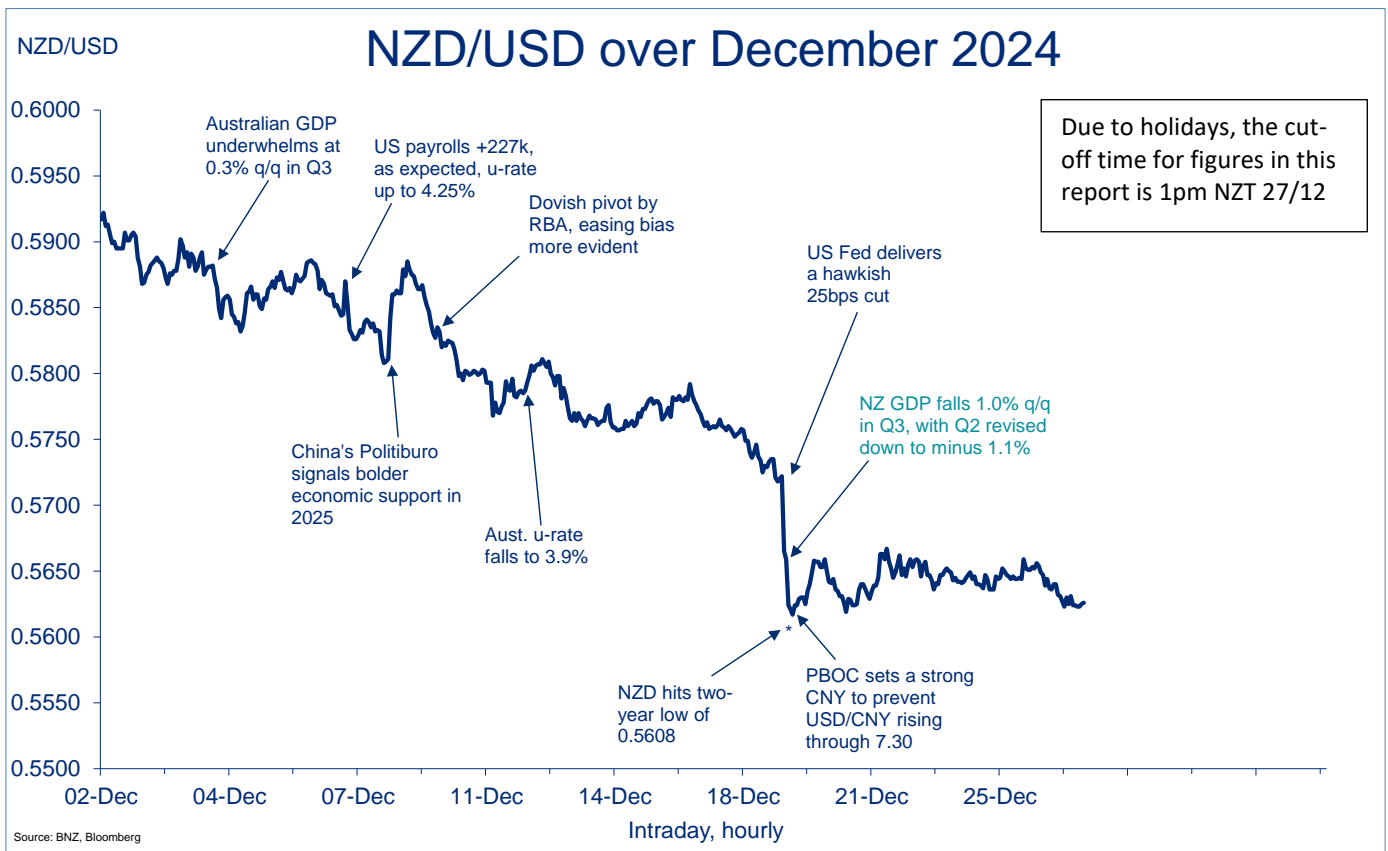


Financial Markets Wrap

27 December 2024

NZ Dollar Dive Deepens in December

- The NZD made another hefty fall in December, extending its fall through Q4 to over 11%
- Contrasting economic fortunes between the US and NZ economy remained notable, with robust US growth continuing against a deeper recession in NZ; NZ-US rate spreads went negative, including longer maturities
- Anticipation of Trump’s policies remained a key driver for USD strength and NZD (and other currency) weakness



| Quick Outlook | | December ranges |
|----------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|
| NZD/USD | After a horror Q4, President Trump’s tariff announcements on the day(s) after his 20-Jan inauguration could determine whether the NZD lurches down further or sharply recovers through Q1. We’re watching 0.55 closely as a possible support level. | 0.5610-0.5930 |
| NZD/AUD | Our models continue to suggest fair value is well south of 0.90, given NZ’s economic underperformance versus Australia and NZ-Australia rate spreads. Further tests below 0.90 expected over coming months. | 0.9020 – 0.9140 |
| NZD/GBP | NZD is much more at risk than GBP on Trump’s tariff agenda, but after reaching a nine-year low further downside risk from here could be limited. | 0.4460 – 0.4660 |
| NZD/EUR | Both NZD and EUR are likely to see some downside spillover risk from Trump’s tariff agenda. EUR also faces political risks over coming months. After falling to the bottom of the range we see more potential for upside than downside risk over the next 3-6 months. | 0.5395 – 0.5620 |
| NZD/JPY | Further BoJ tightening likely against the global trend over the coming year is yen supportive, although the BoJ is evidently reluctant to tighten. Still look for downside in the cross over the medium-term but prone to volatile trading episodes. | 86.7– 89.3 |

The NZD’s horror run through the December quarter continued, with a monthly fall of 5% taking its cumulative drop to over 11%. Contrasting economic fortunes between the US and NZ economy remained notable, with robust US growth continuing against a deeper recession in NZ. NZ-US rate spreads continued to fall, with negative spreads extending through to the long-end of the curve, with a much larger rise over the month for the US 10-year rate compared to NZ. Anticipation of Trump’s policies remained a key driver for USD strength and NZD (and other currency) weakness.

In contrast to the recent period of overwhelmingly positive US economic surprises, the flow of US economic data was more mixed. However, the picture remained of the US economy growing above trend and significantly outperforming other regions. GDP growth was revised up to an annualised pace of 3.1% in Q3, driven by consumer spending. Retail sales remained robust through to November. Non-farm payrolls bounced back in November with an increase of 227k, although the unemployment rate ticked higher to 4.2%. Data showed inflation stabilising in a 2½-3% range.

PMI data showed a large gap between the US and European indices remained, with the composite PMI index for the US rising to a 2½ year high of 56.6 and the index for the euro area lifting but remaining in the contraction zone at 49.5.

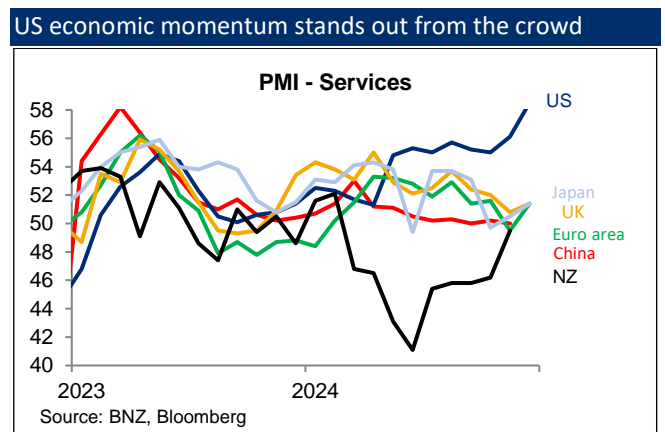
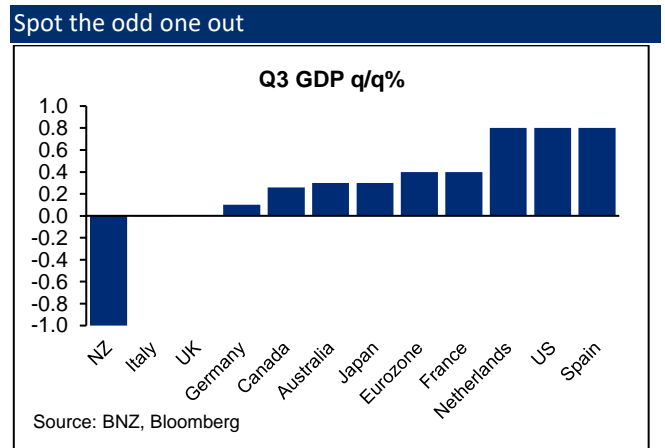
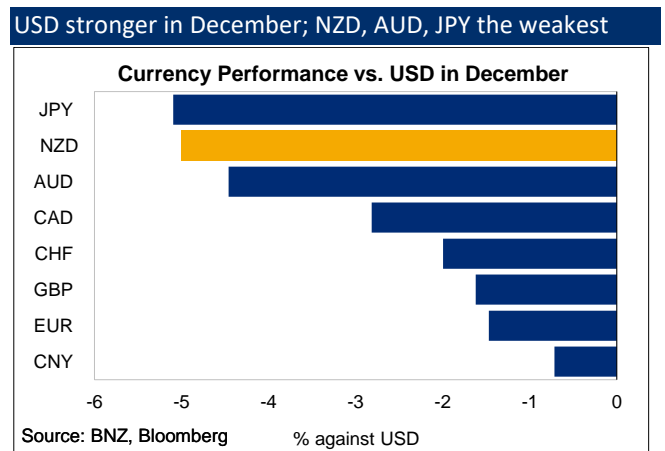
The contrasting economic fortunes between the US and Europe was also reflected in monetary policy outlooks. The US Fed reluctantly delivered a 25bps rate cut, as widely expected, taking the Fed Funds target range down to 4.25-4.5%, but the announcement included a number of hawkish surprises. Cleveland Fed President Hammack voted to keep rates on hold, while three non-voting FOMC members would also have preferred to leave policy on hold. The projections showed just two cuts for next year, with more evident uncertainty about the inflation outlook. Chair Powell’s press conference didn’t sway from the more hawkish policy bias. He noted the decision to cut rates at the meeting was a closer call compared to November and policy is now “significantly closer to neutral” after 100bps of rate cuts.

At the start of the month the market was pricing in 64bps of rate cuts next year and towards the end of the month this had been pared down to 38bps. The US Treasuries curve steepened significantly, with the 2s10s gap at 25bps, the steepest since mid-2022. The 10-year rate broke above 4.6% towards the end of the month, a seven-month high. The 41bps lift at the time of writing was largely driven by an increase in real rates, rather than inflation expectations.

Domestically, NZ economic data were a mixed bag. Timelier high frequency indicators such as the PMI, PSI, job ads and house sales conveyed a picture of improving economic momentum out of a deep trough, while business and consumer confidence indicators continued to show improving trends, with lower rates driving increased optimism about the economic outlook.

The NZ GDP release was a mixed bag. Optically it was terrible, with the economy contracting by a much larger than expected 1.0% in Q3, and with Q2 heavily revised down to 1.1% q/q, suggesting the economy contracting at an annualised pace of more than 4% over the six-month period. But upward historical revisions meant that this contraction was off a much stronger base. Measured against the RBNZ’s November forecasts, the level of economic activity was 0.6% higher than expected, even if the more recent period showed a much deeper downturn.

The government’s economic and fiscal update made for sobering reading, with a downgrading of the economic outlook relative to the May Budget projections resulting in a significant downgrading of the fiscal accounts. This was



best summarised by the government needing to borrow an extra \$20b over the next four years. Upwardly revised deficits are becoming a habit of the government, past and present, resulting in a steady upward trajectory of government debt levels.

There was no RBNZ update during the month but the market gained increased conviction on rate cuts for next year. June bill futures rallied 30bps, supporting the narrative of a front-loaded easing cycle, and the terminal OCR rate down to about 3%. In contrast to higher short-term US rates, NZ's 2-year swap rate was down 33bps to 3.38% towards month-end, while global forces drove some curve steepening. The prospect of ongoing heavy debt issuance added to widening swap spreads.

In currency markets, the USD continued its rapid ascent through Q4, with the DXY index reaching a fresh two-year high above 108 – reflecting US economic exceptionalism and higher US-global rate spreads. The strong rally of the USD post-election followed the same outcome as in 2016, with the market seeing President Trump as pro-growth and policies adding to inflation pressures.

Many currencies around the world reached fresh multi-year, or in some cases record, lows against the USD and the NZD was one of them. The high for the month for NZD/USD was the first trading day, with a fairly steady decline thereafter. The NZD hit a two-year low of 0.5608 on 19-December in the wake of the Fed's hawkish cut and NZ GDP Q3 shocker, before settling. Towards month-end the NZD was down 5% at 0.5625, extending its quarter-to-date fall to over 11%, following the 2024 high set on 30-September.

One mitigating factor for NZD losses was the intent of the PBoC to prevent USD/CNY from rising up through 7.30 by setting strong daily CNY reference rates. CNY was the strongest of the key majors we closely follow. USD/CNY was down less than 1% for the month. China's Politburo signalled bolder economic support next year, shifting to a "moderately loose" monetary policy stance, a step-up from "prudent" monetary policy that has been in place for 14 years. It also signalled "more proactive" fiscal policy, and promising to "forcefully boost consumption", and stabilise the property and stock markets. The announcement was short on specifics, keeping the market guessing on the extent of any fiscal support next year to counteract Trump's tariff policy.

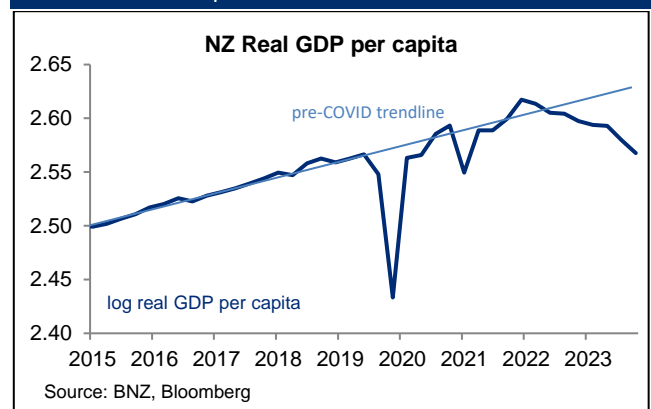
The AUD also performed poorly for the month, resulting in only a modest fall in NZD/AUD. Surprising the market, the RBA made a dovish pivot, with the statement noting "the Board is gaining some confidence that inflation is moving sustainably towards target". The previous comment of not ruling anything in or out regarding policy was removed.

Governor Bullock said the change in wording was deliberate, following some softer data than expected. While the market brought forward the first full rate cut to April, economic data weren't wholly compliant. Australia's labour market

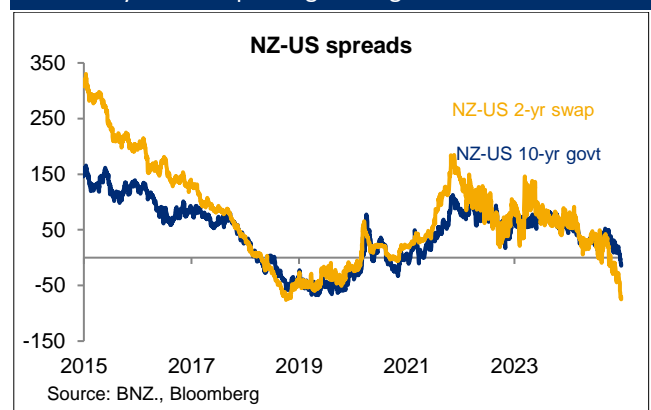
report was strong, with the unemployment rate falling two-tenths to an eight-month low of 3.9% in November, defying market expectations for a nudge up to 4.2%.

JPY significantly underperformed, reflecting the backdrop of much higher US Treasury yields and a lack of intent by the BoJ to normalise monetary policy. The BoJ kept policy unchanged, although one Board member voted for a 25bps rate hike. But in a dovish tilt, Governor Ueda said "it will take a long time before the full picture is clear for both the spring wage negotiations and the Trump administration's policies", reducing expectations that the BoJ would hike in January, delaying the decision until March/April. NZD/JPY range traded through the month between 86.7-89.3.

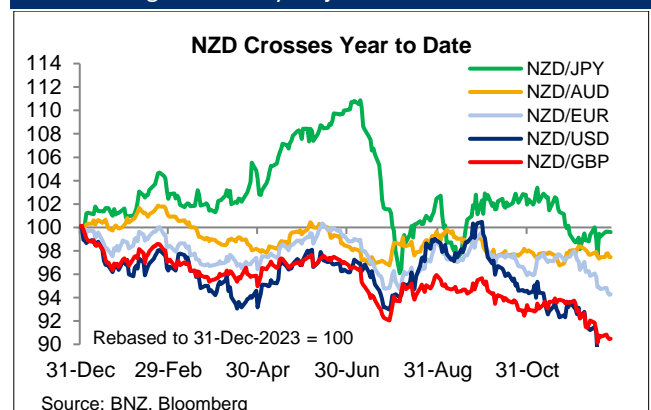
NZ economic slump continues



NZ-US 10-year rate spread goes negative



NZD lower against all key majors for 2024 to date



NZD/GBP fell to a nine-year low of about 0.4460 before recovering to 0.45, reflecting lower NZ-UK rate differentials and the UK being much less exposed than NZ to Trump's tariff policies. The BoE kept its policy rate unchanged at 4.75% but the outcome was dovish, with the vote being 6-3 – Deputy Governor Ramsden and newest MPC member Taylor joining perennial dove Dhingra in voting for a 25bps cut. Governor Bailey said “we think a gradual approach to future interest rate cuts remains right...but with heightened uncertainty in the economy we can't commit to when or by how much we will cut rates in the coming year.”

NZD/EUR fell to the bottom of its trading range this year, with rising political risk in France and Germany not

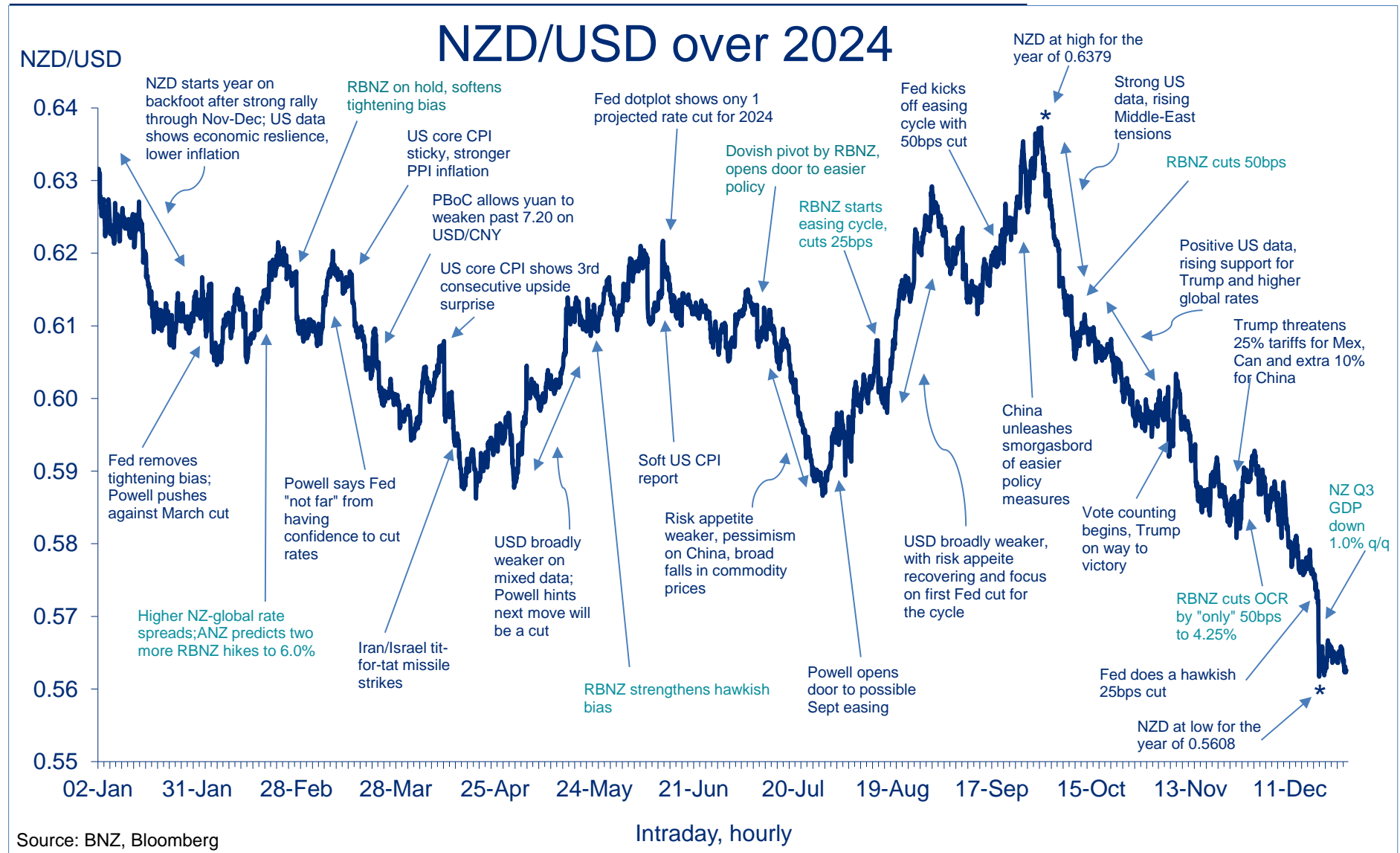
materially impacting the euro. The ECB cut its policy rates by 25bps for a third successive meeting, taking the deposit rate down to 3.0%, as widely expected, with rates now having been cut by 100bps so far this cycle. Prior language that policy would remain “sufficiently restrictive for as long as necessary” was dropped and replaced with policy “will follow a data-dependent and meeting-to-meeting approach”.

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Due to holidays, the cut-off time for figures in this report is 1pm NZT 27/12

| Monthly Performance Table | | | | | | | |
|-----------------------------------|---------|---------|--------|----------------------------------|---------|---------|--------|
| | end-Dec | end-Nov | Change | | end-Dec | end-Nov | Change |
| Currencies | | | | NZ Rates | | | |
| NZD/USD | 0.5625 | 0.5922 | -5.0% | OCR | 4.25 | 4.25 | 0.00 |
| NZD/AUD | 0.9039 | 0.9091 | -0.6% | NZ 90day BB | 4.19 | 4.36 | -0.17 |
| NZD/EUR | 0.5397 | 0.5598 | -3.6% | NZ 2yr sw ap | 3.38 | 3.71 | -0.33 |
| NZD/GBP | 0.4490 | 0.4650 | -3.4% | NZ 5yr sw ap | 3.52 | 3.74 | -0.22 |
| NZD/JPY | 88.74 | 88.65 | 0.1% | NZ 10yr sw ap | 3.94 | 4.06 | -0.12 |
| NZD/CNY | 4.106 | 4.290 | -4.3% | | | | |
| TWI | 67.6 | 69.7 | -3.1% | NZ Govt (5/26) | 3.67 | 3.82 | -0.14 |
| AUD/USD | 0.6223 | 0.6514 | -4.5% | NZ Govt (4/29) | 3.85 | 3.92 | -0.07 |
| EUR/USD | 1.0422 | 1.0578 | -1.5% | NZ Govt (5/34) | 4.48 | 4.38 | 0.09 |
| GBP/USD | 1.2529 | 1.2735 | -1.6% | NZ Govt (5/41) | 4.95 | 4.82 | 0.14 |
| USD/JPY | 157.76 | 149.72 | 5.4% | | | | |
| USD/CNY | 7.30 | 7.25 | 0.7% | Global 10 year bond rates | | | |
| USD/CAD | 1.4411 | 1.4005 | 2.9% | US | 4.58 | 4.17 | 0.41 |
| USD DXY | 108.13 | 105.74 | 2.3% | Canada | 3.29 | 3.08 | 0.21 |
| Asia dollar index | 89.47 | 90.63 | -1.3% | UK | 4.57 | 4.24 | 0.33 |
| | | | | France | 3.14 | 2.89 | 0.24 |
| Equity Markets | | | | Germany | 2.32 | 2.09 | 0.23 |
| MSCI AC Wrld, loc. | 2,429 | 2,426 | 0.1% | Italy | 3.49 | 3.28 | 0.22 |
| MSCI World, loc. | 14,010 | 14,018 | -0.1% | Spain | 3.02 | 2.79 | 0.23 |
| MSCI EM, USD | 2,876 | 2,856 | 0.7% | Portugal | 2.80 | 2.53 | 0.27 |
| US S&P 500 | 6,038 | 6,032 | 0.1% | Ireland | 2.60 | 2.39 | 0.21 |
| Euro STOXX 600 | 503.8 | 510.3 | -1.3% | Japan | 1.08 | 1.04 | 0.04 |
| Germany DAX | 19,849 | 19,626 | 1.1% | Australia | 4.42 | 4.34 | 0.08 |
| France CAC 40 | 7,283 | 7,235 | 0.7% | | | | |
| UK FTSE 100 | 8,137 | 8,287 | -1.8% | Commodities (USD) | | | |
| Aust S&P/ASX 200 | 8,278 | 8,436 | -1.9% | WTI Crude | 69.67 | 68.00 | 2.5% |
| Japan Topix | 2,767 | 2,681 | 3.2% | Brent Crude | 73.26 | 72.94 | 0.4% |
| China CSI 300 | 3,987 | 3,917 | 1.8% | R/B CRB Index | 291.4 | 286.9 | 1.6% |
| NZX50 | 13,128 | 13,067 | 0.5% | Gold spot | 2,633 | 2,643 | -0.4% |
| Volatility: VIX | 14.73 | 13.51 | 9.0% | Silver spot | 29.80 | 30.63 | -2.7% |
| | | | | Copper | 407.2 | 408.1 | -0.2% |
| 3-mth Money Market Futures | | | | Iron Ore | 100.80 | 104.02 | -3.1% |
| NZD Jun-25 | 96.62 | 96.33 | 0.29 | Thermal coal | 126.75 | 141.50 | -10.4% |
| AUD Jun-25 | 96.13 | 95.92 | 0.21 | Corn | 453.8 | 433.0 | 4.8% |
| USD Jun-25 | 95.90 | 95.98 | -0.08 | Wheat | 541.0 | 548.0 | -1.3% |
| EUR Jun-25 | 97.99 | 98.12 | -0.13 | SGX-NZX Dairy WM P | 3,700 | 4,000 | -7.5% |
| GBP Jun-25 | 95.66 | 95.88 | -0.22 | SGX-NZX Milk Price '25 | 9.95 | 10.10 | -2.3% |
| CAD Jun-25 | 97.18 | 97.16 | 0.02 | | | | |

Source: BNZ, Bloomberg



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