

18 October 2021



Events Round-Up

NZ: Manufacturing PMI, Sep: 51.4 vs. 39.7 prev.
 US: Retail sales (m/m%), Sep: 0.7 vs. -0.2 exp.
 US: Retail sales ex auto & gas (m/m%), Sep: 0.7 vs. 0.4 exp.
 US: Retail sales control group (m/m%), Sep: 0.8 vs. 0.5 exp.
 US: University Michigan consumer sentiment, Oct: 71.4 vs. 73.1 exp.

Good Morning

For all the recent talk of stagflation, last week's price movements suggest that the *reflation* trade might be making a comeback. Equities and commodities were again higher on Friday with the NZD outperforming, closing the week around 0.7070. The US 10-year rate rebounded to near its recent high with the market continuing to bring forward the expected timing of the Fed's first hike, with June 2022 now almost 50% priced. Last week saw an almost 20bps increase in the key NZ 2-year swap rate ahead of this morning's CPI release, which we expect to be a whopper.

Last week was a good one for risk assets, with solid gains across all the major equity markets, big increases in base metal prices and new multi-year highs for oil prices. The S&P500 was up 0.8% on Friday, bringing its gain on the week to 1.8%, while the EuroStoxx 600 was up 2.7% last week. Copper traded above \$10,000 for the first time since the start of May, an almost 10% rise on the week, while oil was up another 1% on Friday, with WTI oil futures hitting a fresh 7-year high, above \$82 per barrel. Both the Bloomberg Commodity Index and the LME Metals Index finished last week at record highs.

Despite a long list of risks the market has been fretting about for the past few months, including the energy crisis in Europe and China spilling over to slower global growth, the risk of higher inflation leading to earlier central bank tightening, and the possibility of a downturn in China's overleveraged real estate sector from an imminent default by Evergrande, equity markets have remained resilient. The S&P500 is around 1.5% from its recent all-time high.

A strong start to the US corporate earnings season, with Goldman Sachs reporting earnings that exceeded even the highest analyst forecast on Friday, and the continued trend lower in Covid-19 cases in the US, with the number of

cases over the last week at their lowest level since early August, have helped support equity market sentiment.

The US retail sales release on Friday was stronger than expected for the second month in a row, with a 0.7% monthly increase in ex auto and gas spending. The fundamentals for the US consumer remain strong given still large accumulated savings balances from the pandemic and a very strong labour market. Despite all the recent talk of stagflation, economists expect economic activity to remain very strong, with consensus looking for 6.3% global growth for 2021 and 4.9% next year.

Global rates rebounded on Friday after the positive surprise to US retail sales and amidst an undercurrent of rising inflationary pressures. The US 5-year rate was 8bps higher on Friday, taking it to an 18-month high of 1.13%, while the 10-year rate was 6bps higher, at 1.57%. The market now prices at almost 50% chance of a Fed rate hike by June next year, with a full 25bps hike now fully priced in for September (previously November). Were the Fed to hike in June next year, it would imply little to no gap after the end of the Fed's tapering process, which officials have indicated is likely to conclude by mid-2022.

Higher inflation expectations are behind the recent moves higher in global bond yields. The US 10-year breakeven inflation rate was 3bps higher on Friday, to 2.56%, taking it to within a whisker of its highest level since 2013, while the European 10-year inflation swap hit an 8-year high, above 2%. This means 10-year real yields remain extremely low, around the -1% mark for the US, although it's surely only a matter of time before these begin to head higher too.

Underlying the rise in inflation expectations has been strong commodity prices, broadening core inflation momentum in the US (including a sharp pick-up in rental inflation), and signs of extreme tightness in the US labour market, leading Fed officials to sound increasingly less confident in their 'transitory' inflation narrative. If anyone wanted confirmation that the US labour market is indeed 'tight', the latest data point from the Atlanta Fed's Wage Growth Tracker, provided it. The measure, which controls for compositional effects unlike some others, showed annual wage growth at 4.2% in September, its highest level since just before the GFC, while the rate of wage growth for those switching jobs was 5.4%, its highest level since 2002. In a sign that employees have indeed regained bargaining power, Bloomberg reported that employees at

nearly 40 companies across the US, including John Deere and Kelloggs, have gone on strike since the start of August in what some are referring to as ‘Strike-tober’.

In other economic data, the University of Michigan’s consumer confidence index was weaker than expected, falling to 71.4 in October, near its recent 10-year low, in part due to higher inflation. The director of the survey observed that “when asked to describe in their own words why conditions were unfavorable, net price increases were cited more frequently than any time since inflation peaked at over 10% in 1978-80”.

Currency moves were fairly restrained on Friday, the USD down around 0.1% in index terms, while the JPY continues to underperform against a backdrop of improving risk appetite and rising global bond yields. USD/JPY was 0.5% higher on Friday, closing the week at a 3-year high, around 114.20. The GBP was the best performing currency on Friday (+0.6%) amidst firming expectations that the BoE will kick off a tightening cycle before the end of the year, while the NZD also performed well, up 0.45% to around 0.7070. The AUD was flat on Friday, seeing the NZD/AUD cross trade back above the 0.95 mark, a gain of 0.5%.

On the week, it was, unsurprisingly, a story of commodity currency strength, with the NZD leading the pack with a 1.85% gain, the AUD up 1.5% and the NOK and CAD seeing gains of 1.3% and 0.8% respectively. With the JPY falling 1.8% last week, NZD/JPY saw a big 3.6% appreciation to its highest level since the start of 2018, around 80.70.

Higher NZ rate differentials might be part of the explanation for the recent resurgence in the NZD. Friday saw a further 5bps rise in the key 2-year NZ swap rate, taking its gain on the week to a chunky 19bps. The market continues to lift OCR expectations for the end of 2022 and 2023, to around 1.8% and 2% respectively. Market pricing for the end of 2022 is now above our 1.75% forecast, which is predicated on OCR hikes at the next two meetings in November and February and quarterly hikes thereafter.

The moves higher in NZ short-end rates likely reflect a combination of factors, as we set out on Friday, including nervousness ahead of this morning’s NZ CPI release. The Bloomberg consensus is for a 1.5% quarterly increase in headline inflation while we are looking for a 1.7% print, which would take the annual rate to 4.4%. The core measures of inflation will be as much, if not more important, for the RBNZ outlook, given its medium-term focus, and the market will be particularly attuned to the 3pm release of the RBNZ’s Sectoral Factor Model of core inflation, which hit a 12-year high of 2.2% y/y last quarter. Expectations of higher inflation in NZ are also visible in the market for inflation-indexed bonds, with the 10-year breakeven inflation rate up 12bps last week to just below 2%, a level that hasn’t been seen since mid-2014.

The government makes its Covid alert level announcement today amidst talk of plans to move away from the current four level system to a traffic light system.

Also out today is a raft of Chinese data, with GDP expected to slow to an annual rate of 5% and focus on the retail sales and industrial production numbers given their unexpected weakness last month.

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Coming Up

		Period	Cons.	Prev.	NZT
NZ	Performance Services Index (PSI)	Sep		35.6	10:30
NZ	CPI (q/q%)	3Q	1.7	1.3	10:45
NZ	CPI (y/y%)	3Q	4.4	3.3	10:45
CH	GDP (q/q%)	3Q	0.35	1.3	15:00
CH	GDP (y/y%)	3Q	5	7.9	15:00
CH	Retail Sales (y/y%)	Sep	3.5	2.5	15:00
CH	Industrial Production (y/y%)	Sep	3.9	5.3	15:00
CH	Fixed Asset Investment (y/y%)	Sep	7.9	8.9	15:00
US	Industrial Production (m/m%)	Sep	0.2	0.4	02:15
US	NAHB Housing Market Index	Oct	75	76	03:00

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	0.7073	+0.4	0.7046	0.7077	CHF	0.9229	-0.1	S&P 500	4,471	+0.7	28.3	Oil (Brent)	84.86	+1.0
AUD	0.7421	+0.1	0.7404	0.7440	SEK	8.617	-0.2	Dow	35,295	+1.1	23.4	Oil (WTI)	82.28	+1.2
EUR	1.1601	+0.0	1.1589	1.1619	NOK	8.423	-0.3	Nasdaq	14,897	+0.5	27.6	Gold	1767.2	-1.6
GBP	1.3751	+0.6	1.3675	1.3773	HKD	7.777	-0.0	Stoxx 50	4,183	+0.8	28.9	HRC steel	1898.0	+0.1
JPY	114.22	+0.5	113.96	114.46	CNY	6.436	-0.1	FTSE	7,234	+0.4	22.2	CRB	239.3	+0.5
CAD	1.2368	-0.0			SGD	1.348	-0.0	DAX	15,587	+0.8	20.7	Wheat Chic.	746.5	+1.3
NZD/AUD	0.9531	+0.5			IDR	14,075	-0.3	CAC 40	6,728	+0.6	36.3	Sugar	19.80	+1.1
NZD/EUR	0.6097	+0.5			THB	33.43	+0.8	Nikkei	29,069	+1.8	24.2	Cotton	107.33	+0.2
NZD/GBP	0.5144	-0.1			KRW	1,182	-0.4	Shanghai	3,572	+0.4	7.1	Coffee	203.4	-2.8
NZD/JPY	80.79	+0.9			TWD	27.99	-0.4	ASX 200	7,362	+0.7	19.2	WM powder	3865.0	+0.4
NZD/CAD	0.8748	+0.5			PHP	50.72	+0.2	NZX 50	13,012	-0.3	4.7	Australian Futures		
NZ TWI	75.26	+0.4										3 year bond	99.16	-0.13
												10 year bond	98.29	-0.09
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			
USD	0.25	0.12	0.54	1.58	USD	1.57	0.06	NZGB 5 1/2 04/15/23	1.09	0.01	1 year	1.22	0.02	
AUD	0.10	0.03	0.46	1.78	AUD	1.65	0.03	NZGB 0 1/2 05/15/26	1.73	0.06	2 year	1.65	0.05	
NZD	0.50	0.69	1.65	2.35	NZD	2.17	0.05	NZGB 0 1/4 05/15/28	1.96	0.06	5 year	2.05	0.05	
EUR	0.00	0.06	-0.39	0.22	GER	-0.17	0.02	NZGB 1 1/2 05/15/31	2.17	0.06	7 year	2.18	0.05	
GBP	0.10	0.14	0.95	1.27	GBP	1.11	0.06	NZGB 2 05/15/32	2.26	0.06	10 year	2.35	0.04	
JPY	-0.05	-0.09	0.01	0.13	JPY	0.08	0.00	NZGB 1 3/4 05/15/41	2.69	0.06	15 year	2.54	0.04	
CAD	0.25	0.46	1.13	2.01	CAD	1.59	0.05	NZGB 2 3/4 05/15/51	2.87	0.07				

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

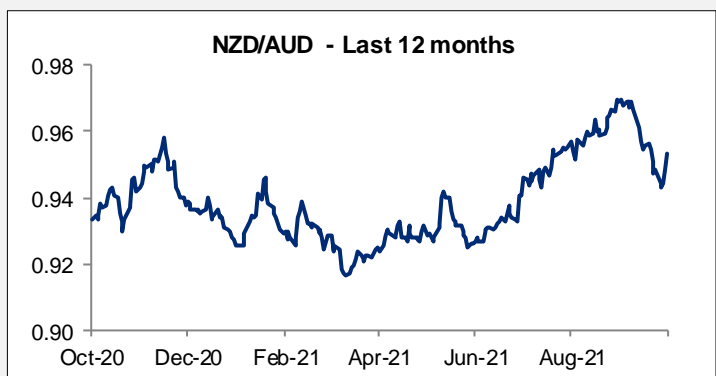
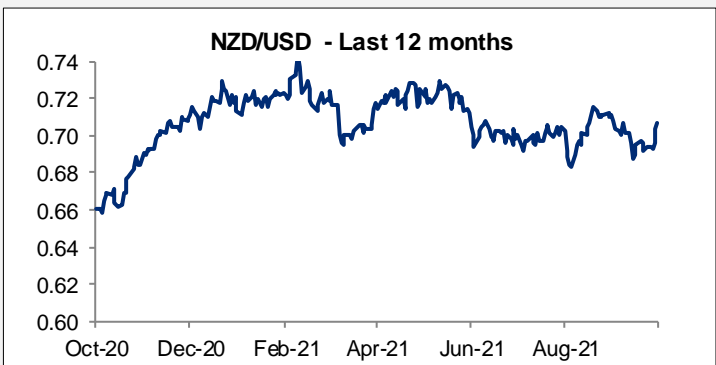
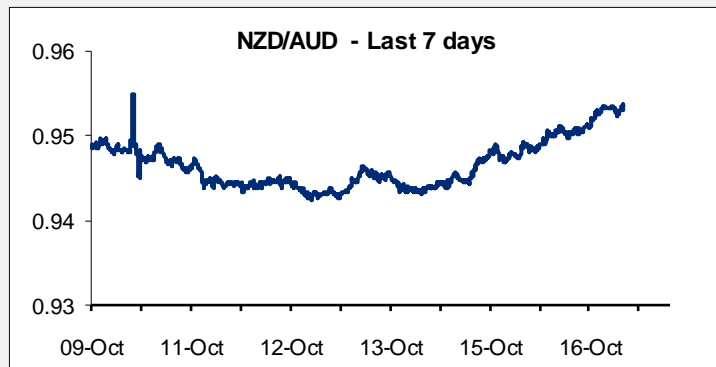
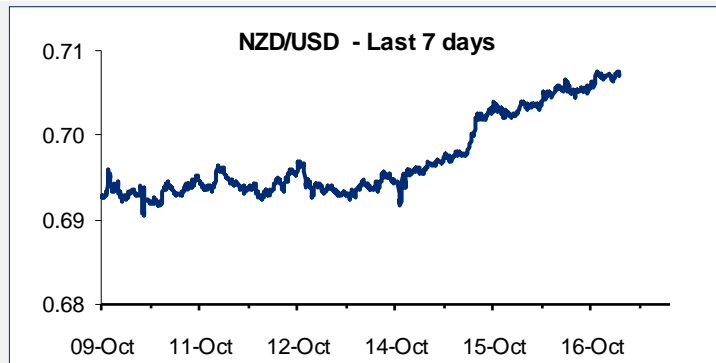
** All near futures contracts, except CRB. Metals prices are CME.

Rates are as of: New York close

Source: Bloomberg

NZD exchange rates

16/10/2021	NY close	Prev. NY close
USD	0.7073	0.7036
GBP	0.5139	0.5146
AUD	0.9523	0.9488
EUR	0.6092	0.6067
JPY	80.72	79.99
CAD	0.8740	0.8704
CHF	0.6522	0.6497
DKK	4.5324	4.5146
FJD	1.4735	1.4680
HKD	5.4963	5.4729
INR	53.18	53.03
NOK	5.9522	5.9438
PKR	120.98	120.41
PHP	35.84	35.61
PGK	2.4796	2.4688
SEK	6.0896	6.0756
SGD	0.9528	0.9490
CNY	4.5480	4.5310
THB	23.54	23.36
TOP	1.5852	1.5793
VUV	78.02	77.94
WST	1.8186	1.8072
XPF	72.64	72.26
ZAR	10.3199	10.4044



NZD/USD Forward Points

	BNZ buys NZD	BNZ sells NZD
1 Month	-2.55	-1.95
3 Months	-8.61	-8.06
6 Months	-21.95	-20.95
9 Months	-41.86	-40.14
1 Year	-64.50	-62.50

NZD/AUD Forward points

	BNZ buys NZD	BNZ Sells NZD
1 Month	-4.83	-3.75
3 Months	-17.00	-15.87
6 Months	-37.59	-35.40
9 Months	-65.40	-61.58
1 Year	-96.47	-91.62

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