

21 February 2012

NZD

The NZD has started the week on the front foot. After shooting higher yesterday morning, the NZD/USD spent the overnight session consolidating in a 0.8385-0.8430 range.

Currency markets were fairly quiet overnight. Investors were reluctant to tip their toe in the water ahead of an expected announcement on the second Greek bailout package (possibly around noon NZ time).

Still, optimism a Greek deal could be just around the corner kept investors' risk appetite underpinned. European equity markets and the EUR/USD scratched out modest gains through the offshore session.

It's worth noting, NZ interest rate differentials widened noticeably yesterday. This mostly reflects a jump in local swap rates (see *Fixed Interest* section), against stable offshore interest rates. NZ-US 3-year swap spreads leapt from 245bps to 259bps, while the NZ-AU equivalent rose from -122bps to -112bps. This boost to the relative yield attractiveness of the NZD amounts to increased "fundamental" support for the currency. Indeed, plugging the higher NZ-US rate spreads into our short-term valuation model sees NZD/USD "fair-value" move up by around ½ cent, to a 0.7450-0.7750 range. This all tends to fit with our view that further gains are in the offing for the NZD/USD this week.

Looking ahead, markets' immediate focus is Greece. Should a second bailout deal be announced today, expect "risk-sensitive" assets like the NZD to outperform. However, there's also some local event risk to watch for.

Across the Tasman, it's an RBA-fest today with the February minutes released at 1:30pm (NZ time) followed by a speech from Governor Stevens at 3:30pm. Should either of these events cause markets to reassess the 40bps of easing still expected from the RBA, the AUD/USD and AUD/NZD could track higher.

Closer to home, today's inflation expectations survey will be the main event of the NZ data week. We're looking for the key 2-year ahead annual CPI expectation in the survey to edge down only a tad, from its very elevated 2.8% reading in November. We suspect the RBNZ will be looking (hoping?) for a more marked fall.

Majors

The USD continued to weaken against most of the major currencies overnight. However, trading volumes were relatively light and most currencies traded relatively tight ranges.

For the most part, markets remain in a holding pattern,

awaiting news on Greece. European finance ministers are still locked in meetings negotiating the terms of the second Greek bailout. Reports suggest a press conference will be held around midday NZ time today.

Despite a dearth of news, market sentiment has generally retained a rosy hue. Early reports of progress on Greece's bailout package (including agreement on lowering the interest rates on Greece's first EU/IMF bailout) helped investors' mood, as did a surprise spike in Italian industrial orders (5.5% m/m vs. 0.4% expected).

European equity markets rose and sovereign credit spreads narrowed. The FTSE index increased 0.7%, the French CAC 40 rose 1%, and the German DAX climbed nearly 1.5%. Oil prices jumped 1.8% and the CRB index (a broad index of global commodity prices) lifted 0.3%.

Broad Greek optimism and improved risk appetite saw the EUR lead most of the major currencies higher. Indeed, the EUR/USD spent the night grinding up towards 1.3300, to trade at around 1.3250 currently. The rest of the majors notched up modest gains of 0.1-1.0% against the USD.

Investors are likely to remain on tenterhooks until an announcement on Greece's bailout deal is made. So keep your eyes on the news wires from around late morning. There is no doubt a deal has been partly priced into markets in recent sessions. However, confirmation of such would still likely spur a relief rally. EUR/USD could easily break through the top of its recent 1.3020-1.3320 range, with "risk-sensitive" currencies like the NZD and AUD likely to share in the gains.

mike_s_jones@bnz.co.nz

Fixed Interest

NZ swap yields broke beyond ranges yesterday, closing up 10-15bps. Bond yields also got dragged up 9bps.

NZ swap yields had a decent leg up yesterday from the open. 2-year yields moved quickly from 2.96% to 3.05% before finding a point of liquidity. They closed at 3.06%, their highest level since early November, with the next resistance level now at 3.20%.

A combination of better NZ data recently, improving global risk appetite, and an RBA that failed to meet market expectations for a rate cut, has seen the market push expectations for RBNZ rate hikes higher. The market now prices 25bps of hikes in the coming year. We expect 75bps, so ultimately yields have further to rise, in our view. Today's RBNZ 2-year-ahead inflation expectations number could give the market further excuse to push yields higher. We expect the reading to nudge down only a tad from the elevated 2.8% November reading.

There were significant moves in the swaps mid curve also, with 5-year yields rising 15bps to 3.78%. Resistance is now seen at the 4.0% level. NZ swap yields have also risen relative to AU equivalents. The NZ-AU 3-year swap spread moved from -122bps to -112bps.

Moves in bonds were slightly less dramatic, though the curve still moved up around 9bps. The yield on NZGB 21s closed at 4.10%. US bonds were not trading overnight due to a US holiday. NZ-US 10-year bond spreads have therefore broken higher to 210bps, their highest level since November. If NZ yields can maintain upward

momentum, independent of contained US yields, the next trading range is 225bps-260bps. We see NZ-US 10-year bond spreads peaking in this range in H2 this year.

Expect upward pressure on NZ yields again today given generally positive sentiment overnight, and solid equity market performance. This could be exacerbated by a stubbornly high inflations expectations reading today.

kymberly.martin@bnz.co.nz

Currencies				US Interest rates				Commodities				Equities					
	Low	High		Open	High	Low	Last	Open	High	Low	Last	Open	High	Low	Last		
NZD	0.8387	0.8417	1 Yr	0.15	0.15	0.15	0.15	Crude	104.65	105.44	104.26	104.9	Wheat	633.0	650.0	631.5	647.8
AUD	1.0747	1.0795	2Yr	0.29	0.29	0.29	0.29	Alti	2178	2190	2150	2164	Sugar	23.73	23.85	23.63	23.8
EUR	1.3183	1.3277	5 Yr	0.86	0.86	0.86	0.86	Copper	8380	8424	8131	8175	Cotton	93.71	94.29	92.39	92.7
GBP	1.5842	1.5881	10 Yr	2.00	2.00	2.00	2.00	Nickel	20000	20300	19410	19625	CRB	0.0	0.0	0.0	317.4
JPY	79.36	79.64	30 Yr	3.15	3.15	3.15	3.15	Gold	1727	1737	1726	1734	GSCI				
Sycom Futures				FX				Asian FX				Equities					
	Open	High	Low	Last	Open	Last		Open	High	Low	Last		Open	Now	chge		
Australia					AUD=	1.0764	1.0751	SGD=	1.2569	1.2570	1.2498	1.25219	Dow	12903	12950	45.8	
3 mth	95.62	95.63	95.6	95.60	NZD=	0.8351	0.8391	IDR=	9031	9045	8997.5	9011	S&P 500	1358.1	1361.2	3.2	
3 Yr	96.29	96.31	96.26	96.27	CAD=	0.9938	0.9931	THB=	30.8	30.8	30.6	30.7	Nasdaq	2958.2	2951.8	-8.1	
10 Yr	95.825	95.85	95.805	95.81	JPY=	79.42	79.52	KRW=	1124	1125	1120	1123	FTSE	5905.1	5945.3	40.2	
NZ					EUR=	1.3163	1.3250	TWD=	29.5	29.6	29.5	29.5	DAX	6892	6948.3	100.2	
3 mth	97.26	97.26	97.26	97.26	GBP=	1.5838	1.5855	PHP=	42.5	42.6	42.4	42.6	SPI (Sycom)				
NZD Crosses				AUD Crosses				NZ Government Bonds				NZ swap yields					
	Last	Previous		Last	Previous		Last	Price		Last	Price		Last	Price			
NZD/EUR	0.6333	0.6333	AUD/EUR	0.8114	0.8153	NZGB 6 1/2 04/15/13	2.626	1 Yr	2.840								
NZD/JPY	66.73	66.21	AUD/JPY	85.48	85.17			2Yr	3.065								
NZD/GBP	0.5292	0.5258	AUD/GBP	0.6780	0.6764	NZGB 5 03/15/19	3.850	5 Yr	3.785								
NZD/AUD	0.7805	0.7773	AUD/NZD	1.2810	1.2865	NZGB 6 05/15/21	4.103	10 Yr	4.515								

Please note the high / low rates are indicative only. They are specific to the trading hours of each asset, which may differ. Please refer to your Dealer for confirmation.

Source: Bloomberg

As at: 7:30

Contact Details

New Zealand	Mike Jones	Currency Strategist	+(64 4) 924 7652
	Kymberly Martin	Strategist	+(64 4) 924 7654
Australia	Peter Jolly	Head of Research	+(61 2) 9237 1406
	Emma Lawson	Currency Strategist	+(61 2) 9237 8154
London	Nick Parsons	Head of Markets Strategy (UK)	+(44 0) 20 7710 2993
	Gavin Friend	Markets Strategist	+(44 0) 20 7710 0898

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.

USA 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.

24 HOUR FOREIGN EXCHANGE SERVICE

Phone Toll Free 6am to 8pm NZT – Wellington Office
0800 739 707 8pm-6am NZT – London Office