

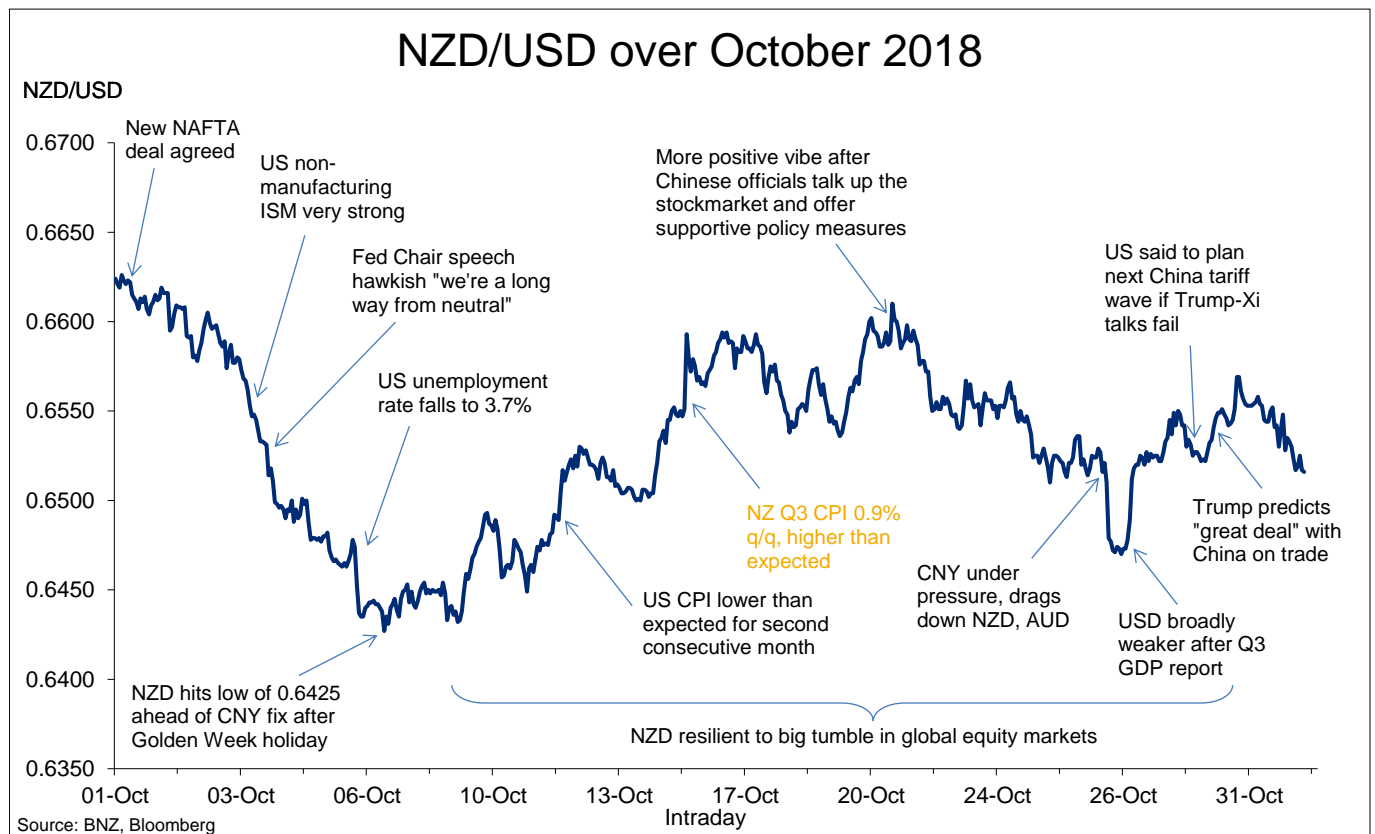
RESEARCH FINANCIAL MARKETS WRAP

1 November 2018



NZD Resilient In October As Equity Markets Tumble

- Global equity markets tumbled in October as risk appetite collapses
- Against that backdrop, the NZD was resilient, down only 1½%, while the TWI was flat
- US Treasuries weren't a safe-haven as rates rose across the curve, while NZ rates fell



Quick Outlook		October ranges
NZD/USD	Downward channel remains intact so that is where the risk lies, but more positive trading dynamics during October give some hope that a period of consolidation will set in. We see too many macro hurdles for a strong rebound to take place.	0.6425 – 0.6630
NZD/AUD	With the heat out of oil prices, the near-term threat of breaking down through 0.90 has evaporated. So back to watching the cross meander in a familiar range, given the similar global and domestic forces on the NZD and AUD.	0.9095 – 0.9290
NZD/GBP	Could move strongly either way in November depending on whether a Brexit withdrawal agreement can be negotiated before the end of the month. Tread carefully.	0.4885 – 0.5170
NZD/EUR	How Brexit negotiations fare this month could be a key short-term factor. Downside bias to cross if some of the recent negative factors for EUR (like Italy's budget) fade.	0.5580 – 0.5790
NZD/JPY	Strong support at 72.25. An improvement in risk appetite in November would be positive for the cross but medium view remains to the downside.	72.3 – 75.5
90-day BB	Flat, with little chance of monetary policy adjustment over coming months.	1.89% - 1.92%

Significant falls across global equity markets were a defining feature of October price action. The MSCI World Index tumbled 6.8% for the month, unwinding all the gains seen over the prior six months. All major markets were affected, with the local market suffering as well, with the NZX-50 down 6.4%. The MSCI emerging markets index fell by 8.7% in USD terms.

A number of factors have been proposed for the major sell-down of equity markets – with high equity market valuations, clearly slowing global growth momentum, escalating US-China trade tensions, and tighter global monetary policy all near the top of the list.

This wasn't your traditional big "risk-off" move, with US Treasury rates actually higher for the month (2-year rate up 5bps, 10-year rate up 8bps) while currency markets were fairly well behaved. The preeminent safe-haven currency JPY outperformed, but less than one would normally have expected, while NZD/USD traded a fairly narrow 2 cents range and was one of the better performers for the month, up on most of the key crosses.

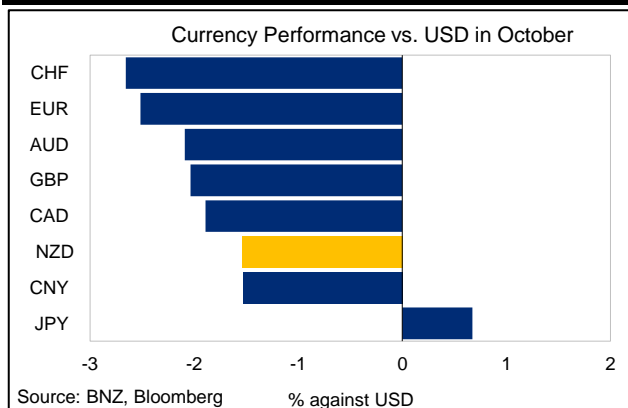
The USD was broadly stronger, rising against all bar JPY for the month across the majors. Early in the month the USD and US Treasury rates were pushed up by a very strong reading for the ISM non-manufacturing index, followed closely by seemingly hawkish comments by Fed Chair Powell. In talking about the Fed Funds rate he said "we may go past neutral, but we're a long way from neutral at this point, probably", adding that interest rates were still "accommodative", despite the removal of that phrase from the FOMC statement. Soon after, data showed the US unemployment rate falling to a new cycle low of 3.7%. While there was a pause in the USD upward trend during the middle of the month, it later resumed as risk appetite deteriorated.

The NZD hit a fresh multi-year low of 0.6425 early in the month before staging a modest recovery. This dynamic was supported by better performance by emerging market currencies, which the NZD has been linked to all year. A notable exception was CNY, which faced ongoing pressure to depreciate for much of the month. Weaker growth in China and escalating US-China trade (as well as political and military) tensions didn't help and speculators frequently tested the resolve of the PBoC to defend the yuan. A number of incrementally easier fiscal and monetary policy measures were adopted to support the economy. These included a plan to cut personal tax rates next year and another cut to banks' reserve requirement ratios. Chinese President Xi vowed to offer "unwavering" support for the private sector.

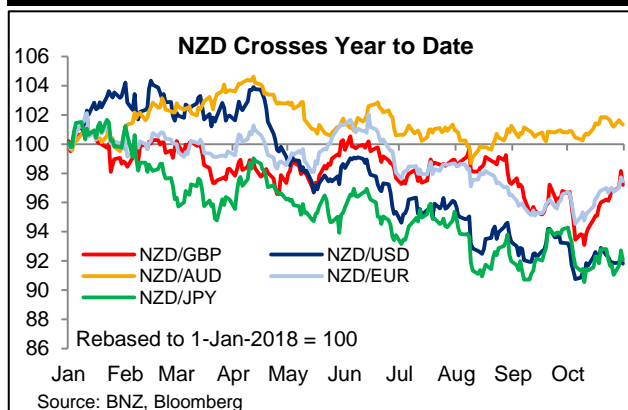
In the semi-annual US Treasury currency report, China wasn't declared a "currency manipulator" although Treasury Secretary Mnuchin stated that "of particular concern are China's lack of currency transparency and the recent weakness in its currency". The report noted that "China is not resisting depreciation through intervention as it had in the recent past."

The NZD ended up performing well in the face of a sharp fall in risk appetite. BNZ's risk appetite index began the month at a risk-loving 73% and ended the month at a below-average 47%, driven by a 75% rise in the VIX index to 21, and wider emerging market and high yield credit spreads. While a closing of speculative short positions

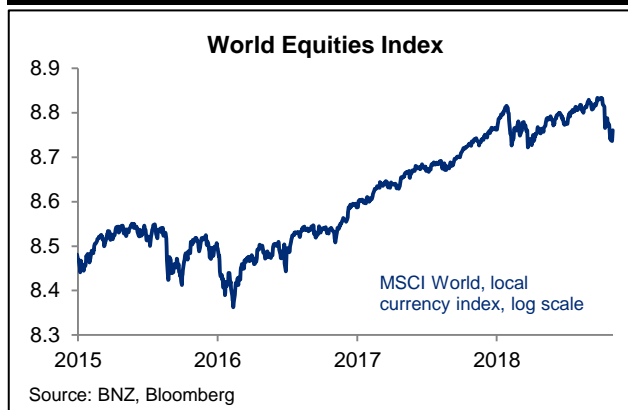
JPY Outperforms; NZD Performs Well Given the Backdrop



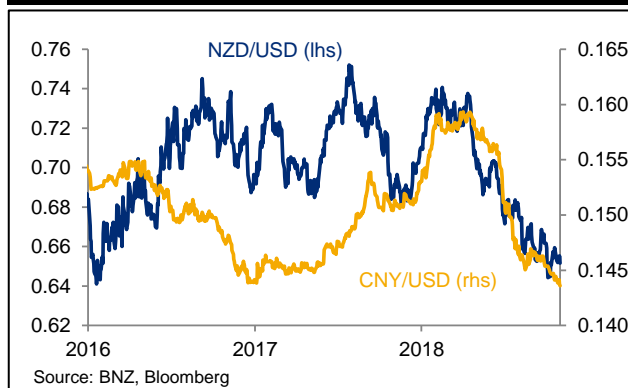
NZD Consolidates in October After a Weak Run



Global Equities Much Lower



Weaker CNY, Weaker NZD



in the NZD might well have been a factor in support for the currency, that wasn't evident in the weekly CFTC commitment of traders reports, which continued to show record short positioning in NZD futures by speculative accounts.

In local economic data, NZ's CPI rose by 0.9% q/q in Q3 (1.9% y/y), above market and RBNZ expectations. Real activity data continued to show economic growth holding up, with electronic card transactions rising by much more than expected in September, rounding out the strongest quarter in 7½ years at 2.3% q/q. Import growth remained strong, a factor in the blowing out of the annual trade deficit through \$5b. Stronger inflation data and a lack of any sign that weaker business confidence was having any real economic impact to date helped support the NZD.

NZD/AUD traded a range around 0.91-0.93 and ended up 0.5% higher for the month. Australia's unemployment rate unexpectedly fell to 5.0%, its lowest level in seven years, while CPI data underwhelmed. The Australian government lost a by-election and therefore its one-seat majority, but the winning Independent candidate pledged support on confidence and supply.

The Bank of Canada hiked its policy rate by 25bps for a fifth time this cycle to 1.75% and offered a hawkish outlook – dropping previous language about a “gradual approach” and indicating that rates will need to “rise to a neutral stance to achieve the inflation target”. US and Canada came to a last minute deal on a revised NAFTA agreement. Still, NZD/CAD ended the month slightly higher after reaching a multi-year low of 0.8320 early in the month.

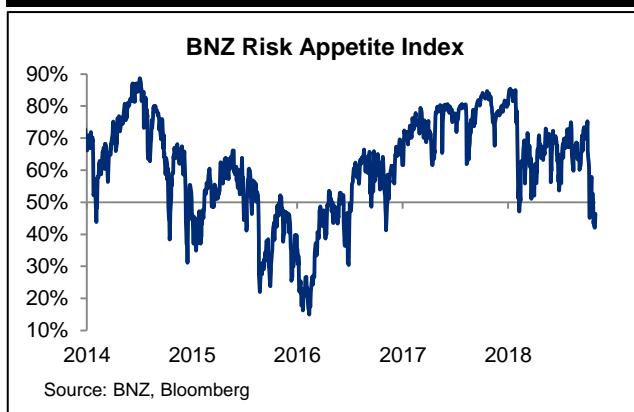
Eurozone PMIs were weak across the board, falling to 2-year lows, indicating much weaker growth momentum in the area. ECB's policy guidance was unchanged, with the Bank set to end its quantitative easing policy at the end of the year and rates to remain on hold “through the summer of 2019”. Italy's run-in with the European Commission over the new government's upward revision of deficit projections was a negative factor for EUR. Italy-German bond spreads rose to fresh highs and, while Italy's credit rating was downgraded, a move into junk territory was avoided. EUR/USD fell 2½% while NZD/EUR was up nearly 1%.

GBP was on the soft side as the UK and EU came to an “impasse” on the Brexit withdrawal agreement, with the Irish border issue a key sticking point. Infighting amongst the Conservative party on the right way forward continued to be an obstacle in the negotiations. PM May continued to face talk of a potential leadership challenge. NZD/GBP traded a wide range and ended the month slightly higher.

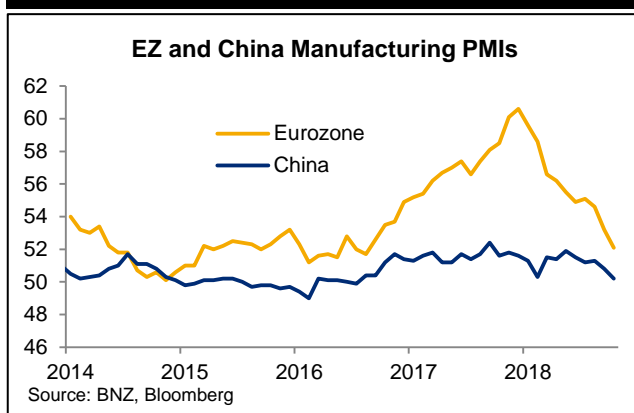
NZD/JPY fell by more than 2% as the yen benefited from safe-haven flows. The TWI was flat for the month.

In commodity markets, oil prices continued their strong run early in the month. Brent crude went up through USD86 per barrel, a multi-year high, as concerns about supply and a tight market predominated, but then prices proceeded to come crashing down, ending the month around \$75.50, down 13% from its peak. Saudi Arabia's energy minister said that OPEC and its allies are in “produce as much as you can mode”.

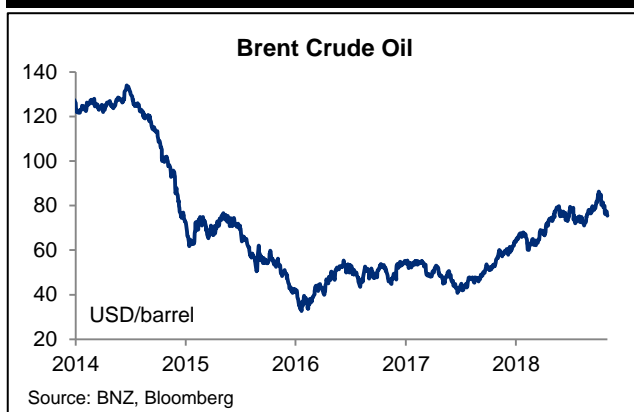
Risk Appetite Plunges to a 2-Year Low



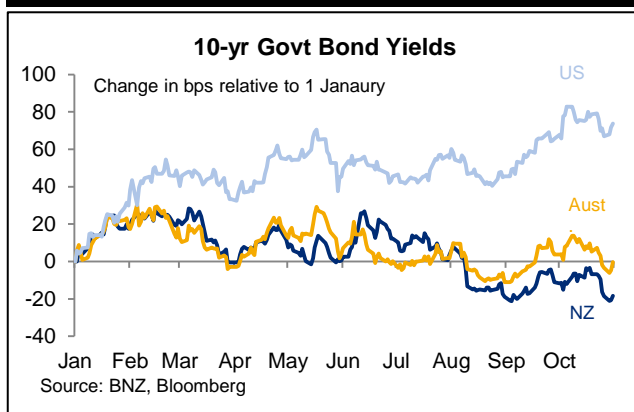
Weaker Global PMIs



A Multi-Year High For Oil Prices Before Plunging



A Fresh High for US Rates; NZ Rates Lower



In the rates market the US 10-year Treasury rate reached a 7-year high of 3.26%, before tumbling equity markets saw a retreat. Still, influenced by strong economic data and Fed Chair Powell's comments earlier in the month, the 10-year rate ended up 8bps higher for the month. The NZ rates market performed well under the circumstances, including the much higher NZ CPI figure and stronger activity data. Long term swap and bond rates were 6-7bps lower for the month, extending NZ-US rate spreads further into negative territory.

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Monthly Performance Table							
	end-Oct	end-Sep	Change		end-Oct	end-Sep	Change
Currencies				NZ Rates			
NZD/USD	0.6517	0.6619	-1.5%	OCR	1.75	1.75	0.00
NZD/AUD	0.9214	0.9166	0.5%	NZ 90day BB	1.93	1.92	0.01
NZD/EUR	0.5760	0.5706	0.9%	NZ 2yr sw ap	2.02	2.04	-0.02
NZD/GBP	0.5105	0.5084	0.4%	NZ 5yr sw ap	2.33	2.40	-0.06
NZD/JPY	73.60	75.27	-2.2%	NZ 10yr sw ap	2.83	2.90	-0.06
NZD/CNY	4.546	4.5496	-0.1%	NZ Govt (4/21)	2.38	2.44	-0.06
TWI	72.0	72.1	-0.1%	NZ Govt (4/23)	1.94	1.98	-0.04
AUD/USD	0.7073	0.7224	-2.1%	NZ Govt (4/27)	2.38	2.44	-0.06
EUR/USD	1.1312	1.1604	-2.5%	NZ Govt (4/29)	2.54	2.61	-0.07
GBP/USD	1.2766	1.3031	-2.0%	Global 10 year bond rates			
USD/JPY	112.94	113.70	-0.7%	US	3.14	3.06	0.08
USD/CNY	6.98	6.87	1.6%	Canada	2.49	2.43	0.07
USD/CAD	1.3157	1.2908	1.9%	UK	1.44	1.57	-0.14
USD TWI major	119.35	117.19	1.8%	France	0.75	0.80	-0.05
Asia DXY	103.23	104.80	-1.5%	Germany	0.38	0.47	-0.09
Equity Markets				Italy	3.43	3.15	0.28
MSCI AC Wrld, loc.	1,152	1,237	-6.9%	Spain	1.55	1.50	0.05
MSCI World, loc.	6,377	6,840	-6.8%	Portugal	1.87	1.87	0.00
MSCI EM, USD	2,132	2,335	-8.7%	Ireland	0.95	0.98	-0.03
US S&P 500	2,712	2,914	-6.9%	Japan	0.12	0.12	0.00
Euro STOXX 600	361.6	383.2	-5.6%	Australia	2.63	2.67	-0.04
Germany DAX	11,448	12,247	-6.5%	Commodities (USD)			
France CAC 40	5,093	5,493	-7.3%	WTI Crude	65.31	73.25	-10.8%
UK FTSE 100	7,128	7,510	-5.1%	Brent Crude	75.47	82.72	-8.8%
Aust S&P/ASX 200	5,830	6,208	-6.1%	R/B CRB Index	191.0	195.2	-2.1%
Japan Topix	1,646	1,817	-9.4%	Gold spot	1,215	1,191	2.0%
China CSI 300	3,154	3,439	-8.3%	Silver spot	14.25	14.66	-2.8%
NZX50	8,752	9,351	-6.4%	Copper	265.9	280.5	-5.2%
Volatility: VIX	21.23	12.12	75.2%	Iron Ore	73.96	67.77	9.1%
3-mth Bill Futures				Coking coal	220.00	200.75	9.6%
NZD Jun-19	98.05	98.01	0.04	Thermal coal	105.20	113.85	-7.6%
AUD Jun-19	98.06	98.03	0.03	Corn	363.3	356.3	2.0%
USD Jun-19	96.96	97.01	-0.05	Wheat	500.5	509.0	-1.7%
EUR Jun-19	100.29	100.26	0.03	NZX Dairy WMP	2,655	2,750	-3.5%
GBP Jun-19	98.99	98.95	0.04	NZX Milk Price 2019	NZD 6.2	NZD 6.27	-1.1%

Source: BNZ, Bloomberg

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