Events Round-Up

GE: Industrial production (m/m%), Oct: -1.7 vs. 0.1 exp.
CA: Employment change (k), Nov: -71 vs. 10 exp.
CA: Unemployment rate (%), Nov: 5.9 vs. 5.5 exp.
US: Chg. in nonfarm payrolls (k), Nov: 266 vs. 180 exp.
US: Unemployment rate (%), Nov: 3.5 vs. 3.6 exp.
US: Average hourly earnings (y/y%), Nov: 3.1 vs. 3 exp.
CH: Imports (US$, y/y%), Nov: 0.3 vs. -1.4 exp.
CH: Exports (US$, y/y%), Nov: -1.1 vs. 0.8 exp.

Good Morning

A much stronger-than-expected nonfarm payrolls report on Friday night set the scene for increases in bond yields, the USD and equity markets. The NZD rose again on Friday, despite this broad-based USD strength, with upbeat comments from RBNZ Deputy Governor Bascand providing support. The NZD/AUD cross broke above 0.96 for the first time since August. All eyes are on HYEFU this Wednesday for the details of Labour’s “significant” fiscal package.

The key driver of markets on Friday night was the big upside surprise to payrolls. The US recorded monthly payrolls growth of 266k in November, well above the 180k consensus. Even taking account of the returning GM workers (who had been on strike), payrolls was still an impressive 220k, while upward revisions of 41k to prior months added to the robust tone of the report. Payrolls has now averaged 180k in 2019, down on 2018’s 225k pace, but similar to that recorded in 2017. Such a pace of job growth should be sufficient to push the unemployment rate lower over time, all else equal. For November, the unemployment rate fell to 3.5%, equalling its lowest level in 50 years, while average hourly earnings were slightly higher-than-expected on a year-on-year basis, at 3.1%.

The strength in the labour market goes a long way to explaining the resilience of the US consumer in the face of the trade war. Indeed, the University of Michigan consumer survey released later on Friday revealed that US consumer confidence had returned to near its cycle highs, also supported by recent gains in equities. Separately, the Atlanta Fed’s GDPNow estimate for Q4 was lifted to 2% (q/q%, annualised) from 1.5%, although the NY Fed’s nowcast has a much more downbeat 0.6% forecast.

Equity markets rose sharply, with payrolls assuaging any lingering fears of an abrupt slowdown in the US economy. The S&P500 closed over 1% higher to within a fraction of its (recently set) record high. Some positive comments on US-China trade talks by White House economic advisor Larry Kudlow added to the positive market sentiment. Kudlow said “the [Phase One] deal is still close...it’s probably even a wee bit closer than when I made that statement in November” adding that “we’re coming down to short strokes” to finalise the agreement. He did however caution that Trump was prepared to walk away from negotiations if he didn’t get what he wanted.

Rates rose after payrolls, although the reaction was relatively subdued. The 10 year Treasury yield rose 3bps to 1.84%, with the market continuing to price a full 25bp rate cut for the Fed into the curve by the end of next year. The FOMC meeting is on Thursday morning, with no change universally expected. There will be interest in the so-called ‘dot plot’, which showed an unusual degree of dispersion between Fed officials interest rate forecasts at the September meeting (some officials forecasted hikes while others forecasted cuts). However, since then it appears that Fed officials have coalesced around an on-hold policy for the foreseeable future (at least based on the Fed’s baseline economic forecasts).

Payrolls helped the USD to its first rise in six trading sessions, with the USD indices we monitor up by around 0.2%. The USD remains in its broader uptrend for now.

In terms of individual currencies, the CAD was the worst performer, down 0.6%, after a large fall in jobs in November and a surprise increase in the unemployment rate. The GBP consolidated its recent gains (It was up 1.7% last week) as the market looks ahead to this week’s general election in the UK. The GBP was down 0.1% to 1.3140, near seven-month highs. Weekend polls generally showed the Conservatives maintaining a large lead over Labour (anywhere between 6% and 15%).

The NZD was the best performing currency on Friday, up 0.3% to 0.6566, despite the broad-based strength in the USD. Upbeat comments by RBNZ Deputy Governor Bascand on Friday added to improving sentiment towards the NZD. Bascand described the economy as “near or around that turning point”, adding that additional fiscal stimulus from the government would be growth-supportive and that the bank capital rules were unlikely to
have major economic impacts. Bascand’s comments follow those from Governor Orr on Thursday in which he mentioned that monetary policy was in a “holding phase”. Recent rhetoric from senior RBNZ officials suggests they plan to keep the OCR on hold, although they have a watchful eye on global events, including US-China trade.

The NZD was also the best performing currency last week, recording a 2.2% increase. The backdrop of strong NZ commodity prices, signs of a bottoming in NZ business confidence, an impending “significant” fiscal stimulus and an RBNZ that now seems likely to be on hold for some time have all helped support the currency. Additionally, there were signs that speculators were starting to close short NZD positions, with CFTC data showing a reduction in the net short position in futures from around $2.3b to $1.8b (in notional equivalent terms). The NZD/AUD traded above 0.96 on Friday for the first time since early August.

NZ rates continued to track higher on Friday, with the 2 and 10 year swap rates closing at four-month highs of 1.25% and 1.66% respectively. That made it an 11bp rise on the week for the 2 year and an 18bp rise for the 10 year, a big underperformance versus the US and Australia.

The highlight in the week ahead is the release of the Half-Year Economic and Fiscal Update (HYEFU) on Wednesday where Finance Minister Grant Robertson will reveal the details of the government’s “significant” fiscal package, focused on infrastructure. Last week Robertson said that the government would start targeting Core Crown debt within a range of 15% - 25% of GDP immediately, rather than from 2023 as he had previously indicated. Given Robertson went out of his way to flag this as a “significant” package, we can only assume it will be sizeable and the government bond programme will be increased.

The fiscal stimulus will (when implemented) provide a boost to growth and may exacerbate labour and broader costs in the construction sector, in turning helping to boost overall inflation. The market has reduced the probability of RBNZ easing to what is now just 10bps (or 40%). Much will depend on the size of the stimulus and the timeframe over which it’s implemented and the market will be eagerly awaiting its release. The prospect of fiscal stimulus means that near-term NZ data is likely to be downgraded in importance by the market, including GDP next week.

Finally, oil prices hit a three-month high on Friday (Brent crude +2%) after Saudi Arabia said it would implement voluntary production cuts of 400,000 barrels per day, over and above the 500,000 bpd agreed by OPEC+.

In the week ahead, there is the FOMC meeting on Thursday morning. Our guess is that this is likely to be one of the least interesting FOMC quarterly meetings for some time, with market participants comfortable with the Fed’s on-hold stance. The UK election is Thursday while Christine Lagarde will oversee her first ECB meeting as President, although no policy changes are expected.

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Coming Up

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<td>JN</td>
<td>GDP (q%, annualised)</td>
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Source: Bloomberg, BNZ

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