November's trends extended into year-end

- Global bond yields and the USD continue to rise in Trump aftermath.
- The US Federal Reserve hiked the Fed Funds rate 25bp, as expected, but also added an extra hike to the 2017 forecast.
- NZ Q3 GDP beat market estimates, but Australia's release disappointed.

The US Federal Reserve was fully expected to lift the Fed Funds rate 25 basis points on December 15 and it did not disappoint. The Fed did surprise though with an adjustment to the forward guidance, adding an additional rate hike for 2017, taking the outlook to three rate increases. Prior to the meeting, yields were already on the way up in the fallout from Donald Trump's US Presidential election victory. The Fed' surprise gave them another nudge higher, impacting right across the globe. The addition of thin markets going into year-end exacerbated the move.

It was also a busy month for New Zealand. Prime Minister John Key surprised with his resignation, but given the new PM is former Minister of Finance, Bill English, there was little impact on financial markets. Further out, it does make this year's election slightly more uncertain, although given the muddle of other uncertainties 2017 holds, the impact in longer-dated securities was limited. **The Government's Half Year Economic and Fiscal Update outlined how November's earthquake is to be paid for.** This will largely be comprised of existing surpluses and diverted spending, with total bond issuance from the Government unchanged, although $1bn of issuance has been moved forward.

The release of New Zealand's Q3 GDP data was delayed due to the earthquake's impact on Stats NZ's ability to process information, although it was only a week late**. The data showed Q3 growth was some way ahead of expectations**, although downward revision to prior quarters meant the annual growth rate, of 3.5%, was around expectations**. Australia's Q3 GDP surprised to the downside,** limiting the move higher for Australian yields and keeping the Australian dollar under pressure.

Almost all currencies suffered to some extent against the USD over the month, as the trend which began with Donald Trump's victory in November continued through the end of the year. This pushed the US Dollar index to all-time highs, with the Japanese Yen, in particular, struggling. The New Zealand Dollar was no exception and also declined - a move that may have been cheered by the RBNZ, with NZD strength one of the key drivers behind ongoing soft inflation in NZ.

Date	Instrument	30-Dec-16	Month %	Quarter %	Year %	5-Year %
Cash	NZ cash rate	1.75	-0.25	-0.25	-0.75	-0.75
	NZ 90-day bank bill	2.00	-0.14	-0.20	-0.75	-0.72
	US 90-day bank bill	1.00	0.12	0.15	0.39	0.42
	NZ - US 90-day bank bill	1.00	-0.26	-0.35	-1.14	-1.14
Fixed	NZ 5-year gov't stock	2.68	0.64	0.75	-0.33	-0.62
Interest	NZ 10-year gov't	3.34	0.81	1.07	-0.24	-0.45
	NZ 10-year swap	3.53	0.82	1.05	-0.26	-0.55
	AUS 10-year gov't	2.77	0.45	0.79	-0.07	-1.02
	US 10-year gov't	2.48	0.68	0.93	0.18	0.58
Equities	NZ - NZX50 Capital (NZ$)	3287	-0.5%	-7.0%	4.5%	67.9%
	AUS - All Ords (A$)	5719	3.9%	3.5%	7.0%	39.1%
	JAP - Nikkei (¥)	19114	4.4%	16.2%	0.4%	126.1%
	UK - FT100 (£)	7143	5.3%	3.5%	14.4%	28.2%
	US - S&P500 (US$)	2239	1.8%	3.3%	9.5%	78.0%
	WORLD - MSCI (US$)	1751	2.3%	1.5%	5.3%	48.1%
	MSCI in NZD (NZ$)	2516	4.3%	5.9%	3.5%	64.1%
Exchange	NZD/USD	0.6960	-1.9%	-4.2%	1.8%	-9.7%
Rates	NZD/AUD	0.9632	3.1%	1.2%	2.5%	26.6%
	NZD/JPY	81.07	9.6%	10.1%	-1.6%	35.3%
	NZD/GBP	0.5677	-2.7%	1.4%	23.0%	13.4%
	NZD/EUR	0.6618	2.4%	2.2%	5.8%	11.1%
	NZ TWI	77.62	1.5%	0.6%	4.5%	10.1%
	EUR/USD	1.0516	-4.3%	-6.2%	-3.8%	-18.8%

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

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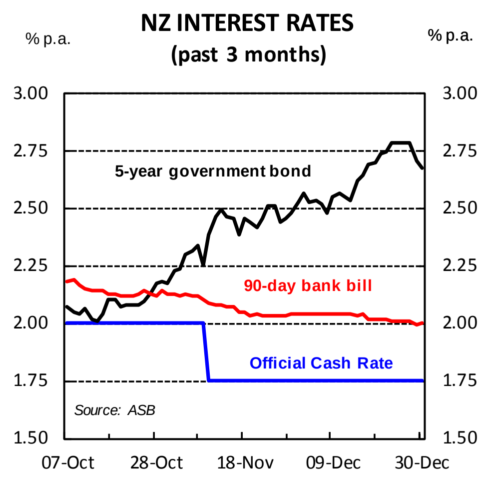
Cash

With no RBNZ meeting in December, the main action was in the US where the Federal Reserve lifted the Fed Funds rate 25bp, although this was 100% priced in. The surprise came with an additional rate hike being added to the 2017 forecast, taking it to 3 from 2.

RBNZ Governor Wheeler did deliver a speech titled "Some Thoughts on NZ's Economic Expansion" but impact was limited. The RBNZ said it expects the economy to continue growing strongly over the next 18 months, with the main risks sitting in the NZ housing market and global shocks. The RBNZ remained comfortable that interest rates are now low enough. Term deposit rates did climb though, as banks seek to encourage deposit growth amid firm competition.

Elsewhere there was no change from the Reserve Bank of Australia, but the European Central Bank did extend its bond-buying programme.

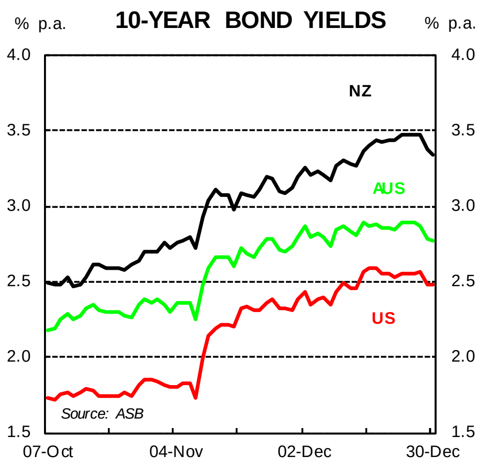


Fixed interest

Bond yields continued to march higher through December, extending November's trend. This trend has been supported by continued rhetoric from US President-elect Trump, who, if anything, indicated even more fiscal stimulus is in the pipeline once he takes the hot-seat on January 20.

The lift in US bond yields dragged global interest rates higher right across the curve. In New Zealand, the effect was more than enough to offset the RBNZ's November Official Cash Rate (OCR) cut. Indeed, market pricing for the NZ OCR moved dramatically to suggest rate hikes are expected in 2017 and 2018. An increase in mortgage-fixing demand has also added support to yields. Meanwhile, extremely thin liquidity at the end of the calendar year may have exacerbated market moves during this period.

Australian yields lagged NZ moves a touch, with the soft Australian Q3 GDP result keeping RBA rate hike talk firmly some way down the track.

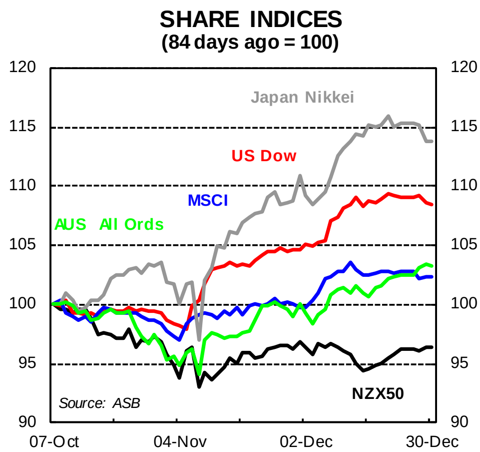


Equities

The spur given to US equities by Donald Trump's unexpected victory in November continued in December, pushing the Dow Jones close to, but not through, the 20,000 level. US domestic stocks were again top of the pile, with technology shares trailing a touch.

The lift in US equities filtered through global equity markets, much as the moves in global yields did. UK stocks continued to rise as well, aided by the low value of the Pound, inflating the value of offshore earnings. However, the longer-term outlook for the UK remains uncertain due to Brexit.

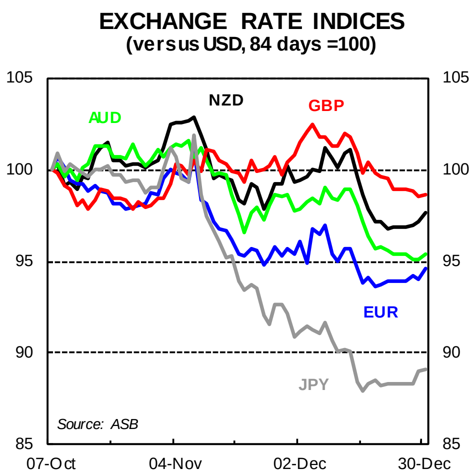
The NZX50 had another difficult month, down 0.5%, taking the quarter's move to -7.0%. This after the stellar start to the year, but there was no one specific event that generated the correction and it is worth highlighting the longer-term economic outlook for NZ remains upbeat.



Exchange rates

More USD strength was the general theme of December, with the currency aided by the US Federal Reserve adding another rate hike to its 2017 forecast, surprising many. This pushed the US Dollar index to record highs a number of times during December, to the detriment of almost all other currencies. The British Pound suffered the least of the major currencies, as UK economic data continues to hold up post-Brexit, although that is not expected to last.

The NZD, like its peers, moved lower vs. the USD, but elsewhere was fairly buoyant. This was especially the case against the Australian Dollar, which was undermined by the soft Australian Q3 GDP result. NZD/JPY also moved higher, with the Yen still suffering in the aftermath of the US election result. The Euro also had a difficult month, with the political fallout and uncertainty from the Italian Referendum result doing much of the damage.



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