

20 February 2012

NZD

The NZD/USD has leapt over ½ cent higher early this morning, to around 0.8390. This follows a surprise Chinese policy easing over the weekend (see *Majors*), which has bolstered investor demand for global “growth-sensitive” assets like the NZD.

Despite the strong start to the week, the NZD/USD remains firmly within the 0.8250-0.8420 range that has contained the currency over the past fortnight.

Last week, global risk sentiment and the NZD/USD were torn between the positives of improving US economic data, and the negatives of the European debt crisis. Our risk appetite index (which has a scale of 0-100%) was chopped around between 55% and 60%. As a result, the NZD/USD continued to track a volatile sideways path.

There was much more action in NZD/JPY. A surprise expansion to the Bank of Japan’s asset purchase (money printing) scheme launched the cross from 64.00 to 7-month highs above 66.00.

It’s a relatively quiet week ahead in terms of the NZ data flow. Tuesday afternoon’s inflation expectations survey will be the main event. 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. Before this, today’s Q4 producer prices are expected to maintain a relatively firm pulse. Also today, we get January’s PSI and the crown accounts to December, which will likely show similar fiscal pressures to the recently released Budget Policy Statement.

None of this should be of any relevance to the NZD. Instead, offshore trends in risk sentiment should continue to dictate the fortunes of the currency. China’s surprise easing and hopes of more to come should continue to underpin investors’ risk appetite this week. What’s more, Europe’s finance ministers are close to (finally) agreeing on a second bailout package for Greece. If approved, this would provide an additional kicker for risk sentiment.

Should positive trends in offshore risk appetite remain intact, the NZD/USD is likely to track higher this week. Resistance at 0.8420 may well be tested. However, keep a close eye on the Greek bailout news. More delays/disappointment on this front would rapidly undermine the “risk-sensitive” NZD/USD. A daily close below support at 0.8250 would suggest the uptrend has run out of steam.

Majors

It was a fairly sleepy session in currency markets on Friday. The USD index simply shuffled sideways in a tight

79.15-79.50 range.

Hopes a second Greek bailout package will be announced this week kept the rally in “risky” assets alive. The EuroStoxx 50 rose 1.2% on Friday, while the S&P500 ticked up a more modest 0.2%. The EUR/USD spent the night consolidating above 1.3100.

A modest upside surprise on January US inflation figures (2.9%/y vs. 2.8% expected) helped USD/JPY finish the week on a strong note, as US interest rates ground higher. Widening US-JP interest rate differentials have been a key “fundamental” ingredient in the USD/JPY’s recent climb. US-JP 2-year bond spreads rose 3bps last week to 18bps, supporting the USD/JPY’s at near 6-month highs around 79.50.

On Saturday, the PBOC announced a surprise 50bp cut in Chinese banks’ reserve requirements. Investors had been hoping for more PBOC easing (which is positive for Chinese growth and therefore supportive of “risk-sensitive” currencies like the NZD and AUD), but were not expecting any action ahead of February’s Chinese economy data. This bringing forward of policy easing has seen the “safe-haven” USD start the week on the back-foot. Meanwhile, the AUD/USD has opened the week almost ¾ cent higher around 1.0760.

Despite January’s spike in Chinese CPI, supporting growth (at or above 8%) still appears to be Beijing policymakers’ biggest priority. As a result, further Chinese policy easing can be expected. This should help cushion any declines in the AUD and NZD in coming months.

Also on Saturday, the Greek parliament passed the extra austerity measures required by the EU to gain access to more bailout cash. The ball is now in the court of the European finance ministers, who meet tonight. Overall, investors are still expecting a bailout deal to be announced tonight or tomorrow. However, there are still plenty of doubters. Indeed, a weekend Reuters report suggested the chances of a deal are about 50/50.

Investors are likely to remain on tenterhooks until an announcement on Greece’s bailout deal is made. Given this, it could be a quiet start to the week in currency markets. This is especially so given Monday is a holiday in the US. If a Greek deal is made, expect “risk-sensitive” assets to outperform and the USD to suffer. Later in the week, markets’ focus will move back to economic data.

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Fixed Interest

NZ swap yields closed up 6-8bps on Friday. Bond yields also rose.

NZ swap yields rose across the curve on Friday, with a slight steepening bias. Most of the move came via pay side interest at the short-end. 2-year saw good liquidity and closed at its high of 2.96%. This takes it back to its recent high, and opens the way for a break higher to the next resistance level at 3.20%. 5-year yields broke above the 3.60%, closing at 3.63%. Technical resistance may now be as high as the 4.0% level. The market prices 15bps of rate hikes from the RBNZ in the year ahead. We expect this pricing to gradually rise. Tuesday's RBNZ survey of 2-year-ahead inflation expectations could provide a catalyst, if it remains stubbornly up around 2.8%.

NZ bond yields closed up around 4bps across the curve. The yield on 21s closed at 4.01%, at the top of recent ranges. The NZ-US 10-year spread is still quite wide at just over 200bps. This suggests further upside to NZ long

bonds will require US bonds to convincingly break above the 2.0% level. On Friday night they traded as high as 2.03% before returning to trade at 2.0%.

Ongoing uncertainty in Greek negotiations is maintaining demand for "safe haven" US and German long bonds. US Federal Reserve purchases are also holding down US long yields, suggesting it will be heavy work for US long yields to rise meaningfully. This will keep NZ long yields lower than otherwise dictated by domestic fundamentals.

Aside from tomorrow's inflation expectations data, local data is of general 2nd tier importance this week. Expect NZ yields to take their cue from offshore, with a bias to yields inching higher.

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Currencies				US Interest rates				Commodities									
	Low	High		Open	High	Low	Last	Open	High	Low	Last	Open	High	Low	Last		
NZD	0.8306	0.8381	1 Yr	0.16	0.16	0.15	0.15	Crude	102.35	104.14	102.25	103.2	Wheat	633.0	650.0	631.5	647.8
AUD	1.0688	1.0785	2Yr	0.29	0.30	0.28	0.29	Alti	2178	2190	2150	2164	Sugar	23.73	23.85	23.63	23.8
EUR	1.3115	1.3198	5 Yr	0.86	0.91	0.85	0.86	Copper	8380	8424	8131	8175	Cotton	93.71	94.29	92.39	92.7
GBP	1.5790	1.5862	10 Yr	1.98	2.04	1.98	2.00	Nickel	20000	20300	19410	19625	CRB	317.4	317.8	316.2	317.4
JPY	78.98	79.62	30 Yr	3.14	3.18	3.14	3.15	Gold	1728	1736	1717	1723	GSCI				
Sycom Futures				FX				Asian FX				Equities					
	Open	High	Low	Last	Open	Last		Open	High	Low	Last		Open	Now	chge		
Australia					AUD=	1.0764	1.0783	SGD=	1.2569	1.2570	1.2554	1.25555	Dow	12903	12950	45.8	
3 mth	95.6	95.62	95.59	95.60	NZD=	0.8351	0.8392	IDR=	9067.5	9073.13	8982.5	9030	S&P 500	1358.1	1361.2	3.2	
3 Yr	96.37	96.4	96.31	96.35	CAD=	0.9938	0.9940	THB=	30.8	30.8	30.7	30.7	Nasdaq	2958.2	2951.8	-8.1	
10 Yr	95.895	95.93	95.86	95.90	JPY=	79.42	79.61	KRW=	1126	1127	1123	1126	FTSE	5885.4	5905.1	19.7	
NZ					EUR=	1.3163	1.3178	TWD=	29.6	29.6	29.5	29.6	DAX	6811	6848	96.1	
3 mth	97.26	97.26	97.26	97.26	GBP=	1.5838	1.5845	PHP=	42.7	42.7	42.6	42.7	SPI (Sycom)				
NZD Crosses				AUD Crosses				NZ Government Bonds				NZ swap yields					
	Last	Previous		Last	Previous		Last Price										
NZD/EUR	0.6333	0.6333	AUD/EUR	0.8183	0.8153	NZGB 6 1/2 04/15/13	2.590	1 Yr	2.790								
NZD/JPY	66.81	66.21	AUD/JPY	85.84	85.17			2Yr	2.960								
NZD/GBP	0.5296	0.5258	AUD/GBP	0.6805	0.6764	NZGB 5 03/15/19	3.752	5 Yr	3.633								
NZD/AUD	0.7773	0.7773	AUD/NZD	1.2851	1.2865	NZGB 6 05/15/21	4.006	10 Yr	4.378								

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

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