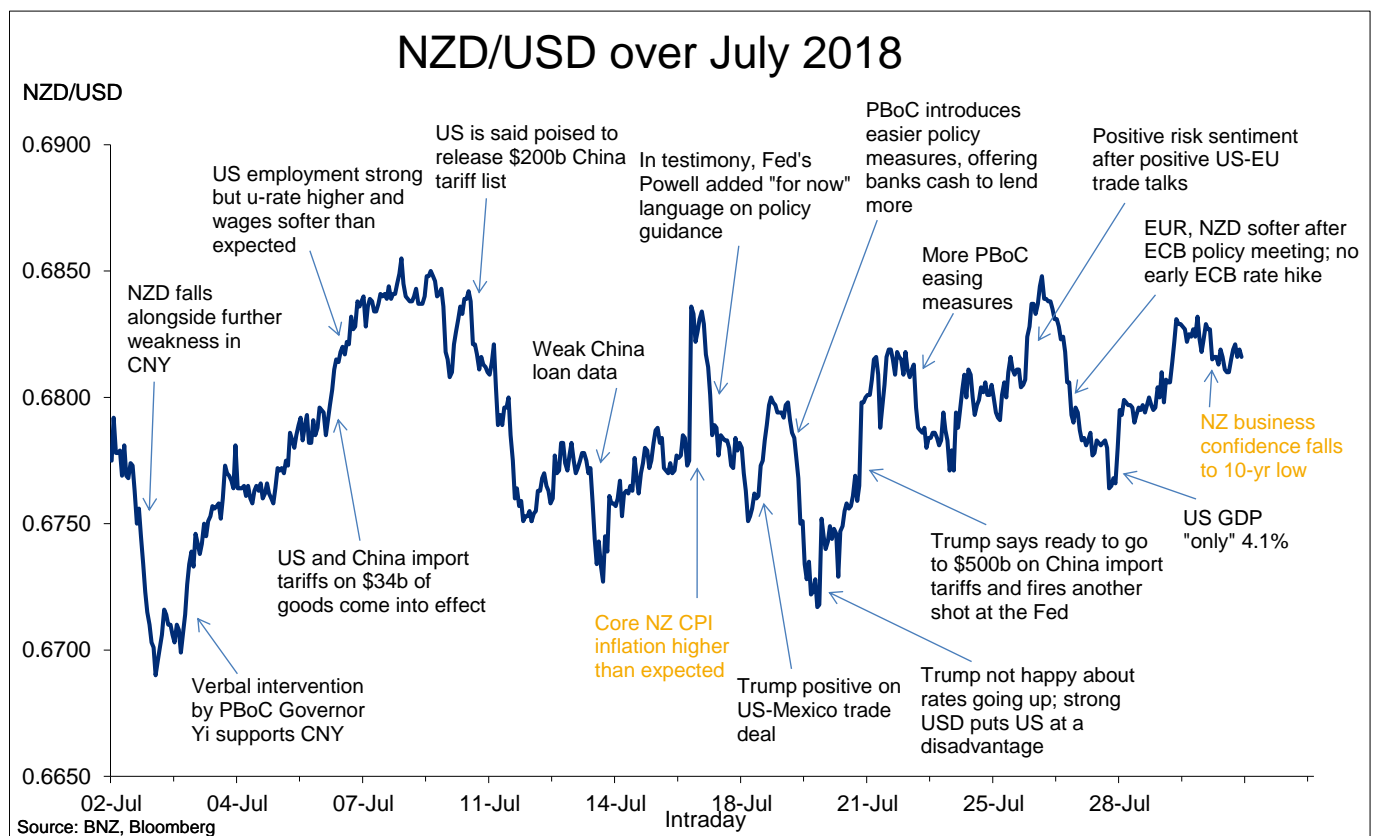
RESEARCH FINANCIAL MARKETS WRAP

1 August 2018



NZD Consolidates Through July

- After its recent steep fall, the NZD was modestly higher on all the key crosses in July
- China was a focus for the month, with CNY depreciating significantly further
- NZ bond market continued to outperform



Quick Outlook		July ranges
NZD/USD	Has recently consolidated between 0.67-0.69 and we expect more of the same over coming months. We expect our current fair value model estimate of 0.70-0.71 to drift lower over the same period, meeting the spot rate.	0.6690 – 0.6860
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 & monetary policy outlooks	0.9100– 0.9225
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 assuming a soft-Brexit eventually prevails.	0.5100 – 0.5210
NZD/EUR	Currently near the bottom of its trading range this year. We see the path of least resistance as one of further modest downside pressure over the medium term.	0.5755 – 0.5840
NZD/JPY	BoJ policy tweaks support a weak yen and a near-term trading range might well prevail on this cross, but medium-term pressure remains to the downside as the yen remains super-cheap.	74.1 – 76.9
90-day BB	Flat, with little chance of monetary policy adjustment over coming months.	1.91% - 1.99%

Currency markets were relatively stable through July, with low volatility across the key majors. CNY was a notable exception, with significant weakness evident, encouraged by an easier monetary policy stance adopted by the PBoC. At times, there were spillover effects for the NZD, but overall it maintained its poise and traded in a tight range, showing signs of consolidation through the month after the steep fall from mid-April to end-June.

As the annotated NZD chart on the first page highlights, China featured predominately in key financial market news during July. After unusually significant weakness for CNY during June, the market was focused on the currency and response of Chinese authorities. After USD/CNY rose up through 6.70, PBoC Governor Yi verbally intervened, and this saw a temporary reversal, but upward pressure on the cross returned. Trump went ahead with fresh tariffs on \$34b of Chinese imports with another \$16b due to take effect after further analysis. China retaliated immediately with its own tariffs against US imports, strategically directed towards commodities that would impact the heartland of Trump's support base. Tension escalated further after Trump's threat that tariffs could be imposed on all \$500+b of imports from China.

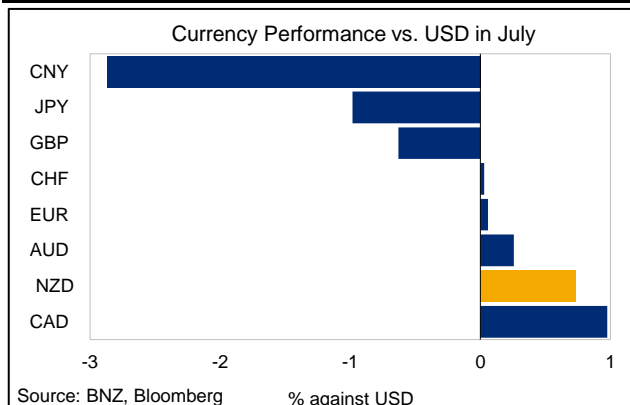
With the threat to weaker trade and growth, China's policymakers offered further incremental policy support in the direction of easier monetary and fiscal policy. This included a "funding-for-lending" scheme that offered banks cash to lend more to businesses. Easier policy and a more uncertain outlook for China continued to drive a weaker CNY and weaker yuan on the PBoC's currency basket. USD/CNY ended the month up 3%, while China's currency on the basket depreciated by 3%, taking its cumulative depreciation since mid-June to almost 6%.

The NZD remained correlated with the day-to-day gyrations in CNY, with some obvious spillover effects, but managed to maintain its poise for the month overall. Local news was limited and wasn't a key market driver. The biggest market reaction came after NZ core inflation was revised higher on the RBNZ's preferred sectoral factor model and the reading for Q2 came in at a 7-year high of 1.7%. However, the blip higher in the NZD proved to be temporary. Activity data tended to come in on the soft side, including weaker manufacturing and services PMIs, lower net migration, a deterioration in the trade balance and weaker business and consumer confidence.

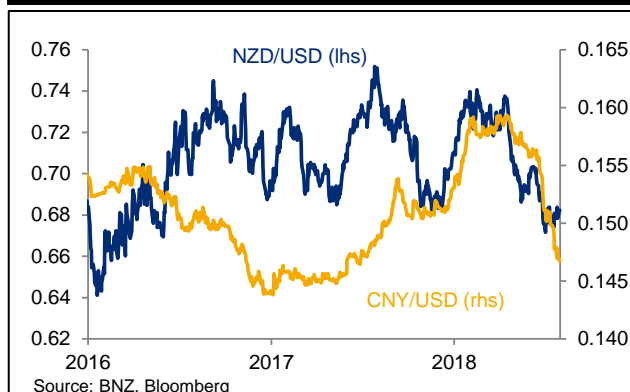
The NZD was supported by higher risk appetite, with BNZ's risk appetite index reaching a 10-week high of 73% late in the month, supported by a lower VIX index and narrower credit spreads that make up the index. Global equity markets were generally stronger, with the MSCI World index up 3% for the month, supported by a strong US earnings season.

Weaker commodity prices were an offsetting influence on the NZD. The CBA index of NZ export commodity prices showed a weaker trend through the month, driven by lower dairy prices. NZX futures showed whole milk powder prices down by over 5% for the month. Oil prices showed signs of peaking early in the month, with OPEC's increased oil production agreement taking effect 1 July.

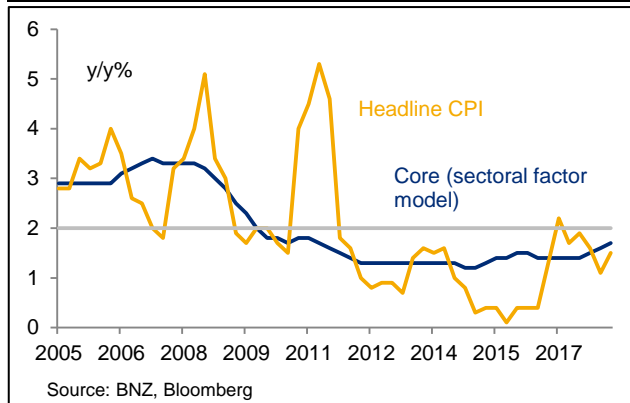
CNY the Biggest (and Only) Mover for the Month



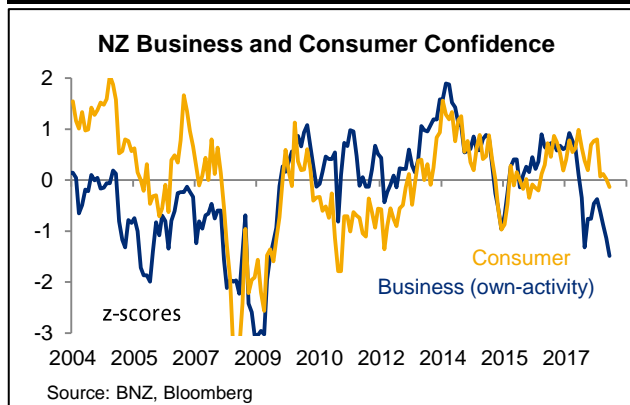
NZD Stable as CNY Keeps Depreciating



NZ Core Inflation Trending Higher



NZ Business and Consumer Confidence Head South



There was little change in NZ monetary policy expectations despite the more obvious uptick in the recent core inflation trend now. The OIS market prices in a small chance of easier policy over the next six months, as it did a month ago. The 90-day bank bill rate fell by 9bps over the month, but this had little to do with monetary policy expectations and reflected an unwinding of the ramp-up in the bills-OIS spread over previous months, driven largely by global forces.

NZ-US interest rate spreads continued to narrow, a reflection of the divergent RBNZ and Fed monetary policy trends. NZ's 10-year government bond rate (2029 bond) fell by 9bps to 2.76%, while the US 10-year rate rose by 10bps to 2.96%. The strength in NZ government bonds appeared to be driven by a large flow late in the month, which drove rates lower. The NZ 5-year and 10-year swap rates rose slightly, but still consistent with outperformance versus the US.

The NZD traded in a tight range of 0.6690-6860 (rounded) for the month and ended up by less than 1%. Tight ranges were evident on the crosses. There was little pulse in the NZD/AUD cross as it traded a 0.9100-0.9225 range.

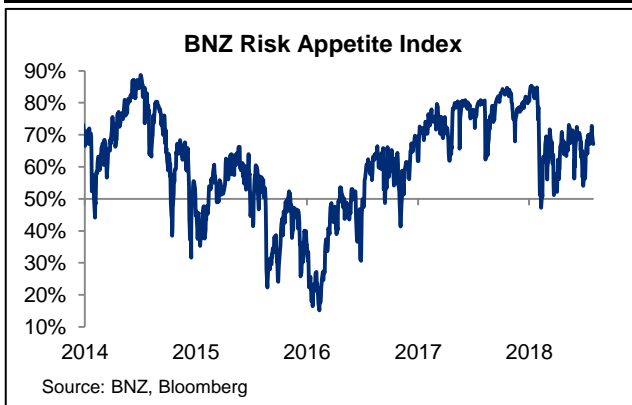
Of the G10 majors, GBP traded in the widest percentage range, a reflection of the ongoing political battle in the UK to come up with an agreeable Brexit proposal. PM May faced a few high profile resignations from her Cabinet after her whitepaper on Brexit to present to the EU was released. She managed to secure her position as leader, but continues to hang on by a thread. Signs are emerging that European leaders are becoming concerned about the lack of progress on talks that are being led by the European Commission. NZD/GBP was just over 1% higher for the month.

NZD/EUR was in a remarkably tight range for month (0.5755-0.5840), less than 1.5% even using intraday extremes. The ECB reiterated its policy guidance of winding down its asset purchase programme by the end of the year and holding rates unchanged "through the summer of 2019".

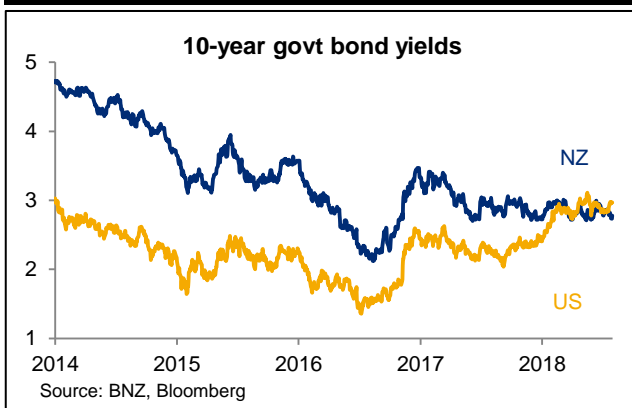
NZD/JPY ended the month 1½% higher as the yen was on the weaker side of the ledger. Mid-month, the yen weakened as speculators added to short positions after seeing data showing record buying of offshore equities by domestic investors. Later in the month attention turned to the BoJ, which was seen to be looking for a way to make its easy policy stance more sustainable and less detrimental to local banks. The central bank offered an array of minor tweaks to its policy stance including the introduction of forward guidance to keep rates low for an "extended period of time". Governor Kuroda noted that the effective range that the 10-year JGB will be allowed to trade in would be doubled, from +/- 10bps to +/-20bps, whilst keeping the official target level at zero percent.

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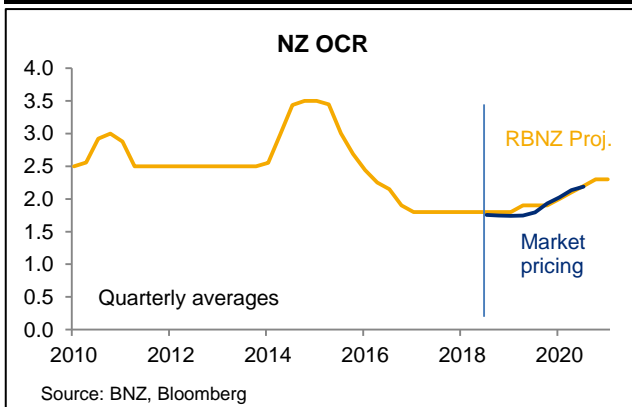
Risk Appetite More Positive in July



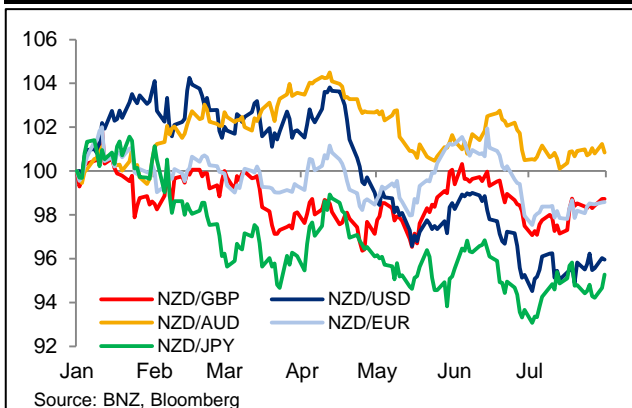
NZ Long-Term Rates Below US Rates



No Change in NZ Monetary Policy on the Horizon



NZD Crosses Through 2018: Mostly Lower



Monthly Performance Table

	end-Jul	end-Jun	Change		end-Jul	end-Jun	Change
Currencies				NZ Rates			
NZD/USD	0.6818	0.6768	0.7%	OCR	1.75	1.75	0.00
NZD/AUD	0.9178	0.9146	0.3%	NZ 90day BB	1.91	2.00	-0.09
NZD/EUR	0.5832	0.5795	0.6%	NZ 2yr sw ap	2.14	2.14	0.00
NZD/GBP	0.5196	0.5131	1.3%	NZ 5yr sw ap	2.56	2.53	0.03
NZD/JPY	76.25	74.95	1.7%	NZ 10yr sw ap	3.04	3.02	0.02
NZD/CNY	4.644	4.4870	3.5%	NZ Govt (4/21)	2.61	2.65	-0.04
TWI	73.5	72.5	1.4%	NZ Govt (4/23)	2.14	2.15	-0.01
AUD/USD	0.7424	0.7405	0.3%	NZ Govt (4/27)	2.61	2.65	-0.04
EUR/USD	1.1691	1.1684	0.1%	NZ Govt (4/29)	2.76	2.85	-0.09
GBP/USD	1.3124	1.3207	-0.6%	Global 10 year bond rates			
USD/JPY	111.86	110.76	1.0%	US	2.96	2.86	0.10
USD/CNY	6.82	6.62	3.0%	Canada	2.31	2.17	0.14
USD/CAD	1.3006	1.3133	-1.0%	UK	1.33	1.28	0.05
USD TWI major	116.66	116.83	-0.1%	France	0.73	0.66	0.07
Asia DXY	105.81	107.11	-1.2%	Germany	0.44	0.30	0.14
Equity Markets				Italy	2.72	2.68	0.04
MSCI AC Wrld, loc.	1,216	1,180	3.0%	Spain	1.40	1.32	0.08
MSCI World, loc.	6,695	6,490	3.2%	Portugal	1.73	1.78	-0.05
MSCI EM, USD	2,412	2,358	2.3%	Ireland	0.90	0.81	0.09
US S&P 500	2,816	2,718	3.6%	Japan	0.06	0.03	0.03
Euro STOXX 600	391.6	379.9	3.1%	Australia	2.65	2.63	0.02
Germany DAX	12,806	12,306	4.1%	Commodities (USD)			
France CAC 40	5,511	5,324	3.5%	WTI Crude	68.76	72.46	-5.1%
UK FTSE 100	7,749	7,637	1.5%	Brent Crude	74.21	78.86	-5.9%
Aust S&P/ASX 200	6,280	6,195	1.4%	R/B CRB Index	194.5	200.4	-2.9%
Japan Topix	1,753	1,731	1.3%	Gold spot	1,224	1,253	-2.3%
China CSI 300	3,518	3,511	0.2%	Silver spot	15.52	16.12	-3.7%
NZX50	8,922	8,943	-0.2%	Copper	283.2	295.1	-4.0%
Volatility: VIX	12.83	16.09	-20.3%	Iron Ore	67.67	64.60	4.8%
3-mth Bill Futures				Coking coal	175.00	185.50	-5.7%
NZD Dec-18	97.99	97.94	0.05	Thermal coal	117.55	114.40	2.8%
AUD Dec-18	97.99	98.00	-0.01	Corn	386.5	371.3	4.1%
USD Dec-18	97.32	97.36	-0.04	Wheat	553.8	501.3	10.5%
EUR Dec-18	100.30	100.29	0.01	NZX Dairy WMP	2,975	3,150	-5.6%
GBP Dec-18	99.08	99.13	-0.05	NZX Milk Price 2019	NZD 6.61	NZD 6.83	-3.2%

Source: BNZ, Bloomberg

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