

Markets Monthly

05 September 2018

NZ shares press higher as NZD & interest rates dip

- The NZD weakened across the board during August, easing 2% on a trade weighted basis. The RBNZ held the OCR at 1.75%, and expects to keep it around this level for longer than earlier projected.
- Local bond yields and other interest rates fell over the month, while the NZ sharemarket roared higher.
- Global shares were mixed, with strong gains in the US partly offset by weakness in Europe. The NZ sharemarket set a fresh high, and the Australian market posted gains despite political upheavals.

Local signals were mixed over the month of August. The weak run of business confidence reports continued, and the RBNZ's latest assessment signalled that the OCR could remain low for even longer than earlier signalled (now 2020). Related to both these developments, long term bond yields and the NZD declined significantly over the month. At the end of the month Fonterra lowered its forecast for the 2018/19 season milk price from \$7.00 to \$6.75 per kgMS. Yet the NZ sharemarket cracked on to set fresh highs during the month, as a number of local companies delivered solid quarterly reports. The Australian reporting season has also been encouraging, although the Australian market's 1% gain trailed the 4% gain for local shares in August.

Meanwhile, US President Trump's unorthodox approach to politics continues. Trump reportedly said to donors that he expected Fed Chair Jerome Powell to be a "cheap-money" Chairman, and repeated similar comments in a Reuters interview during the month. Powell was Trump's pick for the job, at the expense of previous Chair Janet Yellen. The Federal Reserve has delivered five rate hikes during Trump's presidency, and is expected to lift the Federal Funds rate again in September. NAFTA was also in the firing line during the month, with Trump claiming to be close to a deal with Mexico, while criticising Canada. Trump tweeted that "there is no political necessity to keep Canada in the new NAFTA deal." Bond yields dipped on the uncertainty, and although Trump's actions rattled shares at the close of the month, the S&P 500 US share index still gained 3% over the August, having set fresh record highs days earlier.

At its August meeting, the Bank of England (BoE) raised interest rates by 0.25% to lift the policy rate to 0.75%. The UK government and the EU re-started Brexit negotiations during the month. UK Brexit Secretary Dominic Raab said 80% of the withdrawal agreement has been completed. UK Prime Minister Theresa May said a "No Deal" Brexit would not be "the end of the world". The UK Share market was weak over the month, but it wasn't all bad news in the UK. The UK unemployment rate printed at a 43- year low of 4% in June, and July retail sales were up 3.7% on a year ago.

Turbulence continued in emerging markets, with both Turkey and Argentina enduring high volatility within their financial markets in August.

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Australian politics delivered more turbulence with Prime Minister Malcolm Turnbull toppled by his own party, and replaced by Scott Morrison. Australia has had six leadership changes in the last 10 years. Australian markets were likely impacted, with equity indices underperforming, Australian bonds rallying, and the AUD generally lower. Sentiment improved when the final decision was announced, and a solid Australian reporting season also helped the All Ords share index lift 1% over the month.

Date		31-Aug-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	1.91	0.00	-0.11	-0.05	-0.74
Fixed Interest	NZ 5-year gov't stock	1.90	-0.24	-0.36	-0.58	-2.17
	NZ 10-year gov't	2.54	-0.23	-0.19	-0.36	-2.02
	AUS 10-year gov't	2.53	-0.14	-0.13	-0.20	-1.39
	US 10-year gov't	2.86	-0.08	0.01	0.71	0.08
Australasian	NZ - NZX50 Capital (NZ\$)	4192	4.1%	6.9%	14.9%	66.1%
	- NZX50 Gross (NZ\$)	9323	4.4%	7.4%	19.3%	105.3%
Equities	AUS - All Ords (A\$)	6428	1.0%	5.0%	11.3%	25.4%
International	JAP - Nikkei (¥)	22865	1.4%	3.0%	16.4%	70.8%
	UK - FT100 (£)	7432	-4.1%	-3.2%	0.0%	15.9%
	US - S&P500 (US\$)	2902	3.0%	7.3%	17.4%	77.7%
	WORLD - MSCI (US\$)	2175	1.0%	3.9%	11.0%	47.7%
	MSCI in NZD (NZ\$)	3275	3.9%	9.2%	19.8%	71.8%
Exchange Rates	NZD/USD	0.66	-2.7%	-4.8%	-7.4%	-14.0%
	NZD/AUD	0.92	-0.3%	-0.8%	0.9%	5.5%
	NZD/JPY	73.74	-2.7%	-2.8%	-6.9%	-2.8%
	NZD/GBP	0.51	-1.8%	-2.8%	-8.0%	2.4%
	NZD/EUR	0.57	-2.3%	-4.9%	-5.7%	-2.6%
	NZ TWI	71.89	-2.0%	-1.9%	-4.5%	-3.8%

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

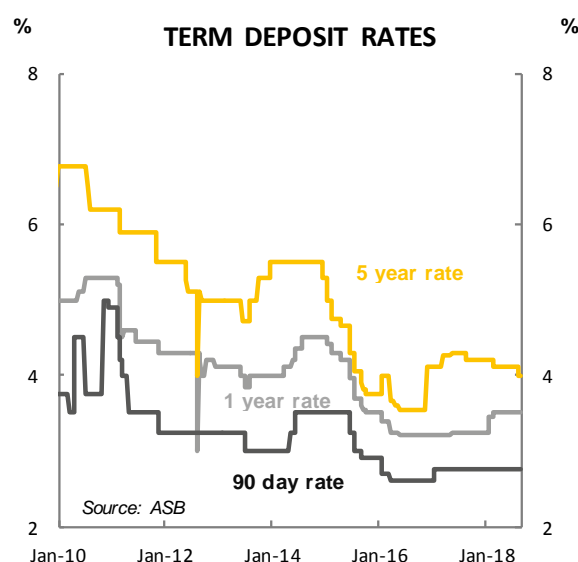
Income Assets

Cash

The RBNZ outlook for the Official Cash Rate (OCR) was more dovish than expected in the RBNZ's August Monetary Policy Statement (MPS). The policy assessment was explicit in saying "we expect to keep the OCR at this level through 2019 and into 2020". RBNZ's published forecasts for the OCR showed a pushing out of prospective OCR increases by a full year (from late 2020), with just 50bps of hikes in the published interest rate track.

In line with Governor Orr's past two decisions, the neutral stance remains clear through continued reference that the next move "could be up or down".

August term deposit rates for amounts over \$10K ranged from 2.75% to 4.0% for 90-day to 5-year terms. 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, most short-term returns on term deposits will likely stay near current levels over the year ahead.



This, however, depends on funding costs

Term deposit rates for longer terms have dipped slightly over the past month, reflecting the broader decline in wholesale rates and bond markets both here and abroad.

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

NZ Fixed Interest

The RBNZ's OCR outlook and economic growth concerns stemming from low business confidence both weighed on New Zealand bond yields in August. NZD yields have dipped significantly, with 5- and 10-year Government Bond yields declining nearly 0.25% over the month. The 10-year NZ Government bond yielded 2.54% at the end of August. Local yields have been lower, with 10-year bond yields dipping to 2.12% in late 2016. At that time influential offshore rates were lower than they are today, NZ CPI inflation was lower than it is now, and the RBNZ had been in the process of unwinding 2014 OCR rate hikes.

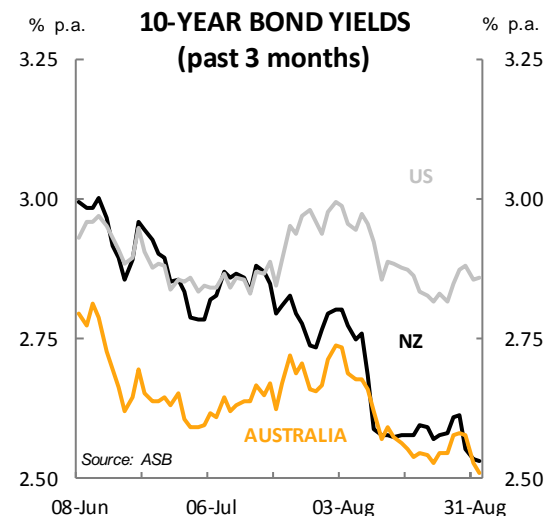
Corporate bond yields also fell during the month, with yields for most local long-term investment grade bonds significantly below 4%.

International Fixed Interest

Global bonds had a moderate rally in August, with yields ending the month lower. Drivers included concerns over escalating trade tensions, and fear that emerging markets stress could spread to become a more global problem. Markets became more concerned over large foreign currency debt in some emerging markets and the exposure of the wider banking system to difficulties in emerging markets, with large exposures in Eurozone banks to Turkish debt.

During the month the US Federal Reserve left its Federal Funds Rate unchanged, but looks set to hike again in September. President Trump reportedly said to donors that he expected Fed Chair Jerome Powell to be a "cheap-money" Chairman, but that shouldn't stand in the way of more interest rate increases from the Fed. Nonetheless, Trump's tweets and comments have added to the uncertainty of the US interest rate outlook. US 10-year Government bond yields declined 8 basis points to yield 2.86% by month end, trading around 0.25% lower than the highs recorded earlier in the year.

Meanwhile, the Bank of England (BoE) raised interest rates by 0.25% to bring the Bank rate to 0.75%. The trajectory for UK rates is lower than what we have observed in the US: BoE Governor Mark Carney told the BBC that UK households should expect a 0.25% rate hike every year over the coming three years. UK 10-year Gilts are trading with yields at around 1.4%. For perceived safe-haven markets (e.g. Germany, Switzerland and Japan) yields remain negative for many tenors, with the 10-year German Bund yielding around 0.3%, and Japanese 10-year bond yields at around 0.1%. However, concerns over fiscal solvency have seen peripheral Eurozone government bond yields move higher, with Italian 10-year yields rising close to 50bps over the month (to 3.23%).



Growth Assets

Australasian Equities

August was another positive month for the local sharemarket, with the NZX50 Gross Index lifting 4.4% over the month. A number of companies posted solid reports for the second quarter, with their performance at odds with the dire level of confidence reported in business confidence surveys. A2's shares lifted 20% over August, boosted by the announcement that the company more than doubled net profit to \$195.7 million in the June year on improved margins and increased sales. Port of Tauranga reported an annual profit increase of 13%, record cargo volumes, and

plans to expand capacity. Fisher & Paykel Healthcare Corp has benefited from the lower NZD, and strong sales growth has led the company to raise its full-year earnings forecast by about \$5 million during the month (their share price rose over 10% in August). It wasn't all about gains during the month. Fletcher Building was a notable decliner, with its share price dropping 9.5% over August.

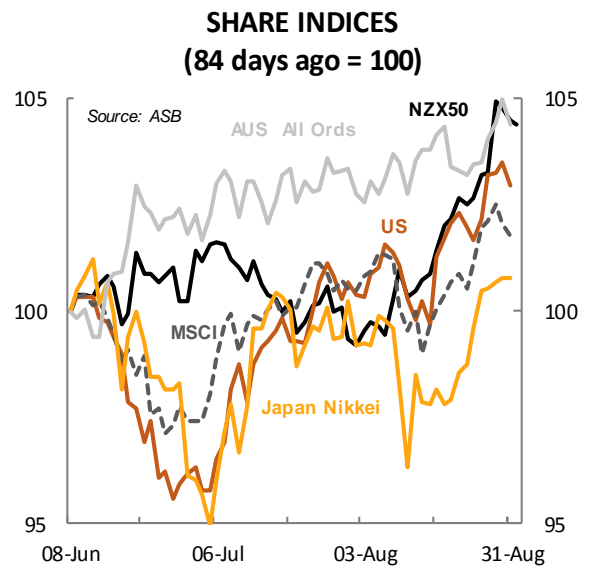
The Australian All Ords share index lifted 1% in August, with a solid reporting season offsetting the political uncertainty and concerns about the implications of the ongoing trade threats from US President Trump. Australian shares weakened as the leadership crisis unfolded, but investors reacted favourably following the election of former Treasurer Scott Morrison as the new Prime Minister.

International Equities

Global equities rose in August, with encouraging economic data offsetting trade tensions and emerging market concerns centered on Turkey. To date, US equity investors have been unfazed over the turmoil that is engulfing the White House. Healthy company earnings results have supported US shares, and late in the month the S&P 500 set a fresh all-time high (2,916). The tech-heavy NASDAQ index also reached an all-time record high above 8,000 points in late August. Japanese shares were also positive, with the Nikkei share index up 1.4% for the month.

In contrast, the UK FTSE 100 and German DAX share indices shed 4.1% and 3.4% respectively in August. Brexit uncertainty was the major headwind for UK shares. European sharemarket weakness was in part attributable to the sizeable Eurozone bank exposures to Turkish debt.

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

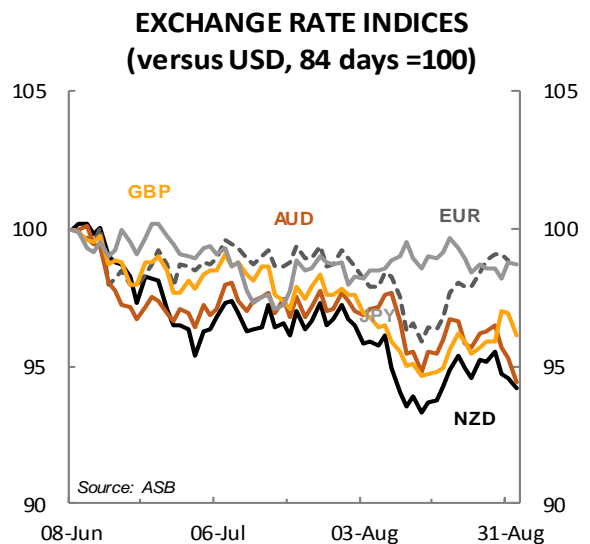


Exchange Rates:

During August the NZD eased to the lowest level against the USD since early 2016. The combination of a firm USD and local developments saw NZD/USD dip to as low as 0.6545 in the middle of the month. On the NZD side of the equation, the NZD fell after the RBNZ stated that "we expect to keep the OCR at this level through 2019 and into 2020, longer than we projected in our May Statement". Weak business confidence and lower dairy prices were other NZD headwinds.

NZD/AUD briefly dipped to a low near 0.8950 in the wake of the RBNZ announcement. But AUD faced headwinds of its own, and by month end the cross rate was back trading near 0.9200 and only declined 0.3% over the month.

The JPY is typically a safe-haven currency and can strengthen during times of increased volatility or uncertainty in foreign exchange markets. That's what appears to have played out in August. During August, Japanese GDP growth for the second quarter was much stronger than expected (0.5% versus 0.2% expected). The JPY was strong over August, which saw NZD/JPY ease by 2.7%.



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