

17 December 2018



Events Round-Up

NZ: Manufacturing PMI, Nov: 53.5 vs. 53.5 prev.

JN: Tankan large business conditions, Q4: 19 vs. 18 exp.

CH: Retail sales (y/y%), Nov: 8.1 vs. 8.8 exp.

CH: Industrial production (y/y%), Nov: 5.4 vs. 5.9 exp.

CH: Fixed assets investment (y/y%), Nov: 5.9 vs. 5.8 exp.

GE: Manufacturing PMI, Dec: 51.5 vs. 51.7 exp.

GE: Services PMI, Dec: 52.5 vs. 53.5 exp.

FR: Manufacturing PMI, Dec: 49.7 vs. 50.7 exp.

FR: Services PMI, Dec: 49.6 vs. 54.8 exp.

EC: Manufacturing PMI, Dec: 51.4 vs. 51.8 exp.

EC: Services PMI, Dec: 51.4 vs. 53.4 exp.

US: Manufacturing PMI, Dec: 53.9 vs. 55 exp.

US: Retail sales ex-auto and gas (m/m%), Nov: 0.5 vs. 0.4 exp.

US: Retail sales control group (m/m%), Nov: 0.9 vs. 0.5 exp.

US: Industrial production (m/m%), Nov: 0.6 vs. 0.3 exp.

Good Morning

Global equity markets got hammered again on Friday amid growing concerns about the global growth outlook. Both Chinese activity data and the European PMIs were much weaker than expected. The USD briefly made a fresh 18-month high, with strong US retail sales release adding weight to the narrative that the US economy is outperforming the rest of the world. The NZD was hit by the weaker Chinese data and the RBNZ's announcement that it was proposing to significantly increase the amount of capital NZ banks need to hold.

Starting with New Zealand, on Friday afternoon the RBNZ released a consultation paper which proposed an increase in the amount of "Tier 1" capital that NZ banks need to hold from 8.5% to 16%. The proposed capital changes (which are still be consulted on) are planned to take effect by 2020 and be phased in over a five year period. The RBNZ estimated that the "Big 4" NZ banks would need to raise \$12.8b in capital to meet the regulatory minimum, but since the banks hold a voluntary "buffer" above the minimum requirements, the required capital raise would likely be greater than this. Since equity is the most costly form of funding (as it is the riskiest), the RBNZ's proposal will likely mean average funding costs for banks will

increase. Share prices of the Big 4 banks were down between 1.7% and 2.7% on Friday versus a 1% decline in the ASX 200.

At face value, the proposed changes might mean higher lending rates for the real economy (although the RBNZ expects the impact to be minimal) and/or a reduction in banks' willingness to supply credit. The RBNZ's survey of international evidence suggests that the steady-state level of GDP might be 0.225% lower (than otherwise) if banks increase Tier 1 capital levels by 7.5%, although there will surely be considerable uncertainty around those estimates. These estimates would suggest that the impact on the economy from the proposed capital changes should be small compared to broader macroeconomic developments, especially so given the five year phase-in period. But it's certainly worth keeping an eye on bank lending rates and credit growth once implementation nears.

There wasn't any immediate reaction to the RBNZ paper, but the NZD slumped around 30 minutes later from 0.6855 to 0.6800. It's hard to say with certainty that the sharp fall in the NZD was directly related to the capital proposal, as it coincided with a fall in the AUD and S&P futures at the same time. While one interpretation might be that higher capital requirements are a pseudo-tightening and therefore increase the chances that the next move by the RBNZ might be a rate cut, there was little reaction in the domestic rates market; NZ swap rates were down between 0.5bp and 1bp. Weaker than expected Chinese retail sales and industrial production released shortly after the RBNZ paper helped push the NZD and AUD further in the direction they had already headed. The NZD was the worst performing G10 currency on Friday, down 0.9% to just below 0.68.

In Europe, a batch of weaker than expected European PMIs added to the existing global growth anxieties in the market. The French Services and Manufacturing PMIs dropped below 50 (the level which divides contraction and expansion), with the recent Yellow Vests protests weighing heavily on business sentiment. The composite PMI for the Eurozone as a whole fell to 51.3, its lowest level since November 2014. While the situation in France will hopefully subside soon, and the French PMI rebound, respondents cited broader concerns over trade and global growth, Brexit and tighter financial conditions.

The EUR fell from 1.1360 to 1.1300 immediately after the release of the PMIs and ended down 0.5% on the day.

The GBP also came under pressure after reports emerged of an acrimonious Summit between Theresa May and EU leaders. EU leaders refused to provide anything other than clarifications on the backstop for the Irish border, meaning the deal is highly unlikely to survive a parliamentary vote. Given the current impasse in parliament, Cabinet minister Liam Fox told the BBC over the weekend that one option was to give MPs a “free vote” on the various options, including May’s deal, no-deal, a second referendum or Norway or Canada-style free-trade deals. The GBP was also 0.5% lower on Friday.

Against a backdrop of further weakness in the GBP and EUR, the USD was stronger once again, with the DXY and BBDXY indices briefly touching 18-month highs. The narrative that the US economy is outperforming other countries was reinforced by a very strong US retail sales release, which exceeded expectations and saw the prior month revised significantly higher. The Atlanta Fed GDPNow estimate for Q4 increased to 3% after the retail sales release, which (if realised) would mark the third consecutive quarter of 3%+ annualized growth. US industrial production also beat expectations, but was inflated by strength in the (volatile) mining and utilities sectors.

The risk-off tone to markets and increased concerns around global growth led to another sharp fall in equity markets. Equity indices in Europe were down between 0.5% and 1% and Chinese equities between 1.5% and

2.5%. In the US, the S&P500 fell 2%, taking its cumulative decline since early October to almost 12%. The health care sector fared worst within the S&P (-3.4%) after a Texas federal judge ruled that the ‘individual mandate’ provision within the Affordable Care Act (aka ‘Obamacare’) – the bit which requires all US citizens to have a basic level of health insurance cover - was unconstitutional and therefore so was the whole of Obamacare. There was only a modest decline in US rates, the 10 year Treasury yield down 2bps to 2.89%; the stronger than expected retail sales release was one offset for the US rates market.

In the week ahead, the major focus offshore will be on the FOMC meeting on Thursday morning. NZ GDP is also released on Thursday, where we are looking for a 0.6% increase in Q3, in line with the Bloomberg median estimate of economists. Across the Tasman, the labour market report is released on Thursday.

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Coming Up

	Period	Cons.	Prev.	NZT
NZ Services PMI	Nov		55.4	10:30
EC CPI Core YoY	Nov F	1	1	23:00
US NAHB Housing Market Index	Dec	61	60	04:00

Source: Bloomberg, BNZ.

Foreign Exchange						Equities				Commodities**				
Indicative overnight ranges (*)					Other FX		Major Indices				Price			
	Last	% Day	Low	High		Last	% Day			Last	Net Day			
NZD	0.6797	-0.9	0.6778	0.6813	CHF	0.9980	+0.4	S&P 500	2,600	-1.9	-2.8	Oil (Brent)	60.28	-1.9
AUD	0.7172	-0.8	0.7151	0.7194	SEK	9.061	+0.0	Dow	24,101	-2.0	-2.2	Oil (WTI)	51.20	-2.6
EUR	1.1306	-0.5	1.1270	1.1362	NOK	8.616	+0.7	Nasdaq	6,911	-2.3	-0.4	Gold	1241.4	-0.5
GBP	1.2584	-0.5	1.2530	1.2633	HKD	7.814	+0.0	Stoxx 50	3,093	-0.6	-13.1	HRC steel	736.0	-0.4
JPY	113.39	-0.2	113.22	113.67	CNY	6.908	+0.4	FTSE	6,845	-0.5	-8.6	CRB	180.3	-1.5
CAD	1.3384	+0.2			SGD	1.376	+0.4	DAX	10,866	-0.5	-17.1	Wheat Chic.	536.5	-1.0
NZD/AUD	0.9477	-0.2			IDR	14,581	+0.6	CAC 40	4,854	-1.5	-9.3	Sugar	12.65	-0.8
NZD/EUR	0.6012	-0.4			THB	32.83	+0.2	Nikkei	21,375	-2.0	-5.2	Cotton	79.60	+0.2
NZD/GBP	0.5401	-0.3			KRW	1,131	+0.7	Shanghai	2,594	-1.5	-20.6	Coffee	102.3	-1.8
NZD/JPY	77.07	-1.1			TWD	30.86	+0.1	ASX 200	5,602	-1.1	-6.6	WM powder	2835.0	+0.4
NZD/CAD	0.9097	-0.7			PHP	53.11	+0.8	NZX 50	8,723	-0.8	4.3	Australian Futures		
NZ TWI	74.83	-0.5										3 year bond	98.035	0.03
												10 year bond	97.56	0.04
Interest Rates														
Rates		Swap Yields			Benchmark 10 Yr Bonds		NZ Government Bonds			NZ Swap Yields				
	Cash	3Mth	2 Yr	10 Yr	Last	Net Day		Last		Last			Last	
USD	2.25	2.80	2.88	2.92	USD	2.89	-0.02	NZGB 6 05/15/21	1.77	-0.03	1 year	2.02	-0.01	
AUD	1.50	2.02	1.97	2.65	AUD	2.46	-0.00	NZGB 5 1/2 04/15/23	1.94	-0.03	2 year	2.08	-0.00	
NZD	1.75	1.97	2.08	2.77	NZD	2.31	-0.03	NZGB 2 3/4 04/15/25	2.15	-0.02	5 year	2.36	-0.00	
EUR	0.00	0.06	-0.14	0.86	GER	0.25	-0.03	NZGB 4 1/2 04/15/27	2.31	-0.03	7 year	2.55	-0.01	
GBP	0.75	0.90	1.16	1.45	GBP	1.24	-0.05	NZGB 3 04/20/29	2.47	-0.03	10 year	2.77	-0.01	
JPY	-0.06	-0.10	0.01	0.19	JPY	0.04	-0.02	NZGB 3 1/2 04/14/33	2.65	-0.04	15 year	3.02	-0.01	
CAD	1.75	1.17	2.40	2.62	CAD	2.10	-0.06	NZGB 2 3/4 04/15/37	2.82	-0.03				

* 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 New York close

Source: Bloomberg

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