

27 August 2018



Events Round-Up

NZ: Trade balance (\$m), Jul: -143 vs. -400 exp.

JN: CPI ex-fresh food and energy (y/y%), Jul: 0.3 vs. 0.3 exp.

US: Durable goods orders (m/m%), Jul: -1.7 vs. -1 exp.

US: Durables ex transportation (m/m%), Jul: 0.2 vs. 0.5 exp.

Good Morning

The S&P500 made a new record high on Friday and the US dollar fell across the board after Fed Chair Powell said there was no clear sign of inflation accelerating above 2%, nor the economy overheating. While Powell said further gradual rate rises remained appropriate (i.e. Fed will likely hike another two times this year) Fed policy is likely to be more data-dependent in 2019. Meanwhile, the CNY rose sharply after the PBOC reintroduced the counter-cyclical factor for the CNY fix, a tool for dampening volatility in the currency. The market's dovish take on Powell's speech and the CNY appreciation have boosted the NZD back to near 0.67.

The main event on Friday was the Fed's annual Jackson Hole symposium, and in particular Chair Powell's keynote address. Powell outlined how the Fed was trying to navigate monetary policy in such a way as to avoid short-circuiting the economic expansion by over-tightening on the one hand versus not tightening fast enough and allowing the economy to overheat and inflation to get away on the other. The task, he explained, was made all the more complicated by the fact that it's very difficult for the Fed to know, in real-time, what the neutral interest rate and NAIRU are.

In concluding, Powell repeated the FOMC's statement that continued gradual tightening remained appropriate provided the economy remained on track. This likely means the Fed intends to hike rates at its September and December FOMC meetings, in turn bringing the Fed Funds rate to 2.5%. The market however took note of his comment that "*we have seen no clear sign of an acceleration [in inflation] above 2 percent, and there does not seem to be an elevated risk of overheating.*" These comments seem to imply that the Fed intends to take the funds rate rates to somewhere in the vicinity of 'neutral' in the first instance, with further tightening likely to require evidence of overheating (either in the economy or financial markets) or a more meaningful rise in inflation. Atlanta

Fed President Bostic echoed these sentiments in an interview later in the day, saying "*we can just stay in the neutral position and then really just wait until we get some signal of directionality in the broader economy*". Fed policy looks set to be more data-dependent and uncertain in 2019.

While the market's initial reaction was to take the Powell speech as dovish, there were two potentially hawkish elements to it. First, he noted that overheating might be more likely to show up in financial markets (i.e. asset bubbles) than in inflation. That suggests Fed policy could become more aggressive if risk assets rise sharply from here. Second, he referenced a recently released staff paper, which concluded that policymakers shouldn't down-weight measures of labour market tightness, even if it is difficult to accurately measure NAIRU.

Regardless, the market seemed to take Powell's comments as dovish, with the S&P500 rising 0.4% after his speech notes were released to a new record high. The 10 year US Treasury yield had risen to 2.85% in advance of Powell's speech, but moved lower to close at 2.81%, towards the lower end of the range that has prevailed since April. The market prices a 95% chance of a September rate rise and a 70% chance of a follow-up increase in December. The market continues to price the terminal rate for the Fed around 2.75%, suggesting the fixed income market doesn't see the Fed tightening much further after this year.

In currencies, the USD was weaker across the board, with both the DXY and broader Bloomberg DXY 0.5% lower, in part due to the Powell speech. The USD indices remain within the ranges that have been in place since May. Earlier in the session, the PBOC announced that it had reintroduced the countercyclical factor for calculating the daily CNY fix, a tool the central bank uses for dampening currency volatility, which sparked a sharp 1% appreciation in the CNY and corresponding weakness in the USD. Analysts interpreted the PBOC's move as another sign that the central bank was uncomfortable with further currency weakness and would take steps to defend the psychologically important 7.0 level on USD/CNY.

The PBOC's move came after the low-level US-China trade talks concluded without any signs of meaningful progress, and it seems unlikely to stop President Trump imposing tariffs on a further \$200b of Chinese imports after public consultation ends on September 5th. On NAFTA, US and Mexican bilateral negotiations were extended into the weekend, with the FT reporting that the two sides were near a breakthrough, although there has been no official

announcement as yet.

The CNY strength and Powell-induced USD weakness combined to help boost the NZD, which was up 0.5% to close the week at 0.6690. Higher commodity prices (copper +2%, oil +1.5%) and a further improvement in risk appetite provided further tailwinds for the NZD and other commodity currencies. Earlier on Friday morning, RBNZ Governor Adrian Orr gave an interview with Bloomberg in which he reiterated that the RBNZ was in no rush to raise rates and said that the biggest challenge the central bank faced was raising inflation. When pressed by the interviewer what could trigger a near-term rate cut, Orr said a decline in business confidence leading to a fall in output, although he added that he thought that was low probability and things were reasonably balanced right now. On the currency, Orr described the NZD as “accommodative” and seemed encouraged that further divergence between the OCR and rates elsewhere should keep pushing down on the NZD, in turn lending support to the economy. There was a brief dip down in the NZD from 0.6640 to 0.6620, which turned out to be the lows of the day, but the reaction didn’t last long. NZ swap rates were around 1bp lower between 5 to 10 years.

The AUD was the best performing currency on Friday, over 1% higher to 0.7325, after Treasurer Scott Morrison was elected leader of the Liberal party after several days of turmoil. Morrison will replace Malcolm Turnbull as

Prime Minister. The move higher in the AUD, coming after several days underperformance, likely reflected the market’s view that Morrison is less likely to make radical policy shifts than fellow leadership contender Peter Dutton. At the margin, Morrison is also likely to be perceived as less likely to lose the next election, which must be held by mid-May next year, although Labor will likely be revealed to be comfortably ahead in the polls when voters are next surveyed. The NZD/AUD eased back from its highs of 0.9160 to 0.9120 after the leadership results came in but has recovered somewhat to 0.9130. The cross remains firmly mid-range, having fully erased the losses sustained in the wake of last month’s RBNZ MPS.

It’s a reasonably quiet week data-wise ahead. Locally, the ANZ business survey will be the highlight when it is released on Thursday. The official Chinese PMIs are released on Friday.

nick.smyth@bnz.co.nz

Coming Up

		Period	Cons.	Prev.	NZT
GE	IFO Business Climate	Aug	101.9	101.7	20:00
GE	Retail Sales (y/y%)	Jul	2	3	09:04
US	Advance Goods Trade Balance	Jul	-68.6	-68.3	00:30
US	Conf. Board Consumer Confidence	Aug	126.5	127.4	02:00

Source: Bloomberg, BNZ.

Foreign Exchange						Equities				Commodities**					
Indicative overnight ranges (*)					Other FX		Major Indices				Price				
	Last	% Day	Low	High		Last	% Day	% Year		Last	Net Day				
NZD	0.6670	+0.5	0.6637	0.6696	CHF	0.9835	-0.3		S&P 500	2,875	+0.6	17.7	Oil (Brent)	75.82	+0.9
AUD	0.7329	+1.1	0.7268	0.7345	SEK	9.129	-0.1		Dow	25,790	+0.5	18.2	Oil (WTI)	68.72	+1.0
EUR	1.1622	+0.7	1.1555	1.1640	NOK	8.328	-0.7		Nasdaq	7,946	+0.9	26.8	Gold	1208.6	+1.5
GBP	1.2846	+0.3	1.2808	1.2881	HKD	7.850	+0.0		Stoxx 50	3,427	+0.2	-0.3	HRC steel	866.0	-0.6
JPY	111.24	-0.0	111.11	111.48	CNY	6.811	-1.0		FTSE	7,577	+0.2	2.4	CRB	192.1	+0.8
CAD	1.3026	-0.4			SGD	1.366	-0.6		DAX	12,395	+0.2	1.9	Wheat Chic.	536.5	-1.0
NZD/AUD	0.9101	-0.3			IDR	14,649	+0.1		CAC 40	5,433	+0.2	6.4	Sugar	10.23	+1.3
NZD/EUR	0.5739	+0.1			THB	32.64	-0.7		Nikkei	22,602	+0.9	16.2	Cotton	81.81	+0.6
NZD/GBP	0.5192	+0.5			KRW	1,119	-0.2		Shanghai	2,729	+0.2	-18.1	Coffee	104.7	+3.2
NZD/JPY	74.20	+0.5			TWD	30.78	-0.0		ASX 200	6,247	+0.0	8.8	WMI powder	2845.0	+0.0
NZD/CAD	0.8688	+0.3			PHP	53.43	-0.1		NZX 50	9,160	+0.2	16.6	Australian Futures		
NZ TWI	72.45	-0.1											3 year bond	97.95	-0.02
													10 year bond	97.45	0.00

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				
USD	2.00	2.31	2.80	2.89	USD	2.81	-0.02	NZGB 6 05/15/21	1.74	0.00	1 year	1.96	-0.01
AUD	1.50	1.95	2.03	2.74	AUD	2.54	0.00	NZGB 5 1/2 04/15/23	1.96	0.01	2 year	2.03	0.00
NZD	1.75	1.91	2.03	2.86	NZD	2.41	0.01	NZGB 2 3/4 04/15/25	2.23	0.00	5 year	2.36	-0.01
EUR	0.00	0.06	-0.15	0.88	GER	0.35	0.01	NZGB 4 1/2 04/15/27	2.41	0.01	7 year	2.60	-0.00
GBP	0.75	0.81	1.09	1.53	GBP	1.28	0.01	NZGB 3 04/20/29	2.57	0.00	10 year	2.86	-0.00
JPY	-0.06	-0.03	0.05	0.32	JPY	0.10	0.00	NZGB 3 1/2 04/14/33	2.74	0.01	15 year	3.11	-0.01
CAD	1.50	1.17	2.43	2.64	CAD	2.26	-0.00	NZGB 2 3/4 04/15/37	2.89	0.01			

* 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

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

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