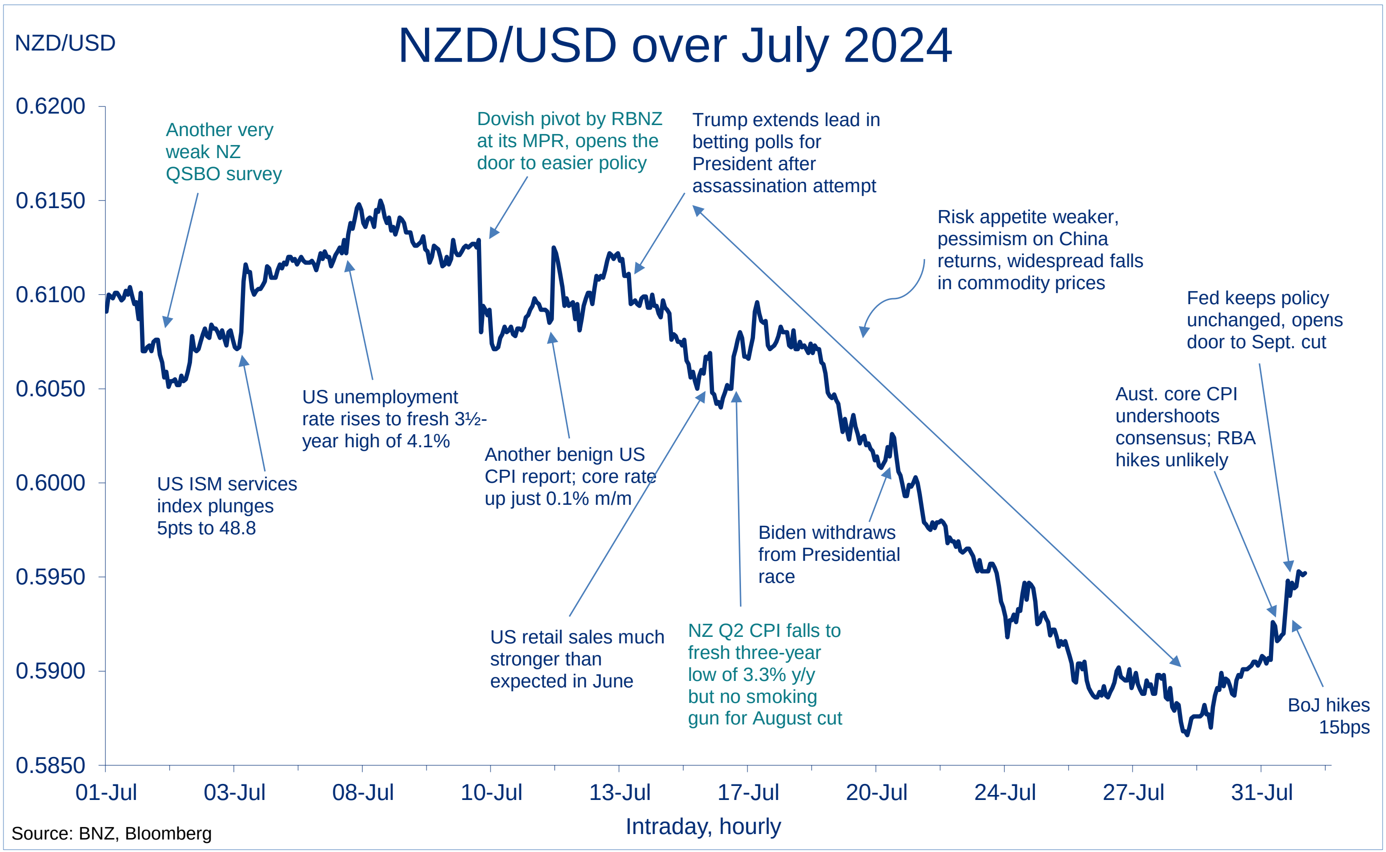
Financial Markets Wrap

1 August 2024

July Jolt

- **Commodity currencies underperformed on weaker risk appetite and lower commodity prices; NZD/USD fell 2.3% to 0.5950.**
- **The RBNZ's dovish pivot provided an added NZD headwind, with a sharp narrowing in NZ-global rate spreads.**
- **Short yen positions unwound resulting in a sharp recovery in the JPY; NZD/JPY plunged nearly 9%.**



Quick Outlook		July ranges
NZD/USD	Balance of risk skewed higher over coming months, after the battering through July. However, RBNZ August MPS is a key risk event and a rate cut before the Fed in September could delay any recovery in the NZD.	0.5860 – 0.6150
NZD/AUD	Apt to consolidate after recent large swing but we ultimately see a sustained move below 0.90, based on NZ's much weaker economy relative to Australia, manifested in a rising unemployment rate differential and lower NZ-AU rate spreads.	0.8970 – 0.9150
NZD/GBP	Apt to consolidate after July's tumble to reach an 8-year low. Fall looks slightly overdone.	0.4565 – 0.4825
NZD/EUR	Apt to consolidate after reaching the bottom of its annual trading range, with fall looking slightly overdone.	0.5420 – 0.5685
NZD/JPY	A vicious tumble in July from an over-bought level, but only back to our FX projections sub-90. Further BoJ tightening likely against the global trend. Still look for further downside over the medium-term, but due for a period of consolidation.	88.7– 99.0

After a sedate June, there was plenty of price action in July, with increased market volatility. The combination of weaker risk appetite, lower commodity prices and a dovish pivot by the RBNZ dealt a blow to the NZD, leaving it the worst performer for the month. At the other end of the scale, JPY surged from an oversold level, sending NZD/JPY tumbling. Global rates were lower, supported by cooperative data that increased the chance of the Fed commencing an easing cycle in September. Yield curves steepened, particularly in NZ, where the 2-year swap rate plunged 73bps.

There were plenty of market drivers that caused increased volatility during July. These included a shock result in the French legislative election, US political gyrations including President Biden withdrawing from the election race, significant unwinding of the yen-carry trade, the RBNZ's dovish pivot, and benign US inflation data to name some key influences on the market.

Early in the month, Citigroup's US economic surprise index fell to a fresh two-year low before improving somewhat. The key US employment report was consistent with an easier labour market, with moderating employment growth, lower wage inflation and the unemployment rate rising to 4.1%, its highest level in 3½ years. Stronger than expected GDP data later in the month, with growth running at an annualised 2.8% pace in Q2, supported the soft-landing narrative, as did many other indicators.

Importantly, inflation data were benign, with a successive undershooting of CPI data relative to consensus and the core measure (excluding food and energy) rising by just 0.1% m/m and falling to a fresh three-year low of 3.3% y/y. The data supported the case that the surprise blip up in inflation in Q1 was an aberration, against a backdrop of broad disinflationary pressure, and cemented in expectations of the Fed easing monetary policy from September. At the FOMC meeting, just a few hours ahead of the NY close for the month, the Fed opened the door for cutting rates in September. Chair Powell said the Fed was more confident that inflation is heading back toward 2% and, while the FOMC has made no decisions about future meetings, a rate cut could happen as soon as the next meeting.

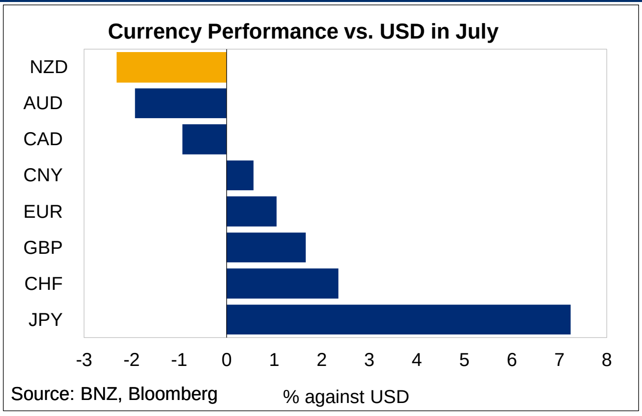
Domestically, the economic dataflow remained woeful. The NZIER's Quarterly Survey of Business Opinion Activity indicators were very weak, consistent with economic recession. Supporting that view, the PMI slumped to 41.1 in June and the PSI fell to 40.2, a record low outside of COVID-lockdown periods.

The RBNZ expressed a clear change in view at its Monetary Policy Review. In contrast to the surprisingly hawkish May MPS, where the Bank noted upside risk to the policy rate, the MPR opened the door to cutting the policy rate with the comment monetary restraint "will be tempered over time consistent with the expected decline in inflation pressures". The Bank acknowledged weaker higher frequency indicators and included a laundry list of weak variables it has been watching, including financial stress indicators.

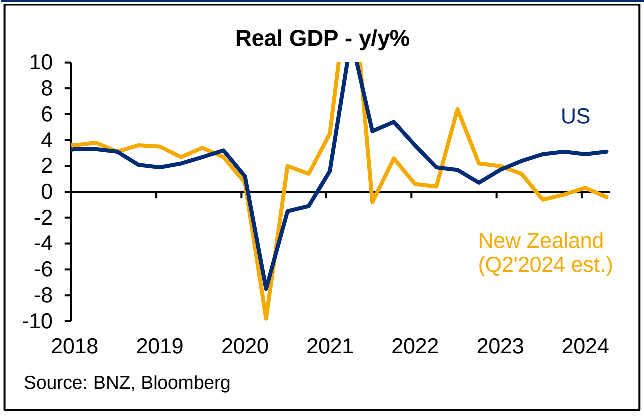
Subsequent NZ CPI data showed further progress towards the RBNZ meeting its inflation target, with the headline rate down to a three-year low of 3.3% and core measures averaging 3½%. While headline inflation was three-tenths lower than the RBNZ's May projection, non-tradeables inflation was a tenth stronger, at 5.4% y/y, keeping the market guessing on the timing of the first rate cut.

The RBNZ's dovish pivot shocked the market, driving down NZ rates as the market priced in an earlier and more aggressive rate cut cycle. By month-end the OIS market was pricing in a two-thirds chance of a 25bps rate cut in August, over 75bps of cuts priced by November and 165bps of cuts priced before the middle of next year.

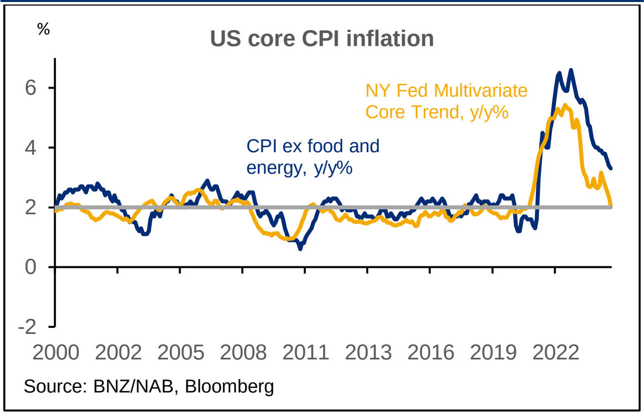
Commodity currencies underperform in July; NZD worst



A tale of two countries – GDP growth



US inflation closing in on target



The 2-year swap rate closed the month down a massive 73bps to 4.23%, after trading near two-year lows. There was significant steepening of the yield curve, with the 10-year rate down 44bps to 4.07%. The NZGB 10-year rate fell 33bps to 4.34%. These were larger interest rate declines compared to other markets, resulting in lower NZ-global rate spreads. With increased confidence of the Fed kicking off the easing cycle within a couple of months, the US 2-year Treasury yield fell 50bps to 4.26% while the 10-year rate fell 36bps to 4.03%.

Another key theme for July, was lower commodity prices, with expectations of soft demand from China a key factor. Brent crude oil fell 7%, to around USD80 per barrel. Bloomberg's industrial metals price index fell over 7%. Chinese economic data continued to underwhelm. Q2 GDP was softer than consensus at 4.7% yoy, with softer consumer spending and the ongoing drag from the significant property market downturn notable forces. The PBoC eased monetary policy further, with rates down 10-20bps in a further bid to support the real economy.

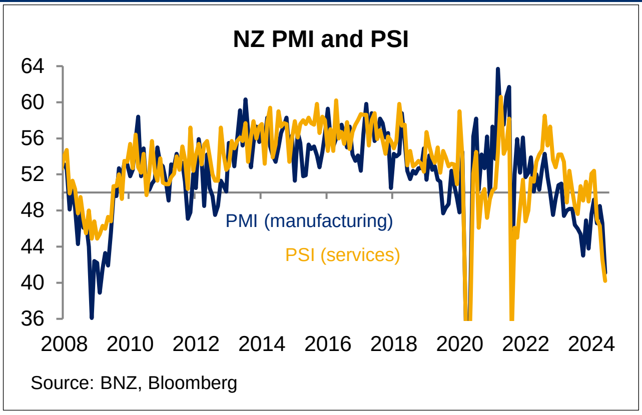
In currency markets the NZD was the weakest of the majors we closely follow, driven down by lower risk appetite, tumbling commodity prices, lower NZ-global rate spreads and an unwind of the yen-carry trade. Our risk appetite index fell to a nine-month low below 60%, largely reflecting a higher VIX index. It wasn't a classic risk off backdrop, with the MSCI World equity index modestly higher for the month and small cap stocks significantly outperforming large caps, supported by global monetary policy easing expectations.

The NZD traded a high of 0.6154 on 8 July in the trading session after the softer US employment report. The NZD showed a steady decline thereafter, with selling pressure intensifying in the second half of the month on global forces, before a modest recovery towards month-end. The NZD traded a three-month low of 0.5858 on 30 July and closed the month down 2.3% at 0.5950.

The NZD was weaker on all the key crosses, with modest losses against the AUD and CAD as commodity currencies underperformed in unison. NZD/AUD traded below 0.90 for the first time since October 2022, following a sharp narrowing of NZ-Australia rate spreads. A softer than expected Australian Q2 trimmed mean CPI print at the end of the month reduced the chance of the RBA delivering another rate hike this cycle, seeing some reversal of the cross rate and rate spreads, and the cross closed down only 0.4% at 0.9100.

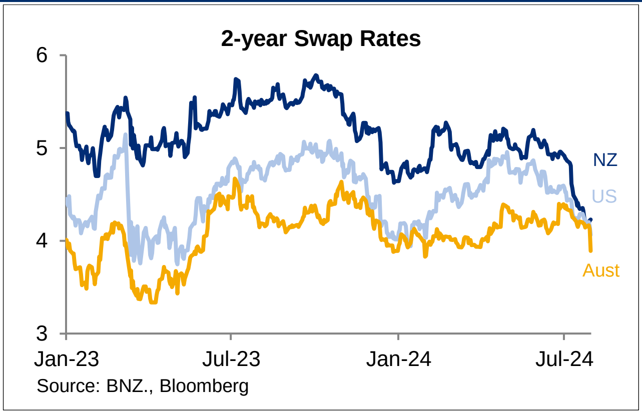
JPY was the strongest of the majors by far, recovering from 40-year lows, supported by weaker risk appetite, further official intervention to support the currency and anticipation of BoJ rate hikes, against the grain of other major central banks. On the last day of the month, the BoJ delivered a 15bps rate hike to 0.25% and outlined a plan to gradually reduce bond purchases. During the month, some short-yen speculative positions were shaken out, adding to yen strength and likely a factor in the weaker NZD as carry trades unwound. NZD/JPY peaked just over 99, before tumbling below 90, for a monthly fall of almost 9%.

NZ PMI/PSI probing GFC lows



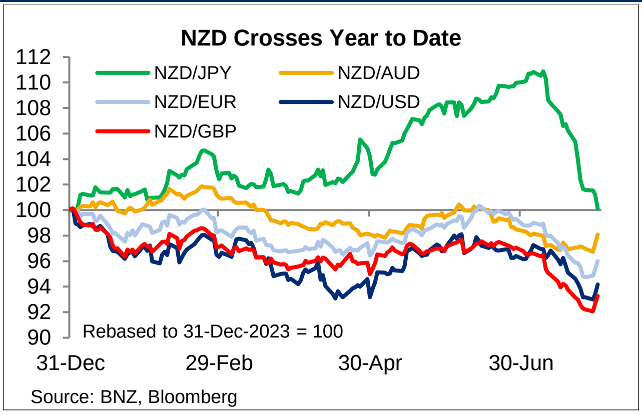
Source: BNZ, Bloomberg

NZ rate charging lower through July



Source: BNZ., Bloomberg

NZD now flat vs JPY year-to-date, down versus the others



Source: BNZ, Bloomberg

NZD/EUR and NZD/GBP fell between 3-4% for the month, with the former trading at the bottom of its annual range and the latter probing an eight-year low. The French election dealt a surprise result, with a sharp swing to the left compared to pre-election polling. With no party or coalition in a strong position to form a government, a period of political uncertainty overhung France, which the market didn't seem fussed about. There was little market impact from the ECB's decision to leave rates unchanged, as expected. ECB President Lagarde said the September meeting decision was 'wide open', while the market fully priced a 25bps cut at that meeting.

The UK election delivered a landslide majority to the Labour Party, as expected. Optimism that a new functioning government could lift UK's long-run growth rate and productivity supported GBP. While annual UK CPI inflation was steady at 2%, still-strong services CPI inflation of 5.7% y/y kept the market guessing about whether the BoE would deliver a first rate cut for the cycle on 1 August.

On US politics, during the month, some interpreted various market moves as driven by Trump's rising poll numbers – showing him to be a shoo-in winner – following President Biden's poor showing at the first debate in late June. There was significant pressure on Biden to step down from the race and he eventually obliged, replaced by VP Harris as the presumptive Democratic nominee. This induced a reversal in poll performance and by month-end the Presidential race was wide open again.

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Monthly Performance Table

	end-Jul	end-Jun	Change
Currencies			
NZD/USD	0.5951	0.6092	-2.3%
NZD/AUD	0.9096	0.9133	-0.4%
NZD/EUR	0.5495	0.5686	-3.4%
NZD/GBP	0.4629	0.4818	-3.9%
NZD/JPY	89.23	98.00	-8.9%
NZD/CNY	4.301	4.427	-2.9%
TWI	69.9	72.0	-2.9%
AUD/USD	0.6542	0.6670	-1.9%
EUR/USD	1.0827	1.0714	1.1%
GBP/USD	1.2855	1.2645	1.7%
USD/JPY	150.03	160.89	-6.8%
USD/CNY	7.23	7.27	-0.6%
USD/CAD	1.3807	1.3679	0.9%
USD DXY	104.10	105.87	-1.7%
Asia dollar index	90.72	90.20	0.6%
Equity Markets			
MSCI AC Wrld, loc.	2,271	2,243	1.2%
MSCI World, loc.	13,030	12,867	1.3%
MSCI EM, USD	2,854	2,844	0.4%
US S&P 500	5,522	5,460	1.1%
Euro STOXX 600	518.2	511.4	1.3%
Germany DAX	18,509	18,235	1.5%
France CAC 40	7,531	7,479	0.7%
UK FTSE 100	8,368	8,164	2.5%
Aust S&P/ASX 200	8,092	7,767	4.2%
Japan Topix	2,794	2,810	-0.5%
China CSI 300	3,442	3,462	-0.6%
NZX50	12,405	11,717	5.9%
Volatility: VIX	16.36	12.44	31.5%
3-mth Money Market Futures			
NZD Dec-24	95.17	94.69	0.48
AUD Dec-24	95.76	95.49	0.27
USD Dec-24	95.40	95.15	0.25
EUR Dec-24	96.89	96.70	0.19
GBP Dec-24	95.41	95.28	0.13
CAD Dec-24	96.15	95.76	0.39

	end-Jul	end-Jun	Change
NZ Rates			
OCR	5.50	5.50	0.00
NZ 90day BB	5.46	5.63	-0.18
NZ 2yr swap	4.23	4.96	-0.73
NZ 5yr swap	3.89	4.46	-0.57
NZ 10yr swap	4.07	4.50	-0.44
NZ Govt (5/26)	4.34	4.88	-0.54
NZ Govt (4/29)	4.03	4.52	-0.49
NZ Govt (5/34)	4.34	4.67	-0.33
NZ Govt (5/41)	4.73	4.95	-0.22
Global 10 year bond rates			
US	4.03	4.40	-0.37
Canada	3.16	3.50	-0.34
UK	3.97	4.17	-0.20
France	3.01	3.30	-0.29
Germany	2.30	2.50	-0.20
Italy	3.65	4.07	-0.42
Spain	3.11	3.42	-0.30
Portugal	2.92	3.24	-0.32
Ireland	2.69	2.94	-0.25
Japan	1.05	1.05	0.00
Australia	4.12	4.31	-0.19
Commodities (USD)			
WTI Crude	77.91	81.54	-4.5%
Brent Crude	80.72	86.41	-6.6%
R/B CRB Index	278.1	290.5	-4.3%
Gold spot	2,448	2,327	5.2%
Silver spot	29.01	29.14	-0.5%
Copper	417.7	439.1	-4.9%
Iron Ore	100.92	106.02	-4.8%
Thermal coal	140.10	133.45	5.0%
Corn	399.8	420.8	-5.0%
Wheat	527.3	573.5	-8.1%
SGX-NZX Dairy WMP	3,030	3,145	-3.7%
SGX-NZX Milk Price '24	7.87	7.87	0.0%

Source: BNZ, Bloomberg

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