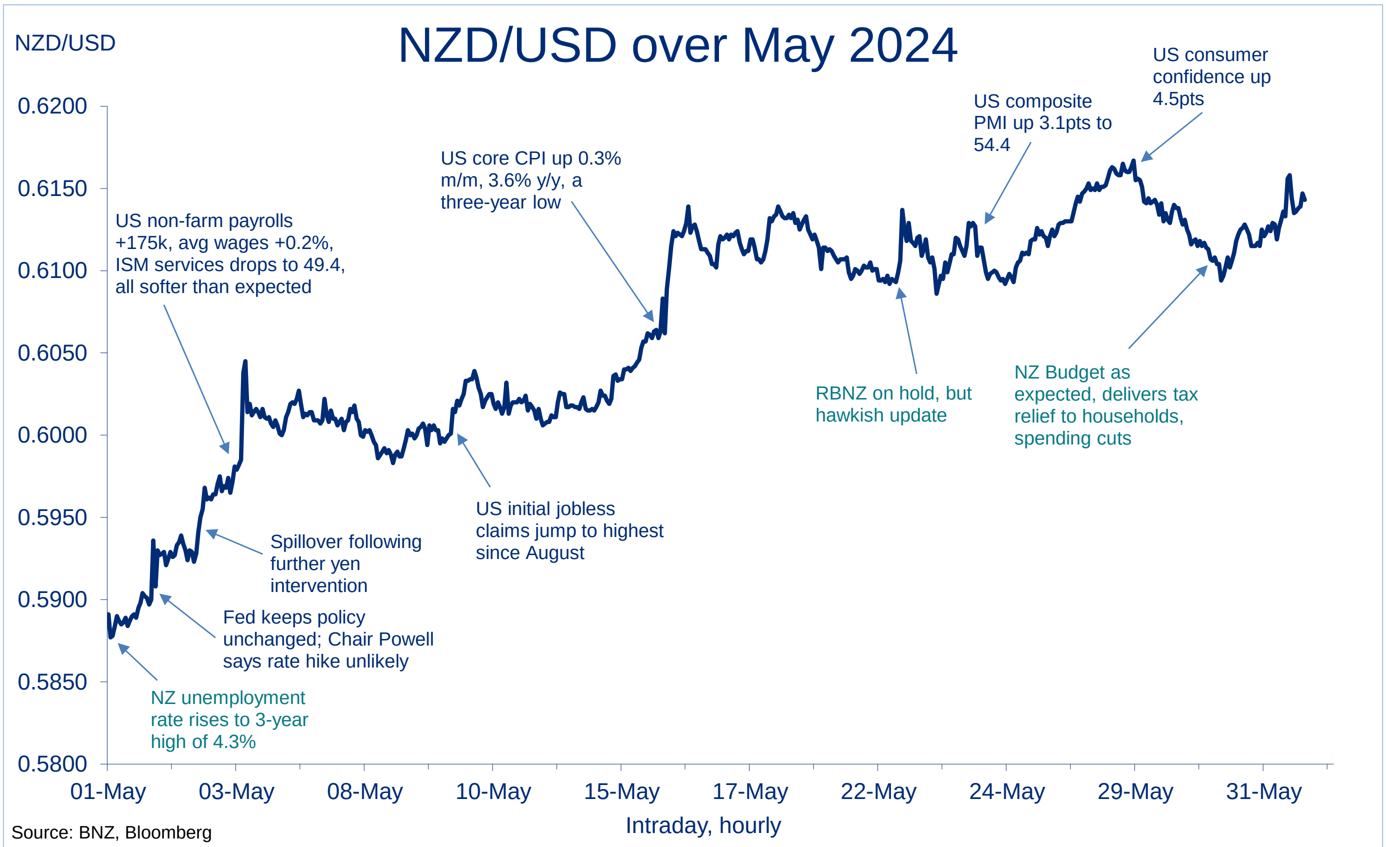
Research
Financial Markets Wrap

4 June 2024

Kiwi flies through May

- **After a poor run through the first four months of the year, NZD/USD bounced back strongly in May, up 4½%.**
- **A broadly weak USD, higher risk appetite, higher commodity prices and a more hawkish than expected RBNZ were factors.**
- **The NZD's outperformance saw it higher on all the key crosses, including reaching a 17-year high against the beleaguered yen.**



Source: BNZ, Bloomberg

Quick Outlook		May ranges
NZD/USD	Despite the strong bounce-back the NZD remains very cheap on our fundamental model, but apt to consolidate before any further recovery. Fed Funds pricing remains a key driver of direction; market pricing of only modest Fed rate cuts provides room for further Kiwi upside.	0.5875 – 0.6170
NZD/AUD	The hawkish RBNZ has reduced any near-term scope for the cross to go sub-0.90, but ultimately that remains the play on divergent macro forces, with NZ's much weaker economy versus Australia. For now, can consolidate around current level.	0.9065 – 0.9255
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.	0.4705 – 0.4835
NZD/EUR	The ECB will kick off its easing cycle in June, but this is already well anticipated. We don't have a strong directional bias and see some consolidation in the cross near current levels within its now-familiar range.	0.5510 – 0.5675
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.	90.8– 96.7

After a poor run through the first four months of the year, the NZD bounced back strongly in May, up 4½%. Supporting the move was broad-based USD weakness, higher risk appetite, higher commodity prices and a more hawkish than expected RBNZ. US economic data were mixed but overall supportive of a soft-landing narrative, alongside better-behaved inflation indicators. Global equity markets were strong, rising to fresh record highs.

Early in the month, the Fed kept policy steady and noted "there has been a lack of further progress toward the Committee's 2 percent inflation objective." But Chair Powell was keen to hose down views that the Fed could tighten again this cycle, given policy was already seen to be restrictive enough, and seemed much happier to convey the message that the next move would be a cut, but that depended on receiving some more inflation-friendly data.

US economic data releases were mixed. Through most of the month, economic activity data negatively surprised, driving Citigroup's US economic surprise index down to a 16-month low. These releases included a softer non-farm payrolls print seeing a lift in the unemployment rate to 3.9%, weaker ISM manufacturing and services indices, the latter unexpectedly falling into contractionary territory for the first time since December 2022, and weaker retail sales. Later in the month, the composite PMI index rose to highest level since April 2022, and the Conference Board measure of consumer confidence unexpectedly bounced-back.

Inflation indicators were better behaved. Core CPI inflation, which had surprised to the upside for three consecutive months, was in line with expectations at 0.3% m/m, taking the annual increase down to a three-year low of 3.6%. Average hourly earnings fell to 3.9%, the lowest in nearly three years. Overall, US data releases supported the soft-landing narrative with moderating inflation pressures.

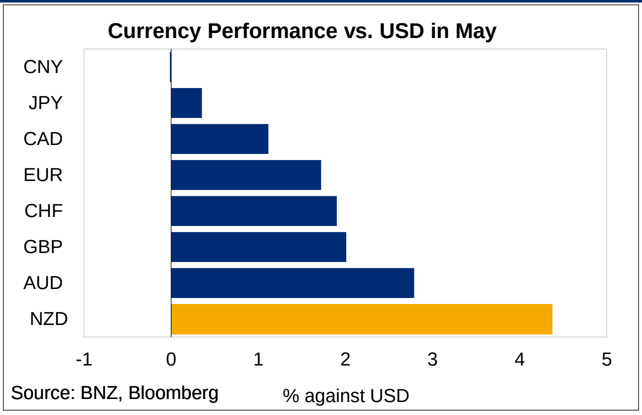
US Treasury yields fell in the first half of the month, with the 10-year rate hitting a low around 4.3%, before reversing course in the second half, with a net fall of 18bps to 4.50% for the month.

In NZ, key labour market data were in line with expectations, with the unemployment rate rising to a three-year high of 4.3% and the labour cost index rising by 0.8% q/q, taking the annual increase to an 18-month low of 3.8%. The message was one of a clear easing in labour market pressures, driving weaker wage inflation. The performance of services index fell to a more than two-year low of 47.1 and, when combined with the manufacturing index remaining in contractionary territory, suggested real GDP growth remained very weak. Real retail sales were stronger than expected, but the 0.5% q/q gain in Q1 followed eight consecutive quarterly contractions.

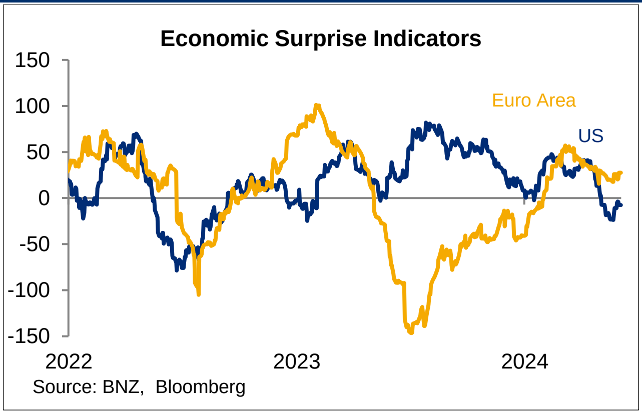
In its Monetary Policy Statement, the RBNZ left the official cash rate steady at 5.5% but the Bank strengthened its hawkish bias and considered whether to hike the OCR further. The Bank put more emphasis on the sticky domestic inflation pressures than the economic recessionary conditions. The projected OCR track was lifted, with the implication that the next move was more likely to be a rate hike than a cut. This tone surprised the market, which was looking for hints on the timing of the first easing,

Market expectations for RBNZ easing this year were re-priced, with the first full rate cut pushed out to February next year at month-end. Against a backdrop of lower US and Australian short-term rates, NZ's 2-year swap rate closed the month little changed at 5.10%. The curve flattened, with 10-year swap down 11bps to 4.66%.

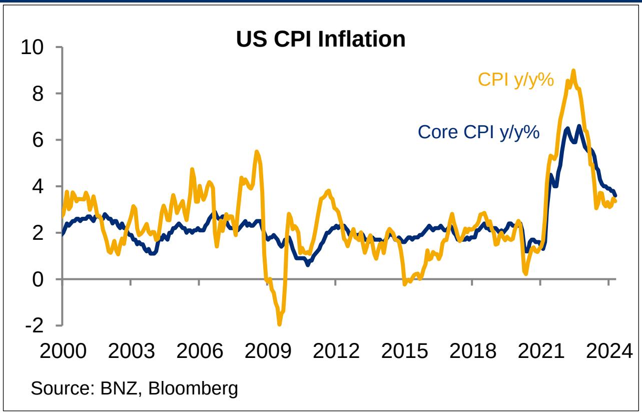
USD broadly weaker in May; NZD outperforms



US eco surprise index falls to 16-month low before turning



US core CPI inflation continues to moderate



The NZ Budget didn't move the market although the RBNZ will likely see the fiscal impulse as greater than assumed, given the as-expected tax cuts were yet to be incorporated into its forecasts. The deterioration in the fiscal accounts saw a $12b lift in the domestic bond issuance programme over the next four years.

In currency markets there were both domestic and global drivers for the NZD. Higher risk appetite contributed to broad USD weakness and NZD strength, with our risk appetite index rising to a historically high level of 85% before easing. While oil prices were lower for the month, global commodity prices were generally stronger, including record highs for copper prices. Dairy prices continued to trend higher, with the GDT price index up almost 35% from the August low.

The NZD was the strongest of the key majors, trending higher through the month after falling through the first four months of the year. NZD/USD rose around 4½% to 0.6145. The low of 0.5875 was on the 1st day of the month after labour market data showed a contraction in employment and the unemployment rate rose to a three-year high. The high of 0.6170 was reached on 28 May. Much of the gain was ahead of the hawkish RBNZ update, although the NZD pushed a little higher post the meeting.

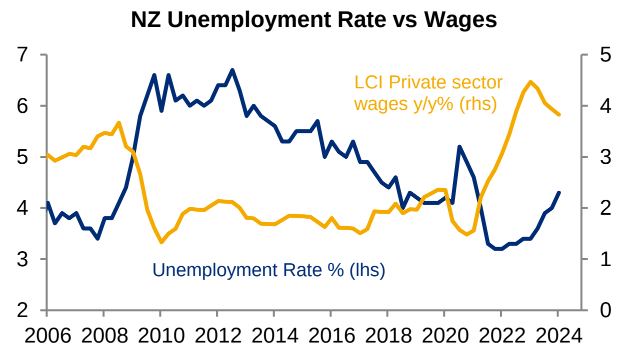
NZD/AUD trended higher for the month, to rise 1½% to 0.9235, with higher NZ-Australian rate differentials contributing. The RBA kept it policy rate unchanged at 4.35% but the tone of the statement was less hawkish than widely anticipated, keeping the previous language of "not ruling anything in or out" regarding the policy outlook. The Bank did not take much signal from the upside surprise to Q1 CPI inflation, but Governor Bullock said it needed to be "alert and vigilant" on inflation, while adding she "believes we have rates at the right level". Australian labour market data showed the unemployment rate rising to 4.1%, two-tenths higher than consensus, hot on the heels of weaker than expected wage inflation data.

NZD/JPY rose over 4% to 96.6, trading at its highest level in 17-years. Early in the month, Japan's MoF intervened in the currency market to support the yen for a second time (after intervention in late-April). At the end of the month, data showed intervention from late April amounted to USD62b. The yen was one of the weakest majors despite the intervention, and JGB yields rising to their highest levels in over a decade across the curve, alongside higher JGB-global rate spreads. While BoJ commentary was consistent with more tightening in policy this year, the market was unimpressed by the overly cautious attitude to raising rates whilst inflation remained above target.

NZD/EUR rose over 2½% to 0.5660. Euro area PMI data showed further gains, consistent with a modest recovery in the region, while Q1 GDP rose by 0.3% q/q. ECB speakers continued to run the line that the easing cycle could be kicked off in June, with a 25bps rate cut, which became fully priced by the market.

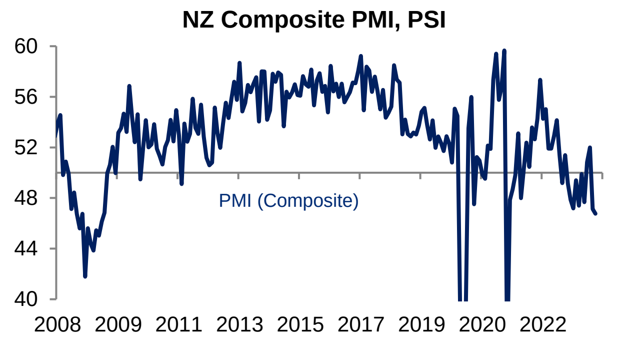
NZD/GBP rose over 2% to 0.4820. The BoE left its policy rate unchanged but signalled that rate cuts were coming. The MPC voted 7-2, with two members prepared to ease policy immediately. At the press conference, Governor Bailey said a June rate cut was neither "ruled out" or a "fait accompli", adding "It's likely that we will need to cut bank rates over the coming quarters… possibly more so than currently priced into market rates." Expectations for near-term rate cuts faded after UK inflation declined less than expected in April, with services sector inflation remaining far too high at 5.9% y/y. The UK economy exited the technical recession from the second half of 2023, with real GDP expanding by a much stronger than expected 0.6% in Q1.

NZ labour market pressures easing



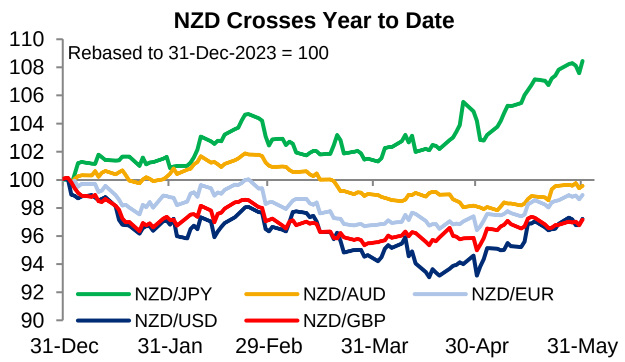
Source: BNZ, Bloomberg

NZ PMI, PSI composite points to NZ economy contracting



Source: BNZ, Bloomberg

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



Source: BNZ, Bloomberg

USD/CNY was flat at 7.24 as the PBoC continued to actively manage the yuan, and consistently set the daily CNY reference rate at a strong premium to the market rates. Monthly activity data in China revealed the economy was not rebounding quickly. Although industrial production was stronger relative to expectations, consumption remained soft. The government made further considerable policy measures to support the beleaguered property market. Included in the measures was central bank funding to assist the purchase of excess inventory from developers which would be converted into affordable housing. NZD/CNY rose over 4% for the month.

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Monthly Performance Table

	end-May	end-Apr	Change		end-May	end-Apr	Change
Currencies				**NZ Rates**			
NZD/USD	0.6144	0.5887	4.4%	OCR	5.50	5.50	0.00
NZD/AUD	0.9234	0.9094	1.5%	NZ 90day BB	5.63	5.63	0.00
NZD/EUR	0.5663	0.5519	2.6%	NZ 2yr swap	5.10	5.11	-0.01
NZD/GBP	0.4822	0.4712	2.3%	NZ 5yr swap	4.62	4.69	-0.08
NZD/JPY	96.61	92.83	4.1%	NZ 10yr swap	4.66	4.77	-0.11
NZD/CNY	4.438	4.264	4.1%				
TWI	72.4	70.0	3.4%	NZ Govt (5/26)	4.91	4.92	-0.01
AUD/USD	0.6654	0.6473	2.8%	NZ Govt (4/29)	4.65	4.72	-0.07
EUR/USD	1.0849	1.0666	1.7%	NZ Govt (5/34)	4.82	4.90	-0.08
GBP/USD	1.2743	1.2492	2.0%	NZ Govt (5/41)	5.05	5.16	-0.12
USD/JPY	157.27	157.82	-0.4%				
USD/CNY	7.24	7.24	0.0%	**Global 10 year bond rates**			
USD/CAD	1.3627	1.3779	-1.1%	US	4.50	4.68	-0.18
USD DXY	104.67	106.22	-1.5%	Canada	3.63	3.82	-0.19
Asia dollar index	90.31	90.18	0.1%	UK	4.32	4.35	-0.03
				France	3.14	3.05	0.08
Equity Markets				Germany	2.66	2.58	0.08
MSCI AC Wrld, loc.	2,188	2,108	3.8%	Italy	3.98	3.92	0.06
MSCI World, loc.	12,571	12,072	4.1%	Spain	3.39	3.35	0.04
MSCI EM, USD	2,734	2,718	0.6%	Portugal	3.25	3.20	0.05
US S&P 500	5,278	5,036	4.8%	Ireland	3.03	2.96	0.08
Euro STOXX 600	518.2	504.9	2.6%	Japan	1.06	0.87	0.19
Germany DAX	18,498	17,932	3.2%	Australia	4.41	4.42	-0.01
France CAC 40	7,993	7,985	0.1%				
UK FTSE 100	8,275	8,144	1.6%	**Commodities (USD)**			
Aust S&P/ASX 200	7,702	7,664	0.5%	WTI Crude	76.99	81.93	-6.0%
Japan Topix	2,772	2,743	1.1%	Brent Crude	81.62	87.86	-7.1%
China CSI 300	3,580	3,604	-0.7%	R/B CRB Index	290.2	291.5	-0.4%
NZX50	11,867	11,958	-0.8%	Gold spot	2,327	2,286	1.8%
Volatility: VIX	12.92	15.65	-17.4%	Silver spot	30.41	26.29	15.6%
				Copper	460.2	456.5	0.8%
3-mth Money Market Futures				Iron Ore	118.58	116.83	1.5%
NZD Dec-24	94.58	94.68	-0.10	Thermal coal	142.40	142.25	0.1%
AUD Dec-24	95.59	95.56	0.03	Corn	446.3	446.8	-0.1%
USD Dec-24	95.03	94.94	0.09	Wheat	678.5	603.3	12.5%
EUR Dec-24	96.60	96.68	-0.08	SGX-NZX Dairy WMP	3,285	3,125	5.1%
GBP Dec-24	95.16	95.22	-0.06	SGX-NZX Milk Price '24	7.85	7.84	0.1%
CAD Dec-24	95.65	95.54	0.12				

Source: BNZ, Bloomberg

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