

# Markets Monthly

06 June 2018

## Markets wax and wane over May

- Italian politics weighed on the EUR and caused significant volatility in Italian bond yields during May.
- President Trump flip-flops on tariffs and the North Korean Summit: both are back on at the time of writing.
- Long term government bond yields fell over the month, with US 10-year Treasury yields dipping below 3% again.
- The RBNZ's new Governor Adrian Orr made his first OCR announcement on May 10, and held the OCR at 1.75%.

May was action packed with events that impacted financial markets, particularly in the closing days of the month. US President Trump continued to bluster away and US import tariffs were back on the table, troubling markets. Italian politics also caused some concern and related volatility during May.

U.S. Commerce Secretary Wilbur Ross confirmed new U.S. tariffs on steel and aluminium imports will come into effect on 1 June. Unsurprisingly, Canada, Mexico and the EU immediately announced retaliatory tariffs and their intent to appeal to the World Trade Organisation (WTO). The latest tariff announcements came just days before a third round of trade talks with China and the G7 Finance Ministers and Central Bank Governors meeting in Canada. The Commerce Secretary said he was looking forward to "continued negotiations" indicating the potential for the tariff wars to subside. Accordingly, the latest developments have a familiar feeling of brinkmanship that we saw in Trump's moves earlier in the year. Separately, at the time of writing, it's uncertain whether a summit between President Trump and North Korea's leader Kim will take place, but it appears that officials are making progress towards the meeting planned for 12 June.

US bond yields rose in the first half of the month, and fell in the second. The US 10-year Treasury yield went from 2.96% on 1 May, and peaked at 3.12% on 18 May. It was mostly downhill from there, with the 10-year Treasury yield falling as low as 2.76% before ending the month at around 2.85%. The early May lift in US yields coincided with increasing oil prices, still-positive risk sentiment and signals from the Fed meeting that US rates were still likely to move up. The subsequent rally in US yields coincided with the deterioration in risk appetite, which saw the US dollar rise, oil prices fall and yields on safe haven bonds ease. The crisis in Italian politics was the main catalyst for the late May rally (yields lower) for highly rated sovereign bonds. Over the full month US, Australian and New Zealand 10-year Government bond yields declined around 11-12 bps.

A new Italian government was finally formed after the Italian President accepted Giuseppe Conte as the new Italian Prime Minister. Conte has agreed to form a government, ending months of uncertainty in Italy. However, the make-up of the new government points to further political instability ahead. Anti-establishment Five Star Party leader Luigi Di

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Maio will be the Economic Development Minister, Anti-immigrant League Party leader Matteo Salvini will be the Interior Minister, and Eurosceptic economist Paolo Savona will be the European Affairs Minister. Italian Government bonds were sold heavily late in the month as the political situation deteriorated, but recovered some of the losses by month end after the new government was announced. The 10-year Italian government bond yield started the month trading around 1.79%, got as high as 3.44%, and closed the month around 2.79%.

Argentina was also in the spotlight during May. Argentina asked for financial support from the International Monetary Fund after the peso collapsed, and the Argentinian central bank lifted its benchmark interest rate to 40% to stem the currency sell-off. Since April, the Argentinian peso has fallen nearly 20% against the USD, and is down around 35% on year-ago levels.

By comparison, New Zealand was fairly quiet on the financial news front. Budget 2018 showed a healthy set of books, and the new Government looks to be on track to get net debt below 20% of GDP by 2021/22. As expected, the Debt Management Office (DMO) has made a small increase in the Government bond programme. The net lift in borrowing over the forecast period is \$1bn.

As was widely expected, the RBNZ left the Official Cash Rate at 1.75% in May. The new Governor Adrian Orr lived up to his reputation as a straight talker, stating “the direction of our next move is equally balanced, up or down”. We continue to expect the OCR will be on hold until the second half of 2019.

NZ company news was mixed, but overall the month was positive. The NZX 50 gross index was up 2.8% over May, and closed the month just shy of its all-time high set in the middle of the month.

Early in the month, NZD/USD fell below \$US 0.7000 for the first time since December 2017. The pair reached a low of 0.6851 on 16 May, only to climb back towards 0.7000 by month end. Over the full month the NZD declined 2.4% against the USD, and 1.5% against the AUD.

Date		31-May-18	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	2.02	0.00	0.10	0.05	-0.63
Fixed Interest	NZ 5-year gov't stock	2.26	-0.11	-0.17	-0.21	-0.70
	NZ 10-year gov't	2.72	-0.11	-0.23	-0.06	-0.86
	AUS 10-year gov't	2.66	-0.12	-0.13	0.26	-0.72
	US 10-year gov't	2.85	-0.11	-0.05	0.62	0.74
Australasian	NZ - NZX50 Capital (NZ\$)	3921	2.3%	2.0%	12.5%	55.9%
	- NZX50 Gross (NZ\$)	8683	2.8%	3.7%	17.2%	92.5%
Equities	AUS - All Ords (A\$)	6124	0.9%	0.1%	6.3%	24.6%
International	JAP - Nikkei (¥)	22202	-1.2%	0.6%	13.0%	61.2%
	UK - FT100 (£)	7678	2.2%	6.2%	2.1%	16.6%
	US - S&P500 (US\$)	2705	2.2%	-0.3%	12.2%	65.9%
	WORLD - MSCI (US\$)	2093	0.3%	-1.2%	9.5%	42.2%
	MSCI in NZD (NZ\$)	2998	1.7%	2.3%	11.1%	64.5%
Exchange Rates	NZD/USD	0.70	-1.4%	-3.4%	-1.5%	-13.6%
	NZD/AUD	0.92	-1.3%	-0.5%	-2.9%	10.2%
	NZD/JPY	75.89	-1.8%	-2.0%	-3.5%	-6.9%
	NZD/GBP	0.52	2.2%	1.0%	-5.1%	-1.1%
	NZD/EUR	0.60	2.6%	1.2%	-5.6%	-3.4%
	NZ TWI	73.27	-0.4%	-1.6%	-4.3%	-3.4%

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

## Income Assets

### Cash

The RBNZ's new Governor Adrian Orr made his first OCR announcement on May 10. The Reserve Bank of New Zealand (RBNZ) has held the Official Cash Rate (OCR) at 1.75% since November 2016, and Orr's first meeting stuck with the pattern as far as interest rates are concerned. The RBNZ's latest forecasts continue to suggest the OCR will likely remain at the current level until at least the second half of 2019. The risks for the OCR are equally balanced, and the RBNZ stated that the next OCR move could be either up or down. ASB Economics have an August 2019 rate hike of 0.25% pencilled into ASB's forecasts.

Term deposit rates for amounts over \$10K ranged from 2.75% to 4.1% for terms between 90 days and 5 years. Over the past 10 years term deposit rates have averaged between 0.9% and 1.5% higher than the 90-day bank bill rate. If OCR hikes are a way off, and funding costs remain contained (see our note [here](#)) most short-term returns on term deposits will likely stay near current levels over the year ahead.

ASB Economic forecasts have been factoring in some upward pressure on longer term deposit rates over the year from lifting global rates. However, jitters in global financial markets late in the month saw key global interest rates decline from mid-May highs. Local long-term bond yields also declined, while NZ term deposit rates remained steady over the month.

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

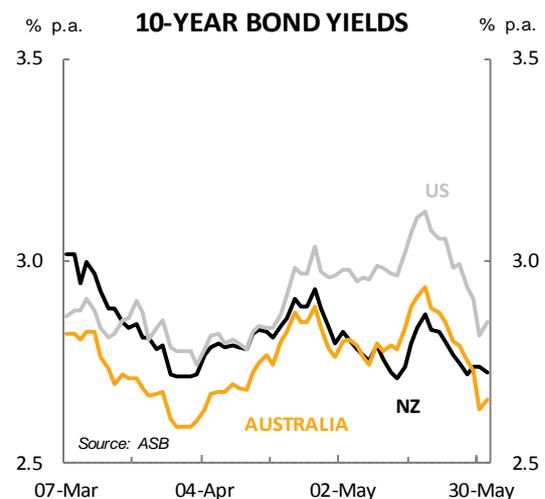
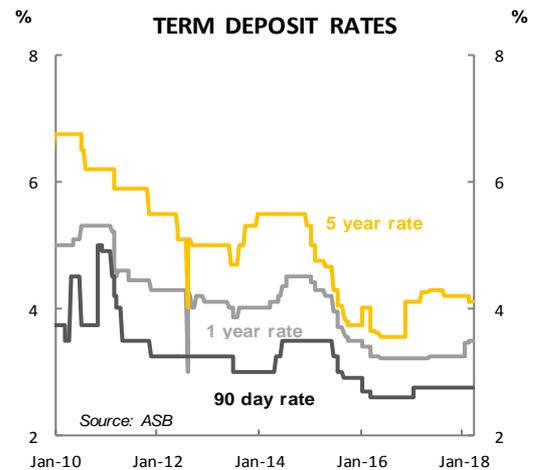
### NZ Fixed Interest

New Zealand Government bonds continued the recent pattern of trading with lower yields than their US counterparts for most maturities. Local bonds joined the global rally (yields lower) over the closing stages of the month, and the 10-year yield Government bond yield was down 11 bps over May.

We continue to expect long-term local bond yields to rise modestly over the year ahead, which will eventually boost the income for investors receiving income from fixed interest investments. Despite this, we expect the return on NZ fixed income investments over the year ahead will remain lower than long-term averages.

### International Fixed Interest

The US Federal Reserve made no changes at the early May meeting, but stated that economic conditions would likely "warrant further gradual increases in the Federal Funds rate". Accordingly an interest rate hike from the Fed in June is widely expected. Against this backdrop, US yields were on the rise in early May, with the 10-year Treasury yield reaching an intra-day high of 3.12% on 18 May. However, as the Italian political stress and other global concerns reached a crescendo, the 10-year Treasury yield rallied all the way back down to 2.76%. By month end yields had lifted off those lows, but the US 10-year Treasury yield still dipped 11 bps over the full month of May. We believe that the overall direction for US yields is up over the year ahead, although US Government bond yields are expected to remain under 3.5% for most tenors over the next few years.



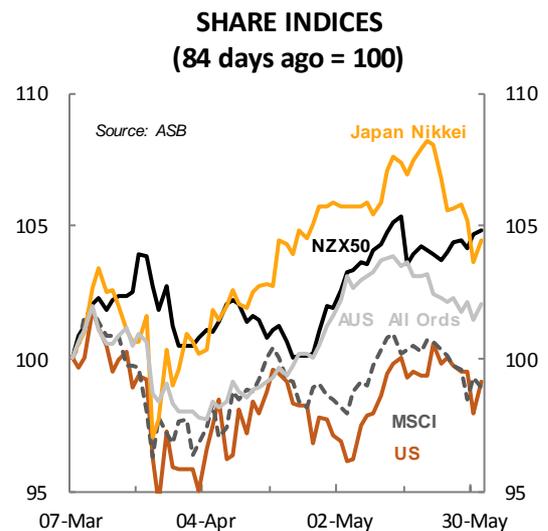
In Europe, bonds were mixed. Fears over political instability in Italy caused a major sell off in Italian bonds, triggering lifts in other peripheral European Sovereign yields. By contrast, yields for higher rated sovereigns, like Germany, rallied sharply. The 10yr German Bund began the month yielding 0.55% and rose slowly to 0.65% only to rally nearly 40bp as the Italian problems intensified. Bunds closed out May with a 10-year yield of 0.34%, a rally of 21bp for the month.

## Growth Assets

### Australasian Equities

May was a positive month for the local sharemarket, with the NZX50 Gross Index lifting 2.8% over the month, to be 17.2% higher over the year. Market darling A2 slumped after the company's latest trading update appeared to have fallen short of investors' lofty expectations. In contrast, shares for F&P Healthcare were up nearly 5% over May, as the company reported a record profit for the 2018 financial year. Mainfreight also performed well, posting a record full-year sales revenue of \$2.62 billion (reported in May).

The Australian All Ords share index lifted 0.9% in April, and was up 6.3% over the year. It was a mixed month when looking at the performance of the various sectors in Australia. Equities in the Household & personal products sector lifted 22.5%, underpinned by Blackmores, whose share price rose over 30% during the month. In contrast, Telstra shares were down around 16% over the month, dragging the Telecom sector lower by 10.2%.



### International Equities

Global sharemarkets ended mixed in May. The key political influences were on-again off-again trade tensions between the US and China, the proposed US-North Korea summit, and President Trump signalling the US would exit the Iran nuclear deal. Political instability in Italy and Spain added to the mix later in the month. Markets also grappled with (generally positive) earnings results and volatile oil prices.

Over May the US S&P 500 index increased by 2.2% and the tech-heavy Nasdaq lifted 5.3%. Shares in Apple rose 4.4% on 2 May after solid earnings figures were reported, with the stock up close to 28% on its mid-February lows. Across Europe, the German Dax fell by 0.1% but the London FTSE lifted by 2.2%. In Japan, the Nikkei fell by 1.2% over the month.

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

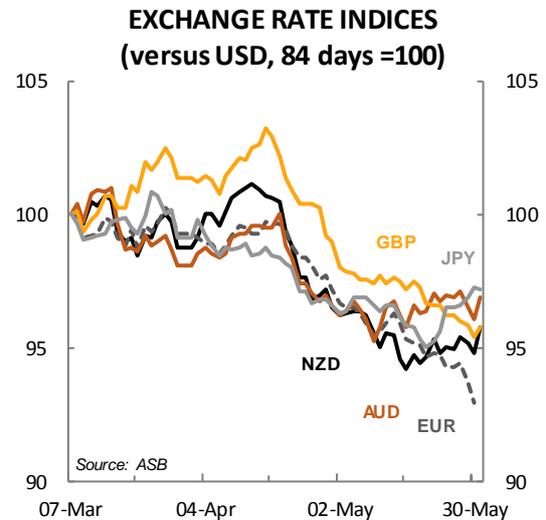
## Exchange Rates:

USD strength remained the key theme in currency markets during most of May. The USD had been in a downtrend since early 2017, but has lifted over 5% since mid-April (as measured by the DXY USD index).

Italian political concerns weighed on the EUR during the month, and EUR/USD declined more than 3% over May. The EUR recovered some of its losses over the last two days of May, after a new Italian government was finally formed after months of uncertainty.

Over the latter part of the month the NZD, AUD and JPY lifted off recent lows against the USD, while the GBP and EUR continued to decline against the USD right into month end.

Early in May, NZD/USD fell below \$US 0.7000 for the first time since December 2017. The pair reached a low of 0.6851 on 16 May, before climbing back towards 0.7000 by month end. Over the full month the NZD declined 2.4% against the USD, and 2.9% against the JPY. NZD/AUD was also down 1.5% over the month. By contrast, the NZD posted gains against the GBP (+1.5%) and the EUR (+2.6%) over May.



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