Markets in positive mindset

As was widely expected, the US Federal Open Market Committee (FOMC) left its policy interest rates unchanged at around operational lows and maintained the current rate of asset purchases. The FOMC affirmed it expects rates to remain close to zero till 2023, with the FOMC to continue to increase its bond holdings to preserve the flow of credit until the economy gets back to full employment. **The 'DOT plots' (range of staff member forecasts), however, showed some members signalling the potential for rate hikes in 2023, which has seen US yields and the USD firm.**

Markets traded in a positive fashion overnight. **Negotiations are ongoing, but there is increasing confidence Congressional Democrats and Republicans will agree to a circa USD900bn temporary stimulus package** (which includes a fresh round of stimulus cheques) that will be enacted before earlier support measures expire towards the end of the year. **Rising hopes of a breakthrough on a UK trade deal pushed sterling higher, with the Pound rising to a 2½ year high against the USD** (1.355). Negotiations between the UK and European Union have continued to make progress with an agreement on fishing rights the last major obstacle according to European Commission president von der Layen. The UK Government has also reportedly put its parliamentary members on standby to vote on a potential agreement.

Niggles remain. COVID-19 continues to cast a large shadow with cases soaring in Tokyo and South Korea, and with rising cases and deaths in Germany and the US. The discovery of a new community case of COVD-19 in Sydney highlighted that a trans-Tasman bubble from early next year is not a sure thing. Media reports suggest Australia is set to challenge China at the World Trading Organisation over China's recent imposition of tariffs, as relations have soured. President Elect Biden is looking increasing likely to be declared US President by the US Congress on January 6, but the trade tensions which marred the last few years are unlikely to dissipate anytime soon. The US Treasury labelled Switzerland and Vietnam as currency manipulators, with the US potentially taking action unless "bilateral engagement" satisfied its concerns. China also remains on the US watch list and was urged to "improve transparency" in currency management. This is despite the USD index hovering around 2½ year lows. Hmmm.

US equities rose for the first session in five leading up to this morning's Fed decision, with modest overnight gains for the S&P500 and Nasdaq, with the DOW down slightly but still close to record highs. European equities were firmer, with the FTSE100 (+0.9%) and DAX (+1.5%) the major outperformers. The major indices were generally firmer in the Asian session. Optimism on strengthening global demand also rubbed off on commodity prices, with oil and other commodity prices generally firmer.

US Treasury yields edged higher after the FOMC statement (10Y 0.92%), with the yield curve its steepest since 2017. These was outpaced by more sizeable increases in Eurozone (Germany and France 10Y +4bps), with UK gilt yields modestly higher (10Y +1bps to 0.27%). Australian yields were a touch higher on light volumes. Local yields were fractionally higher yesterday with a mild steepening bias, with the 2-year swap yield (0.27%) still sitting above the 0.25% OCR.

December PMIs continued their trend recovery in Australia (manufacturing 56, services 57.4), UK (57.3 and 49.9), Germany (58.6 and 47.7), and the Eurozone (55.5 and 47.3). Momentum was checked in the US (56.5 and 55.3) and November US retail sales disappointed to the downside (-1.1% mom, control group -0.5% mom) and consistent with the flaring up of COVID-19 cases and subsequent imposition of restrictions. The December NAHB housing market index also eased (86, mkt: 88, prior 90). CPI inflation readings modestly surprised to the upside in Canada (1.0% yoy, mkt: +0.8% yoy), while UK headline (0.3% yoy, mkt: 0.6% yoy) and core CPI readings (1.1% yoy, mkt: 1.4% yoy) were weaker than expected.

There was minimal immediate market reaction as yesterday's release of the **NZ Government's Half-Year Economic & Fiscal Update (HYEFU) confirmed expectations of an improving (albeit still weak) fiscal outlook** (see our take here)**.** Forecasts for GDP were revised up, with nominal GDP expected to surpass $400bn by 2024/25. Forecast OBEGAL deficits were trimmed over the projection period by an average of $6bn per annum, with net core Crown debt to peak at 52.6% of GDP by 2022/23 and to decline as a share of GDP thereafter. Forecasts of the NZ Government bond programme were trimmed by $20bn over 2021/24, with a cumulative $135bn in gross issuance (total of $160bn over 2021/25).

FX Update: The USD index touched 2½ year lows last night and edged higher leading up to this morning's Fed decision. The NZD is currently in the lower part of its 0.7070 to 0.7125 USD overnight range and has eased to around 93.6 Australian cents and is down around 74.1 on a NZD TWI basis after being as high as 74.45 last night. USD weakness and the resilient NZ outlook have been key NZD supports. Until these influences fade it is difficult to see marked NZD downside from here.

Day ahead: Plenty. The main local focus is NZ Q3 GDP (mkt: 12.9% qoq, ASB: 13% qoq), leaving the level of economic activity just 2% below its pre-COVID-19 peaks, testament to the considerable resilience of the NZ economy. Further increases in Australian employment are expected from the November labour market report (mkt: +40k, CBA: +50K), with CBA expecting the unemployment rate to ease to 6.7% (mkt: 7.0%). Today's Australian mid-year Economic and Fiscal. Outlook is expected to mimic the HYEFU and show an improved fiscal outlook and hence reduced bond issuance profile. Housing starts, building permits and jobless claims are out for the US, with improving signs expected from the latter. The Bank of England is expected to maintain current policy settings in its decision tonight. **Author**: mark.smith4@asb.co.nz

Currencies			**Currencies**			**Commodities**			**Equities**		
NZD/USD	0.7080	-0.1%	NZD/SEK	5.926	-0.2%	NZX WMP	3225.0	0.0%	Dow	30129	-0.2%
NZD/AUD	0.9364	-0.2%	NZD/DKK	4.327	-0.3%	Gold $/o	1856.3	0.1%	S&P 500	3698	0.1%
NZD/EUR	0.5816	-0.3%	NZD/THB	21.2	-0.2%	WTI Oil $/b	47.6	0.0%	NASDAQ	12642	0.4%
NZD/JPY	73.38	-0.3%	AUD/USD	0.7561	0.0%	**Money Market (%)**			FTSE	6571	0.9%
NZD/GBP	0.5250	-0.6%	EUR/USD	1.217	0.1%	90 Day BB	0.25	0.00	CAC-40	5548	0.3%
NZD/CAD	0.9032	-0.6%	USD/JPY	103.6	-0.1%	OCR	0.25	0.00	DAX	13566	1.5%
NZD/CHF	0.6281	5.5%	**10 Yr Bond Yields (%)**			**ASB Swap Rates (%)**			H.Seng	26460	1.0%
NZD/HKD	5.489	-0.1%	NZ	0.88	0.01	1yr	0.26	0.00	Nikkei	26757	0.3%
NZD/SGD	0.9413	-0.3%	US	0.92	0.01	2yr	0.27	0.00	ASX200	6679	0.7%
NZD/CNH	4.612	-0.3%	Aust	0.97	0.00	5yr	0.47	0.01	NZX50	12829	0.5%

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