Events Round-Up

NZ: Food prices (m/m%), Jul: 1.1 vs. -0.7 prev.
AU: NAB business conditions, Jul: 2 vs. 4 prev.
UK: Employment change (3m/3m), Jun: 115k vs. 60k exp.
UK: Unemployment rate (%), Jun: 3.9 vs. 3.8 exp.
GE: ZEW survey expectations, Aug: -44.1 vs. -28 exp.
US: NFIB small business optimism, Jul: 104.7 vs. 104 exp.
US: CPI ex food and energy (m/m%), Jul: 0.3 vs. 0.2 exp.
US: CPI ex food and energy (y/y%), Jul: 2.2 vs. 2.1 exp.
US: CPI (y/y%), Jul: 1.8 vs. 1.7 exp.

Good Morning

Equities and bond yields moved sharply higher overnight after the US announced it would delay the imposition of 10% tariffs on some consumer goods until mid-December, the first sign of some compromise since the trade war re-erupted several weeks ago. The Japanese yen fell sharply and the Australian dollar and Chinese renminbi outperformed. The positive market reaction has been kept somewhat in check by the ongoing clashes in Hong Kong, with Trump saying that he had been told the Chinese government had moved troops to the border.

Overnight, the US Trade Representative (USTR) announced that it would delay the 10% tariffs on some consumer goods until mid-December. Trump explained the timing was aimed to coincide with “the Christmas season”, in effect shielding consumers from higher prices on goods includes mobile phones, laptops, video games, and certain toys, footwear and clothing. US Trade Representative Lighthizer and Treasury Secretary Mnuchin spoke on the phone to Chinese Vice Premier Liu, the first high-level talks between the two sides since Trump abruptly announced his latest tariffs, and the negotiators have reportedly agreed to speak again in a fortnight. Trump described it as a “very productive” discussion said he thought China wanted to “do something dramatic” on trade. The reengagement between the two sides increases the chances that Chinese negotiators will travel to the US to resume trade talks in September, as previously scheduled.

While the exemption for some consumer goods only represents a portion of the $300b of Chinese imports that are due to receive 10% tariffs on 1st September, the announcement is the first real sign of compromise on the US side since tensions re-escalated. It may reveal that Trump is sensitive to the potential for a fall in the equity market and weakness in the US economy to jeopardise his re-election prospects. The S&P500 had, before today’s news, fallen 5% from the record highs after Trump’s latest tariff announcement. The risks of both a long, drawn-out conflict and some resolution ahead of the Presidential election mean the potential range of market outcomes is very wide.

US equities spiked sharply higher after the announcement, with the S&P500 rising 1.7% and the NASDAQ 2.1% higher. The Information Technology (+2.6%) and Consumer Discretionary (+1.9%) sectors unsurprisingly led gains on the S&P500, with a larger proportion of those companies set to benefit from the delay in some tariffs. Apple’s share price was 5% higher on the day.

US Treasury yields also moved sharply higher, with the 10 year Treasury yield 3bps higher at 1.68%, having traded as low as 1.62% earlier in the session. The US Treasury moves were most pronounced at the short-end of the yield curve, with the 2 year yield rising by 8bps to 1.67% as the market pared back Fed rate cut expectations. As a consequence, the commonly followed 2 year/10 year Treasury curve has flattened further, to just 1bp, its flattest level since 2007. Were the 2 year/10 year curve to cross the zero threshold, it would be another indicator warning of the risk of US recession (the 3 month/10 year Treasury curve has been inverted since late-May). The market prices 58bps of rate cuts by year-end from the Fed and around 100bps in total by the end of 2020.

While the news on trade immediately boosted risk sentiment, the ongoing protests in Hong Kong continue to cast a shadow over the market. Amidst increasingly violent clashes between protestors and police and further disruption at Hong Kong’s international airport, China warned that the protestors were showing “signs of terrorism”. Trump said intelligence officials had told him that China had moved troops to the border, and the risk of Chinese military intervention continues to unsettle markets. The Hang Seng index fell 2.1% yesterday, bringing its cumulative decline in August to 9%.

Economic data proved to be a sideshow to the news on trade and the ongoing protests in Hong Kong, but for the record US CPI was stronger than expected in July. Core CPI inflation rose by 0.3% for the second successive month, bringing the annual rate up to 2.1%. Core inflation was boosted by the heavily-weighted Shelter category (which makes up 42% of the core index), medical care medical
services (amidst some signs of wage pressure feeding through) and used car prices, which have reversed some of their weakness from earlier in the year. There were also signs of tariffs impacting end-user consumer prices with a 3.9% year-on-year increase in furniture and bedding prices and a 6% increase in floor coverings. 10 year US breakeven inflation increased a surprisingly modest 3bps, to 1.63%. The NFIB business survey was also stronger than expected, at an elevated level, although the survey pre-dated Trump’s announcement of 10% tariffs on Chinese imports. In Europe, the ZEW survey expectations index fell to its lowest since December 2011, in the depth of the European sovereign crisis.

The Japanese yen (-1.3%) and Swiss franc (-0.7%) have been the underperformers in FX markets amidst the risk-on market backdrop. On the other side of the ledger, the market’s favourite China proxy in the G10, the Australian dollar, is 0.65% stronger and is hovering just below 0.68. The AUD tracked moves in the offshore renminbi (the CNH), which is 1.25% stronger (USD/CNH is just above the key 7.0 level). The Norwegian Krona and Canadian dollars have also increased, albeit more modestly, boosted by an almost 5% rise in Brent crude oil prices.

The NZD had been trading as low as 0.6422 shortly before the trade announcement hit the wires, but the news saw it reverse those earlier losses. The NZD is now close to unchanged on the day, at 0.6450. That still looks like a stark underperformance in the NZD relative to the change in the CNY, which it has been closely correlated to since the trade war erupted.

NZ rates fell again yesterday and the curve flattened, with the 2 year swap rate down 1bp to 0.97% and the 10 year swap rate down 2.5bps to 1.28%. Those moves should reverse today, with bond futures pointing to a 4bp increase in Australia’s 10bp government bond yield.

Today’s session sees the monthly dump of Chinese activity data (retail sales, industrial production and fixed asset investment). The Australian wage price index is released in this time zone and German and European second quarter GDP tonight.

**Coming Up**

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<th>Period</th>
<th>Cons.</th>
<th>Prev.</th>
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<tr>
<td>AU</td>
<td>Wage Price Index (q/q%)</td>
<td>2Q</td>
<td>0.5</td>
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<td>CH</td>
<td>Fixed Assets Ex Rural (y/y% ytd)</td>
<td>Jul</td>
<td>5.8</td>
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<tr>
<td>EC</td>
<td>Industrial Production (m/m%)</td>
<td>Jun</td>
<td>-0.1</td>
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<tr>
<td>EC</td>
<td>GDP (q/q%)</td>
<td>2Q</td>
<td>-0.1</td>
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<tr>
<td>AU</td>
<td>RBA’s Debelle Speaks on Sydney Panel</td>
<td>Jun</td>
<td>1.8</td>
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<tr>
<td>UK</td>
<td>Core CPI (y/y%)</td>
<td>Jul</td>
<td>1.8</td>
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<td>Industrial Production (m/m%)</td>
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<td>NZ</td>
<td>GDP (q/q%)</td>
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Source: Bloomberg, BNZ