

17 January 2022



Events Round-Up

UK: GDP (3m/3m%), Nov: 1.1 vs. 0.8 exp.

US: Retail sales (m/m%), Dec: -1.9 vs. -0.1 exp.

US: Retail sales, ex auto/gas (m/m%), Dec: -2.5 vs. -0.2 exp.

US: Retail sales, control group (m/m%), Dec: -3.1 vs. 0 exp.

US: Uni. Michigan consumer sentiment, Jan: 68.8 vs. 70 exp.

Good Morning

It's been an action-packed start to 2022, with some large moves seen across asset classes. US Treasury yields have moved sharply higher to start the year on the back of more hawkish rhetoric from the Fed and generally strong economic data, with the market now expecting the first rate hike to come in March. After a strong end to 2021, US equity indices have fallen this year, led by interest rate-sensitive tech stocks. The USD is generally weaker, despite the market increasing its Fed rate hike expectations. But the NZD has underperformed, still trading around 0.68.

The broad theme to start 2022 appears to be one of more optimism in the global economic recovery. Scientific research, backed up so far by real world experience in South Africa and the UK, suggests the Omicron variant is much less deadly than Delta, giving markets confidence that the hit to growth from recently imposed Covid restrictions in some places (and more restrained consumer behaviour more generally) will be fleeting and the recovery will resume after a few months of disruption. Economic data, of which we cover some of the recent highlights at the bottom of this note, remains generally firm - the Citi Global Economic Surprise Index has reached its highest level since August. Inflation is very high, with headline US CPI hitting a 40-year high of 7% y/y in December and core inflation a 30-year high of 5.5%. An area of concern for the global economy and supply chains is China, with the authorities still pursuing their zero-tolerance approach even as Omicron cases emerge.

Against a backdrop of extremely high inflation and a tight labour market, the Fed has continued to move in a more hawkish direction. The minutes to the Fed's December meeting, which were released earlier this month, stated that policy tightening could come *"sooner or at a faster pace than participants had earlier anticipated"*, which investors took as a cue to bring forward the expected timing of the initial Fed rate hike to March (currently over

90% priced). The minutes also signalled that the Fed will likely start balance sheet reduction (whereby it allows some of its bond holdings to mature, rather than reinvest the proceeds) shortly after the first hike. Powell told the Senate this process of balance sheet reduction, also sometimes referred to as 'Quantitative Tightening', would happen *"sooner and faster"* than the last cycle. Even some of the most traditionally dovish voices on the committee, such as Chicago Fed President Evans, are on board with a three-hike baseline for 2022, with the risk of more hikes were inflation to remain elevated. The market now prices 95bps of rate hikes by the Fed this year, up from around 75bps at the end of 2021.

In shades of early 2021, US rates have started the year with a surge higher. The US 10-year rate, which finished last year around 1.50%, is up to 1.78%, having reached a two-year high of 1.80% last week. But, in contrast to early 2021, the move has been entirely led by real yields, rather than inflation expectations, which may be a sign of increased market confidence in the economic outlook. Ahead of the Fed's anticipated tightening cycle, the 10-year real yield remains extremely low, at -0.70%, so we should expect further increases in US rates – and, by extension, global rates – this year, although this trade already appears well populated. Outside the US, global 10-year bond rates are higher, by around 14bps in Germany (with the 10-year bund yield nearing 0%), 20bps in Australia and 13bps in New Zealand (to 2.49%).

Higher interest rates have put pressure on tech stocks, with the NASDAQ more than 4% lower year-to-date, admittedly after a strong end to 2021. The S&P500 is down a lesser 1.8%, with the weakness in tech stocks a big drag on the broader index. But the strong performance of cyclical sectors this year hints at a more optimistic narrative around the global economy's growth prospects. The Energy subgroup is up some 16% this year, fuelled by higher oil prices, while the Financials sector is up 4.5%, and Industrials are slightly positive year-to-date. Equity indices in Europe, which are largely dominated by such sectors, are up between 0.7% and 3.7%. Likewise, an index of US airline, hotel, and cruise operator share prices – i.e. those sectors most exposed to Covid – has jumped almost 4% this year.

In terms of commodities themselves, Brent crude oil is around 11% higher this year, at \$86.30, near its highest level since 2014. Industrial metals such as iron ore (+6%) and copper (+3%) have also performed well, suggesting the

market is factoring in a more positive global growth outlook, as opposed to this just being related to idiosyncratic supply issues in the oil market.

The main theme for the year so far in currencies has been one of USD weakness, albeit with some pullback during Friday's trading session. The BBDXY USD index is down around 0.5% this year having hit a two-month low earlier on Friday. USD weakness has been reasonably broad based, with losses against seven of the G10 currencies, including 1.1% against the GBP, 0.8% against the JPY and 0.4% against the EUR. The EUR reached a two-month high of around 1.1480 on Friday before turning lower in New York trading to close at around 1.1415.

The depreciation in the USD appears, at first glance, as rather anomalous considering the repricing in Fed rate expectations and 40bps jump in the 10-year US real yield, not to mention a somewhat more cautious backdrop for risk appetite (our risk appetite index is down to 56% from 64% at the end of last year). It might reflect the weight of investor positioning (heavily long USD according to CFTC data) but also, potentially, an improvement in global growth expectations, to which the USD has historically been negatively correlated.

The NZD, alongside the AUD, has struggled this year despite the weaker USD backdrop. The NZD is down around 0.3% year-to-date, with only the AUD (-0.8% YTD) performing worse. The NZD reached a high of almost 0.69 last week, although it is now back to around the 0.68 mark. The NZD is slightly lower on the crosses, except versus the AUD. Of note, the NZD/GBP cross hit a 16-month low of around 0.4965 last week (currently 0.4978).

The NZ yield curve has steepened this year, with the surge in US rates dragging longer-term NZ rates higher while shorter-term rates have been more stable. The 10-year swap rate is up 9bps this year (and likely to open higher this morning after Friday night's US Treasury sell-off) while the 2-year swap rate is up just 4bps, at around 2.20%. OCR expectations have been reasonably steady, with the market pricing around a 10% chance of a 50bps hike at the RBNZ's upcoming February meeting even with labour market and inflation indicators pointing to strong CPI and HLFS data releases over the coming few weeks. We think the unemployment rate is likely to fall to a record low of

3.2% in Q4, with further declines likely this year, potentially even to below 3%.

In terms of major economic data over the past month, US nonfarm payrolls was weaker than expected, with just 199k jobs created in December (450k exp.), although the bigger picture is one of an exceptionally tight US labour market. The US unemployment rate fell to 3.9% (4.1% exp.), approaching its pre-Covid lows, while the Atlanta Fed's Wage Growth Tracker, one of the best wage measures, is running at an annual rate of 4.7%, its highest reading since 2002. The "quits rate" is at a record high 3%. Both the ISM Services and Manufacturing indices have moderated this year, albeit to still very strong levels on a historical basis (57.6 and 58.7 respectively), with the surveys suggesting some tentative signs that supply-chain issues may be starting to normalise (whether that trend continues is likely to depend, in part, on how disruptive an Omicron outbreak in China is for global production). US retail sales released on Friday were very weak, although the broader trend is one of a healthy US consumer sitting on significant savings accumulated through the pandemic. CPI inflation remains high almost everywhere (except Japan and China it seems), with core inflation at 5.5% y/y in the US and 2.6% in the Euro Area, although this is expected to be the peak in European inflation. Chinese data released today will give another read on the activity pulse in China, with quarterly GDP expected to rebound to 1.2% in Q4.

Locally, the highlight this week is the QSBO survey, although the market's focus is on next week's CPI release and the HLFS labour force data the week after.

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Coming Up

		Period	Cons.	Prev.	NZT
CH	Industrial Production (y/y%)	Dec	3.7	3.8	15:00
CH	Fixed Asset Investment (y/y%)	Dec	4.8	5.2	15:00
CH	Retail Sales (y/y%)	Dec	3.8	3.9	15:00
CH	GDP (q/q%)	4Q	1.2	0.2	15:00
CH	GDP (y/y%)	4Q	3.6	4.9	15:00

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	0.6808	-0.8	0.6792	0.6874	CHF	0.9140	+0.3	S&P 500	4,663	+0.1	22.9	Oil (Brent)	86.29	+2.2
AUD	0.7214	-1.0	0.7198	0.7294	SEK	9.026	+1.0	Dow	35,912	-0.6	15.9	Oil (WTI)	83.82	+2.6
EUR	1.1415	-0.4	1.1399	1.1481	NOK	8.764	+0.5	Nasdaq	14,894	+0.6	13.6	Gold	1816.5	-0.2
GBP	1.3680	-0.2	1.3653	1.3743	HKD	7.785	-0.0	Stoxx 50	4,272	-1.0	17.3	HRC steel	1437.0	-0.1
JPY	114.19	-0.0	113.49	114.15	CNY	6.353	-0.1	FTSE	7,543	-0.3	10.9	CRB	245.4	+1.0
CAD	1.2549	+0.3			SGD	1.348	+0.2	DAX	15,883	-0.9	13.5	Wheat Chic.	744.5	-0.2
NZD/AUD	0.9437	+0.3			IDR	14,296	+0.0	CAC 40	7,143	-0.9	25.7	Sugar	18.31	+1.3
NZD/EUR	0.5964	-0.5			THB	33.21	-0.1	Nikkei	28,124	-1.3	-1.4	Cotton	119.70	+2.5
NZD/GBP	0.4977	-0.6			KRW	1,187	-0.0	Shanghai	3,521	-1.0	-1.3	Coffee	239.7	+1.1
NZD/JPY	77.74	-0.9			TWD	27.58	-0.1	ASX 200	7,394	-1.1	10.1	WM powder	4190	-0.2
NZD/CAD	0.8543	-0.5			PHP	51.12	+0.1	NZX 50	12,790	-0.3	-1.8	Australian Futures		
NZ TWI	72.71	-0.6										3 year bond	98.69	-0.05
												10 year bond	98.09	-0.07
Interest Rates														
	Rates		Swap Yields		Benchmark 10 Yr Bonds		NZ Government Bonds		NZ Swap Yields					
	Cash	3Mth	2 Yr	10 Yr	USD	Last	Net Day	Last	Last	Last	Last			
USD	0.25	0.24	1.16	1.85	USD	1.78	0.08	NZGB 5 1/2 04/15/23	1.54	0.00	1 year	1.75	0.01	
AUD	0.10	0.07	1.06	2.15	AUD	1.85	-0.01	NZGB 0 1/2 05/15/26	2.26	-0.02	2 year	2.21	-0.02	
NZD	0.75	0.97	2.22	2.75	NZD	2.51	-0.02	NZGB 0 1/4 05/15/28	2.37	-0.02	5 year	2.61	-0.02	
EUR	0.00	0.06	-0.23	0.39	GER	-0.05	0.04	NZGB 1 1/2 05/15/31	2.45	-0.02	7 year	2.68	-0.03	
GBP	0.25	0.51	1.20	1.21	GBP	1.15	0.05	NZGB 2 05/15/32	2.51	-0.02	10 year	2.74	-0.03	
JPY	-0.04	-0.02	0.01	0.13	JPY	0.14	0.01	NZGB 1 3/4 05/15/41	2.89	-0.03	15 year	2.78	-0.03	
CAD	0.25	0.58	1.74	2.24	CAD	1.77	0.07	NZGB 2 3/4 05/15/51	2.94	-0.02				

* These are indicative ranges from 5pm NZT; please confirm rates with your BNZ dealer

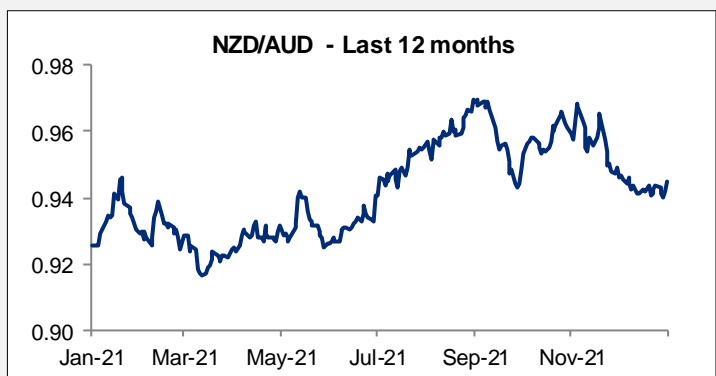
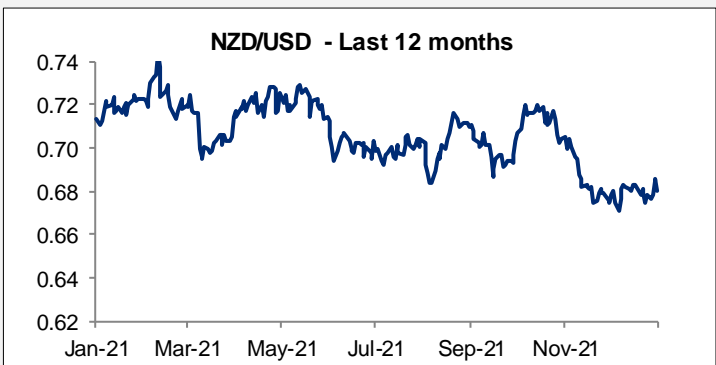
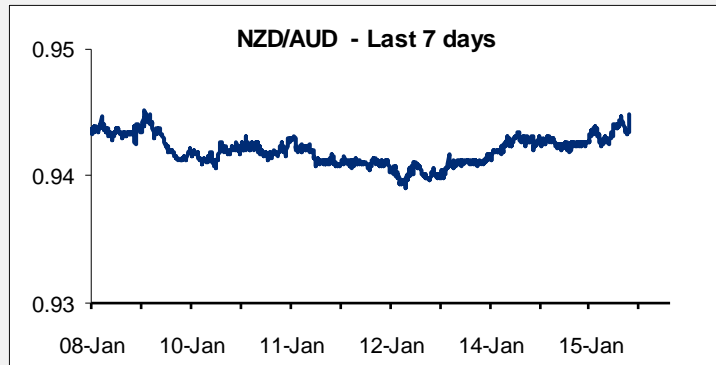
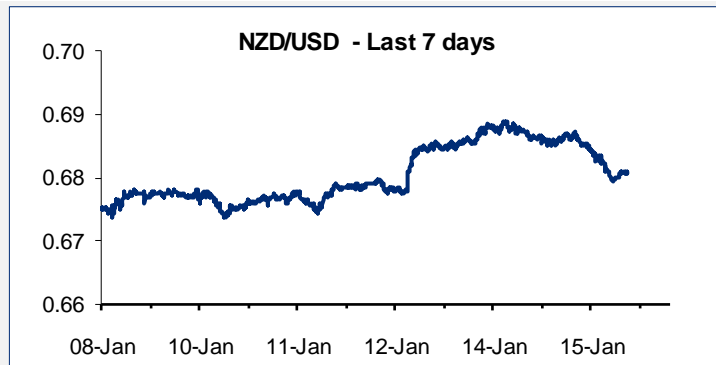
** All near futures contracts, except CRB. Metals prices are CME.

Rates are as of: New York close

Source: Bloomberg

NZD exchange rates

15/01/2022	NY close	Prev. NY close
USD	0.6804	0.6861
GBP	0.4976	0.5006
AUD	0.9440	0.9421
EUR	0.5963	0.5990
JPY	77.69	78.35
CAD	0.8540	0.8590
CHF	0.6219	0.6251
DKK	4.4375	4.4570
FJD	1.4357	1.4484
HKD	5.2966	5.3424
INR	50.45	50.69
NOK	5.9627	5.9805
PKR	119.84	121.04
PHP	34.78	35.03
PGK	2.3874	2.4074
SEK	6.1411	6.1315
SGD	0.9170	0.9232
CNY	4.3224	4.3635
THB	22.60	22.78
TOP	1.5366	1.5449
VUV	76.18	77.14
WST	1.7700	1.7781
XPF	71.20	71.78
ZAR	10.4713	10.5696



NZD/USD Forward Points

	BNZ buys NZD	BNZ sells NZD
1 Month	-3.06	-2.50
3 Months	-11.11	-10.61
6 Months	-27.35	-26.35
9 Months	-48.85	-46.85
1 Year	-70.86	-68.86

NZD/AUD Forward points

	BNZ buys NZD	BNZ Sells NZD
1 Month	-5.33	-4.19
3 Months	-19.62	-18.15
6 Months	-47.08	-44.18
9 Months	-79.26	-74.71
1 Year	-109.35	-103.93

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