

21 December 2018



Events Round-Up

US: FOMC Fed Funds (%), Dec: 2.25-2.5 vs. 2.25-2.5 exp.

NZ: Trade balance (\$m), Nov: -861 vs. -880 exp.

NZ: GDP (q/q%), Q3: 0.3 vs. 0.6 exp.

NZ: GDP (y/y%), Q3: 2.6 vs. 2.8 exp.

AU: Employment chg (k), Nov: 37.0 vs. 20.0 exp.

AU: Unemployment rate (%), Nov: 5.1 vs. 5.0 exp.

UK: Retail sales ex auto fuel (m/m%), Nov: 1.2 vs. 0.2 exp.

JN: BOJ 10-yr yield target (%), Dec: 0.0 vs. 0.0 exp.

UK: Bank of Eng. bank rate (%), Dec: 0.75 vs. 0.75 exp.

US: Philly Fed business outlook, Dec: 9.4 vs. 15.0 exp.

Good Morning

Global equity markets are sinking deeper into the red, the US yield curve flattens further and the USD has weakened overnight, reversing some of its post-Fed gains yesterday. This leaves the NZD higher in overnight trading but still 1% down since this time yesterday.

There has been plenty of newsflow over the past 24 hours, much of it bad. After we went to press yesterday, the Fed delivered on the expected rate hike but the tone of the statement wasn't as dovish as the market had hoped for. The Fed signalled "some" further gradual increases in the Fed Funds rate and Chair Powell reiterated that the rundown of the Fed's balance sheet was on auto-pilot. The Fed still sees the US economy activity as "rising at a strong rate" and gave a token nod to the implications of global economic and financial developments.

The market's reaction is consistent with the belief that the Fed might be making a policy mistake, with the yield curve flattening further and, after an initial rise, the USD has fallen back. The US 10-year rate has fallen to as low as 2.75% and now trades at 2.77%, showing some signs of consolidation, and down about 5bps from the pre-FOMC level. The closely watched 2s10s yield curve slipped just below 10bps. In economic news, the Bloomberg Consumer Comfort Index's monthly expectations gauge fell to a one-year low as more respondents said the economy is getting worse. Meanwhile, the weekly comfort measure declined to a three-month low, driven by weaker sentiment on the economy. We'd add that the chunky fall in US equities is also likely damaging consumer confidence. The Philly Fed's business activity

index dropped to its lowest level in more than two-years, following the weaker Empire index earlier in the week which also fell to a fresh low.

In the latest on US-China trade war developments, the US accused two Chinese nationals of coordinating with state security officials on a decade-long campaign against dozens of companies in the US and abroad to steal intellectual property and other data. The WSJ reported that the Trump administration will also formally accuse China of violating a 2015 bilateral agreement under which both countries vowed to not engage in state-sponsored hacking for economic gain.

The possibility of a US government shutdown at the end of the week lies in the hands of President Trump who is hardening his demand for funding a border wall and will shortly hold a meeting with House Republicans.

Oil prices just keep on falling, which has seen WTI crude fall below \$46 and Brent below \$55. OPEC and its allies announced they would give clarity on supply cuts on Friday but the WSJ reports that the demand side of the crude equation is starting to flash red – some analysts say oil demand next year could grow at its slowest pace in eight years.

Against that backdrop, the S&P500 is currently down 1.3%, taking its cumulative fall this month to over 10%. The fall has been led by economically sensitive sectors and energy. Against a backdrop of falling equity and oil prices it is surprisingly that US Treasury rates haven't fallen overnight. The charts suggest a support level for the 10 year rate around the low 2.70s.

The US is lower overnight against the majors apart from CAD, weighed down by lower oil prices, while the AUD has also under-performed, with its terms of trade also weakened by lower oil prices, with LNG prices linked to crude oil benchmarks. The AUD dropped below 0.71 and currently sits just above that level.

The NZD trades this morning at 0.6775, up 0.5% from the NZ close, but still about 1% lower from this time yesterday. Q3 GDP figures were underwhelming, suggesting weaker growth momentum, even if historical revisions meant that the level of activity was stronger than expected. One of our banking competitors called for a series of RBNZ rate cuts from November next year, which added to the prevailing downside pressure in the rates market. The 2-year swap rate closed down 7bps to 1.98%, the 5-year rate fell 9bps to 2.23% and the 10-year

rate fell by 8bps to 2.66%, the longer end rates reaching fresh multi-year lows. The OIS curve now prices in sub-OCR rates from February next year, with a rising chance of a rate cut through the year. The recent RBNZ proposal to significantly raise capital requirements for NZ banks directionally points to a lower OCR to offset the likely upward pressure on lending rates that would arise from this policy.

There is plenty of other news to report, with three other central banks having policy meetings.

The BoJ left monetary policy unchanged even as it looks increasingly unlikely that the government will meet its inflation target. Governor Kuroda said that the BoJ has more tools for adding stimulus if needed – we’d beg to differ – and he added that it’s no problem if government bond yields fall into negative territory, so long as the move reflects economic fundamentals and yields remain within the BOJ’s target range. USD/JPY is down 1.2% to around 111, largely driven by weaker risk appetite, while NZD/JPY is down to 75.25.

The Bank of England kept rates on hold, as it awaits greater clarity on Brexit. A smooth Brexit deal would open the door for a rate hike – not currently priced in – with the Bank signalling “an ongoing tightening of monetary policy over the forecast period, at a gradual pace and to a limited extent, would be appropriate”. And a bad exit could open the door for a rate cut, with the Bank signalling a monetary policy response “in either direction” depending on the outcome. Against a backdrop of a softer USD, both EUR and GBP are stronger, up to 1.1460 and 1.2670 respectively, and the NZD weaker on these crosses.

Finally, Sweden’s Riksbank hiked its policy rate for the first time in seven years, from -0.50% to -0.25%, only half expected by the market as the first policy move had previously been guided towards either December or February. The Riksbank said that the next hike will probably happen in the second half of next year. SEK has been the strongest of the majors.

The economic calendar ahead is heavy, with the key releases being US durable goods orders and the PCE deflators tonight.

BNZ Markets Today will not be published over the Christmas/New Year period. Regular publication will resume sometime between 8-14th January depending on weather and market conditions. We thank you for your readership over the year and hope you have a good break during the festive season.

Merry Christmas



jason.k.wong@bnz.co.nz

Coming Up

		Period	Cons.	Prev.	NZT
NZ	ANZ consumer confidence	Dec		118.6	10:00
JN	CPI ex fresh food (y/y%)	Nov	1.0	1.0	12:30
CA	Retail sales ex auto (m/m%)	Oct	0.2	0.1	02:30
CA	GDP (m/m%)	Oct	0.2	-0.1	02:30
US	Durable goods orders (m/m%)	Nov	1.6	-4.3	02:30
US	Durables ex trans. (m/m%)	Nov	0.3	0.2	02:30
EC	Consumer confidence	Dec	-4.3	-3.9	04:00
US	Personal income (m/m%)	Nov	0.3	0.5	04:00
US	Personal spending (m/m%)	Nov	0.3	0.6	04:00
US	Core PCE deflator (m/m%)	Nov	0.2	0.1	04:00
US	Core PCE deflator (y/y%)	Nov	1.9	1.8	04:00

Source: Bloomberg, BNZ.

Foreign Exchange							Equities				Commodities**					
Indicative overnight ranges (*)				Other FX			Major Indices				Price					
	Last	% Day	Low	High		Last	% Day			Last	% Day	Net Day				
NZD	0.6777	+0.1	0.6725	0.6791	CHF	0.9888	-0.6			S&P 500	2,474	-1.4	-7.6	Oil (Brent)	55.06	-3.8
AUD	0.7113	+0.1	0.7086	0.7149	SEK	8.971	-1.4			Dow	22,906	-1.8	-7.4	Oil (WTI)	46.28	-3.9
EUR	1.1463	+0.8	1.1380	1.1486	NOK	8.675	-0.5			Nasdaq	6,521	-1.7	-6.3	Gold	1255.9	+0.3
GBP	1.2678	+0.5	1.2619	1.2707	HKD	7.830	+0.0			Stoxx 50	3,000	-1.7	-15.6	HRC steel	753.0	+0.5
JPY	111.08	-1.2	111.02	112.36	CNY	6.885	-0.1			FTSE	6,712	-0.8	-10.8	CRB	173.7	-1.4
CAD	1.3518	+0.3			SGD	1.370	-0.2			DAX	10,611	-1.4	-18.8	Wheat Chic.	532.8	+0.6
NZD/AUD	0.9528	+0.1			IDR	14,473	+0.2			CAC 40	4,692	-2.0	-12.3	Sugar	12.45	-0.2
NZD/EUR	0.5912	-0.6			THB	32.66	-0.3			Nikkei	20,393	-2.8	-10.8	Cotton	75.71	-1.3
NZD/GBP	0.5345	-0.4			KRW	1,128	+0.4			Shanghai	2,536	-0.5	-23.1	Coffee	101.7	+0.9
NZD/JPY	75.28	-1.1			TWD	30.81	+0.0			ASX 200	5,506	-1.3	-9.2	WMI powder	2780.0	-0.4
NZD/CAD	0.9161	+0.4			PHP	53.15	+0.1			NZX 50	8,772	+0.1	4.9	Australian Futures		
NZ TWI	74.22	-0.1												3 year bond	98.175	0.02
														10 year bond	97.66	0.02
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	Last						
USD	2.50	2.79	2.81	2.80	USD	2.77	0.01	NZGB 6 05/15/21	1.69	-0.08	1 year	1.97	-0.03			
AUD	1.50	2.06	1.91	2.59	AUD	2.34	-0.04	NZGB 5 1/2 04/15/23	1.84	-0.09	2 year	1.98	-0.07			
NZD	1.75	1.97	1.95	2.64	NZD	2.18	-0.09	NZGB 2 3/4 04/15/25	2.02	-0.10	5 year	2.23	-0.09			
EUR	0.00	0.06	-0.16	0.82	GER	0.23	-0.01	NZGB 4 1/2 04/15/27	2.18	-0.09	7 year	2.43	-0.09			
GBP	0.75	0.91	1.14	1.45	GBP	1.27	-0.01	NZGB 3 04/20/29	2.33	-0.10	10 year	2.66	-0.08			
JPY	-0.07	-0.09	0.00	0.18	JPY	0.03	-0.01	NZGB 3 1/2 04/14/33	2.51	-0.10	15 year	2.91	-0.08			
CAD	1.75	1.17	2.28	2.46	CAD	1.96	-0.00	NZGB 2 3/4 04/15/37	2.67	-0.10						

* 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 06:55

Source: Bloomberg

Contact Details

Jason Wong

Senior Markets Strategist
+64 4 924 7652

Nick Smyth

Interest Rate Strategist
+64 4 924 7653

National Australia Bank

Ray Attrill

Head of FX Strategy
+61 2 9237 1848

Rodrigo Catril

Senior FX Strategist
+61 2 9293 7109

Gavin Friend

Senior Market Strategist
+44 20 7710 1588

Skye Masters

Head of Fixed Income Research
+61 2 9295 1196

Alex Stanley

Senior Interest Rate Strategist
+61 2 9237 8154

Analyst Disclaimer: The Information accurately reflects the personal views of the author(s) about the securities, issuers and other subject matters discussed, and is based upon sources reasonably believed to be reliable and accurate. The views of the author(s) do not necessarily reflect the views of the NAB Group. No part of the compensation of the author(s) was, is, or will be, directly or indirectly, related to any specific recommendations or views expressed. Research analysts responsible for this report receive compensation based upon, among other factors, the overall profitability of the Global Markets Division of NAB.

NAB maintains an effective information barrier between the research analysts and its private side operations. Private side functions are physically segregated from the research analysts and have no control over their remuneration or budget. The research functions do not report directly or indirectly to any private side function. The Research analyst might have received help from the issuer subject in the research report.

New Zealand: This publication has been provided for general information only. Although every effort has been made to ensure this publication is accurate the contents should not be relied upon or used as a basis for entering into any products described in this publication. To the extent that any information or recommendations in this publication constitute financial advice, they do not take into account any person's particular financial situation or goals. Bank of New Zealand strongly recommends readers seek independent legal/financial advice prior to acting in relation to any of the matters discussed in this publication. Neither Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication. **National Australia Bank Limited is not a registered bank in New Zealand.**

USA: If this document is distributed in the United States, such distribution is by nabSecurities, LLC. This document is not intended as an offer or solicitation for the purchase or sale of any securities, financial instrument or product or to provide financial services. It is not the intention of nabSecurities to create legal relations on the basis of information provided herein.