NZD falls against a strong USD in July

- The USD made broadly based gains in July, reversing losses in June, seeing NZD/USD down 2½%
- Against a backdrop of higher US Treasury rates, NZ and Australian rates fell to record lows
- GBP under pressure with Boris Johnson now in charge

### Quick Outlook

<table>
<thead>
<tr>
<th>Currency Pairs</th>
<th>July ranges</th>
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</thead>
<tbody>
<tr>
<td>NZD/USD</td>
<td>0.6545 – 0.6790</td>
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<tr>
<td>NZD/AUD</td>
<td>0.9485 – 0.9630</td>
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<tr>
<td>NZD/GBP</td>
<td>0.5270 – 0.5470</td>
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<tr>
<td>NZD/EUR</td>
<td>0.5880 – 0.6050</td>
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<tr>
<td>NZD/JPY</td>
<td>71.3 – 73.2</td>
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</table>
The USD showed broadly based strength in July, with stronger than expected data seeing some easing priced out of the curve and driving US Treasury rates flat-to-higher, while the market moved to price in greater easing elsewhere, given relatively softer data and policy signals. NZD/USD ended the month down 2½%, with the TWI down just over 1%, given better performance on the crosses. NZ rates fell to fresh record lows.

The NZD started the month on a softer note, as the afterglow from the trade war ceasefire agreed by Presidents Trump and Xi at the end of June quickly wore off. Throughout the month there was little progress in trade talks.

Some key US data releases were stronger than expected, including non-farm payrolls, retail sales and CPI readings for June. The Fed had plenty of opportunity to push back on the idea of kicking off a policy easing cycle, but Chair Powell remained dovish in his testimony to lawmakers and in a later speech in Paris. The underlying message seemed to be that the Fed wasn’t data dependent and was alert to the risks around trade tensions and concerns about the strength of the global economy, with weakness weighing on the US economic outlook.

Dovish speeches and comments by other key FOMC members supported the likelihood of rate cuts, and the debate shifted to “insurance cuts” or the beginning of a prolonged easing cycle? Close to month-end, the Fed cut rates for the first time in a decade, by 25bps, taking the Fed Funds target range to 2-2.25%, with Chair Powell characterising the move as a mid-cycle easing. The stronger data and slightly less dovish Fed than expected, led the market to price out some of the aggressive easing that had been built into the rates curve. The 2-year Treasury rate ended the month 12bps higher, while the 10-year rate was “only” 1bp higher at 2.02%, the latter having traded down to a 2½%-year low of 1.94% early in the month.

Higher US rates went against the grain of mainly lower rates elsewhere. Euro-area activity data remained soggy, with Germany’s IFO gauge of business expectations falling to its lowest level since the GFC in 2009, following PMI manufacturing data falling to fresh lows. The ECB kept policy unchanged but provided a clear signal of a likely rate cut at its next meeting in September along with potentially new asset purchases. Adding to downside pressure on euro-area rates, was Christine Lagarde’s appointment to be the next ECB President, seen by markets as cementing Draghi’s activist and dovish monetary policy approach for the coming years. Sharp falls in Italian yields followed news that the populist government had agreed to make changes to its budget to comply with the EU’s rules.

Lower Australian rates had an influential impact on dragging down NZ rates to record lows. The RBA cut its cash rate by 25bps to 1% and said that it could adjust monetary policy further “if needed.” In a later speech, Governor Lowe said that “it is reasonable to expect an extended period of low interest rates”.

Financial Markets Wrap

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The market moved to price in a more protracted easing cycle in Australia and NZ, with terminal cash rates of just above 0.5% and 0.9% priced in by month-end, respectively. NZ rates fell to fresh record lows across the curve, with 5-10 swap rates down in the order of 14bps. NZ’s 10-year government rate fell by 14bps to 1.44%.

NZ economic data didn’t look like getting in the way of further policy easing, with a composite of the PMI and PSI suggesting GDP growth falling to around a 1% annual rate and soggy QSO and ANZ business outlook survey activity indicators. NZ annual CPI inflation picked up to 1.7% y/y, in line with market and RBNZ expectations, while the RBNZ’s core CPI measure based on its sectoral factor model remained steady at 1.7% and unchanged over the past 12 months.

In currency markets, higher US-global rate spreads saw USD indices appreciate towards the top end of their trading ranges this year. The DXY reached a fresh year-to-date high and the currency rose by 2% on a TWI (majors) basis.

The NZD spent most of the month largely confined to a 0.66-0.68 range, but fell on the last day of the month following the Fed’s announcement, reaching a low of 0.6543. Earlier in the month the NZD experienced a mini ‘flash crash’, dropping 0.5% in a matter of seconds in what appeared to be a liquidity vacuum on 10 July. There wasn’t any obvious catalyst for the move and it was quickly reversed.

The NZD also came under pressure after Bloomberg reported a response by the RBNZ to an OIA request for work on non-standard policy measures. The RBNZ reported that “This year the Reserve Bank has begun scoping a project to refresh our unconventional monetary policy strategy and implementation. This is at a very early stage”. After this announcement, the NZD weakened through to month-end, although that period coincided with USD strength and AUD weakness.

NZD/AUD ended the month relatively flat at 0.9580, with Australian and NZ rate falls during the month more or less matching each other. GBP was the weakest of the majors reflecting rising risk of a no-deal Brexit and an early general election, creating added uncertainty about the outlook for the UK. Boris Johnson won the race to be the new Conservative leader and therefore became the new UK Prime Minister. He loaded his Cabinet with Brexit hardliners and appeared determined to proceed with Brexit, deal or no-deal. GBP/USD fell by over 4%, while NZD/GBP rose by 2% to close the month just under 0.54.

There was limited spillover risk of a weaker GBP into EUR, with the market more concerned with prospects for an early UK election, which looked more likely, than a no-deal Brexit. Still, weak data, the prospect of more QE and a generally stronger USD saw EUR/USD down to its lowest level in more than two years of 1.1060. NZD/EUR ended the month barely higher at 0.5920.
JPY, CAD and CNY fell least against the USD, seeing NZD crosses against these currencies down 1½-2%. CNY proved to be remarkably stable, supported by the Xi- Trump détente at the end of June, even if no further progress was made on trade negotiations and Trump maintained his hostile rhetoric towards China via twitter.

Global equity markets were generally stronger in July, with the euro-area dragging the chain. US equities were supported by an earnings season that was running slightly better than expected. Our risk appetite index opened and closed the month at 57%, with a higher VIX index offset by narrower credit spreads. NZ equities continued to outperform, with the NZX50 Index rising by 3½% (up 23% YTD), with lower bond yields supporting valuations and the largest listed company, A2 Milk, continuing its storming run.

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