

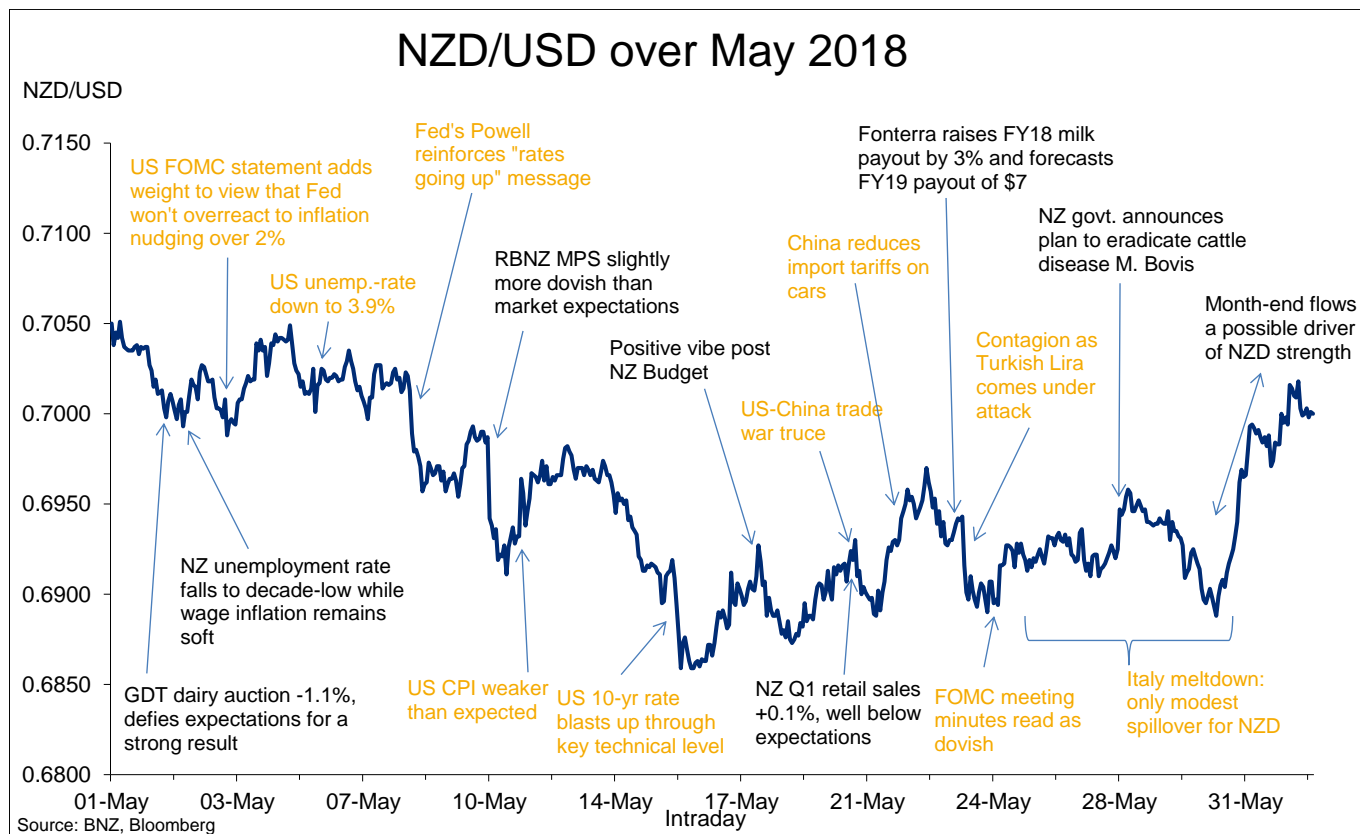
# RESEARCH FINANCIAL MARKETS WRAP

1 June 2018



## NZD Eventually Finds Support During May

- The NZD consolidated after its plunge mid-April to Mid-May
- NZD/EUR and NZD/GBP crosses higher after Italy meltdown scare
- NZ and key global rates end lower after mid-month selloff



	Quick Outlook	May ranges
NZD/USD	In the midst of a consolidation phase, with some levitation towards fair value of 0.71 possible over the near-term. Geo-political risks re Italy, US trade protectionism and the Middle East remain near-term threats to that view.	0.6850 – 0.7050
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	0.9125– 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.	0.5075 – 0.5280
NZD/EUR	Italy risks have seen the cross move to the top of its trading range. As this risk subsides then downside bias should ensue, alongside further subtle shifts in ECB policy that support EUR.	0.5785 – 0.6020
NZD/JPY	The risk of a sustained downward break through support at 76 increases as the year progresses on likely weaker risk appetite and fully exhausted BoJ policy.	74.6 – 77.5
90-day BB	Flat, with little chance of monetary policy adjustment over coming months.	1.98% - 2.05%

May was an eventful month that incorporated some turmoil in emerging markets, swings in oil prices, a meltdown in Italy, and US-China trade tensions. Amidst all that, the record will show the NZD TWI relatively flat for the month, albeit driven by some divergent swings on NZD crosses.

Through the first half of May, the NZD continued to slide, continuing from the sharp fall that began mid-April. Drivers for the slump in the NZD TWI included the ongoing recovery in the USD, supported by higher US interest rates – including the US 10-year rate rising to a multi-year high – and the associated nosedive in emerging market currencies that went hand-in-hand with this move. Adding to the mix was a complete shake-out of long speculative positions in the NZD built up earlier in the year.

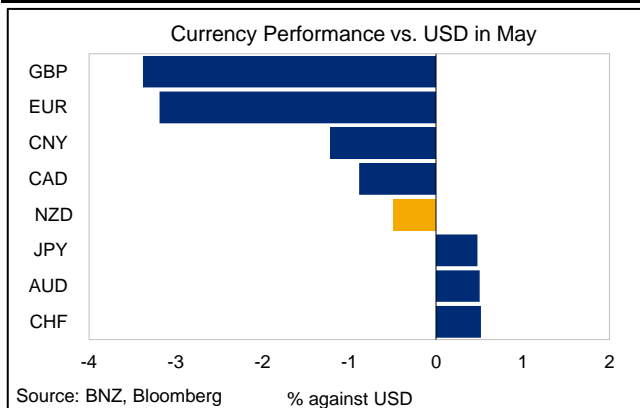
The US 10-year Treasury yield rose to 3.126% at its peak on 18-May, its highest level since June 2011. That move added to the risk for emerging markets, and after Argentina’s Peso came under attack, Turkey’s Lira was the next shoe to fall, not helped by President Erdogan indicating a desire to take control of the country’s monetary policy. While these were idiosyncratic events with limited spillover for the NZD, the higher US interest rate environment was seen as a tightening in global liquidity conditions, a headwind for emerging market and commodity currencies.

Later in the month, Italy moved into the spotlight, as the populist leaders attempted to form a coalition government. President Mattarella initially rejected the proposal, disallowing the appointment of a euro-sceptic Finance Minister, sowing the seeds for the possibility of fresh elections. The market took a dire view of developments, reflecting the marginal increase of the tail-risk of Italy leaving the euro-area. Italy’s 2-year bond rose to as high as 2.76% after beginning the month at minus 0.17%, while the EUR came under significant downward pressure, with some negative spillover for GBP. Flows to safe-havens saw considerable downward pressure on UST and German Bund yields, and upside to JPY and CHF. Spillover for the NZD was limited through this period of angst, with the Italian “crisis” manifested in stronger NZD/EUR and NZD/GBP crosses. By month-end, a new government had been agreed and Italy’s 2-year rate was back below 1%.

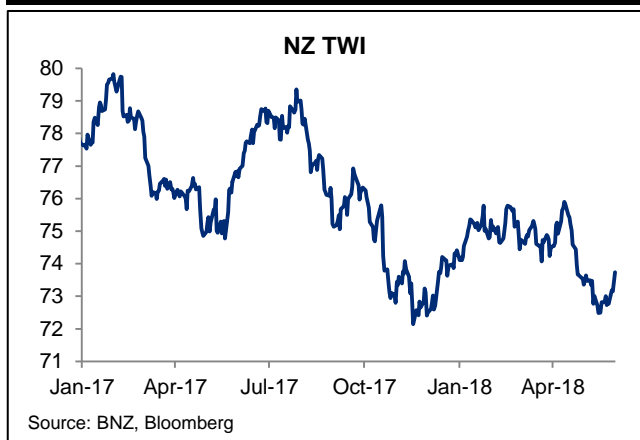
Oil prices can explain some of the upward and downward move in global rates. Prices trended higher for much of the month on tight supply-demand conditions before talk emerged of Saudi Arabia and Russia looking to propose some softening in the current curbs on production at the next OPEC+ meeting. This saw Brent oil prices reach a 3½-year high of USD 80.50, before falling back down to as low as USD 74.50.

The US FOMC added some weight to the view that the Fed wouldn’t over-react to inflation nudging over 2% by emphasising its “symmetric” inflation target. This was confirmed later in the month when the minutes of the meeting were released. Some members noted that a modest inflation overshoot “could be helpful” in anchoring inflation expectations around 2%.

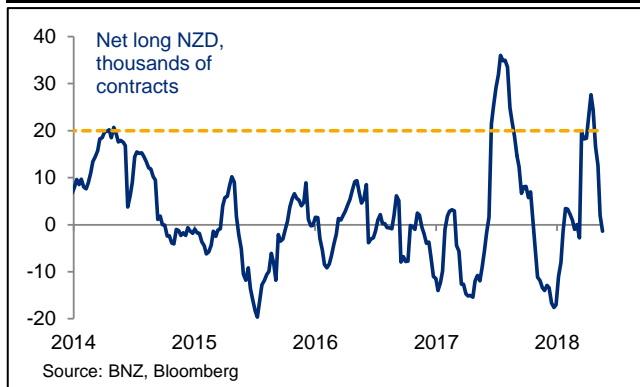
**EUR and GBP the Key Losers in May**



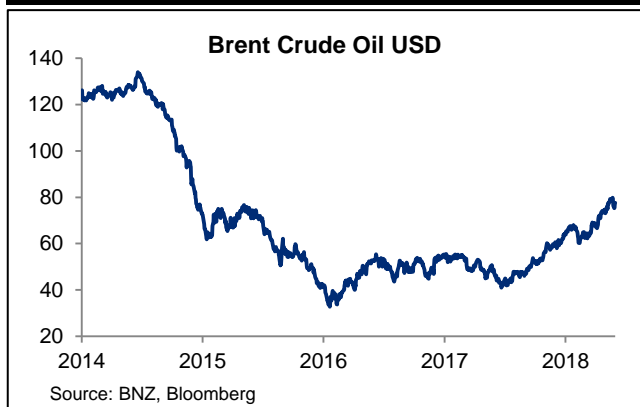
**Consolidates After the Mid-Apr to Mid May Slump**



**NZD Net Spec. Positioning Down From Extreme Long**



**Oil Prices Trend Higher**



Concern about US-China trade wars ebbed and flowed through the month. US Treasury Secretary Mnuchin suggested that a US-China trade war truce was in force while negotiations continued. China cut tariffs on imported cars and car parts and followed that up with tariff reductions on a wide range of consumer goods. However, late in the month, Trump suggested that the US would push ahead with plans to impose tariffs on \$50b worth of Chinese imports, with China responding that it would retaliate accordingly. The temporary exemption for steel and aluminium tariffs on EU, Canada and Mexico imports into the US expired at the end of the month, setting the scene for some retaliatory action ahead.

Looking at domestic news, NZ's unemployment rate fell to a decade-low of 4.4% but came alongside subdued wage inflation. There was much anticipation ahead of new RBNZ Governor Orr's first Monetary Policy Statement, which turned out slightly more dovish than the market expected. The comment upfront in the MPS that "the direction of our next move is equally balanced, up or down" was stark, and puts in writing which the Bank hither to was only prepared to suggest verbally. The NZ Budget was seen to be fiscally responsible, with growing tax revenue and controlled spending that will allow net debt to GDP to fall below the 20% target.

Fonterra raised its projected FY18 milk payout by 3% to \$6.75 and provided a first FY19 forecast payout of \$7.00. Positive news on much higher farm incomes was dampened by ongoing concern about the impact of the cattle disease Mycoplasma Bovis, which had gradually spread across the country. The NZ government announced an expensive plan to eradicate the disease and the impact on the market was still seen to be minor at this stage.

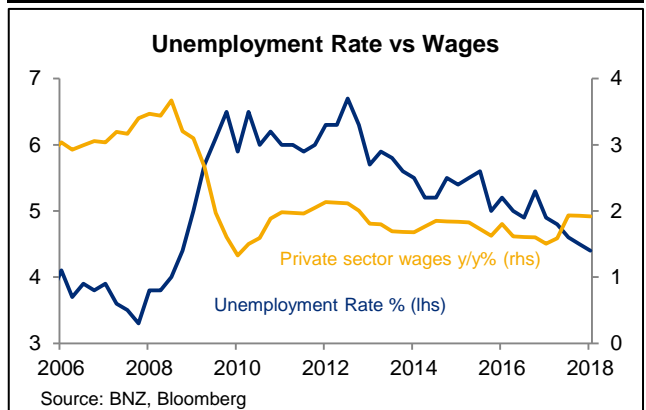
NZD/USD traded in a 0.6850-0.7050 range for the month, with the strong support base in the 0.68-0.69 zone proving once again that that level will be tough to crack. NZD/AUD shifted down to a lower level after the RBNZ's MPS and that move was sustained through the rest of the month.

The lower global bond yield environment helped support JPY, seeing NZD/JPY down for the month as well. The strong support level of 76 that has been in place for the past eighteen months was threatened a number of times through the month and looks increasingly vulnerable. NZD/CNY was up less than 1% for the month, while NZD/EUR and NZD/GBP saw gains near 3%.

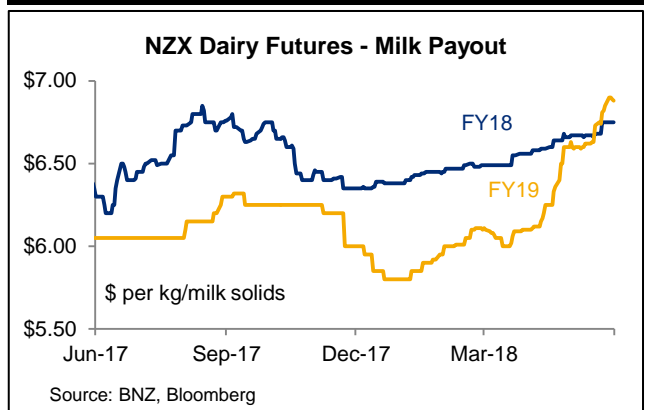
Strong demand for NZ bonds continued, with the NZ 10-year government bond yield trading at its lowest level in a year at the height of Italy's meltdown at 2.66%, before ending the month 11bps lower at 2.73%. A more dovish RBNZ MPS saw some downside pressure at the short end of the curve alongside the prior upward pressure on the Bills-OIS spread fading. NZ's 2-year swap rate closed the month down 6bps at 2.21%, close to the average level it has traded for the past year.

[jason.k.wong@bnz.co.nz](mailto:jason.k.wong@bnz.co.nz)

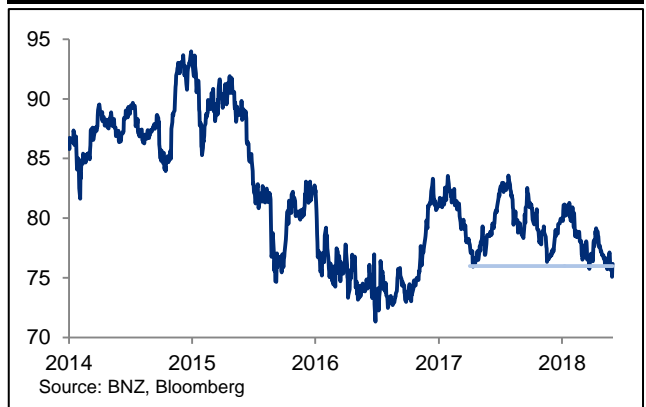
Lower NZ Unemployment Rate; Wage Inflation Steady



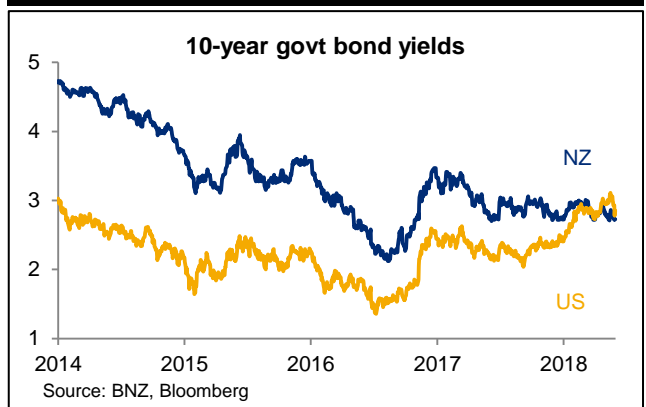
Dairy Farmers' Incomes on the Up



NZD/JPY Looking Vulnerable as Support Breaks



NZ 10-yr Bond Yield Impervious to US Upside Pressure



## Monthly Performance Table

	end-May	end-Apr	Change		end-May	end-Apr	Change
<b>Currencies</b>				<b>NZ Rates</b>			
NZD/USD	0.7001	0.7035	-0.5%	OCR	1.75	1.75	0.00
NZD/AUD	0.9251	0.9344	-1.0%	NZ 90day BB	2.03	2.02	0.01
NZD/EUR	0.5987	0.5825	2.8%	NZ 2yr sw ap	2.21	2.27	-0.06
NZD/GBP	0.5266	0.5112	3.0%	NZ 5yr sw ap	2.63	2.73	-0.10
NZD/JPY	76.17	76.91	-1.0%	NZ 10yr sw ap	3.09	3.21	-0.12
NZD/CNY	4.488	4.4561	0.7%	NZ Govt (4/21)	2.73	2.84	-0.11
TWI	73.7	73.4	0.4%	NZ Govt (4/23)	2.27	2.37	-0.10
AUD/USD	0.7568	0.7530	0.5%	NZ Govt (4/27)	2.73	2.84	-0.11
EUR/USD	1.1693	1.2078	-3.2%	<b>Global 10 year bond rates</b>			
GBP/USD	1.3298	1.3763	-3.4%	US	2.86	2.95	-0.09
USD/JPY	108.82	109.34	-0.5%	Canada	2.24	2.30	-0.06
USD/CNY	6.41	6.33	1.2%	UK	1.23	1.42	-0.19
USD/CAD	1.2958	1.2843	0.9%	France	0.66	0.78	-0.12
USD TWI major	115.82	113.89	1.7%	Germany	0.34	0.56	-0.22
Asia DXY	109.73	110.87	-1.0%	Italy	2.79	1.79	1.01
<b>Equity Markets</b>				Spain	1.49	1.27	0.21
MSCI AC Wrld, loc.	1,180	1,169	0.9%	Portugal	1.96	1.66	0.30
MSCI World, loc.	6,466	6,379	1.4%	Ireland	0.94	0.96	-0.02
MSCI EM, USD	2,440	2,548	-4.2%	Japan	0.03	0.05	-0.02
US S&P 500	2,705	2,648	2.2%	Australia	2.67	2.77	-0.10
Euro STOXX 600	383.1	385.3	-0.6%	<b>Commodities (USD)</b>			
Germany DAX	12,605	12,612	-0.1%	WTI Crude	67.04	68.48	-2.1%
France CAC 40	5,398	5,521	-2.2%	Brent Crude	77.56	74.17	4.6%
UK FTSE 100	7,678	7,509	2.2%	R/B CRB Index	202.8	202.0	0.4%
Aust S&P/ASX 200	6,012	5,983	0.5%	Gold spot	1,299	1,315	-1.3%
Japan Topix	1,747	1,777	-1.7%	Silver spot	16.43	16.33	0.6%
China CSI 300	3,802	3,757	1.2%	Copper	306.5	305.3	0.4%
NZX50	8,659	8,444	2.5%	Iron Ore	64.88	65.40	-0.8%
Volatility: VIX	15.43	15.93	-3.1%	Coking coal	190.75	186.75	2.1%
<b>3-mth Bill Futures</b>				Thermal coal	110.15	99.40	10.8%
NZD Dec-18	97.92	97.84	0.08	Corn	394.0	400.8	-1.7%
AUD Dec-18	98.03	97.98	0.05	Wheat	526.3	510.5	3.1%
USD Dec-18	97.44	97.36	0.08	NZX Dairy WMP	3,255	3,390	-4.0%
EUR Dec-18	100.25	100.31	-0.06	NZX Milk Price 2018	NZD 6.75	NZD 6.66	1.4%
GBP Dec-18	99.21	99.07	0.14	NZX Milk Price 2019	NZD 6.88	NZD 6.6	4.2%

Source: BNZ, Bloomberg

## Contact Details

### Stephen Toplis

Head of Research  
+(64 4) 474 6905

### Craig Ebert

Senior Economist  
+(64 4) 474 6799

### Doug Steel

Senior Economist  
+(64 4) 474 6923

### Jason Wong

Senior Markets Strategist  
+(64 4) 924 7652

### Nick Smyth

Interest Rate Strategist  
+(64 4) 924 7653

## Main Offices

### Wellington

42-52 Willis Street  
Private Bag 39806  
Wellington Mail Centre  
Lower Hutt 5045  
New Zealand  
Toll Free: 0800 283 269

### Auckland

80 Queen Street  
Private Bag 92208  
Auckland 1142  
New Zealand  
Toll Free: 0800 283 269

### Christchurch

111 Cashel Street  
Christchurch 8011  
New Zealand  
Toll Free: 0800 854 854

## National Australia Bank

### Peter Jolly

Global Head of Research  
+(61 2) 9237 1406

### Alan Oster

Group Chief Economist  
+(61 3) 8634 2927

### Ray Attrill

Head of FX Strategy  
+(61 2) 9237 1848

### Skye Masters

Head of Interest Rate Strategy  
+(61 2) 9295 1196

### Wellington

Foreign Exchange +800 642 222  
Fixed Income/Derivatives +800 283 269

### Sydney

Foreign Exchange +61 2 9295 1100  
Fixed Income/Derivatives +61 2 9295 1166

### London

Foreign Exchange +44 20 7796 3091  
Fixed Income/Derivatives +44 20 7796 4761

### New York

Foreign Exchange +1 212 916 9631  
Fixed Income/Derivatives +1 212 916 9677

### Hong Kong

Foreign Exchange +85 2 2526 5891  
Fixed Income/Derivatives +85 2 2526 5891

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