Events Round-Up

GE: IFO business climate, Oct: 94.6 vs. 94.5 exp.
US: Advance goods trade balance, Sep: -70.4 vs. -73.5 exp.

Good Morning

Optimism over US-China trade talks has boosted the S&P500 to an all-time high overnight and global rates have continued to head higher. Currency movements have been more muted, although the NZD has been a notable underperformer since Friday afternoon. It’s a big week offshore with the FOMC and BoJ meetings, RBA Governor Lowe speaking tonight ahead of Australian CPI tomorrow, while US GDP, payrolls and ISM manufacturing are also released.

There have been more positive vibes over the past few days around the so-called ‘Phase-One’ trade agreement between the US and China. On Saturday, China’s Ministry of Commerce said parts of the text for Phase-One were “basically completed” as the two sides reached consensus in areas including standards used by agricultural regulators. Overnight, Trump said that negotiations over Phase-One, which Trump and Xi hope to sign at the APEC meeting in Chile next month, were “ahead of schedule”. Even noted trade hawk Peter Navarro said last Friday that the trade talks had been excellent. The improvement in trade relations increases the chances that the US will suspend planned tariffs on ~$160b of Chinese imports due to take place in December and reduces the chances that the US could slip into recession.

Global equity markets have been buoyed by the more positive tone to trade negotiations. Notably, the S&P500 has increased 0.6% overnight to a new all-time high. The NASDAQ is up 1% and sits a fraction below its all-time high, while the price-weighted Dow Jones has lagged a little, although it too remains within vicinity of its all-time high. Earlier, European indices were mostly up between 0% and 0.4% and the Eurostoxx 600 index was approaching its highest level since mid-2015 while the Nikkei had yesterday reached a more than one-year high. Despite a long list of potential negative risks lurking, the VIX index of implied volatility on the S&P500 has drifted down to below 13, a low level on a historic basis.

Bond yields have risen in tandem with equity markets as growing hopes of a US-China trade truce have led markets to pare back central bank easing expectations and investors have rotated out of safe-havens (amidst reduced downside risks to global growth). The US 10 year Treasury yield is trading at a six-week high of 1.85%, 8bps higher than the levels prevailing on Friday afternoon (NZT) while the 10 year German bund has increased to -0.33%, a two-month high. The increase in bond yields has occurred despite continued expectations that Fed will cut rates by another 25bps this week to 1.75% (the market prices a roughly 90% probability of a 25bp cut). However, future rate cut expectations have been pared back with futures markets now implying only around one further 25bp rate cut by the Fed by the end of 2020. Market pricing suggests the balance of risks around future Fed policy is still towards easing, but less so than previously and the investors will look to the FOMC statement this week for further guidance. The US yield curve has continued to steepen, with the 2y10y curve up to 20bps.

Currency market movements, in contrast to those in equities and bonds, have been relatively subdued. The USD indices have managed to consolidate after last week’s modest rise, although the Bloomberg DXY is still 1.6% lower in October (partly a function of the Brexit-inspired strength in the GBP and, to a lesser extent, EUR). The risk-on market tone and rise in Treasury yields has seen USD/JPY touch 109, its highest level in two-months.

On Brexit, Boris Johnson has agreed to the EU’s offer of a three-month extension to the Brexit deadline to January 31st (or earlier if the withdrawal agreement is ratified in parliament), officially taking a no-deal scenario this week off the table. The GBP is up 0.3% this week, to 1.2860. Johnson is expected to hold another parliamentary vote this morning hoping to secure new elections, although with Labour confirming it will either abstain or vote against it, this is widely expected to fail to pass the two-thirds majority needed. However, Labour leader Corbyn suggested that the party might support a simple bill that fixed the election date in law (and only requires a simple majority to pass), as recently proposed by the Lib Dem and SNP parties. This would allow a general election to take place in December. So we can expect more political noise in the UK, but with the risk of a no-deal scenario seemingly off the table we can probably expect the market to refocus on other issues.

The AUD has been the best performing developed-market currency this week, reflecting greater optimism on US-China trade, although its 0.3% rise to 0.6840 is still relatively modest. The NZD has underperformed since Friday night, despite the improvement in risk appetite and...
strength in the AUD. The NZD has fallen back from a high of 0.6425 seen on Thursday to 0.6345 now, a fall of more than 1%, while the AUD is basically unchanged over that time. There doesn’t appear to have been obvious trigger for the NZD underperformance.

NZ rates had a rollercoaster week last week. The 10 year swap rate reached a 2½ month high of 1.47% early last week as global rates rose amidst optimism on US-China trade talks and a Brexit deal. But rates moved steadily lower from Tuesday afternoon, capped off by a 4bp fall in the 10 year swap rate on Friday (-6bps on the 10 year NZGB yield). On the week, the 10 year swap was little changed, at 1.325%, although that is still well off the record lows of 1.1% reached earlier in the month. Rates will open-up higher this morning given the near 10bp rise in the 10 year Australian bond futures contract this week. As far as RBNZ expectations are concerned, a November OCR cut remains priced as a near certainty, but the market now prices only around a 50% chance of a follow-up rate cut taking place in 2020, with the market seeing the improved global outlook and less easing priced for the RBA and Fed as likely to put less pressure on the RBNZ to follow suit next year.

There hasn't been much economic data released over the past few days. The German IFO on Friday night was close to expectations and near its lowest levels since the GFC, consistent with near-recessionary growth in Germany. The US trade deficit released overnight was optically better than expected, although this occurred through a much larger than expected fall in imports, which offset a lesser fall in exports. The Atlanta Fed’s GDPNow estimate for Q3 GDP has shaven lower to 1.7%, slightly above the consensus of 1.6% (q/q% annualised) for this week’s release.

It’s an action-packed week ahead starting with RBA Governor Lowe’s speech tonight. Australian Q3 CPI is released tomorrow (our NAB colleagues are in-line with consensus in looking for a 0.4% increase to trimmed mean CPI) while the FOMC and BoJ meet on Thursday. On the US data front there is GDP, non-farm payrolls (expected to fall to 90k) and ISM manufacturing (expected to remain below the key 50 level) while the PMIs are released in China. Domestically, the highlight will be the ANZ business survey, where business confidence and activity indicators are likely to remain at subdued levels. Ahead of the release of the RBNZ’s Survey of Expectations released next month, we will also be watching the inflation expectations reading given the focus senior RBNZ officials have put on this in recent months.

nick.smyth@bnz.co.nz

Coming Up

<table>
<thead>
<tr>
<th>Period</th>
<th>Cons.</th>
<th>Prev.</th>
<th>NZT</th>
</tr>
</thead>
<tbody>
<tr>
<td>JN</td>
<td>Tokyo CPI Ex-Fresh Food, Energy (y/y%)</td>
<td>Oct</td>
<td>0.7 0.6</td>
</tr>
<tr>
<td>AU</td>
<td>RBA Governor Lowe Gives Speech in Canberra</td>
<td></td>
<td></td>
</tr>
<tr>
<td>US</td>
<td>Conf. Board Consumer Confidence</td>
<td>Oct</td>
<td>127.6 125.1</td>
</tr>
<tr>
<td>US</td>
<td>Pending Home Sales (m/m%)</td>
<td>Sep</td>
<td>0.5 1.6</td>
</tr>
</tbody>
</table>

Source: Bloomberg, BNZ

www.bnz.co.nz/research
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

Hong Kong
Foreign Exchange
+85 2 2526 5891
Fixed Income/Derivatives
+85 2 2526 5891

London
Foreign Exchange
+44 20 7796 3091
Fixed Income/Derivatives
+44 20 7796 4761

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.