Daily Alert
New Zealand Edition

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Yield curves steepen as fears of imminent monetary tightening fade

A bit of a dampener for Black Caps overnight, with day 4 of the ICC World Test Championship final called off due to rain. While the test can be extended by a further day, it looks like the UK weather will dictate the result. An honourable draw looms.

A relative calm returned to markets overnight as earlier fears over aggressive central bank tightening eased. This was despite mixed messages from Fed speakers. FOMC Vice Chair John Williams (2021 voter), stuck to the central bank script and viewed the current spike in US inflation to be temporary, with US inflation down to 2% in 2022. While the US economy was improving rapidly, the economic and labour market recovery still had a long way to go, and conditions had not shifted enough for the Fed to "shift its stance of strong support for the economic recovery". On a more hawkish note, Robert Kaplan (2023 voter) called for QE tapering to begin "sooner rather than later", whereas Janes Bullard (2022 voter) warned of the possibility of upside risks to the inflation outlook and deemed it "appropriate" policy makers discuss tapering.

ECB President Lagarde maintained a dovish tone and affirmed that the ECB still had room to cut policy interest rates if needed ("we are not at the effective lower bound"). Lagarde viewed underlying pricing pressures as remaining subdued despite a brightening economic picture, with limited risks of higher US inflation impacting prices in the Eurozone. The euro was one of the weaker currencies overnight.

Yield curves steepened in the US and Europe. US Treasury yields were little changed for shorter maturities but firmed for longer-dated tenors (10y 1.48%), with 30-year Treasury yields currently 2.11% after briefly falling below 2% overnight. European yields were generally higher, and curves steeper. NZ yields ended yesterday firmer for shorter dated maturities, with longer-term yield pressured lower by the end of week decline in US Treasury yields. Australian yield curves were also flatter with more marked falls for longer-term yields.

Hopes of no imminent FOMC tightening provided a lift to US equities with decent gains in the major indices following the post-FOMC wobbles (Dow +1.8%, S&P500 +1.3%, Nasdaq +0.8%). European equities indices were also on the up. The selloff in Bitcoin continued with prices falling below USD33,000 following increasing scrutiny from global regulators (including bans for cryptocurrency services being imposed for some large Chinese banks). Equities were lower in the Asian session, with the Nikkei (-3.3%) particularly hard hit. Australasian stocks were lower (ASX 200 -1.8%, NZX50 -0.4%).

The USD was also lower and this looks to have provided a bit of a lift to commodity prices. Oil prices were also boosted on hopes of stronger demand and speculation that the recent talks on a nuclear deal between Iran and world powers will drag on, delaying Iran's entry to global oil markets. Near-term contract prices for Brent crude have approached USD75 per barrel, WTI (USD73.50), trading close to 2018 highs. Gold prices firmed (+1.10%).

Other events: Australian preliminary retail sales climbed just 0.1% in May (mkt: 0.4%, CBA: +1.5% mom), weighed by the lockdown-induced slump in Victoria retail (-1.5% mom). There are many tailwinds for consumer spending, but recent outbreaks in NSW and Victoria are a clear reminder of short-term risks to consumer spending from COVID-19. The Chicago Federal Reserve national activity index was considerably weaker than expected in May (0.29 versus mkt: 0.70), with April revised down to -0.09. China's loan prime rates were left on hold at 3.85% (1-year Prime rate) and 4.65% respectively (5-year).

FX comment: The USD and yen and euro were the weakest performers of the G10 currencies overnight, with commodity currencies amongst the stronger performers. The NZD ground higher against the USD and is currently just shy of 70 US cents after trading in a 0.6940 to 0.7000 USD range. The NZD traded in tight ranges against the AUD and is currently at 0.928 AUD. Strong export commodity prices and our expectation that the RBNZ will be towards the front of the central bank rate hike queue underpin our positive outlook on the NZD.

Day ahead: Locally, we have Q2 Westpac Consumer Confidence for Q2 (prior 105.2) and NZ credit card spending for May. There is not much in the way of data across the Tasman or in Europe, with a modest pullback expected for US existing home sales in May tonight (mkt: 5.71m vs 5.85m in April). The focus will be on central bankers, with Fed Chair Powell's testimony to the US Congress tomorrow morning (6am NZT) particularly pivotal and with FOMC members Daly (2021 voter) and Mester (2022 voter) also on the wires overnight. **Author**: mark.smith4@asb.co.nz

Currencies			Currencies			Commodities			Equities		
NZD/USD	0.6993	0.8%	NZD/SEK	5.965	-0.3%	NZX WMP	3855.0	-0.3%	Dow	33885	1.8%
NZD/AUD	0.9272	0.0%	NZD/DKK	4.364	0.3%	Gold $/o	1783.0	1.1%	S&P 500	4224	1.4%
NZD/EUR	0.5868	0.2%	NZD/THB	22.1	1.3%	WTI Oil $/b	73.7	2.8%	NASDAQ	14140	0.7%
NZD/JPY	77.12	-0.1%	AUD/USD	0.7542	0.8%	**Money Market (%)**			FTSE	7062	0.6%
NZD/GBP	0.5020	-0.1%	EUR/USD	1.192	0.5%	90 Day BB	0.33	0.00	CAC-40	6603	0.5%
NZD/CAD	0.8645	-0.1%	USD/JPY	110.3	0.0%	OCR	0.25	0.00	DAX	15603	1.0%
NZD/CHF	0.6418	0.3%	**10 Yr Bond Yields (%)**			**ASB Swap Rates (%)**			H.Seng	28489	-1.1%
NZD/HKD	5.430	0.3%	NZ	1.74	-0.04	1yr	0.46	0.02	Nikkei	28011	-3.3%
NZD/SGD	0.9386	0.4%	US	1.48	0.05	2yr	0.73	0.03	ASX200	7235	-1.8%
NZD/CNH	4.522	0.3%	Aust	1.53	-0.08	5yr	1.34	0.00	NZX50	12499	-0.4%

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