

A cautious start

It's been a slow start to the week in most financial markets, and this looks set to continue as investors await US employment data at the end of the week.

Risk appetite has softened slightly, with some attributing this to concern about the spread of the Delta COVID-19 variant through parts of the Asia. Both Malaysia and Thailand recently announced new restrictions. But it's just as likely to reflect a bit of profit-taking & positioning ahead of month end.

Most sharemarkets have posted small declines overnight, with the exception of the NASDAQ. A 0.9% increase in the latter, driven by the usual big-tech suspects, has lifted the index to a fresh record high. Bond yields have lost a couple of bps and this general 'risk off' sentiment has seen the USD rise 0.2-0.4% against most of the major FX pairs. The NZD/USD has been one of the weaker performing currencies, but is only around 30pips below levels this time yesterday (around 0.7040).

The head of the German central bank summed up the view of many investors overnight, warning there are "upside risks to price developments being predominant in the euro area". He thus called for the ECB's pandemic-related bond purchases to be reduced once it was clear the "emergency situation" was over. The €1.85t PEPP programme is currently slated to end in March. Market reaction was limited, reflective of the fact the Bundesbank head's views are not widely shared by the ECB Governing Council, with other members running a less hawkish line.

Local front-end swap yields started the week where they left off on Friday, pushing higher. The 2-year yield lifted a further 3bps to 0.80% yesterday - the highest since March 2020. There was little news to drive the move. Rather, it seems to reflect increased nervousness the RBNZ could lift the OCR *this year*. OIS-implied market pricing is now consistent with a better-than-even chance of a 25bps RBNZ rate in November. Our formal view is that the RBNZ will hike rates in May but we have publicly flagged the risk it comes earlier. Moreover, near-term data – e.g. this week's NZ business confidence survey – are likely to reinforce the upward pressure on firms' pricing intentions and inflation pressures.

FX comment Higher local yields have lifted NZ-US 2-year swap differentials to a 3½ year high of +46bps, a clear NZD positive for yield hungry investors. Plugging wider interest rate differentials into our short-term NZD/USD valuation model gives a NZD/USD "fair-value" range of 0.7300-0.7700. In other words, even as NZD/USD spot has undergone a correction in the past few weeks, fair value has pushed higher.

Solid medium-term fundamentals reinforce our constructive NZD/USD view. But, for this week, more consolidation looks likely in the familiar 0.6985-0.7100 range, as investors await Friday's payrolls.

Day ahead: RBNZ Governor Orr is speaking at 4:10pm, but the fact he is speaking to the Bank's *Statement of Intent* suggests the market implications of such will be limited. There's nothing of note out in Australia/China during our time zone and the overnight session also offers up little excitement.

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Currencies			Currencies			Commodities			Equities		
NZD/USD	0.7042	-0.4%	NZD/SEK	5.996	-0.2%	NZX WMP	3835.0	0.0%	Dow	34287	-0.4%
NZD/AUD	0.9308	-0.2%	NZD/DKK	4.392	-0.3%	Gold \$/o	1778.1	-0.2%	S&P 500	4288	0.2%
NZD/EUR	0.5906	-0.3%	NZD/THB	22.5	-0.1%	WTI Oil \$/b	72.9	-1.8%	NASDAQ	14503	1.0%
NZD/JPY	77.88	-0.6%	AUD/USD	0.7567	-0.2%	Money Market (%)			FTSE	7073	-0.9%
NZD/GBP	0.5074	-0.3%	EUR/USD	1.192	-0.1%	90 Day BB	0.34	0.01	CAC-40	6558	-1.0%
NZD/CAD	0.8693	0.0%	USD/JPY	110.6	-0.2%	OCR	0.25	0.00	DAX	15554	-0.3%
NZD/CHF	0.6475	-0.4%	10 Yr Bond Yields (%)			ASB Swap Rates (%)			H.Seng	29268	-0.1%
NZD/HKD	5.466	#VALUE!	NZ	1.83	0.02	1yr	0.50	0.00	Nikkei	29048	-0.1%
NZD/SGD	0.9458	-0.3%	US	1.48	-0.05	2yr	0.79	0.03	ASX200	7307	0.0%
NZD/CNH	4.550	-0.3%	Aust	1.59	0.02	5yr	1.41	0.02	NZX50	12604	-0.2%

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