

9 January 2019



Events Round-Up

AU: Trade balance (\$m), Nov: 1925 vs. 2175 exp.

GE: Industrial production (m/m%), Nov: -1.9 vs. 0.3 exp.

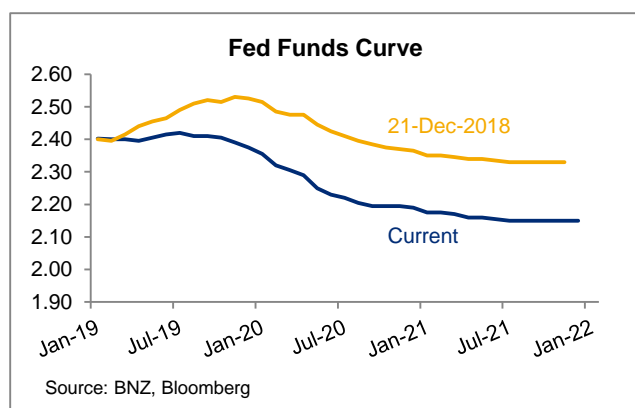
EC: Economic confidence, Dec: 107.3 vs. 108.2 exp.

US: NFIB small bus. optimism, Dec: 104.4 vs. 103.0 exp.

Good Morning

Happy New Year. In this first Markets Today for the year we begin with an overview of key events and market movements since Christmas. In illiquid market conditions we've seen some heightened volatility in equity and bond markets, while currency markets have been well-behaved apart from a "flash crash" a week ago.

Taking the Friday before Christmas as a reference point, the USD has been generally weaker, with the widely followed DXY index down to a near-three month low yesterday. As we note below, survey data has come in weaker than expected in the US, and this has fueled the debate about whether or not the US economy is heading for recession later this year or early 2020. The Fed Funds curve has shifted down, removing any tightening previously priced in for 2019 and the market is currently entertaining the risk of an easing in US monetary policy from later this year. Last week the US 10-year Treasury rate fell to a low of 2.54% – a level not seen since early 2018 – but has since recovered to 2.70%, still down 10bps from the pre-Christmas level.



US consumer confidence and ISM manufacturing indicators significantly undershot market expectations, while the non-manufacturing ISM indicator also underwhelmed. Employment growth was much higher than expected in December but a big increase in labour

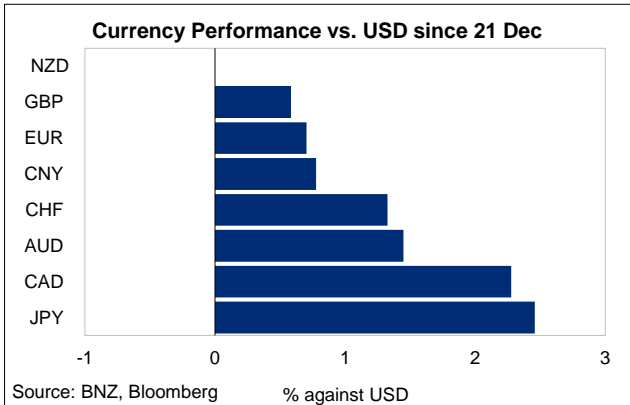
force participation saw the unemployment rate up 0.2% to 3.9%. Average hourly earnings were higher than expected, with wage inflation rising to 3.2% y/y.

The Fed's Kaplan argued that the Fed shouldn't take any further action on interest rates, given the slowing global economy, weakness in rate-sensitive industries and tightening financial conditions, advocating a pause in the first couple of quarters of 2019. On the balance sheet unwind, Kaplan said the Fed should be open to making adjustments if necessary. Chair Powell seemed to support this view, saying the Fed is able to "adjust policy quickly and flexibly", including the balance sheet unwind, adding that the Fed could be patient when it comes to interest rate hikes. He alluded to the example of 2016 when tighter financial conditions led to a pause in tightening cycle.

Those soothing words from Powell as well as the strong employment data helped drive an upturn in risk appetite and US equities have marched higher since. After falling by 9.2% in December, the S&P500 is currently up 2.3% for the year, exhibiting some significant volatility over that time.

In other US news, the government shutdown took effect on Christmas Eve and remains in force until further notice. If the shutdown lasts through to Saturday, it will become the longest US government shutdown on record. The Democrats took up their majority position in the lower House in early January and passed a bill to fund the government, but Trump won't sign the bill until he gets funding for the "Wall". The economic impact of the standoff has been minor so far but threatens to morph into something more significant if it drags on for weeks or months.

Against a weak USD, NZD/USD is flat since our pre-Christmas reference point and has underperformed other currencies, being down on all the crosses. Compared to the volatility seen in bond and equity markets, currency volatility has been largely absent apart from another flash crash that took place on 3 January. The crash was seemingly triggered by selling of TRY and AUD against JPY on a Japanese holiday in illiquid market conditions around the New York close, that spilled over into the NZD. The NZD/USD reached a low of 0.6575 while NZD/JPY went below 69. AUD was harder hit, reaching 0.6740, taking NZD/AUD up to a high of 0.9895. Market conditions and pricing normalised pretty quickly.

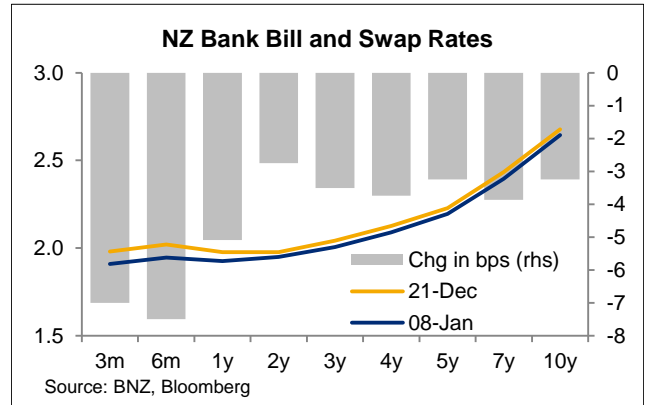


JPY has been the best performing major. It looked too cheap towards the end of last year, lagging the response to the big fall in risk appetite and has played some catch-up to that. Commodity currencies AUD and CAD have performed well, supported by a strong rebound in oil prices since Christmas Eve as OPEC+ looks to trim supply, led by Saudi Arabia.

In China news, PMI manufacturing data were weaker than expected, with both the official and Caixin measures falling below the key 50 level. These indicators supported the prevailing view that a decent economic slowdown in China was well underway. China's PBoC continued along the path of easing monetary policy by cutting the reserve requirement ratio (RRR) for banks by 100bps. This will add 800 billion yuan of net long-term funding to the economy after accounting for the maturity of the medium-term lending facility in Q1.

US-China trade talks are well underway. US and Chinese officials have been meeting this week to move towards an agreement and in overnight news the talks have been extended by an extra day, with Trump tweeting "Talks with China are going very well!" The big slowdown in Chinese growth and the US equity market "catching up" to equity market weakness seen elsewhere, alongside signs that weaker global growth is spilling over into the US economy all provide some incentive for a negotiated agreement to take place within the next few months. Overnight, the WSJ reports that the US and China made progress on narrowing their differences on trade issues, especially on purchases of US goods and services and widening access to China's markets, though the two sides are far from striking a deal.

The local swaps curve is slightly lower since the pre-Christmas level, with rates pulled down by global forces. We've seen bigger falls for bank bills, given a surfeit of local funding rather than economic reasons. The OIS curve through the next 12 months is little changed, with the market (still) pricing an increasing chance of a rate cut as the year progresses, albeit a relatively low one-in-three chance by November.



We'll resume normal service tomorrow but to quickly summarise the last 24 hours, European economic data continued to remain soft, with German industrial production undershooting expectations and showing its weakest annual growth since the GFC at minus 4.7% yoy. European economic confidence, a mix of business and consumer confidence, fell to a 2-year low. US small business confidence didn't fall by as much as expected, but some of the underlying data was weak, including a sharp fall in capex intentions.

The NZD has continued its run of underperformance, down 0.4% over the past 24 hours to 0.6730 and recovering over the last couple of hours after reaching an overnight low of 0.6708. It is down slightly on all the crosses. CFTC positioning data before Xmas showed that the large short positioning had been completely closed so perhaps we are seeing new short positions being taken on board early in the New Year. Global equity markets continue their good start to the year, with the S&P500 currently up 0.5%. The US 10-year rate has nudged up a touch to 2.70%.

Tonight the Bank of Canada is expected to keep its policy rate on hold. FOMC minutes released tomorrow morning hold less interest than usual, having been superseded by the significant market volatility and subsequent walk-back on comments by recent Fed officials.

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Coming Up

		Period	Cons.	Prev.	NZT
AU	Building approvals (m/m%)	Nov	-0.3	-1.5	13:30
EC	Unemployment rate (%)	Nov	8.1	8.1	23:00
CA	Bank of Canada rate (%)	Jan	1.75	1.75	04:00
US	FOMC meeting minutes	Dec			08:00

Source: Bloomberg, BNZ.

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	0.6728	-0.4	0.6708	0.6749	CHF	0.9806	+0.1			S&P 500	2,562	+0.4	-6.8	Oil (Brent)	58.64	+2.3
AUD	0.7141	-0.1	0.7117	0.7146	SEK	8.922	+0.3			Dow	23,661	+0.5	-6.4	Oil (WTI)	49.75	+2.5
EUR	1.1454	-0.2	1.1422	1.1469	NOK	8.546	+0.2			Nasdaq	6,850	+0.4	-4.3	Gold	1287.1	-0.2
GBP	1.2721	-0.4	1.2709	1.2797	HKD	7.839	+0.1			Stoxx 50	3,055	+0.7	-15.5	HRC steel	718.0	+0.3
JPY	108.51	-0.2	108.44	109.09	CNY	6.853	+0.0			FTSE	6,862	+0.7	-10.8	CRB	176.1	+0.8
CAD	1.3301	+0.0			SGD	1.358	+0.1			DAX	10,804	+0.5	-19.2	Wheat Chic.	527.0	+1.1
NZD/AUD	0.9422	-0.3			IDR	14,148	+0.5			CAC 40	4,773	+2.5	-13.0	Sugar	12.76	+0.9
NZD/EUR	0.5874	-0.2			THB	32.04	+0.3			Nikkei	20,204	+0.8	-15.3	Cotton	71.87	-1.2
NZD/GBP	0.5289	+0.1			KRW	1,124	+0.5			Shanghai	2,526	-0.3	-26.0	Coffee	105.0	+2.1
NZD/JPY	73.01	-0.6			TWD	30.84	+0.1			ASX 200	5,722	+0.7	-6.7	WMI powder	2775.0	+0.0
NZD/CAD	0.8949	-0.4			PHP	52.46	-0.0			NZX 50	8,821	+0.2	4.6	Australian Futures		
NZ TWI	73.28	-0.3												3 year bond	98.155	-0.04
														10 year bond	97.63	-0.05
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	2.50	2.80	2.71	2.73	USD	2.70	0.01	NZGB 6 05/15/21	1.70	0.00	1 year	1.92	-0.01			
AUD	1.50	2.06	1.93	2.60	AUD	2.30	0.03	NZGB 5 1/2 04/15/23	1.83	-0.00	2 year	1.95	-0.00			
NZD	1.75	1.91	1.95	2.64	NZD	2.21	-0.00	NZGB 2 3/4 04/15/25	2.03	-0.01	5 year	2.20	0.01			
EUR	0.00	0.06	-0.15	0.81	GER	0.23	0.01	NZGB 4 1/2 04/15/27	2.21	-0.00	7 year	2.40	0.02			
GBP	0.75	0.90	1.14	1.44	GBP	1.27	0.02	NZGB 3 04/20/29	2.39	-0.01	10 year	2.65	0.02			
JPY	-0.07	-0.07	0.00	0.19	JPY	0.01	0.02	NZGB 3 1/2 04/14/33	2.56	-0.01	15 year	2.90	0.02			
CAD	1.75	1.17	2.26	2.45	CAD	1.94	-0.01	NZGB 2 3/4 04/15/37	2.72	-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: NZT 06:53

Source: Bloomberg

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