Events Round-Up

NZ: Manufacturing PMI, Oct: 52.6 vs. 48.2 prev.
US: Empire manufacturing, Nov: 2.9 vs. 6 exp.
US: Retail sales ex auto, gas (m/m%), Oct: 0.1 vs. 0.3 exp.
US: Retail sales – control group (m/m%), Oct: 0.3 vs. 0.3 exp.
US: Industrial production (m/m%), Oct: -0.8 vs. -0.4 exp.

Good Morning

US equity indices closed last week at fresh record highs amidst more positivity around a US-China Phase-One trade deal. Safe haven currencies fell against the USD while commodity currencies outperformed. Domestically, RBNZ Governor Orr and Assistant Governor Hawkesby reinforced the message that the Bank is on hold for now, although it could cut the OCR again if circumstances change.

Market sentiment was supported on Friday by more positive comments on US-China trade talks, as Phase-One negotiations enter the final straight. White House economic advisor Larry Kudlow said that the Phase-One trade deal between the US and China was “coming down to the short strokes” and the “mood music is pretty good.” Meanwhile, US Commerce secretary Wilbur Ross said there would be a deal “in all likelihood” although he cautioned that “the devil is always in the details and we’re down to the last details now.” Over the weekend, Xinhua reported that negotiators had a phone call on Saturday to discuss “each other’s core concerns” and that there had been “constructive discussions”.

The positive headlines on trade led the S&P500 and NASDAQ to increase 0.7% - 0.8%, with both reaching fresh record highs in the process. Healthcare stocks (+2.2%) led gains on the S&P500 after the Trump administration released a plan to improve price transparency in the sector, with the market reaction suggesting that investors had feared worse. The VIX continues to hover near its lowest levels of the past year, at around 12, suggesting that the markets expect low volatility to persist (and showing few signs of concern that the trade talks might fall over again).

Global bonds were little changed Friday despite somewhat softer US economic data. The 10 year Treasury yield closed marginally higher on Friday, at 1.83%, but it was still 10bps lower on the week. US retail sales (ex autos and gas) were weaker than expected in October suggesting a slow-down in the pace of consumer spending in Q4. Industrial production was also much weaker than expected, although hampered by the GM workers’ strike. The preliminary estimate of Q4 GDP calculated by the Atlanta Fed’s GDPNow model was revised lower to just 0.3%, although these early estimates can be subject to significant revisions as more data becomes available.

Currency moves reflected the risk-on backdrop on Friday. The safe haven Swiss franc and Japanese yen were the only currencies to fall against the USD, down 0.2% to 0.4% on the day. Larry Kudlow’s positive comments on US-China trade supported a rise in the CNH (+0.2%) and AUD (+0.5% to around 0.6815). Despite its better performance on Friday, the AUD was still the weakest of the G10 currencies on the week (-0.7%), mainly due to the much weaker than expected Australian employment report the previous day.

A decent rebound in the NZ PMI (more below) and comments by RBNZ Governor Orr and Assistant Governor Hawkesby supported a modest rise in the NZD on Friday and a bounce in the 2 year swap rate. The NZD was the top performing G10 currency last week, rising 1.2% against the USD, mainly reflecting the surprise on-hold decision at the November MPS. The NZD ended the week just above 0.64 against the USD and just under 0.94 against the AUD.

There were multiple comments from RBNZ Governor Orr and Assistant Governor Hawkesby on Friday with the broad message that the RBNZ is on hold for now, although it could cut the OCR again if needed. Hawkesby said “we’ve already got a softening of activity into the end of this year, that’s already baked in...things have to be sufficiently different to get us to reassess.” Governor Orr gave a similar impression in an interview with Bloomberg, indicating that near-term data are likely to look “soggy”, but monetary policy decisions need to focus on the medium-term view, of which the RBNZ expects an improvement. Orr reiterated the message from the MPS that the Bank expects rates to stay low for a prolonged period.

In terms of Friday’s domestic data, the NZ PMI bounced from 48.8 to 52.6, indicating that the manufacturing sector has come out of contraction. It was the highest level of the survey since April, albeit lower than the average over the past few years. Encouragingly, the new orders index, which is often seen as a leading indicator of future activity, bounced to 56.2 while production increased as well.

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The 2 year swap rate had fallen 3bps to 1.14% on Friday morning before the improvement in the PMI and the Hawkesby comments sparked a turnaround. The 2 year swap rate ended up closing 1bp higher at 1.18%. The yield curve flattened, with the fall in global rates the previous evening weighing on 5 and 10 year rates (the 10 year swap rate was 1bp lower at 1.53%).

Governor Orr also mentioned that the Bank would be publishing its principals for unconventional policy early in the New Year. While not a near-term consideration, given that the OCR is still 1%, the Bank has been contingency planning for what measures it might adopt if the economy were to experience a downside shock and the OCR was at, or close to, zero. Asked by the interviewer which measures he would favour, Orr implied he preferred a slightly negative interest rate but also that the Bank was “thinking hard” about interest rate swap intervention (whereby the Bank would receive fixed in interest rate swaps to push down wholesale interest rates). We expect the Bank to indicate that the unconventional policy response will depend on the specific circumstances (if there was a funding/credit crisis then the Bank would presumably consider measures to improve banks’ funding, e.g. long-term lending operations or purchases of bank bonds).

It’s a quieter week ahead. Domestically, the NZ PSI (the services equivalent of the PMI) is released this morning. The services sector in NZ, like many countries, has been more resilient than manufacturing this year, with the PSI sitting comfortably above the 50 mark (54.4 in September). Offshore, the focus is on the ‘flash’ estimates of the European PMIs for November and the release of the FOMC minutes to the Fed’s last meeting.

nick.smyth@bnz.co.nz

Coming Up

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<tr>
<th>Period</th>
<th>Cons. Prev.</th>
<th>NZT</th>
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<tbody>
<tr>
<td>NZ Performance Services Index</td>
<td>Oct</td>
<td>54.4</td>
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<tr>
<td>EC</td>
<td>ECB's Lane speaks in Paris</td>
<td>02:20</td>
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<tr>
<td>US NAHB Housing Market Index</td>
<td>Nov</td>
<td>71</td>
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Source: Bloomberg, BNZ
Contact Details

BNZ Research

Stephen Toplis  
Head of Research  
+64 4 474 6905

Craig Ebert  
Senior Economist  
+64 4 474 6799

Doug Steel  
Senior Economist  
+64 4 474 6923

Jason Wong  
Senior Markets Strategist  
+64 4 924 7652

Nick Smyth  
Interest Rates Strategist  
+64 4 924 7653

Main Offices

Wellington
Level 4, Spark Central
42-52 Willis Street
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Toll Free: 0800 283 269

Auckland
80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Toll Free: 0800 283 269

Christchurch
111 Cashel Street
Christchurch 8011
New Zealand
Toll Free: 0800 854 854

National Australia Bank

Ivan Colhoun  
Global Head of Research  
+61 2 9237 1836

Alan Oster  
Group Chief Economist  
+61 3 8634 2927

Ray Attrill  
Head of FX Strategy  
+61 2 9237 1848

Skye Masters  
Head of Fixed Income Research  
+61 2 9295 1196

Wellington
Foreign Exchange  
+800 642 222
Fixed Income/Derivatives  
+800 283 269

New York
Foreign Exchange  
+1 212 916 9631
Fixed Income/Derivatives  
+1 212 916 9677

Sydney
Foreign Exchange  
+61 2 9295 1100
Fixed Income/Derivatives  
+61 2 9295 1166

Hong Kong
Foreign Exchange  
+85 2 2526 5891
Fixed Income/Derivatives  
+85 2 2526 5891

London
Foreign Exchange  
+44 20 7796 3091
Fixed Income/Derivatives  
+44 20 7796 4761

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