RESEARCH
Markets Today

25 **October** 2022

Events Round-Up

NZ: Trade balance ($b), Sep: -1615 vs. -2447 prev.

JN: CPI (y/y%), Sep: 3 vs. 2.9 exp.

JN: CPI ex fresh food, energy (y/y%), Sep: 1.8 vs. 1.8 exp.

CN: GDP (q/q%), Q3: 3.9 vs. 2.8 exp.

CN: GDP (y/y%), Q3: 3 vs. 3 exp.

CN: Industrial production (YTD y/y%), Sep: 3.9 vs. 3.7 exp.

CN: Fixed asset investment (YTD y/y%), Sep: 5.9 vs. 6 exp.

CN: Retail sales (YTD y/y%), Sep: 0.7 vs. 0.9 exp.

GE: Manufacturing PMI, Oct: 45.7 vs 47 exp.

GE: Services PMI, Oct: 44.9 vs 44.9 exp.

EC: Manufacturing PMI, Oct: 46.6 vs 48 exp.

EC: Services PMI, Oct: 48.2 vs 48.2 exp.

UK: Manufacturing PMI, Oct: 45.8 vs 48 exp.

UK: Services PMI, Oct: 47.5 vs 49 exp.

US: Manufacturing PMI, Oct: 49.9 vs 51 exp.

US: Services PMI, Oct: 46.6 vs 49.5 exp.

Good Morning

After a punishing past few months, the last two trading sessions have seen a burst of optimism, spurred by an article by WSJ 'Fed whisperer' Timiraos that the Fed might consider stepping down the pace of rate hikes in December. The market has pared back Fed rate hike pricing, with the peak in the Fed funds rate now expected to be below 5%, triggering a big steepening in the US curve (the 10-year rate is still near 15-year highs around 4.20%). The S&P500 has ripped higher in response to hints at a prospective step down in the pace of rate hikes, rallying by over 3% since Thursday's close. USD/JPY came close to touching 152 on Friday before the Japanese Ministry of Finance stepping in with another round of FX intervention, driving it back to around 149. The NZD is little changed from where it was on Friday afternoon, with a sharp weakening in the CNY (after Xi promoted zero-Covid advocates) offsetting the improvement in risk appetite.

The main market-moving news since the NZ market closed on Friday afternoon has been an article by WSJ Fed watcher Nick Timiraos, seen by many market participants as a mouthpiece for the Fed. In his WSJ column Timiraos wrote, "Federal Reserve officials are barrelling toward another interest-rate rise of 0.75 percentage point at their meeting Nov. 1-2 and are likely to debate then whether and how to signal plans to approve a smaller increase in December." Consistent with the message from the Timiraos column, in a fireside chat on Friday San Francisco Fed President Mary Daly was quoted as saying "the time is now to start planning for stepping down". Prior to the article, the growing consensus among investors had been that the Fed would likely hike by 75bps at each of the two upcoming meetings, given the strength of the most recent US inflation data.

Timiraos noted that the Fed would want to avoid a situation where a step down in the pace of rate hikes triggered a major increase in equity markets and a broader easing of financial conditions, which would be counterproductive for what it is trying to achieve. As such, a potential step down to a 50bps rate hike in December could accompanied by a lift in the interest rate projections contained in the 'dot plot', which last month showed rates peaking between 4.50% and 4.75%. i.e. the Fed might consider raising its forecasts of the terminal rate in its next set of projections, in a bid to prevent rates from falling and equity market from surging, as they did in July when the market last got excited about a possible 'Fed pivot'.

Inevitably, the market had no time for such subtleties, and the hint of a step down in the pace of tightening from the Fed was enough to trigger a major market reaction on Friday. In the rates market, there has been a big fall in short-term US rates, the 2-year Treasury rate around 12bps lower than where it closed on Friday morning, at around 4.49%, with the market paring back the probability of a 75bps hike in December to around 45% and pulling back expectations for the terminal Fed funds rate to around 4.9% (previously above 5%). The initial market reaction shows the challenge the Fed will face with getting across an appropriately hawkish message when it does eventually step down the pace of rate hikes. The US curve experienced a huge steepening move, with the US 10-year rate largely holding its ground over the past two sessions, still near post-GFC highs at around 4.20%, while the 30-year rate is up around 12bps. The steepening of the curve is consistent with the market pricing less risk of a hard landing/recession scenario.

Equities have had a powerful rally since the Timiraos column, the S&P500 gaining 2.4% on Friday and a further 0.8% overnight. It's likely that downbeat market sentiment and overly bearish positioning have played a part in the sharp rebound in equities. Other equity markets have benefited from the risk-on mood, the EuroStoxx 600 index increasing 1.5% overnight.

The one major exception has been the Hang Seng, down 6.4% yesterday to its lowest level since 2009, as the market digests President Xi's reshuffle of the Politburo Standing Committee, stacking the leadership team with loyalists and advocates of the country's zero-Covid policy while pushing out those seen as more moderate and in favour of economic reform. Investors are worried a prolonged period of zero-Covid policy and interventionist regulation will hamper Chinese growth. Chinese growth worries are also visible in FX, with USD/CNY hitting multi-year highs of 7.26 (the maximum 2% above yesterday's fix) and USD/CNH pushing on to fresh highs of 7.32.

The repricing in Fed rate expectations and improvement in risk appetite has triggered a fall in the USD, with the BBDXY down around 0.6% from the time of the NZ market close on Friday afternoon. The EUR has outperformed, pushing up around 1% to almost 0.99, on the back of a sharp fall in European gas futures, to now below €100, as gas storage levels reportedly approach capacity. The NZD and AUD rallied on Friday night, in response to the improvement in risk sentiment, but they have largely given back those gains this week as the CNY has come under pressure. The NZD closed last week above 0.5750, but it has since pulled back to 0.5680, well within the trading range over the past month. Likewise, after trading above 0.64 yesterday morning, the AUD is back below 0.63.

The other major news in the FX market has been the latest round of FX intervention from the Japanese Ministry of Finance. The MoF stepped in on Friday night as USD/JPY approached 152, triggering an almost 4% fall, although it has since recovered around half its post-intervention falls to trade back around 149. The FT reported that this intervention was around US$30b in size, bigger than the US$20b first round intervention a month ago. There was evidence of further MoF intervention yesterday, although the fall in USD/JPY on this occasion was short lived. History suggests that FX intervention has diminishing returns over time, with the 'shock factor' from the initial intervention episodes gradually wearing off. The consensus is that USD/JPY will remain in an uptrend, irrespective of MoF intervention, while US rates continue to push higher and the BoJ perseveres with its Yield Curve Control (YCC) policy to cap the 10-year Japan bond rate at 0.25%.

The BoJ meets this week and while the base case is it sticks with its ultra-easy monetary policy stance, markets are nervous about the risk of a tweak to YCC. Swap rates in Japan have been on the rise, with the 10-year swap rate hitting 0.70% on Friday, its highest level since 2015. The increase in swap rates relative to the 10-year bond yield likely reflects growing expectations for an eventual shift in YCC, although most think this week comes too soon for such a change. But with the so-called 'core-core' measure of inflation (excluding fresh food and energy) annualising north of 3% over the past six months, a change to YCC appears a matter of when, rather than if. When the BoJ does eventually end (or amend) its YCC it is likely to be a major shock to the global bond market (given Japan's importance as a major investor in foreign bond markets) and will likely be a catalyst for USD/JPY to reverse course.

In Europe, the flash PMIs for October confirmed the region is likely in a recession, with the composite PMI falling to 47.1, its lowest level in almost 10 years (excluding 2020). The US PMIs painted a similarly bleak picture, the composite PMI falling further into contractionary territory at 47.3, although the market reaction was limited, with investors tending to give more weight to the ISM surveys.

In the UK, former Chancellor Rishi Sunak is set to be the new PM after Boris Johnson and Penny Mordaunt and withdrew from the race. Sunak will reportedly retain Jeremy Hunt as Chancellor, paving the way for Hunt to announce fiscal tightening measures at the medium-term fiscal statement on 31 October. UK gilt yields have fallen sharply overnight, by 25-30bps across the curve, as the market has pared back BoE rate hike expectations (tighter fiscal policy implies less inflationary pressure and less work for the BoE to do with monetary policy) and broader risk premia. The market is now pricing a 75bps hike from the BoE next month. There has been a less noticeable impact on the GBP, which is only slightly stronger than where it was on Friday morning, at around 1.1290.

Friday saw a steepening of the NZ swaps curve and that trend is likely to extend today given the moves in the US Treasury market. On Friday, the NZ 2-year rate swap rate was 1bps lower, at 5.31%, while the 10-year rate was 6bps higher, closing above 5% for the first time since 2014. The short end of the curve appeared to find some stability in the latter part of last week after its abrupt repricing to the NZ CPI data surprise, although OCR expectations remain elevated, with a terminal cash rate of around 5.4% priced in. Government bonds continue to perform well (the 10-year yield was unchanged on Friday), as the market braces for an expected surge of demand at month-end as NZGBs officially join the WGBI bond index.

There are several potentially market-moving events offshore this week. Besides the Bank of Japan meeting (no change in policy expected), the Bank of Canada and ECB are expected to raise rates by 75bps, to 4% and 1.5% respectively. The ECB is likely to signal further hikes ahead and may signal a decision around QT (where it runs down its large holding of bonds) will be made in for December. In Australia, the market is looking for another strong CPI release, with headline inflation expected to increase to 7% y/y and core (trimmed mean) inflation expected to hit 5.5%, which would be its highest level since the early

1990s. Given the pattern of upside surprises in most countries of late, the risks would seem to be skewed to a stronger-than-expected inflation print. Over 200 S&P500 companies are reporting this week including Apple, Microsoft, Alphabet and Amazon. Domestically, the highlight is the ANZ business survey for October.

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Coming Up

		Period	Cons.	Prev.	NZT
GE	IFO Business Climate	Oct	83.8	84.3	21:00
AU	Australia-Budget				21:30
UK	BOE's Huw Pill speaks				21:55
US	Conf. Board Consumer Confidence	Oct	105	108	03:00

Source: Bloomberg, BNZ

Foreign Exchange

Indicative overnight ranges (*)

	Last	% Day	Low	High
NZD	0.5677	-1.3	0.5657	0.5746
AUD	0.6294	-1.3	0.6273	0.6339
EUR	0.9870	+0.1	0.9807	0.9893
GBP	1.1278	-0.3	1.1258	1.1382
JPY	148.94	+0.9	148.29	149.46
CAD	1.3732	+0.7		
NZD/AUD	0.9020	-0.2		
NZD/EUR	0.5752	-1.5		
NZD/GBP	0.5034	-0.7		
NZD/JPY	84.55	-0.7		
NZD/CAD	0.7796	-0.7		
NZ TWI	68.56	-0.8		

Other FX

	Last	% Day
CHF	1.0020	+0.4
SEK	11.195	+0.2
NOK	10.529	-0.1
HKD	7.850	+0.0
CNY	7.263	+0.4
SGD	1.423	+0.6
IDR	15,586	-0.3
THB	38.18	+0.4
KRW	1,440	-0.1
TWD	32.26	+0.2
PHP	58.88	+0.2

Equities

Major Indices

	Last	% Day	% Year
S&P 500	3,778	+0.7	-16.9
Dow	31,413	+1.0	-12.0
Nasdaq	10,883	+0.2	-27.9
Stoxx 50	3,528	+1.5	-15.8
FTSE	7,014	+0.6	-2.6
DAX	12,931	+1.6	-16.8
CAC 40	6,131	+1.6	-8.9
Nikkei	26,975	+0.3	-5.7
Shanghai	2,978	-2.0	-17.5
ASX 200	6,779	+1.5	-8.9
NZX 50	10,782	-0.5	-17.6

Commodities**

Price

	Last	Net Day
Oil (Brent)	92.96	-0.6
Oil (WTI)	84.34	+0.5
Gold	1648.7	-0.1
HRC steel	757.0	-0.7
CRB	272.4	+0.2
Wheat Chic.	860.5	-1.0
Sugar	18.13	-1.4
Cotton	76.13	-3.8
Coffee	190.4	+0.3
WM powder	3430	-0.6

Australian Futures

	Last	Net Day
3 year bond	96.32	0.11
10 year bond	95.84	0.07

Interest Rates

	Rates: Cash	Rates: 3Mth	Swap Yields: 2 Yr	Swap Yields: 10 Yr
USD	3.25	4.36	4.86	4.24
AUD	2.60	3.04	4.19	4.85
NZD	3.50	4.13	5.31	5.01
EUR	0.75	1.54	2.93	3.17
GBP	2.25	3.38	4.72	4.00
JPY	-0.05	-0.03	0.19	0.70
CAD	3.25	4.65	4.59	4.03

Benchmark 10 Yr Bonds

	Last	Net Day
USD	4.22	0.00
AUD	4.15	-0.05
NZD	4.65	-0.00
GER	2.33	-0.09
GBP	3.75	-0.31
JPY	0.26	-0.00
CAD	3.57	-0.05

NZ Government Bonds

	Last	
NZGB 0 1/2 05/15/24	4.64	-0.01
NZGB 4 1/2 04/15/27	4.64	-0.01
NZGB 3 04/20/29	4.62	-0.00
NZGB 1 1/2 05/15/31	4.63	-0.00
NZGB 2 05/15/32	4.65	-0.00
NZGB 1 3/4 05/15/41	5.00	-0.00
NZGB 2 3/4 05/15/51	4.93	-0.00

NZ Swap Yields

	Last	
1 year	5.27	0.00
2 year	5.31	-0.01
5 year	5.07	0.03
7 year	5.03	0.04
10 year	5.01	0.06
15 year	5.03	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: NZT 06:52

Source: Bloomberg

NZD exchange rates

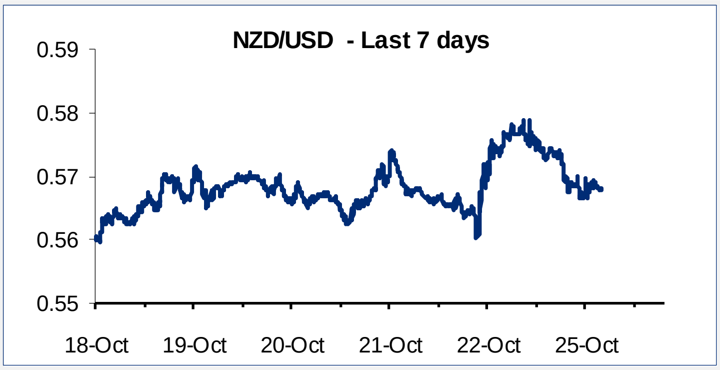
25/10/2022	6:52 a.m.	Prev. NY close
USD	0.5677	0.5749
GBP	0.5034	0.5086
AUD	0.9020	0.9012
EUR	0.5752	0.5829
JPY	84.55	84.88
CAD	0.7796	0.7842
CHF	0.5688	0.5736
DKK	4.2789	4.3358
FJD	1.3190	1.3373
HKD	4.4563	4.5127
INR	46.94	47.58
NOK	5.9774	6.0557
PKR	125.07	126.99
PHP	33.42	33.78
PGK	1.9989	2.0243
SEK	6.3556	6.4230
SGD	0.8078	0.8136
CNY	4.1232	4.1569
THB	21.78	21.94
TOP	1.3799	1.3923
VUV	69.48	71.66
WST	1.5958	1.5800
XPF	69.38	70.61
ZAR	10.4709	10.3995

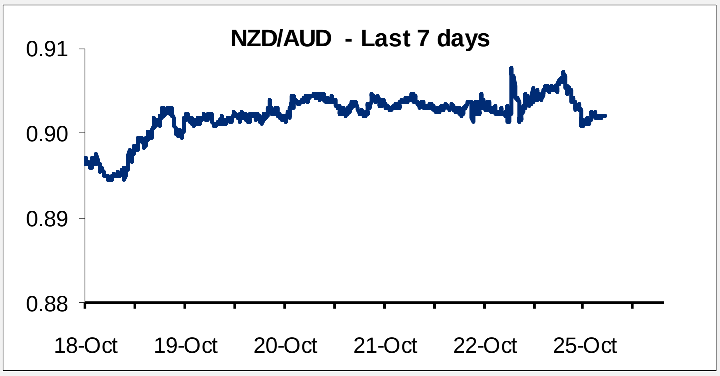
NZD/USD Forward Points

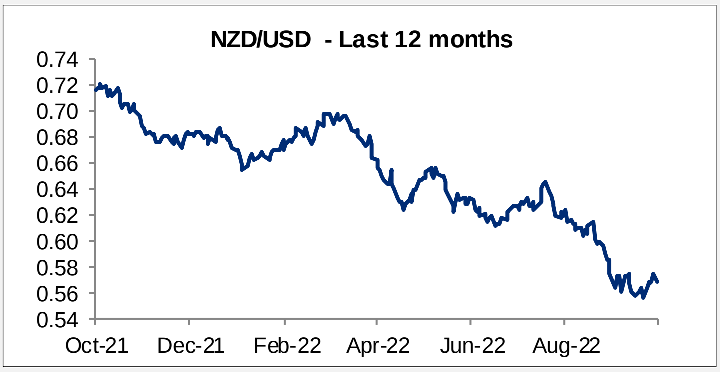
	BNZ buys NZD	BNZ sells NZD
1 Month	1.49	1.91
3 Months	4.11	5.19
6 Months	6.17	7.68
9 Months	0.89	4.83
1 Year	-2.96	-0.46

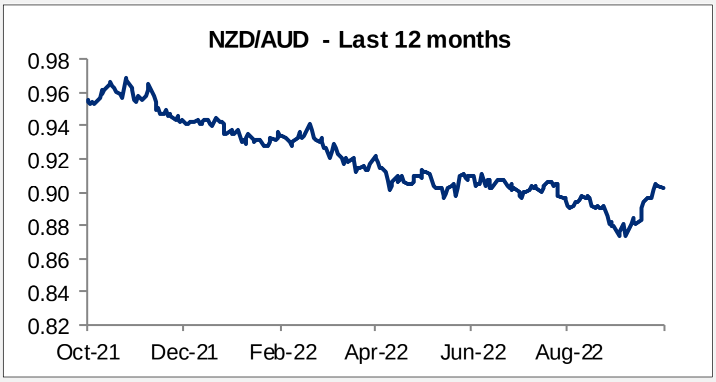
NZD/AUD Forward points

	BNZ buys NZD	BNZ Sells NZD
1 Month	-4.55	-3.59
3 Months	-21.84	-19.43
6 Months	-48.33	-44.52
9 Months	-74.27	-65.91
1 Year	-90.79	-83.39









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