

29 November 2021



Events Round-Up

NZ: ANZ Consumer confidence, Nov: 96.6 vs. 98 prev.

AU: Retail sales (m/m%), Oct: 4.9 vs. 2.2 exp.

Good Morning

What was expected to be a quiet post-Thanksgiving session on Friday turned into a mini market meltdown, as investors took fright at the discovery of new Covid-19 variant, Omicron. Equities and oil prices plunged while government bond yields fell sharply as investors scaled back expected tightening from central banks. Risk-sensitive currencies, including the NZD, fell while the JPY and EUR appreciated strongly. Markets are likely to remain volatile until more information is known about the variant and particularly how effective the current crop of vaccines are against it.

Markets have been rattled by the discovery of a new Covid-19 variant originating from Southern Africa. The WHO has formally designated it a variant of concern and named it Omicron. The variant contains a significant (around 50) number of mutations from the original version of the virus, including, notably, a large number on the spike protein. Scientists have warned that this could potentially mean that vaccines, which target the spike protein, might be less effective against Omicron and it is also possible it could be even more infectious than Delta. The Chair of the South African Medical Association observed that the cases she had seen so far had caused "mild disease", without prominent symptoms, in healthy younger people. There is still significant uncertainty around the variant, and much more will be known in a few weeks, after vaccine makers and scientists have had time to run tests and observe real world experience.

Cases have already been detected in Israel, Belgium, Germany, the UK, and the Netherlands. More cases offshore are likely to emerge in the coming days. It's not great timing for Europe which is already battling a "fourth wave" of Covid, with Austria in lockdown and Netherlands further tightening restrictions over the weekend.

Despite the limited information currently available on the variant, the market reaction on Friday was one of 'shoot first, ask questions later'. Risk asset markets were down heavily on the risk of further growth-damaging Covid restrictions, including possibly lockdowns, in major economies. The S&P500 was off 2.4%, its biggest one day

fall since January, in a shortened trading session. Cyclical sectors, including energy (-4%) and financials (-3.3%), were particularly hard hit while the tech and stay-at-home stocks that benefited from last year's lockdown (think Zoom and Peleton) outperformed. The VIX jumped to 28.6, its highest level since March. Meanwhile, Brent crude oil tumbled 12%, to \$71.55 per barrel, with the market anticipating less air and other travel and consequently softer oil demand.

Government bonds experienced big falls in yields as the market quickly pared back expectations of central bank tightening. The US 10-year rate was down 16bps, to 1.49%, while the 2-year rate was off 14bps, to 0.50%, with the market pushing back the expecting timing of the Fed's first hike from June to September. Similar moves were seen in other markets, with the German and UK 10-year rates down 9bps and 15bps respectively, and the market now pricing only a 50% chance of a 15bps Bank of England rate hike next month.

It's fair to say the market reactions on Friday were likely exaggerated by thin liquidity, with many US-based market participants off for a long weekend after Thanksgiving. The falls in equities, rates and commodities also need to be seen in the context of their significant run-ups over recent months, arguably leaving them vulnerable to unexpected negative news.

Currency markets also saw risk-off moves, with the safe-haven JPY the star performer, up some 1.7%, and the Swiss franc (+1.4%) and EUR (+1%) also seeing big gains. The USD typically benefits during periods of risk aversion, but the sharp pullback in Fed rate hike expectations and unwinds of USD long positions saw the main USD indices fall between 0.3% - 0.7%.

Commodity and risk-sensitive currencies naturally took a hit, as they typically do when markets worry about the global growth outlook. The plunge in oil prices saw the CAD and NOK down more than 1%, while the AUD was down 0.9%, to near its lowest level in 12 months, at 0.7125. The NZD performed comparatively well, down only 0.4% on Friday, ending the week near its year-to-date lows, at 0.6820.

Markets are likely to remain jumpy and volatile until there is greater clarity on the new variant and particularly how effective vaccines are against it. Encouragingly, the mRNA technology used in the Pfizer and Moderna vaccines can be

readily adapted to mutations in the virus, with BioNTech saying that it and Pfizer could distribute new versions of its vaccine within 100 days and Moderna saying it could have large quantities of a new version of its vaccine ready by early 2022. Of course, it takes time to scale up production and renewed lockdowns, were they to take place, would hit confidence and growth, albeit with fiscal support likely to swing into gear. If it turns out that vaccines are still effective against Omicron, or that the variant only leads to mild illness, then we can expect a sharp reversal of Friday's moves, as the previous narrative around high inflation and a strong global recovery returns to the forefront.

There was some central bank commentary on Friday, with Atlanta Fed President Bostic reiterating he was open to a quicker tapering of QE, with purchases possibly ending as soon as late Q1 2022. He mentioned that his outlook was predicated on Omicron being "similar to Delta", on which we will need to wait and see. BoE Chief Economist Huw Pill said "the ground has now been prepared for policy action" (i.e. rate hikes) but acknowledged that a new pandemic and lockdowns were "the type of events which clearly would change our view of the world." Central banks are in the dark as much as anyone else, but the market's initial reaction to Friday's news suggests investors think they are likely to slow down plans for monetary policy tightening if new Covid restrictions are put in place, even with inflation uncomfortably high. Yield curves will likely steepen if this is the case.

The New Zealand interest rate market has more tightening priced than any other developed market and is potentially vulnerable to a correction if global growth concerns mount and risk assets come under pressure. As of Friday, the market was pricing the OCR to reach around 2.25% at the end of 2022, implying six RBNZ rate hikes at the seven meetings next year. Friday saw a 7bps fall in the 2-year swap rate and 8bps falls in 5 and 10-year rates but, given

offshore rates continued to fall sharply after the NZ market closed, we can expect local interest rates to open sharply lower this morning.

Finally, in domestic data, the ANZ NZ consumer confidence survey showed confidence falling to its lowest level since April last year and, before that, its lowest level since 2009. Consumer confidence remains well below its historical average which is understandable in the context of high inflation, which is cutting into real incomes, and the significant increase in retail mortgage rates. There is also significant uncertainty around how confidence will hold up in the face of Covid spreading across the country in the coming months, with the RBNZ MPS highlighting this as a risk which could dampen spending.

Markets are likely to be dominated this week by news and developments with Omicron. Fed Chair Powell's testimony on Tuesday, alongside Treasury Secretary Yellen, will be closely watched for his reaction to recent events and whether it could alter the Fed's tapering plans. Nonfarm payrolls are released on Friday, with the market looking for another solid month of job gains (535k) while Eurozone CPI is released, with core inflation expected to pick up to 2.2% y/y. In NZ, the highlight is Tuesday's ANZ business survey for November.

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Coming Up

		Period	Cons.	Prev.	NZT
GE	CPI (EU Harmonized, m/m%)	Nov P	-0.6	0.5	02:00
GE	CPI (EU Harmonized, y/y%)	Nov P	5.2	4.6	02:00
US	Pending Home Sales (m/m%)	Oct	0.7	-2.3	04:00

Source: Bloomberg, BNZ

Foreign Exchange					Equities				Commodities**						
Indicative overnight ranges (*)					Other FX				Major Indices			Price			
	Last	% Day	Low	High		Last	% Day			Last	Net Day		Last	Net Day	
NZD	0.6822	-0.6	0.6805	0.6835	CHF	0.9231	-1.4		S&P 500	4,595	-2.3	26.6	Oil (Brent)	72.72	-11.3
AUD	0.7123	-0.9	0.7113	0.7156	SEK	9.163	+0.8		Dow	34,899	-2.5	16.8	Oil (WTI)	68.15	-13.1
EUR	1.1317	+1.0	1.1221	1.1322	NOK	9.077	+1.2		Nasdaq	15,492	-2.2	28.1	Gold	1785.5	+0.4
GBP	1.3337	+0.1	1.3279	1.3349	HKD	7.798	+0.0		Stoxx 50	4,090	-4.7	16.5	HRC steel	1605.0	-3.7
JPY	113.38	-1.7	113.05	114.66	CNY	6.393	+0.1		FTSE	7,044	-3.6	10.7	CRB	226.7	-4.9
CAD	1.2791	+1.1			SGD	1.372	+0.3		DAX	15,257	-4.2	14.8	Wheat Chic.	840.3	-1.2
NZD/AUD	0.9577	+0.4			IDR	14,358	+0.5		CAC 40	6,740	-2.6	21.1	Sugar	19.35	-2.7
NZD/EUR	0.6028	-1.5			THB	33.64	+0.8		Nikkei	28,752	-2.5	7.9	Cotton	116.60	-4.5
NZD/GBP	0.5115	-0.7			KRW	1,194	+0.3		Shanghai	3,564	-0.6	4.6	Coffee	243.0	-1.6
NZD/JPY	77.35	-2.3			TWD	27.85	+0.2		ASX 200	7,279	-1.7	10.3	WM powder	4225.0	+0.0
NZD/CAD	0.8726	+0.6			PHP	50.43	+0.1		NZX 50	12,629	-1.3	-0.1	Australian Futures		
NZ TWI	73.48	-0.5											3 year bond	98.98	0.22
													10 year bond	98.32	0.20

Interest Rates													
	Rates		Swap Yields		Benchmark 10 Yr Bonds		NZ Government Bonds		NZ Swap Yields				
	Cash	3Mth	2 Yr	10 Yr	Last	Net Day		Last		Last			
USD	0.25	0.18	0.74	1.53	USD	1.47	-0.16	NZGB 5 1/2 04/15/23	1.45	-0.05	1 year	1.54	-0.06
AUD	0.10	0.05	0.91	1.98	AUD	1.74	-0.13	NZGB 0 1/2 05/15/26	2.20	-0.06	2 year	2.16	-0.07
NZD	0.75	0.80	2.16	2.73	NZD	2.53	-0.05	NZGB 0 1/4 05/15/28	2.35	-0.07	5 year	2.64	-0.08
EUR	0.00	0.06	-0.38	0.14	GER	-0.34	-0.08	NZGB 1 1/2 05/15/31	2.45	-0.06	7 year	2.68	-0.08
GBP	0.10	0.12	1.03	1.10	GBP	0.83	-0.14	NZGB 2 05/15/32	2.53	-0.05	10 year	2.73	-0.08
JPY	-0.05	-0.10	0.01	0.11	JPY	0.07	-0.01	NZGB 1 3/4 05/15/41	2.84	-0.04	15 year	2.77	-0.08
CAD	0.25	0.49	1.47	2.04	CAD	1.61	-0.16	NZGB 2 3/4 05/15/51	2.92	-0.02			

* These are indicative ranges from 5pm NZT; please confirm rates with your BNZ dealer

** All near futures contracts, except CRB. Metals prices are CME.

Rates are as of: New York close

Source: Bloomberg

NZD exchange rates

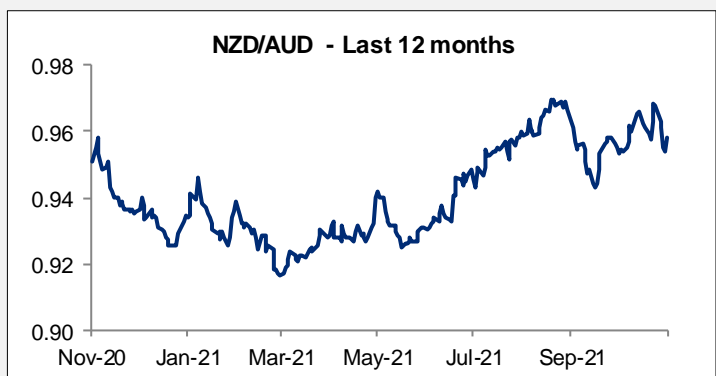
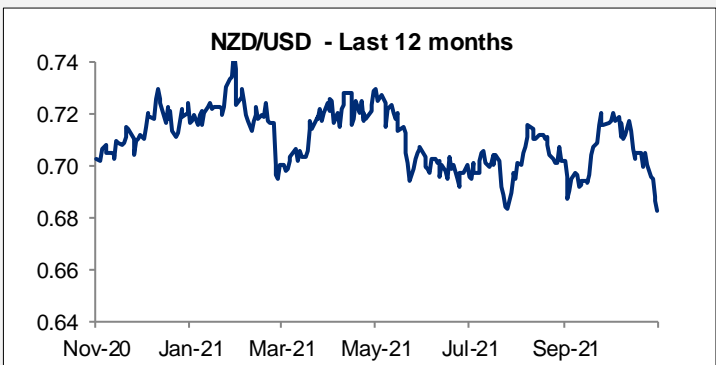
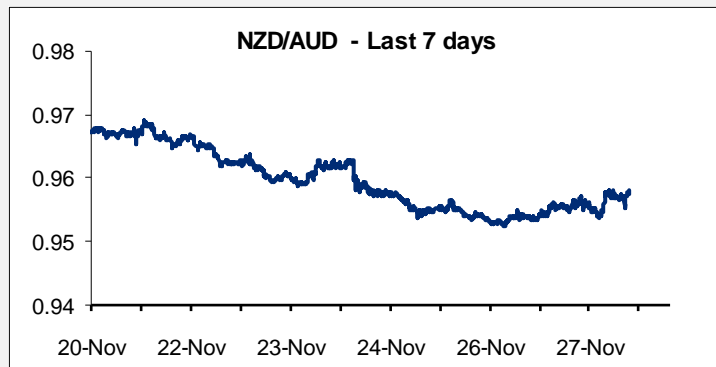
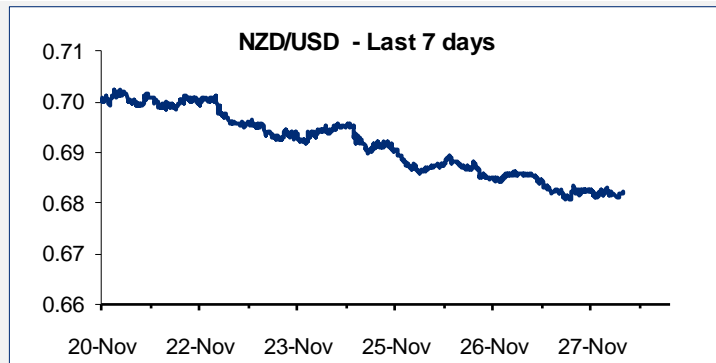
27/11/2021	NY close	Prev. NY close
USD	0.6822	0.686
GBP	0.5115	0.5149
AUD	0.9577	0.9541
EUR	0.6028	0.6120
JPY	77.35	79.14
CAD	0.8726	0.8677
CHF	0.6297	0.6421
DKK	4.4823	4.5510
FJD	1.4481	1.4568
HKD	5.3201	5.3486
INR	51.08	51.11
NOK	6.1921	6.1550
PKR	119.75	119.94
PHP	34.40	34.57
PGK	2.4004	2.4096
SEK	6.2507	6.2338
SGD	0.9358	0.9382
CNY	4.3615	4.3809
THB	22.92	22.89
TOP	1.5407	1.5430
VUV	76.90	76.98
WST	1.7644	1.7404
XPF	71.52	73.12
ZAR	11.1103	10.9567

NZD/USD Forward Points

	BNZ buys NZD	BNZ sells NZD
1 Month	-3.04	-2.64
3 Months	-9.19	-8.69
6 Months	-26.22	-24.82
9 Months	-50.28	-47.77
1 Year	-78.38	-76.38

NZD/AUD Forward points

	BNZ buys NZD	BNZ Sells NZD
1 Month	-5.59	-4.68
3 Months	-18.51	-17.09
6 Months	-43.76	-39.89
9 Months	-75.66	-69.62
1 Year	-109.13	-101.69



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