

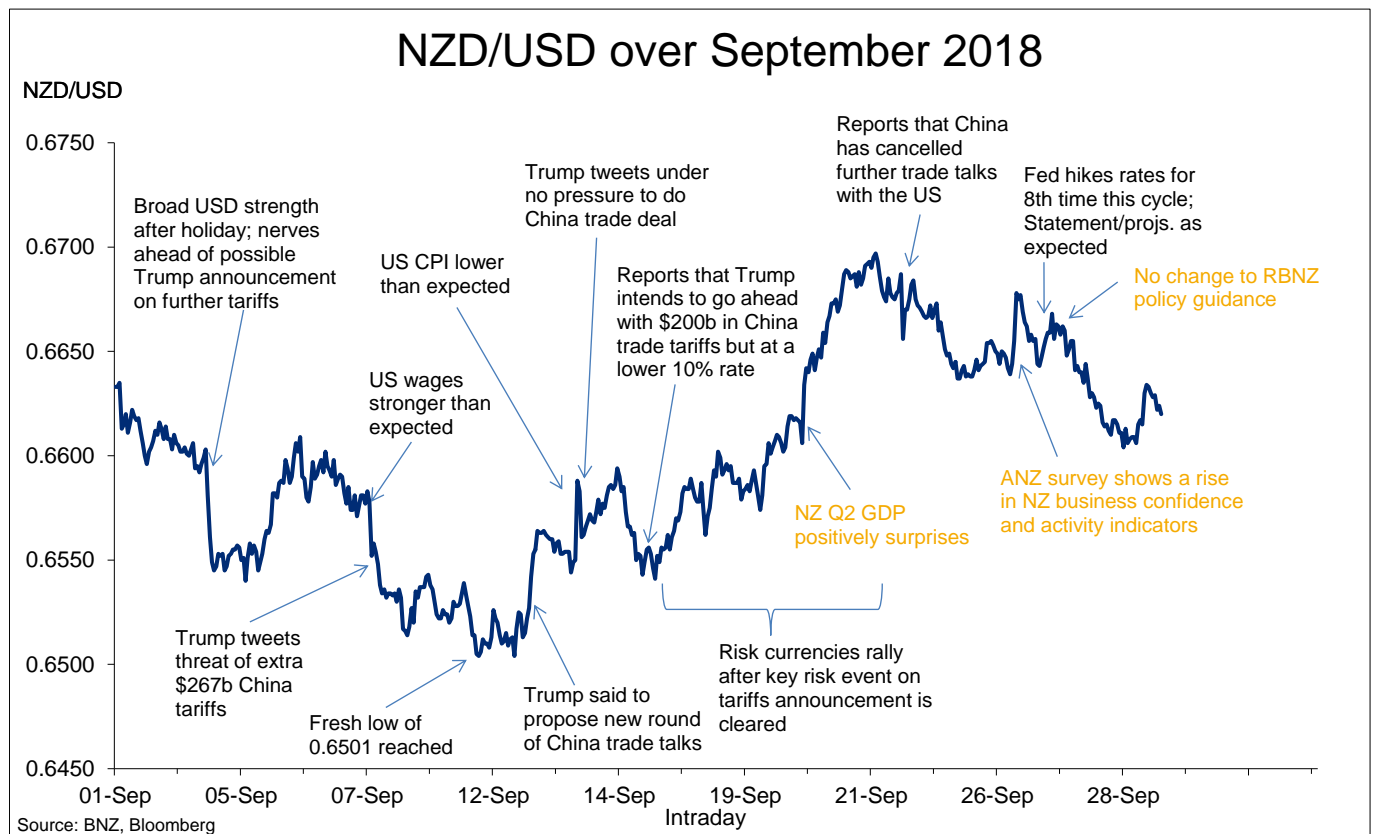
# RESEARCH FINANCIAL MARKETS WRAP

1 October 2018



## NZD Flat In September

- NZD reached a multi-year low during September but ended the month flat
- Yen under pressure, sees higher NZD/JPY but other NZD crosses flat
- Higher interest rates for the month, while NZ-US rate spreads reach a record low



Quick Outlook		September ranges
NZD/USD	Trading at a significant discount to our FV model (0.70) but fundamental forces remain negative, the latest being a rise in oil prices or a negative terms of trade shock. Hard to see much prospect for a decent recovery over the near-term and the greater near-term risk is that the downtrend remains intact.	0.6500 – 0.6700
NZD/AUD	Still range trading, with support just under 0.90. A further rise in oil prices would represent a negative factor for the cross and challenge the support level.	0.9075 – 0.9210
NZD/GBP	Brexit headlines will intensify over coming months and a range of outcomes from dire to good remain possible. Too hard to call over the short-term.	0.4990 – 0.5145
NZD/EUR	We continue to see the path of least resistance as one of further modest downside pressure over the medium term. Near-term Italian risks should eventually be reversed.	0.5610 – 0.5720
NZD/JPY	Recent yen weakness has been somewhat surprising. Medium-term pressure remains to the downside as the yen remains super-cheap and we're overdue for a fall in risk appetite that would foster a lower near-term cross.	72.3 – 75.5
90-day BB	Flat, with little chance of monetary policy adjustment over coming months.	1.89% - 1.93%

US-China trade tensions dominated during the month. A focal point was Trump's decision on Chinese import tariffs after the period of public consultation ended early in the month. Trump threatened to impose tariffs on all Chinese imports and this contributed to further weakness in emerging market currencies, which helped drag the NZD down to a fresh 2½-year low of 0.6501.

In the event, Trump opted for a more moderate 10% tariff on an additional \$200b of Chinese imports, lower than the 25% figure mooted. However, the higher rate will apply from 1 January if no progress is made on trade negotiations. China immediately retaliated with 5-10% tariffs on \$60b of US imports, lower than the prior top-of-the-range 25%. The lower tariff imposts helped support a broad rally in risk assets, with emerging market currencies recovering and the NZD going along for the ride. By month-end, US-China relationships didn't look good, with no further trade talks scheduled and President Trump accusing China of meddling in US elections.

Supporting a recovery in the NZD from its low, Q2 GDP data positively surprised, coming in at 1.0% q/q, well above RBNZ expectations of 0.5%. Furthermore, the ANZ business outlook survey showed some recovery in business confidence and activity indicators, a welcome reprieve from the prior disturbing downward trend. The RBNZ considered these reports at its September OCR Review and concluded that its projection for the economy was little changed. The Bank repeated its August comments that the direction of the next OCR move could be up or down and that it expected to keep the OCR unchanged through 2019 and into 2020.

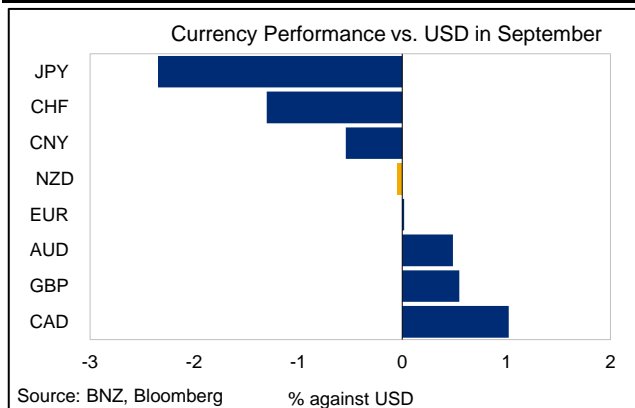
Some of the support for emerging market currencies and the NZD reflected the fact that the USD struggled to push higher after its strong run over the prior few months.

The key USD indices were flat for the month despite a good run of economic data suggesting an ever-tightening labour market and stronger wage inflation than expected. Conviction in Fed rate hikes increased through the month, with almost another full rate hike over the next couple of years priced into the curve. This was reflected in the 19bps rise in the US 2-year Treasury rate and the 20bps rise in the 10-year rate. As expected, at its September meeting the Fed hiked rates by 25bps for the eighth time this cycle, while the projections showed some conviction of another rate rise in December, while keeping another three hikes projected through 2019.

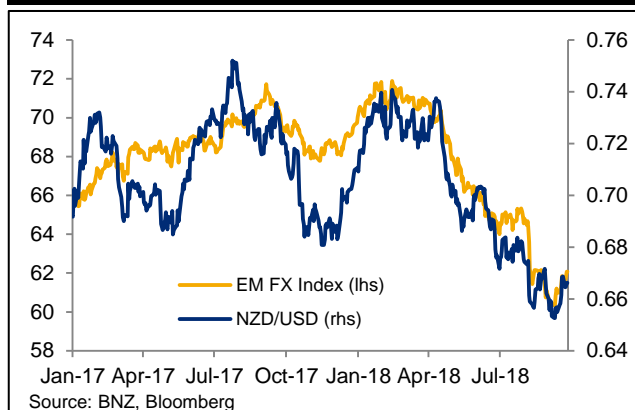
The recovery in the NZD wasn't sustained and it fell over the final week as the USD showed broad-based strength heading into month-end. The NZD ended the month close to where it began at 0.6620.

In commodity markets, Brent oil prices reached their highest level since 2014, blasting up through USD82 per barrel as supply shortages overhang the market. OPEC left production steady after its last gathering and the market worried that US sanctions against Iran and outages in Venezuela would lead to supply shortages, while infrastructure bottlenecks in the US limited increased supply there.

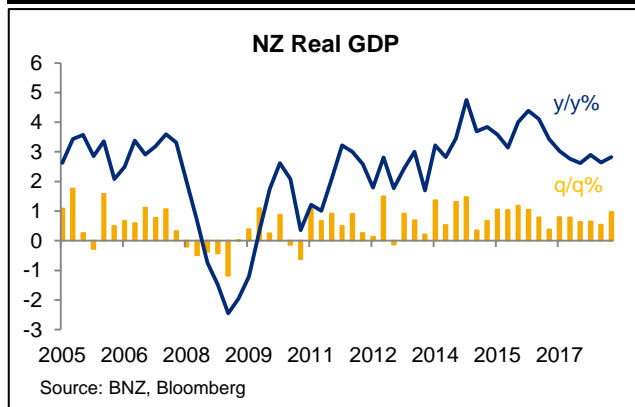
Small Movements in FX; Yen Notably Underperformed



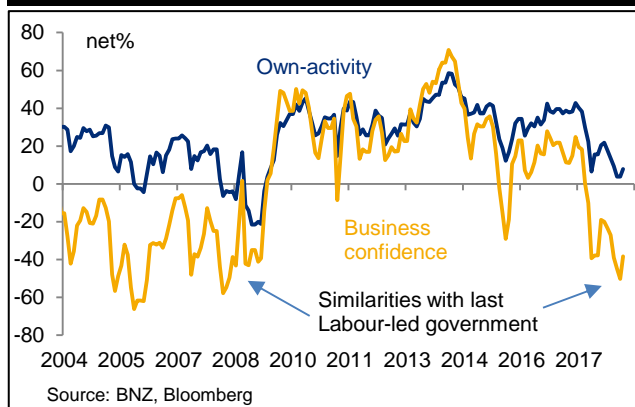
NZD Follows EM Currencies Through 2018



A Stronger NZD GDP Figure for Q2



NZ Business Confidence Stops Falling



Wholemilk powder prices continued to fall in September, with NZX futures dipping below USD2700 per tonne at one stage and down about 13% over the past quarter. The combination of falling dairy prices and rising oil prices is negative for NZ's terms of trade. Citigroup's NZ commodity terms of trade index showed a substantial fall over the month and quarter and goes some way in explaining the weaker NZD over recent months.

CAD was the strongest of the majors, supported by stronger oil prices and hope that a new NAFTA deal would soon be agreed, although at month-end agreement had still not been reached. GBP performed better than other currencies, as optimism grew that the UK and EU could cobble together a deal on Brexit and sign up to a Withdrawal Agreement by October or November. However, there was a distinct lack of progress at the Salzburg summit and UK PM May agreed that the UK and EU were at an impasse. Despite GBP losing 1.5% on the day after the summit, it still ended up 0.5% for the month.

EUR was flat for the month and so was NZD/EUR. Late in the month, the common currency suffered as focus returned to Italian budget negotiations, with the end result being a larger-than-expected projected fiscal deficit. By month-end there were lingering concerns about a downgrade to Italian debt and the spillover implications this might have for the wider euro-area.

The AUD essentially followed the same path of the NZD during the month, largely driven by sentiment for emerging market currencies. NZD/AUD was range bound, spending most of the month between 0.91-0.92.

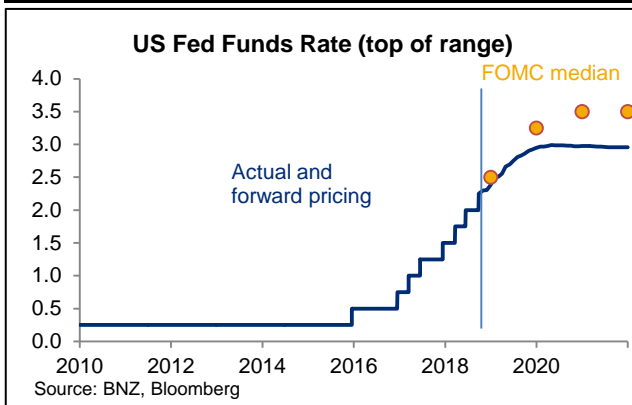
JPY was the weakest of the majors by far, reflecting the more risk-loving backdrop. Our risk appetite index rose by 8 percentage points to 73%, reflecting narrower emerging market and high yield credit spreads, while the VIX index tracked down towards 12. A softer yen also reflected higher global bond rates against the BoJ's policy of keeping JGB yields low and there was evidence of domestic Japanese investors seeking the higher yield of foreign currency bonds. NZD/JPY ended the month nearly 2½% higher.

A weaker CNY went against the grain of stronger emerging market currencies. The PBoC was probably content in seeing its currency weaken against the backdrop of increased economic risks stemming from the US import tariffs.

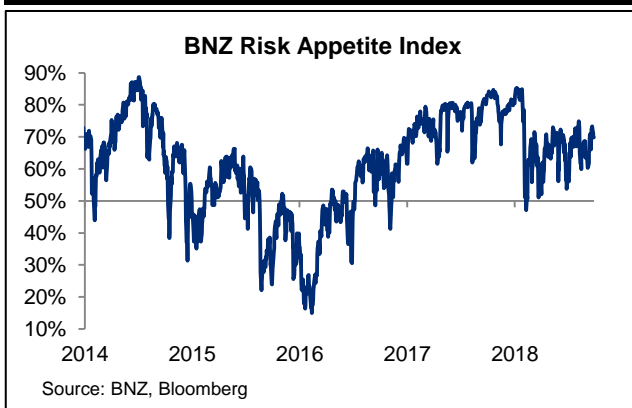
Higher global rates put upward pressure on the NZ curve although NZ bonds continued to outperform, with the 7-8bps rise in 5-10 year swap and government rates moderate compared to the approximate 20bps rise in the US Treasury curve. On our calculations the NZ-US 10-year government spread reached a record low around minus 45bps. Some of the rise in NZ short rates reflected the stronger NZ GDP data. After that report, the market priced in a reduced chance of easier monetary policy over the coming year. For the month, the June-19 bill futures fell 7bps and the 2-year swap rate was up 6bps to 2.04%.

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

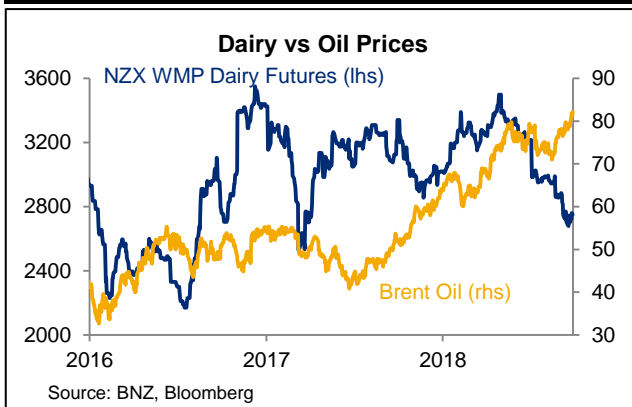
Fed Funds Rate on a Clear Upward Path



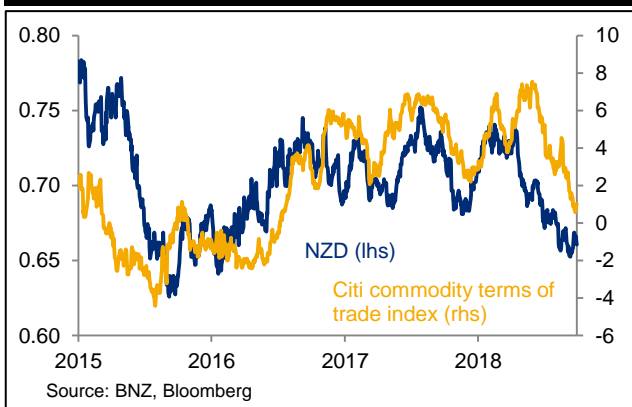
Risk Appetite Up in September And Still Above Average



Higher Oil, Lower Dairy Prices



NZ's Commodity Terms of Trade Weaken



## Monthly Performance Table

	end-Sep	end-Aug	Change		end-Sep	end-Aug	Change
<b>Currencies</b>				<b>NZ Rates</b>			
NZD/USD	0.6619	0.6622	0.0%	OCR	1.75	1.75	0.00
NZD/AUD	0.9166	0.9206	-0.4%	NZ 90day BB	1.92	1.91	0.01
NZD/EUR	0.5706	0.5706	0.0%	NZ 2yr sw ap	2.04	1.98	0.06
NZD/GBP	0.5084	0.5109	-0.5%	NZ 5yr sw ap	2.40	2.32	0.08
NZD/JPY	75.27	73.54	2.4%	NZ 10yr sw ap	2.90	2.83	0.07
NZD/CNY	4.550	4.5216	0.6%	NZ Govt (4/21)	2.44	2.37	0.07
TWI	72.1	72.0	0.1%	NZ Govt (4/23)	1.98	1.91	0.08
AUD/USD	0.7224	0.7189	0.5%	NZ Govt (4/27)	2.44	2.37	0.07
EUR/USD	1.1604	1.1602	0.0%	NZ Govt (4/29)	2.61	2.53	0.08
GBP/USD	1.3031	1.2960	0.5%	<b>Global 10 year bond rates</b>			
USD/JPY	113.70	111.03	2.4%	US	3.06	2.86	0.20
USD/CNY	6.87	6.83	0.5%	Canada	2.43	2.23	0.20
USD/CAD	1.2908	1.3040	-1.0%	UK	1.57	1.43	0.15
USD TWI major	117.19	117.21	0.0%	France	0.80	0.68	0.12
Asia DXY	104.80	105.09	-0.3%	Germany	0.47	0.33	0.14
<b>Equity Markets</b>				Italy	3.15	3.24	-0.09
MSCI AC Wrlld, loc.	1,237	1,230	0.6%	Spain	1.50	1.47	0.03
MSCI World, loc.	6,840	6,788	0.8%	Portugal	1.87	1.92	-0.04
MSCI EM, USD	2,335	2,347	-0.5%	Ireland	0.98	0.85	0.13
US S&P 500	2,914	2,902	0.4%	Japan	0.12	0.10	0.02
Euro STOXX 600	383.2	382.3	0.2%	Australia	2.67	2.52	0.15
Germany DAX	12,247	12,364	-0.9%	<b>Commodities (USD)</b>			
France CAC 40	5,493	5,407	1.6%	WTI Crude	73.25	69.37	5.6%
UK FTSE 100	7,510	7,432	1.0%	Brent Crude	82.73	77.40	6.9%
Aust S&P/ASX 200	6,208	6,319	-1.8%	R/B CRB Index	195.2	193.0	1.1%
Japan Topix	1,817	1,735	4.7%	Gold spot	1,191	1,201	-0.9%
China CSI 300	3,439	3,335	3.1%	Silver spot	14.66	14.54	0.8%
NZX50	9,351	9,313	0.4%	Copper	280.5	264.9	5.9%
Volatility: VIX	12.12	12.86	-5.8%	Iron Ore	68.11	65.93	3.3%
<b>3-mth Bill Futures</b>				Coking coal	201.50	187.00	7.8%
NZD Jun-19	98.01	98.08	-0.07	Thermal coal	113.85	118.00	-3.5%
AUD Jun-19	98.03	98.05	-0.02	Corn	356.3	365.0	-2.4%
USD Jun-19	97.01	97.14	-0.13	Wheat	509.0	545.5	-6.7%
EUR Jun-19	100.26	100.25	0.00	NZX Dairy WMP	2,750	2,850	-3.5%
GBP Jun-19	98.95	98.95	0.00	NZX Milk Price 2019	NZD 6.27	NZD 6.51	-3.7%

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

**ANALYST DISCLAIMER:** The person or persons named as the author(s) of this report hereby certify that the views expressed in the research report accurately reflect their personal views about the subject securities and issuers and other subject matters discussed. No part of their compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in the research report. Research analysts responsible for this report receive compensation based upon, among other factors, the overall profitability of the Markets Division of National Australia Bank Limited, a member of the National Australia Bank Group ("NAB"). The views of the author(s) do not necessarily reflect the views of NAB and are subject to change without notice. NAB may receive fees for banking services provided to an issuer of securities mentioned in this report. NAB, its affiliates and their respective officers, and employees, including persons involved in the preparation or issuance of this report (subject to the policies of NAB), may also from time to time maintain a long or short position in, or purchase or sell a position in, hold or act as advisors, brokers or commercial bankers in relation to the securities (or related securities and financial instruments), of companies mentioned in this report. NAB or its affiliates may engage in these transactions in a manner that is inconsistent with or contrary to any recommendations made in this report.

**NEW ZEALAND DISCLAIMER:** This publication has been provided for general information only. Although every effort has been made to ensure this publication is accurate the contents should not be relied upon or used as a basis for entering into any products described in this publication. Bank of New Zealand strongly recommends readers seek independent legal/financial advice prior to acting in relation to any of the matters discussed in this publication. Neither Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication.

**US DISCLAIMER:** If this document is distributed in the United States, such distribution is by nabSecurities, LLC. This document is not intended as an offer or solicitation for the purchase or sale of any securities, financial instrument or product or to provide financial services. It is not the intention of nabSecurities to create legal relations on the basis of information provided herein.

**National Australia Bank Limited is not a registered bank in New Zealand.**