



Markets Monthly

03 October 2017

Waiting for news

- New Zealanders have voted, but uncertainty prevails late in the month and into October.
- US-North Korean tensions continue. Trump finally makes progress on tax reform, but fails again on health.
- Sharemarkets both here and abroad continue to post gains.

Some of the global news headlines seem like they have gone from bad to worse over the year. Related to this, the most frequent question investors ask is how are these events impacting their investments? More often than not the answer is that the events that dominate the news aren't having the negative impact many expect. And despite the global concerns during the month, the US sharemarket rose 1.9% over September, and the NZ sharemarket is up 1.2%.

Tensions between North Korea's Kim Jong-Un and US President Trump were an unpleasant theme during September. The month ended with child-like name calling and traded insults from both leaders, which seems completely at odds with the seriousness of the situation. Kim Jong-Un wants North Korea to be recognised as a nuclear state, and use the capability as a deterrent to the US threat to his regime. Trump's preferred response so far has been bullying and tactless pronouncements rather than diplomacy.

As far as his management the US economy is concerned, investors may feel like they are suffering from Trump fatigue. Many of Trump's announcements are now met with little in the way of market reaction. The S&P 500 index of US shares closed the month at a record high level, despite or because of Trump developments, depending on who you want to listen to. The bond market's "Trump trade" (higher bond rates in expectation of higher US inflation and interest rates under Trump) has been unwinding, with the US 10-year Government bond yield currently trading around 40 basis points or 0.4% below its highs set following last year's election victory. It's the actual inflation data, and central bank developments that are driving the US bond market, rather than anything Trump is saying or doing now. Trump did unveil a tax reform plan late in September, and proposes that the corporate tax rate will fall from 35% to 20% (rather than the 15% rate he campaigned on), and there will be three (or possibly four) tax rates for individuals, down from the current seven. The proposal still lacks detail. We do not know the degree of fiscal stimulus generated by the proposal, or the impact on US government debt. Furthermore, the tax treatment of repatriated foreign earnings by US businesses is not clear.

Although feisty at times, the New Zealand political dialogue during the campaign period for the General Election seems tame by comparison to the US rhetoric. The month ended with the uncertainty that we have got used to with MMP elections, but financial markets have taken that uncertainty in their stride so far. And that's usually what

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happens, our analysis of earlier NZ elections under MMP shows. In the long term the underlying domestic and global economic environment drives NZ financial markets, rather than elections. Nonetheless, the formation of the next NZ government will be a key focus during October. The final vote count is not available until 7 October and, from that point, it will likely take another week or so until a new government is formed.

Long-term bond yields both here and abroad rose modestly over the month. Yet despite the increase, long-term bond yields are still low relative to long-run historical averages. However, the trend of slowly rising long-term interest rates is one we expect to continue over the years ahead, assuming that global economic growth and the associated inflation lifts. Meanwhile, the Reserve Bank of New Zealand (RBNZ) continues to hold the Official Cash Rate (OCR) at a record low, which is constraining the returns on cash and short-term fixed interest investments and term deposits.

Date	Instrument	30-Sep-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	1.96	0.00	-0.02	-0.24	-0.69
Fixed Interest	NZ 5-year gov't stock	2.55	0.07	-0.12	0.62	-0.33
	NZ 10-year gov't	2.95	0.05	-0.02	0.68	-0.52
	AUS 10-year gov't	2.80	0.08	0.20	0.82	-0.24
	US 10-year gov't	2.24	0.09	-0.04	0.69	0.60
Australasian Equities	NZ - NZX50 Capital (NZ\$)	3662.77	0.4%	2.8%	3.7%	66.5%
	- NZX50 Gross (NZ\$)	7906.03	1.2%	3.7%	7.6%	106.2%
	AUS - All Ords (A\$)	5744.90	-0.5%	-0.3%	4.0%	30.4%
International Equities	JAP - Nikkei (¥)	20356	3.6%	1.6%	23.7%	129.5%
	UK - FT100 (£)	7373	-0.8%	0.8%	6.9%	28.4%
	US - S&P500 (US\$)	2519	1.9%	4.0%	16.2%	74.9%
	WORLD - MSCI (US\$)	2001	2.1%	4.4%	15.9%	52.5%
	MSCI in NZD (NZ\$)	2775	1.5%	6.1%	16.8%	76.7%
Exchange Rates	NZD/USD	0.7209	0.5%	-1.6%	-0.7%	-13.7%
	NZD/AUD	0.9153	0.9%	-3.8%	-3.8%	14.8%
	NZD/JPY	80.99	2.2%	-1.2%	10.0%	25.2%
	NZD/GBP	0.5363	-3.3%	-4.7%	-4.2%	4.5%
	NZD/EUR	0.6113	1.3%	-4.5%	-5.6%	-5.3%
	NZ TWI	75.86	0.8%	-3.1%	-1.7%	1.6%

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%, as expected. RBNZ forecasts released in August suggest the RBNZ expects to keep the OCR around the current level (1.75%) until late 2019. 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.

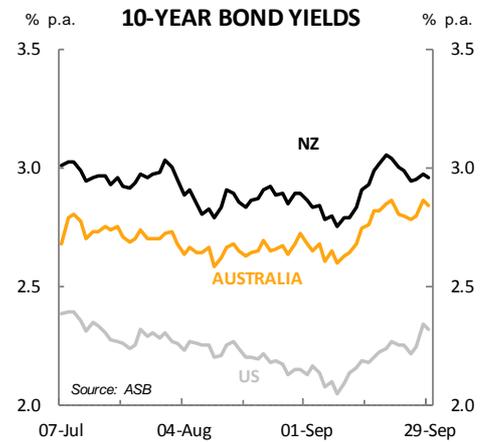
Term deposit rates for the popular terms out to 18 months have barely moved in recent months, reflecting the low, stable OCR. Meanwhile, the upward pressure we saw on the longer-term deposit rates earlier in 2017 has eased. Term deposit rates from 2-5 years were reduced by 10bps (0.10%) late in August, but were unchanged in September.

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. However, banks are continuing to offer higher “specials” on selected term deposit rates.

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

NZ Fixed Interest

NZ Government bond yields lifted modestly over the month, partially reversing the previous month's fall. The yield on the 5-year bond rose 5 basis points (bps) or 0.05%, and 10-year bond rose 6 bps, closing at 2.53% and 2.96%, respectively. Fixed-interest yields remain very low relative to long-run averages, but have lifted off the even lower levels recorded last year. 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. The yield is under 4% for almost all the investment grade bonds publicly trading in the New Zealand market, and investors looking for higher returns need to commit for the longer tenors or lower credit ratings at present.



International Fixed Interest

Offshore, the Federal Open Market Committee (FOMC) meeting on 20 September was a major focus. The FOMC signaled the process of selling down the US Federal Reserve's huge holdings of bonds purchased in the wake of the Global Financial Crisis will start in October. The FOMC held the Federal funds rate steady at the September meeting, as widely expected. We anticipate the FOMC will next lift the Federal funds rate by 25bps in December.

The reduction in the Federal Reserve's holding of Treasury and agency securities will shrink the balance sheet by roughly US\$750 billion over the next two years. Our view remains that the Fed's balance sheet tapering process has been well-telegraphed and will not lead to markedly tighter financial conditions in the US. In fact, the Federal Reserve Bank of Kansas City found that the expected reduction in the Fed's balance sheet over the next two years is about equivalent to just a 25bps fed funds rate hike.

The yield on the US 10-year Government Bond lifted modestly over the month (+9bps), and is up 69bps on a year ago. Nonetheless, US yields remain historically low, and are below the year's highs recorded back in March.

Growth Assets

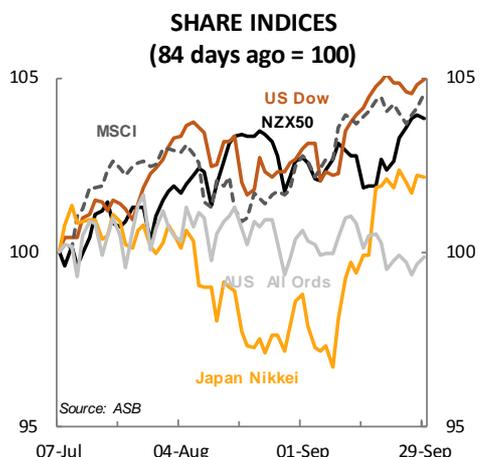
Australasian Equities:

The NZX50 index of local shares set further record highs during September, and closed out the month less than 0.1% off the record. Synlait Milk and Restaurant Brands set record highs on the last day of the month. And A2 Milk's stellar run continued, with the share price also hitting an all-time high late in the month. Xero had a strong month, with its share price lifting to the highest level in several years, trading back above \$30 again.

Across the Tasman, the All Ords index of shares dipped 0.5% over the month. The recent weakness in the Australian sharemarket is at odds with some decent economic data from Australia this year. The economy is clearly gathering momentum, and over the last six months over a quarter of a million jobs have been created. More jobs should lead to more confident consumers and higher wages down the track.

International Equities:

International sharemarkets were largely positive in September. The MSCI index of world shares was up 2.1% in USD terms over the month, to be up 15.9% over the year. US sharemarket investors appear confident in the FOMC's slow but steady approach to raising US interest



rates, and comfortable with the progress on tax reform, and lack of progress on healthcare reform.

Late in the month the OECD's latest forecasts were released and showed the organisation anticipates global GDP growth of 3.5% and 3.7% in 2017 and 2018, respectively. That's a stronger pace of growth than experienced in almost all the years since the Global Financial Crisis, and reflects improving economic growth for industrialised economies.

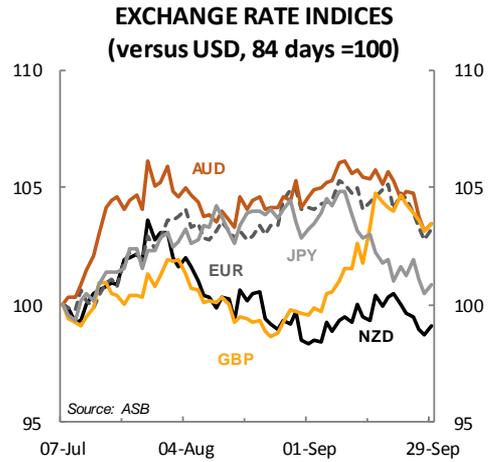
ASB Securities has more information on sharemarkets and trading [here](#).

Exchange Rates:

In September the NZD/USD strengthened, and is trading around 0.72c, which is just above its average level over the past 12 months (0.7142). The NZD lifted against the other currencies we monitor over September, with the exception of NZD/GBP.

The GBP was the strongest performing major currency over September. Financial market pricing implies around 80% probability for a 25bp rate increase at the November BoE meeting. GBP is being supported by the view that the Bank of England (BoE) will begin lifting UK interest rates in the very near future.

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



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