Markets Today

5 February 2018

Events Round-Up

NZ: ANZ consumer confidence, Jan: 126.9 vs. 121.8 prev.

NZ: Building permits (m/m%), Dec: -9.6% vs. 10.8% prev.

NZ: Net migration, Dec: 5700 vs. 5610 prev.

UK: Construction PMI, Jan: 50.2 vs. 52.0 exp.

US: Change in nonfarm payrolls, Jan: 200k vs. 180k exp.

US: Unemployment rate, Jan: 4.1% vs. 4.1% exp.

US: Average hourly earnings (y/y%), Jan: 2.9% v 2.6% exp

US: University of Michigan sentiment, Jan: 95.7 v. 95 exp.

Good Morning

US bond yields rose further on Friday night after the US non-farm payrolls report showed faster than expected wage growth. The growing prospect of higher US inflation and faster Fed tightening spilled over into other markets, with US stock markets slumping around 2%, the USD strengthening and the VIX rising to its highest level since the US Presidential election.

Non-farm payrolls showed a larger than expected increase in jobs growth for January, but the catalyst for the rise in bond yields and the USD was the acceleration in average hourly earnings, to just below 3% YoY, much higher than expected. Looking through the month to month volatility, US average hourly earnings have been trending higher over the past five years, lending support to the Fed's argument that the falls in the US unemployment rate will eventually generate wage pressure. Other aspects of the non-farm payrolls report were a bit softer. The broader U6 measure of underemployment ticked up, average weekly hours declined (likely weather related), while wage growth for "production and non-supervisory workers" was flat at 2.4% YoY (in contrast to the headline wages number the market reacted to).

The 10 year Treasury rose 5 basis points to 2.84%, its highest since early 2014, and up 15bps since just Thursday morning. The wages data boosted US inflation expectations, with 10 year breakeven inflation rising to its highest level since September 2014, at 2.14%. Interestingly, the yield curve steepened, with the 2 year yield actually falling slightly on the day despite several hawkish comments from Fed officials in the aftermath of the payrolls release. Dallas Fed President Kaplan said that while his base case for this year was 3 hikes, it could be more. Even Minneapolis Fed President Kashkari, who dissented against the last Fed rate rise, said "*this is one of the first signs that we're seeing wage growth finally starting to pick up…and if wage growth continues that could have an effect on the path of interest rates*." The market continues to price close to three rate rises by the Fed this year.

US stocks had their largest one day fall in over a year on Friday, in response to rise in bond yields and the potential for faster inflation and Fed tightening. The S&P 500 was down more than 2% on Friday and around 4% for the week, albeit from what were record highs. At this stage, the fall in global stock markets looks more like a correction than something more sinister. For one, the global economy is experiencing a synchronised upturn and measures of recession risk are low. Second, while most economists forecast US inflation to rise from here, they do not expect the kind of acceleration that would lead to a rapid Fed tightening cycle. Nevertheless, the VIX rose to its highest level since the US Presidential election and there is still the risk that the increase in volatility triggers further selling from some investors.

In FX markets, the US dollar was stronger for a change, rising against all currencies on Friday. Sentiment towards the US dollar has been extremely negative for some time, and the wage data probably triggered some position reduction from investors. The fall in stocks markets probably also lent support to the USD as a 'safe haven' currency. The Bloomberg DXY was up 0.9% on the day but remains over 3% lower than the end of last year.

The NZD was down over a percent on Friday, one of the worst performing major currencies (only the AUD fell by more). Having been over 0.74 at lunchtime on Friday, the NZD ended the week at 0.73. The decline in global stock markets contributed to the NZD's underperformance; the NZD has historically tended to perform poorly during periods of risk aversion.

In other currencies, the GBP declined around a percent against the USD. Following on from the disappointing Manufacturing PMI on Wednesday, the Construction PMI also missed expectations on Friday. And amid more infighting within the Conservative party on Brexit, Trade Secretary Liam Fox said on Friday it would be "incompatible" for the UK to be in a customs union with the EU post-Brexit. We continue think it's likely that the UK and EU agree to a transitional deal in the coming months that maintains the status quo trading relationship for a few years yet and in that environment, we expect NZD/GBP to fall below 0.50 this year.

In local rates markets, the NZ swap curve continued to steepen on Friday in response to the rise in global yields. We'd expect more of the same to start this week as the NZ market responds to the moves in US Treasuries seen on Friday. The market will now look ahead to the RBNZ meeting on Thursday, the last under interim Governor Grant Spencer, and the labour market reports on Wednesday (we expect the unemployment rate to fall to 4.5% vs consensus of 4.7%).

Offshore, the focus will be on central banks this week. A number of Fed officials will be speaking, including NY Fed President Dudley on Thursday morning. The Bank of England meets Friday morning with rates expected to be unchanged but the market will be looking for any signals about the potential timing of rate rises this year. RBA Governor Phil Lowe speaks on Wednesday ahead of the Statement of Monetary Policy released on Friday.

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Coming Up

		Period	Cons.	Prev.	NZT
EC	Markit Eurozone Composite PMI	Jan F	58.6	58.6	22:00
UK	Markit/CIPS UK Services PMI	Jan	54	54.2	22:30
UK	Markit/CIPS UK Composite PMI	Jan		54.9	22:30
EC	Retail Sales YoY	Dec	1.8	2.8	23:00
US	ISM Non-Manf. Composite	Jan	56.5	55.9	04:00

Source: Bloomberg, BNZ

Foreign Exchange

Indicative overnight ranges (*)

	Last	% Day	Low	High
NZD	0.7300	-1.3	0.7300	0.7380
AUD	0.7931	-1.3	0.7921	0.8015
EUR	1.2463	-0.4	1.2410	1.2518
GBP	1.4118	-1.0	1.4102	1.4273
JPY	110.17	+0.7	109.53	110.48
CAD	1.2429	+1.3		
NZD/AUD	0.9204	+0.1		
NZD/EUR	0.5857	-0.9		
NZD/GBP	0.5171	-0.3		
NZD/JPY	80.42	-0.6		
NZD/CAD	0.9073	+0.0		
NZ TWI	74.97	-0.8		

Other FX

	Last	% Day
CHF	0.9314	+0.5
SEK	7.903	+0.8
NOK	7.733	+1.2
HKD	7.821	+0.0
CNY	6.301	+0.1
SGD	1.320	+0.9
IDR	13,452	+0.2
THB	31.45	+0.5
KRW	1,080	+0.8
TWD	29.23	+0.1
PHP	51.66	+0.2

Equities

Major Indices

	Last	% Day	% Year
S&P 500	2,762	-2.1	20.2
Dow	25,521	-2.5	27.2
Nasdaq	7,241	-2.0	27.8
Stoxx 50	3,523	-1.5	7.6
FTSE	7,443	-0.6	3.5
DAX	12,785	-1.7	9.7
CAC 40	5,365	-1.3	11.2
Nikkei	23,275	-0.9	23.0
Shanghai	3,462	+0.4	10.3
ASX 200	6,121	+0.5	8.9
NZX 50	8,415	+0.4	18.6

Commodities**

Price

	Last	Net Day
Oil (Brent)	68.58	-1.5
Oil (WTI)	65.45	-0.5
Gold	1337.3	-0.8
HRC steel	722.0	+0.0
CRB	198.3	+0.0
Wheat Chic.	459.8	-1.0
Sugar	13.63	+1.9
Cotton	77.30	-1.3
Coffee	120.4	-0.8
WM powder	3225.0	+0.0

Australian Futures

3 year bond	97.8	-0.02
10 year bond	97.12	-0.03

Interest Rates

	Rates		Swap Yields		Benchmark 10 Yr Bonds		
	Cash	3Mth	2 Yr	10 Yr		Last	Net Day
USD	1.50	1.79	2.37	2.88	USD	2.84	0.05
AUD	1.50	1.78	2.05	3.06	AUD	2.83	0.03
NZD	1.75	1.89	2.18	3.28	NZD	2.95	0.03
EUR	0.00	0.06	-0.12	1.12	GER	0.77	0.05
GBP	0.50	0.52	0.96	1.65	GBP	1.58	0.05
JPY	-0.05	-0.04	0.06	0.31	JPY	0.09	-0.01
CAD	1.25	1.17	2.23	2.70	CAD	2.36	-0.00

NZ Government Bonds

	Last	
NZGB 3 04/15/20	1.93	-0.01
NZGB 6 05/15/21	2.12	0.00
NZGB 5 1/2 04/15/23	2.43	0.01
NZGB 2 3/4 04/15/25	2.73	0.02
NZGB 4 1/2 04/15/27	2.95	0.03
NZGB 3 1/2 04/14/33	3.31	0.04
NZGB 2 3/4 04/15/37	3.47	0.04

NZ Swap Yields

	Last	
1 year	1.98	0.00
2 year	2.17	-0.00
5 year	2.74	0.01
7 year	3.01	0.02
10 year	3.28	0.02
15 year	3.52	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 NY close

Source: Bloomberg

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