

Markets Monthly

10 January 2022

Mixed year for local investments

The New Zealand economy has proved to be remarkably resilient over the course of 2021, despite the ongoing challenges of the COVID-19 pandemic. By several key macro-economic measures New Zealand is looking good compared to other developed economies. Our unemployment rate is low compared to elsewhere, and economic growth has held up better too. Consumer price inflation has become a major concern, and so has house price inflation. These issues are not unique to New Zealand: most central bankers around the world will have a wary eye on tightening labour markets, inflation, and housing markets during 2022.

The RBNZ delivered two rate hikes in 2021, lifting the Official Cash Rate to (a still low) 0.75% in November. More hikes are due for 2022. The RBNZ was initially looking a bit lonely in lifting its cash rate but was joined in the rate hike cycle by one of the big guns when the Bank of England (BoE) surprised financial markets and voted 8-1 to hike its target bank rate by 15bps to 0.25% in December. We, and most market participants expected 'lift off' at the next meeting in February 2022. The Central Bank of Norway has also lifted its target rate in 2021 but the BoE is the first major central bank to lift its target rate in the wake of the COVID-19 pandemic.

| Date | | 31-Dec-21 | Month % | Quarter % | Year % | 5-Year % |
|------------------------|-------------------------------|-----------|---------|-----------|--------|----------|
| Cash | NZ Official Cash Rate | 0.75 | 0.00 | 0.50 | 0.50 | -1.00 |
| | NZ 90-day bank bill | 0.97 | 0.16 | 0.32 | 0.70 | -1.04 |
| Fixed Interest | NZ 5-year gov't stock | 2.21 | 0.00 | 0.68 | 1.82 | -0.47 |
| | NZ 10-year gov't | 2.31 | -0.12 | 0.31 | 1.31 | -1.04 |
| | AUS 10-year gov't | 1.68 | -0.07 | 0.20 | 0.70 | -1.09 |
| | US 10-year gov't | 1.51 | 0.00 | 0.00 | 0.59 | -0.97 |
| Australasian Equities | NZ - S&P/NZX50 Capital (NZ\$) | 5328 | 2.2% | -2.2% | -2.9% | 62.1% |
| | - S&P/NZX50 Gross (NZ\$) | 13034 | 2.5% | -1.8% | -0.4% | 89.1% |
| Equities | AUS - All Ords (A\$) | 7779 | 2.5% | 2.0% | 13.6% | 36.0% |
| International Equities | JAP - Nikkei (¥) | 28792 | 3.5% | -2.2% | 4.9% | 50.6% |
| | UK - FT100 (£) | 7385 | 4.6% | 4.2% | 14.3% | 3.4% |
| | US - S&P500 (US\$) | 4766 | 4.4% | 10.6% | 26.9% | 112.9% |
| | WORLD - MSCI (US\$) | 3232 | 4.2% | 7.5% | 20.1% | 84.5% |
| | - MSCI return in NZD | | 4.3% | 8.4% | 27.2% | 88.3% |
| Exchange Rates | NZD/USD | 0.6821 | -0.1% | -0.9% | -5.5% | -2.0% |
| | NZD/AUD | 0.9403 | -1.5% | -1.6% | 0.3% | -2.4% |
| | NZD/JPY | 78.50 | 1.2% | 1.9% | 5.4% | -3.2% |
| | NZD/GBP | 0.5053 | -1.4% | -1.2% | -4.7% | -11.0% |
| | NZD/EUR | 0.6027 | -0.2% | 1.7% | 2.6% | -8.9% |
| | NZ TWI | 72.52 | -0.9% | -1.4% | -3.1% | -6.6% |

For the latest performance information on ASB's funds click [here for ASB KiwiSaver Scheme](#), click [here for ASB Investment Funds](#). More information on [ASB Securities is here](#).

The reasons for the BoE hike in December were very familiar to those in NZ – concerns over “more persistent” medium-term inflation and very tight labour markets according to BoE Governor Bailey.

The US Federal Open Market Committee (FOMC) also made a hawkish turn during December, although in contrast to the BoE, there was no surprise rate hike, and the change to its tapering of asset purchases was largely expected. The FOMC doubled the pace of tapering to \$US30bn per month at the December meeting. The FOMC’s bond purchase (QE) program will now end this March. We expect the FOMC to increase its Federal Funds Rate four times in 2022, starting in May, to a target range of 1.00% to 1.25%. Inflation watchers will be interested that the FOMC has removed the reference of inflation being “transitory”.

In contrast to these “hawkish” developments, the European Central Bank seems committed to staying on the side lines while other central banks raise rates. In December ECB President Lagarde reaffirmed 2022 ECB rate hikes were very unlikely despite the risks to the inflation outlook. In a similar vein, the Reserve Bank of Australia continues to hold the line about being patient in terms of rate hikes. Governor Lowe reiterated this in a speech in December. However, we continue to expect an earlier lift off for rate hikes than the RBA is signalling and have a rate hike cycle starting in the fourth quarter of this year pencilled into our forecasts.

Investment performance is driven by both macro and microeconomics, and 2021 has been a year where the local share and bond markets were somewhat disconnected with offshore counterparts. US Treasury and Australian bond yields out to the 10-year tenor was about 80-90 basis points are higher than at the start of 2021. This pales in comparison to the circa 150bp jump in NZ counterparts. The NZ 2-year swap rate is up close to 200bps as markets have priced in multiple RBNZ rate hikes over the next two years.

Global sharemarket performance was strong over 2021, with the MSCI global index up 20%, the US S&P500 up 27%, and Australia’s All-Ords index up nearly 14%. In contrast, the local sharemarket was down over the course of the year, due to both micro (i.e., company and sector specific) issues, as well as macroeconomic headwinds including rising interest rates, capacity constraints, and closed borders. The 0.4% drop in the local sharemarket was the first annual decline for the S&P/NZX50 Gross benchmark since 2011.

The management of the pandemic will remain a key challenge over the year ahead. Now the focus is the Omicron variant, but who knows what Greek letter we will be up to by the end of this year? Despite the waves of Covid challenges, financial markets remain focussed on reopening economies. Central banks will continue to support the economic recovery but are increasingly concerned about the inflation outlook. Fixed interest markets will be challenging, and interesting to watch over 2022. Meanwhile, improving prospects for global growth should improve the outlook for growth assets. This is reflected in the strength in global sharemarkets, and bond market movements over December and early 2022.

Income Assets

Cash

ASB’s term deposit rates have lifted several times this year, including an early December lift. The longest terms have lifted the most. The 3– to 5-year rates are now over 2% above the record lows recorded over the past year. The short-term rates of less than six months remain closer to their lows, as tabled below.

| Term Deposit Rates | 90-days | 6 months | 9 months | 1 Year | 2 years | 3 years | 4 years | 5 years |
|--------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| 10-year ave | 2.52 | 3.17 | 3.21 | 3.28 | 3.50 | 3.67 | 3.83 | 3.96 |
| Low | 0.35 | 0.80 | 0.75 | 0.75 | 0.80 | 0.90 | 1.00 | 1.00 |
| Jan-22 | 0.70 | 1.30 | 1.55 | 2.00 | 2.50 | 3.00 | 3.05 | 3.10 |
| 2021 increase | 0.35 | 0.50 | 0.80 | 1.25 | 1.70 | 2.10 | 2.05 | 2.10 |

All of ASB’s term deposit interest rates are [tabled here](#). Inflation has been low until recently, but is now on the rise and could erode all the return from term deposits. CPI inflation is expected to run at between 2-3% p.a. over the coming years, above all but the longer term deposit rates. Related to the inflation outlook, and the strong economic recovery in the wake of the COVID-19 pandemic, the RBNZ lifted the Official Cash Rate in early October, and again in November. More increases are signalled for this year. ASB Economics thinks every meeting over the year ahead is “live” for a rate increase from the RBNZ. Our report on the RBNZ’s latest decision and the outlook [is here](#). We also

expect to see some more increases in term deposit rates over the years ahead, and our term deposit reports can be [read here](#).

| Asset | Instrument | 31-Dec-21 Yield (%) | Month | Quarter | Year | 5-Year |
|----------------|-----------------------|------------------------|-------|---------|-------|--------|
| | | Yield Change | | | | |
| Cash | NZ Official Cash Rate | 0.75 | 0.00 | 0.50 | 0.50 | -1.00 |
| | NZ 90-day bank bill | 0.97 | 0.16 | 0.32 | 0.70 | -1.04 |
| | US 90-day bank bill | 0.21 | 0.04 | 0.08 | -0.02 | -0.78 |
| Fixed Interest | NZ 5-year gov't stock | 2.21 | 0.00 | 0.68 | 1.82 | -0.47 |
| | NZ 10-year gov't | 2.31 | -0.12 | 0.31 | 1.31 | -1.04 |
| | NZ 10-year swap | 2.64 | -0.06 | 0.40 | 1.66 | -0.84 |
| | AUS 10-year gov't | 1.68 | -0.07 | 0.20 | 0.70 | -1.09 |
| | US 10-year gov't | 1.51 | 0.00 | 0.00 | 0.59 | -0.97 |

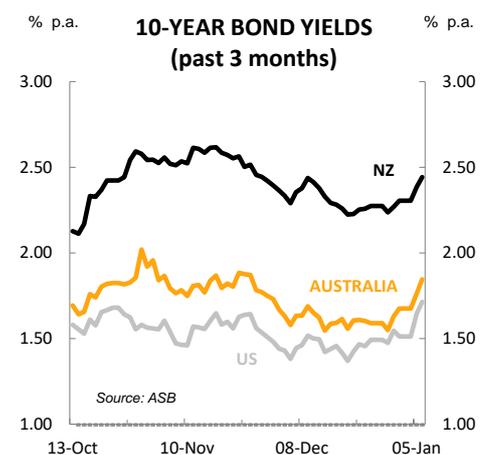
Fixed Interest

NZ Government bond yields have risen sharply over the past year, but the upward lift has paused in the last couple of months of 2021. The pattern is similar in the US and Australia, with long-term yields retreating from recent peaks, but still up significantly on year-ago levels. In early 2022, the upward pressure on rates has resumed, as shown in the chart to the right.

The NZ 10-year government bond yield eased 12 basis points over December but remains circa 1.8% higher than the lows reached during the pandemic. The five-year yield was flat over the month, but similarly, is up significantly over the past year. The lift in long term yields over 2021 has caused significant drops in the mark-to-market valuations of bonds within portfolios.

The Australian 10-year government bond yield dipped 27 basis points in November, and another 7 basis points over December, but still traded around 70 basis points higher than a year ago. The US 10-year yield has been range-trading around 1.5% over the last quarter of the year. In early January the yield has kicked up towards 1.8% and is up circa 125 basis points on the 2020 lows at the time of writing.

One of the consequences of the larger lift in local rates is that New Zealand bonds resume the more normal pattern of trading with a yield advantage vis-à-vis the Australian and US equivalents. It also means local bond portfolios have tended to underperform global bond portfolios. Over the year ahead a big question is when other central banks will join the RBNZ and tighten monetary policy. This development will be important for the relative performance of local vs. global bond portfolios as well as currency markets.



Growth Assets

| Asset | Index | 31-Dec-21 | Month % | Quarter % | Year % | 5-Year %p.a. |
|----------|-------------------------------|-----------|---------|-----------|--------|--------------|
| | | Level | | | | |
| Equities | NZ - S&P/NZX50 Capital (NZ\$) | 5328 | 2.2% | -2.2% | -2.9% | 10.1% |
| | - S&P/NZX50 Gross (NZ\$) | 13034 | 2.5% | -1.8% | -0.4% | 13.6% |
| | AUS - All Ords (A\$) | 7779 | 2.5% | 2.0% | 13.6% | 6.3% |
| | All Ords in NZD | 8273 | 4.1% | 3.6% | 13.2% | 6.9% |
| | JAP - Nikkei (¥) | 28792 | 3.5% | -2.2% | 4.9% | 8.5% |
| | UK - FT100 (£) | 7385 | 4.6% | 4.2% | 14.3% | 0.7% |
| | US - S&P500 (US\$) | 4766 | 4.4% | 10.6% | 26.9% | 16.3% |
| | WORLD - MSCI (US\$) | 3232 | 4.2% | 7.5% | 20.1% | 13.0% |

Local and International Equities

The New Zealand sharemarket was out of step with global markets over 2021, and despite a 2.5% lift over December, the S&P/NZX50 Gross benchmark still recorded its first annual decline since 2011. Nonetheless, over the longer term the local sharemarket has still performed well, reflected in the 5-year performance tabled above.

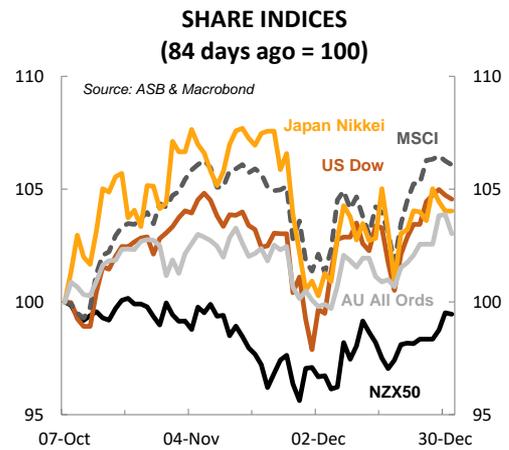
The Aussie sharemarket outperformed the NZ market throughout 2021. In contrast with the local sharemarket's decline of 0.4% over the year, the Australian All Ords benchmark is up 13.6% over the period, helped by a solid 2.5% lift over December.

US shares dipped in November, but bounced back strongly over December, with the S&P500 index of shares up 4.4% over the month. That saw the index gain 26.9% over 2021.

Japanese shares have had a volatile year, including in December. A 3.5% gain over the month offset some of the losses earlier in Q4 and left the Nikkei index with a 4.9% gain for 2021. The UK's FTSE 100 index posted the strongest gain of the main markets we monitor during December, lifting 4.6%. That gain helped the UK sharemarket benchmark post a 14.3% gain over the year.

In sum, **the MSCI index of global shares** was up 4.2% in USD terms for December, and 7.5% over the fourth quarter. The 20% gain for global shares over 2021 is impressive, given the challenging economic environment.

ASB Securities has more information on sharemarkets and trading [here](#).



Exchange Rates

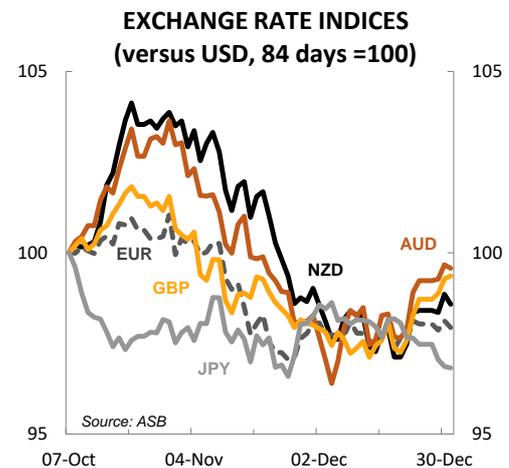
Throughout 2021 currency movements were less volatile than in 2020, with the NZD trading in a USD 7¢ range against the greenback largely between USD 0.6720 and USD 0.7430, and an AUD 6¢ range between 0.9150-0.9700 vis-à-vis the AUD.

On a trade-weighted (TWI) basis the NZD range was 71.8 to 76.4 over 2021.

During the month of December, the NZD TWI eased 0.9% and NZD was mixed on cross rates. The NZD eased 1.5% against the AUD and 1.4% against the GBP but was up 1.2% against the JPY. The NZD ended the month little changed vis-à-vis the USD and EUR.

The NZD starts 2022 near the bottom of last year's range against the USD and GBP, and TWI.

More information about currencies is available in ASB's weekly economic report which can be [downloaded here](#).



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