

RBNZ gets the message across, still waiting for Trump spending

- Markets wait for US fiscal stimulus plans.
- RBNZ holds rates and contains market rate-hike expectations.
- Federal Reserve rate hike odds lift heading into month-end.

February was a busy month in markets, both at home and abroad as the Donald Trump effect showed no signs of slowing down, while the RBNZ came to the table and delivered a message that was received loud and clear.

The RBNZ found itself in an interesting position leading into its first Monetary Policy Statement (MPS) of 2017. After cutting the OCR by 25bp in November, the change in the balance of risks meant the RBNZ was instead expected to provide some indication of when interest rate hikes might take place. **The challenge for the RBNZ, however, was to deliver a neutral easing bias** for the first time in over a year but, at the same time, to lower market expectations of imminent OCR hikes.

The RBNZ held the OCR steady at 1.75%, as expected, but surprised by weakening its inflation outlook, helping to push back market pricing which had got to the stage where a rate hike was expected in November. **The RBNZ did lift its OCR outlook track, putting in one hike, all the way out in late 2019.** Following the announcement market participants responded by pushing out market pricing for when the first OCR increase will occur. Now only around a 50% chance of a hike by the end of the year is priced in, compared to being almost fully priced pre-meeting. The NZD also took a step back.

Offshore, the market spent the month waiting for US President Trump to finally announce his spending plans, somewhat in vain. During the wait some investors stepped back from US assets, with the USD and bond yields declining. This did not extend to the stock market though, **with the Dow and others marking a number of new record highs through the month,** while the pace of the rise also troubled the record books. **Some controversy around members of Trump's administration did little to support demand for the USD, despite equity market strength.** However, as the month wore on, it was expected that Trump would announce spending plans at the State of the Union address on February 28. As it turned out, the address was again light on fiscal detail and some spending details now look as if they will arrive during March. **The lack of spending signposts do not look as if they will deter the Federal Reserve from lifting interest rates though, with pricing moving higher through the month, closing at around an 80% chance of a hike at the March 16 meeting .**

Date	Instrument	28-Feb-17	Month %	Quarter %	Year %	5-Year %
Cash	NZ cash rate	1.75	0.00	-0.25	-0.75	-0.75
	NZ 90-day bank bill	2.00	0.01	-0.14	-0.56	-0.76
	US 90-day bank bill	1.05	0.02	0.17	0.42	0.57
	NZ - US 90-day bank bill	0.95	-0.01	-0.31	-0.98	-1.33
Fixed	NZ 5-year gov't stock	2.57	-0.13	0.53	0.12	-1.10
Interest	NZ 10-year gov't	3.23	-0.13	0.70	0.27	-0.89
	NZ 10-year sw ap	3.51	-0.12	0.80	0.40	-0.99
	AUS 10-year gov't	2.75	0.02	0.43	0.35	-1.36
	US 10-year gov't	2.37	-0.10	0.58	0.62	0.43
Equities	NZ - NZX50 Capital (NZ\$)	3417	1.5%	3.5%	10.4%	72.4%
	AUS - All Ords (A\$)	5761	1.5%	4.7%	16.4%	31.3%
	JAP - Nikkei (¥)	19119	0.4%	4.4%	19.3%	96.6%
	UK - FT100 (£)	7263	2.3%	7.1%	19.1%	23.7%
	US - S&P500 (US\$)	2364	3.7%	7.5%	22.3%	73.1%
	WORLD - MSCI (US\$)	1839	2.6%	7.4%	18.8%	41.6%
	MSCI in NZD (NZ\$)	2559	4.1%	6.1%	8.8%	65.9%
Exchange	NZD/USD	0.7184	-1.4%	1.2%	9.3%	-14.7%
Rates	NZD/AUD	0.9348	-2.9%	0.1%	1.4%	20.0%
	NZD/JPY	80.90	-2.2%	9.4%	8.6%	19.4%
	NZD/GBP	0.5779	-0.8%	-0.9%	21.8%	9.4%
	NZD/EUR	0.6786	-0.4%	5.0%	12.8%	8.7%
	NZ TWI	78.14	-1.9%	2.2%	8.7%	4.9%
	EUR/USD	1.0587	-1.1%	-3.6%	-3.1%	-21.5%

Equity indices are the respective end-of-month closes. Interest rates and exchanges rates are at 5pm NZ.

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Cash

The RBNZ held its first MPS for almost 4 months in February and, as firmly expected, held the OCR at the record low of 1.75%. The tone of the statement made it clear the Bank has little expectation of having to adjust interest rates in the near future. It did, however, add one hike into its OCR track. This is all the way out in late 2019. The Bank's messages were received loud and clear by the market, which had been pricing in a full hike as soon as November 2017. Following the announcement and follow-up press comments, pricing drifted out to around a 50% chance of a hike and then continued to decline through the rest of the month.

Elsewhere the Federal Reserve held the Fed Funds rate steady at the start of the month, as expected. However, as the month progressed various Fed officials started introducing a more hawkish tone to comments, lifting the pricing for a rate hike at the march meeting. The RBA held steady, as expected.

Fixed interest

Global bond yields took a small step back in February, although remained well above levels seen prior to the US election. Domestically, the RBNZ's decision and statements pulled NZ yields lower, with the 2-year yield losing around 15bp to 2.16% and the 10-year declined from 3.36% to 3.23%. This was a function of the RBNZ's actions, as well as the shift in the global environment.

Offshore, the chances of a rate hike from the Fed in March were estimated to be declining though the first part of the month, while the lack of spending plan announcements from President Trump led to some market repositioning. However, the State of the Union address was seen as an opportunity for some sort of announcement, giving yields a lift heading into month end. In the event, Trump's speech was light on spending detail, but a fiscal stimulus announcement is expected before March is done, supporting yields to some extent. A number of hawkish comments from a range of Fed officials also gave rate hike expectations a boost into month-end, to finish at around 80%.

Equities

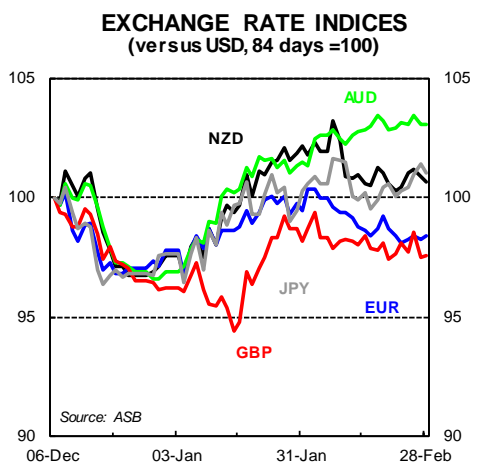
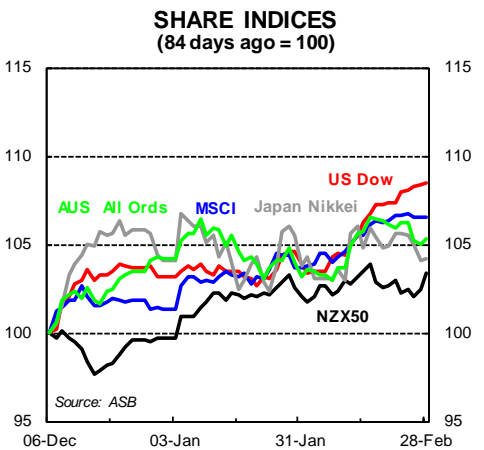
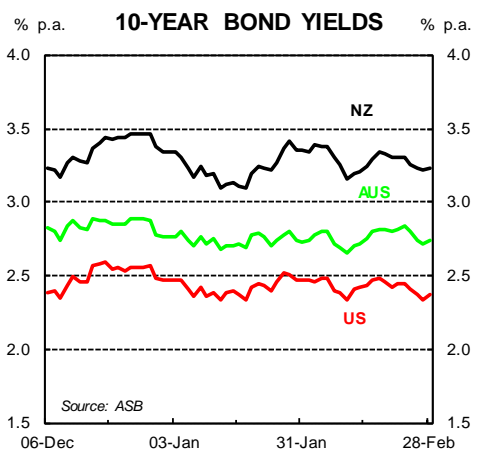
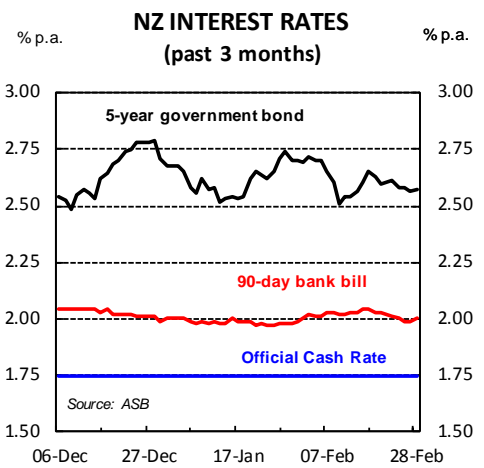
The Trump-inspired run in US equities continued into February, with another series of record highs set. Records for the length of the bull-run were also set, despite the lack of definitive spending plans from President Trump. Even so, the general rhetoric of pro-growth spending was enough to add to the US rally. This spilled out into selected overseas markets as well, although European political concerns limited gains there.

The NZX50 built on January's gains to add another 1.5% in the quarter. It was aided by a robust reporting season in general. In addition, selected keynote stocks, which suffered in the Q3 sell-off, extended the come-back trail. Elsewhere, selected take-over bids/talk also supported some listed firms. However, it was not enough for the NZX50 to keep pace with US counterparts.

Exchange rates

Much of February was spent waiting for President Trump to announce his spending plans, somewhat in vain. This led to a slight moderation in USD strength against the AUD. The AUD was also boosted by the continued positive news around commodity prices and exports. The British Pound and Euro failed to take advantage of any USD weakness, with the Brexit negotiations and political uncertainty ahead of key European elections weighing on the currencies.

The NZD started the month on the front foot. However, the RBNZ MPS saw NZ rate hike expectations lowered somewhat. This pulled the NZD back at the announcement. The currency remained under pressure through the latter stages of the month, as traders paired bets the RBNZ would begin a tightening cycle in 2017. A subdued Q4 retail sales report failed to offer the currency any support on the run-in to month end.



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