Markets Monthly

05 December 2018

NZD surges as risk of an OCR cut recedes

- **The NZD lifted over November, boosted by reasonable local data and an associated lift in local interest rates.**
- **Sharemarkets were mixed, with NZ and US indices posting modest gains, while Australian and UK indices fell.**
- **US Treasury yields declined over the month, with the US 10-year yield dipping back below 3%.**
- **US-China tensions and Brexit developments troubled markets during the month, and oil prices plummeted.**

Global sharemarkets were mixed in November, as some of recent concerns eased, while others intensified. US long-term interest rates eased, oil prices plummeted over 20%, while continuing trade tensions and Brexit concerns plagued UK financial markets through most of the month.

Date		30-Nov-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	1.98	0.07	0.07	0.07	-0.73
Fixed Interest	NZ 5-year gov't stock	2.01	0.07	0.11	-0.31	-2.28
	NZ 10-year gov't	2.56	0.02	0.03	-0.15	-2.21
	AUS 10-year gov't	2.59	-0.03	0.06	0.07	-1.65
	US 10-year gov't	3.02	-0.11	0.17	0.64	0.27
Australasian Equities	NZ - NZX50 Capital (NZ$)	3922	0.6%	-6.5%	4.2%	50.1%
	- NZX50 Gross (NZ$)	8824	0.8%	-5.4%	8.1%	84.0%
	AUS - All Ords (A$)	5749	-2.8%	-10.6%	-5.1%	8.2%
International Equities	JAP - Nikkei (¥)	22351	2.0%	-2.2%	-1.6%	42.7%
	UK - FT100 (£)	6980	-2.1%	-6.1%	-4.7%	5.0%
	US - S&P500 (US$)	2760	1.8%	-4.9%	4.3%	52.8%
	WORLD - MSCI (US$)	2041	1.0%	-6.2%	-1.7%	25.4%
	MSCI in NZD (NZ$)	2973	-3.8%	-9.2%	-2.0%	47.9%
Exchange Rates	NZD/USD	0.6866	5.0%	3.4%	0.3%	-15.2%
	NZD/AUD	0.9380	1.6%	2.4%	4.0%	5.1%
	NZD/JPY	77.86	5.1%	5.6%	1.6%	-6.2%
	NZD/GBP	0.5371	4.3%	5.2%	5.7%	8.5%
	NZD/EUR	0.6024	4.4%	5.8%	4.4%	1.3%
	NZ TWI	74.79	3.7%	4.0%	3.5%	-3.2%
Equity indices are the respective end-of-month closes. Interest rates and exchanges rates are at 5pm NZ.						

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.

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Please refer to the important disclosures at the end of this document.

US President Trump was hardly out of the news, tweeting about everything from US trade to forest fires. Tweets also covered Trump's dislike of the Fed's interest rate hikes, climate change, GM factory closures and the Mueller investigation. Trump was understandably more enthusiastic about the fall in oil prices, and even tweeted thanks to himself for the decline.

A few months ago oil was trading around US$75bbl for the West Texas Intermediate (WTI) grade. Geopolitical concerns (including the impact of US sanctions against Iran) had boosted prices, with fears we could see US$100bbl oil prices in the future. By late November, however, WTI oil prices were down to around US$50bbl, which prompted the "Thanks President T" tweet. Regardless of the cause of the recent fall, cheaper oil is generally good news for consumers around the world whose budgets had been hit by higher fuel prices.

Rising interest rates have been another concern in the US this year, but long-term rates took a breather and eased in November. The 10-year Government bond yield dipped back below 3% towards the end of the month, and remains below 3% at the time of writing. Nevertheless, US interest rates look set to move higher, regardless of the concerns Trump has been expressing.

The Federal Open Market Committee (FOMC) did keep the target for the Funds rate at 2.00 - 2.25% at its November meeting. This decision was in line with widely held expectations. But the FOMC continues to indicate that *"further gradual increases"* in the Funds rate are expected in the future.

The US Federal Reserve is, in its own words, *"ultimately accountable to the public and the Congress",* rather than the President and Administration. Governors are appointed for 14-year terms (which are staggered) while the Chair (currently Jay Powell) is appointed for a four-year term. Elected officials and members of the Administration cannot serve on the Federal Reserve Board. This independence prevents Trump or other politicians from influencing US monetary policy, beyond the freedom to voice displeasure about it.

Late in the month Fed Chair Jay Powell said interest rates are *"just below the broad range of estimates of the level that would be neutral for the economy"*. Investors reacted positively to this, as it relieved some fears that the FOMC could raise interest rates too far. We think more interest rate increases are in the pipeline, but there is a growing risk the FOMC signals a pause in its tightening cycle. This may occur after the upcoming 19 December meeting, where we expect a fourth and final rate hike of 2018 will be delivered.

The US mid-term elections were a blow for Republicans who lost control of the House of Representatives. However, the Republican majority in the Senate remains, leaving power in the states more divided than it was. The outcome was broadly in line with polls leading up to the vote. A "divided" Congress makes it harder for the Trump Administration to introduce further fiscal stimulus such as "middle income" tax cuts. However, the divided election outcome means the corporate tax cuts are unlikely to be reversed. U.S. equity markets lifted after the election as the uncertainty passed.

During the month General Motors announced it will close five plants and cut nearly 15,000 jobs in North America. Car sales for US based manufacturers have been weakening for a while now, so the situation isn't completely surprising. However, with Trump's protectionist strategy in mind, the news was disappointing. GM's announcement came just days before Trump signed the USMCA trade agreement which amongst other things was touted to support the US auto industry.

The G20 Buenos Aires summit at the end of the month was a major focus for global politics and financial markets. The meeting between President Trump and Chinese President Xi was highly anticipated. Sharemarkets were weak during the month as investors worried about the escalation in trade tensions. However, after markets had closed for the month, a temporary truce between the two countries was announced. Trump and Xi have agreed not to impose new tariffs over the coming months, and will immediately begin negotiations on a number of issues, over a 90-day timeline. If there is a sense of déjà vu with these developments, it's because we've been here before. Back in April it appeared that US-China trade tensions were easing when President Xi Jinping announced that he would promote import growth and open up the Chinese services sector to increased foreign investment. It didn't last long, and by May the trade brinkmanship was back on.

Meanwhile, on the other side of the Atlantic, a messy EU-UK divorce (AKA Brexit) continues to play out. European leaders and UK Prime Minister May signed off a withdrawal agreement and political declaration during November. May is now engaged in the process of getting UK MPs to back the deal for a vote that will take place on 11 December. One way or another UK will likely leave the EU on 29 March 2019. The question is can UK politicians agree to the EU-May plan, or will it be rejected, meaning Britain leaves the EU with no agreement. During the month the Bank of England released forecasts that forecast possible impacts of various Brexit scenarios (the report can be read here). UK shares were weak, while gilt yields ended the month lower.

Tensions between Italy and the European Commission over Italy's fiscal position continue, and weighed on the EUR during the month. EUR/USD fell to an 18-month low. The Italian government initially told the EC that it won't change the 2019 budget target. In response, the EC reiterated that Italy's budget is in serious non-compliance with EU fiscal rules and noted that Excessive Deficit Procedure is warranted. Later in the month, Italian politicians suggested the government may reduce the deficit target to be more in line with EU fiscal rules.

Here in the Land of the Long White Cloud recent developments have been mixed but in sum positive (ignoring the All Black's loss to Ireland). Starting with some negatives, retail sales growth over Q3 was weaker than expected, with higher petrol prices over the quarter clearly having an impact on spending elsewhere. Business confidence has also remained weak, posing a key risk to the economic growth outlook. However, other developments have been a little more encouraging. First, the retreat in global oil prices combined with a strengthening NZD is pushing petrol prices back down. Second, local export commodity prices remain elevated, despite dairy prices being under some pressure due to very high spring production volumes. The New Zealand Terms of Trade, the prices of our exports relative to our imports, is within 2% of its late 2017 peak and a major support to the NZ outlook. The RBNZ reiterated its expectation to keep the OCR its record low setting into 2020. Related to this, mortgage rates have dipped, with major banks offering sub-4% mortgages during the month. In its November Financial Stability Report, the RBNZ signalled that from 2019 it will marginally ease lending restrictions for residential borrowing. These are supportive developments that offset some of the uncertainties created by more global financial market volatility, pending tax changes and the recent tightening in criteria for offshore purchases of NZ property.

Stronger than expected NZ Q3 labour market data was released at the start of the month and triggered sizeable reaction in currency and interest rate markets. The unemployment rate fell to a 10-year low (3.9%), with the labour force participation and employment rates at their highest on record. That result saw market participants switch from pricing in cuts to hikes for the OCR over the next 12 months, with the NZD surging following the release of the labour market figures. The NZD was the strongest currency we monitor during November, lifting 5% against the USD to trade above US$0.69 and up 3.7% on a trade weighted basis.

Income Assets

Cash

The RBNZ kept the OCR on hold at 1.75% at its November meeting, and reiterated its expectation to keep the OCR at this level into 2020. ASB continue to expect the OCR will remain on hold this year and next, with the first OCR move (up) expected in the second half of 2020. The risks of an OCR cut in the near-term appear to have reduced, in part due to better than expected NZ economic performance over recent months including the solid Q3 labour market data that was released in November.

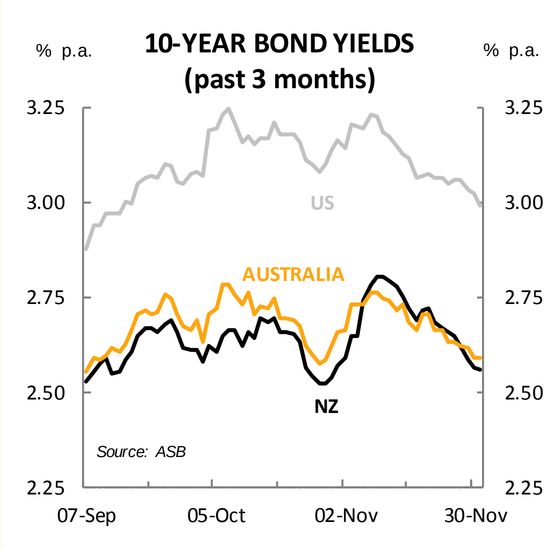
During September some term deposit rates eased, with rates for amounts over $10K now ranging from 2.7% for a 90-

day term, up to 3.8% for a 5-year term. There were no changes in October and November.

With OCR hikes a way off, ASB Economics expect most short-term returns on term deposits will likely stay near current levels over the year ahead. Further dips cannot be ruled out, particularly if the RBNZ decides to cut the OCR.

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

NZ Fixed Interest



NZ Government bond yields initially rose, then eased over November. Overall yields are slightly higher, with the biggest lift coming for shorter term rates. One of the drivers of the lift came as investors' expectations of RBNZ rate cuts were reduced over the course of the month, as discussed above. The 5-year Government bond yield lifted 7 basis points to 2.01% while the 10-year yield lifted 2 basis points to 2.56%.

By contrast, US 10-year Treasury yields eased around 14 basis points over the month to dip back below 3% on the last day of November. NZ Government bond yields continued to trade below the US equivalents during November, which looks set to continue as the RBNZ remains on the interest rate sidelines and the US FOMC continues to hike rates, albeit gradually.

The concerns that have troubled equity investors also had an impact on the corporate bond market in November. NZ corporate bond yields lifted during the month, and credit spreads widened.

International Fixed Interest

US bond yields ended the month lower, after initially rising at the start of the month, then declining into month end. The US 10-year Government bond (or Treasury) yield peaked at 3.25% on 7 November, just a basis point below the October peak of 3.26%, which in turn was a seven year high. Then it was one-way traffic, with 10-year yields declining to 2.99% at the end of the month.

The Federal Open Market Committee (FOMC) kept the target for the Funds rate at 2.00 - 2.25% at the November meeting, in line with market expectations. The FOMC continued to indicate that *"further gradual increases"* in the Federal Funds would likely be delivered. However, late in the month Fed Chair Jay Powell said interest rates are *"just below the broad range of estimates of the level that would be neutral for the economy"*. Recall, in October Powell noted *"we're a long way from neutral at this point, probably".* We think there is a growing risk the FOMC signals a pause in its tightening cycle – and this may occur after the upcoming 19 December meeting, where fourth 25bp rate hike of 2018 is expected to be delivered.

European bond yields generally eased on signs that economic growth was slowing. German Bunds rallied (yields lower) into month end, and the 10-year yield is back down near 0.3%, where it last traded in August. Italy's budget woes also remained in focus. Italian 10-year bond yields got as high as 3.69% during November, but eased towards 3.20% by month end. Progress by the new Italian Government in presenting a budget package that was more consistent with Stability and Growth Pact criteria helped dampen Italian yields. Italian 10-year Government bond yields had been around 1.75% earlier in the year, before the Italian election.

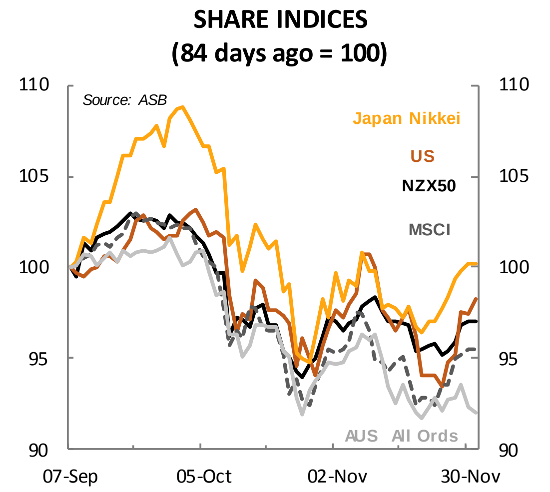
UK gilt yields followed a similar pattern to US yields, lifting in the early stages of the month, then rallying lower into month end on heightened Brexit risks. The UK 10-year yield ended the month near 1.35%, at the bottom of the range for the past three months. Meanwhile the Japanese 10-year yield dipped as low as 0.08%, having peaked at 0.16% in October.

Growth Assets

Australasian Equities

It was a mixed month for Australasian equities, with the NZX50 Gross Index up 0.8%, but the Australian All Ords index dipping 2.8% in November.

The local sharemarket has clawed back a small portion of its October losses, and at the time of writing was around 5% below its September record high. Trade Me's 26% gain due to a takeover offer kept the market in positive territory, while at the other end of the scale Fletcher Building's share price decline continued.



Australian sharemarket weakness was broad based, with 18 of the 22 sub sectors in the All-Ords posting declines over the month. Energy stocks suffered due to lower energy commodity prices, with the sector benchmark down 10%.

International Equities

Global sharemarkets were mixed over November, as the issues that troubled investors in October continued to play out. Brexit and US-China trade tensions were key developments. US economic data remained solid, but was somewhat eclipsed by views on the outlook for US interest rates during the month. Various FOMC speakers (including Chair Jay Powell) delivered speeches and the FOMC minutes confirmed that the committee would be monitoring economic developments closely as interest rates approach more normal levels. Falling oil prices was a fresh theme for markets. Only a few months ago were worried about rising energy prices.

News regarding the upcoming Trump-Xi meeting (that took place in the weekend after markets closed for November) influenced sentiment during the month. In the first day of trade in December the trade truce initially had a positive influence on markets.

Over the full month the S&P 500 index of US shares rose 1.8% while the tech-heavy US NASDAQ Composite edged up 0.3%, making little in the way of inroads to the previous months 9.2% decline. Japan's Nikkei fell by 9.1% in October, but rebounded 2% in November. In Europe, the German Dax fell another 1.7% and the UK's FTSE index of shares declined 2.1%. In sum, the latest moves leave global markets down on year ago levels, with the MSCI index of global shares down 1.7% in USD terms.

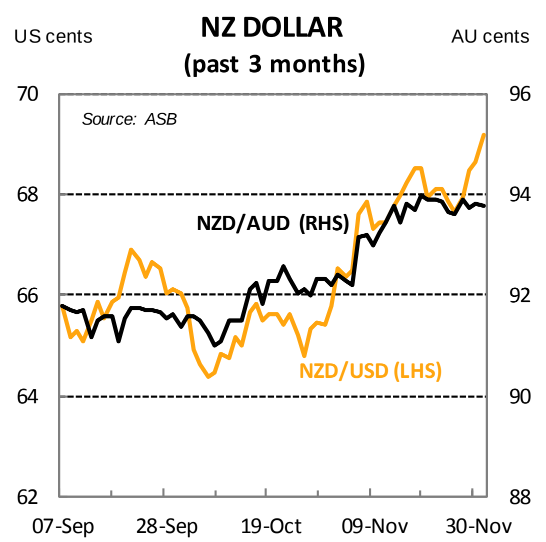
ASB Securities has more information on sharemarkets and trading [here.](#)

Exchange Rates:

The NZD was the strongest currency we monitor during November. The NZD/USD exchange rate was as low as 0.6425 back in October, and 0.6550 at the start of November. The NZD has lifted 5% against the USD to end the month trading near 0.6900. The NZD also lifted against the other currencies we monitor, to be up 3.7% on a trade weighted basis.

The Australian dollar was also strong during the month, and lifted against all the major currencies, but declined 2% against the NZD.

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



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