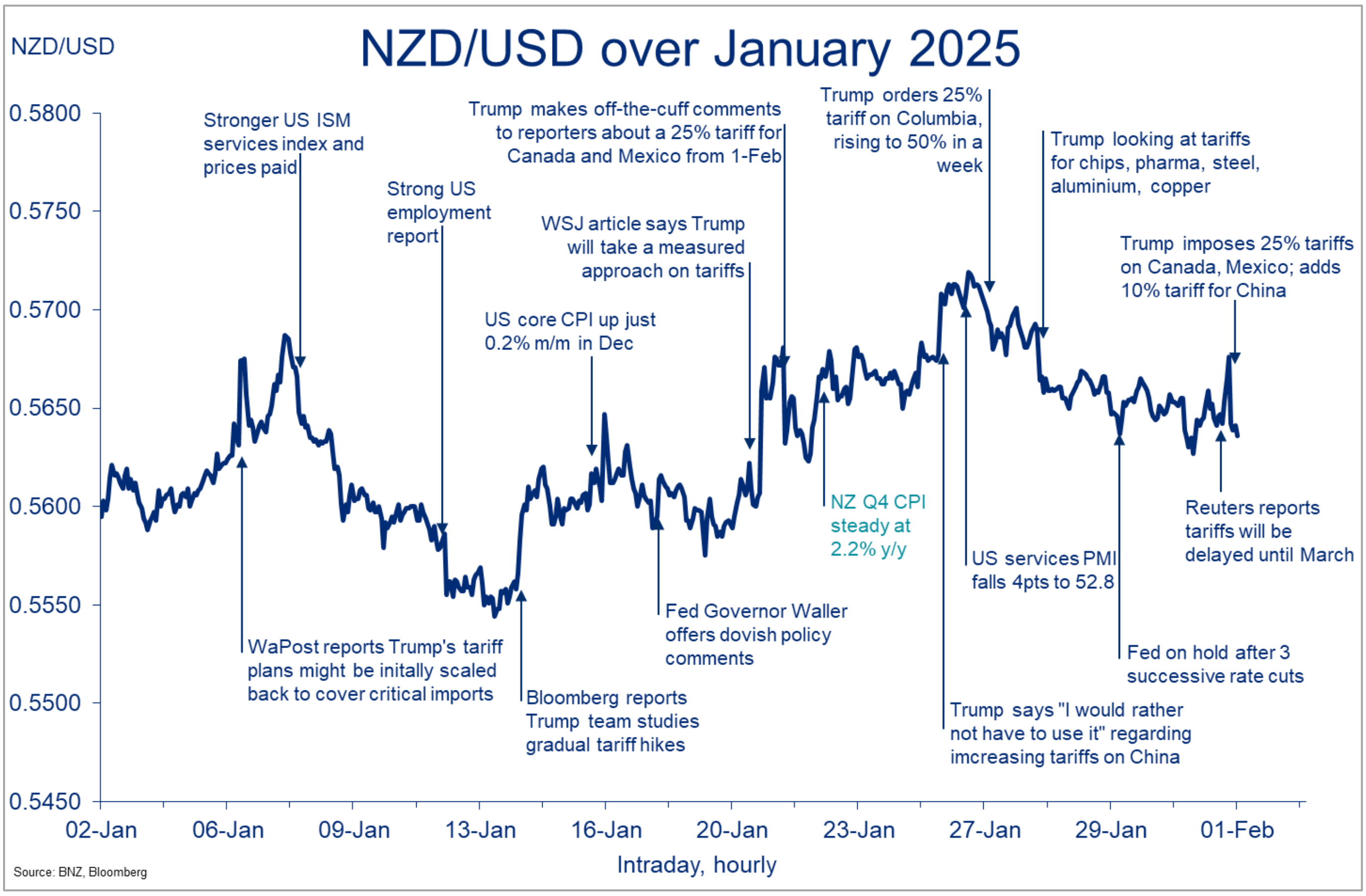
Research

Financial Markets Wrap

3 February 2025

January jitters as Trump threatens tariffs

- **Currency markets were jumpy in January, reacting to Trump's soundbites on tariffs, but without any material reaction overall.**
- **NZD/USD recovered from a nearly 12% plunge in Q4 to show some signs of stability through January and a modest net gain.**
- **The NZD was up on most crosses; net moves in global rates were modest; global equity markets reached a fresh record high.**



	Quick Outlook	January ranges
NZD/USD	Short-term outlook at the whim of Trump's tariff announcements. The opening 10% salvo against China is moderate, but downside risk to the NZD will prevail if these are upscaled over coming months and the yuan weakens.	0.5540-0.5720
NZD/AUD	Stuck in a tight trading range, with 0.90-0.91 covering most of the price action over the past four months. Our projections are consistent with a retest below 0.90 at some stage. However, the AUD would suffer more than the NZD on any aggressive tariff move against China.	0.9005 – 0.9085
NZD/GBP	NZD is much more at risk than GBP on Trump's tariff agenda, but we are fairly neutral on the outlook with the cross rate not far off a nine-year low.	0.4465 – 0.4610
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 in December, we see more potential for upside than downside risk over the next 3-6 months.	0.5400 – 0.5485
NZD/JPY	Further BoJ tightening is likely over the coming year, which contrasts with the global trend, and is yen supportive. The yen's safe-haven characteristics in a trade war also appeals. Still looking for downside in the cross over the medium-term but prone to volatile trading episodes.	86.7– 89.7

January proved to be relatively uneventful across most markets. There were some jitters in the currency market after Trump took the reins as President and he threatened tariffs, but the lack of firm action (until the very end of the month) came as a relief. The NZD found a base after its horror performance in Q4, and ended the month modestly higher against most of the key majors. NZ and US rates showed modest net changes, with a notable lift over the first half of the month unwinding. Global equities rose to a fresh record high.

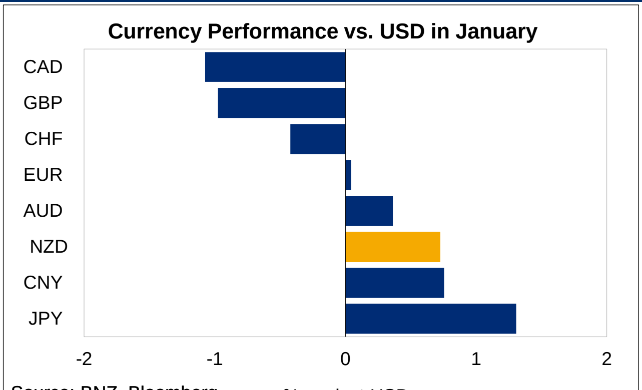
President Trump's early moves as the new leader of the US was a key focus of market attention in January. Ahead of President Trump's inauguration, he called President Xi which he relayed as "a very good one". In the opening lines of his inauguration address he highlighted that he will be putting America first. He indicated his first measures as President, declaring a national emergency at the southern border with Mexico and thereby zeroing in on curbing illegal immigration, addressing inflation to rapidly bring down costs and prices, and declaring a national energy emergency.

On trade, Trump said "Instead of taxing our citizens to enrich other countries, we will tariff and tax foreign countries to enrich our citizens". But market fears of early tariffs were not borne out, with plenty of threats to impose tariffs repeated but no firm action (until the last day of the month). The market didn't take seriously Trump's off-the-cuff comment to reporters the threat to impose 25% tariffs on Canada and Mexico from 1 February or a 10% tariff on China. Later in a Fox News interview, Trump said "I would rather not have to use it" in reference to increasing tariffs on China. In afternoon trading on 31 January NY time, Trump announced 25% tariffs on Canada and Mexico and lifted tariffs on China by 10%. He later carved out Canadian energy products, reducing that tariff to 10%, and said the tariffs would commence on 4 February.

US economic data releases played a backseat role to the political backdrop. Inflation data were market-friendly, with the CPI ex food and energy index rising just 0.2% m/m in December, breaking a four-month run of 0.3% increases. The data were consistent with a narrative that inflation has settled in a 2½-3%% range, with the core PCE deflator up 2.8% y/y, above the 2% target.

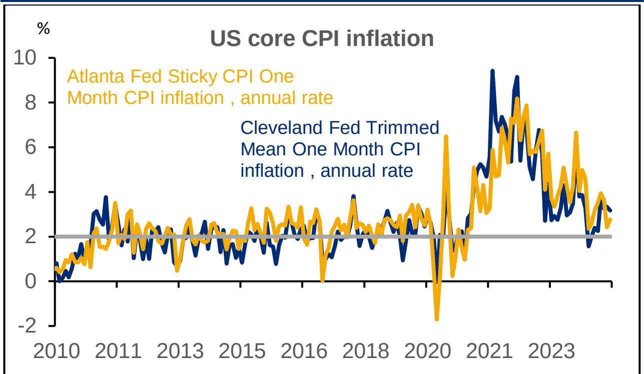
The US Fed left policy unchanged as expected, breaking a three-meeting run of successive rate cuts. Chair Powell said the Bank didn't need to be in a hurry to cut rates further, citing a strong economy, a labour market in balance and a need to see further progress on reducing inflation. He said that the Fed Funds rate remained meaningfully above neutral, although interest rates are no longer restraining the economy as much as they had been. GDP data at the end of the month showed growth at an annualised rate of 2.3% in Q4 and 2.5% y/y, supported by very strong consumer spending.

Mixed FX performance in January; NZD up modestly



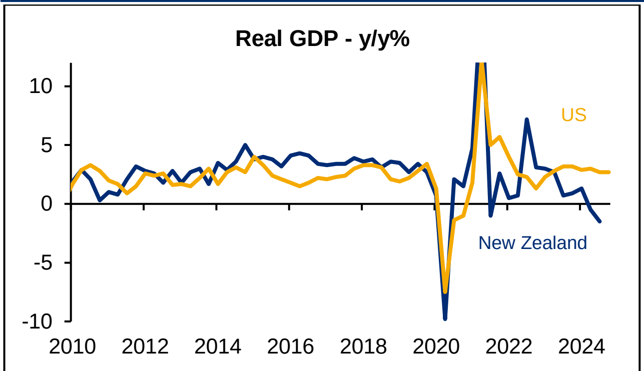
Source: BNZ, Bloomberg

US core CPI settling in 2½-3% zone



Source: BNZ/NAB, Bloomberg

US GDP growth still solid, unlike NZ



Source: BNZ, Bloomberg

Over the first half of the month, the US 10-year Treasury yield rose to a 14-month high just over 4.8%, continuing the bond market sell-off evident since mid-September, before rates reversed course. The rate closed the month at 4.54%, down just 3bps.

In domestic news, NZ Q4 CPI data were broadly in line with market expectations, even if annual inflation remained steady at 2.2% rather than ticking down further. All annual core measures fell further and averaged 2.6% on six measures we look at. Non-tradeables inflation of 0.7% q/q was the weakest in nearly four years. One red flag was the seasonally adjusted CPI rising by a chunky 0.8% q/q, breaking a downward trend, a sign that the disinflation process could well be over.

Timely monthly activity indicators such as the PMI, PSI, house sales, and job adds all pointed to the NZ economy remaining very weak, if not contracting further in Q4. In the QSBO, a net 26% (seasonally adjusted) of businesses reported that activity deteriorated in Q4, in line with earlier readings through 2024.

NZ rates showed the same pattern as the US, with higher rates in the first half giving way to lower rates in the second half. There was nothing in the data to dissuade the market from believing that the RBNZ would cut the OCR by another 50bps at the February meeting, with 49bps priced at month-end. There was a modest paring of rate cut expectations for the year ahead. The 2-year swap rate closed the month up 7bps to 3.44% and the 10-year rate rose 17bps to 4.09%.

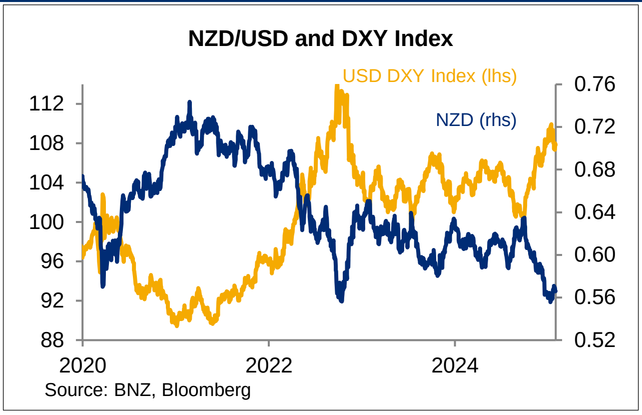
Turning to the currency market, the USD's strong upward trend continued early in the month, with the DXY index reaching a fresh two-year high above 110. From an overbought level, a media report that the Trump team was studying gradual tariff hikes saw a reversal in USD sentiment, causing a sharp fall. Other media reports that Trump would take a measured approach to tariffs and Trumps' lack of firm action in imposing tariffs, even if threatened, supported further USD weakness.

Trump's utterances on tariffs, often at random times as he faced reporters, caused small temporary blips in market pricing. The NZD reached a fresh two-year low of 0.5542 on 13-January (above the previous intra-day nadir in October 2022) before the reversal of the USD's fortunes supported a stronger NZD. The high for the month of 0.5723 was reached on 25-January. Stepping back from the noise, the NZD looked to be forming a base after the nearly 12% plunge in Q4.

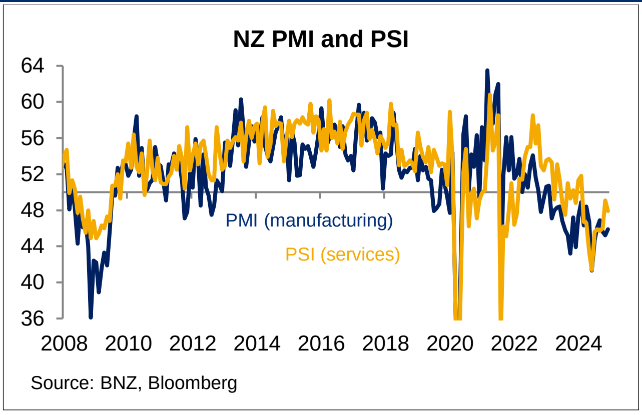
The NZD showed gains on most crosses, the notable exception being a modest 0.6% fall on NZD/JPY. The yen was well supported as speculation grew that the BoJ would be hiking rates again. The BoJ raised its policy rate by 25bps to 0.5%, its third rate hike this cycle, after kicking it off in March last year. The Bank upgraded its CPI inflation projections to show above target (at least 2%) inflation across the three-year projection period. Governor Ueda repeated the message "we'll raise rates and adjust policy if our outlook is realised" and he added "we have no preconception on the pace of rate hikes".

Early in the month, the PBoC finally relented and allowed USD/CNY to trade above 7.30 although it kept a firm grasp on the currency to restrain yuan weakness. The lack of immediate Chinese tariffs and Trump's seemingly less hawkish comments against China, supported USD/CNY falling below 7.25. China GDP picked up in Q4 as expected, with positive revisions seeing the annual increase for the quarter at 5.4% y/y. For the full year, growth matched the government's 5% target, not coincidentally, with the ramp up in stimulus later in the year saving the day. China's manufacturing and service sector PMIs were weaker than expected in January at 49.1 and 50.2 respectively, suggesting growth lost momentum, despite the increased stimulus at the end of last year.

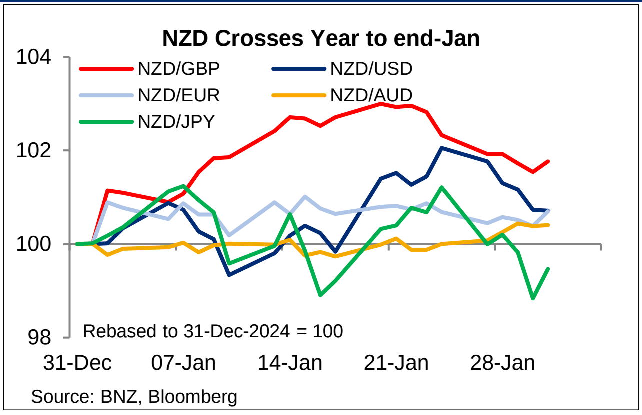
USD peaks out, NZD finds a base



NZ-PMI and PSI still in contractionary territory



NZD flat to higher on key crosses



NZD/AUD maintained a tight trading range and closed the month up 0.4% to 0.9075. Australian labour market data continued to convey a tight labour market, with the unemployment rate nudging up to 4.0%. However, Q4 core CPI inflation (trimmed mean) of 3.2% y/y was two-tenths below the RBA's November forecast, giving the market more confidence in the RBA kick starting an easing cycle in February.

GBP was the weakest of the majors, after being the strongest of the majors relative to the USD over 2024. NZD/GBP rose 1.7% to 0.4550. UK economic activity data were on the soft side, with a fall in retail sales volumes in December and flat GDP over the three months to November, adding to the narrative of a UK economy struggling to gain any traction under the new government.

UK inflation data also undershot market expectations, more so for the services CPI which hitherto had been high and sticky. The data paves the way for the BoE to cut rates at its February meeting.

NZD/EUR showed a modest 0.7% gain to 0.5440. The ECB cut its policy rate by 25bps for a fifth time this cycle, taking the deposit rate to 2.75%. The Bank signalled future rates cuts, with President Lagarde still describing the current monetary policy stance as restrictive. In contrast to the robust US economy, euro area GDP was flat in Q4, signalling a deterioration in economic momentum after modest growth earlier in 2024.

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Monthly Performance Table

	end-Jan	end-Dec	Change		end-Jan	end-Dec	Change
Currencies				**NZ Rates**			
NZD/USD	0.5635	0.5595	0.7%	OCR	4.25	4.25	0.00
NZD/AUD	0.9073	0.9041	0.4%	NZ 90day BB	3.93	4.17	-0.24
NZD/EUR	0.5440	0.5403	0.7%	NZ 2yr swap	3.44	3.38	0.07
NZD/GBP	0.4547	0.4471	1.7%	NZ 5yr swap	3.67	3.51	0.16
NZD/JPY	87.45	87.96	-0.6%	NZ 10yr swap	4.09	3.93	0.17
NZD/CNY	4.087	4.081	0.1%				
TWI	67.4	67.3	0.2%	NZ Govt (5/26)	3.62	3.63	-0.01
AUD/USD	0.6211	0.6188	0.4%	NZ Govt (4/29)	3.90	3.76	0.15
EUR/USD	1.0359	1.0354	0.0%	NZ Govt (5/34)	4.50	4.42	0.09
GBP/USD	1.2392	1.2514	-1.0%	NZ Govt (5/41)	4.96	4.91	0.05
USD/JPY	155.19	157.22	-1.3%				
USD/CNY	7.24	7.30	-0.8%	**Global 10 year bond rates**			
USD/CAD	1.4539	1.4383	1.1%	US	4.54	4.57	-0.03
USD DXY	108.37	108.49	-0.1%	Canada	3.06	3.23	-0.16
Asia dollar index	89.81	89.29	0.6%	UK	4.54	4.56	-0.03
				France	3.20	3.19	0.01
Equity Markets				Germany	2.46	2.36	0.09
MSCI AC Wrld, loc.	2,466	2,388	3.3%	Italy	3.55	3.52	0.03
MSCI World, loc.	14,233	13,754	3.5%	Spain	3.07	3.06	0.01
MSCI EM, USD	2,905	2,853	1.8%	Portugal	2.87	2.84	0.03
US S&P 500	6,041	5,882	2.7%	Ireland	2.72	2.64	0.09
Euro STOXX 600	539.5	507.6	6.3%	Japan	1.24	1.09	0.15
Germany DAX	21,732	19,909	9.2%	Australia	4.43	4.36	0.07
France CAC 40	7,950	7,381	7.7%				
UK FTSE 100	8,674	8,173	6.1%	**Commodities (USD)**			
Aust S&P/ASX 200	8,532	8,159	4.6%	WTI Crude	72.53	71.72	1.1%
Japan Topix	2,789	2,785	0.1%	Brent Crude	76.76	74.64	2.8%
China CSI 300	3,817	3,935	-3.0%	R/B CRB Index	305.0	296.7	2.8%
NZX50	12,995	13,111	-0.9%	Gold spot	2,798	2,625	6.6%
Volatility: VIX	16.43	17.35	-5.3%	Silver spot	31.30	28.90	8.3%
				Copper	427.9	402.7	6.3%
3-mth Money Market Futures				Iron Ore	105.70	100.06	5.6%
NZD Jun-25	96.62	96.62	0.00	Thermal coal	115.50	125.25	-7.8%
AUD Jun-25	96.15	96.13	0.02	Corn	482.0	458.5	5.1%
USD Jun-25	95.90	95.96	-0.06	Wheat	559.5	551.5	1.5%
EUR Jun-25	97.86	97.97	-0.11	SGX-NZX Dairy WMP	4,125	3,690	11.8%
GBP Jun-25	95.86	95.69	0.17	SGX-NZX Milk Price '25	10.12	9.92	3.9%
CAD Jun-25	97.44	97.28	0.16				

Source: BNZ, Bloomberg

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