**Events Round-Up**

JN: Tokyo CPI ex-fresh food, energy (y/y%), Jul: 0.8 vs. 0.7 exp.
US: GDP (q/q%, annualised), Q2: 2.1 vs. 1.8 exp.
US: Personal consumption (q/q%, ann.), Q2: 4.3 vs. 4 exp.
US: Core PCE deflator (q/q%, ann.), Q2: 1.8 vs. 2 exp.

**Good Morning**

US equities ended last week at record highs, supported by generally stronger corporate earnings. The USD strengthened after a better than expected US GDP report and after White House advisor Larry Kudlow said that the US administration had ruled out FX intervention to weaken the dollar, albeit Trump’s later comments on the matter were more ambiguous. The NZD was the weakest of the G10 currencies last week as the market starts to toy with the idea of a 0.75% cash rate. It’s a big week ahead with the FOMC meeting (~25bps expected), nonfarm payrolls, the ISM surveys, Chinese PMIs and Australian CPI all released while US-China trade negotiations resume face-to-face in China.

It was a good session for equity markets on Friday, with both the S&P500 (+0.7%) and NASDAQ (+1.1%) closing at fresh record highs. Stronger earnings reports supported equities, with Google’s parent Alphabet rising more than 10% after it beat analyst expectations for earnings and revenue and announced a share buyback programme of up to $25b (released after the market close on Thursday). Twitter and Starbucks were among other companies to see their share prices rise after strong earnings reports while Amazon shares saw a modest fall after missing earnings expectations. Of the nearly 40% of companies to have reported so far, over 75% have beaten expectations (with the caveat that analysts had been paring those expectations in the lead-up to earnings season). The week ahead is the busiest of the corporate earnings season, with almost 170 companies reporting, including Apple.

While earnings will be in focus in the week ahead, the main event is the FOMC meeting on Thursday morning NZT, at which is the Fed is widely expected to cut 25bps, its first rate cut since 2008. The Fed’s dovish pivot and the ensuing fall in US Treasury yields has been a major factor behind the recent surge in equities (the S&P500 is up more than 10% since the start of June). The VIX measure of implied equity market volatility ended the week around 12, a relatively low reading by historical standards, with the market seemingly convinced that more monetary policy easing from the Fed will be forthcoming if the economy weakens.

In economic data, the advanced reading for US second quarter GDP was better than expected, at a 2.1% annualised pace of growth, higher than both the market consensus (1.8%) and the Atlanta Fed’s GDPNow estimate (1.3%). Personal consumption drove Q2 GDP growth, rising 4.3% annualised in the quarter and rebounding from its subdued 1.1% pace in Q1. Q2 GDP growth was dragged down by weakness in business investment, net foreign trade and inventories. The report was accompanied by the annual revisions to historic GDP, which saw 2018 growth revised lower from 3% to 2.5% and 2017 revised up from 2.5% to 2.8%. Meanwhile, the core PCE deflator, the Fed’s preferred measure of inflation, was slightly lower than expected. Rates markets were little moved on Friday, with the 10 year Treasury yield 1bp lower, at 2.07%, and the market pricing a 28.5bp reduction to the Fed funds effective rate for the meeting this week.

The USD was stronger against all the G10 currencies on Friday. The Bloomberg DXY reached a one month high while the (euro-heavy) DXY index rose to near its highest level since mid-2017. Besides the GDP data, which provided a short-term boost, the USD was supported by comments by White House economic advisor Larry Kudlow who told CNBC that the administration had last week “ruled out” FX intervention to weaken the USD. Market speculation has been rising over the past few months that the US could unilaterally intervene in the FX market by selling the USD, given Trump’s frequent complaints about alleged currency manipulation by the likes of China and Europe, ambiguous comments from senior US administration officials about whether the US still has a ‘strong dollar’ policy, and Trump’s track record of going against previous norms as part of his America-first doctrine (i.e. the use of tariffs). Late in the trading session Trump told reporters in the White House that the strength in the USD was “a beautiful thing in one way, but it makes it harder to compete” and he muddied the water further by saying “I didn’t say I’m not going to do something” about the currency, implying he hadn’t made a decision yet on intervention. There was little reaction to Trump’s comments, which came shortly before the market closed for the week.

The GBP was the biggest underperformer on Friday, down 0.6% to a two year-low against the USD, with the market
focused on the twin risks of a no-deal Brexit and new UK elections. New Prime Minister Boris Johnson told Macron and Merkel that the so-called Irish backstop needed to be scrapped from the Withdrawal Agreement, something the EU has consistently said is not up for negotiation. Over the weekend, cabinet minister Michael Gove told the Sunday Times that the government was “working on the assumption” of a no-deal Brexit and that preparations were being stepped up (with Johnson having directed to Gove chair meetings of civil servants and advisors seven days a week until Brexit is delivered). The paper also reported that Johnson had declared to advisors that he intends to deliver Brexit “by any means necessary.” Of course, with parliament opposed to a no-deal Brexit, this would appear to make a new election a reasonably high probability, in order to break the impasse (the Conservatives have enjoyed a 10% bounce in the polls since Johnson took charge, mainly at the expense of the Brexit Party). The betting markets now place an uncomfortably high 36% chance of a no-deal Brexit at the end of October, up from 30% on Friday.

The NZD and AUD also underperformed on Friday, with the AUD also down 0.6% against the USD and the NZD 0.4% lower. Having reached a 3½ month high last Friday, the NZD was the weakest of the G10 currencies last week, falling almost 2% against the USD. The fall in the NZD last week accompanied an increase in OCR rate cut expectations, with the 2 year NZ-US swap differential falling 12bps on the week. NZ swap rates closed down 1-2bps on Friday and at record low levels. The market now prices the terminal OCR at 0.93% by mid-2020, implying a not insignificant chance the OCR is cut to 0.75%. The ANZ business survey, released on Wednesday, is the highlight data-wise locally this week.

On the trade-front, US Treasury Secretary Mnuchin and US Trade Representative Lightziger travel to China this week to resume face-to-face negotiations with Chinese negotiators, led by Vice Premier Liu. Ahead of those meetings, Trump told reporters he thought China might hold off agreeing to a deal until after the Presidential election next year, in the hope that a Democrat might win (Joe Biden has expressed a softer line on China than both Trump and many of the other Democratic candidates). Meanwhile, Kudlow told CNBC not to expect “any grand deal” resulting from these talks and that the aim was to “reset the stage and hopefully go back to where the talks left off last May.” Kudlow cautioned that the sticking points remain the deep-seated structural issues such as alleged intellectual property theft and forced technology transfers. So the message appears to be not to expect any meaningful progress any time soon, and the threat of further escalation will continue to hang over the market for some time.

nick.smyth@bnz.co.nz

Coming Up

Nothing of note

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**Economy Watch**

29 July 2019

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**Foreign Exchange**

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* These are indicative ranges from 5pm NZST; 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

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Contact Details

BNZ Research

Stephen Toplis  
Head of Research  
+64 4 474 6905

Craig Ebert  
Senior Economist  
+64 4 474 6799

Doug Steel  
Senior Economist  
+64 4 474 6923

Jason Wong  
Senior Markets Strategist  
+64 4 924 7652

Nick Smyth  
Interest Rates Strategist  
+64 4 924 7653

Main Offices

Wellington
Level 4, Spark Central  
42-52 Willis Street  
Private Bag 39806  
Wellington Mail Centre  
Lower Hutt 5045  
New Zealand  
Toll Free: 0800 283 269

Auckland
80 Queen Street  
Private Bag 92208  
Auckland 1142  
New Zealand  
Toll Free: 0800 283 269

Christchurch
111 Cashel Street  
Christchurch 8011  
New Zealand  
Toll Free: 0800 854 854

National Australia Bank

Ivan Colhoun  
Global Head of Research  
+61 2 9237 1836

Alan Oster  
Group Chief Economist  
+61 3 8634 2927

Ray Attrill  
Head of FX Strategy  
+61 2 9237 1848

Skye Masters  
Head of Fixed Income Research  
+61 2 9295 1196

Wellington
Foreign Exchange  
+800 642 222

Fixed Income/Derivatives  
+800 283 269

New York
Foreign Exchange  
+1 212 916 9631

Fixed Income/Derivatives  
+1 212 916 9677

Sydney
Foreign Exchange  
+61 2 9295 1100

Fixed Income/Derivatives  
+61 2 9295 1166

London
Foreign Exchange  
+44 20 7796 3091

Fixed Income/Derivatives  
+44 20 7796 4761

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