

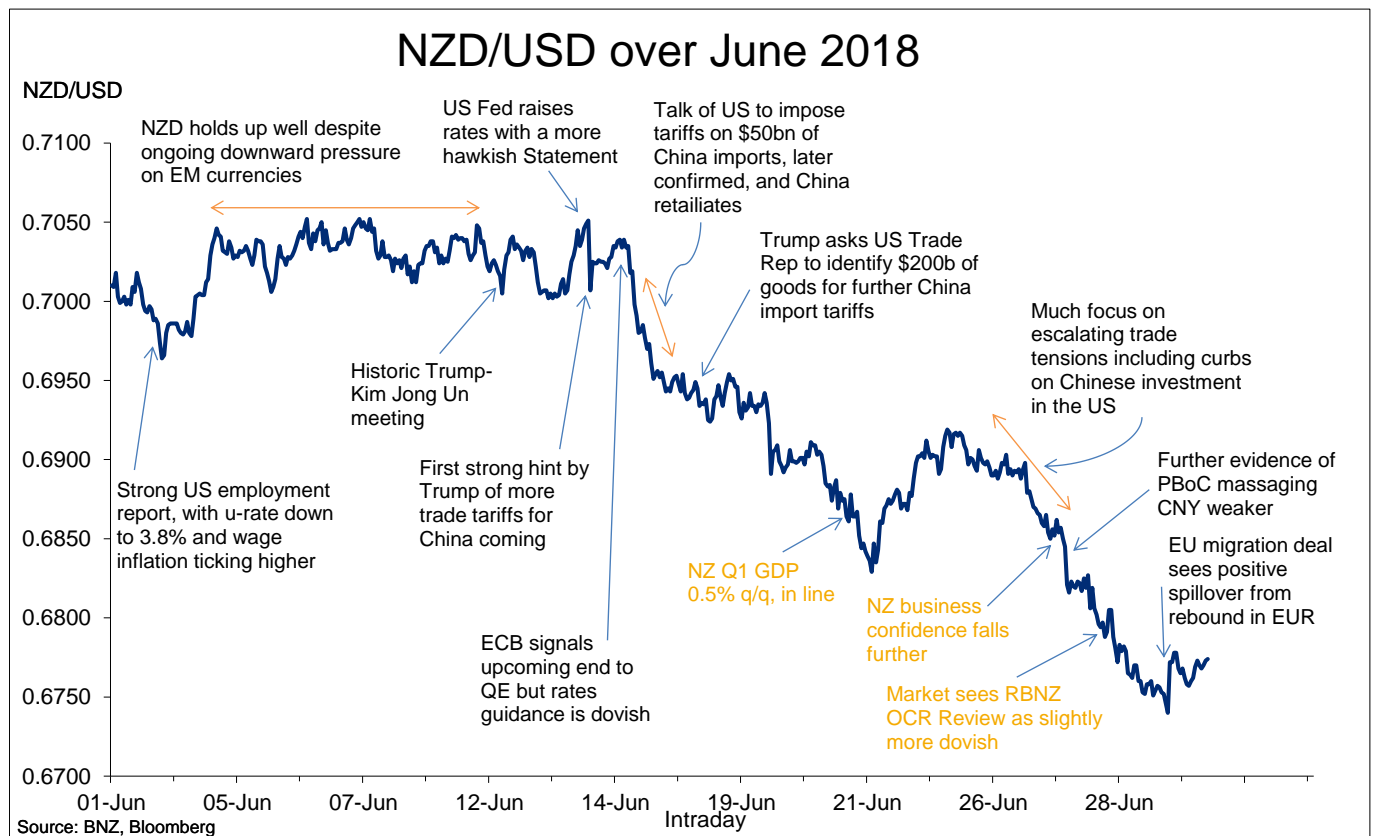
RESEARCH FINANCIAL MARKETS WRAP

2 July 2018



NZD Struggles In June

- The NZD showed a broadly based fall over June as global and domestic factors weighed
- Fresh 2-year low reached for NZD/USD
- NZ-US rate differentials continued to fall



Quick Outlook		June ranges
NZD/USD	Looking short-term oversold but technical support is broken and sentiment remains heavy against the Kiwi. Could go either way short term but eventually we see the broad USD recovery losing steam and reversing course, helping NZD.	0.6735 – 0.7060
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	0.9145– 0.9380
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.	0.5125 – 0.5285
NZD/EUR	Subsiding Italy risks have seen the cross reverse course seeing it back towards the bottom of the range, and the path of least resistance is for further downside pressure over the medium term as further subtle shifts in ECB policy support EUR.	0.5795 – 0.6035
NZD/JPY	We continue to see clear medium-term downside pressure for the cross as the Yen remains super-cheap. Any short-term bounces expected to be short-lived.	74.4 – 77.9
90-day BB	Flat, with little chance of monetary policy adjustment over coming months.	2.00% - 2.04%

A key theme for June was escalation of global trade tensions, with President Trump's tariff policies met with retaliation from the EU and China. The possibility of a trade war reducing the global growth outlook alongside further recovery in the USD applied significant downward pressure to emerging market asset prices. This spilled over into a weaker NZD, with domestic factors adding to the NZD's demise.

The USD continued to recover, with the USD major TWI index up 1% for the month and 4% for the quarter. While Citigroup's US economic surprise indicator fell during the month, implying some mild disappointment of indicators relative to expectations, US data still looked relatively stronger compared to other regions and this helped support the USD. The US Fed delivered a second rate hike for the year and issued a slightly more hawkish statement. The median dot plot showed a projected Fed Funds track 25bps higher than previously for 2018 and 2019, but that simply reflected an upgrading of view of just one member, with the mean projected Fed Funds rate barely changed across all horizons.

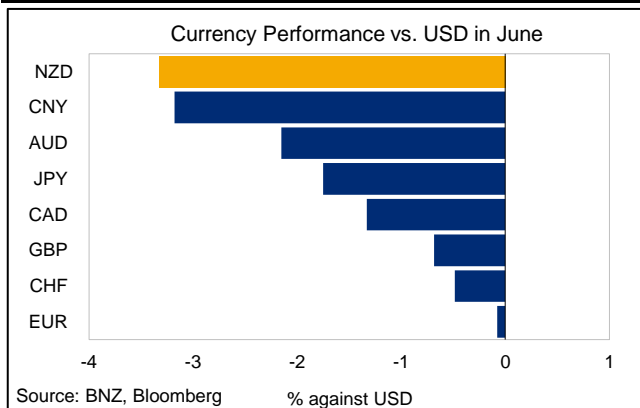
With the stronger USD acting like a tightening in global financial conditions, it dampened support for emerging market assets. While the MSCI developed market equities index was broadly flat for the month, the emerging markets index fell by 4% in USD terms. Emerging market currencies remained under significant downward pressure, with JP Morgan's emerging market currency index down 2½% for the month, taking its fall since the peak in mid-February to over 10%.

The stronger USD wasn't the only reason for the selldown of emerging market assets, with escalating global trade tensions hogging the headlines. US tariffs on steel and aluminium imports from Canada, Mexico and the EU came into effect after being previously given a waiver. The US then decided to impose 25% tariffs on \$50b of Chinese imports. It didn't take long for China to respond, with the Ministry of Finance announcing that it would impose 25% tariffs on \$50b of imported US goods (heavily tilted towards agricultural products). President Trump said he would respond to Chinese retaliation with yet more tariffs, announcing that he had asked the US Trade Representative to identify \$200b worth of Chinese goods for additional 10% tariffs. Later in the month the chatter was about imposing curbs on Chinese investment in the US.

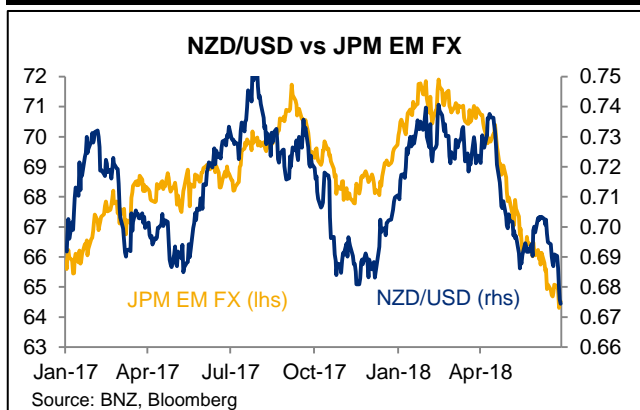
Alongside the determination of the US to reduce its trade deficit with China, Chinese activity and credit data implied weaker growth and raised concerns about a slowdown in the Chinese economy. The PBoC cut the reserve ratio requirement for large commercial banks by 0.5% and cut reserve requirements for smaller banks, suggesting that it recognised the deterioration in the economic outlook.

It also looked like the PBoC was prepared to allow its currency to weaken, setting a weaker reference rate than implied by market movements, encouraging CNY to depreciate against a basket of currencies by about 2½% over the month. USD/CNY was up by 3.3%.

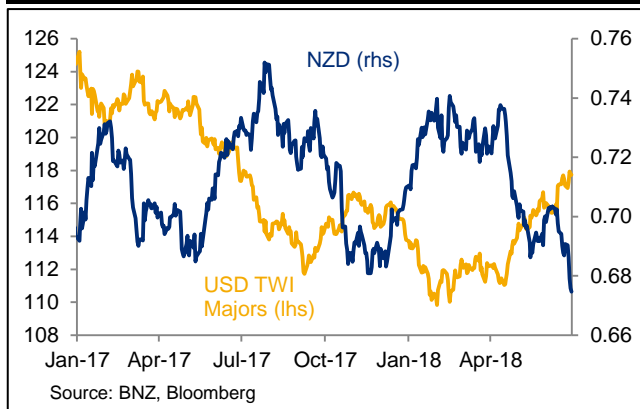
NZD the Worst of the Majors in June



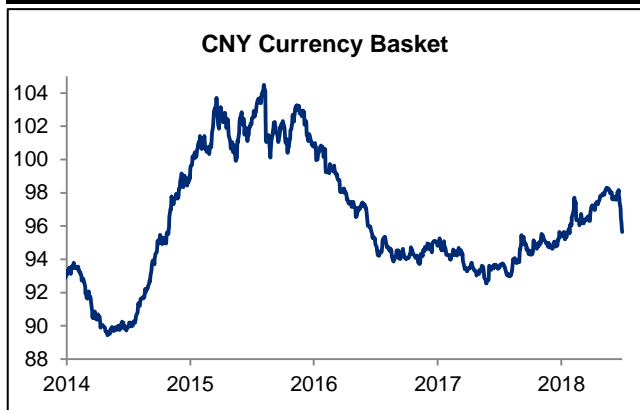
NZD and EM Currencies Fall Together Recently



NZD Weaker Against Backdrop of Stronger USD TWI



PBoC Engineers a Weaker CNY Basket



Commodity prices generally declined, influenced by the stronger USD and growing concerns about the impact of the trade war on the outlook for global growth.

Bloomberg's commodity price index fell by nearly 4% and the fall would have been greater if not for an 11% rise in WTI oil prices to a 3-year high, although notably Brent crude was up a milder 3% for the month. OPEC+ announced that it would raise crude oil production by one million barrels a day starting July, although details were scant and most countries aren't in a position to increase production by much. NZ commodity prices have held up much better than global commodity prices, even against global agricultural products.

Global forces noted above – the trade tensions, the downfall for emerging markets and softer global commodity prices – conspired to drive the NZD weaker across the board. NZD/USD ended June down 3.3%, taking the fall for the June quarter to 6½%, making a 2-year low of 0.6736 in the process. The NZD was the worst of the majors, with CNY and the AUD rounding out the top three under-performers.

Domestic factors added to the NZD's downdraft. GDP data confirmed that the economy got off to a weak start while business confidence continued to fall, given a range of factors, including grumpiness in the direction of government policy. Already facing pressure on margins from a tight labour market and higher minimum wages, the government announced that it would set up a panel charged with redesigning the country's industrial relations regime to implement "Fair Pay Agreements".

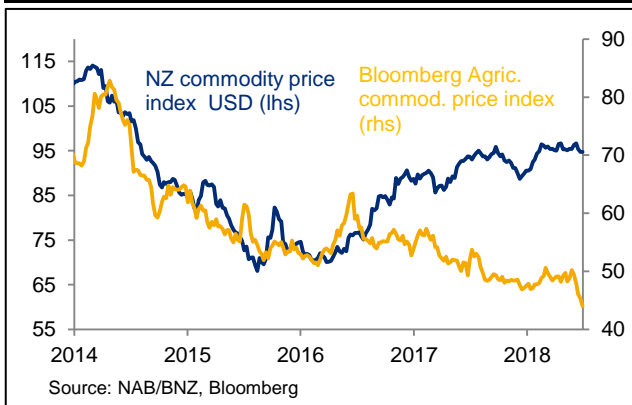
The market saw the RBNZ's OCR Review as slightly more dovish than the May MPS, with a deliberate change in wording in the first paragraph. The Bank commented that that the OCR will remain at 1.75% "for now", previously "for some time". The market saw this as the Bank becoming more open to the idea that the OCR might need to be cut, should the recent trend of bad news continues. The market priced in a (very) small chance of a rate cut over the next six months for the first time since the end of the easing cycle, with mid-pricing for August to November OIS priced at 1.745% by the end of the month.

NZD/AUD fell by 1% and NZD/CNY was flat for the month, while the other crosses were down in the order of 1½-3%. The ECB outlined a tapering of its asset purchase programme, from the current €30bn per month rate through to September down to €15bn per month over Q4, before ending. This timeframe for the end of QE policy was well anticipated but the interest rate guidance was surprising, with no plans to change the key policy rates until "at least through the summer of 2019", or longer if needed.

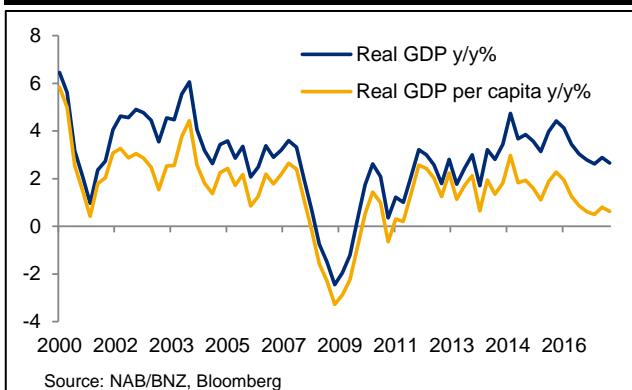
For GBP, there was no progress on Brexit, with the UK government itself not in a position to agree to a plan to put forward to the EU. A BoE rate hike came more into focus, with a 6:3 vote to keep rates unchanged, with an additional dissent coming from Chief Economist Haldane.

It was a fairly uneventful month for the bond market, with the US 10-year Treasury yield spending much of the month trading within a 15bp range, and ending flat at 2.86%.

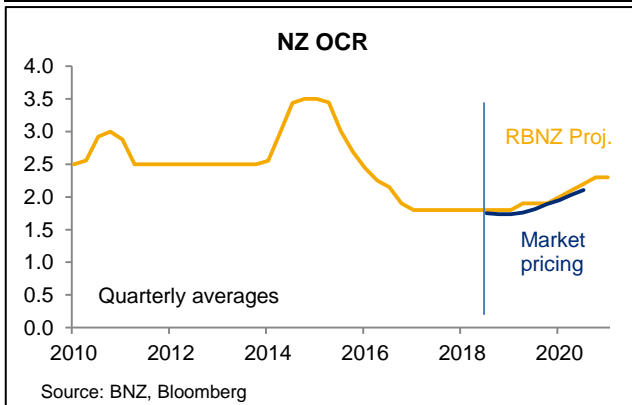
NZ Commodity Prices Outperform Global Agri. Index



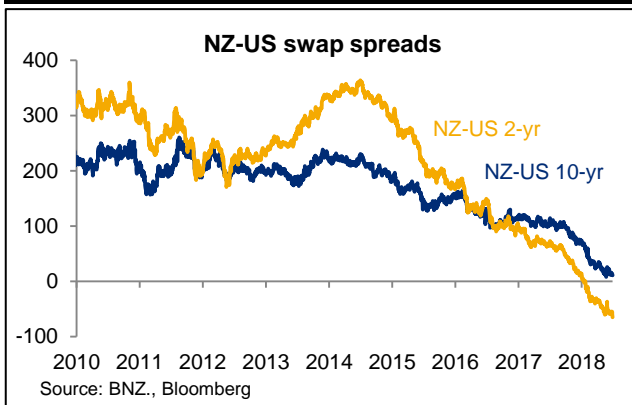
NZ GDP per Capita Growth Barely Positive



Market Pricing of OCR Shifts to Below RBNZ Proj.



NZ-US Rate Spreads Continue to Fall



NZ rates had a downward bias, reflecting soft domestic data releases and the RBNZ's more dovish OCR Review statement. The 2-year swap rate fell 7bps to 2.14%, the bottom of its range over the past year. Against flat US rates, NZ longer term rates fell, with 5-10 year swap rates down 8-10bps. For the first time since the end of the easing cycle, the market priced in a lower forward rate track than implied by the RBNZ OCR projections.

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Monthly Performance Table							
	end-Jun	end-May	Change		end-Jun	end-May	Change
Currencies				NZ Rates			
NZD/USD	0.6768	0.7001	-3.3%	OCR	1.75	1.75	0.00
NZD/AUD	0.9146	0.9251	-1.1%	NZ 90day BB	2.00	2.03	-0.03
NZD/EUR	0.5795	0.5987	-3.2%	NZ 2yr sw ap	2.14	2.21	-0.07
NZD/GBP	0.5131	0.5266	-2.6%	NZ 5yr sw ap	2.53	2.63	-0.10
NZD/JPY	74.95	76.17	-1.6%	NZ 10yr sw ap	3.02	3.09	-0.08
NZD/CNY	4.487	4.4877	0.0%	NZ Govt (4/21)	2.65	2.73	-0.09
TWI	72.5	73.7	-1.6%	NZ Govt (4/23)	2.15	2.27	-0.12
AUD/USD	0.7405	0.7568	-2.2%	NZ Govt (4/27)	2.65	2.73	-0.09
EUR/USD	1.1684	1.1693	-0.1%	Global 10 year bond rates			
GBP/USD	1.3207	1.3298	-0.7%	US	2.86	2.86	0.00
USD/JPY	110.76	108.82	1.8%	Canada	2.17	2.24	-0.08
USD/CNY	6.62	6.41	3.3%	UK	1.28	1.23	0.05
USD/CAD	1.3133	1.2958	1.4%	France	0.66	0.66	0.00
USD TWI major	116.83	115.82	0.9%	Germany	0.30	0.34	-0.04
Asia DXY	107.11	109.73	-2.4%	Italy	2.68	2.79	-0.11
Equity Markets				Spain	1.32	1.49	-0.17
MSCI AC Wrl, loc.	1,180	1,180	0.0%	Portugal	1.78	1.96	-0.18
MSCI World, loc.	6,490	6,466	0.4%	Ireland	0.81	0.94	-0.13
MSCI EM, USD	2,358	2,458	-4.1%	Japan	0.03	0.03	0.00
US S&P 500	2,718	2,705	0.5%	Australia	2.63	2.67	-0.04
Euro STOXX 600	379.9	383.1	-0.8%	Commodities (USD)			
Germany DAX	12,306	12,605	-2.4%	WTI Crude	74.15	66.91	10.8%
France CAC 40	5,324	5,398	-1.4%	Brent Crude	79.23	77.25	2.6%
UK FTSE 100	7,637	7,678	-0.5%	R/B CRB Index	200.4	202.8	-1.2%
Aust S&P/ASX 200	6,195	6,012	3.0%	Gold spot	1,253	1,299	-3.5%
Japan Topix	1,731	1,747	-0.9%	Silver spot	16.12	16.43	-1.9%
China CSI 300	3,511	3,802	-7.7%	Copper	295.1	306.5	-3.7%
NZX50	8,943	8,659	3.3%	Iron Ore	64.73	64.81	-0.1%
Volatility: VIX	16.09	15.43	4.3%	Coking coal	185.75	190.25	-2.4%
3-mth Bill Futures				Thermal coal	114.40	110.15	3.9%
NZD Dec-18	97.94	97.92	0.02	Corn	371.3	413.8	-10.3%
AUD Dec-18	98.00	98.03	-0.03	Wheat	501.3	543.0	-7.7%
USD Dec-18	97.36	97.44	-0.08	NZX Dairy WMP	3,150	3,255	-3.2%
EUR Dec-18	100.29	100.25	0.03	NZX Milk Price 2019	NZD 6.83	NZD 6.88	-0.7%
GBP Dec-18	99.13	99.21	-0.08				

Source: BNZ, Bloomberg

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