Markets Today

1 February 2019

Events Round-Up

US: Fed funds target rate (upper bound): 2.5% vs. 2.5% exp.

CH: Non-manufacturing PMI, Jan: 54.7 vs. 53.8 exp.

CH: Manufacturing PMI, Jan: 49.5 vs. 49.3 exp.

EC: GDP (q/q%), Q4: 0.2 vs. 0.2 exp.

US: Employment cost index (q/q%), Q4: 0.7 vs. 0.8 exp.

CA: GDP (m/m%), Nov: -0.1 vs. -0.1 exp.

US: New home sales (k), Nov: 657 vs. 570 exp.

US: Initial jobless claims (k): 253 vs. 215 exp.

US: Chicago PMI, Jan: 56.7 vs. 61.5 exp.

Good Morning

Markets are trading in risk-on mode. US equities have extended gains made in the aftermath of the dovish FOMC meeting yesterday morning, helped by better corporate earnings results. US Treasury yields have continued to move lower as the market digests the Fed's switch to a neutral bias, while the USD is trading at a four month low. The NZD has increased to its highest level since early December amidst broad-based USD weakness.

US equity markets have continued where they left off after the FOMC meeting yesterday, with the S&P500 up 0.7%, at its highest level since early December, and the NASDAQ 1.4% higher. Corporate earnings results have added further upside impetus to equities. Facebook reported better than expected earnings and revenue at its quarterly earnings call alongside increases in daily active user numbers across all the regions, which has seen its share price surge 12%. GE's share price rose 15% after it beat earnings expectations and said it was close to settling a legacy case with the DoJ related to a former subprime lender that it owned. The financials sector has underperformed, with lower rates perceived to be negative for bank net interest margins.

The moves in US equity indices overnight follow from gains of 1.5% to 2.5% higher yesterday after the Fed meeting. The Fed statement was unambiguously dovish, as it removed its reference to further gradual rate changes and pledged instead to be "*patient*" on rates. The Fed has effectively dropped its tightening bias and, while data can always change its outlook in the future, its base case appears to be that it won't need to hike rates again this cycle. The Fed alluded to "*global economic and financial developments and muted inflation pressures*" as the rationale for the change in policy stance. In the press conference, Powell said that the Fed may stop its balance sheet reduction earlier than it had previously expected (i.e. it might aim to keep a larger balance sheet than it had thought), adding that the Fed would finalise its plan in the coming meetings. While we're a bit sceptical that the Fed's balance sheet reduction directly caused the sell-off in risk assets late last year, Powell's comments indicate that the Fed is listening to market concerns, and it is likely to boost broader market sentiment.

US rates have extended their falls following the Fed, with the curve steepening. The 10 year Treasury yield, which was 2.72% before the Statement, has fallen to 2.63%. The market has completely priced-out the risk of rate hikes this year, and now prices a 25% chance of a cut by year-end and a full rate cut by the end of 2020. The US yield curve has steepened, and inflation expectations increased (10y US breakeven inflation +6bps), as the market prices less chance of a Fed policy mistake leading to US recession. Looking ahead, we expect the US 10 year rate to be range-bound for some time. If the Fed has completed its tightening cycle – as seems to be its new base case – then the chance of a US recession is reduced, and so rate cuts are unlikely (the Fed usually moves into an easing cycle ahead of recession). But equally, the upside for US Treasury yields should be limited if the hurdle for further hikes is high. Such a backdrop should be supportive of low volatility and risk assets more broadly.

US economic data released overnight has been completely overshadowed by the Fed meeting. The employment cost index revealed private wages had increased 3.1% over the past year, a similar growth rate to the more timely average hourly earnings data. The Chicago PMI fell sharply in January, catching up to last month's fall in the ISM manufacturing survey. And weekly jobless claims spiked higher, although this was likely distorted by the Martin Luther King holiday and the government shutdown. Of more importance is the non-farm payrolls report tonight and the ISM manufacturing survey. Equity markets and global rates fell sharply earlier in the year after a much weaker than expected ISM survey raised fears of a US recession, although markets have since recovered substantially.

On the trade-front, President Trump tweeted that the "*meetings are going well with good intent and spirit on both sides*" but added that "*no final deal will be made until* *my friend President Xi, and I, meet in the near future to discuss and agree on some of the longstanding and more difficult points."* There will reportedly be a concluding statement issued after the talks finish later today. Most analysts don't expect the talks over the past two days to yield any breakthrough and instead think a deal is likely to hinge on another Trump-Xi summit.

In FX markets, the USD has unsurprisingly weakened following the dovish FOMC statement. The Bloomberg DXY fell 0.4% yesterday, to its lowest level since late September, and it has largely consolidated those losses overnight. Emerging market currencies, the AUD and NZD have outperformed amidst the risk-on tone to markets and lower US rate outlook. The JPM emerging market FX index is at its highest level since August, and the NZD and AUD remain correlated to the CNY and EM FX more broadly. The EUR has underperformed overnight (-0.3% to 1.1450), and has given back most of its post-FOMC gains. Eurozone 4th quarter GDP met expectations of just 0.2%, but forward-looking PMI and confidence readings in the region point to a period of subdued growth in the months ahead.

The NZD is sitting just above 0.69, having been 0.6830 before the FOMC statement. The NZD received an additional short-term boost yesterday when credit rating agency S&P said that it had upgraded its rating outlook on the government from stable to positive. The NZ government currently has a AA foreign currency, long-term rating and a AA+ local currency, long-term rating, so were S&P to eventually upgrade the ratings, New Zealand government bonds (in NZD) would become AAA. Long-term NZGBs fell by around 6bps yesterday, outpacing the 4bp fall in the 10 year swap rate, amidst the ratings news and a very strong tender of 2025 maturity bonds.

In NZ swap markets, rates were lower across the curve, following on from the dovish Fed statement and falls in US rates. The 5 year swap rate fell 3.5bps to 2.0975%, leaving it within a whisker of its all-time low of 2.06% set in mid-2016. The 2 year swap rate was down a lesser 1bp to 1.915% as OCR expectations remained sticky. The implications of the Fed's dovish shift for the RBNZ are ambiguous. While a potential further rise in the NZD would complicate the RBNZ's task of getting core inflation up to the 2% mid-point, a more dovish Fed should reduce some of the downside risks to US (and global) growth and markets. We continue to think OCR cuts are unlikely.

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Coming Up

		Period	Cons.	Prev.	NZT
NZ	ANZ Consumer Confidence Index	Jan		121.9	10:00
CH	Caixin China Manufacturing PMI	Jan	49.6	49.7	14:45
UK	UK PMI Manufacturing	Jan	53.5	54.2	22:30
EC	Core CPI (y/y%)	Jan A	1	1	23:00
US	Change in Nonfarm Payrolls	Jan	165	312	02:30
US	Unemployment Rate	Jan	3.9	3.9	02:30
US	Average Hourly Earnings (m/m%)	Jan	0.3	0.4	02:30
US	Average Hourly Earnings (y/y%)	Jan	3.2	3.2	02:30
US	ISM Manufacturing	Jan	54	54.1	04:00

Source: Bloomberg, BNZ

Foreign Exchange

Indicative overnight ranges (*)

	Last	% Day	Low	High
NZD	0.6915	+0.3	0.6898	0.6939
AUD	0.7271	+0.3	0.7260	0.7295
EUR	1.1447	-0.3	1.1436	1.1514
GBP	1.3119	+0.0	1.3098	1.3160
JPY	108.81	-0.2	108.50	108.90
CAD	1.3145	-0.0		
NZD/AUD	0.9510	-0.1		
NZD/EUR	0.6041	+0.6		
NZD/GBP	0.5271	+0.3		
NZD/JPY	75.24	+0.1		
NZD/CAD	0.9090	+0.3		
NZ TWI	74.48	+0.2		

Other FX

	Last	% Day
CHF	0.9938	-0.0
SEK	9.050	+0.1
NOK	8.440	+0.2
HKD	7.847	+0.1
CNY	6.696	-0.3
SGD	1.346	-0.1
IDR	13,973	-1.1
THB	31.24	-0.1
KRW	1,113	-0.3
TWD	30.72	-0.2
PHP	52.17	-0.3

Equities

Major Indices

	Last	% Day	% Year
S&P 500	2,699	+0.7	-4.4
Dow	24,955	-0.2	-4.6
Nasdaq	7,278	+1.3	-1.8
Stoxx 50	3,159	-0.1	-12.5
FTSE	6,969	+0.4	-7.5
DAX	11,173	-0.1	-15.3
CAC 40	4,993	+0.2	-8.9
Nikkei	20,773	+1.1	-11.5
Shanghai	2,585	+0.3	-25.0
ASX 200	5,865	-0.4	-3.7
NZX 50	8,985	+0.7	7.2

Commodities**

Price

	Last	Net Day
Oil (Brent)	62.09	+0.7
Oil (WTI)	54.76	+0.9
Gold	1320.0	+0.8
HRC steel	697.0	+0.1
CRB	180.8	+0.4
Wheat Chic.	519.8	-0.5
Sugar	12.80	+2.0
Cotton	74.52	+0.2
Coffee	106.1	+3.9
WM powder	2910.0	+0.3

Australian Futures

	Last	Net Day
3 year bond	98.275	0.00
10 year bond	97.78	0.00

Interest Rates

	Rates: Cash	Rates: 3Mth	Swap Yields: 2 Yr	Swap Yields: 10 Yr
USD	2.50	2.74	2.61	2.66
AUD	1.50	2.07	1.88	2.46
NZD	1.75	1.93	1.92	2.53
EUR	0.00	0.06	-0.17	0.66
GBP	0.75	0.92	1.09	1.41
JPY	-0.06	-0.10	-0.02	0.15
CAD	1.75	1.17	2.18	2.39

Benchmark 10 Yr Bonds

	Last	Net Day
USD	2.63	-0.04
AUD	2.24	0.00
NZD	2.07	-0.06
GER	0.15	-0.04
GBP	1.22	-0.04
JPY	0.01	0.00
CAD	1.88	-0.04

NZ Government Bonds

	Last	
NZGB 6 05/15/21	1.70	-0.02
NZGB 5 1/2 04/15/23	1.75	-0.04
NZGB 2 3/4 04/15/25	1.92	-0.04
NZGB 4 1/2 04/15/27	2.07	-0.06
NZGB 3 04/20/29	2.25	-0.06
NZGB 3 1/2 04/14/33	2.43	-0.06
NZGB 2 3/4 04/15/37	2.61	-0.06

NZ Swap Yields

	Last	
1 year	1.91	-0.02
2 year	1.92	-0.01
5 year	2.10	-0.03
7 year	2.29	-0.04
10 year	2.53	-0.04
15 year	2.79	-0.04

* 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: NZT 07:00

Source: Bloomberg

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