

16 May 2018



### Events Round-Up

CH: Industrial production (y/y%), Apr: 7% vs. 6.4% exp.

UK: Unemployment rate, Mar: 4.2% vs. 4.2% exp.

UK: Average weekly earnings (ex-bonus, y/y%), Mar: 2.9% vs. 2.9% exp.

UK: Employment change (3m/3m), Mar: 197k vs. 125k exp.

EZ: GDP (y/y%), Q1: 2.5% vs. 2.5% exp.

NZ: GDT whole milk powder, May: \$3,226 vs. \$3,311 exp.

US: Retail sales ex-auto and gas (m/m%), Apr: 0.3% vs. 0.4% exp.

US: Empire manufacturing survey, May: 20.1 vs. 15 exp.

### Good Morning

The big news overnight is that the 10 year Treasury yield has broken above its highs from early 2014, and now sits at 3.08%. The rise in yields has boosted the USD, which reached new highs for this year, and weighed on equities. Amid the strong USD backdrop, the NZD has (again) underperformed and is around 0.6860.

After around three weeks of consolidating around the 3% mark, the 10 year Treasury yield has surged higher overnight – it is currently up 9bps at 3.09%, its highest level since 2011. The proximate trigger for the rise in yields was the release of US retail sales data, which contained some upward revisions to prior months, and an Empire manufacturing survey that showed the highest prices paid component since 2011. While the data was a bit stronger than expected, the main reason for the large move appears to be the technical break of 3.05%, the highs from early 2014, which added to selling pressure in bonds. 3.25% will probably be the next 'line in the sand' that the market will attempt to challenge. The yield curve steepened from near its flattest levels since 2007, with the spread between the 2 year and 10 year bond yields widening 5bps to 50bps.

Comments overnight from Fed officials generally reinforced the notion that they would continue to progress with raising rates, but there was no clear case to accelerate the pace. Soon-to-be NY Fed President Williams noted that "*inflation has just barely reached our 2 percent goal*" and said that he thought the chances of two or three additional hikes this year were reasonably balanced. Dallas Fed President Kaplan acknowledged that

the Fed was "*basically achieving both of our dual mandate objectives*" and so it should continue moving towards 'neutral'. As the Fed continues hiking we should expect discussion to intensify around what the Fed thinks that 'neutral' rate is. Williams said he thought the "new normal" for the neutral rate was around 2.5% (he added that he didn't expect the fiscal stimulus to have any more than a 0.25% impact on neutral) while Kaplan put it in a range of 2.5-3%. Of course, central banks usually raise rates above neutral if they need to slow the economy, but expectations of the neutral rate help anchor longer-term bond yields. The market currently prices a near 40% chance of an additional third hike this year by the Fed and sees the Fed funds rate above 2.75% at the end of 2019.

The move higher in US yields has boosted the USD across the board with both the Bloomberg DXY and the more euro-centric DXY up more than 0.5%. Both reached new highs for 2018 overnight. The EUR, which only yesterday had met resistance at 1.20, fell to as low as 1.1820. It has recovered slightly to 1.1850 as we write. Eurozone GDP met expectations and caused little reaction, with the market more focused on higher frequency economic data to determine whether the slow-down in Q1 growth was indeed a soft patch.

The GBP has been one of the outperformers in the FX market overnight, although it's still down 0.3% against the USD on the day. The GBP continues to hold above 1.35 for now. The UK labour market report showed a larger than expected increase in employment and wages rising to near 3% - the fastest pace of growth since 2015 (albeit matching expectations). Brexit uncertainty continues to linger in the background, with the two factions of the Conservative party still unable to agree on a path forward to deal with the Irish border and the customs arrangement with the EU. The EU's chief negotiator Michael Barnier said yesterday that there had been "*little*" progress in talks since March and highlighted the June EU Summit as a "*key rendezvous*" to agree a deal that can be signed off in time by European parliaments.

The NZD is once again one of the underperformers in FX markets, against a backdrop of broad USD strength. The NZD has fallen over 7% in the space of a month, with the NZD/AUD cross down over 3% over that time. The relative decline in NZ's interest rates post the RBNZ MPS has added to the downward pressure on the NZD since then. Meanwhile, the Global Dairy Trade auction overnight showed a 1.9% rise while the whole milk powder price fell 2.6%; there was little discernible impact

on the currency.

US equity markets came under pressure overnight in response to the move higher in US yields. The S&P500 is down around 0.9% with the NASDAQ down a similar amount, although both remain near two month highs. The financial sector is one of the outperformers on the day, supported by higher rates and a steeper curve (generally thought to be supportive of banks' net interest margins) and media reports that US regulators are preparing to scale back some of the restrictions imposed by the Volcker Rule.

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### Coming Up

		Period	Cons.	Prev.	NZT
JN	GDP SA QoQ	1Q P	0	0.4	11:50
AU	Wage Price Index QoQ	1Q	0.6	0.6	13:30
AU	Wage Price Index YoY	1Q	2.1	2.1	13:30
EC	CPI Core YoY	Apr F	0.7	0.7	21:00
US	Housing Starts	Apr	1310	1319	00:30
US	Industrial Production MoM	Apr	0.6	0.5	01:15

Source: Bloomberg, BNZ

Foreign Exchange								Equities				Commodities**		
Indicative overnight ranges (*)				Other FX				Major Indices				Price		
	Last	% Day	Low	High		Last	% Day		Last	% Day	% Year		Last	Net Day
NZD	0.6864	-0.7	0.6954	0.6987	CHF	1.0019	+0.1	S&P 500	2,711	-0.7	12.9	Oil (Brent)	78.38	+0.1
AUD	0.7476	-0.7	0.7532	0.7567	SEK	8.677	+0.4	Dow	24,666	-0.9	17.6	Oil (WTI)	71.36	+0.5
EUR	1.1855	-0.6	1.1891	1.1968	NOK	8.105	+0.9	Nasdaq	7,337	-1.0	19.3	Gold	1291.3	-2.1
GBP	1.3515	-0.3	1.3502	1.3596	HKD	7.850	+0.0	Stoxx 50	3,564	-0.0	-2.1	HRC steel	874.0	+0.1
JPY	110.28	+0.6	109.15	109.52	CNY	6.378	+0.6	FTSE	7,723	+0.2	3.6	CRB	203.5	-0.2
CAD	1.2863	+0.4			SGD	1.345	+0.7	DAX	12,970	-0.1	1.3	Wheat Chic.	509.8	+0.3
NZD/AUD	0.9181	-0.0			IDR	14,037	+0.5	CAC 40	5,553	-0.4	2.5	Sugar	11.52	+2.3
NZD/EUR	0.5790	-0.1			THB	32.16	+0.8	Nikkei	22,818	-0.2	14.5	Cotton	83.76	+0.1
NZD/GBP	0.5079	-0.4			KRW	1,074	+0.5	Shanghai	3,192	+0.6	2.5	Coffee	117.0	-0.6
NZD/JPY	75.70	-0.1			TWD	29.85	+0.4	ASX 200	6,098	-0.6	4.2	WM powder	3250.0	+0.3
NZD/CAD	0.8829	-0.3			PHP	52.45	+0.1	NZX 50	8,709	-0.1	17.6	<b>Australian Futures</b>		
NZ TWI	72.28	-0.3										3 year bond	97.725	-0.05
												10 year bond	97.10	-0.07
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	2.33	2.79	3.11	USD	3.08	0.07	NZGB 6 05/15/21	2.00	0.02	1 year	2.06	0.00	
AUD	1.50	1.90	2.12	3.03	AUD	2.83	0.06	NZGB 5 1/2 04/15/23	2.29	0.02	2 year	2.20	0.01	
NZD	1.75	2.01	2.22	3.18	NZD	2.74	0.03	NZGB 2 3/4 04/15/25	2.56	0.02	5 year	2.67	0.02	
EUR	0.00	0.06	-0.12	1.08	GER	0.65	0.03	NZGB 4 1/2 04/15/27	2.74	0.03	7 year	2.92	0.02	
GBP	0.50	0.65	1.05	1.67	GBP	1.52	0.05	NZGB 3 04/20/29	2.91	0.02	10 year	3.17	0.02	
JPY	-0.04	-0.03	0.06	0.28	JPY	0.06	0.01	NZGB 3 1/2 04/14/33	3.09	0.02	15 year	3.42	0.02	
CAD	1.25	1.17	2.39	2.86	CAD	2.51	0.08	NZGB 2 3/4 04/15/37	3.24	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 06:50

Source: Bloomberg

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