

13 September 2018



Events Round-Up

EC: Industrial production (y/y%), Jul: -0.1 vs. 1 exp.

US: PPI ex food and energy (y/y%), Aug: 2.3 vs. 2.7 exp.

Good Morning

Press reports that US Treasury Secretary Steve Mnuchin had invited China to attend trade talks have given a sharp lift to the NZD and AUD. There wasn't much reaction in either equity or bond markets to the trade news though. US yields have drifted lower ahead of tonight's US CPI release.

After reaching a low of 0.6503 in the London morning, the NZD has since moved almost 1% higher to 0.6560 after the WSJ reported on a possible resumption in US-China trade talks. According to the reports, US Treasury Secretary Mnuchin – who is perceived to be one of the more moderate voices within the US administration – had invited Chinese officials to meet in the coming weeks to discuss trade. President Trump may hold off on imposing tariffs on the \$200b of Chinese imports before the conclusion of the talks.

Market expectations of a breakthrough are probably reasonably low given the two sides have failed to reach agreement in previous rounds of talks (the US demands to date have been unacceptable to China), but the news came as a welcome boost to the CNH and, consequently, the NZD and AUD. The CNH is around 0.7% stronger on the day, with the AUD – the market's preferred China 'proxy' within G10 – up 0.8%. Given the current negative sentiment towards China and the near-record short positioning in the NZD and AUD according to the CFTC, there is the potential for last night's moves to extend further in the near-term.

Outside of EMFX and commodities, which were both higher on the day, there wasn't much positive spill-over from the trade news to broader risk markets. The S&P500 is down around 0.1% on the day and the NASDAQ 0.5% lower. US equities have been relatively unaffected by the ratcheting up in trade tensions over recent months, which suggests they probably won't benefit to the same extent as Chinese equities, for instance, from more positive developments.

US rates have drifted slightly lower over the past 24 hours, with the 10 year yield down 1bp to 2.96%, but still within

reach of the psychologically important 3% level. Lower than expected US PPI and a strong US 10 year bond auction both helped support bonds on the day, although there will be far more interest in the US CPI report released tonight.

Fed Governor Brainard, seen as an influential member of the FOMC, spoke overnight and echoed comments from several other Fed officials recently that the cash rate may need to go into restrictive territory. Brainard noted that "*it appears reasonable to expect the shorter-run neutral rate to rise somewhat higher than the longer-run neutral rate.*" Brainard said she kept a close eye on the yield curve (the 2s10s curve is now just 21bps), but cautioned that the decline in the term premium may be distorting the level of longer-dated Treasury yields and, by extension, the information content that the curve provides; an inverted yield curve has been a historically reliable lead indicator of US recession since WWII. Finally, Brainard noted rising risks in the corporate sector, and in particular leveraged lending, which could suggest some emerging signs of 'overheating' in the financial sector. Brainard's comments didn't have much impact on market pricing, but we would interpret them as implying the Fed intends to tighten by more than the market currently prices.

In FX, the USD is weaker across the board against G10 currencies, as well as most of the EMFX universe, amidst the more positive news on trade. The DXY is 0.4% lower on the day and at a two-week low.

Oil prices have moved higher again, with Brent crude oil reaching \$80 per barrel for the first time since 2014. Against a backdrop of reduced Iranian oil supply and the impending arrival of Hurricane Florence (which is expected to pressure US gasoline supplies), the weekly DOE report showed a larger than expected drawdown in crude inventories.

The rise in oil prices and growing hopes of a NAFTA deal has boosted the Canadian dollar by over 1% from this time yesterday. Shortly after we published our report yesterday, the CAD moved higher after President Trump said that talks were going well and Canada wanted a deal. Those gains have extended overnight after Mexico's economy minister Guajardo said he believed there was a "high chance" of a US-Canada trade deal. USD/CAD has now moved below the 1.30 mark.

NZ rates moved up 1-1.5bps yesterday following the previous sessions moves in US Treasury yields, with a

steepening bias evident on the curve. The long-end of the government bond curve was 2-2.5bps higher ahead of the NZDMO's tender of \$250m of 2029 maturity nominal bonds today. NZ inflation-indexed bonds performed strongly for the second day running, with real yields falling around 2bps, although the implied 10y market 'breakeven inflation rate' is still languishing around 1.3%, well below the 2% midpoint of the RBNZ's inflation target.

There is a busy session ahead with the Australian labour market report released, the BoE and ECB meetings and US core CPI. The Turkish central bank also meets, with the median expectation for a 325bp hike to 21%, although the range of estimates for the central bank's move at this meeting is as wide as 725bps.

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Coming Up

		Period	Cons.	Prev.	NZT
NZ	Food Prices (m/m%)	Aug		0.7	10:45
AU	Employment Change	Aug	18	-3.9	13:30
AU	Unemployment Rate	Aug	5.3	5.3	13:30
GE	CPI EU Harmonized (y/y%)	Aug F	1.9	1.9	18:00
UK	Bank of England Bank Rate	41518	0.75	0.75	23:00
EC	ECB President Draghi Holds Press Conference				00:30
US	CPI (y/y%)	Aug	2.8	2.9	00:30
US	CPI Ex Food and Energy (y/y%)	Aug	2.4	2.4	00:30
US	Fed's Quarles Testifies to Senate Banking Committee				02:00

Source: Bloomberg, BNZ.

Foreign Exchange					Equities				Commodities**				
Indicative overnight ranges (*)					Major Indices				Price				
	Last	% Day	Low	High		Last	% Day	% Year		Last	Net Day		
NZD	0.6561	+0.5	0.6503	0.6566	S&P 500	2,885	-0.1	15.9	Oil (Brent)	79.64	+0.7		
AUD	0.7180	+0.9	0.7095	0.7182	Dow	25,966	-0.0	17.7	Oil (WTI)	70.33	+1.5		
EUR	1.1633	+0.2	1.1570	1.1650	Nasdaq	7,934	-0.5	23.4	Gold	1207.7	+0.9		
GBP	1.3054	+0.2	1.2980	1.3079	Stoxx 50	3,327	+0.5	-4.8	HRC steel	822.0	+0.0		
JPY	111.22	-0.4	111.12	111.59	FTSE	7,313	+0.5	-1.4	CRB	193.4	+0.9		
CAD	1.2993	-0.6			DAX	12,032	+0.5	-3.6	Wheat Chic.	527.0	-2.0		
NZD/AUD	0.9138	-0.3			CAC 40	5,332	+0.3	3.0	Sugar	11.67	+4.2		
NZD/EUR	0.5640	+0.3			Nikkei	22,605	-0.3	13.8	Cotton	82.76	+0.4		
NZD/GBP	0.5026	+0.4			Shanghai	2,656	-0.3	-21.5	Coffee	102.1	+1.8		
NZD/JPY	72.97	+0.2			ASX 200	6,176	-0.1	7.5	WM powder	2755.0	+0.7		
NZD/CAD	0.8525	-0.0			NZX 50	9,196	-0.3	17.5	Australian Futures				
NZ TWI	71.50	+0.2							3 year bond	97.975	0.01		
									10 year bond	97.43	0.03		
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	2.00	2.33	2.92	3.03	USD	2.96	-0.01	NZGB 6 05/15/21	1.67	0.00	1 year	1.94	0.00
AUD	1.50	1.93	2.00	2.75	AUD	2.59	0.01	NZGB 5 1/2 04/15/23	1.89	0.00	2 year	1.99	0.01
NZD	1.75	1.89	1.99	2.82	NZD	2.40	0.02	NZGB 2 3/4 04/15/25	2.17	0.00	5 year	2.32	0.02
EUR	0.00	0.06	-0.15	0.92	GER	0.41	-0.02	NZGB 4 1/2 04/15/27	2.40	0.02	7 year	2.56	0.02
GBP	0.75	0.80	1.12	1.58	GBP	1.48	-0.02	NZGB 3 04/20/29	2.58	0.02	10 year	2.83	0.02
JPY	-0.06	-0.04	0.05	0.32	JPY	0.11	-0.00	NZGB 3 1/2 04/14/33	2.77	0.02	15 year	3.09	0.02
CAD	1.50	1.17	2.48	2.72	CAD	2.33	-0.01	NZGB 2 3/4 04/15/37	2.92	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: NZT 06:54

Source: Bloomberg

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