

18 July 2018



## Events Round-Up

NZ: REINZ house sales (y/y%), Jun: -1.6% vs 1.3% prev.

NZ: CPI (q/q%), Q2: 0.4% vs 0.5% exp.

NZ: CPI (y/y%), Q2: 1.5% vs 1.6% exp.

NZ: CPI – Sectoral Factor Model (y/y%), Q2: 1.7% vs 1.5% prev.

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

UK: Average weekly earnings ex bonuses (3m/3m), May: 2.7% vs 2.7% exp.

NZ: Global Dairy Trade – avg. winning price: \$3,222 vs \$3,232 prev.

NZ: Global Dairy Trade – whole-milk powder: \$2,973 vs \$2,905 prev.

## Good Morning

In his semi-annual testimony to Senate, Chair Powell said that the Fed intends to stick to its gradual rate rise path “for now”. US equities are higher on the day and the USD stronger but bond yields are little changed. Politics continue to weigh on the GBP, although the Government narrowly avoided defeat on a pro-EU amendment to the Trade bill. The NZD is the top performing currency over the past 24 hours after a surprise increase in the RBNZ’s Sectoral Factor Model of underlying inflation.

The NZD is slightly higher than this point yesterday at 0.6785 but it is the strongest performing currency in the G10. Headline CPI data released yesterday morning showed a 0.4% increase in Q2, slightly below the median expectation of 0.5%, but allaying some market fears of a very weak print. There was a very short-lived dip in the NZD on the release but it subsequently recovered those earlier losses. But the big surprise was an unexpected increase in the RBNZ’s Sectoral Factor Model of underlying inflation which was released at 3pm. The Sectoral Factor Model showed an annual underlying inflation rate of 1.7% in Q2, higher than Q1’s 1.5% (subsequently revised to 1.6%). After revisions, the Sectoral Factor Model now shows an increase from 1.4% in Q3 last year to 1.7% currently – still below target, but now giving the impression that it is certainly moving in the right direction.

After initially failing to react much to the core inflation release, the NZD powered up from 0.6770 to 0.6840 while

the NZD/AUD moved from 0.9140 to 0.92. The rates market reaction was also swift, with the market completely eliminating the (10%) pricing of rate cuts in the short-end of the curve and swap rates moving higher. The 2 year swap rate rose 4bps while the 10 year rate ended the day 6bps higher. With the market having been more focused on the risk of a negative surprise to the CPI data and the risk the next move in the OCR could be down – and positioned accordingly – the Sectoral Factor Model provided a major surprise.

The NZD has since drifted back from 0.6840 to 0.6785 amid broad-based USD strength – the Bloomberg dollar index is up 0.4% on the day – but it has retained most of its gains on the crosses. The Global Dairy Trade auction overnight showed a 1.7% fall in the broader index, which was within the -1% to -4% range we expected, while whole-milk powder prices rose 1.5%.

In the US, Fed Chair Powell delivered his semi-annual address to the Senate where he largely stuck to the script that the US economy was in good shape, the risks to growth were roughly balanced and added further gradual rate rises were warranted “for now”. The inclusion of the phrase “for now” suggests that the Fed will become more data dependent as the Fed funds rate approaches neutral and may speed up hikes, if inflation moves “persistently” above target, or stop them completely, say if downside growth risks materialize. Market expectations of Fed tightening didn’t change much after Powell’s comments; the market prices a more than 90% chance of a September rate rise and prices the Fed funds rate to rise to around 2.7% next year (which is below Fed officials ‘dot’ forecasts but close to the central bank’s estimates of the neutral rate). The US 10 year Treasury yield was unchanged on the day and there was a further modest flattening in the yield curve, with the 2s10s curve moving below 25bps – its flattest level since 2007. Powell appears before Congress tonight.

While there wasn’t much reaction in the rates market to Powell’s comments, US equities moved higher, with the S&P500 up 0.5% on the day as I write (and up 0.8% from when Powell’s testimony was released). It’s possible the equity market had attached some risk to Powell taking a hawkish stance, which might explain the rise that followed his testimony. The NASDAQ is 0.7% higher, to a new record high, having shrugged off Netflix’s disappointing results after the bell yesterday, in which the company said it had added fewer subscribers than analyst expectations. Netflix opened almost 14% lower today but has since

pared that loss to be “only” 5% down from its pre-earnings level.

Finally, the GBP has been the weakest currency overnight as politics continues to overshadow economic data. The UK Government managed to narrowly avoid defeat on an amendment to the Trade bill that would have sought to keep the UK in the Customs Union if the Government couldn't agree on frictionless trade with the EU by January 2019. If the amendment were accepted (and the Government defeated), there was speculation there would be a leadership challenge on Theresa May and possibly a vote of no confidence from Labour. GBP fell to as low as 1.3070 ahead of the vote, but has since recovered slightly to 1.3120 after it was defeated (leaving the GBP still the worst performing currency on the day). So Theresa May hangs on by the skin of her teeth but the political outlook remains highly uncertain. The UK labour market report met expectations and market pricing of an August BoE rate rise remained around 85%. UK CPI is released tomorrow.

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Coming Up

	Period	Cons.	Prev.	NZT
UK CPI YoY	Jun	2.6	2.4	20:30
UK CPI Core YoY	Jun	2.1	2.1	20:30
EC CPI Core YoY	Jun F	1	1	21:00
US Housing Starts	Jun	1320	1350	00:30
US Fed Chairman Powell Appears Before House Panel				02:00
US U.S. Federal Reserve Releases Beige Book				06:00

Source: Bloomberg, BNZ.

Foreign Exchange					Equities				Commodities**						
Indicative overnight ranges (*)					Other FX				Major Indices			Price			
	Last	% Day	Low	High		Last	% Day	% Year		Last	Net Day				
NZD	0.6782	+0.1	0.6769	0.6839	CHF	0.9995	+0.3		S&P 500	2,812	+0.5	14.3	Oil (Brent)	72.10	+0.4
AUD	0.7388	-0.4	0.7376	0.7436	SEK	8.832	+0.1		Dow	25,101	+0.2	16.0	Oil (WTI)	68.07	+0.0
EUR	1.1662	-0.4	1.1650	1.1745	NOK	8.144	+0.5		Nasdaq	7,848	+0.6	24.3	Gold	1228.0	-0.9
GBP	1.3121	-0.9	1.3070	1.3269	HKD	7.849	-0.0		Stoxx 50	3,458	+0.2	-1.7	HRC steel	911.0	-0.2
JPY	112.84	+0.5	112.23	112.93	CNY	6.707	+0.2		FTSE	7,626	+0.3	3.0	CRB	191.1	-0.0
CAD	1.3192	+0.4			SGD	1.365	+0.2		DAX	12,662	+0.8	0.6	Wheat Chic.	512.3	+1.8
NZD/AUD	0.9180	+0.5			IDR	14,378	-0.1		CAC 40	5,423	-0.4	3.7	Sugar	11.13	+0.1
NZD/EUR	0.5815	+0.5			THB	33.31	+0.1		Nikkei	22,697	+0.4	13.5	Cotton	88.34	+0.6
NZD/GBP	0.5169	+0.9			KRW	1,124	-0.4		Shanghai	2,798	-0.6	-12.2	Coffee	109.3	-1.1
NZD/JPY	76.53	+0.6			TWD	30.51	-0.2		ASX 200	6,204	-0.6	9.1	WM powder	2945.0	+0.0
NZD/CAD	0.8947	+0.5			PHP	53.34	-0.2		NZX 50	8,979	-0.0	16.5	<b>Australian Futures</b>		
NZ TWI	73.04	+0.3											3 year bond	97.915	0.00
													10 year bond	97.36	0.03
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					
USD	2.00	2.33	2.84	2.92	USD	2.86	0.00	NZGB 6 05/15/21	1.96	0.04	1 year	2.04	0.01		
AUD	1.50	2.01	2.10	2.84	AUD	2.66	0.02	NZGB 5 1/2 04/15/23	2.18	0.04	2 year	2.17	0.04		
NZD	1.75	1.94	2.14	3.08	NZD	2.68	0.04	NZGB 2 3/4 04/15/25	2.49	0.04	5 year	2.59	0.05		
EUR	0.00	0.06	-0.17	0.87	GER	0.35	-0.02	NZGB 4 1/2 04/15/27	2.68	0.04	7 year	2.83	0.06		
GBP	0.50	0.75	1.05	1.51	GBP	1.26	-0.02	NZGB 3 04/20/29	2.87	0.04	10 year	3.08	0.06		
JPY	-0.07	-0.04	0.04	0.25	JPY	0.04	0.00	NZGB 3 1/2 04/14/33	3.05	0.04	15 year	3.34	0.06		
CAD	1.50	1.17	2.27	2.52	CAD	2.13	-0.01	NZGB 2 3/4 04/15/37	3.19	0.04					

\* 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 07:03

Source: Bloomberg

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