

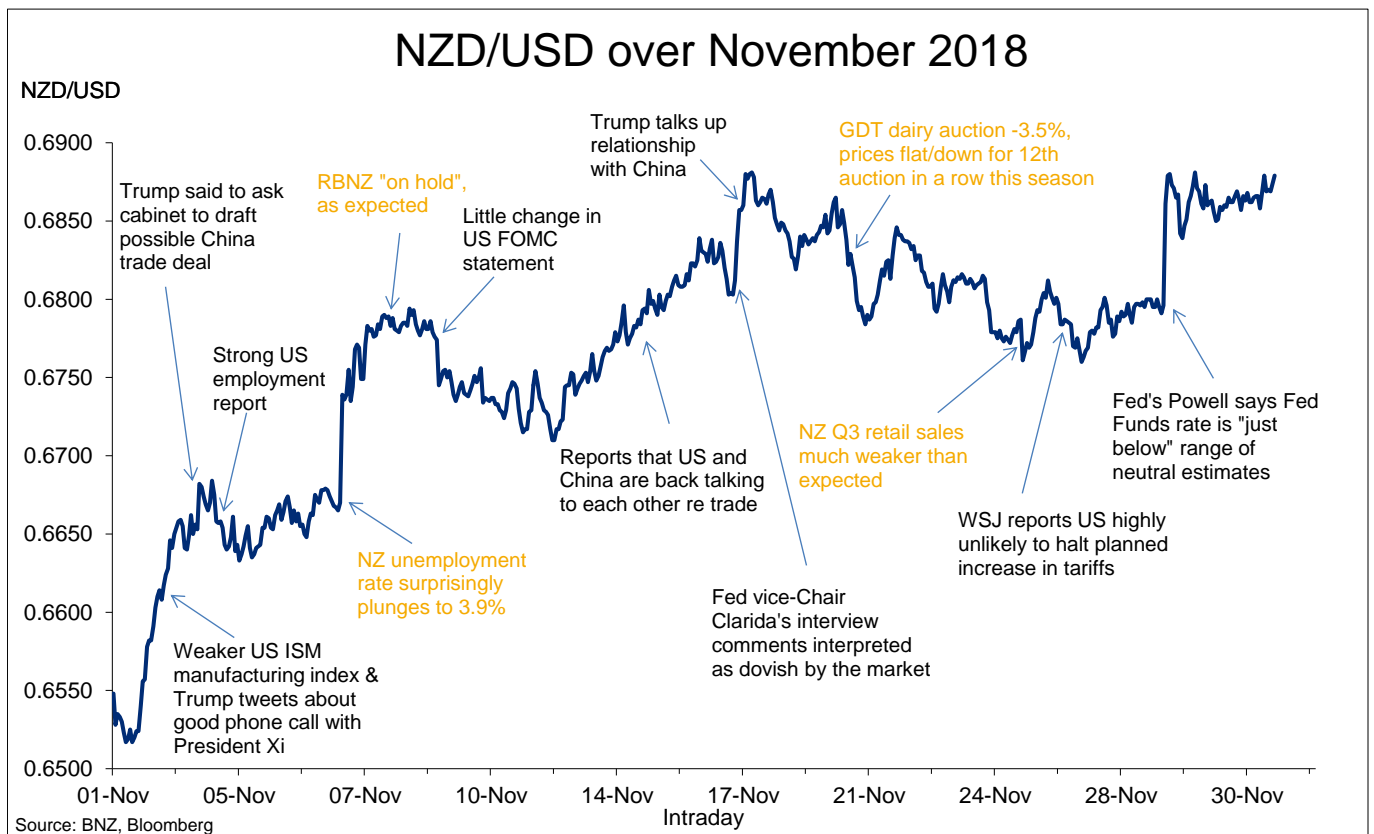
RESEARCH FINANCIAL MARKETS WRAP

3 December 2018



NZD Recovers Strongly in November

- The NZD bounced back strongly, up 5½% for the month
- Supported by optimism on US-China trade relations, a less hawkish Fed outlook, and positive domestic data
- NZ rates higher against a backdrop of lower global rates



Quick Outlook		November ranges
NZD/USD	After the strong Nov. rally, the NZD has gone from cheap to modestly over-bought on our short-term model. US-China trade war risks have subsided. Seasonal factors are usually positive in Dec. but some consolidation now due.	0.6515 – 0.6885
NZD/AUD	Oil price collapse has seen the cross push up to the higher end of the familiar 0.90-0.95 range. Should find some increased resistance from here.	0.9195 – 0.9440
NZD/GBP	Highly dependent on how the Brexit vote in Parliament goes and what develops after a possible rejection of the deal. Could be choppy, but if common sense prevails, then a strong recovery in GBP and a much lower NZD/GBP could ensue over coming months.	0.5080 – 0.5395
NZD/EUR	Short-term likely influenced by how GBP travels. A more constructive GBP and some fading of the Italian budget impact could see a lower cross over coming months.	0.5760 – 0.6080
NZD/JPY	Looking overbought after a strong run. Expect some resistance to develop around 78-79, with more chance of falling on a 3-6 month view	73.5 – 78.2
90-day BB	Flat, with little chance of monetary policy adjustment over coming months.	1.92% - 2.01%

The NZD performed strongly in November, the best-performing of the key majors we follow. Both global and domestic forces were in play.

On the global side, a key theme for the month was a number of headlines on developments in the US-China trade war, ahead of the key Trump-Xi meeting on the sidelines of the G20 meeting held at the end of the month. Many of the headlines were NZD-supportive. Early in the month, Trump and Xi had a “good and long” phone conversation. By mid-month, official trade negotiations between the US and China were underway at all levels.

Domestically, a strong employment report came out-of-the-blue. In Q3, much stronger than expected employment drove a plunge in the unemployment rate to 3.9%, its lowest level in a decade. The key LCI wage data were in line, consistent with inflation running near the middle of the target range. The data added to the evidence that the NZ economy was doing just fine, with no sign that weaker business confidence was impacting the real economy.

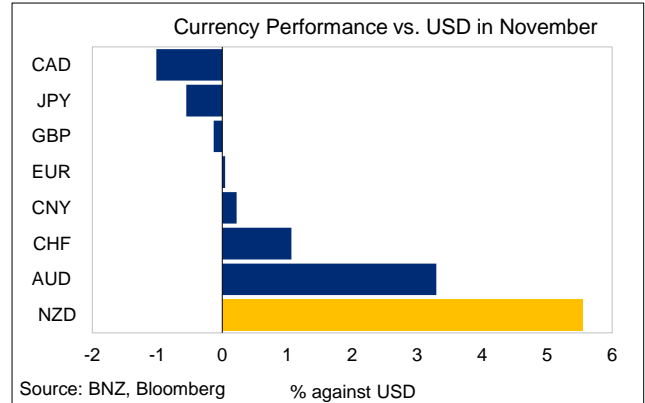
That data came a day ahead of the RBNZ’s latest Monetary Policy Statement, giving the Bank time to change the headline message. The Bank deleted the reference from previous statements that the direction of the next OCR move could be up or down. Following the run of stronger data that predated the employment report, the underlying text and forecasts of the MPS looked to convey a more hawkish bias compared to August, with upside risks to inflation and with employment already near its “maximum sustainable level”. While the Bank wasn’t ready to admit an explicit tightening bias, the numbers were clear for all to see, including inflation forecasts that spent more time above 2% than below.

The strong labour market report and subsequent MPS were instrumental in driving NZ rates higher. At one stage the 2-year rate swap was up as much as 18bps for the month at 2.20%, before receiving interest returned in the second half of the month, leaving it up only 7bps for the month at 2.09%. The 5-year swap rate was up 31bps to 2.64%, before ending the month up “only” 11bps to 2.44%.

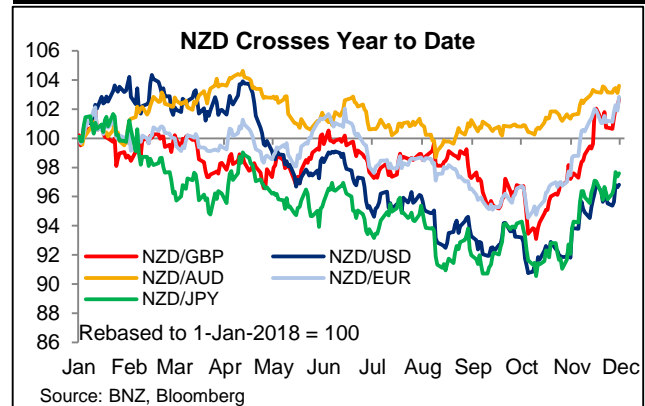
Higher NZ rates went against the grain of lower global rates. The divergence in performance goes some way in correcting for the NZ market’s extreme outperformance experienced for much of this year.

US rates were dragged lower as expectations of tighter monetary policy were toned down, a reflection of weaker global and US growth momentum, a dovish interpretation of some Fed speakers including new vice-Chair Clarida and plunging oil prices. Towards the end of the month, in a speech Fed chair Powell sounded more cautious about the outlook and commented that the Fed Funds rate was “just below” the range of neutral estimates. This contrasted with his off-the-cuff comment in October that “we may go past neutral, but we’re a long way from neutral at this point, probably”, which at the time triggered significantly higher US rates and USD.

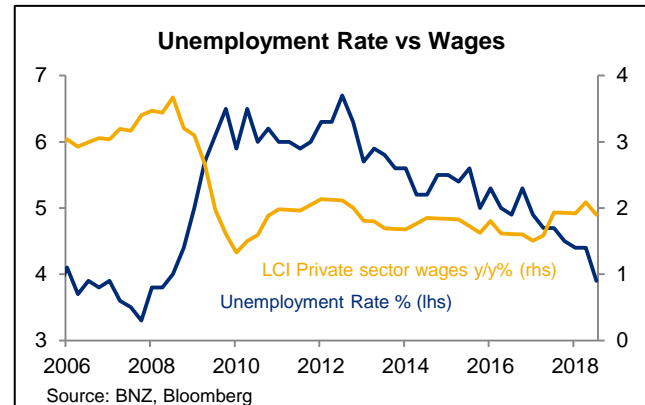
NZD and AUD the Best Performers By Far in November



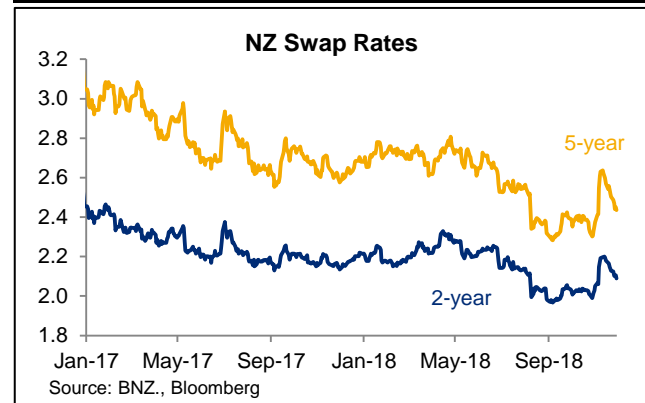
NZD Claws Back a Lot of Prior Losses



NZ Unemployment Rate Continues to Fall



NZ Swap Rates Spike Higher



For the month, some 16bps of Fed rate hikes were priced out of the curve through to the end of next year, while the 10-year Treasury rate fell by 16bps to 2.99%, after reaching as high as 3.25% early in the month.

In the US elections, the Democrats won enough seats to take the House, while the Republicans extended their Senate majority. The divided government reduces the chance of further tax cuts and will act as a restraint on changes to domestic policy. Republican control of the Senate still gives plenty of leeway for Trump on political appointments and foreign policy, including trade.

Oil prices slumped as it became clearer that a state of oversupply was developing. Trump's relaxation of sanctions against imports of Iranian oil supported supply alongside his pressure on Saudi Arabia to keep pumping to depress prices. Meanwhile, US oil production continued to rise, making it the largest oil-producing country. Brent and WTI crude were both down 22% for the month. This dynamic supported NZ's terms of trade even though NZ's export commodity prices remained on a declining trend. GDT dairy prices have been flat to down at every fortnightly auction so far this season.

Our risk appetite index fell to a 2-year low of 40%, before recovering a little. While the VIX index oscillated around 20 during the month, much of the fall reflected wider credit spreads. The US high yield bond spread rose by almost 50bps during the month while the emerging market credit spread was up over 20bps.

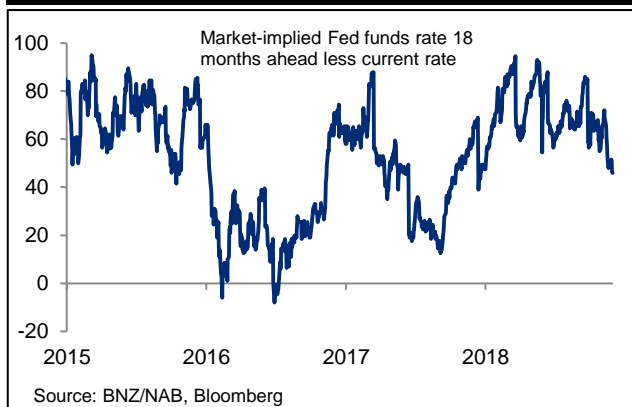
Stronger NZ labour market data, higher terms of trade, higher NZ-US rates, and the positive US-China trade vibe helped drive the recovery in the NZD, which well and truly broke out of the strong downward channel evident April through to October. Softer risk appetite was no hurdle for the NZD recovery as the currency looked to make up some of the substantial prior losses. NZD/USD rose by 5½% for the month, with a high of 0.6886, taking it to a level not seen since June. NZD crosses were also strong, some 5-6% against EUR, GBP, CNY and JPY.

The positive US-China trade vibe also supported emerging market currencies, equity markets and the AUD. Still, NZD/AUD was higher by over 2% as those positive domestic forces helped and lower oil prices dented Australia's terms of trade. Lower oil prices were a key factor behind the underperformance of CAD.

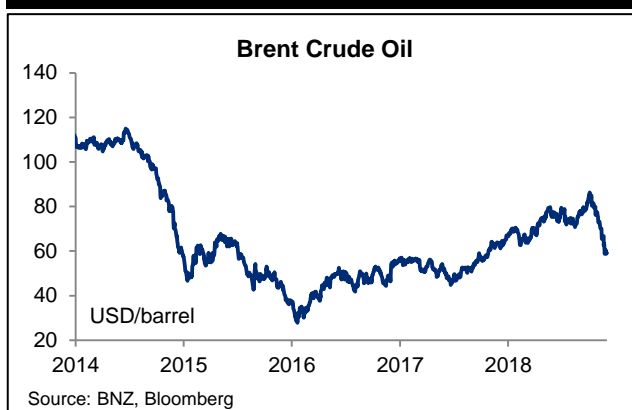
Both GBP and EUR were weighed down by Brexit concerns. The EU and UK finalised a Withdrawal Agreement, a dense 500+ page legal document that outlined the scope of Brexit. A political declaration on a future UK-EU relationship was also agreed in principle that pledges an "ambitious, broad, deep and flexible partnership". However it remains questionable whether the agreement can pass the UK Parliament in December and uncertainty remains about what happens in the event that the vote doesn't pass.

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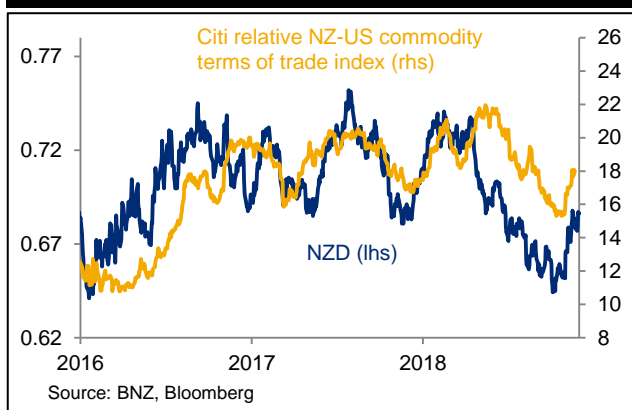
Market Expects Less Fed Tightening Ahead



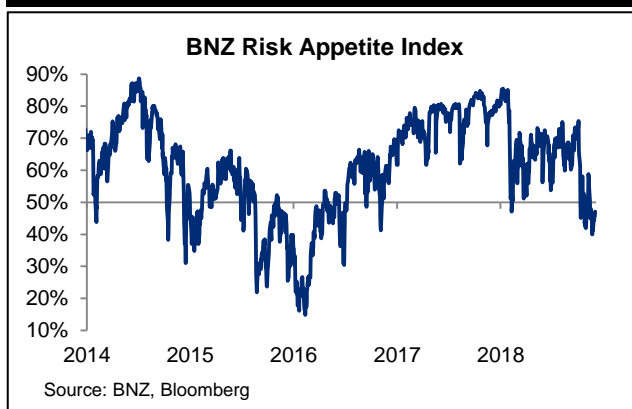
Oil Prices Slump After Strong Rally



Recovery in Terms of Trade Can Explain NZD Recovery



Risk Appetite Fell to a 2-year Low During November



Monthly Performance Table

	end-Nov	end-Oct	Change		end-Nov	end-Oct	Change
Currencies				NZ Rates			
NZD/USD	0.6879	0.6517	5.6%	OCR	1.75	1.75	0.00
NZD/AUD	0.9418	0.9214	2.2%	NZ 90day BB	1.98	1.93	0.05
NZD/EUR	0.6078	0.5760	5.5%	NZ 2yr sw ap	2.09	2.02	0.07
NZD/GBP	0.5394	0.5105	5.7%	NZ 5yr sw ap	2.44	2.33	0.11
NZD/JPY	78.02	73.60	6.0%	NZ 10yr sw ap	2.90	2.83	0.06
NZD/CNY	4.787	4.5462	5.3%	NZ Govt (4/21)	2.40	2.38	0.02
TWI	75.2	72.0	4.3%	NZ Govt (4/23)	2.01	1.94	0.07
AUD/USD	0.7306	0.7073	3.3%	NZ Govt (4/27)	2.40	2.38	0.02
EUR/USD	1.1317	1.1312	0.0%	NZ Govt (4/29)	2.56	2.57	0.00
GBP/USD	1.2749	1.2766	-0.1%	Global 10 year bond rates			
USD/JPY	113.57	112.94	0.6%	US	2.99	3.14	-0.16
USD/CNY	6.96	6.98	-0.2%	Canada	2.27	2.49	-0.23
USD/CAD	1.3292	1.3157	1.0%	UK	1.36	1.44	-0.07
USD TWI major	119.60	119.35	0.2%	France	0.68	0.75	-0.07
Asia DXY	104.46	103.23	1.2%	Germany	0.31	0.38	-0.07
Equity Markets				Italy	3.21	3.43	-0.21
MSCI AC Wrlld, loc.	1,168	1,152	1.4%	Spain	1.50	1.55	-0.04
MSCI World, loc.	6,453	6,377	1.2%	Portugal	1.82	1.87	-0.05
MSCI EM, USD	2,220	2,132	4.1%	Ireland	0.91	0.95	-0.04
US S&P 500	2,760	2,712	1.8%	Japan	0.09	0.12	-0.04
Euro STOXX 600	357.5	361.6	-1.1%	Australia	2.59	2.63	-0.03
Germany DAX	11,257	11,448	-1.7%	Commodities (USD)			
France CAC 40	5,004	5,093	-1.8%	WTI Crude	50.93	65.31	-22.0%
UK FTSE 100	6,980	7,128	-2.1%	Brent Crude	58.71	75.47	-22.2%
Aust S&P/ASX 200	5,667	5,830	-2.8%	R/B CRB Index	181.7	191.0	-4.8%
Japan Topix	1,667	1,646	1.3%	Gold spot	1,221	1,215	0.5%
China CSI 300	3,173	3,154	0.6%	Silver spot	14.20	14.25	-0.3%
NZX50	8,824	8,752	0.8%	Copper	277.8	265.9	4.5%
Volatility: VIX	18.07	21.23	-14.9%	Iron Ore	64.77	72.40	-10.5%
3-mth Bill Futures				Coking coal	216.00	221.00	-2.3%
NZD Jun-19	98.01	98.05	-0.04	Thermal coal	101.70	105.20	-3.3%
AUD Jun-19	98.06	98.06	0.00	Corn	377.8	375.8	0.5%
USD Jun-19	97.09	96.96	0.13	Wheat	515.8	516.0	0.0%
EUR Jun-19	100.30	100.29	0.01	NZX Dairy WMP	2,715	2,655	2.3%
GBP Jun-19	98.97	98.99	-0.02	NZX Milk Price 2019	NZD 6.07	NZD 6.2	-2.1%

Source: BNZ, Bloomberg

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