

# Markets Monthly

02 November 2017

## Shares rise and NZD falls in the wake of the election

- The main local focus during October was on the formation of the new Government.
- The NZD has weakened over October, and is down between 3% and 5% on the major currencies we monitor.
- Meanwhile, sharemarkets both here and abroad pressed higher, with the NZ market up 3%.

**The NZD seemed to bear the brunt of the political developments over most of October.** It wasn't all about the election and NZD weakness – the USD firmed somewhat over October too, as favourable U.S. tax reform developments and high expectations of a December Fed funds rate hike underpinned the USD. The combination of themes saw NZD/USD dip over 5% during the month. The NZD was the weakest of all the currencies we monitor over the month, down 3% on the AUD and 4.6% on a trade weighted basis.

**We think the NZD depreciation is an over-reaction** to the change from a centre-right government to a centre-left Labour-led government. Typical of a change in governing party, there are uncertainties about future policy.

But we think the **policy differences on issues that influence the currency are not large enough to overwhelm the fundamentals supporting NZD.** The major medium-term driver of NZD is the Terms of Trade (export prices relative to import prices). New Zealand's Terms of Trade are near record highs because of firm commodity prices and weak import prices. **The high level of the Terms of Trade suggests that NZD may be oversold recently.**

In contrast to the sinking NZD, **the local sharemarket has remained buoyant over the month.** The staggering run for a2 Milk continues, with the share price up over 32% in October. Sticking with a dairy theme, Fonterra Shareholders Fund (+6%) and Synlait Milk (+24%) performed strongly during October. In the software space, Xero also continued to climb higher, lifting 12% over the month.

Despite the strong outlook for construction in New Zealand, the challenges for Fletcher Building continue, and that company's share price declined 9% over October. Elsewhere there was no over-arching theme for property-related stocks over the month. Some, like Goodman Property Trust & Precinct Properties were up, while Kiwi Property and Property for Industry were down.

The housing market remained quiet, and we wait for the busier months of summer for both the details of the new Government's policies, and clearer steer on how that market is coping with the various influences.

**For the Official Cash Rate and the return on cash, it looks like more of the same (i.e. low).** Sure the RBNZ will get a

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new Governor and a changed Policy Target Agreement with the new Finance Minister. **But these changes won't change the near-term course for the Official Cash Rate which should remain at 1.75% until 2019 in our view.**

Meanwhile in global bond markets, Australasian bonds moved in the opposite direction to US bonds. Yields dipped in our part of the world, but lifted in the US.

Central bank expectations are a factor behind the divergence. The RBA and RBNZ look set to remain on hold, while in the US, the FOMC is committed to a path of gradual increases in the Fed Funds Rate as well as a gradual reduction of its bond holdings.

Date	Instrument	31-Oct-17	Month %	Quarter %	Year %	5-Year %
Cash	NZ Official Cash Rate	1.75	0.00	0.00	-0.25	-0.75
	NZ 90-day bank bill	1.95	-0.01	0.00	-0.19	-0.72
Fixed Interest	NZ 5-year gov't stock	2.43	-0.10	-0.14	0.25	-0.41
	NZ 10-year gov't	2.91	-0.05	-0.07	0.21	-0.58
	AUS 10-year gov't	2.68	-0.16	-0.02	0.32	-0.46
	US 10-year gov't	2.36	0.05	0.08	0.52	0.63
Australasian	NZ - NZX50 Capital (NZ\$)	3757	2.6%	4.3%	12.4%	65.7%
	- NZX50 Gross (NZ\$)	8146	3.0%	5.9%	17.0%	105.9%
Equities	AUS - All Ords (A\$)	5976	4.0%	3.5%	10.6%	31.8%
International Equities	JAP - Nikkei (¥)	22012	8.1%	10.5%	26.3%	146.5%
	UK - FT100 (£)	7493	1.6%	1.6%	7.7%	29.6%
	US - S&P500 (US\$)	2575	2.2%	4.2%	21.1%	82.4%
	WORLD - MSCI (US\$)	2037	1.8%	3.9%	20.5%	56.5%
	MSCI in NZD (NZ\$)	2975	7.3%	13.9%	25.8%	87.8%
Exchange Rates	NZD/USD	0.68	-5.1%	-8.8%	-4.3%	-16.7%
	NZD/AUD	0.89	-3.0%	-5.2%	-5.1%	12.7%
	NZD/JPY	77.47	-4.6%	-6.6%	3.4%	18.5%
	NZD/GBP	0.52	-3.6%	-9.3%	-11.6%	1.5%
	NZD/EUR	0.59	-3.9%	-8.0%	-9.8%	-7.2%
	NZ TWI	72.61	-4.6%	-8.1%	-5.8%	-1.8%

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

## Income Assets

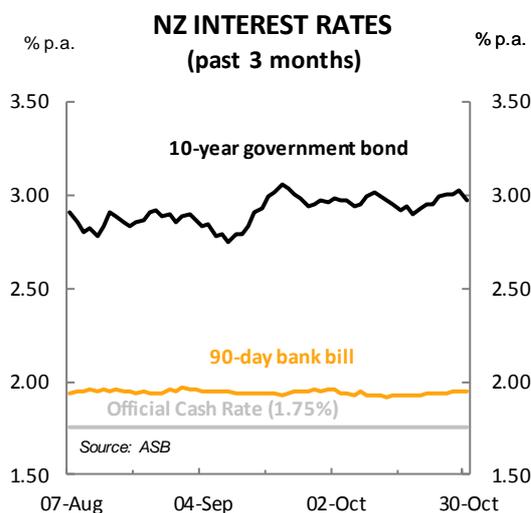
### Cash

The RBNZ held its latest review on 28 September, and kept the Official Cash Rate (OCR) at 1.75%. RBNZ forecasts released in August suggest the RBNZ expects to keep the OCR around the current level (1.75%) until late 2019.

The next RBNZ forecasts are due on 9 November, and aren't expected to change dramatically. Like the RBNZ, ASB Economics expect that OCR hikes are a long way off, although our forecast has the first OCR increase pencilled in for the first half of 2019.

**Term deposit rates** for the popular terms out to 18 months have barely moved in recent months, reflecting the low, stable OCR.

Meanwhile, the upward pressure we saw on the longer-term deposit rates earlier in 2017 has eased. Term deposit rates from 2-5 years were reduced by 10bps (0.10%) late in August, but have not changed since then. If OCR hikes are



still a long way off, most **short-term fixed interest returns on term deposits will likely stay near current levels** over the next year.

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

## NZ Fixed Interest

NZ Government bond yields dipped over the month, but remain up on year-ago levels. The yield on the 5-year bond dipped 10 basis points (bps) or 0.1%, and the 10-year bond yield dipped 5 bps. Bond valuations move in the opposite direction to yield, so the lift in yield over the 12-month period is weighing on annual returns for bond portfolios. Bank and corporate bond yields are similarly low relative to historic average levels at the moment, and also dipped over the month. Ongoing high demand for bonds means the yield is under 4% for almost all the investment grade bonds publicly trading in the New Zealand market. Investors looking for higher returns need to commit for the longer tenors or lower credit ratings at present.

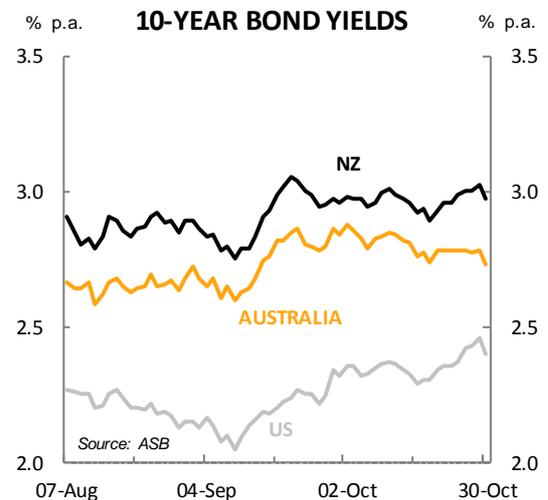
## International Fixed Interest

Developments at the US Federal Reserve remain a major focus offshore. The process of selling down the US Federal Reserve's huge holdings of bonds purchased in the wake of the Global Financial Crisis is underway, but as expected, it hasn't had a noticeable impact on the market yet. The Federal Open Market Committee (FOMC) held the Federal funds rate steady at the November meeting, as widely expected.

We anticipate the FOMC will next lift the Federal funds rate by 25bps in December.

The other development of interest in early November is the appointment of the next Fed Chair, with Fed Governor Powell looking like the favourite at the time of writing.

The yield on the US 10-year Government Bond lifted modestly over the month (+5bps), and at 2.36%, is up just over 1% on last year's lows. We expect the upward drift in US yields will continue over the year ahead. In the long-run, that expected development will help improve the running yield on bond portfolios. But in the short term, rising yields are a headwind for portfolio valuations because of the inverse relationship between bond prices and yield.

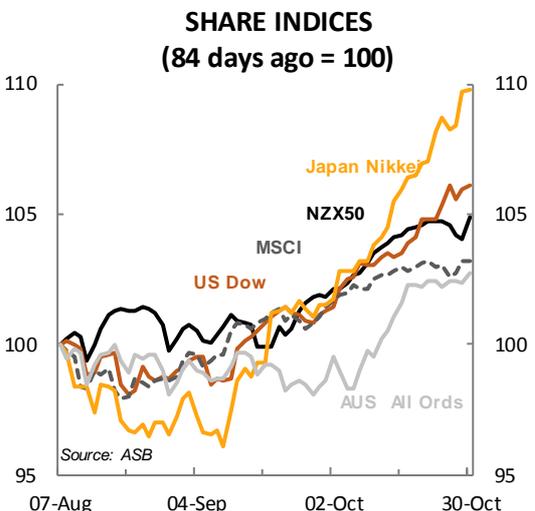


## Growth Assets

### Australasian Equities:

The NZX50 set further record highs during October, with the recent strong run continuing for names such as a2, Synlait and Xero. And at the other end of the returns scale, the challenges for Fletcher Building continued to weigh on the share price, with another profit downgrade announced during the month. The NZX50 gross index lifted 3% over October.

Across the Tasman, the All Ords index was up 4%, with 20 out of 21 industry sectors in Australia lifting. Leading the charge, food, beverages & tobacco rose 14%; while software & services rose 9%; and health care equipment & services rose by 8%.



## International Equities:

The 30th anniversary of the October 1987 share market crash has passed, but the ominous milestone failed to rattle investors. Rather, global share markets were solid over October, with the world's major share indices posting decent gains. Over October, the S&P 500 index of US shares lifted 2.2% while the tech-heavy NASDAQ rose 3.6%.

In Europe, the German DAX rose by 3.1% while the UK's FTSE share index lifted 1.6%. Japan's Nikkei soared 8.1%. Drivers during the quarter included earnings results, discussion about the likelihood of President Trump getting tax cut legislation passed by Congress, and the appointment of the next Federal Reserve Chair. And investors watched developments in Spain, after the Catalonia parliament declared independence.

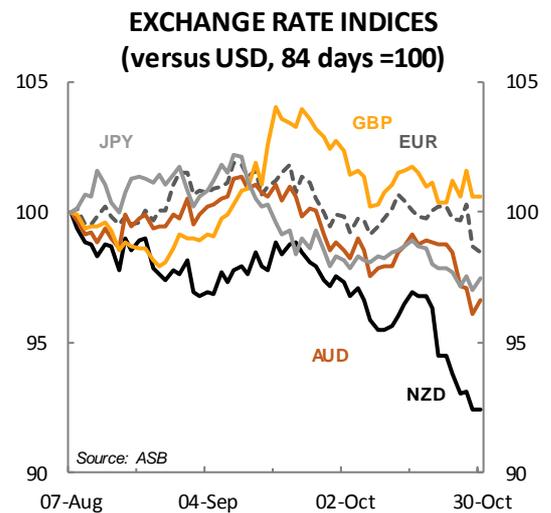
**ASB Securities has more information on sharemarkets and trading [here](#).**

## Exchange Rates:

Favourable U.S. tax reform developments and high expectations of a December Fed funds rate hike underpinned a firmer USD in October. The USD major trade weighted index increased by 1.6% over the month.

NZD/USD fell almost continuously in October from over 0.72 at the beginning of the month to just over 0.68 by month end. A stronger USD was an important part of the reason for the sharp fall, but the NZD seemed to bear the brunt of the political developments over most of October.

The NZD was down 4.6% on a trade weighted basis over the month, and is nearly 10% off its peak over the past year.



For more insights into currency issues, our latest **ASB Kiwi Dollar Barometer** can be downloaded [here](#).

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