

7 February 2018



## Events Round-Up

US: ISM Non-Manufacturing, Jan: 59.9 vs. 56.7 exp.  
AU: Trade Balance, Dec: -\$1.35b vs. \$200m exp.  
AU: Retail Sales (m/m%), Dec: -0.5% vs. -0.2% exp.  
AU: RBA Cash Rate Target, Feb: 1.5% vs. 1.5% exp.  
NZ: Global Dairy Trade avg. winning price: \$3,553 vs. \$3,310 prev.  
US: Trade Balance, Dec: -\$53.1b vs. -\$52b exp.

## Good Morning

There were wild market moves on Monday night and Tuesday with US stocks down sharply and erasing the gains for 2018. At one point yesterday, S&P500 futures were down more than 8% from where they closed last week, although they have bounced back somewhat over the past few hours and are starting to show some signs of stabilising (for now at least). The VIX rose to 50. Bond yields have fallen sharply in response to the stock market meltdown but FX has been surprisingly stable. The NZD is close to 0.73, similar to where it closed last week.

US stocks had finished last week on a soft note, down around 2% on Friday in response to the higher than expected US wages data and rising bond yields. The losses accelerated on Monday afternoon in New York, with the S&P500 and Dow closing down more than 4% (the Dow had been down more than 6% at one point), and then continued in Asian hours yesterday. At one point yesterday, S&P500 index futures were over 8% lower than their close last week and more than 12% off their intraday record highs set in late January. Market measures of volatility have unsurprisingly ratcheted higher amid these extreme moves; the VIX rose from below 15 last week to 50 yesterday, its highest level since the Chinese currency devaluation in 2015.

Markets have shown some signs of stabilising since the European market opened last night; S&P500 futures are 4% off their lows. The VIX is down to 35, but remains at very elevated levels compared to the past few years.

There was no obvious catalyst for the market moves this week. On Monday, the US ISM non-manufacturing index rose to its highest level since 2005 with the important sub-components all doing well. Dallas Fed President Kashkari softened his comments in the wake of US non-farm payrolls, saying US wage growth was "not yet" enough

and "it could be a blip, but let's not ignore it".

The fall in stock markets likely reflected a combination of factors. First, the wages data on Friday added to the growing sense that US inflation was starting to pick up which will probably lead to faster Fed tightening (and higher bond yields). To date, stock markets have benefited from a 'goldilocks' environment marked by reasonably strong growth and earnings yet low inflation and low interest rates (and hence low recession risk). Equity funds saw their largest monthly inflows on record in January amid growing investor optimism, and this positive market sentiment was arguably vulnerable to a correction. Second, the starting point for stock market valuations (at least on conventional metrics like P/E ratios) was already very high. Lastly, the increase in market volatility likely triggered selling from investors who had calibrated their position sizes to the previous low volatility environment.

We're still inclined to view the move lower in stocks as a correction (from record highs) rather than the start of a bear market. The global growth outlook remains very strong and US inflation, while gradually rising, doesn't appear likely to increase sharply, at least according to most economists. In that environment, recession risk should remain reasonably low for the immediate future. That said, we suspect there will be more volatility in the coming days.

Bond yields moved sharply lower in response to the sharp declines in stock markets. The 10 year US Treasury yield, which had reached a 3 year high of 2.88% on Monday, fell more than 20bps at one point yesterday. As stock markets have stabilised overnight, bond yields have bounced back, and the 10 year yield is back above 2.75% (albeit below where it was before the US wages release). The decline in US bond yields was probably exacerbated by short covering from speculative investors.

Strangely, FX markets have been reasonably stable despite the very large moves seen in stock and bond markets; most major currencies have moved by less than a percent against the USD since the end of last week. The JPY has appreciated, as one would expect during such a period of risk aversion, but it is only up around 0.75% since the end of last week.

The NZD is actually higher than the end of last week, just above 0.73, which is unusual given it historically has tended to underperform during such 'risk-off' episodes. The Global Dairy Trade auction overnight, which showed a 7.6% rise in whole milk powder, probably helped the NZD

at the margin. NZ labour market data are released today and we are looking for a decline in the unemployment rate to 4.5% against market expectations of a rise to 4.7%.

The RBA left its cash rate at 1.50% at its meeting yesterday and expressed greater confidence that unemployment and inflation will move gradually back to target. There was little market reaction and the market now awaits Governor Lowe's speech tomorrow and the Statement of Monetary Policy on Friday. The NZD/AUD has risen to 0.9275, its highest level in almost 6 months.

Overnight, NY Fed President Dudley's is speaking and the market will be especially focused on what he has to say about recent market volatility.

[Nick.Smyth@bnz.co.nz](mailto:Nick.Smyth@bnz.co.nz)

Coming Up

	Period	Cons.	Prev.	NZT
NZ Unemployment Rate	4Q	4.7	4.6	10:45
NZ Employment Change QoQ	4Q	0.4	2.2	10:45
NZ Employment Change YoY	4Q	3.6	4.2	10:45
GE Industrial Production WDA YoY	Dec	6.8	5.6	20:00
US Fed's Dudley Speaks in Moderated Q&A				02:30
US Fed's Evans Speaks on Economic and Policy Outlook				04:15

Source: Bloomberg, BNZ

Foreign Exchange					Equities				Commodities**							
Indicative overnight ranges (*)					Other FX				Major Indices				Price			
	Last	% Day	Low	High		Last	% Day			Last	% Day	% Year		Last	Net Day	
NZD	0.7313	+0.7	0.7267	0.7319	CHF	0.9373	+0.6		S&P 500	2,656	+0.1	15.9		Oil (Brent)	67.11	-0.7
AUD	0.7887	+0.1	0.7836	0.7895	SEK	7.956	-0.3		Dow	24,339	-0.0	21.4		Oil (WTI)	64.03	-0.4
EUR	1.2392	+0.2	1.2314	1.2434	NOK	7.823	-0.2		Nasdaq	6,982	+0.1	23.3		Gold	1331.6	-0.4
GBP	1.3955	-0.0	1.3836	1.4000	HKD	7.820	-0.0		Stoxx 50	3,395	-2.4	4.8		HRC steel	733.0	+0.4
JPY	109.24	+0.1	108.46	109.65	CNY	6.291	-0.0		FTSE	7,141	-2.6	-0.4		CRB	195.2	-0.3
CAD	1.2521	-0.1			SGD	1.320	-0.1		DAX	12,393	-2.3	7.7		Wheat Chic.	458.5	+1.4
NZD/AUD	0.9272	+0.5			IDR	13,540	+0.1		CAC 40	5,162	-2.9	8.0		Sugar	13.83	-0.6
NZD/EUR	0.5901	+0.4			THB	31.51	-0.4		Nikkei	21,610	-4.7	14.3		Cotton	76.43	-0.3
NZD/GBP	0.5240	+0.7			KRW	1,091	+0.2		Shanghai	3,371	-3.4	6.9		Coffee	122.0	+2.0
NZD/JPY	79.89	+0.8			TWD	29.34	-0.1		ASX 200	5,833	-3.2	3.8		WM powder	3230.0	+0.2
NZD/CAD	0.9157	+0.5			PHP	51.43	-0.1		NZX 50	8,242	-2.1	16.2		<b>Australian Futures</b>		
NZ TWI	75.08	+0.6												3 year bond	97.82	0.00
														10 year bond	97.15	0.02
<b>Interest Rates</b>																
Rates		Swap Yields			Benchmark 10 Yr Bonds		NZ Government Bonds			NZ Swap Yields						
	Cash	3Mth	2 Yr	10 Yr	Last	Net Day		Last		Last		Last				
USD	1.50	1.79	2.32	2.80	USD	2.77	0.06	NZGB 3 04/15/20	1.94	0.00	1 year	1.98	0.00			
AUD	1.50	1.77	2.03	3.00	AUD	2.82	-0.11	NZGB 6 05/15/21	2.13	0.00	2 year	2.18	0.00			
NZD	1.75	1.89	2.16	3.28	NZD	2.98	0.00	NZGB 5 1/2 04/15/23	2.45	0.00	5 year	2.76	0.00			
EUR	0.00	0.06	-0.14	1.08	GER	0.69	-0.04	NZGB 2 3/4 04/15/25	2.76	0.00	7 year	3.04	0.00			
GBP	0.50	0.52	0.93	1.59	GBP	1.52	-0.04	NZGB 4 1/2 04/15/27	2.98	0.00	10 year	3.32	0.00			
JPY	-0.04	-0.06	0.05	0.30	JPY	0.08	-0.01	NZGB 3 1/2 04/14/33	3.34	0.00	15 year	3.56	0.00			
CAD	1.25	1.17	2.17	2.70	CAD	2.35	0.06	NZGB 2 3/4 04/15/37	3.50	0.00						

\* 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 07:09

Source: Bloomberg

---

## Contact Details

**Jason Wong**

Senior Markets Strategist  
+64 4 924 7652

**Nick Smyth**

Interest Rate Strategist  
+64 4 924 7653

## National Australia Bank

**Ray Attrill**

Head of FX Strategy  
+61 2 9237 1848

**Rodrigo Catril**

Currency Strategist  
+61 2 9293 7109

**Gavin Friend**

Senior Markets Strategist  
+44 20 7710 2155

**ANALYST DISCLAIMER:** The person or persons named as the author(s) of this report hereby certify that the views expressed in the research report accurately reflect their personal views about the subject securities and issuers and other subject matters discussed. No part of their compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in the research report. Research analysts responsible for this report receive compensation based upon, among other factors, the overall profitability of the Markets Division of National Australia Bank Limited, a member of the National Australia Bank Group ("NAB"). The views of the author(s) do not necessarily reflect the views of NAB and are subject to change without notice. NAB may receive fees for banking services provided to an issuer of securities mentioned in this report. NAB, its affiliates and their respective officers, and employees, including persons involved in the preparation or issuance of this report (subject to the policies of NAB), may also from time to time maintain a long or short position in, or purchase or sell a position in, hold or act as advisors, brokers or commercial bankers in relation to the securities (or related securities and financial instruments), of companies mentioned in this report. NAB or its affiliates may engage in these transactions in a manner that is inconsistent with or contrary to any recommendations made in this report.

**NEW ZEALAND DISCLAIMER:** 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. 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.

**USA DISCLAIMER:** 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.

**National Australia Bank Limited is not a registered bank in New Zealand.**