

Coming to terms with a post-Brexit global economy

- A month on from the unexpected Brexit vote and a sense of calm has been restored into markets.
- Sharemarkets have rebounded strongly after the Brexit shock, with some hitting all-time highs.
- In New Zealand, expectations of an OCR cut in August weighed on interest rates and, to a lesser degree, the NZD.

July started in the shadow of the unexpected Brexit vote where a cloud of uncertainty and confusion weighed on sentiment and drove market volatility. However, this cloud was surprisingly short-lived with markets seemingly shrugging the Brexit off for the time being. For one, after the initial shock, it soon became clear that it would be at least 2 years before the UK split from the EU and as a result, volatility is likely to pick up again as we get closer to this event. The appointment of a new British Prime Minister, Theresa May, also appeared to calm nerves as that removed political uncertainty from the market.

Over July, one of the standout performances has been in equity markets. All the major equity markets we monitor rose over the month, erasing any post-Brexit losses. In fact, the US S&P500 hit an all-time high on the 22nd of July before closing the month 3.6% higher. The Euro Stoxx 500 recovered most losses over the month but remains 1.6% lower than the pre-Brexit level. And, as mentioned in last month's Markets Monthly, the UK FTSE 100 had recovered from its losses before the end of June. Over July, the index rose another 3.4%. The NZX50 was a star performer over the month, up 6.5% over the month to be 18.8% higher than its year-ago level.

Bond returns and interest rates were more influenced by central bank actions over the month, especially as the month wore on. In the US, the Federal Reserve held off raising rates, as expected, but continued to signal that the economy was moving towards further rate hikes. This saw US bond yields rise after a Brexit-related dip earlier in the month, to end the month largely flat. In Australia, growing expectations that the RBA would cut interest rates in response to low inflation weighed on bond yields.

The Reserve Bank of New Zealand did not meet in July, but did release an out-of-turn Economic Assessment due to the longer than normal gap between Monetary Policy Statements. The dovish rhetoric in the assessment, combined with the RBNZ's earlier announcement of further investor LVR restrictions, increased expectations for an August rate cut. Short-term interest rates and bond yields dipped as did the NZD, albeit to a lesser degree.

Date	Instrument	31-Jul-16	Month %	Quarter %	Year %	5-Year %
Cash	NZ cash rate	2.25	0.00	0.00	-0.75	-0.25
	NZ 90-day bank bill	2.28	-0.13	-0.12	-0.82	-0.64
	US 90-day bank bill	0.76	0.11	0.12	0.46	0.50
	NZ - US 90-day bank bill	1.52	-0.24	-0.24	-1.28	-1.14
Fixed Interest	NZ 5-year gov't stock	1.87	-0.16	-0.38	-0.85	-2.19
	NZ 10-year gov't	2.19	-0.16	-0.65	-1.16	-2.78
	NZ 10-year sw ap	2.49	-0.22	-0.54	-1.22	-2.70
	AUS 10-year gov't	1.90	-0.11	-0.62	-0.87	-2.93
	US 10-year gov't	1.54	0.02	-0.29	-0.72	-1.41
Equities	NZ - NZX50 Capital (NZ\$)	3580	6.5%	7.1%	18.8%	71.4%
	AUS - All Ords (A\$)	5644	6.3%	6.2%	-0.7%	25.4%
	JAP - Nikkei (¥)	16569	6.4%	-0.6%	-19.5%	68.5%
	UK - FT100 (£)	6724	3.4%	7.7%	0.4%	15.6%
	US - S&P500 (US\$)	2174	3.6%	5.2%	3.3%	68.2%
	WORLD - MSCI (US\$)	1722	4.1%	3.1%	-2.5%	31.8%
	MSCI in NZD (NZ\$)	2425	3.9%	1.3%	-9.5%	60.9%
Exchange Rates	NZD/USD	0.7100	0.3%	1.7%	7.8%	-18.0%
	NZD/AUD	0.9425	-1.0%	3.6%	4.5%	19.4%
	NZD/JPY	73.34	0.8%	-2.0%	-10.2%	9.2%
	NZD/GBP	0.5385	1.9%	13.1%	27.7%	1.6%
	NZD/EUR	0.6406	0.4%	4.6%	6.5%	6.0%
	NZ TWI	75.78	0.0%	3.4%	7.8%	0.2%
	EUR/USD	1.1084	-0.2%	-2.7%	1.3%	-22.7%

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

Cash

Despite no RBNZ OCR meetings in July, short-term interest rates moved lower over the month. The RBNZ opted to provide the market with an out-of-turn Economic Assessment towards the end of the month. This assessment was dovish and, combined with the implementation of new investor LVR policies, signaled that the RBNZ would cut the OCR by 25bp in August.

Term deposit interest rates have remained near recent lows over the month. All maturity and deposit sizes at the main banks are now returning well below 4% in NZ. While that might seem low relative to history, in a global context, interest rates remain relatively high in NZ (e.g. non-negative).

Longer-term interest rates are also influenced by offshore events. The US Federal Reserve is once again readying to raise interest rates in the US. As a result, this should limit how much lower longer-term NZ interest rates drop over the rest of the year, if at all.

Fixed interest

Mixed is probably the best word to describe how bonds performed in July. The market was busy coming to terms with the post-Brexit outlook and market sentiment often swung between risk-on and risk-off. However, expectations around central banks' actions were a key driver of yield movements over the month.

In the US, the 10-year Treasury bond yield ended the month largely flat. But, there was plenty of movement through the month as yields fell early on before recovering around the middle of the month. Poor global sentiment drove demand for US bonds, before growing expectations of a Fed rate hike later in the year saw yields lift (bond prices fall).

In Australia and New Zealand, yields fell by 11% and 16% respectively. Markets were expecting the RBA and the RBNZ to cut interest rate cuts in August, which weighed on yields over July. In fact, the RBA did cut interest rates on the 3rd of August.

Equities

Equities out-performed most assets in July. After falling sharply at the end of June after the Brexit vote, equities more than recovered shortly afterwards. The realisation that Brexit would be a long, drawn out process helped rather than an immediate shock to shore up sentiment.

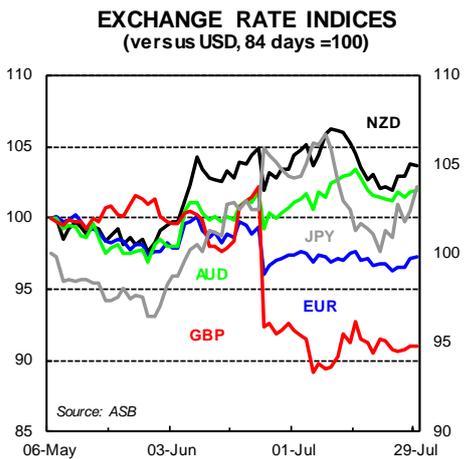
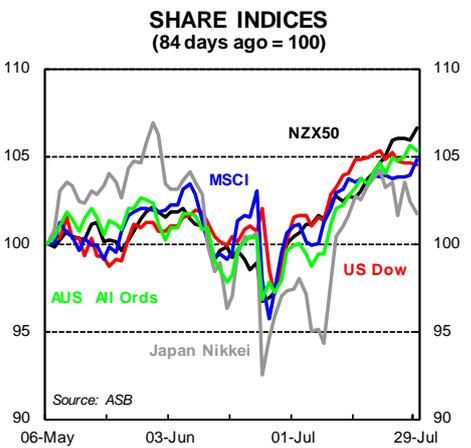
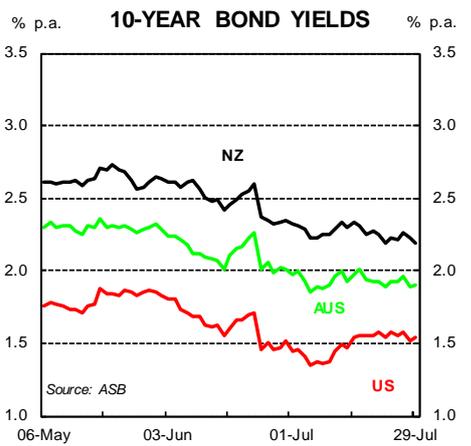
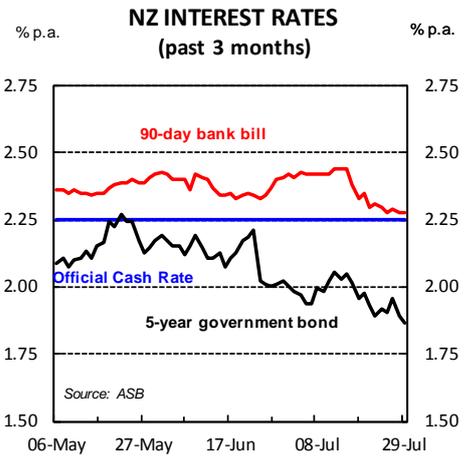
In the US, the S&P 500 hit an all-time high in July and closed the month 3.6% higher. Even in the UK, the FTSE100 closed the month up 3.4% and the FTSE250 ended the month over 5% higher. In Japan the Nikkei rose 6.4% and the Australian All Ords lifted 6.3% in July.

NZX50 gained the most out of all the major equities we monitor. Over the month the NZX50 gained 6.5%. On an annual basis, the NZX50 is now 18.8% higher than in July 2015, far outperforming other equities. The next closest is the US S&P500, which is sitting 3.3% higher than year-ago levels.

Exchange rates

The NZ Trade-Weighted Index ended July unchanged, but the NZD had a rather mixed month against the major currencies we monitor. The NZD/AUD ended 1.0% lower after temporarily lifting following the Australian election and credit rating warning by Standard & Poors at the start of the month. But solid Australian data supported the AUD over the remainder of the month. On the other hand, the NZD rose 1.9% against the GBP as the Brexit vote continued to weigh heavily on the GBP.

The NZD ended the month mostly unchanged against the USD, but traded in a range of just under 4 cents over the month. After starting the month strong following a RBNZ speech, the NZD/USD fell after the RBNZ announced investor LVR restrictions and the Economic Assessment. However, the fall was short-lived as weak US data weighed on the USD at the end of the month.



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