

## US rate hike rhetoric ramps higher

- RBA surprises with 25bp rate cut.
- A number of US Fed speakers talked up the chances of a near-term rate hike.
- The odds of a cut from the RBNZ faded through the month.

Central bank guessing games were the overriding theme of May. This after the Reserve Bank of Australia got the month off to a flying start with a surprise 25bp cut, taking rates down to 1.75%. Talk swiftly turned towards the possibility of more to come from the RBA, but the statement and minutes, while dovish, did not offer much in the way of timing clarity.

The US Federal Reserve speakers talked up the possibility of a hike in rates, and soon. How soon though was not explicitly spelt out, with the UK-EU referendum regularly picked out as a risk. Most speakers highlighted the importance of economic data to guide decisions to come.

The Reserve Bank of New Zealand's June 9 decision was also the subject of much speculation. The general theme was a reduction in the odds of further easing in the month ahead, fanned by the lack of new macro-prudential housing measures. In addition, the idea of the Fed hiking, and doing some of the RBNZ's heavy lifting for them by weakening the NZD/USD, gained ground.

Back to the afore-mentioned UK 'Brexit' referendum and it generated a lot of volatility. The month started off with polls showing the 'Bremain' camp gaining ground and taking the lead. This faded as May drew to a close, leaving 'Brexit' marginally ahead. The uncertainty is not only creating volatility in UK and global markets, but also denting UK consumer/business confidence and hitting investment intentions there.

The Bank of Japan did not offer any further stimulus, but there was talk of a package from the Government, as well as a delay in sales tax hikes, formally announced on June 1.

Date	Instrument	31-May-16	Month %	Quarter %	Year %	5-Year %
Cash	NZ cash rate	2.25	0.00	-0.25	-1.25	-0.25
	NZ 90-day bank bill	2.42	0.02	-0.14	-1.05	-0.27
	US 90-day bank bill	0.67	0.04	0.04	0.39	0.42
	NZ - US 90-day bank bill	1.75	-0.02	-0.18	-1.44	-0.69
Fixed Interest	NZ 5-year gov't stock	2.17	-0.08	-0.29	-1.01	-1.94
	NZ 10-year gov't	2.61	-0.23	-0.36	-1.02	-2.54
	NZ 10-year sw ap	2.98	-0.04	-0.13	-0.95	-2.23
	AUS 10-year gov't	2.30	-0.22	-0.10	-0.44	-2.92
	US 10-year gov't	1.86	0.04	0.12	-0.27	-1.22
Equities	NZ - NZX50 Capital (NZ\$)	3440	2.9%	11.1%	14.9%	57.2%
	AUS - All Ords (A\$)	5448	2.5%	10.1%	-5.7%	13.8%
	JAP - Nikkei (¥)	17235	3.4%	7.5%	-16.2%	77.8%
	UK - FT100 (£)	6231	-0.2%	2.2%	-10.8%	4.0%
	US - S&P500 (US\$)	2097	1.5%	8.5%	-0.5%	55.9%
	WORLD - MSCI (US\$)	1675	0.2%	8.2%	-5.9%	23.6%
	MSCI in NZD (NZ\$)	2489	4.0%	5.8%	0.0%	51.5%
Exchange Rates	NZD/USD	0.6727	-3.6%	2.3%	-5.8%	-18.4%
	NZD/AUD	0.9277	1.9%	0.6%	-0.4%	20.5%
	NZD/JPY	74.76	-0.1%	0.4%	-15.4%	11.6%
	NZD/GBP	0.4583	-3.7%	-3.4%	-1.6%	-8.1%
	NZD/EUR	0.6041	-1.3%	0.4%	-7.4%	5.4%
	NZ TWI	72.57	-1.0%	1.0%	-3.1%	0.4%
	EUR/USD	1.1136	-2.3%	1.9%	1.7%	-22.6%

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

**Cash**

The RBNZ did not meet in May, with the next decision due June 9. This didn't stop a huge amount of speculation over the future rates path, with the odds of a cut in June declining. This was in part aided by the lack of additional housing measures in the Financial Stability Review. Given the overheating housing market, this was taken as a sign another rate cut in June would be less likely.

The RBA got May off to a busy start with a 25bp rate cut on May 2. Soft inflation was the main driver. However, the follow-up statement and minutes saw speculation see-saw between more easing in the next few months and the bank standing back.

There was no Fed meeting, but lots of Fed speakers. The general theme was guarded hawkishness, with even Fed Chair Yellen hinting of hiking. However, many speakers pointed out the risks from the Brexit referendum on June 23 (i.e. after the Fed's June meeting). They also said moves would be data dependent.

**Fixed interest**

Yields were impacted by speculation surrounding the Fed, RBA and RBNZ. The chances of a rate hike from the Fed increased through the month, with Fed speakers talking up the potential, but reiterating action depends on the data flow. May ended with a 70% chance of Fed tightening in either June or July, lifting yields in general.

After the RBA's surprise cut at the start of the month, there was talk of more to come and soon. The statement and minutes did not paint a conclusive picture through. Still, yields were still generally pushed lower.

The odds of the RBNZ following the RBA and cutting rates declined through May, partly due to the lack of new housing measures, with yields steadily rising. The government 2-year yield gained 4bp, to close around 2.10% and was as high as 2.19% at one stage.

**Equities**

A generally positive month across global share markets was in part due to the recovery in oil, which broke through \$50/bbl at one stage. Fears that Fed hiking could undermine the US recovery also faded, but did prevent the Dow from gaining further.

Australian equities built on the positive end to April, with the surprise RBA rate cut on May 2 contributing. The recovery in commodity prices also pushed the index higher.

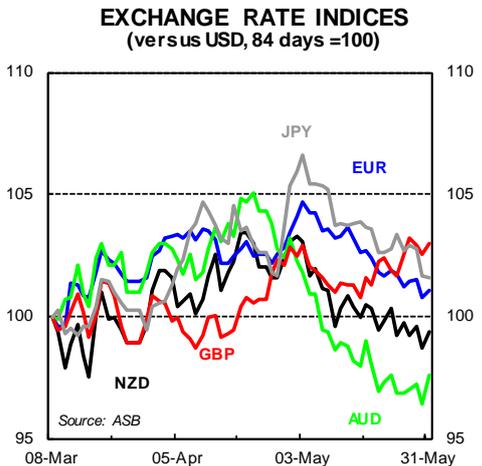
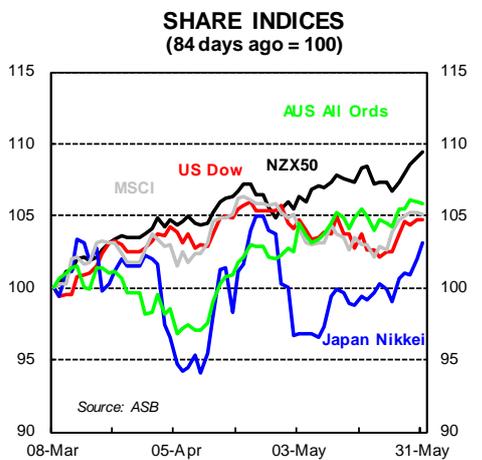
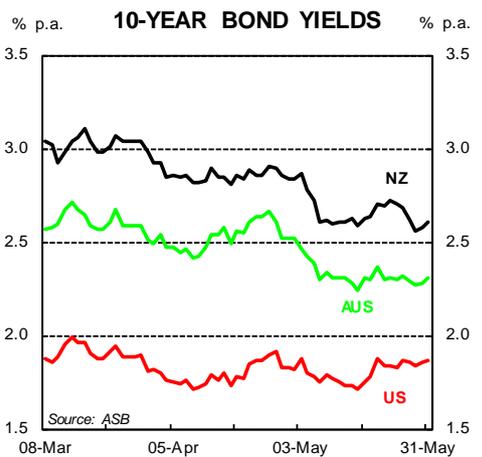
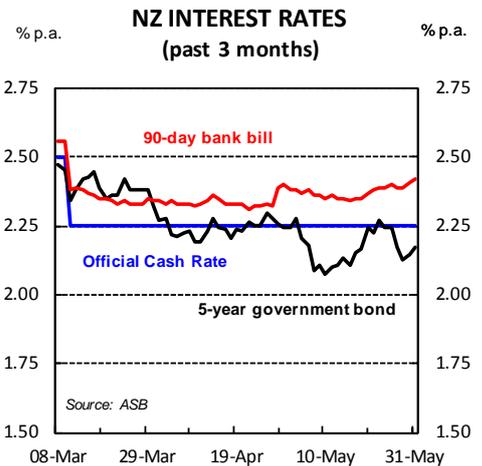
The UK FTSE underperformed on building worries the UK-EU referendum on June 23 will see the country exit the European Union. This also impacted EU bourses, although to a lesser extent.

**Exchange rates**

It was a whippy but range-bound month for the NZD, with rate cut odds lengthening. The Financial Stability Review, 2016 Budget and Fonterra forecast for the new season's milk price, also impacted. The USD found traction, aided by Fed rate hike talk. Taken together NZD/USD traded a 0.6700-0.7050 range but closed the month 0.6725 vs the 0.6950 open.

The AUD fell following the surprise rate cut on May 2. Moves were generated by the staggered released of the statement and minutes. Commodity price volatility, and the same Fed speculation as the NZD endured, also impacted. In general the AUD saw a softer month than the NZD, boosting NZD/AUD.

The Pound was still restrained by 'Brexit' uncertainty ahead of the June 23 vote. Recent polls show the gap between leaving and going narrowing and the uncertainty is impacting across FX markets in general. The Yen weakened circa 3.5% on speculation the BOJ would deliver more easing.



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