No change from central banks but perhaps soon

- Central bank inactivity in the limelight.
- Speculation over rate cuts for New Zealand, Australia and Japan continues.
- The New Zealand Dollar was whippy but remains elevated.

While the Reserve Bank of New Zealand, Bank of Japan, Reserve Bank of Australia and US Federal Reserve all held meetings in the month, only the BoJ actually adjusted monetary policy and, even then, only at the margins. Instead speculation has turned to the short-to-medium-term outlook, with all four expected to make changes in the coming months. Such speculation made its presence felt though markets and, while there was a return to volatility after the northern hemisphere summer, most markets finished September close to the levels they entered the month at.

The RBNZ's OCR review saw some adjustments in the statement, mainly around comments on the strength of the NZD, but the easing bias was underlined. We continue to expect another 25bp cut in the OCR, coming at the November meeting, due to the continued absence of price pressures. However, the outlook for the RBA is less sure, and after starting the month off with a 25bp cut 86% priced in by May next year, that fell that just 70% by the end of the month.

December still looks the most likely pick for the US Federal Reserve to lift the Fed Funds rate. However, with a large and vocal number of FOMC members (both voters and those without a vote) having their say through the month, there was some speculation a move could come at the September meeting. That did not arrive and with November generally considered to be too close to the US Presidential election to take such a policy decision, focus shifted to December. The BoJ is still expected to deliver further stimulus in the near future, but what form this may take is still open for debate. September's meeting saw some fine tuning but no major changes. Given the BoJ only has limited conventional policy instruments left in its tool box, predicting the next course of action is trickier than normal.

In foreign exchange, the NZD started off on the front foot, but momentum soon slipped. This put talk of a 'parity party' against the AUD back on ice, at least for now. Given the RBNZ is still expected to cut at least once more while the RBA is looking less likely to take such action, the NZD/AUD may be passed its peak for the time being.

Date	Instrument	30-Sep-16	Month %	Quarter %	Year %	5-Year %
Cash	NZ cash rate	2.00	0.00	-0.25	-0.75	-0.50
	NZ 90-day bank bill	2.20	-0.08	-0.21	-0.64	-0.65
	US 90-day bank bill	0.85	0.00	0.20	0.52	0.47
	NZ - US 90-day bank bill	1.35	-0.08	-0.41	-1.16	-1.12
Fixed	NZ 5-year gov't stock	1.93	0.10	-0.10	-0.78	-1.46
Interest	NZ 10-year gov't	2.27	0.03	-0.07	-1.01	-2.19
	NZ 10-year swap	2.48	0.04	-0.23	-1.06	-2.08
	AUS 10-year gov't	1.98	0.09	-0.04	-0.62	-2.28
	US 10-year gov't	1.55	-0.03	0.04	-0.52	-0.44
Equities	NZ - NZX50 Capital (NZ$)	3534	-1.9%	5.1%	26.3%	75.3%
	AUS - All Ords (A$)	5525	-0.1%	4.0%	9.2%	35.7%
	JAP - Nikkei (¥)	16450	-2.6%	5.6%	-5.4%	89.1%
	UK - FT100 (£)	6899	1.7%	6.1%	13.8%	34.5%
	US - S&P500 (US$)	2168	-0.1%	3.3%	12.9%	91.6%
	WORLD - MSCI (US$)	1726	0.4%	4.4%	9.1%	56.3%
	MSCI in NZD (NZ$)	2376	0.2%	1.8%	-4.3%	64.4%
Exchange	NZD/USD	0.7263	0.2%	2.6%	14.0%	-4.9%
Rates	NZD/AUD	0.9515	-1.2%	-0.1%	4.7%	21.3%
	NZD/JPY	73.65	-1.4%	1.2%	-3.5%	25.9%
	NZD/GBP	0.5599	1.2%	5.9%	33.3%	14.2%
	NZD/EUR	0.6475	-0.4%	1.5%	14.4%	14.6%
	NZ TWI	77.18	-0.2%	1.8%	11.2%	9.2%
	EUR/USD	1.1217	0.5%	1.0%	-0.4%	-17.0%

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

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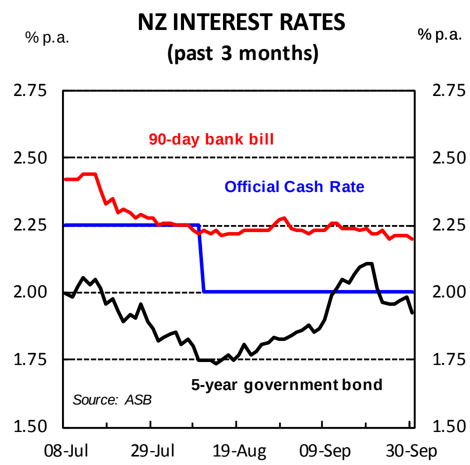
Cash

The RBNZ's September OCR Review delivered what was expected, with no change in the 2.00% rate. The accompanying statement was also broadly in-line with expectations. However, the RBNZ did acknowledge that some of the strength in the NZD is due to underlying fundamentals. The clear easing bias of "further policy easing will be required" was retained in the statement.

We continue to expect the RBNZ to cut the OCR to 1.75% in November, with a risk of a further cut to 1.5% in 2017. Key factors for determining a second cut include inflation expectations, the NZD and developments in bank funding costs.

The Bank of Japan held rates steady but introduced "yield curve control" under which it will buy long-term government bonds to keep 10-year bond yields around zero percent. The Federal Reserve was also on-hold, as expected. Expectations remain for a hike in the Fed Funds rate in December.

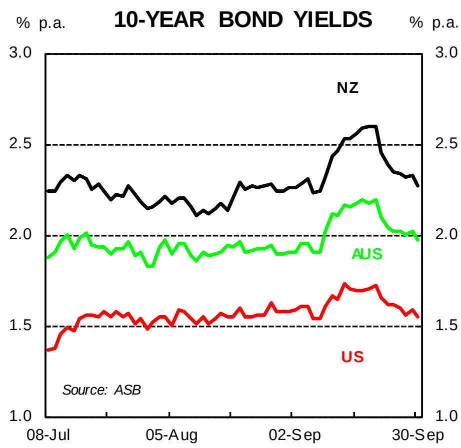


Fixed interest

There was a fair amount of volatility for NZ rates, but it was mainly confined to a fairly narrow range, with the odds of an OCR cut in November swimming between 60-80%. The longer end is more uncertain, with the inflation outlook suggesting another OCR cut in 2017 could be on the cards. However, from a growth point of view, there appears to be less need for greater stimulus.

Australian markets have been fairly calm, with expectations of another move lower by the RBA this year being reduced. The RBA minutes did nothing to dispel this, although much remains dependent on the labour market and inflation outlook.

In the US, the 10-year Treasury bond yield ended the month only 3bp higher. Yields moved around a fair bit though, on yet more mixed US economic data. Political uncertainty is also having an impact and could drive even bigger swings in asset prices in the run up to the November vote.

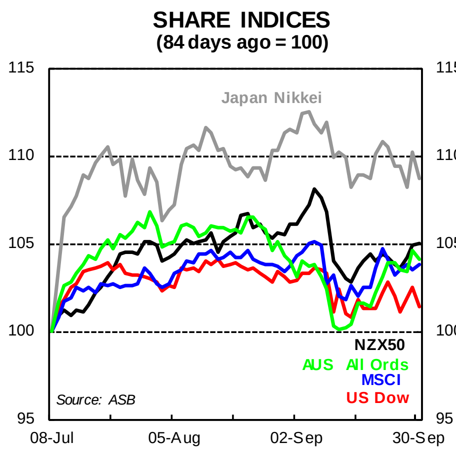


Equities

Issues at Deutsche Bank kept equity markets on their toes through the month, with concern the US Department of Justice's fine on the bank could push it towards needing a bail-out. This impacted banking stocks across the globe and also affected overall risk sentiment.

In the US, the upcoming election and potential for FOMC rate hikes stopped share markets getting too ahead of themselves.

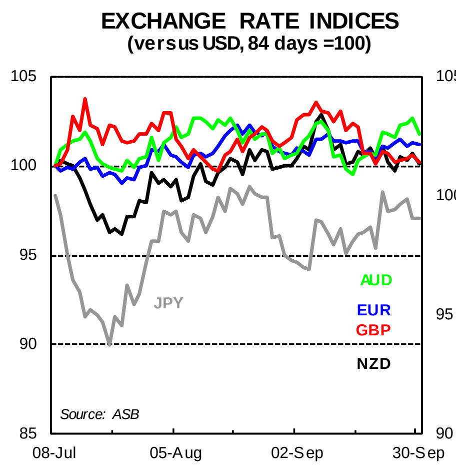
The NZX50 gave back some of the strong gains seen the month prior, despite Fonterra lifting its 2016/17 milk payout forecast to $5.25/kg milk solids. Even so, the index lost 1.3% through September, but on an annual basis the index is up 26.3%. NZ is by far the best performing index of those tracked in this report. This performance is in part due to rate cuts from the RBNZ and the growth momentum in the economy.



Exchange rates

While the NZD closed the month not too far from its opening level, that does not tell half the story. The NZD/USD got close to 0.75 early on, supported by the dairy price recovery, as well as some USD weakness in the run-up to the September Federal Reserve meeting. However, the late September GDT dairy auction did not build on the earlier gains. Q2 GDP data exceeded the RBNZ's estimate, but fell short of the market consensus, though Q1 growth was revised up.

Talk of a parity party between the New Zealand and Australian Dollars faded through the month, with the AUD side-stepping the negative influences faced by the NZD. The AUD also found support in the wake of RBA minutes, with a downward revision in the chances of another rate cut from the RBA this year following the release.



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