12 November 2018

bnz

Events Round-Up

US: FOMC Fed funds range (%), Nov: 2-2.25 vs. 2-2.25 exp.

CH: PPI (y/y%), Oct: 3.3 vs. 3.3 exp.

CH: CPI (y/y%), Oct: 2.5 vs. 2.5 exp.

UK: GDP (m/m%), Sep: 0 vs. 0.1 exp.

UK: GDP (q/q%), Q3: 0.6 vs. 0.6 exp.

US: PPI ex food and energy (y/y%), Oct: 2.6 vs. 2.3 exp.

US: U of Mich. consumer sentiment, Nov: 98.3 vs. 98 exp.

Good Morning

Equities ended last week on a soft note, led by the tech sector. Amidst a backdrop of more cautious risk sentiment, US Treasury yields declined and the US dollar rose – the DXY is almost back to 18-month highs. Locally, NZ rates rose again on Friday, although there were some signs of receiving interest finally emerging after a very volatile week.

After rising strongly in the aftermath of the mid-term elections, US equities gave up some of their weekly gains on Friday. The S&P closed down 0.9% on Friday while the NASDAQ fell 1.6%, even after a quick rally in the last hour of trading. There was no obvious catalyst for the turn-down in equities, although a further fall in oil prices weighed on the energy sector while Apple's admission of hardware problems in some iPhone X and MacBook Pro models was one of the factors cited for weakness in the tech sector. The S&P500 was still over 2% higher on the week, while the NASDAQ underperformed, up less than 1%.

Chinese equities had set the tone for risk appetite earlier in the day, with the CSI300 down 1.4% and the Hang Seng down 2.4%. The Chinese regulator announced that it was setting lending targets for banks to private sector companies, which weighed on Chinese bank stocks. While the move might provide a boost to growth in the short-term, it was seen as a heavy-handed measure, and might reveal that the Chinese economy is slowing faster than the official statistics indicate so far.

US Treasury yields were dragged lower by the falls in equities - the 10 year Treasury yield fell 5.5bps to 3.18% on the day. Economic data was generally solid, although with little lasting impact on rates. US PPI ex-food and energy was much stronger than expected, although the "core core" measure (which also strips out the volatile trade services component) was in-line with expectations. The University of Michigan consumer confidence index remained near its highest level since the early 2000s, despite the recent wobble in the equity market.

Oil prices fell again on Friday, with both Brent crude and West Texas Intermediate falling into 'bear market' territory (ie. 20% below the recent peak in early October). Comments are now filtering out of the OPEC+ meeting in Abu Dhabi. Saudi's energy minister said there was no consensus in the OPEC+ group on output cuts at this meeting, but the cartel would reconsider at its meeting next month. Separately, Saudi Arabia said it would unilaterally cut its oil output by 500,000 barrels per day next month, which might provide a short-term boost for prices.

The USD appeared to be a beneficiary of the more cautious risk sentiment, alongside the safe-haven Japanese yen and Swiss franc. The USD has had an inverse correlation with the S&P500 over the past month – strengthening during periods of risk aversion. Friday's moves left the DXY index near its recent 18 month highs.

The strength in the US dollar was also partly a by-product of weakness in the British pound, which in turn weighed on the euro. Amidst reports that EU and UK negotiators were close to a breakthrough on a draft Brexit deal, Jo Johnson (brother of Boris) unexpectedly announced he was standing down from his cabinet position in protest at the deal being negotiated. Johnson, who supported Remain, unlike his brother, called for a second referendum. Later, DUP leader Arlene Foster told the BBC that her party couldn't support Theresa May's proposed agreement in its current form. This raises the risk that, even if Theresa May could reach a compromise agreement with the EU, the deal could be voted down by parliament, leading to new elections. The Conservatives have a thin majority, and the DUP, numerous Eurosceptics, and even some remain-supporting MPs are threatening to vote against it. The GBP was 0.7% lower on the day at 1.2970, the second-worst performing G10 currency on Friday, and this spilled over into the EUR, which fell 0.25% to 1.1335.

Against a backdrop of fading risk appetite and a stronger USD, the NZD was also down 0.25% on the day to 0.6740. Even so, it was the strongest performing G10 currency on the week (up over 1% against the USD), mainly due to the sharp rise after the NZ employment report mid-week. CFTC data released over the weekend showed speculative investors had reduced their short positioning in the NZD by around one-quarter, as of last Tuesday.

NZ rates had another volatile session on Friday as the market continued to re-price after the exceptionally strong NZ employment report. After heavy pay-side pressure during the London session on Thursday night, as investors closed out received positions, NZ swaps opened higher on Friday morning by around 3bps. There was more position unwinding during the NZ session, with the 2 year swap trading as high as 2.22% (up 4.25bps on the day) and the 5 year swap trading as high as 2.67% (up 6bps on the day). But good sized receiving interest emerged in the afternoon, and swap yields ended the day between 1.5 to 2bps higher. NZ swap rates rose by 14 to 26bps on the week, with the 5 year point of the curve underperforming. A November 2019 RBNZ rate rise is now around 45% priced.

We see the sharp increase in NZ rates as largely correcting for the extreme outperformance it has experienced against other markets this year. Even after the moves over the past week, NZ is still the only developed market in which the 10y swap rate has fallen this year (albeit only slightly now). The sell-off was amplified by unwinds of ‘carry trades’ in NZ swaps (received swap positions), which now appear more risky in light of the potential for earlier RBNZ tightening and volatility in the 90 day bank bill rate. The 90 day bank bill rate set 1.5bps higher on Friday, at 1.99%, meaning it has increased 10bps over the past fortnight, independent of the OCR outlook. We favour higher NZ swap rates from here, albeit there may be a period of consolidation over the coming few weeks given the extent of the recent move (and the fact the next major piece of NZ data is GDP, which is released shortly before Christmas).

It will likely be a quiet session ahead with the US out for Veteran’s Day holiday. US CPI on Wednesday night and retail sales on Thursday night are the data highlights in the US. There will be a lot of interest in Fed Chair Powell’s speech on Wednesday as well – his hawkish comments in a CNBC interview early last month added to the sharp US rates sell-off at the time. In China, the monthly batch of activity data is released on Wednesday. And across the Tasman, Q3 wage data is released on Wednesday ahead of the labour market report on Thursday (our NAB colleagues expect the unemployment rate to remain unchanged at 5%, slightly below the 5.1% consensus). Finally, in Europe, Italy has a Tuesday deadline to respond to the European Commission over its 2019 budget, which the EC sees as in breach of the zone’s rules.

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Coming Up

		Period	Cons.	Prev.	NZT
NZ	Card spending retail (m/m%)	Oct	0.6	1.1	10:45

Source: Bloomberg, BNZ.

Foreign Exchange

Indicative overnight ranges (*)

	Last	% Day	Low	High
NZD	0.6737	-0.3	0.6728	0.6759
AUD	0.7226	-0.4	0.7219	0.7251
EUR	1.1336	-0.2	1.1316	1.1360
GBP	1.2972	-0.7	1.2975	1.3055
JPY	113.83	-0.2	113.64	113.98
CAD	1.3212	+0.4		
NZD/AUD	0.9323	+0.2		
NZD/EUR	0.5943	-0.1		
NZD/GBP	0.5193	+0.4		
NZD/JPY	76.69	-0.4		
NZD/CAD	0.8901	+0.2		
NZ TWI	73.96	+0.0		

Other FX

	Last	% Day
CHF	1.0056	-0.0
SEK	9.080	+0.7
NOK	8.435	+0.7
HKD	7.832	+0.1
CNY	6.957	+0.3
SGD	1.379	+0.2
IDR	14,678	+1.0
THB	33.06	+0.3
KRW	1,128	+1.0
TWD	30.77	+0.4
PHP	53.04	+0.6

Equities

Major Indices

	Last	% Day	% Year
S&P 500	2,781	-0.9	7.7
Dow	25,989	-0.8	11.0
Nasdaq	7,407	-1.6	9.7
Stoxx 50	3,229	-0.3	-10.1
FTSE	7,105	-0.5	-4.4
DAX	11,529	+0.0	-12.2
CAC 40	5,107	-1.1	-5.1
Nikkei	22,250	-1.1	-1.9
Shanghai	2,599	-1.4	-24.3
ASX 200	5,922	-0.1	-1.8
NZX 50	8,931	+0.4	12.0

Commodities**

Price

	Last	Net Day
Oil (Brent)	70.18	-0.7
Oil (WTI)	60.19	-0.8
Gold	1208.6	-1.3
HRC steel	804.0	-0.6
CRB	188.5	-0.7
Wheat Chic.	512.3	-1.4
Sugar	12.73	-0.9
Cotton	78.09	-1.2
Coffee	117.5	-2.2
WM powder	2680.0	+0.0

Australian Futures

3 year bond	97.83	0.04
10 year bond	97.26	0.05

Interest Rates

	Rates: Cash	Rates: 3Mth	Swap Yields: 2 Yr	Swap Yields: 10 Yr
USD	2.25	2.62	3.12	3.24
AUD	1.50	1.94	2.08	2.91
NZD	1.75	1.99	2.19	3.10
EUR	0.00	0.06	-0.11	0.97
GBP	0.75	0.87	1.21	1.66
JPY	-0.07	-0.10	0.04	0.31
CAD	1.75	1.17	2.68	2.92

Benchmark 10 Yr Bonds

	Last	Net Day
USD	3.18	-0.06
AUD	2.76	0.00
NZD	2.64	0.02
GER	0.41	-0.05
GBP	1.49	-0.07
JPY	0.12	0.00
CAD	2.51	-0.04

NZ Government Bonds

	Last	
NZGB 6 05/15/21	1.95	0.01
NZGB 5 1/2 04/15/23	2.19	0.02
NZGB 2 3/4 04/15/25	2.44	0.02
NZGB 4 1/2 04/15/27	2.64	0.02
NZGB 3 04/20/29	2.79	0.02
NZGB 3 1/2 04/14/33	2.97	0.01
NZGB 2 3/4 04/15/37	3.11	0.01

NZ Swap Yields

	Last	
1 year	2.04	0.00
2 year	2.19	0.02
5 year	2.63	0.02
7 year	2.85	0.02
10 year	3.10	0.02
15 year	3.35	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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