

5 October 2018



## Events Round-Up

AU: Trade balance, Aug: \$1600m vs. \$1450m exp.

US: Jobless claims, Sep 29: 207k vs. 215k exp.

US: Factory orders (m/m%), Aug: 2.3 vs. 2.1 exp.

US: Durable goods orders (m/m%), Aug (final): 4.4 vs. 4.5 exp.

## Good Morning

After a large move higher on Thursday, US Treasury yields have stabilized somewhat overnight. Global bond yields have continued to rise, although NZ rates continue to lag the moves elsewhere. US equities have come under pressure overnight, alongside emerging markets, from the rise in yields. Meanwhile, the NZD fell to its lowest level since March 2016.

The US bond market is the centre of attention again after a huge move higher on Wednesday night and Thursday. After we wrote our report yesterday, Fed Chair Powell added to the upward pressure on yields with a series of hawkish comments in an interview. Powell said "*we may go past neutral, but we're a long way from neutral at this point, probably.*" He added that interest rates were still "*accommodative*", despite the removal of that phrase from the FOMC statement, and said "*there's really no reason to think that this cycle can't continue for quite some time, effectively indefinitely.*" The US 10 year Treasury yield closed the US trading session yesterday at 3.18%, a 12bp rise on the day, and extended its move to 3.23% in the early London morning. It has since drifted back to 3.19% as we write, likely due to the fall in US equities. All eyes are on payrolls tonight.

The sharp US Treasury yield move, to its highest level since 2011, reflects several factors. First, recent US data has been very strong (especially the ISM non-manufacturing index on Wednesday night), suggesting that Fed rate hikes have not yet had a material impact on slowing the US economy. The market has thus started to take the Fed rate projections, of three hikes in 2019, more seriously (the market now prices 55bps of 2019 rate hikes). Second, Fed officials, including the Chair, have reinforced the sense that the Fed intends to keep tightening, with several saying they probably intend to hike past 'neutral.' Third, the sharp nature of the 'bear steepening' in the US curve suggests that market positioning has probably exacerbated the moves (the yield

curve flattener was seen as a 'popular' position in the market). And finally, these factors have all come together at a time when the US Treasury is increasing supply to fund Trump's fiscal expansion and the Fed is running down its holdings of US Treasuries (and mortgage bonds).

Yields have moved higher elsewhere on the back of the US Treasury move. The 10 year gilt yield was 9bps higher overnight, to near its highest level since the Brexit referendum, while the 10 year bund yield moved up 6bps. An MNI report that the ECB was considering extending the duration of its QE reinvestment purchases next year (what the article dubbed an 'operation twist' of sorts), did little to stop the move higher in European rates.

NZ swap rates predictably moved higher across the curve yesterday, although they once again materially lagged the moves elsewhere. The 10 year swap rate was 4bps higher on the day to 2.89%, although that merely reversed the previous day's falls. Since the end of last week, the US 10 year Treasury yield is 15bps higher, while the 10 year NZ swap rate is 0.5bps lower. This pattern won't persist indefinitely, especially if other (non-US) global markets join in the bond sell-off.

Overnight, US equities and emerging markets have come under pressure from the move higher in rates. The S&P500 is down over 1% while the NASDAQ is down 2.2%. After holding up through most of yesterday's session, despite the rise in US rates, US equities fell into the market close. Downward pressure on US equities has extended overnight. Financial sector stocks are higher on the day, with higher rates and a steeper curve perceived as supportive of bank net interest margins, but almost all the other sectors are lower. Emerging market equities and currencies are also lower against a backdrop of higher US rates and a stronger USD. The JP Morgan EMFX index is 0.9% lower on the day, with several Asian EM currencies, such as the Indian rupee and Indonesian rupiah, hitting fresh lows.

The USD has had a mixed performance against the majors overnight. It's down against the JPY (probably reflecting the risk-off tone in equity markets) and the GBP, amid an FT report that Ireland was supportive of Theresa May's compromise backstop plan for the Irish border. The DXY and Bloomberg DXY continue to sit towards the upper-end of the ranges that have been in place since June.

The NZD and AUD have both moved to their lowest levels against the USD since the start of 2016. The NZD broke

below the year-to-date lows of 0.6501 yesterday afternoon, and despite some recovery in the EUR, the NZD has pushed on to 0.6475 as we write. The backdrop of a strengthening USD, ever widening US-NZ interest rate differentials, further weakness in EM currencies (to which the NZD and AUD have been closely tied), and the overnight moves lower in equities are all playing a part in the NZD's fall. We lowered our forecast for the NZD over the next six months to 0.65, which in practice means a plausible range of 0.63 – 0.67 (see yesterday's BNZ Currency Research note for more detail). Despite relatively stability in the NZD/AUD, the NZD is down on all the other major crosses, and the TWI has also moved to its lowest level since mid-2016.

Attention tonight is squarely focused on US non-farm payrolls.

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Coming Up

		Period	Cons.	Prev.	NZT
AU	Retail Sales MoM	Aug	0.3	0	14:30
AU	RBA's Heath gives speech in Canberra				14:35
US	Trade Balance	Aug	-53.5	-50.1	01:30
US	Change in Nonfarm Payrolls	Sep	181	201	01:30
US	Unemployment Rate	Sep	3.8	3.9	01:30
US	Average Hourly Earnings MoM	Sep	0.3	0.4	01:30
US	Average Hourly Earnings YoY	Sep	2.8	2.9	01:30
CA	Unemployment Rate	Sep	5.9	6	01:30
US	Fed's Bostic Speaks at Financial Literacy Conference				05:40

Foreign Exchange						Equities				Commodities**				
Indicative overnight ranges (*)					Other FX		Major Indices				Price			
	Last	% Day	Low	High	Last	% Day	Last	% Day	% Year		Last	Net Day		
NZD	0.6478	-0.6	0.6474	0.6510	CHF	0.9921	-0.1	S&P 500	2,887	-1.3	13.8	Oil (Brent)	84.22	-2.5
AUD	0.7070	-0.5	0.7066	0.7097	SEK	9.059	+0.0	Dow	26,492	-1.2	16.9	Oil (WTI)	73.93	-3.3
EUR	1.1507	+0.3	1.1466	1.1543	NOK	8.256	+0.3	Nasdaq	7,847	-2.2	20.1	Gold	1202.2	-0.0
GBP	1.3014	+0.6	1.2926	1.3041	HKD	7.835	-0.0	Stoxx 50	3,375	-0.9	-6.1	HRC steel	825.0	-0.6
JPY	113.77	-0.7	113.63	114.46	CNY	6.869	-0.3	FTSE	7,418	-1.2	-0.7	CRB	198.6	-1.3
CAD	1.2920	+0.4			SGD	1.381	+0.1	DAX	12,244	-0.4	-5.1	Wheat Chic.	535.8	+0.2
NZD/AUD	0.9163	-0.1			IDR	15,179	+0.7	CAC 40	5,411	-1.1	0.9	Sugar	12.33	+0.9
NZD/EUR	0.5630	-0.8			THB	32.73	+0.7	Nikkei	23,976	-0.6	16.2	Cotton	76.24	-0.3
NZD/GBP	0.4978	-1.1			KRW	1,130	+1.0	Shanghai	2,821	+1.1	-15.8	Coffee	107.0	+0.2
NZD/JPY	73.70	-1.2			TWD	30.80	+0.4	ASX 200	6,176	+0.5	9.3	WM powder	2715.0	-1.3
NZD/CAD	0.8370	-0.2			PHP	54.34	+0.1	NZX 50	9,257	-0.4	16.1	<b>Australian Futures</b>		
NZ TWI	71.16	-0.5										3 year bond	97.91	0.01
												10 year bond	97.28	0.02
Interest Rates						NZ Government Bonds				NZ Swap Yields				
	Rates		Swap Yields		Benchmark 10 Yr Bonds		Last			Last				
	Cash	3Mth	2 Yr	10 Yr	Last	Net Day								
USD	2.25	2.41	3.05	3.24	USD	3.19	0.01	NZGB 6 05/15/21	1.77	0.02	1 year	1.94	-0.00	
AUD	1.50	1.94	2.01	2.88	AUD	2.71	0.07	NZGB 5 1/2 04/15/23	1.98	0.02	2 year	2.02	0.01	
NZD	1.75	1.90	2.02	2.89	NZD	2.44	0.03	NZGB 2 3/4 04/15/25	2.23	0.02	5 year	2.38	0.02	
EUR	0.00	0.06	-0.09	1.04	GER	0.53	0.06	NZGB 4 1/2 04/15/27	2.44	0.03	7 year	2.62	0.03	
GBP	0.75	0.80	1.18	1.73	GBP	1.67	0.09	NZGB 3 04/20/29	2.61	0.04	10 year	2.89	0.04	
JPY	-0.06	-0.07	0.06	0.37	JPY	0.16	0.02	NZGB 3 1/2 04/14/33	2.79	0.04	15 year	3.15	0.04	
CAD	1.50	1.17	2.64	2.93	CAD	2.56	0.01	NZGB 2 3/4 04/15/37	2.92	0.04				

\* 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 06:50

Source: Bloomberg

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