

Markets Monthly

10 June 2019

RBNZ cuts, yields fall, & global shares slump in May

- The RBNZ cut the Official Cash Rate to a record low 1.50% in May. We expect another cut is coming.
- Global government bond yields plunged, led by the US. New Zealand 10-year yields set fresh lows.
- Global sharemarkets retreated, as trade tensions and broader global growth concerns intensified.
- In contrast, Australasian sharemarkets posted further gains over the month.
- The NZD continued to slide against through the month, declining 1.2% on a trade-weighted basis

Date		31-May-19	Month %	Quarter %	Year %	5-Year %
Cash	NZ Official Cash Rate	1.50	-0.25	-0.25	-0.25	-1.50
	NZ 90-day bank bill	1.67	-0.15	-0.23	-0.36	-1.76
Fixed Interest	NZ 5-year gov't stock	1.39	-0.21	-0.28	-0.87	-2.56
	NZ 10-year gov't	1.72	-0.19	-0.45	-1.01	-2.54
	AUS 10-year gov't	1.47	-0.34	-0.63	-1.19	-2.21
	US 10-year gov't	2.18	-0.35	-0.49	-0.67	-0.30
Australasian	NZ - NZX50 Capital (NZ\$)	4427	0.9%	7.1%	12.9%	59.6%
	- NZX50 Gross (NZ\$)	10118	1.0%	8.5%	16.5%	95.3%
Equities	AUS - All Ords (A\$)	6492	1.1%	3.8%	6.0%	18.6%
International Equities	JAP - Nikkei (¥)	20601	-7.4%	-3.7%	-7.2%	40.8%
	UK - FT100 (£)	7162	-3.5%	1.2%	-6.7%	4.6%
	US - S&P500 (US\$)	2752	-6.6%	-1.2%	1.7%	43.1%
	WORLD - MSCI (US\$)	2046	-6.1%	-1.9%	-2.2%	19.3%
	MSCI in NZD (NZ\$)	3144	-3.9%	3.2%	4.9%	55.8%
Exchange Rates	NZD/USD	0.6509	-2.3%	-5.0%	-6.8%	-23.4%
	NZD/AUD	0.9412	-0.5%	-1.8%	1.9%	3.2%
	NZD/JPY	70.95	-4.5%	-6.5%	-6.5%	-17.8%
	NZD/GBP	0.5162	0.3%	0.3%	-1.6%	1.6%
	NZD/EUR	0.5849	-1.7%	-2.8%	-2.3%	-6.4%
	NZ TWI	71.83	-1.2%	-2.8%	-2.0%	-10.7%

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

May was a tough month for the main offshore sharemarkets, and the MSCI index of global shares slumped 6.1% in USD terms, and 3.9% in NZD terms over the month. Concerns about global trade, and broader global growth concerns weighed on investor sentiment over the month as trade tensions ratcheted up. Beyond the US-China tensions, at the

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end of the month US President Trump also threatened to impose tariffs on Mexican goods on June 10 unless Mexico stopped people from crossing illegally into the US (read more in the International Equities section below). For NZ investors, the lower NZD helped cushion falls.

In contrast to the weakness in global markets, the local sharemarket posted a 1% gain. Investors across the Tasman also enjoyed a positive month, with the Australian sharemarket up by just over 1% during May.

US long-term yields plunged over the month, with US long term yields easing to their lowest level since September 2017 as market participants ponder the growing possibility of interest rate cuts by the US Federal Reserve. Late last year the Fed was predicting it would be delivering rate hikes this year, and the 10-year Treasury yield was north of 3%. Now it's dipping back towards 2%. In early June US Federal Reserve Chair Jerome Powell said the central bank will "act as appropriate to sustain the [US] expansion", signalling an openness to cut US interest rates if needed.

The RBNZ cut the Official Cash Rate to a record low 1.5% in May. New Zealand's Official Cash Rate briefly matched that of the Reserve Bank of Australia, but the RBA delivered a rate cut in early June, taking their cash rate to 1.25%. The current pricing of various interest rate instruments in Australia and New Zealand suggest both central banks will cut their policy rates again. We concur and believe both central banks will lower policy interest rates in August.

The NZD eased during May, and briefly traded below US \$0.6500 for the first time since October 2018. The NZD was down 1.2% on a trade weighted basis over the month of May, easing against all the major currencies apart from GBP.

Income Assets

Cash

In a decision that was widely seen as a close call, the newly-formed RBNZ Monetary Policy Committee reached a consensus decision that an Official Cash Rate (OCR) cut was necessary. The OCR was cut 0.25% to a record low 1.50%. The committee deliberations seemed to be centred on cutting the OCR in May vs continuing to wait while signalling a rate cut. The RBNZ decided to get on the front foot and "establish a more balanced outlook for interest rates". We have another 0.25% cut penciled in for August, but emphasize the timing is far from certain.

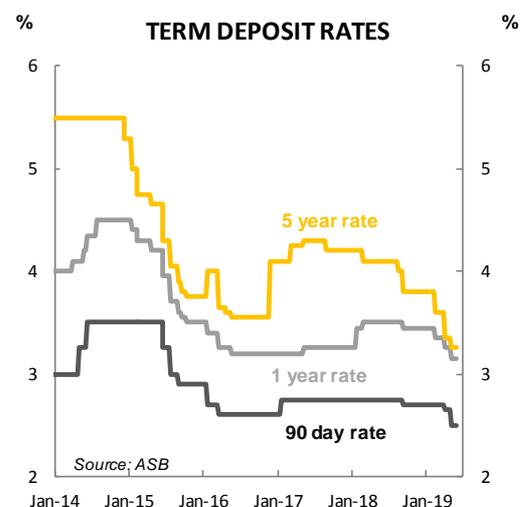
Term deposit rates dipped further over May. For amounts over the \$10k range, 5-year term deposits fell to a new low of 3.25%, shedding another 10 bps in May. One year term deposit rates dipped 10 bps to 3.15%. The 90-day rate was down 15bps to 2.50%. Wholesale interest rates and term deposit rates are much flatter across the curve (i.e. long-term rates are only marginally higher than short-term rates).

We now have a situation where just 10 bps separates 1 and 5 year term deposit rates, more evidence of the lower-for-longer view on interest rates moving forward. We expect term deposit rates to stay low, and the risk is they dip further if the RBNZ delivers a follow up rate cut later in the year.

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

NZ Fixed Interest

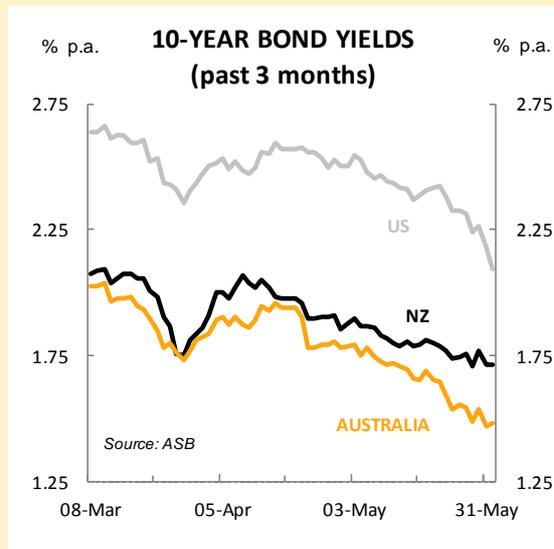
Government bond yields crept upward during April, but fell sharply in May. Yields on the NZ 10-year bond dropped 19 bps over the month to 1.72%. The 5-year yield declined 21 bps, closing the month at 1.39%. The 10-year yield is



trading around record lows, and is now 1% lower than a year ago, and 2.5% lower than 5 years ago.

Dovish central bank signaling and persistently low inflation have been the key drivers pushing yields down. Over the past month the RBNZ and the RBA have acted on their earlier signals. The expectation of another RBNZ rate cut, combined with the dovish sentiment from offshore central banks should maintain downward pressure on NZ fixed interest rates. Budget 2019 did not change the outlook for New Zealand interest rates, although the government debt issuance outlook is slightly higher than earlier forecasts.

With forward-looking economic indicators for NZ continuing to look soggy, the trend we have been highlighting for interest rates to remain 'even lower for even longer' looks set to stay over the year ahead.



International Fixed Interest

Increased investor risk aversion triggered the fall in global yields over May as concerns over the global outlook grew. Global government bond yields fell during the month, led by the US market. US 10-year Treasury bond yields declined 35bps to 2.18%, to their lowest since late 2017. Australian 10-year Government bond yields fell by a similar margin to end the month at 1.47%.

Like NZ long-term bonds, Australian long-term government bond yields are currently around record lows. In contrast, US 10-year Treasury yields are still close to 80bps higher than their July 2016 lows. The trend in global yields has been downward. NZ, Australian, and US 10-year yields are over 1% lower than a year ago, and more than 2% below the levels recorded 5 years ago.

European government bond yields remain extremely low. Ten year government bond yields are in negative territory in Germany, Switzerland and the Netherlands. UK 10-year gilt yields are back below 1%, and trading at levels last seen in 2016. Given their high public debt loads, weaker fiscal outlooks (Italy is still running the risks of European Union sanctions) and less political stability, yields on Italian and Greek 10-year Government bonds are somewhat higher in outright terms (around 2.5% and 2.9% respectively). Greek yields are considerably below where they were a year or so ago, whereas Italian yields are somewhat higher.

Growth Assets

Australasian Equities

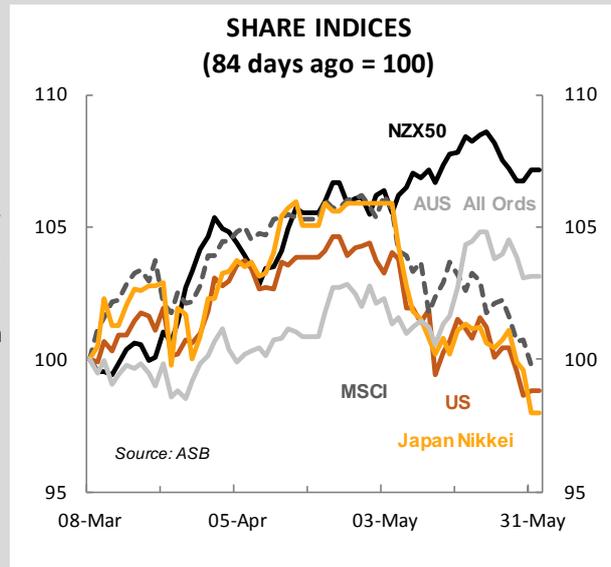
Australasian sharemarkets bucked the negative global trend in May, with the NZX50 Gross index up 1%, and the Australian All Ords index up 1.1% over the month. Both indices are up significantly on a year ago, with respective gains of 12.9% and 16.5%. Within the New Zealand sharemarket, Vista Group (film industry software provider) was the biggest gainer in May, up over 14%. The recent strong run for electricity generator/retailer stocks continued, while Synlait, a2 Milk and Fonterra were laggards in May.

In Australia, a key focus for investors was the federal election. The Coalition government claimed election victory, which for investors means the risk of changes to negative gearing and dividend imputation rules are now off the table. The Australian sharemarket rose in the wake of the result.

International Equities

Global sharemarkets retreated in May, as investors became increasingly troubled by US-led trade tensions. The US S&P 500 share index fell by 6.6% and Nasdaq lost 6.8%. In Europe, the German Dax fell by 4.1% and UK FTSE eased by 3.5%. In Asia, Japan's Nikkei lost 7.4%.

By the end of May the trade tensions troubling investors weren't just about the US vs China. Mexico is now in the mix after President Trump threatened a 5% tariff on all goods imported unless Mexico does something about the 'illegal immigration crisis'. The tariff will increase in staged steps to 25% by 1st October or "until such time as illegal migrants come through Mexico, and into our country, STOP" (Source: Twitter). Mexico announced it would not retaliate until the matter was discussed directly with the US. This was despite recent US data showed illegal immigration and illegal border crossings at near multi-decade lows. In addition, the US may also terminate India's designation as a developing nation, meaning India will no longer be able to export goods to the US duty-free



On a more positive note, earlier in the month Trump announced that he'd decided to delay any decision on auto tariffs for up to six months. Continuing with the positives, the US labour market remains very strong. Non-farm Payrolls increased by 236,000 in April and the unemployment rate eased to 3.6%, the lowest since 1969.

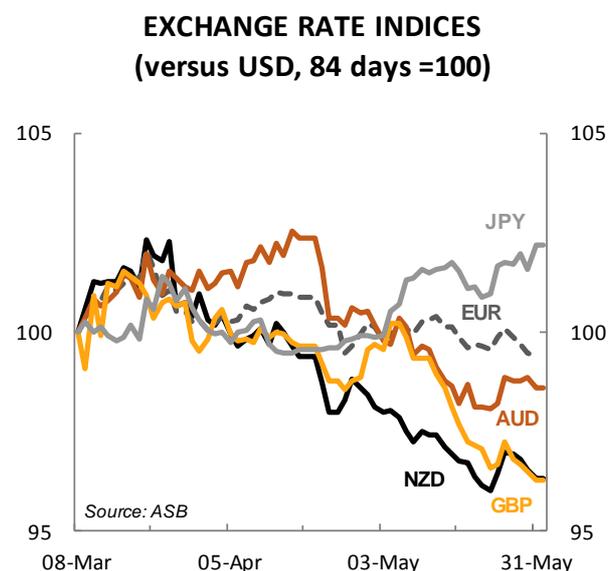
Nonetheless, the feeling by the end of the month is that the US-led trade tensions are worsening rather than improving at the moment. Partly offsetting this have been the dovish tilt by global central banks, with the RBA and RBNZ cutting policy rates and the US Federal Reserve showing an increased readiness to lower US interest rates if needed. As such, global sharemarkets are likely to remain pushed and pulled by the negative trade developments and the positive "lower for longer" interest rate theme in global fixed interest markets for a while yet.

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

Exchange Rates:

The NZD fell 1.2% on a trade-weighted basis over May falling against most of the major currencies we monitor, but gained against the GBP. The NZD fell 2.3% versus the USD, 0.5% against the AUD, 4.5% against the yen, and 1.7% versus the EUR. In contrast, NZD/GBP rose 0.3% over May. The GBP is the only major currency that the NZD has not depreciated against over the past three months.

The month's NZD/USD high of 0.6681 was recorded on the 1st of May, and from there the trend was downward. Towards the end of the month the NZD was trading around a 7-month low vis-a-vis the USD, recording the month's low of 0.6482 on 23rd May. The NZD has subsequently firmed against the USD and AUD to be around 0.66 USD and 0.95 AUD at the time of writing.



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

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