

11 May 2018



## Events Round-Up

NZ: RBNZ OCR, May: 1.75% vs. 1.75% exp.  
CH: CPI (y/y%), Apr: 1.8% vs. 1.9% exp.  
CH: PPI (y/y%), Apr: 3.4% vs. 3.4% exp.  
UK: Industrial production (y/y%), Mar: 2.9% vs. 3.1% exp.  
UK: BoE base rate, May: 0.5% vs. 0.5% exp.  
US: CPI (y/y%), Apr: 2.5% vs. 2.5% exp.  
US: CPI ex-food and energy (y/y%), Apr: 2.1% vs. 2.2% exp.

## Good Morning

US equities moved up to their highest level since mid-April and the USD fell after a slightly lower than expected US core CPI release. US Treasury yields declined slightly but market expectations of Fed tightening haven't been materially affected. The BoE revised down its inflation forecasts in its Inflation Report and the market has pushed back rate hikes in the UK. The NZD is the worst performing currency the past 24 hours, with the market taking a dovish interpretation of the RBNZ MPS and Governor Orr's comments afterwards.

The USD is generally weaker overnight after the lower than expected US core CPI release (2.1% vs. 2.2% exp) reduced fears of more aggressive Fed tightening. Having appreciated almost 5% in the space of a month, the Bloomberg DXY retreated 0.6% overnight, but remains near its highs for the year. The miss in core CPI relative to expectations looked to be heavily affected by idiosyncratic factors (used car prices plunged on the month while airfares were very soft as well), rather than reflecting a slowing in the underlying pace of inflationary pressures. The USD was probably overdue a correction after its recent run-up, and CPI provided the catalyst.

US Treasury yields initially declined after the CPI data, but these moves were quickly reversed, with the interest rate market seeing limited implications for the Fed's tightening path. The 10 year Treasury yield declined from 2.98% immediately before the release to 2.94%, before recovering to almost where it was. Market pricing puts the probability of a third additional hike this year by the Fed at 33%, and speculation around the Fed's interest rate projections (the so called 'dots') will start to mount as we approach the 14th June FOMC meeting (in the last

meeting, Fed officials were largely split between forecasting an additional two or three hikes for this year).

US equities are up a little less than 1% overnight, boosted by the lower than expected US core CPI release. The S&P500 is now at its highest level since mid-April, while volatility also continues to drift lower (VIX down to just above 13).

The GBP was the second worst performing currency over the past 24 hours (after the NZD) after the Bank of England Inflation Report was seen as more dovish than expected. The GBP has recovered after the US CPI release though to back above 1.35. The BoE kept rates on hold at 0.5% in a 7-2 vote, as widely expected, but lowered its inflation forecasts for 2019 and 2020 to 2% (from around 2.2%) and said there was value in waiting to confirm the weakness in economic data in Q1 was a "soft patch". The Bank's forecasts for inflation are mechanically calculated based off market pricing leading into the decision, and suggest that the BoE sees around one hike a year over the next three years as broadly appropriate. The market has lowered its probability of an August rate hike to 50% (from 65%) with a hike by November almost fully priced.

The RBNZ MPS yesterday saw a reasonably significant reaction in both FX and interest rate markets. The NZD immediately fell from around 0.6980 before the Statement to 0.6940, before grinding lower over the remainder of the NZ trading day to as low as 0.6903. The NZD has recovered overnight, largely due to the weakness in the USD post-CPI. The NZD/AUD remains at its intraday lows though, below 0.9250 – a three month low.

The market seemed to seize on the Bank's statement that the OCR "will remain at 1.75% for some time" with the Governor emphasising that the chance of a cut or a hike was equally balanced. The market in turn has pushed out the timing of the first hike to September next year (from June previously), with the Governor seeming to approve of the market reaction, saying later in an interview that "some of that message has got through." We also moved out our forecast of the expecting timing of the first hike to May next year (from February previously). The Governor highlighted in that same interview that he wanted to see core inflation rising towards 2% before he would consider raising rates, and that higher wage pressure was key to that happening.

The 2 year swap rate fell 5bps to 2.23%, its lowest level in

a month, and near its narrowest spread to the 90 day bank bill rate since 2016. NZ interest rates compressed to those offshore, with the spread between 10 year NZ swaps and those of the US falling to 15bps, near the narrowest on record.

Finally, former Italian PM Berlusconi announced overnight that he was dropping his opposition to a coalition between the far-left Five-Star movement and far-right League, after months of failed negotiations to form a government. The two potential coalition partners have plenty of ideological differences on economic policy (the League want a flat income tax while Five Star want a guaranteed income scheme for the poor) but are seemingly united by their mistrust of Brussels and dislike of austerity. The Five Star movement has in the past called for a referendum on the euro, and while they have backed away from that stance recently (calling it a "last resort") investors are likely to be unsettled. The spread between Italian government bonds and those of German bunds widened 5bps overnight, although it remains well off the wides reached when the market was worried about the French election last year.

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Coming Up

		Period	Cons.	Prev.	NZT
NZ	BusinessNZ Manufacturing PMI	Apr		52.2	10:30
NZ	Food Prices MoM	Apr		1	10:45
CA	Unemployment Rate	Apr	5.8	5.8	00:30
US	U. of Mich. Sentiment	May P	98.3	98.8	02:00

Source: Bloomberg, BNZ

Foreign Exchange						Equities				Commodities**					
Indicative overnight ranges (*)					Other FX		Major Indices				Price				
	Last	% Day	Low	High		Last	% Day	% Year		Last	Net Day				
NZD	0.6965	-0.3	0.6903	0.6971	CHF	1.0022	-0.3		S&P 500	2,715	+0.7	13.1	Oil (Brent)	77.50	+0.4
AUD	0.7538	+1.0	0.7456	0.7539	SEK	8.643	-0.7		Dow	24,738	+0.8	18.1	Oil (WTI)	71.38	+0.4
EUR	1.1929	+0.7	1.1851	1.1946	NOK	8.000	-1.0		Nasdaq	7,396	+0.8	20.7	Gold	1321.5	+0.7
GBP	1.3523	-0.2	1.3460	1.3618	HKD	7.850	-0.0		Stoxx 50	3,570	-0.0	-2.1	HRC steel	870.0	+0.0
JPY	109.35	-0.4	109.32	110.02	CNY	6.349	-0.2		FTSE	7,701	+0.5	4.3	CRB	204.5	+0.4
CAD	1.2762	-0.7			SGD	1.337	-0.7		DAX	13,023	+0.6	2.1	Wheat Chic.	523.0	-0.8
NZD/AUD	0.9240	-1.2			IDR	14,084	+0.2		CAC 40	5,546	+0.2	2.7	Sugar	11.27	-0.3
NZD/EUR	0.5839	-0.9			THB	31.96	-0.6		Nikkei	22,497	+0.4	12.7	Cotton	84.56	-1.6
NZD/GBP	0.5150	-0.1			KRW	1,073	-0.7		Shanghai	3,174	+0.5	3.7	Coffee	119.6	+0.7
NZD/JPY	76.16	-0.6			TWD	29.86	-0.2		ASX 200	6,119	+0.2	4.1	WM powder	3250.0	+0.0
NZD/CAD	0.8889	-1.0			PHP	51.96	+0.0		NZX 50	8,638	+0.2	15.3	<b>Australian Futures</b>		
NZ TWI	72.95	-0.7											3 year bond	97.795	0.02
													10 year bond	97.21	0.02
Interest Rates						NZ Government Bonds				NZ Swap Yields					
	Rates		Swap Yields		Benchmark 10 Yr Bonds		Last		Last		Last				
	Cash	3Mth	2 Yr	10 Yr	Last	Net Day									
USD	1.75	2.36	2.78	3.01	USD	2.97	-0.04	NZGB 6 05/15/21	2.02	-0.05	1 year	2.09	-0.04		
AUD	1.50	1.94	2.10	2.94	AUD	2.77	-0.01	NZGB 5 1/2 04/15/23	2.31	-0.05	2 year	2.23	-0.04		
NZD	1.75	2.05	2.22	3.18	NZD	2.76	-0.04	NZGB 2 3/4 04/15/25	2.57	-0.04	5 year	2.70	-0.05		
EUR	0.00	0.06	-0.14	0.99	GER	0.56	-0.00	NZGB 4 1/2 04/15/27	2.76	-0.04	7 year	2.94	-0.04		
GBP	0.50	0.68	1.03	1.58	GBP	1.43	-0.03	NZGB 3 04/20/29	2.94	-0.03	10 year	3.18	-0.04		
JPY	-0.05	-0.03	0.05	0.27	JPY	0.05	-0.00	NZGB 3 1/2 04/14/33	3.13	-0.04	15 year	3.44	-0.04		
CAD	1.25	1.17	2.32	2.75	CAD	2.40	0.00	NZGB 2 3/4 04/15/37	3.28	-0.05					

\* 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 06:56

Source: Bloomberg

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