

# Markets Monthly

08 March 2019



## Sharemarket recovery continues over February.

- Global equities continued to recover from the December quarter slump over February.
- Bond yields eased, both here, and abroad. Lower for longer is the theme for central banks.
- The prospect of lower interest rates and improving US-China trade sentiment supported shares.
- The NZD was mixed, and eased against the USD and GBP during the month.

| Date           |                           | 28-Feb-19 | Month % | Quarter % | Year % | 5-Year % |
|----------------|---------------------------|-----------|---------|-----------|--------|----------|
| Cash           | NZ Official Cash Rate     | 1.75      | 0.00    | 0.00      | 0.00   | -0.75    |
|                | NZ 90-day bank bill       | 1.89      | -0.03   | -0.09     | 0.04   | -1.08    |
| Fixed          | NZ 5-year gov't stock     | 1.67      | -0.08   | -0.34     | -0.76  | -2.37    |
| Interest       | NZ 10-year gov't          | 2.16      | -0.10   | -0.40     | -0.79  | -2.40    |
|                | AUS 10-year gov't         | 2.10      | -0.14   | -0.49     | -0.69  | -1.94    |
|                | US 10-year gov't          | 2.67      | -0.01   | -0.35     | -0.23  | 0.03     |
| Australasian   | NZ - NZX50 Capital (NZ\$) | 4132      | 3.7%    | 5.4%      | 7.5%   | 52.3%    |
|                | - NZX50 Gross (NZ\$)      | 9328      | 3.7%    | 5.7%      | 11.4%  | 86.9%    |
| Equities       | AUS - All Ords (A\$)      | 6253      | 5.3%    | 8.8%      | 2.2%   | 15.5%    |
| International  | JAP - Nikkei (¥)          | 21385     | 2.9%    | -4.3%     | -3.1%  | 44.1%    |
| Equities       | UK - FT100 (£)            | 7075      | 1.5%    | 1.4%      | -2.2%  | 3.9%     |
|                | US - S&P500 (US\$)        | 2784      | 3.0%    | 0.9%      | 2.6%   | 49.7%    |
|                | WORLD - MSCI (US\$)       | 2086      | 2.8%    | 2.2%      | -1.5%  | 24.5%    |
|                | MSCI in NZD (NZ\$)        | 3046      | 3.8%    | 2.4%      | 3.9%   | 52.5%    |
| Exchange Rates | NZD/USD                   | 0.6848    | -1.0%   | -0.3%     | -5.2%  | -18.4%   |
|                | NZD/AUD                   | 0.9582    | 0.7%    | 2.2%      | 3.3%   | 2.3%     |
|                | NZD/JPY                   | 75.92     | 0.9%    | -2.5%     | -2.0%  | -11.1%   |
|                | NZD/GBP                   | 0.5148    | -2.2%   | -4.1%     | -1.0%  | 2.4%     |
|                | NZD/EUR                   | 0.6017    | 0.1%    | -0.1%     | 1.8%   | -1.7%    |
|                | NZ TWI                    | 73.91     | -0.4%   | -1.2%     | -0.7%  | -7.8%    |

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

Over February, all major global sharemarkets were higher, building on the recovery that started in late December. The US-China trade truce continued, and investors were encouraged by signs of progress during the month's negotiations. Late in the month US President Trump delayed a tariff increase on Chinese imports that was due to kick in on 1 March, citing "substantial progress" in trade negotiations. Investors were also encouraged by the shifting

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](#).

stance of the US Federal Reserve, which was discussed in [last month's report](#). President Trump also met with North Korean President Kim Jong-Un in Vietnam for a summit which abruptly ended without any statement or agreement from the pair.

Iron ore prices rose sharply in early February after the tragic dam collapse at a mine in Brazil. Copper prices continued to rebound from early 2019 lulls. Coal prices rose towards the end of the month on reports of restrictions to Australian coal exports to China. Authorities have yet to confirm reports but given Australia exports nearly 25% of its coal to China, this is an important situation to monitor. Share prices for BHP Billiton and Rio Tinto lifted 6.9% and 10.5% respectively during February.

In New Zealand, healthy dairy prices are a mixed blessing for corporate earnings in the sector. Dairy auction prices from the GlobalDairyTrade portal have surged by nearly 24% in USD terms since November. Fonterra has lifted its 2018/19 milk price forecast range by 30 cents to \$6.30-\$6.60/kg. While this is good news for farmers, the news for Fonterra's shareholders hasn't been so good. The increase in milk price "has put pressure on margins", and Fonterra has revised down its 2018/19 forecast range of earnings per share by 10 cents to a 15-25 cents range. Fonterra also announced that it will not pay an interim dividend this year. The Fonterra Shareholders Fund share price hit an all-time low and dropped 12% over the month.

Early in the month the Reserve Bank of Australia (RBA) shifted its forward guidance on the cash rate (currently 1.50%) from a mild tightening bias to a neutral stance. Governor Lowe stated in a speech that, "*over the past year, the next move is up scenarios [for the cash rate] were more likely than the next move is down scenarios. Today, the probabilities appear to be more evenly balanced*". Financial markets are pricing in a reasonable probability that the next move for the RBA is a cut to the cash rate.

The European Central Bank joined in on the "lower for longer" interest rate theme, by pushing out the expected timing of any increase in its targeted interest rates at its early March meeting. The ECB now expects its key interest rates to remain at their present levels at least "through the end of 2019" instead of at "least through the summer of 2019". The ECB's balance sheet will also expand over the next few months via a new refinancing operations targeted to stimulate bank lending. Yields on German 10-year bunds declined to 0.06%, a 2½ year low.

In February, the RBNZ held the OCR at 1.75% and pledged to keep policy rates on hold through 2019 and 2020. The news flow from the RBNZ will be keenly monitored by financial markets, with pricing over the next 12 months biased towards OCR cuts. Another interesting development to watch will be the RBNZ's review of capital adequacy, in which it was proposed that locally incorporated New Zealand banks hold higher Tier 1 (i.e. equity) capital. If the proposals go ahead, the higher capital requirements will likely influence customer deposit (downwards) and lending rates (upwards) over the years ahead. The submission period for the capital review is underway and ends in May

Another local focus during the month was the release of the Tax Working Group's final report to the government. The report contained nearly 100 proposals and recommendations, but the biggest interest was in the proposed capital gains tax. The report is thorough and it will take time for markets, policymakers and investors to get to grips with the key details and implications. Our initial thoughts on the report can be found by [clicking on this link](#).

## Income Assets

### Cash

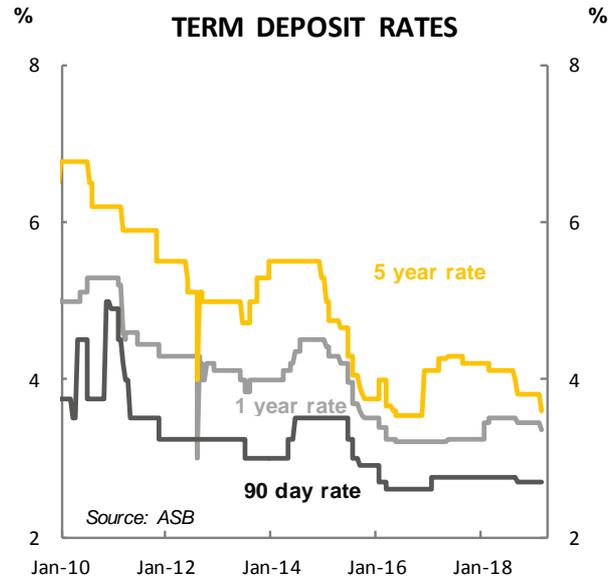
The RBNZ kept the OCR on hold at 1.75% at its February meeting, and pushed out the length of time that it expects to retain this setting. The RBNZ “expect to keep the OCR at this level through 2019 and 2020”. And the direction of the next OCR move “could be up or down”.

The ASB economics team recently extended its view on how long the 1.75% OCR will be retained. ASB now expects the OCR to remain on hold at 1.75% until February 2021 (previously August 2020). A key influence on the view change is the likely impact of the RBNZ bank capital proposals on banking funding costs and the broader economy. These dynamics are also important for cash and

term deposit returns. With OCR hikes a way off, ASB Economics expect most short-term returns on term deposits will likely stay near current levels over 2019. Further dips in term deposit rates remain a risk, particularly if other long term interest rates continue to decline, or the RBNZ decides to cut the OCR.

Term deposit rates have been fairly steady since September 2018, but the rates on some terms were trimmed by between 5bps and 20 bps in February. Term deposit rates for amounts over \$10K range from 2.7% for a 90-day term (unchanged on earlier months), up to 3.6% for a 5-year term (down 20 bps).

The latest ASB term deposit rates [can be found here](#).

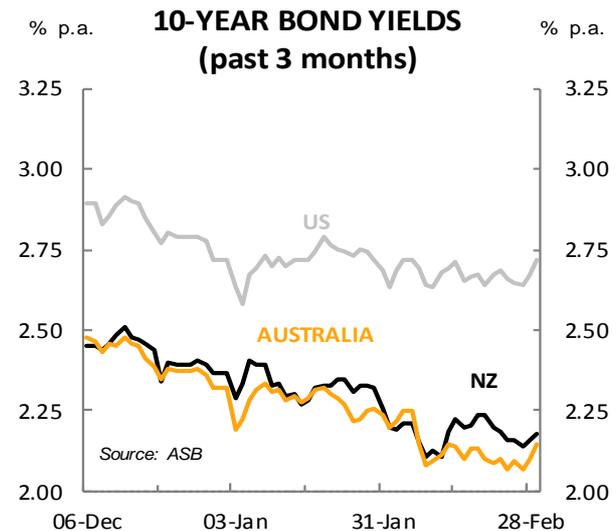


### NZ Fixed Interest

NZ Government bond yields have continued to decline over February, and the 10-year yield has set fresh lows during the month. The 5-year and 10-year Government bond yield traded as low as 1.61% and 2.11% respectively on 12 February, but subsequently rose to end the month about 7 bps higher. Local Government Funding Agency, NZ bank, and NZ corporate bond yields also pressed lower during the month. Bank bond yields remained significantly lower than term deposit rates for corresponding banks and matching terms. For example an ASB bond that matures on 22 February 2022 (circa 3 years) currently yields 2.57%, whereas a three year ASB term deposit currently pays 3.5%.

The key event for local bonds during January was the US

Federal Reserve’s change in stance discussed in last month’s ASB Markets Monthly. In February, the RBNZ and the RBA joined the Fed in providing a more cautious outlook for interest rates. The RBA moved to a neutral stance, and the RBNZ pushed out the expected timing of its tightening cycle. All of these dynamics are behind the “lower for longer” sentiment in the local fixed interest market.



### International Fixed Interest

The US Federal Reserve’s late January meeting was a pivotal event for global financial markets, and has set the tone

for both bond markets and share markets in February. Fed voters indicated in January that the next move in the Fed Funds rate could be a rate rise or a rate cut, in contrast to earlier signals that more (gradual) rate hikes were in the pipeline. The softer stance supported a strong rally in bonds, and US yields remained low through February, trading in a narrow range. At the time of writing the US 2-year yield is around 2.47%, and the 10-year yield is only 17 basis points higher at 2.64%. This difference in yields, referred to as the “2-10 slope” has narrowed over recent months, back to levels last seen prior to the global financial crisis, a decade or so ago. Back then the US yield curve inverted, with 2 year yields higher than 10-year counterparts. Flat and/or inverted yield curves typically signal a pending slowdown in economic activity, and many investors do not expect the Federal Reserve to raise rates again in the foreseeable future. European bond yields remained low in February. German Bunds traded in an incredibly low range over February, with 10-year yields between 0.08% and 0.18%. UK gilt yields remain trading in the lower part of recent ranges with the 10-year yield near 1.2% at the time of writing. Japanese 10-year yields spent the month trading with a negative yield, but briefly turned positive in early March, to yield 0.01%. While the negative interest rates in Japan seem strange, they are not unique. In Switzerland yields are also negative for terms including the 10-year bond. The 5-year yield is also negative in France, Sweden and the Netherlands at present.

## Growth Assets

### Australasian Equities

February was a great month for Australasian equities. The NZX50 index rose 3.7%, while across the Tasman the ASX 200 posted a 5.3% gain for the month.

A surge in dairy prices is good news for farmers, but the increase in milk price has put pressure on margins for Fonterra. The Fonterra Shareholders Fund share price hit an all-time low and dropped 12% over the month. By contrast, investors have been encouraged by the latest results from the a2 Milk Company, whose share price rose 13% over February. Synlait’s shares were up by nearly 14% over the month. Top spot on the NZX 50 went to Fisher & Paykel Healthcare, which rose 17% over February. In Australia, the switch to a neutral bias by the RBA, rising iron ore prices and a lift in bank shares supported the broader market.

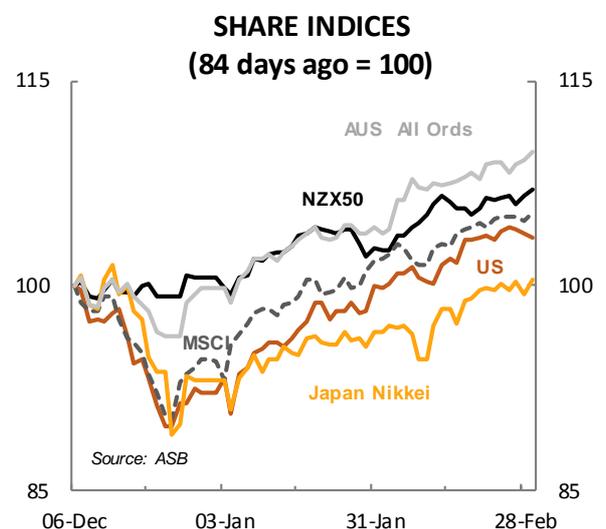
The NZX 50 Gross index set a fresh record high in early March. The Australian “All Ords” index is 2% shy of its 2018 peak. But the index is still around 7% down on the record high set back in 2007. By way of comparison, the US S&P500 is still around 7% below its September 2018 record high.

### International Equities

Sharemarkets have made a great start to 2019, having suffered the worst year since the Global Financial Crisis in 2018. Over both January and February, all the major sharemarkets we monitor have pressed higher. The US S&P 500 index of US shares was up 7.9% in January, and another 3% in February. Despite the solid recovery that started in late December, the index is still around 6% off its 2018 high.

The German Dax index rose by 3.1% in February. Despite the Brexit dramas continuing, the UK FTSE index rose 1.5%. Japan’s Nikkei 225 rose 2.9%, but the index is still over 10% below its 2018 peak. The recovery in global sharemarkets over the past two months has recouped a lot of the late 2018 losses, but world shares are still down on year ago levels (measured by the MSCI index of global shares in USD terms).

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



## Exchange Rates:

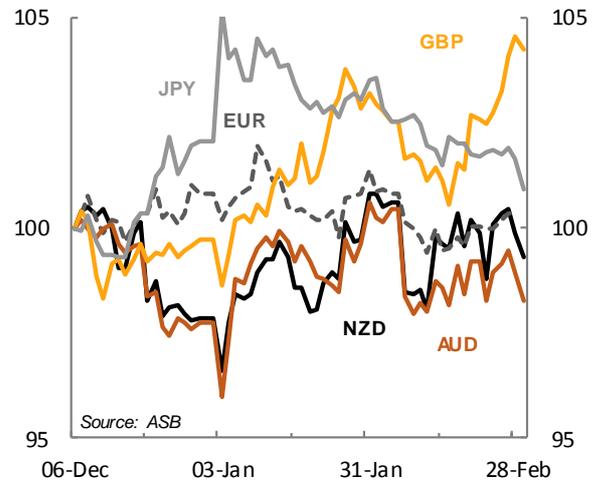
The NZD was mixed over February, easing against the USD and GBP but gaining on the other cross rates we monitor. On a trade-weighted basis the NZD eased 0.4% over the month.

The GBP firmed against all the major currencies over the month as sentiment regarding Brexit improved. NZD/GBP eased 2.2% over the February.

The NZD firmed against the AUD during the month, trading near 0.9600. The AUD has weakened in part because the Reserve Bank of Australia has softened its stance and shifted to a neutral outlook for the Australian cash rate.

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

**EXCHANGE RATE INDICES  
(versus USD, 84 days =100)**



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