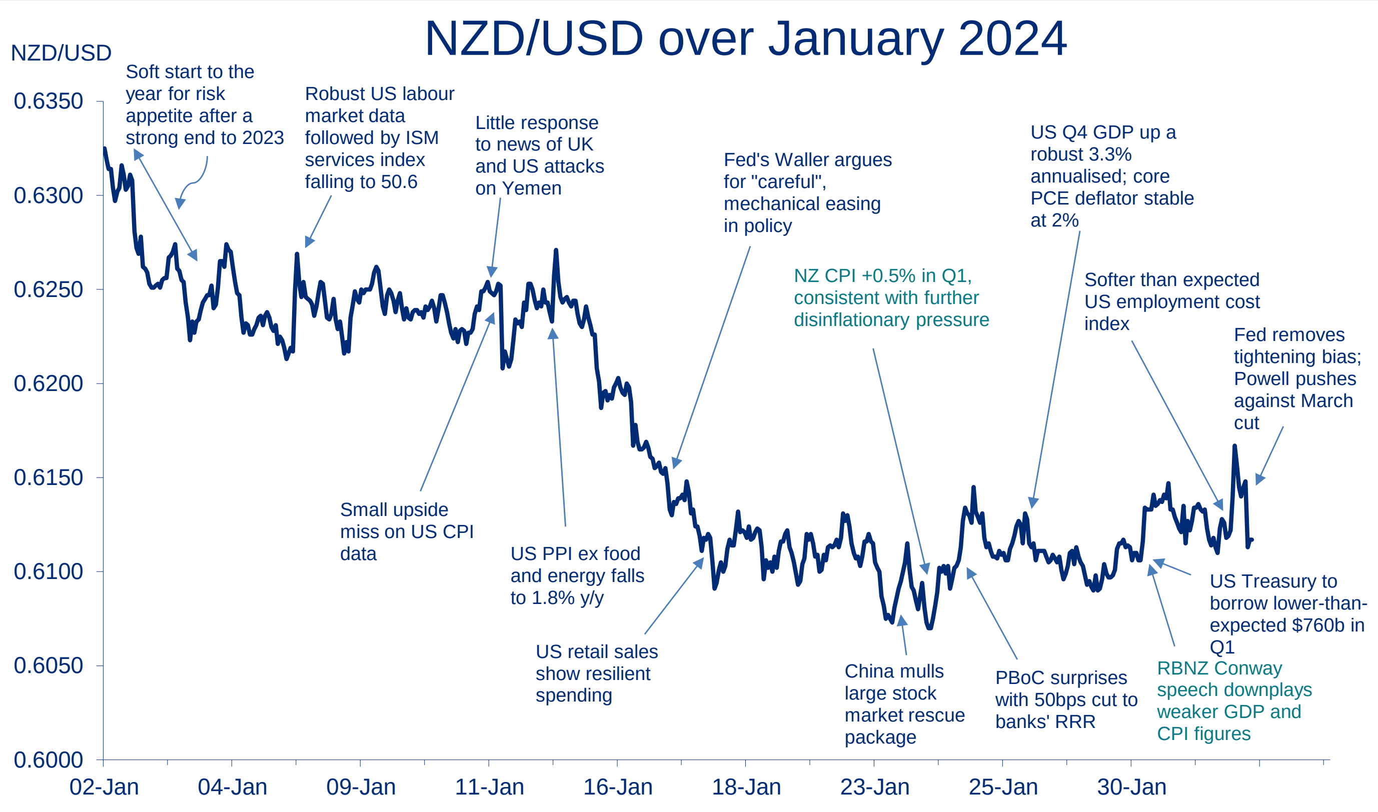
Research

Financial Markets Wrap

1 February 2024

A pullback in the NZD after late-2023 exuberance

- **NZD/USD fell over 3% in January, retracing some of the 8½% rally through November-December**
- **Broad USD strength, retracing some late-2023 weakness; US economic resilience and some paring of Fed cut expectations**
- **Global equities power up to fresh record highs; global rates push higher retracing late-2023 moves**



Source: BNZ, Bloomberg

Quick Outlook		January ranges
NZD/USD	In a consolidation phase within a broad range of 0.60-0.64 until the next downward leg in the USD commences. Despite a number of ongoing headwinds, we have a constructive outlook for much of this year, but heavily reliant on the USD weakening as the Fed easing cycle kicks off.	0.6065 – 0.6325
NZD/AUD	Still range-bound but we see skewed risks to the downside, based on NZ’s poor economic performance relative to Australia ultimately triggering a weaker cross, as rates ultimately converge.	0.9230 - 0.9355
NZD/GBP	Both UK and NZ economic outlooks are sluggish and the market sees similar scope and scale of rate cuts in 2024. We don’t have a strong directional bias and see some consolidation in the cross in the high 0.40s.	0.4775 - 0.4980
NZD/EUR	Both euro area and NZ economic outlooks are sluggish. We don’t have a strong directional bias and see some consolidation in the cross near current levels in the high 0.50s.	0.5575 – 0.5745
NZD/JPY	BoJ policy stance continues to hinder yen performance, but we could be within months of a hawkish pivot, against the grain of other central banks. Cross remains vulnerable to significant downside pressure over the medium-term. Timing remains uncertain.	88.6 – 91.0

The new year kicked off with global rates pushing higher and a recovery in the USD, reflecting a reversal from some of the extreme price action seen late last year. Higher rates didn't perturb equity market investors, with the MSCI World Index rising to fresh record highs. The NZD joined the AUD and JPY near the bottom of the currency leaderboard.

US economic data remained consistent with the Goldilocks theme of growth not too hot or cold and the Fed achieving the coveted soft-landing (so far), as it succeeds in meeting its inflation target. GDP rose a robust 3.3% in Q4 on an annualised basis, with the core PCE deflator running very close to the target rate of 2% for the past six months. Key US activity releases printed stronger than expected, spanning retail sales, consumer sentiment, housing market indicators and most labour market indicators.

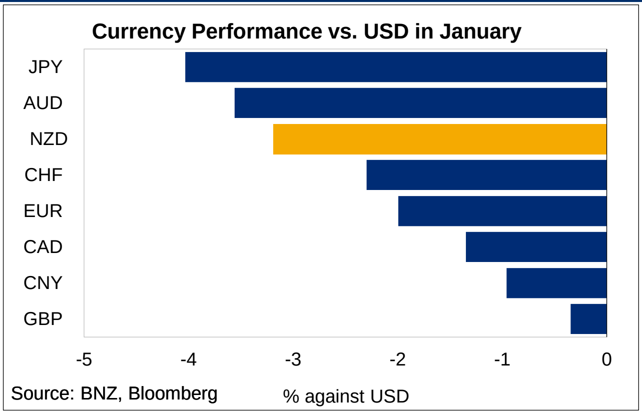
Debate raged on whether the US Fed would be more focused on the increasingly benign inflation backdrop or the economic resilience. As it turned out the market took rates higher, although in the context of sharp declines through late 2023. By month-end the market had priced in around 145bps of rate cuts for 2024, a paring of rate-cut expectations worth 158bps as at the end of last year. Respected Fed Governor Waller suggested "when the time is right to begin lowering rates, I believe it can and should be lowered mechanically and carefully.

On the last day of the month, the Fed removed any remnants of its tightening policy at the first FOMC meeting for the year, with the committee looking for greater confidence that inflation is moving sustainably toward 2% before cutting rates. Chair Powell said he didn't think it was likely the Fed will be cutting as soon as March, although the central bank remains data dependent.

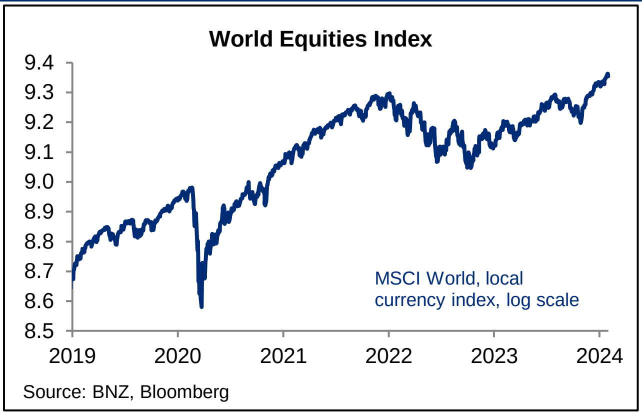
Over the course of the month the US Treasuries curve steepened, with the 2-year rate down 4bps to 4.21% and the 10-year rate up 3bps to 3.91%, from a high of 4.2%, helped by a significant rally in the days leading up to month-end.

Euro area economic data largely continued to underwhelm. Contrasting with US economic strength in 2023, Germany GDP contracted 0.3% q/q and fell 0.2% y/y in Q4, consistent with economic recession conditions. Germany was a drag on euro area GDP growth, which showed a 0.1% q/q contraction in Q4 and growth of just 0.1% for the year. At the ECB policy meeting, President Lagarde stood by her comments in Davos that the ECB would likely be cutting rates in the summer, but she didn't offer significant pushback to the market's view that rate cuts could come earlier. She noted downside risks to growth, projections for lower inflation, and that wage pressures have started to ease. In post meeting commentary, some Governing Council members wouldn't rule out cutting rates soon, with the French central bank governor saying not one meeting is excluded, "everything will be open at our next meetings". By month-end a full 25bps rate cut was priced by the April meeting.

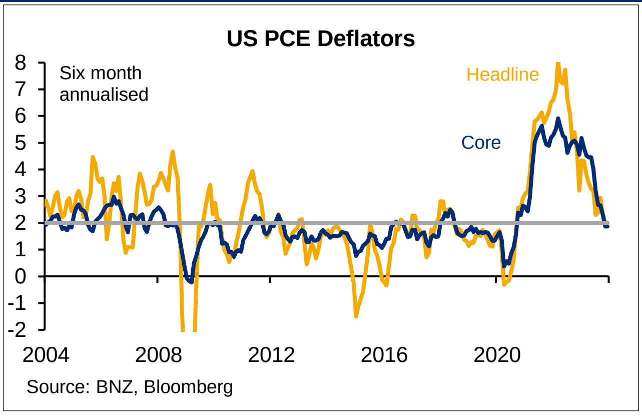
USD broadly stronger in January



World equities power on up to fresh record highs



US inflation at target on six months annualised basis



The Bank of Japan left its policy rate and yield curve control parameters unchanged. The BoJ is seeing 'higher certainty' of reaching its price target and the minutes suggested a deepening discussion on the timing of the exit from current ultra-easy monetary policy and the appropriate pace of raising policy interest rates thereafter. However, compared to expectations late last year, the market lost some faith in an early start to the normalisation of monetary policy, explaining some of JPY's notable underperformance for the month, although the backdrop of higher global rates didn't help.

In a surprise move in terms of size and timing, the PBoC said it would cut the reserve requirement ratio for all banks by 50bps to 7.0%, the first cut since September. Despite that policy move, alongside other incremental measures to support the beleaguered economy and sharemarket, pessimism around the outlook for China remained rife. Against a backdrop of record high global equities, China's CSI300 index hit a fresh 5-year low during the month. The PBoC stepped up its campaign to support the yuan, increasing the premium of CNY to market estimates during the daily reference rate fixes. China's economy grew 5.2% in 2023, slightly ahead of the government's 5% target but, overall, a disappointing recovery following the economy's re-opening after COVID19-related lockdowns.

NZ data remained weak, with retail card spending falling 2.0% m/m in December, and the composite of the manufacturing and services PMIs consistent with the economy remaining in recession in late 2023. The quarterly survey of business opinion, showed a sharp lift in confidence and activity indicators, reflecting the election of a more business-friendly government. The value-add of the survey was further signs of disinflationary pressure in the economy, with the selling price indicator falling to +37%, now only modestly above the long-term average, while finding labour has become outright easy, the data portending a sharp lift in the unemployment rate.

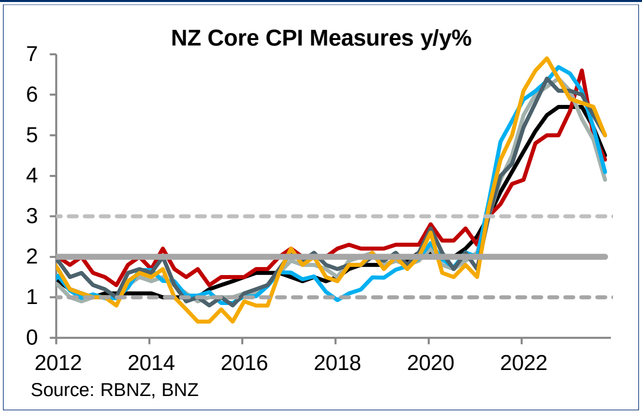
NZ's much anticipated Q4 CPI report came in bang in line with market expectations (and 0.3% below the RBNZ's estimate), at 0.5% q/q and 4.7% q/q. The key take-out from the release was that inflation was falling significantly, best illustrated by the seasonally adjusted CPI inflating at its lowest rate in three years. The 0.7 q/q lift in seasonally adjusted headline inflation puts annualised inflation back within the 1-3% target range. All core measures of inflation have been falling rapidly as well.

In a rare speech, RBNZ Chief Economist Conway downplayed the recent big downside miss to GDP and lower than anticipated inflation, giving the impression that there is little reason for the Bank to change its policy stance, in a pushback to the market's view that the Bank could be easing policy as soon as mid-year.

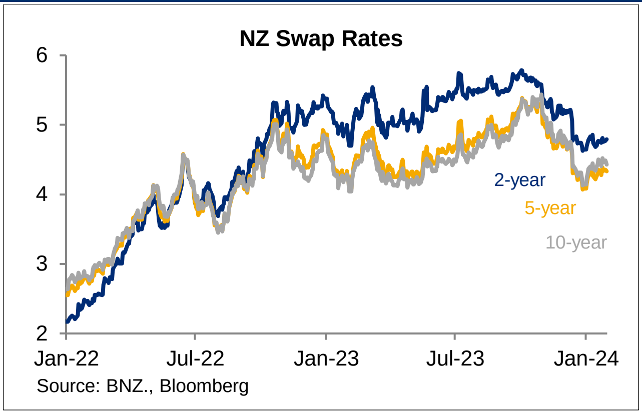
The NZ rates market followed the global theme, with a paring of rate cut expectations for 2024 and higher rates across the curve. The swap curve steepened, with the 2-year rate up 14bps to 4.78% and the 10-year rate up 25bps to 4.40%. NZGBs showed similar moves, with the 10-year rate up 23bps to 4.60%. NZDM said that it expected to launch, via syndication, a new 2054 nominal bond in Q1. In terms of timing, the week beginning 19 February seems the most likely window.

In currency markets, the USD was broadly stronger, the DXY index rising 2.2%, recovering some of the 5% loss endured through November and December. Although one could argue a reversal of sorts was always on the cards, fundamentally the move was supported by ongoing signs of US economic resilience and the market paring Fed rate cut expectations for 2024.

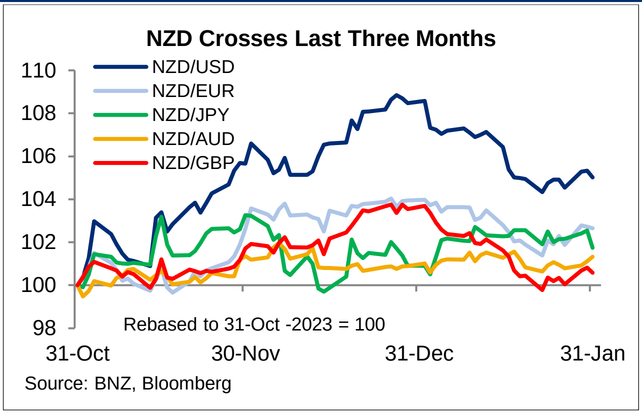
Annual NZ core CPI inflation heading down fast



Rates push higher in January following late-2023 falls



NZD soft in January, but up across the board last 3 months



All key major currencies we follow were weaker against the USD, with JPY, NZD and AUD the worst performers. The NZD hit its high for the month of 0.6328 on the first trading day of the year, with the low of 0.6062 reached on the 24th, closing the month at 0.6117 for a fall of just over 3%. We see the fall as exaggerated by December's strong seasonal bounce and less driven by fundamental forces. Risk appetite was only slightly weaker for the month, remaining mostly within a top-quartile level. NZ dairy prices were slightly stronger for the month and NZ rate movements weren't out of line with global moves.

Weakness in JPY reflected the higher global rate environment and the market losing a little faith in an early-

2024 tightening in monetary policy. NZD/JPY rose nearly 1% to just below 90.

NZD/AUD remained within a familiar trading range and closed the month modestly higher at just over 0.93. There was no RBA meeting during the month but slightly softer than expected Q4 CPI data near month-end supported the market's widely held view that the window for any further policy tightening was now likely closed, and the next move would be a rate cut.

The NZD was weaker against both EUR and GBP, with NZD crosses down over 1% and nearly 3% respectively. NZD crosses were still higher over the past three months, so we put the NZD weakness down to its seasonal kick higher late last year combined with some prior exuberance.

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Monthly Performance Table

	end-Jan	end-Dec	Change
Currencies			
NZD/USD	0.6117	0.6319	-3.2%
NZD/AUD	0.9313	0.9278	0.4%
NZD/EUR	0.5654	0.5724	-1.2%
NZD/GBP	0.4821	0.4963	-2.9%
NZD/JPY	89.85	89.11	0.8%
NZD/CNY	4.385	4.484	-2.2%
TWI	71.4	72.4	-1.4%
AUD/USD	0.6568	0.6810	-3.6%
EUR/USD	1.0818	1.1038	-2.0%
GBP/USD	1.2687	1.2731	-0.3%
USD/JPY	146.96	141.03	4.2%
USD/CNY	7.17	7.10	1.0%
USD/CAD	1.3435	1.3254	1.4%
USD DXY	103.27	101.33	1.9%
Asia dollar index	91.82	93.16	-1.4%
Equity Markets			
MSCI AC Wrld, loc.	2,002	1,977	1.3%
MSCI World, loc.	11,519	11,314	1.8%
MSCI EM, USD	2,518	2,641	-4.6%
US S&P 500	4,846	4,770	1.6%
Euro STOXX 600	485.7	479.0	1.4%
Germany DAX	16,904	16,752	0.9%
France CAC 40	7,657	7,543	1.5%
UK FTSE 100	7,631	7,733	-1.3%
Aust S&P/ASX 200	7,681	7,591	1.2%
Japan Topix	2,551	2,366	7.8%
China CSI 300	3,215	3,431	-6.3%
NZX50	11,872	11,770	0.9%
Volatility: VIX	14.35	12.45	15.3%
3-mth Bill Futures			
NZD Jun-24	94.60	94.81	-0.21
AUD Jun-24	95.87	95.91	-0.04
USD Jun-24	95.39	95.49	-0.09
EUR Jun-24	96.75	96.90	-0.15
GBP Jun-24	95.27	95.49	-0.22
CAD Jun-24	95.00	95.28	-0.28

	end-Jan	end-Dec	Change
NZ Rates			
OCR	5.50	5.50	0.00
NZ 90day BB	5.67	5.64	0.04
NZ 2yr swap	4.78	4.64	0.14
NZ 5yr swap	4.31	4.08	0.23
NZ 10yr swap	4.40	4.14	0.25
NZ Govt (5/26)	4.61	4.40	0.21
NZ Govt (4/29)	4.37	4.14	0.23
NZ Govt (5/34)	4.60	4.37	0.23
NZ Govt (5/41)	4.85	4.63	0.23
Global 10 year bond rates			
US	3.91	3.88	0.03
Canada	3.32	3.11	0.21
UK	3.79	3.53	0.26
France	2.66	2.56	0.10
Germany	2.17	2.02	0.14
Italy	3.73	3.70	0.03
Spain	3.09	2.98	0.10
Portugal	2.96	2.63	0.33
Ireland	2.59	2.35	0.24
Japan	0.73	0.61	0.12
Australia	4.01	3.96	0.06
Commodities (USD)			
WTI Crude	75.85	71.65	5.9%
Brent Crude	81.71	77.04	6.1%
R/B CRB Index	272.4	263.8	3.3%
Gold spot	2,040	2,063	-1.1%
Silver spot	22.96	23.80	-3.5%
Copper	390.6	389.1	0.4%
Iron Ore	130.57	137.80	-5.2%
Thermal coal	116.50	146.40	-20.4%
Corn	448.3	471.3	-4.9%
Wheat	595.3	628.0	-5.2%
SGX-NZX Dairy WMP	3,365	3,300	2.0%
SGX-NZX Milk Price '24	7.83	7.75	1.0%

Source: BNZ, Bloomberg

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