

25 October 2017

Events Round-Up

GE: Markit manufacturing PMI, Oct P: 60.5 vs. 60.0 exp.

GE: Markit services PMI, Oct P: 55.2 vs. 55.5 exp.

EC: Markit manufacturing PMI, Oct P: 58.6 vs. 57.8 exp.

EC: Markit services PMI, Oct P: 54.9 vs. 55.6 exp.

US: Markit manufacturing PMI, Oct P: 54.5 vs. 53.5 exp.

US: Markit services PMI, Oct P: 55.9 vs. 55.2 exp.

Good Morning

The NZD has underperformed again as the policy vacuum continues, while overnight we've seen US equities power on higher and US 10-year rates breach the critical 2.40% mark.

The only economic data of note has been provisional PMIs for October, which showed manufacturing indices in the US and euro area slightly stronger than expected, and services indices slightly weaker for the latter – nothing there to change the view that the world economy is on a strong footing. Strong earnings results from US bellwether companies like Caterpillar and 3M added to the "growth is good" backdrop and powered the Dow Jones index up to a fresh record high. Data at the end of the week is expected to show US growth running above trend.

That backdrop has fuelled a further nudge up in the US 10-year rate to 2.41%, past what many consider to be a key technical resistance level of 2.40%. We'll see how the market closes and what happens over the next day or so, but it opens up a possible quick run-up to 2.60%, with the year-to-date high of 2.63% back in March the next area of interest. The rates sell-off hasn't been confined to Treasuries, with Germany's 10-year rate up 4bps to 0.48% as the market positions itself for the ECB's tapering announcement due early Friday morning NZ time.

In the currency market the NZD has been the standout performer down 1% to sub-0.69 and near its lows for the session. The currency lurched down after the coalition agreements were revealed by the new government. They outlined the key areas of policy agreement, including a steep rise in the minimum wage (around 6% per annum over the next four years), reform of the RBNZ Act, a slush fund for regional development, moderate cuts to immigration based on Labour's rather than NZ First's policy, and looking into foreign ownership of land and existing housing.

The document was surprisingly vague and didn't reveal anything new. The information vacuum was probably the main reason for the fall in the NZD, with the level of uncertainty about the outlook likely to remain heightened for longer. That the NZD can fall on no new news was a friendly reminder that we can expect increased volatility in the months ahead. Overseas media headlining that "Kiwis now led by a Commie" and comparing PM-elect Ardern to Trump will be doing no favours to the NZD. It adds to the political risk premium that is currently being built into the NZD.

EUR and USD have been the currencies of choice over the past 24 hours, although movements have been fairly modest overall for the majors. JPY and GBP have been on the soft side, the former driven by the higher global yield environment. On the crosses, NZD/EUR is down over 1% to 0.5860, while falls for the other crosses have been in the order of 0.5-0.6%, with NZD/AUD down to 0.8860. Over the last few years, the 0.8800-0.8850 level has proven to be an area of strong support, with multiple tests of that region.

China's 5-yearly Communist Party Congress drew to a close, with the party approving a sweeping charter revision that elevates President Xi's status, declaring him the party's "core" leader indefinitely. That didn't seem to raise any eyebrows and there was little reaction in the currency market.

Compared to the currency market, the NZ rates and equity market reaction to the new government has been more orderly. The NZX-50 rose for the 15th day in a row, a remarkable achievement, although for over half of those days the gain has been 0.1% or less.

The swap curve showed rates flat to down 1bp, so little movement there. More price action was evident in the bond market, with a clear steepening bias and the 10-year government rate about to breach the 3% mark. The linkers market showed further increases in implied break-even inflation rates, with our calculations showing an interpolated 10-year inflation rate rising from 1.16% just over a week ago to 1.36%. That level still seems way too low (as seen on other markets), but the direction of travel certainly seems appropriate. One thing the market is certain about is that inflation will increase based on the weaker NZD, higher wages and a higher cost of doing business. But the short end of the rates market seems to think that the new RBNZ Act (which might well not come into play for over a year) will see the RBNZ sit idly and watch inflation take off. That's not a judgment we agree with.

In the day ahead, in Australia CPI data is the focus, with headline inflation expected to be driven up by gas charges, but core inflation expected to remain near the bottom of the 2-3% target range. The AUD and rates market is likely to be sensitive to both upside and downside surprises, with the market on tenterhooks wondering how soon the RBA will move to a tightening bias

Tonight, the Bank of Canada is expected to pause its tightening cycle after back-to-back rate increase, while UK GDP data is expected to show another soft quarterly reading of 0.3% q/q.

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Coming Up

| | Period | Cons. | Prev. | NZT |
|---------------------------------|--------|-------|-------|-------|
| AU CPI (q/q%) | Q3 | 0.8 | 0.2 | 13:30 |
| AU CPI (y/y%) | Q3 | 2.0 | 1.9 | 13:30 |
| AU CPI trimmed mean (y/y%) | Q3 | 2.0 | 1.8 | 13:30 |
| AU CPI weighted median (y/y%) | Q3 | 2.0 | 1.8 | 13:30 |
| GE IFO expectations | Oct | 107.3 | 107.4 | 21:00 |
| UK GDP (q/q%) | Q3 | 0.3 | 0.3 | 21:30 |
| US Durable goods orders (m/m%) | Sep P | 1.0 | 2.0 | 01:30 |
| US Durables ex transportation | Sep P | 0.5 | 0.5 | 01:30 |
| CA Bank of Canada rate decision | Oct | 1.0 | 1.0 | 03:00 |
| US New home sales | Sep | 555 | 560 | 03:00 |

Source: Bloomberg, BNZ

| Foreign Exchange | | | | | Equities | | | | Commodities** | | | | |
|---------------------------------|-------------|-------|--------|--------|-----------------------|---------|---------------------|---------------------|---------------------------|--------|---------|------|-------|
| Indicative overnight ranges (*) | | | | | Major Indices | | | | Price | | | | |
| | Last | % Day | Low | High | | Last | % Day | % Year | | Last | Net Day | | |
| NZD | 0.6888 | -1.1 | 0.6888 | 0.6951 | S&P 500 | 2,571 | +0.2 | 19.5 | Oil (Brent) | 58.22 | +1.5 | | |
| AUD | 0.7776 | -0.4 | 0.7771 | 0.7823 | Dow | 23,466 | +0.8 | 28.8 | Oil (WTI) | 52.46 | +1.1 | | |
| EUR | 1.1761 | +0.1 | 1.1743 | 1.1777 | Nasdaq | 6,607 | +0.3 | 24.4 | Gold | 1275.0 | -0.3 | | |
| GBP | 1.3126 | -0.5 | 1.3113 | 1.3225 | Stoxx 50 | 3,611 | +0.1 | 16.7 | HRC steel | 595.0 | +0.0 | | |
| JPY | 113.88 | +0.4 | 113.31 | 114.02 | FTSE | 7,527 | +0.0 | 7.7 | CRB | 185.7 | +0.5 | | |
| CAD | 1.2688 | +0.3 | | | DAX | 13,013 | +0.1 | 20.9 | Wheat Chic. | 453.5 | -0.3 | | |
| NZD/AUD | 0.8858 | -0.7 | | | CAC 40 | 5,395 | +0.1 | 18.5 | Sugar | 14.28 | +2.9 | | |
| NZD/EUR | 0.5857 | -1.2 | | | Nikkei | 21,805 | +0.5 | 25.6 | Cotton | 69.55 | -0.3 | | |
| NZD/GBP | 0.5248 | -0.6 | | | Shanghai | 3,388 | +0.2 | 8.2 | Coffee | 123.2 | -0.8 | | |
| NZD/JPY | 78.44 | -0.7 | | | ASX 200 | 5,898 | +0.1 | 8.4 | WM powder | 2950.0 | -1.7 | | |
| NZD/CAD | 0.8739 | -0.8 | | | NZX 50 | 8,130 | +0.0 | 16.1 | Australian Futures | | | | |
| NZ TWI | 73.06 | -0.9 | | | | | | | 3 year bond | 97.84 | -0.03 | | |
| | | | | | | | | | 10 year bond | 97.17 | -0.02 | | |
| Interest 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 | Last | | |
| USD | 1.25 | 1.37 | 1.81 | 2.39 | USD | 2.41 | 0.04 | NZGB 3 04/15/20 | 2.03 | -0.02 | 1 year | 2.02 | -0.00 |
| AUD | 1.50 | 1.70 | 2.01 | 2.96 | AUD | 2.77 | -0.02 | NZGB 6 05/15/21 | 2.18 | -0.01 | 2 year | 2.17 | -0.00 |
| NZD | 1.75 | 1.94 | 2.17 | 3.20 | NZD | 2.99 | 0.02 | NZGB 5 1/2 04/15/23 | 2.49 | 0.00 | 5 year | 2.67 | -0.01 |
| EUR | 0.00 | 0.06 | -0.18 | 0.91 | GER | 0.48 | 0.04 | NZGB 2 3/4 04/15/25 | 2.79 | 0.01 | 7 year | 2.93 | -0.01 |
| GBP | 0.25 | 0.40 | 0.82 | 1.38 | GBP | 1.36 | 0.05 | NZGB 4 1/2 04/15/27 | 2.99 | 0.02 | 10 year | 3.20 | -0.01 |
| JPY | -0.04 | -0.04 | 0.04 | 0.26 | JPY | 0.07 | 0.00 | NZGB 3 1/2 04/14/33 | 3.34 | 0.04 | 15 year | 3.43 | -0.01 |
| CAD | 1.00 | 1.17 | 1.85 | 2.36 | CAD | 2.05 | 0.03 | NZGB 2 3/4 04/15/37 | 3.53 | 0.03 | | | |

* 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

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