

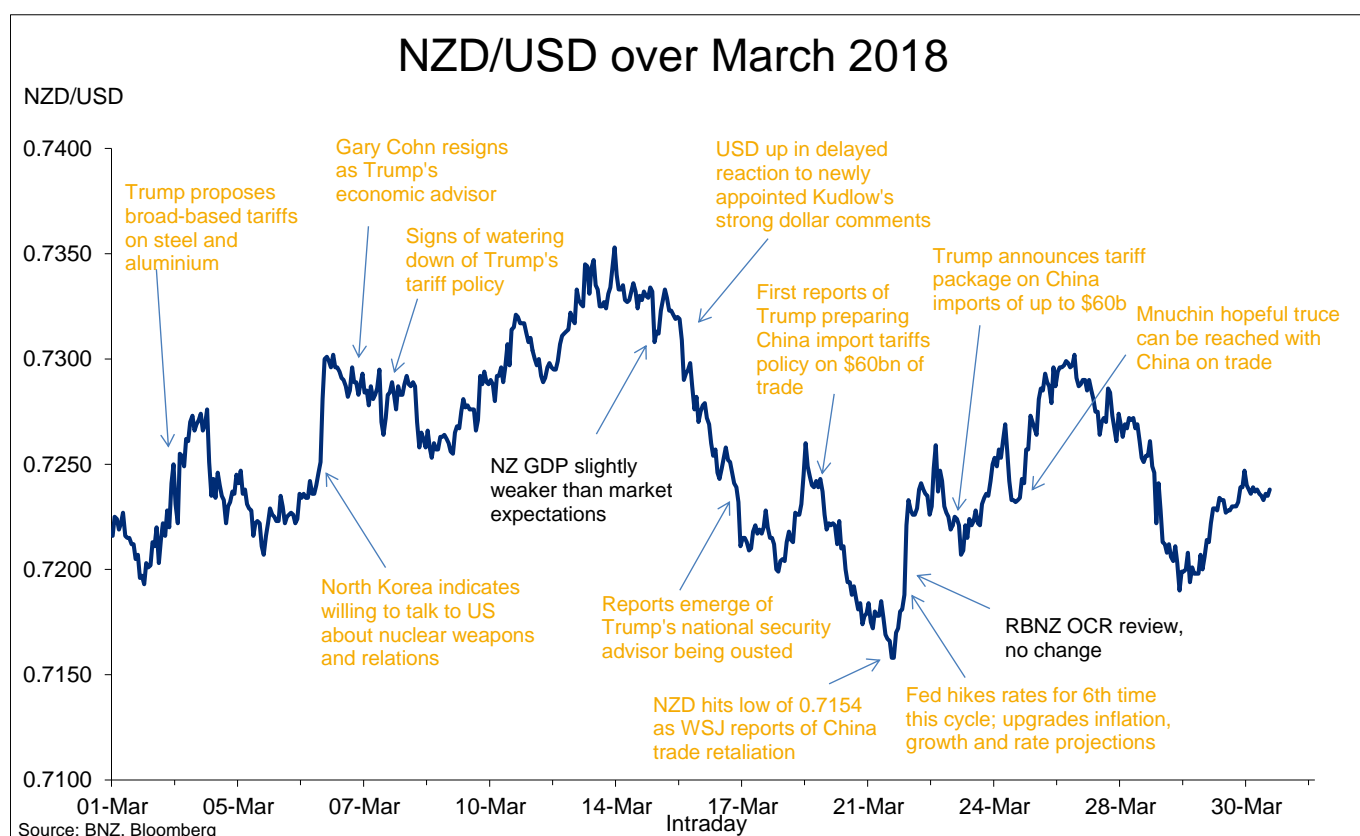
# RESEARCH FINANCIAL MARKETS WRAP

3 April 2018



## NZD Flat in March

- Global equity markets weak and volatile
- But little spillover for currency markets; NZD/USD and NZ TWI flat
- Safe-haven flows see global rates lower; NZ-US yield compression continues



Quick Outlook		March ranges
NZD/USD	More downside than upside risk over the quarter ahead amidst a period of weaker risk appetite and US-China trade tensions. Fed still clearly on a path towards higher rates while the RBNZ stands pat.	0.7155 – 0.7355
NZD/AUD	Downside risk following its recovery over Q1 and being nearer the top than the bottom of its well established trading range.	0.9260– 0.9465
NZD/GBP	Brexit transitional deal helps pave the way for further BoE tightening and general support for GBP. Cross to head lower.	0.5090 – 0.5285
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.	0.5825 – 0.5945
NZD/JPY	Cross vulnerable in a more volatile and risk-off environment. Shelf-life of downside support around 75.5-76.0 might be drawing to a close.	75.55 – 78.60
90-day BB	Flat, with little chance of monetary policy adjustment over coming months.	1.89% - 1.97%

The increase in market volatility seen in February was sustained through March, albeit remained largely confined to equity markets. Another chunky fall in global equities was matched with further widening in credit spreads and government bonds outperformed, with lower yields across the board. There wasn't much evidence of the risk-off tone and equity market volatility pervading currency markets, with currency markets showing fairly modest movements and the NZ TWI flat.

A predominant theme for the month was increased global trade tensions, kicked off by US President Trump. Early in the month, Trump initially proposed broadly based US import tariffs on steel and aluminium, but this policy was significantly watered down, exempting many countries. The read-through was that Trump's trade policy boiled down to a trade-war principally against China, with a target to reduce its annual bilateral trade deficit by \$100bn, a big reduction from last year's deficit of \$375bn.

Trump proposed tariffs on up to \$60bn of Chinese imports alongside other trade and investment restrictions. China's initial response was measured, looking to implement tariffs on just \$3bn of US exports in retaliation. At times, the market feared a tit-for-tat trade war but by month-end US and China officials were negotiating, having "productive conversations" according to US Treasury Secretary Mnuchin.

An added source of reduced market sentiment was Trump's ousting of a number of his key advisors, including his respected economic advisor Cohn and national security advisor McMaster, the latter replaced by Bolton, a known hawk with a penchant for war.

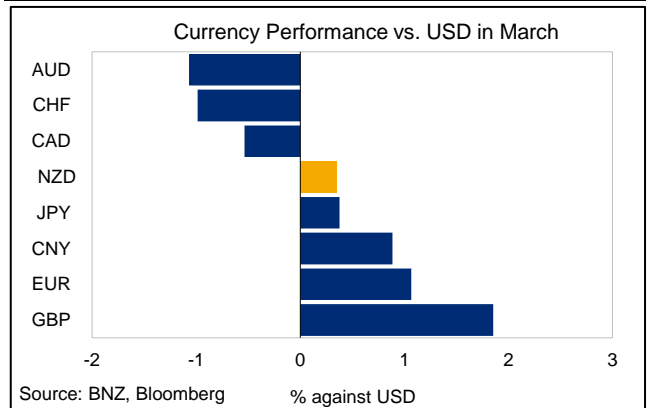
On the economic front, global growth looked to be losing some momentum. Citigroup's G10 economic surprise indicator continued to head south, suggesting that the economic data flow was surprising to the downside, as occurred through February as well. This trend was led by the euro area, including PMI data that showed growth was slowing from its recent strong pace. China's PMI data underwhelmed as well, albeit possibly deflated by the timing of Chinese New Year holidays.

It wasn't all bad news. North Korean leader Kim Jong Un told a visiting South Korean delegation that he was willing to hold talks with the US about giving up nuclear weapons and normalising relations with Washington, and would halt weapons tests during any negotiations. China-North Korea talks backed this up, with de-nuclearisation said to be on the table for talks with US.

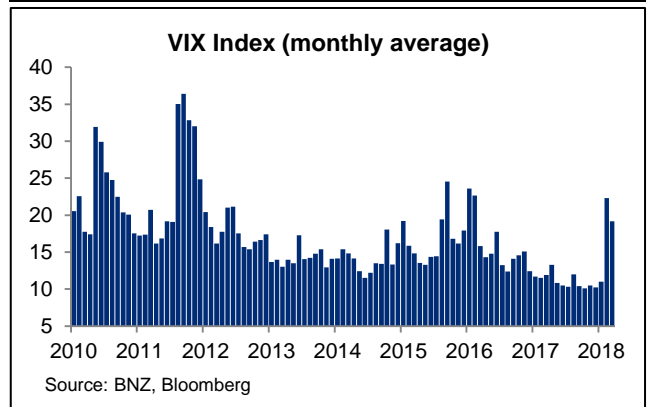
The Fed hiked rates for a sixth time this cycle and continued to project three hikes for this year. Growth and inflation forecasts were nudged higher, as was the Fed Funds rate track from next year onwards, reaffirming the case that US monetary policy remains on a clear tightening path, with some way to go yet.

The USD showed signs of consolidation after its weakness earlier in the year. Trump's new economic advisor Kudlow seemed to be an advocate for the US strong dollar policy, declaring that he would buy "King Dollar".

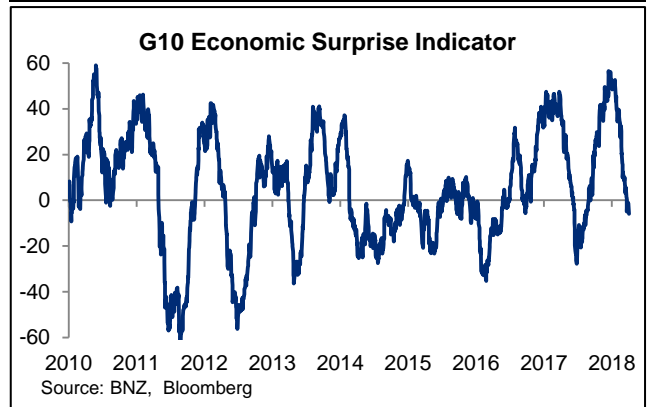
NZD in the Middle of the Pack For March



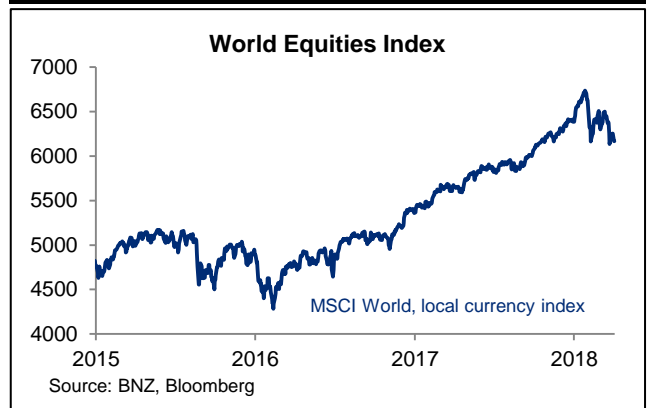
A Higher VIX Index Compared to Recent Years



A Less Supportive Dataflow for Risk Assets



Global Equity Markets Lower Again



Despite significant equity market volatility, with the US S&P500 trading an 8% range, the spillover for the NZD was modest. The NZ TWI has been stuck in a tight range of 74-76 for most of this year and that remained the case for March, with modest changes on the crosses as well. The intra-month low for NZD/USD was 0.7154 at the height of US-China trade tensions while the high was just two cents higher at 0.7355.

The RBNZ's OCR review, the last under Acting Governor Spencer, came and went with no surprise, with the bank's guidance of unchanged policy for "a considerable time" remaining. Incoming Governor Orr signed a new Policy Targets Agreement, which added "supporting maximum sustainable employment" alongside price stability in the objectives. The PTA reiterated a continued focus on the mid-point of the 1-3% target range, while a new Monetary Policy Committee that includes a minority of external personnel will operate from sometime in 2019.

Of the major currencies, GBP was the strongest. The UK and EU reached a transitional agreement for the period post Brexit. Further negotiation needs to be worked through including the unresolved Northern Ireland border issue. The Bank of England left its policy rate unchanged at 0.5% in a 7-2 vote, with the two dissenters arguing for an immediate rate hike. The MPC maintained its tightening bias and all members agreed that any future increases in the policy rate would likely be at a gradual pace and limited extent. NZD/GBP fell by 1½% in March.

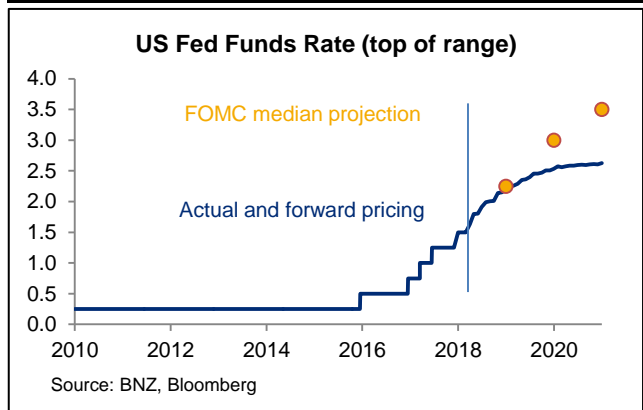
EUR outperformed as well. The ECB dropped its easing bias, removing the pledge to increase the asset purchase programme if economic conditions deteriorate, a further step in the progression of communication to end the programme entirely. However, President Draghi, wary of adding further fuel to EUR, downplayed the removal of the easing bias, indicating that inflation remained subdued, that policy would be "reactive not proactive", and warned that trade protectionism presents a new downside risk.

NZD/JPY reached its lowest level since November 2016, when risk appetite was at its lowest. Earlier in the month, JPY was supported after the BoJ's Kuroda said that the central bank would start thinking about how to complete its unprecedented monetary stimulus around the fiscal year beginning April 2019, the same time it expects to reach its 2% inflation target. He has previously refused to comment on any exit strategy.

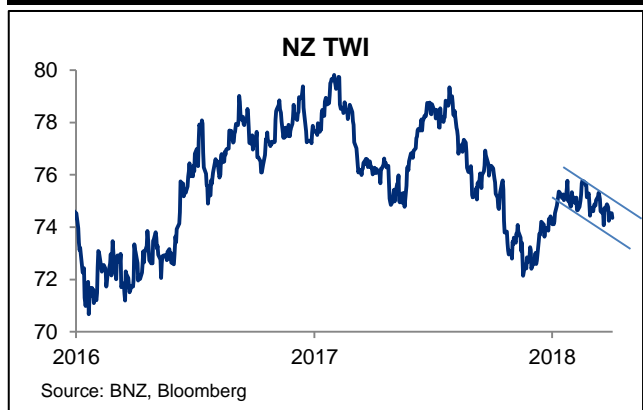
The AUD was the weakest of the majors, not helped by some chunky falls in iron ore, coal prices and other metal prices. US-China trade tensions didn't help either as some traders took this as a reason to short the AUD on projected spillover effects. NZD/AUD rose by 1½% for the month and reached its highest level since July last year in the process.

Global government bond markets were well supported as risk appetite soured, with all major markets seeing lower 10-year rates, including the US Treasuries down 12bps to 2.74%. NZ bonds performed particularly well. The trend of NZ-US spread compression continued, driven by the short end. The NZ Apr-2027 bond closed the month down 23bps at 2.72%.

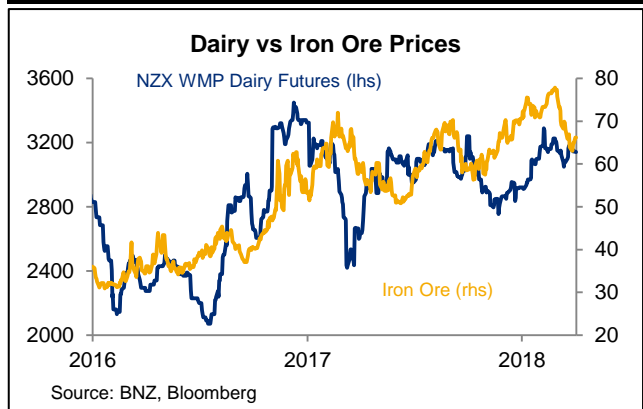
US Monetary Policy Tightens Further



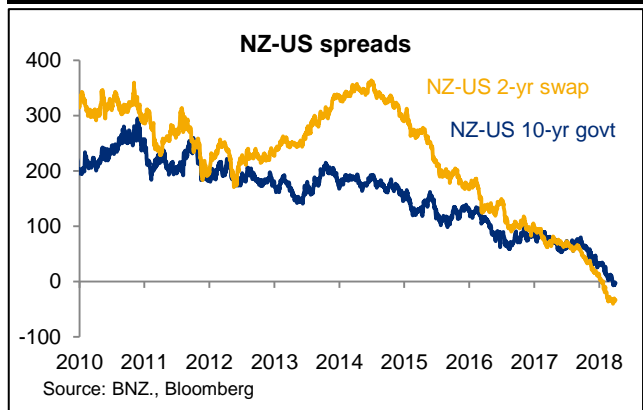
NZ TWI Flat in March But Downward Channel in Play?



Iron Ore Prices Fall; Dairy Prices More Stable



NZ-US Rate Compression Continues



The NZDMO issued \$2b of a new 2029 maturity nominal bond at a yield of 3.135%. The bond was issued at the tight end of price guidance (a spread of 16bps to the existing 2027 bond) and attracted an order book of over \$5b, indicative of strong demand for NZ bonds.

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Monthly Performance Table							
	end-Mar	end-Feb	Change		end-Mar	end-Feb	Change
<b>Currencies</b>				<b>NZ Rates</b>			
NZD/USD	0.7237	0.7212	0.3%	OCR	1.75	1.75	0.00
NZD/AUD	0.9426	0.9289	1.5%	NZ 90day BB	1.96	1.92	0.04
NZD/EUR	0.5876	0.5912	-0.6%	NZ 2yr sw ap	2.22	2.20	0.02
NZD/GBP	0.5164	0.5240	-1.5%	NZ 5yr sw ap	2.62	2.72	-0.10
NZD/JPY	76.91	76.92	0.0%	NZ 10yr sw ap	3.06	3.23	-0.17
NZD/CNY	4.555	4.5646	-0.2%	NZ Govt (4/21)	2.72	2.95	-0.23
TWI	74.5	74.5	0.0%	NZ Govt (4/23)	2.29	2.42	-0.13
AUD/USD	0.7679	0.7762	-1.1%	NZ Govt (4/27)	2.72	2.95	-0.23
EUR/USD	1.2324	1.2194	1.1%	<b>Global 10 year bond rates</b>			
GBP/USD	1.4015	1.3760	1.9%	US	2.74	2.86	-0.12
USD/JPY	106.28	106.68	-0.4%	Canada	2.09	2.23	-0.15
USD/CNY	6.28	6.33	-0.9%	UK	1.35	1.50	-0.15
USD/CAD	1.2900	1.2831	0.5%	France	0.72	0.92	-0.20
USD TWI major	112.19	112.60	-0.4%	Germany	0.49	0.65	-0.16
Asia DXY	111.84	110.96	0.8%	Italy	1.79	1.97	-0.19
<b>Equity Markets</b>				Spain	1.16	1.53	-0.38
MSCI AC Wrld, loc.	1,147	1,173	-2.2%	Portugal	1.60	1.98	-0.38
MSCI World, loc.	6,253	6,397	-2.2%	Ireland	0.90	1.07	-0.17
MSCI EM, USD	2,559	2,606	-1.8%	Japan	0.04	0.05	0.00
US S&P 500	2,641	2,714	-2.7%	Australia	2.60	2.81	-0.21
Euro STOXX 600	370.9	379.6	-2.3%	<b>Commodities (USD)</b>			
Germany DAX	12,097	12,436	-2.7%	WTI Crude	64.94	61.47	5.6%
France CAC 40	5,167	5,320	-2.9%	Brent Crude	69.34	64.46	7.6%
UK FTSE 100	7,057	7,232	-2.4%	R/B CRB Index	195.4	193.9	0.7%
Aust S&P/ASX 200	5,759	6,016	-4.3%	Gold spot	1,325	1,318	0.5%
Japan Topix	1,716	1,768	-2.9%	Silver spot	16.37	16.42	-0.3%
China CSI 300	3,899	4,024	-3.1%	Copper	303.0	311.0	-2.6%
NZX50	8,319	8,374	-0.7%	Iron Ore	64.89	77.15	-15.9%
Volatility: VIX	19.97	19.85	0.6%	Coking coal	189.75	237.00	-19.9%
<b>3-mth Bill Futures</b>				Thermal coal	96.00	104.00	-7.7%
NZD Dec-18	97.85	97.86	-0.01	Corn	387.8	382.0	1.5%
AUD Dec-18	98.03	98.02	0.01	Wheat	451.0	495.0	-8.9%
USD Dec-18	97.51	97.47	0.03	NZX Dairy WMP	3,145	3,215	-2.2%
EUR Dec-18	100.30	100.27	0.03	NZX Milk Price 2018 NZD	6.56	6.49	1.1%
GBP Dec-18	98.92	98.98	-0.06				

Source: BNZ, Bloomberg

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