

3 December 2021



Events Round-Up

NZ: Terms of trade (q/q%), Q3: 0.7 vs. 2 prev.

EC: Unemployment rate (%), Oct: 7.3 vs. 7.3 exp.

US: Initial jobless claims (k), 27-Nov: 222 vs. 240 exp.

Good Morning

After a rocky couple of trading sessions, equities and bond yields have rebounded overnight. Volatility is high and sentiment fickle and much will depend on news on Omicron over the coming days and weeks. Currencies have seen limited movement overnight, with the NZD hovering just above 0.68. Yesterday saw a huge flattening in the NZ yield curve, with the gap between 5-year and 10-year swap rates shrinking to Obps for the first time since the GFC.

Markets remain volatile and sentiment driven as investors grapple with the risks around Omicron. Shortly after this report was sent yesterday, there was a significant sell-off in US equities into the market close, with the S&P500 falling almost 3% from its intraday highs after news of the first Omicron in case in the US, in California. Another US case has been reported overnight in Minnesota in an individual who was recently in New York. Of course, Omicron was going to eventually find its way into the US, like other countries, but the market reaction speaks to heightened nervousness among market participants.

There has been a reasonable recovery in risk sentiment overnight, on no major news, with the S&P500 up around 1.5% and the NASDAQ 0.9%. Cyclical industries and those sensitive to Covid restrictions have led the rebound, with an index of airlines, hotels and cruise operators bouncing back over 3% overnight. Implied volatility remains elevated, with the VIX sitting just under 30.

Covid-19 cases have gone exponential in South Africa, where scientists first detected the Omicron variant, with around 8,500 new cases reported on Wednesday, almost double the previous day's total. Doctors in the country have observed increased instances of people who have previously had Covid being reinfected with the new variant, a sign that Omicron might evade immunity generated by vaccines or prior infection. However, there is still hope that vaccines might provide protection against severe illness and death. Overnight, Pfizer repeated what its vaccine partner BioNTech had said earlier in the week, that it didn't expect its vaccine would see a significant drop

in effectiveness, while cautioning that we would need to wait for a week or two for confirmation from test results.

As Germany battles a surge in Covid cases, outgoing Chancellor Merkel announced new restrictions on unvaccinated individuals, banning them from restaurants, bars, and other non-essential shops. The measures have been labelled a "lockdown of the unvaccinated". Merkel also flagged that Germany might follow Austria in making vaccination mandatory from February next year as an "act of national solidarity", with a vote in parliament likely to happen soon.

There has been a chorus of Feb policy makers overnight reiterating their openness to speeding up tapering, among them Daly, Quarles, Mester, and Bostic. An earlier end to QE opens the door to earlier rate hikes, with Fed officials now signalling they want the option to do so if inflation and employment are stronger than expected. If the tapering pace were doubled, from \$15b per month to \$30b per month, QE would end in March rather than June.

US Treasury yields are higher and the curve flatter on the back of improved risk sentiment and these hawkish comments from Fed officials. The market has brought forward the expected timing of the first Fed rate hike to June next year. The US 10-year rate is up 5bps since yesterday morning, at 1.46%, while the 2-year rate is 7bps higher, at 0.62%. The yield curve between 5-year and 30-year US rates was 5bps flatter, at 55bps, its lowest level since early 2019.

At its meeting overnight, OPEC+ announced that it would go ahead with its planned increase in oil supply in January (400k barrels per day). It added that it would "monitor the market closely and make immediate adjustments if required", suggesting the cartel might quickly halt supply increases if Omicron leads to a major downturn in oil demand. Oil prices fell as much as 4.8% on the initial headlines, before rebounding to now be higher on the day (Brent crude +1.5%). This has helped market-based inflation expectations recover, with the 10-year breakeven inflation rate in the US rising 4bps to 2.47%.

Currencies have been relatively stable, with the NZD trading a narrow range between around 0.6800 – 0.6830 over the past 24 hours. Both the NZD and AUD remain close to their year-to-date lows and are trading around 0.6810 and 0.7100 respectively this morning. The BBDXY

USD index is close to unchanged on the day, hovering near its highest level in 16 months.

In the domestic rates market, there was another huge flattening in the NZ yield curve yesterday. The 2-year swap rate was 7bps higher on the day, at 2.26%, while the 10-year rate was 5bps lower, at 2.62%, in a “twist” move. The spread between 5 and 10-year swap rates hit 0bps for the first time since the GFC and this curve segment might invert today, given the overnight flattening moves in global bond markets. An inverted yield curve is often seen as a sign that the market thinks the central bank might ‘overdo’ the tightening cycle, leading to a major growth slowdown in the future.

The fall in longer-term NZ rates yesterday is easily explained given the sharp falls in US and Australian 10-year rates on the session. The upward pressure at the short end of the curve is a little more puzzling considering the RBNZ’s message at the MPS of “considered steps”. The market is pricing the OCR to be around 2.40% by the end of next year, implying (almost) a hike at each of the seven meetings in 2022. We suspect mortgage-related paying in swaps and some profit taking among investors has caused the latest indigestion, with the market seemingly struggling to absorb the pay-side flows.

The nonfarm payrolls report should be the focus tonight. The market is expecting a solid 545k increase in jobs in November and anything in that ballpark should be sufficient for the Fed to announce an accelerated taper

pace at its meeting in two weeks (unless Omicron developments get in the way). The ISM Services index is expected to pull back slightly, albeit to what would still be its second-highest reading on record.

Locally, Fonterra is scheduled to deliver a business update today, at which it might upgrade its forecast milk price for the 2021/22 season from the current \$7.90 to \$8.90 range. We are forecasting an \$8.90 milk price once the season is all done, which would be a record, while NZX futures are at \$9. Unlike the weakness seen in some other commodities in recent times, milk prices remain firm, reflecting, amongst other factors, constrained global supply.

nick.smyth@bnz.co.nz

Coming Up

		Period	Cons.	Prev.	NZT
CH	Caixin China PMI Services	Nov	53	53.8	14:45
EC	Retail Sales (m/m%)	Oct	0.3	-0.3	23:00
US	Change in Nonfarm Payrolls (k)	Nov	545	531	02:30
US	Unemployment Rate (%)	Nov	4.5	4.6	02:30
US	Average Hourly Earnings (m/m%)	Nov	0.4	0.4	02:30
US	Average Hourly Earnings (y/y%)	Nov	5	4.9	02:30
CA	Unemployment Rate (%)	Nov	6.6	6.7	02:30
CA	Net chg. In employment (k)	Nov	37.5	31.2	02:30
US	ISM Services Index	Nov	65	66.7	04:00

Source: Bloomberg, BNZ

Foreign Exchange						Equities				Commodities**				
Indicative overnight ranges (*)					Other FX			Major Indices				Price		
	Last	% Day	Low	High		Last	% Day			Last	% Day	Net Day		
NZD	0.6809	+0.0	0.6799	0.6831	CHF	0.9208	+0.1	S&P 500	4,583	+1.5	24.9	Oil (Brent)	69.82	+1.4
AUD	0.7094	-0.1	0.7085	0.7114	SEK	9.048	-0.4	Dow	34,660	+1.9	16.0	Oil (WTI)	66.70	+1.7
EUR	1.1302	-0.2	1.1296	1.1348	NOK	9.096	+0.4	Nasdaq	15,383	+0.8	24.6	Gold	1762.0	-1.1
GBP	1.3302	+0.2	1.3277	1.3334	HKD	7.791	-0.0	Stoxx 50	4,108	-1.7	16.7	HRC steel	1590.0	-0.3
JPY	113.21	+0.4	112.71	113.33	CNY	6.377	+0.1	FTSE	7,129	-0.6	10.3	CRB	218.4	-0.4
CAD	1.2819	-0.0			SGD	1.369	+0.3	DAX	15,263	-1.4	14.6	Wheat Chic.	818.5	+3.5
NZD/AUD	0.9598	+0.2			IDR	14,398	+0.4	CAC 40	6,796	-1.3	21.7	Sugar	18.61	+0.1
NZD/EUR	0.6025	+0.2			THB	33.88	+0.5	Nikkei	27,753	-0.7	3.5	Cotton	109.45	+0.1
NZD/GBP	0.5119	-0.2			KRW	1,176	-0.3	Shanghai	3,574	-0.1	3.8	Coffee	236.7	+1.5
NZD/JPY	77.08	+0.4			TWD	27.73	+0.1	ASX 200	7,225	-0.1	9.2	WM powder	4255	-0.1
NZD/CAD	0.8728	-0.0			PHP	50.41	+0.1	NZX 50	12,670	-0.4	0.2	Australian Futures		
NZ TWI	73.33	+0.1										3 year bond	98.875	-0.04
												10 year bond	98.31	-0.03

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	0.17	0.85	1.53	USD	1.45	0.05	1 year	1.67	0.07
AUD	0.10	0.06	0.94	1.99	AUD	1.68	-0.05	2 year	2.26	0.06
NZD	0.75	0.86	2.27	2.63	NZD	2.42	-0.04	5 year	2.62	0.00
EUR	0.00	0.06	-0.36	0.11	GER	-0.37	-0.03	7 year	2.62	-0.02
GBP	0.10	0.11	1.06	1.07	GBP	0.81	-0.01	10 year	2.62	-0.05
JPY	-0.06	-0.08	0.00	0.10	JPY	0.06	-0.00	15 year	2.62	-0.07
CAD	0.25	0.49	1.50	1.99	CAD	1.51	0.02			

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

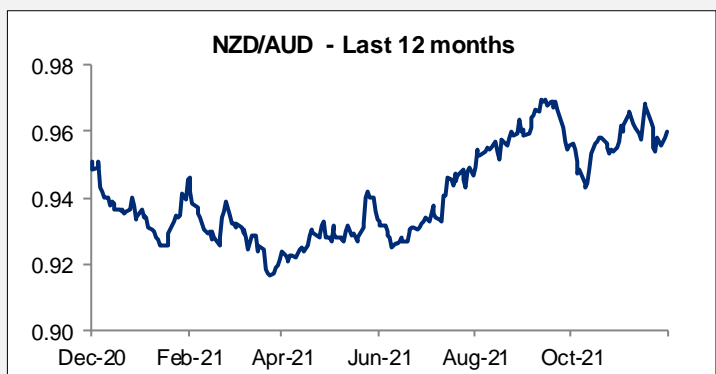
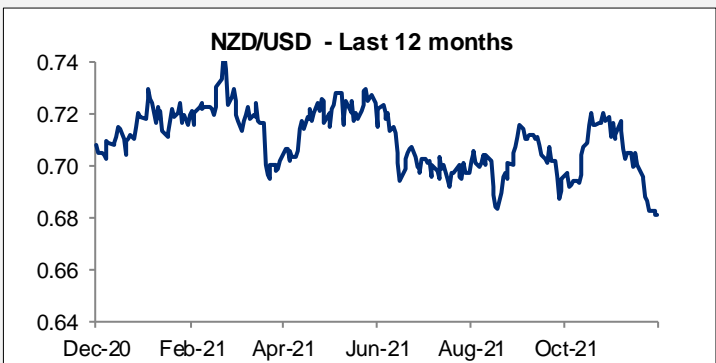
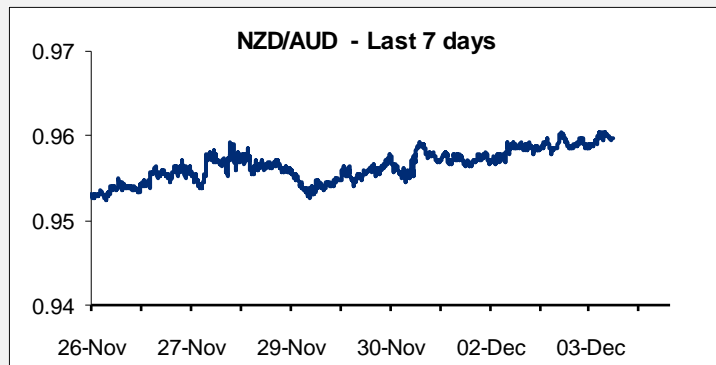
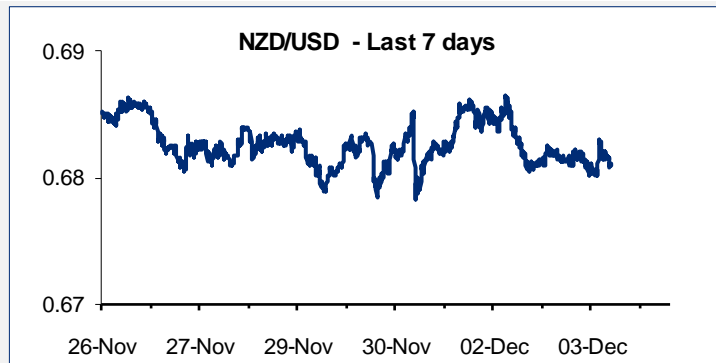
** All near futures contracts, except CRB. Metals prices are CME.

Rates are as of: NZT 06:53

Source: Bloomberg

NZD exchange rates

3/12/2021	6:54 a.m.	Prev. NY close
USD	0.6809	0.6809
GBP	0.5119	0.5128
AUD	0.9598	0.9583
EUR	0.6025	0.6015
JPY	77.08	76.79
CAD	0.8728	0.8728
CHF	0.6270	0.6264
DKK	4.4799	4.4730
FJD	1.4512	1.4515
HKD	5.3050	5.3062
INR	51.06	51.00
NOK	6.1934	6.1664
PKR	119.68	119.35
PHP	34.32	34.29
PGK	2.3891	2.3891
SEK	6.1609	6.1841
SGD	0.9322	0.9296
CNY	4.3422	4.3360
THB	23.06	22.97
TOP	1.5384	1.5388
VUV	77.07	76.93
WST	1.7512	1.7693
XPF	72.06	72.08
ZAR	10.8723	10.9201



NZD/USD Forward Points

	BNZ buys NZD	BNZ sells NZD
1 Month	-2.48	-1.82
3 Months	-9.08	-8.55
6 Months	-26.80	-25.80
9 Months	-50.84	-48.84
1 Year	-78.37	-76.37

NZD/AUD Forward points

	BNZ buys NZD	BNZ Sells NZD
1 Month	-8.69	-7.24
3 Months	-19.87	-18.67
6 Months	-46.55	-44.15
9 Months	-80.44	-76.26
1 Year	-115.14	-110.26

Contact Details

BNZ Research

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
Senior Interest Rates Strategist
+64 4 924 7653

Main Offices

Wellington

Level 4, Spark Central
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

Ivan Colhoun
Global Head of Research
+61 2 9237 1836

Alan Oster
Group Chief Economist
+61 3 8634 2927

Ray Attrill
Head of FX Strategy
+61 2 9237 1848

Skye Masters
Head of Fixed Income Research
+61 2 9295 1196

Wellington

Foreign Exchange +800 642 222
Fixed Income/Derivatives +800 283 269

New York

Foreign Exchange +1 212 916 9631
Fixed Income/Derivatives +1 212 916 9677

Sydney

Foreign Exchange +61 2 9295 1100
Fixed Income/Derivatives +61 2 9295 1166

Hong Kong

Foreign Exchange +85 2 2526 5891
Fixed Income/Derivatives +85 2 2526 5891

London

Foreign Exchange +44 20 7796 3091
Fixed Income/Derivatives +44 20 7796 4761

This document has been produced by Bank of New Zealand (BNZ). BNZ is a registered bank in New Zealand and is only authorised to offer products and services to customers in New Zealand.

Analyst Disclaimer: The Information accurately reflects the personal views of the author(s) about the securities, issuers and other subject matters discussed, and is based upon sources reasonably believed to be reliable and accurate. The views of the author(s) do not necessarily reflect the views of the NAB Group. No part of the compensation of the author(s) was, is, or will be, directly or indirectly, related to any specific recommendations or views expressed. Research analysts responsible for this report receive compensation based upon, among other factors, the overall profitability of the Global Markets Division of NAB.

NAB maintains an effective information barrier between the research analysts and its private side operations. Private side functions are physically segregated from the research analysts and have no control over their remuneration or budget. The research functions do not report directly or indirectly to any private side function. The Research analyst might have received help from the issuer subject in the research report.

New Zealand: 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. To the extent that any information or recommendations in this publication constitute financial advice, they do not take into account any person's particular financial situation or goals. 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. National Australia Bank Limited is not a registered bank in New Zealand.

USA: 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.