

RESEARCH

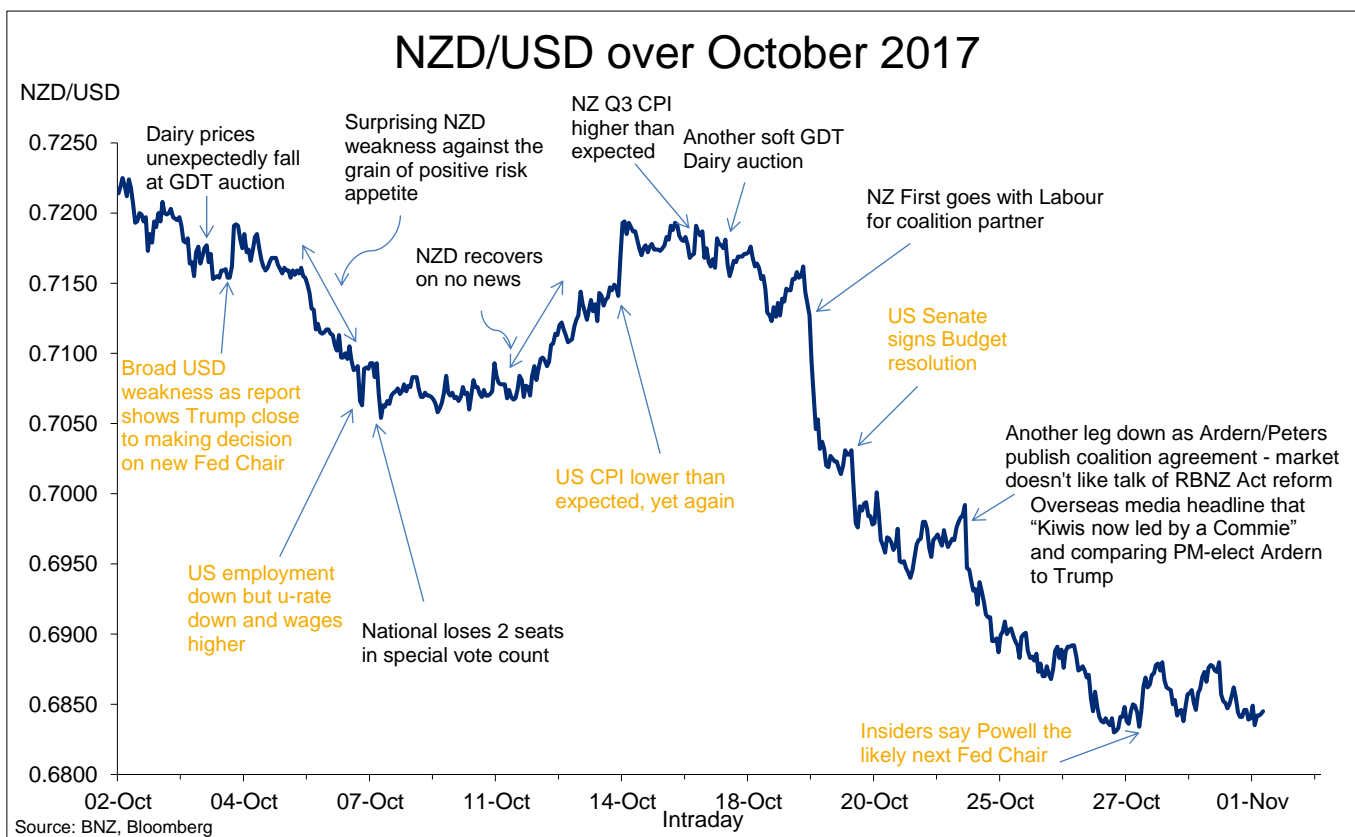
FINANCIAL MARKETS WRAP

1 November 2017



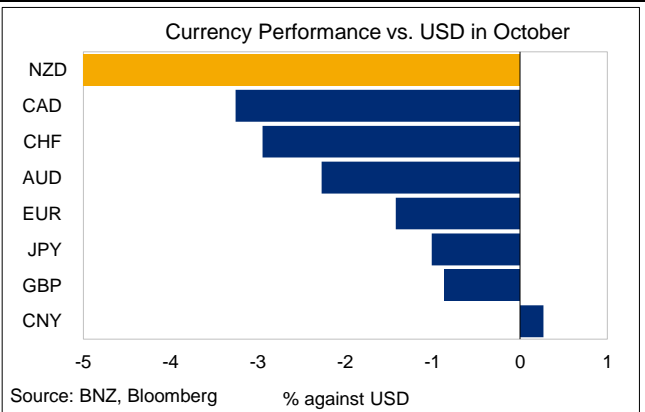
Domestic politics weigh on NZD

- NZD down 4½% on TWI basis on political change and uncertainty
- NZ rates lower post-election; NZ equities higher
- USD and US rates higher

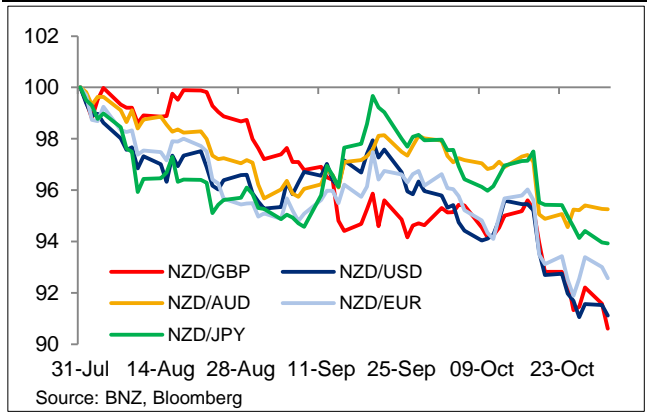


Quick Outlook		October ranges
NZD/USD	NZD looks oversold on domestic political forces so it wouldn't be surprising to see a recovery of sorts over the coming month if the positive global backdrop can continue.	0.6820 – 0.7230
NZD/AUD	Looking a little oversold on this cross due to domestic political forces, so the path of least resistance is a nudge back up into the low 0.90s.	0.8855 – 0.9215
NZD/GBP	BoE language around its expected rate hike this week will set the theme for the month. Soft UK economic outlook is an outlier amidst a stronger global economy, which should limit any GBP upside. UK Budget 22 November won't look flash.	0.5150 – 0.5450
NZD/EUR	We still like EUR despite the ECB's best efforts to give the impression that QE might last longer than previously thought. Positive fundamentals will drive a higher EUR but over the near term the NZD looks a little over-sold.	0.5810 – 0.6140
NZD/JPY	An NZD recovery from its oversold level and higher global rates into year-end would support a return to around 80. Main threat to that would be a lurch down in risk appetite.	77.4 – 81.4
90-day BB	Flat, with little chance of monetary policy adjustment over coming months.	1.92% - 1.97%

NZD Clearly Underperforms in October



NZD Lower on Key Crosses Over Last Quarter



NZD down sharply on Labour-NZ First coalition

NZ First Leader Peters' 19 October decision to form a coalition government with Labour was a defining moment for the NZD, seeing it tumble and face significant selling pressure for much of the rest of the month. We saw a broadly based reduction, resulting in a fall in the TWI of near 4½% for the month and falls on the major crosses in the order of 3-5%. While Peters' decision was always going to be a close-call and local commentators tended not to have any conviction about which way he'd go, clearly the market was positioned for a National-led government. CFTC data suggested net long NZD speculative positions ahead of the announcement, albeit much reduced from a few months ago. The NZD reached a low of 0.6818, matching the intra-day low set in May and making this area a key level of support.

Policy detail lacking

The information vacuum did not help sentiment for the NZD. The currency had another lurch down after the coalition agreement signed between Labour and NZ First lacked detail. The market seemed most concerned about the potential reform of the RBNZ Act, lower immigration and restrictions on foreign investment. While the parties provided broad parameters for these areas, the market was awaiting further detail.

Inflation expectations increase

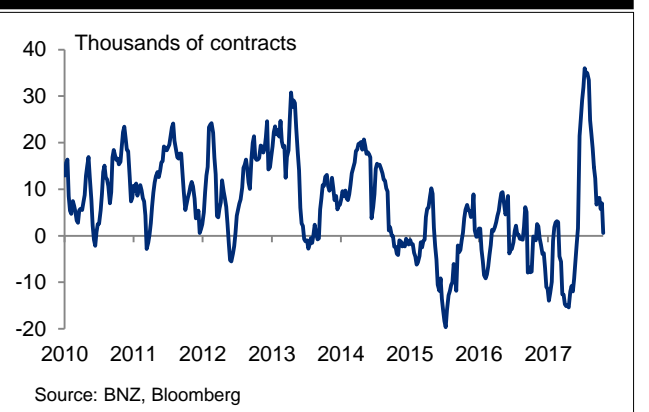
The local rates market saw the new government as adding to long-term inflationary pressure and seemed to believe that reform of the RBNZ Act would allow the Bank to sit back and allow higher inflation to develop. Implied break-even inflation rates on inflation-linked bonds rose in the order of 20bps for the month. NZ's 2-year swap rate fell by 6bps to 2.15%, with the market believing that any RBNZ tightening this cycle would be pushed out. Bond-swap spreads widened on the view of increased debt issuance to pay for the new government's promises, but the NZ-US 10-year government bond spread remained near the lower end of its trading range, supported by lower rate spreads at the short end of the curve, reflecting different paths for monetary policy. The NZ equity market was unperturbed by the election result and government formation. The NZX-50 index ended the month 2.7% higher, in line with global equities.

Higher NZ equities

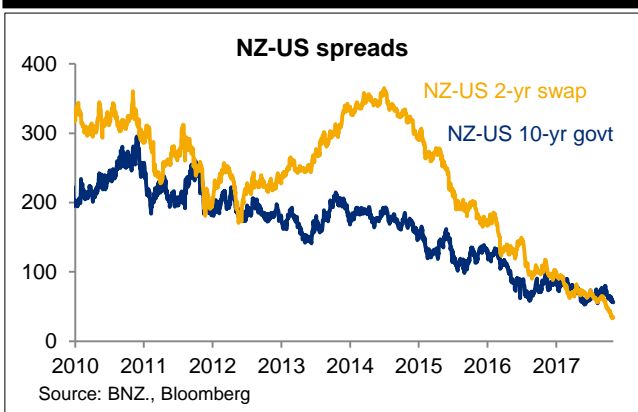
Lower dairy prices

Ahead of Peters' announcement the NZD had been trading flat to down, with weaker dairy prices getting the market's attention. NZX whole milk powder futures were down in the order of 10% for the month and the milk price future for the current season fell by 5% to \$6.40. BNZ was amongst others downgrading Fonterra's milk payout given the backdrop of weaker dairy pricing.

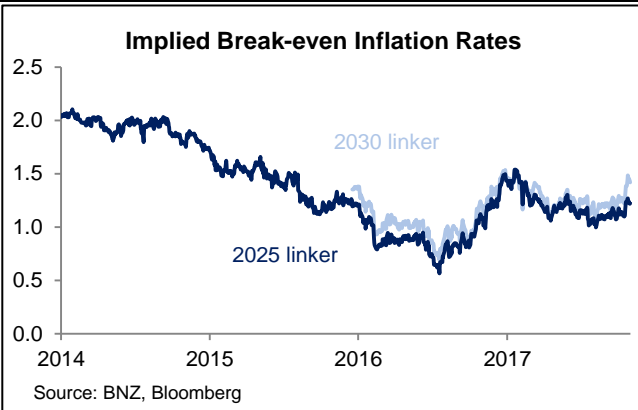
Speculative Net-long NZD Positions Closed



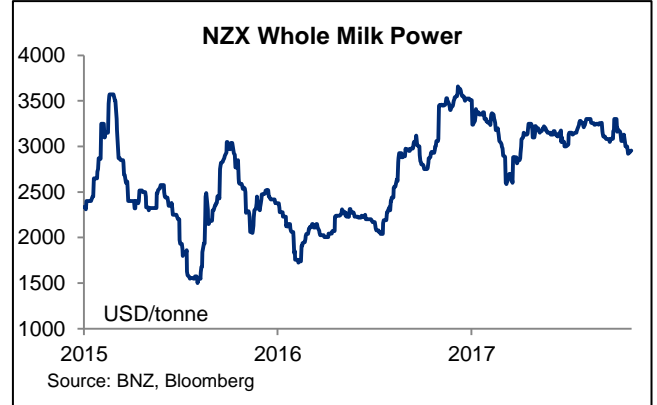
NZ-US Rate Spreads Narrow



Inflation Expectations on the Rise



Dairy Prices Heading South



Positive USD news

The USD performed well, with the USD majors TWI up 2%. Citigroup’s US economic surprise indicator continued to rise sharply, fully unwinding the lurch down earlier this year, reflecting the stronger than expected dataflow. There was increased confidence that some sort of tax reform package would see the light of day, as both the US Senate and Congress signed off a budget resolution, clearing the first hurdle for tax reform to proceed. Despite another month of soft US CPI data, the generally positive dataflow and tax reform hopes led to increased expectations of Fed hikes ahead.

AUD down as rate hike expectations pushed out

AUD was on the soft side, not helped by iron ore prices falling another 6% taking them down to a 4-month low and projected RBA rate hikes priced out of the curve, with the Australian 2-year swap rate down 12bps for the month. Q3 CPI inflation was lower than expected and RBA officials were in no mood to break away from a decisively neutral stance. AUD/USD fell to levels not seen since July, and was down over 2% for the month. NZD/AUD reached a 19-month low of 0.8856 before regaining some composure to end the month down less than 3% to 0.8944.

CNY flat

China’s 5-yearly Communist Party Congress drew to a close, with the party approving a sweeping charter revision that elevates President Xi’s status, declaring him the party’s “core” leader indefinitely. That did not seem to raise any eyebrows and there was little reaction in the currency market, with CNY flat for the month. Xi emphasised quality of growth and the environment, rather than setting any quantitative target for growth.

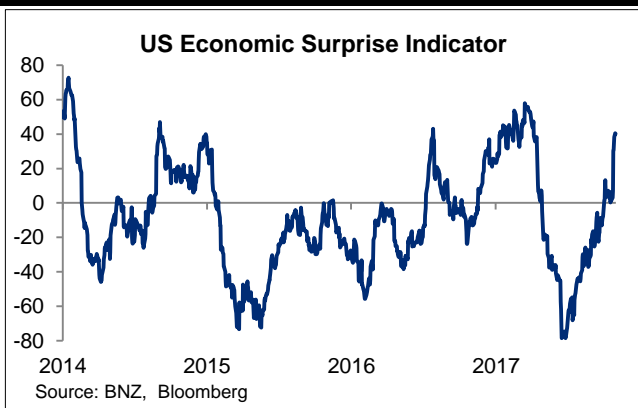
ECB offers a “dovish taper”

EUR was impacted to some extent by political risk emanating from Spain, with rebel republic Catalan moving to declare independence after its illegal referendum and the end result being Spain’s Administration ousting the regional government and announcing fresh elections for the region. But EUR weakness for the month was more impacted by the ECB’s “dovish” taper of its asset purchase programme, keeping it open-ended, delaying the likelihood of any possible rate hike into 2019.

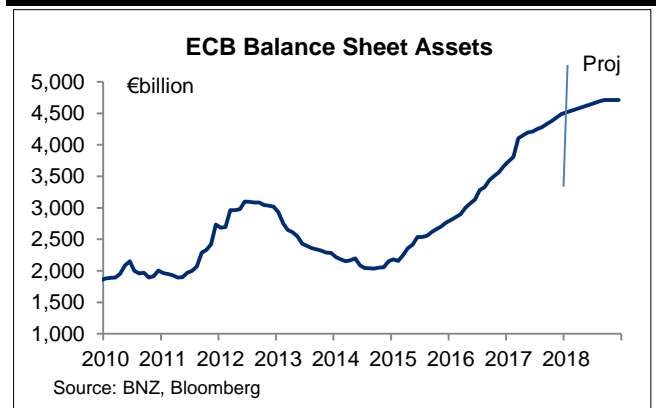
BoE set to hike rates

GBP ebbed and flowed against the backdrop of Brexit negotiations and speculation about whether some transitional deal might be arranged to avoid the March 2019 cliff-edge scenario. By month-end a BoE rate hike for early November, the first in a decade, was all but priced, giving GBP some support, even as its economic indicators lagged the positive momentum seen in many global indicators.

US Economic Dataflow Continues to Improve



ECB Bond Buying Continues At Least Another Year



US rates higher US Treasury rates were higher on the back of the positive economic dataflow and increased confidence of tax reform ahead. An added source of volatility was speculation about Trump's appointment for the next Fed Chair. The US 10-year Treasury rate broke up through the important 2.40% technical level, and reached as high as 2.47% before falling back down to 2.38%, up 5bps for the month. Near the end of the month current Fed board governor Powell looked to have the inside running for the job over the more hawkish Taylor.

JPY continued to be joined at the hip with US 10-year rates. USD/JPY reached highs around 114.45 as US 10-year rates peaked around the 2.47% mark.

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Monthly Performance Table							
	end-Oct	end-Sep	Change		end-Oct	end-Sep	Change
Currencies				NZ Rates			
NZD/USD	0.6847	0.7209	-5.0%	OCR	1.75	1.75	0.00
NZD/AUD	0.8944	0.9202	-2.8%	NZ 90day BB	1.95	1.96	-0.02
NZD/EUR	0.5878	0.6103	-3.7%	NZ 2yr sw ap	2.15	2.22	-0.06
NZD/GBP	0.5155	0.5381	-4.2%	NZ 5yr sw ap	2.62	2.75	-0.13
NZD/JPY	77.79	81.12	-4.1%	NZ 10yr sw ap	3.15	3.27	-0.12
NZD/CNY	4.540	4.7837	-5.1%	NZ Govt (4/20)	2.01	2.09	-0.08
TWI	72.8	76.2	-4.4%	NZ Govt (4/23)	2.44	2.54	-0.10
AUD/USD	0.7656	0.7834	-2.3%	NZ Govt (4/27)	2.92	2.97	-0.05
EUR/USD	1.1646	1.1814	-1.4%	Global 10 year bond rates			
GBP/USD	1.3283	1.3398	-0.9%	US	2.38	2.33	0.05
USD/JPY	113.64	112.51	1.0%	Canada	1.95	2.10	-0.15
USD/CNY	6.64	6.65	-0.3%	UK	1.33	1.36	-0.03
USD/CAD	1.2888	1.2472	3.3%	France	0.75	0.74	0.01
USD TWI major	116.48	114.21	2.0%	Germany	0.36	0.46	-0.10
Asia DXY	107.62	107.23	0.4%	Italy	1.83	2.11	-0.28
Equity Markets				Spain	1.45	1.60	-0.14
MSCI AC Wrld, loc.	1,137	1,107	2.7%	Portugal	2.06	2.36	-0.31
MSCI World, loc.	6,214	6,058	2.6%	Ireland	0.57	0.73	-0.16
MSCI EM, USD	2,428	2,346	3.5%	Japan	0.06	0.06	0.00
US S&P 500	2,575	2,519	2.2%	Australia	2.67	2.84	-0.17
Euro STOXX 600	395.2	388.2	1.8%	Commodities (USD)			
Germany DAX	13,230	12,829	3.1%	WTI Crude	54.38	51.95	4.7%
France CAC 40	5,503	5,330	3.3%	Brent Crude	60.94	56.59	7.7%
UK FTSE 100	7,493	7,373	1.6%	R/B CRB Index	187.6	183.1	2.4%
Aust S&P/ASX 200	5,909	5,682	4.0%	Gold spot	1,271	1,280	-0.6%
Japan Topix	1,766	1,675	5.4%	Silver spot	16.72	16.66	0.4%
China CSI 300	4,007	3,837	4.4%	Copper	310.1	295.5	4.9%
NZX50	8,146	7,930	2.7%	Iron Ore	58.52	62.05	-5.7%
Volatility: VIX	10.18	9.51	7.0%	Coking coal	173.50	166.00	4.5%
3-mth Bill Futures				Thermal coal	99.90	97.25	2.7%
NZD Jun-18	97.95	97.91	0.04	Corn	345.8	355.3	-2.7%
AUD Jun-18	98.19	98.04	0.15	Wheat	418.5	448.3	-6.6%
USD Jun-18	98.24	98.30	-0.06	NZX Dairy WMP	2,955	3,300	-10.5%
EUR Jun-18	100.32	100.29	0.02	NZX Milk Price 2018	NZD 6.4	NZD 6.75	-5.2%
GBP Jun-18	99.24	99.23	0.01				

Source: BNZ, Bloomberg

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