

10 September 2018



## Events Round-Up

GE: Industrial production (m/m%), Jul: -1.1 vs. 0.2 exp.  
CH: Foreign reserves (\$b), Aug: 3,109 vs. 3,115 exp.  
US: Change in non-farm payrolls, Aug: 201k vs. 198k exp.  
US: Unemployment rate, Aug: 3.9% vs. 3.8% exp.  
US: Average hourly earnings (y/y%), Aug: 2.9 vs. 2.7 exp.  
CA: Unemployment rate, Aug: 6% vs. 5.9% exp.  
CH: Exports (y/y%), Aug: 9.8 vs. 10 exp.  
CH: Imports (y/y%), Aug: 20 vs. 17.7 exp.

## Good Morning

The NZD and AUD fell sharply on Friday after a double whammy of stronger than expected US wage growth and President Trump's latest threat that he could impose tariffs on all Chinese imports. There was no announcement on the \$200b Chinese imports, although Trump said it could happen *"very soon"*. US Treasury yields moved sharply higher after the wage data, with the market pushing up Fed tightening expectations.

The main surprise from the US non-farm payrolls report was the larger than expected increase in average hourly earnings, which increased 2.9% from a year ago (vs. 2.7% expected), the fastest pace of wage growth since 2009. Looking through the month-to-month volatility, US wage growth (across multiple measures) has been trending gradually higher over the past five years, lending support to the Fed's view that the tight labour market will eventually lead to higher wage and price inflation.

For the record, payrolls in August was slightly higher than expected although previous months were revised down by 50k. The unemployment rate was unchanged at 3.9%, near its lowest level since 1969, but the broader measures of underemployment continued to move lower. The pace of job growth is still more than sufficient to keep pushing down on the unemployment rate over time, which suggests the trend higher in wage growth should remain in place (albeit probably in a continued gradual manner).

US Treasury yields moved sharply higher after the payrolls report, with the 2 and 10 year yields moving up 7bps to 2.94% and 2.70% respectively. The market boosted its expectations for Fed tightening, with a September rate rise now priced at close to 100% and the probability of a follow-up hike in December near 80%. The market prices

a further 1½ hikes in 2019.

With the Fed funds rate likely to be 2.5% come year-end (and the 2 year yield already 2.7%), it will be increasingly difficult for the 10 year Treasury yield to fall very far from here, absent some evidence of a turn in the US economic cycle or a sustained risk-off event (like a serious fall-out from the US-China trade stand-off – more below). As it stands, the ISM surveys and payrolls continue to paint a picture of a strong economy, inflation is at the Fed's target, and the risks to US Treasury yields looked skewed to the upside. The FOMC meeting later this month, and in particular the 'dot plot' forecasts of Fed officials, will be keenly watched by market participants for a signal to the Fed's policy in 2019. Chair Powell has been non-committal with his intentions, saying only that a gradual rate rise path is appropriate *"for now"*, although the median projection from the June meeting indicated an additional three hikes next year, which would likely see the Fed funds rate in 'restrictive' territory. On Friday, Boston Fed President Rosengren noted *"if things work out well for the economy, and that's what I expect and hope, then we'll be in a situation where we need to have somewhat restrictive policy over time."*

The USD was unsurprisingly boosted by the wage data, with the DXY index rising 0.4% immediately after its release. Interest rate differentials remain a supportive factor for the USD, with the US having the highest interest rates in the developed world and that margin continuing to extend – the spread between the US 2 year swap rate and the DXY-weighted average 2 year rate is 331bps, its highest level since 2007. The USD was stronger against all G10 currencies on Friday with the exception of the Swedish Krona, which was reportedly supported by short covering ahead of the national election over the weekend.

The AUD was the worst performing currency on the day, down 1.3% to 0.7106, with the NZD not far behind, down 0.8% to 0.6534. Both currencies are now at their lowest levels since early 2016. Aside from the broad-based USD strength after payrolls, President Trump's subsequent threat to impose tariffs on all Chinese imports to the US saw a further leg down in the NZD and AUD. With public comment on the proposed \$200b tariffs now over, Trump said it *"could take place very soon, depending on them—to a certain extent it depends on China."* Trump added that *"there is another \$267 billion ready to go on short notice if I want."* Trump's economic advisor Larry Kudlow said on Friday that the administration still had a decision to make on the tariff rate(s), the volume of goods to apply

tariffs to, and the timing of any action.

US equities pared their earlier gains after Trump's comments, with the S&P500 down 0.25% on the day. The relatively modest reaction in equities to the President's latest comments on tariffs may suggest that they are now fairly well flagged and may be 'priced in' to a certain extent. It could also be the case that market participants are waiting for evidence the trade conflict is actually having a real impact on the US economy – so far there have been anecdotes of businesses delaying investment and hiring decisions, but US economic data for the most part remains robust.

Elsewhere, the UK parliament released a transcript from the EU's chief negotiator Michel Barnier in which he said the EU was open to a different back-stop plan for Northern Ireland and said there were parts of the UK White Paper that were useful. The GBP rose from around 1.2930 to 1.3028 after the comments were published, although the post-payrolls rally in the USD saw the GBP move back to near unchanged on the day. The GBP was still one of the best performing currencies on Friday, and NZD/GBP fell to around 0.5050, near its lowest levels since the Brexit vote. The recent spikes higher in the GBP around

even mild positive comments on Brexit negotiations are probably symptomatic of a market that is positioned short.

Finally, NZ rates were marginally lower on Friday, with the 2 year swap rate down 0.5bps to 1.9675 – near its record low of 1.94%. But we will see a move higher in NZ rates today, led by the long-end of the curve, in response to the moves in US Treasuries. We will be watching NZ manufacturing activity data today as an input into our GDP forecast – we currently have 0.7% pencilled in for Q2 against the RBNZ's MPS forecast of 0.5%.

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Coming Up

		Period	Cons.	Prev.	NZT
NZ	Mfg Activity Volume QoQ	2Q		1.4	10:45
JN	GDP SA QoQ	2Q F	0.7	0.5	11:50
CH	PPI YoY	Aug	4	4.6	13:30
CH	CPI YoY	Aug	2.1	2.1	13:30
UK	Industrial Production YoY	Jul	1.1	1.1	20:30
UK	Monthly GDP 3M/3M Change	Jul	0.5	0.2	20:30
US	Fed's Bostic Discusses Economic Outlook				04:00

Source: Bloomberg, BNZ.

Foreign Exchange						Equities				Commodities**				
Indicative overnight ranges (*)					Other FX		Major Indices				Price			
	Last	% Day	Low	High		Last	% Day			Last	Net Day			
NZD	0.6534	-0.8	0.6528	0.6587	CHF	0.9692	+0.4	S&P 500	2,872	-0.2	16.7	Oil (Brent)	76.83	+0.4
AUD	0.7107	-1.3	0.7099	0.7171	SEK	9.058	-0.5	Dow	25,917	-0.3	18.9	Oil (WTI)	67.75	-0.0
EUR	1.1553	-0.6	1.1551	1.1649	NOK	8.453	+0.4	Nasdaq	7,903	-0.3	24.3	Gold	1195.1	-0.3
GBP	1.2920	-0.1	1.2909	1.3028	HKD	7.850	+0.0	Stoxx 50	3,293	-0.1	-4.5	HRC steel	822.0	+0.9
JPY	110.99	+0.2	110.56	111.25	CNY	6.844	+0.1	FTSE	7,278	-0.6	-1.4	CRB	190.4	+0.3
CAD	1.3161	+0.1			SGD	1.379	+0.3	DAX	11,960	+0.0	-2.8	Wheat Chic.	531.5	-0.7
NZD/AUD	0.9194	+0.4			IDR	14,820	-0.5	CAC 40	5,252	-0.4	2.7	Sugar	11.01	+1.9
NZD/EUR	0.5656	-0.3			THB	32.84	+0.2	Nikkei	22,307	-0.8	15.7	Cotton	82.13	+0.9
NZD/GBP	0.5057	-0.7			KRW	1,123	-0.1	Shanghai	2,702	+0.4	-19.7	Coffee	102.5	+0.2
NZD/JPY	72.52	-0.6			TWD	30.77	-0.1	ASX 200	6,144	-0.3	8.3	WM powder	2750.0	-3.0
NZD/CAD	0.8599	-0.7			PHP	53.72	-0.3	NZX 50	9,095	-0.1	15.8	<b>Australian Futures</b>		
NZ TWI	71.53	-0.5										3 year bond	97.98	-0.02
												10 year bond	97.42	-0.04
Interest Rates						NZ Government Bonds				NZ Swap Yields				
Rates		Swap Yields		Benchmark 10 Yr Bonds										
	Cash	3Mth	2 Yr	10 Yr	Last	Net Day	Last			Last				
USD	2.00	2.33	2.90	3.00	USD	2.94	0.07	NZGB 6 05/15/21	1.65	-0.00	1 year	1.93	-0.00	
AUD	1.50	1.93	2.00	2.76	AUD	2.55	-0.02	NZGB 5 1/2 04/15/23	1.87	-0.01	2 year	1.97	-0.01	
NZD	1.75	1.90	1.98	2.81	NZD	2.35	-0.01	NZGB 2 3/4 04/15/25	2.14	-0.01	5 year	2.28	-0.00	
EUR	0.00	0.06	-0.14	0.90	GER	0.39	0.03	NZGB 4 1/2 04/15/27	2.35	-0.01	7 year	2.53	0.00	
GBP	0.75	0.80	1.09	1.54	GBP	1.46	0.04	NZGB 3 04/20/29	2.52	-0.01	10 year	2.80	0.00	
JPY	-0.05	-0.03	0.05	0.33	JPY	0.11	0.00	NZGB 3.5 04/15/33	2.70	-0.01	15 year	3.06	-0.00	
CAD	1.50	1.17	2.43	2.68	CAD	2.29	0.06	NZGB 2 3/4 04/15/37	2.85	-0.01				

\* 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 New York close

Source: Bloomberg

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