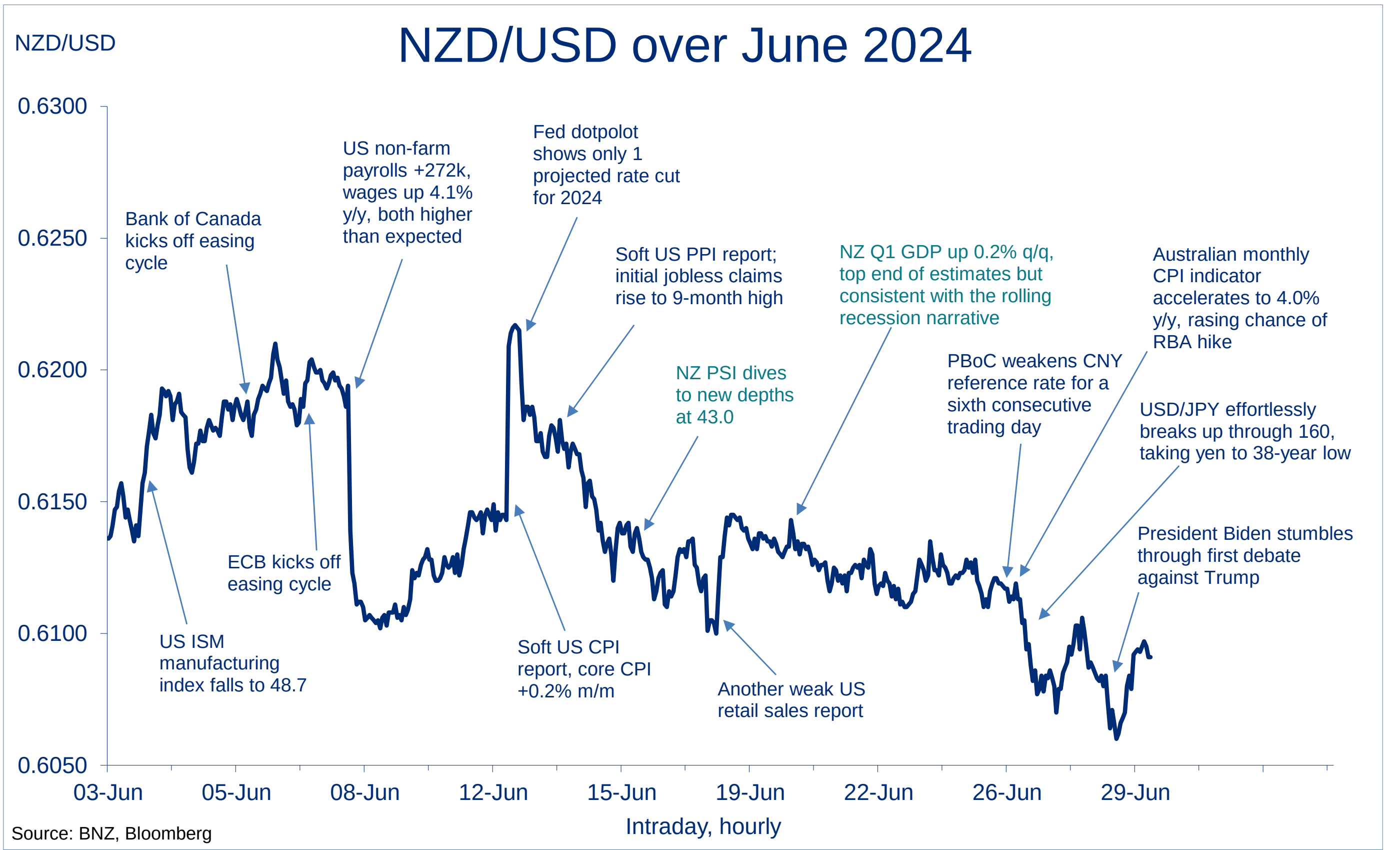
Research

Financial Markets Wrap

29 June 2024

NZD consolidates in June

- **After the strong performance in May, NZD/USD consolidated in a tight range in June, closing the month down less than 1%.**
- **NZD/AUD fell just over 1% after a weak run of NZ economic data and stronger than expected Australian inflation data.**
- **JPY was the worst performer, reflecting the BoJ's reluctance to tighten policy; NZD/JPY traded at its highest level since 1986.**

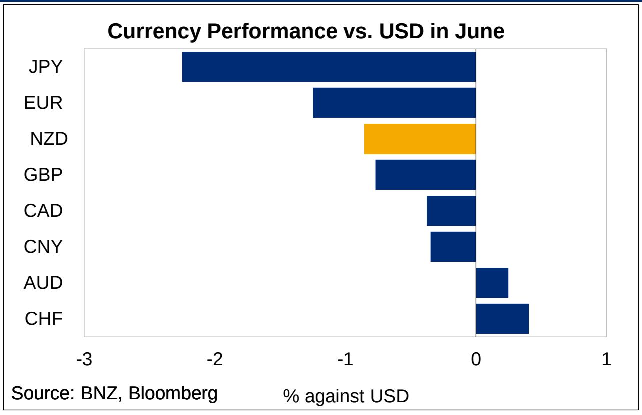


Source: BNZ, Bloomberg

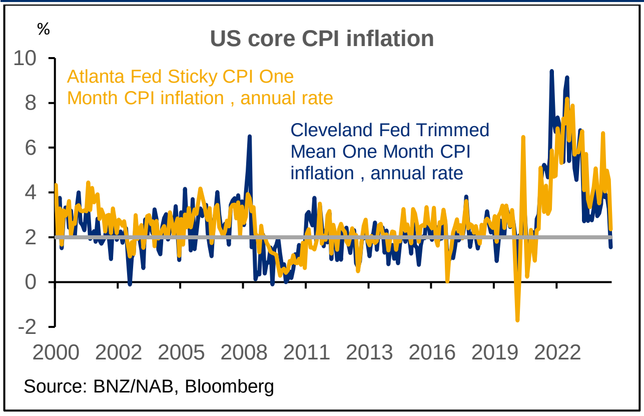
Quick Outlook		June ranges
NZD/USD	The NZD remains cheap on our fundamental model, but is apt to continue to consolidate before any further recovery. Fed Funds pricing remains a key driver of direction; market pricing of less than two full rate cuts this year provides room for further Kiwi upside.	0.6060 – 0.6220
NZD/AUD	Ultimately the cross should head lower, sub-0.90, based on NZ's much weaker growth trajectory compared to Australia. Both a hawkish pivot by the RBA and a dovish pivot from the RBNZ over coming months would support such a move.	0.9120 – 0.9315
NZD/GBP	The BoE still looks likely to be cutting rates ahead of the RBNZ but we don't have a strong directional bias and continue to see some consolidation in the cross in the high 0.40s. A decisive UK labour party victory in the upcoming general election should already be well-priced.	0.4795 – 0.4850
NZD/EUR	The ECB is likely to adopt a cautious stance towards any further easing. We don't have a strong directional bias and see some consolidation in the cross near current levels within its now-familiar range. French election is a key risk event for early July.	0.5645 – 0.5750
NZD/JPY	The BoJ remains overly dovish in our view, contributing to a very weak yen. Cross is subject to large swings as ongoing intervention risk overhangs the market. Ultimately we see the cross heading lower on a sustained basis but this requires the BoJ to action tighter policy.	95.3– 98.1

Market volatility was lower than usual during June, with most markets in a consolidation mode, with a notable exception being French assets after President Macron called a snap election. Spillover from this move was limited and global rates were mostly lower. Currency movements were modest and, after the strong 4+% recovery in May, NZD/USD fell less 1% to around 0.6090. NZD/AUD fell over 1% to 0.9130 after a weak run of NZ economic data and stronger than expected Australian inflation data.

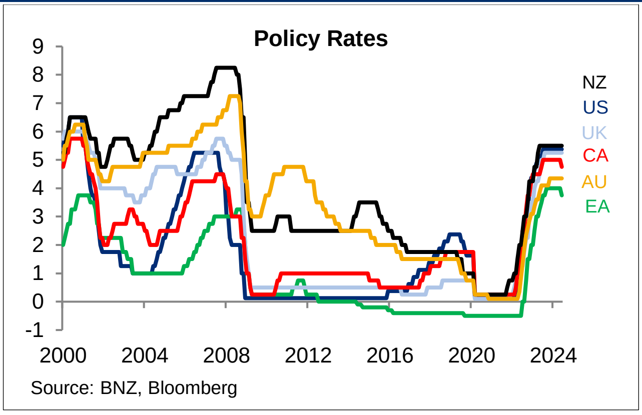
JPY and EUR the worst performers in June



US core inflation running close to annualised 2% in May



Easing cycle begins for some: ECB and BoC



There were a number of US data releases that negatively surprised, taking Citigroup's US economic surprise index down to its lowest level in almost two years. These included a weaker ISM manufacturing index, another soft retail sales report, and signs of a more decisive upward trend in jobless claims, consistent with other indicators pointing to a weaker labour market. Going against the grain, nonfarm payrolls rose a strong 272k in May, although the unemployment rate — which is derived from the alternative household survey — increased to 4%, the highest level in over two years. Also against the grain, the services ISM rebounded sharply to 53.8 in May, from 49.4 in April.

US inflation data were market-friendly, with the core CPI inflation rising 0.2% m/m, taking the annual increase down to a three-year low of 3.4%. Importantly, prior sticky measures of services inflation were weak. The core PE deflator rose just 0.1% m/m, the smallest increase since late 2020. The data suggested that after the surprising blip up in inflation in Q1, possibly caused by unaccounted for seasonal factors, disinflationary forces were back in charge.

The Fed left policy unchanged but the projections showed just one rate cut this year as committee members assumed no further progress in bringing inflation down this year and the unemployment rate steady at 4.0%. Based on those assumptions and the ongoing message of data dependency, there was evidently a low hurdle rate for more cuts to be delivered than projected.

By month-end, the market priced 44bps of rate cuts this year, so more than one but less than two full rate cuts, and US Treasury yields were lower across the curve. The 10-year rate closed the month down 10bps to 4.40% after meeting some resistance around 4.2%.

The global monetary policy easing cycle showed more vigour with both the Bank and Canada and ECB kick-starting the process with 25bps rate cuts, while the Swiss National Bank cut rates for a second time.

The Bank of Canada said it is “reasonable to expect further cuts” if inflation eases and that policy settings “no longer need to be as restrictive”. The ECB rate cut came despite inflation forecasts being revised up by 0.1-0.2% through 2024 and 2025 so inflation now isn't back to target until 2026. Regarding the policy outlook the Governing Council said it “will keep policy rates sufficiently restrictive for as long as necessary”, will be data dependent, and it is “not pre-committing to a particular path”. ECB President Lagarde was non-committal on the timing of the next rate cut.

The Bank of England left its policy rate unchanged, with the same 7-2 vote split as the previous meeting, with two officials again voting to cut rates by 25bps. However, the Bank opened the door for a near-term rate cut, saying that the decision not to ease at this meeting was “finely balanced” for some MPC members.

The European Parliamentary elections resulted in poor showings for the parties of French President Macron and German Chancellor Scholz. Macron surprised the market and called a snap election for the French Parliament. A European political risk premium was immediately built into

European asset prices, centred in France. However, premia were pared after Marine Le Pen's party, the likely beneficiary of the election, showed some moderation in policies and offered soothing words to the market by arguing they'd be fiscally responsible.

Domestically, the economic dataflow remained woeful, with indicators for May particularly weak, including retail spending falling, a fall in the manufacturing PMI to 47.2 (its fifteenth consecutive month in contractionary territory), weaker consumer confidence, lower house prices, plunging job ads and, perhaps the worst of the lot, the performance of services index slumping to 43.0, a record low excluding the COVID lockdown months. NZ GDP rose by 0.2% q/q in Q1, at the top end of market estimates and in line with the RBNZ's estimate. But on a per capita basis the economy has now contracted for six consecutive quarters, amounting to a cumulative retrenchment of 4.3%.

NZ rates fell broadly in line with other markets, with the 2-year swap rate down 14bps to 4.96% and the 10-year rate down 16bps to 4.50%. At month-end, the OIS market was pricing in 30bps of easing for this year, with the market ignoring the RBNZ's projection of rate cuts not occurring until late 2025.

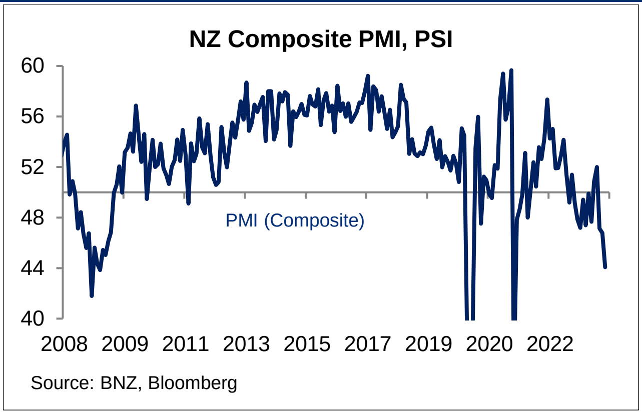
Currency movements were well contained for the month with only small net changes apart from a more than 2% fall in JPY against the USD. NZD/USD fell by less than 1% to around 0.6090, following the strong gain of more than 4% in May. The NZD traded in a tight range, with a high of 0.6222 reached on the 13th in the aftermath of the softer US CPI print and a low of 0.6058 was reached on the 28th in the wake of President Biden's poor performance in the first Presidential debate against Trump.

The AUD outperformed in June. The RBA left rates on hold but the tone of the statement and the press conference were more hawkish than expected, with Governor Bullock saying that a rate hike was discussed while a rate cut was not and recent data "reinforced the need to remain vigilant to the upside risks to inflation". Late in the month, the monthly CPI indicator came in two-tenths higher than consensus estimates, at 4.0%, with a strong underbelly. This raised the prospect of an August rate hike – going against the global trend – drove down NZ-Australian rate spreads, supported the AUD, and added to downside pressure on NZD/AUD. NZD/AUD ended the month down just over 1% to 0.9130.

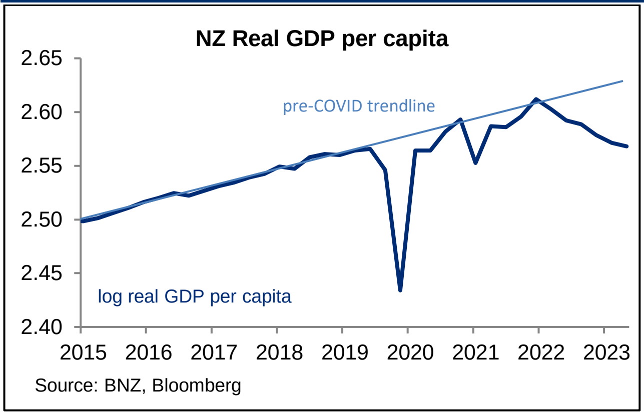
JPY was the worst performing major. The Bank of Japan kept its policy rate unchanged at 0.1% as was widely expected and suggested a plan to reduce its JGB purchases. However, the plan for reduced bond buying will be specified at its next meeting, and the timing came as a disappointment to the market. Japan's annual CPI inflation rate has been above the 2% target for 26 consecutive months and rose to 2.8% in May. The lack of intent to tighten policy in any meaningful way encouraged the market to drive down the value of the yen and USD/JPY effortlessly pushed up through 160, taking the yen to a fresh 38-year low, despite the backdrop of hollow threats by Japanese officials that they were prepared to intervene in the market if necessary. NZD/JPY continued to push higher and reached a fresh 38-year high just over 98 at month-end.

The PBoC left its key policy rate unchanged for a tenth successive month, continuing to be reluctant to ease monetary policy to avoid further pressure on the yuan. The array of monthly activity indicators showed slower industrial production against a small lift in retail sales and overall didn't give much confidence that China's economy was on a stronger economic path. The property market downturn remained a source of concern and Chinese house prices continued to fall in the over-supplied market.

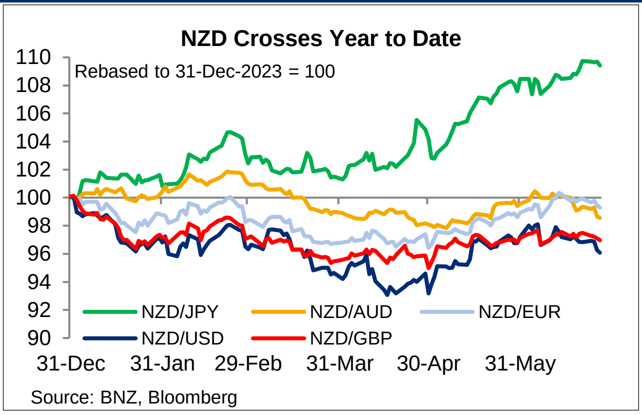
A disturbing lurch down in NZ PMI/PSI composite



NZ economy heading in wrong direction



NZD up vs. JPY year-to-date, down versus the others



The yuan fell to a fresh low for the year, with the PBoC allowing the USD/CNY reference rate to nudge higher. USD/CNY traded mostly near the upper 2% limit of its daily trading range, suggesting market pressure to take the yuan lower, but the PBoC was evidently tightly managing the process.

The euro was on the weak side of the ledger, reflecting the political risk premia built into European assets, centred in France, following President Macron's shock snap election announcement, although spillover was limited. NZD/EUR met some resistance at 0.5750 and closed the month modestly higher around 0.5685.

In the UK, the Labour party looked set for a decisive victory in the early-July general election, a result well-anticipated by the market and with seemingly little consequence for markets. There was some prevailing optimism that a new government could get on and govern and send the UK economy on a better trajectory. NZD/GBP traded in a tight range and was flat around 0.4820.

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Monthly Performance Table

	end-Jun	end-May	Change		end-Jun	end-May	Change
Currencies				**NZ Rates**			
NZD/USD	0.6092	0.6144	-0.9%	OCR	5.50	5.50	0.00
NZD/AUD	0.9133	0.9234	-1.1%	NZ 90day BB	5.63	5.63	0.00
NZD/EUR	0.5686	0.5663	0.4%	NZ 2yr swap	4.96	5.10	-0.14
NZD/GBP	0.4818	0.4822	-0.1%	NZ 5yr swap	4.46	4.62	-0.16
NZD/JPY	98.00	96.61	1.4%	NZ 10yr swap	4.50	4.66	-0.16
NZD/CNY	4.427	4.438	-0.2%				
TWI	72.0	72.4	-0.5%	NZ Govt (5/26)	4.88	4.91	-0.03
AUD/USD	0.6670	0.6654	0.2%	NZ Govt (4/29)	4.52	4.65	-0.13
EUR/USD	1.0714	1.0849	-1.2%	NZ Govt (5/34)	4.67	4.82	-0.15
GBP/USD	1.2645	1.2743	-0.8%	NZ Govt (5/41)	4.95	5.05	-0.09
USD/JPY	160.89	157.27	2.3%				
USD/CNY	7.27	7.24	0.3%	**Global 10 year bond rates**			
USD/CAD	1.3679	1.3627	0.4%	US	4.40	4.50	-0.10
USD DXY	105.87	104.67	1.1%	Canada	3.50	3.63	-0.13
Asia dollar index	90.20	90.31	-0.1%	UK	4.17	4.32	-0.15
				France	3.30	3.14	0.16
Equity Markets				Germany	2.50	2.66	-0.17
MSCI AC Wrld, loc.	2,243	2,188	2.6%	Italy	4.07	3.98	0.10
MSCI World, loc.	12,867	12,571	2.4%	Spain	3.42	3.39	0.03
MSCI EM, USD	2,844	2,734	4.0%	Portugal	3.24	3.25	-0.02
US S&P 500	5,460	5,278	3.5%	Ireland	2.94	3.03	-0.09
Euro STOXX 600	511.4	518.2	-1.3%	Japan	1.05	1.06	-0.02
Germany DAX	18,235	18,498	-1.4%	Australia	4.31	4.41	-0.10
France CAC 40	7,479	7,993	-6.4%				
UK FTSE 100	8,164	8,275	-1.3%	**Commodities (USD)**			
Aust S&P/ASX 200	7,767	7,702	0.9%	WTI Crude	81.54	76.99	5.9%
Japan Topix	2,810	2,772	1.3%	Brent Crude	86.41	81.62	5.9%
China CSI 300	3,462	3,580	-3.3%	R/B CRB Index	290.5	290.2	0.1%
NZX50	11,717	11,867	-1.3%	Gold spot	2,327	2,327	0.0%
Volatility: VIX	12.44	12.92	-3.7%	Silver spot	29.14	30.41	-4.2%
				Copper	439.1	460.2	-4.6%
3-mth Money Market Futures				Iron Ore	106.83	118.20	-9.6%
NZD Dec-24	94.69	94.58	0.11	Thermal coal	133.45	142.40	-6.3%
AUD Dec-24	95.49	95.59	-0.10	Corn	420.8	467.0	-9.9%
USD Dec-24	95.15	95.03	0.11	Wheat	573.5	699.5	-18.0%
EUR Dec-24	96.70	96.60	0.10	SGX-NZX Dairy WMP	3,145	3,285	-4.3%
GBP Dec-24	95.28	95.16	0.12	SGX-NZX Milk Price '24	7.87	7.85	0.3%
CAD Dec-24	95.76	95.65	0.10				

Source: BNZ, Bloomberg

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