

Fed up

Markets remain in a grumpy state. Sentiment has become more cautious this week and, overnight, the mood worsened. Pinpointing an exact catalyst is difficult but concerns about the spreading Delta variant and a possible peaking in global growth momentum are the most widely quoted. Japan announced a state of emergency yesterday and banned spectators from the upcoming Tokyo Olympics.

Following a dour day in Asian equity markets (with the exception of the outperforming NZX 50, up 0.04%), offshore equity markets have slumped 0.8-2.3%. The US S&P500 is down around 1% with 'reflation' trade beneficiaries like financials and industrials tending to underperform at the expense of tech stocks (NASDAQ -0.7%).

In bond markets, the scramble to unwind short positions at the long-end continued with 10-year US Treasury yields off a further 3bps overnight to 1.28% – a 4 ½ month low. The rapid and unexpected fall in long US yields is exerting its usual strong influence on other interest rate markets, with NZ 10-year swap yields falling 4bps to 1.74% yesterday.

This has produced a marked steepening in the local yield curve. The "2s-10s" measure of yield curve slope is down to just 88bps from 140bps at the start of June. While part of the move in long rates likely reflects the concerns noted above, at least part looks overdone and likely reflective of positioning. As noted by the *Financial Times'* Robert Armstrong, there's been "Plenty of explanations for falling yields, but none of them are much good."

Encouragingly, China may be about to turn on the monetary stimulus tap again which would ultimately bode well for commodity-sensitive currencies and risk assets. China's State Council signalled yesterday a possible cut to the Required Reserve Ratio (RRR) in order to support the real economy, especially small and medium-sized businesses. The implication, according to our CBA colleagues, is that the deceleration in Chinese credit growth may soon reverse.

The COVID-19 situation in NSW appears to be worsening, bringing increased health and economic risks. As our CBA colleague Phil Brown puts it: "there were 38 cases <yesterday> but, importantly, 14 of them were infectious out in the community. The current lockdown is slowing the spread, but not reversing the upward trend. There is a real risk that the lockdown is extended longer than the current lift date of 16 July."

Next week looms large for the economic trainspotters (like us) trying to fine-tune RBNZ expectations (meeting preview [here](#)). But our wealth economist "CTB" cuts to the chase for mortgage holders, yesterday delivering the latest in a string of warnings about the likelihood that mortgage interest rates move higher over the next couple of years: "we expect mortgage interest rates will lift to levels around 1-2% higher than they are now by 2025". Full report [here](#).

FX Comment: Currency markets have displayed the standard 'risk-off' reaction, with strength in the safe-haven USD, CHF, and JPY and underperformance in the CAD, AUD, and NZD. NZD/AUD has flat-lined around 0.9350 over the past 24 hours, indicative of the extent the USD is in the driving seat for FX markets. At around 0.6950, the NZD/USD is now within a whisker of the key 0.6930 support level – the lows from the mid-June sell-off.

Day ahead: The week looks set to end with a whimper rather than a bang, at least for the antipodean data calendar. There's just Chinese CPI out in our time-zone (8.8% yoy expected, thanks to base effects). Tonight, all eyes will be on the latest (June) US inflation numbers. Another increase is expected, to 5.0% yoy from 4.9% in May, with core measures also expected to lift again. The data may just serve as a reminder to markets 'peak-flation' hasn't been reached yet.

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Currencies			Currencies			Commodities			Equities		
NZD/USD	0.6944	-1.0%	NZD/SEK	5.970	-1.3%	NZX WMP	3765.0	-0.1%	Dow	34422	-0.7%
NZD/AUD	0.9349	-0.3%	NZD/DKK	4.360	-1.4%	Gold \$/o	1802.4	-0.1%	S&P 500	4321	-0.9%
NZD/EUR	0.5862	-1.3%	NZD/THB	22.6	-0.4%	WTI Oil \$/b	72.9	1.0%	NASDAQ	14560	-0.7%
NZD/JPY	76.23	-1.8%	AUD/USD	0.7427	-0.7%	Money Market (%)			FTSE	7031	-1.7%
NZD/GBP	0.5037	-0.9%	EUR/USD	1.185	0.4%	90 Day BB	0.35	0.00	CAC-40	6397	-2.0%
NZD/CAD	0.8706	-0.6%	USD/JPY	109.8	-0.8%	OCR	0.25	0.00	DAX	15421	-1.7%
NZD/CHF	0.6353	-2.2%	10 Yr Bond Yields (%)			ASB Swap Rates (%)			H.Seng	27153	-2.9%
NZD/HKD	5.394	-1.0%	NZ	1.68	-0.09	1yr	0.58	-0.03	Nikkei	28118	-0.9%
NZD/SGD	0.9393	-0.7%	US	1.29	-0.03	2yr	0.86	-0.03	ASX200	7341	0.2%
NZD/CNH	4.509	-1.4%	Aust	1.33	-0.07	5yr	1.34	-0.04	NZX50	12753	0.0%

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