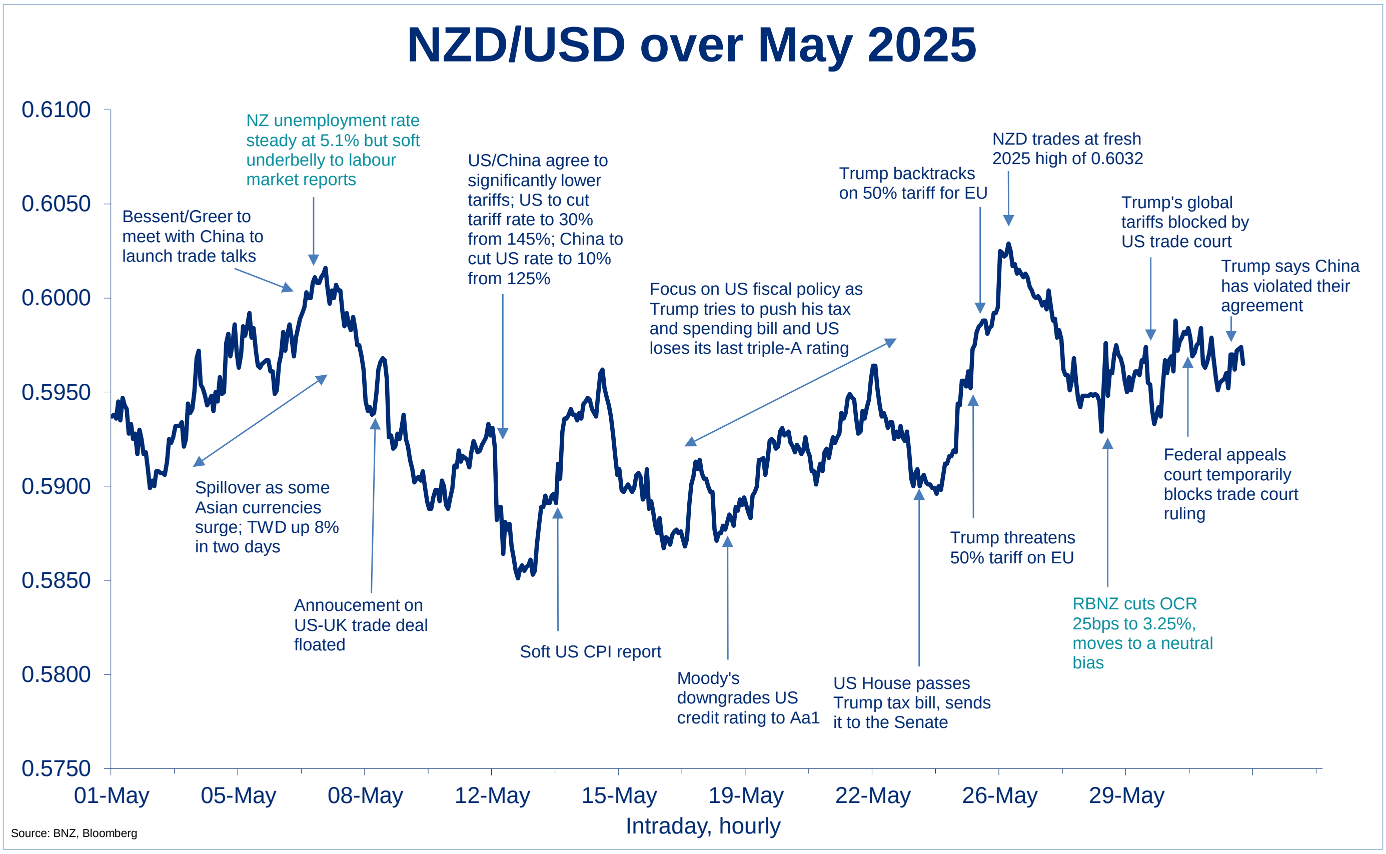
Research

Financial Markets Wrap

2 June 2025

Currencies consolidate in May

- **The de-escalation of the US-China trade war resulted in much calmer market conditions in May, compared to April's turmoil**
- **Net major currency movements were modest, even if the USD was broadly weaker again. NZD/USD rose ½%.**
- **Higher risk appetite and more focus on US fiscal policy saw upside pressure on global rates**



Quick Outlook		May Ranges
NZD/USD	Period of consolidation can continue but the next big move is expected to be higher, driven by the USD-leg, as investors move out of US assets and increase hedging into local currencies. The NZD/USD recovery can continue through the end of the year, with the occasional hiccup.	0.5845 – 0.6030
NZD/AUD	The cross is expected to track directionless over the foreseeable future, with the outlook for the NZ and Australian economies similar at this juncture, following a prolonged period of NZ economic underperformance.	0.9155 – 0.9295
NZD/GBP	NZD is more at risk than GBP on Trump's tariff agenda and impact on global growth, but we find it hard to get bearish on the cross rate with it trading near a nine-year low. We have a modest positive bias over the year ahead.	0.4390 – 0.4505
NZD/EUR	Europe should be a key benefactor of any asset allocation out of US assets, and this should be euro-supportive, alongside easier fiscal policy, led by Germany. But at current levels we are neutral and have it largely tracking sideways through the rest of the year.	0.5220 – 0.5315
NZD/JPY	The global backdrop sees the BoJ more cautious in its delivery of tighter monetary policy this year, but the yen's safe-haven characteristics appeals under heightened uncertainty. Still looking for downside in the cross over the medium-term but prone to volatile trading episodes.	84.6 – 87.7

Compared to the extreme volatility seen during April, financial markets were much calmer during May, helped by de-escalation of the US-China trade war. Global equities rose 6%. The higher risk appetite backdrop was detrimental to bond market performance, with increased focused on the poor state of US fiscal accounts adding to upside pressure on global rates. Although net currency movements were modest, the USD was broadly weaker again, with dollar indices falling for a fifth successive month. Some major currencies like the NZD traded at fresh 2025 highs. NZD/USD closed the up ½% to 0.5965.

In the first half of May there was de-escalation of the trade war, with US-China trade talks leading to a joint announcement to significantly reduce tariffs, a much better outcome than anyone imagined. The US agreed to lower the recently imposed 145% tariff on Chinese goods to 30% (representing the 10% baseline that applies to all countries and the 20% "fentanyl" tariffs). The sector specific tariffs that apply to most countries would remain. China agreed to lower the recently imposed 125% tariff on US goods to 10% and said it would cancel or suspend some non-tariff measures, including easing export restrictions on critical minerals. The agreement is temporary, lasting 90-days, while the two sides continued negotiations to work on a broader trade deal.

President Trump announced a trade framework with the UK, the first so-called trade deal in a long list of countries that were apparently lined up. The deal included the 10% baseline tariff on most goods remaining. Trump said that the 10% baseline tariff is probably the lowest end for any country tariff. Towards the end of the month, Trump threatened to impose a 50% tariff on imports from the EU from 1 June, saying the region was difficult to deal with, but within 48 hours he backtracked and extended the date to 9-July. He also threatened to impose a 25% tariff on foreign-made smartphones, including those from Apple.

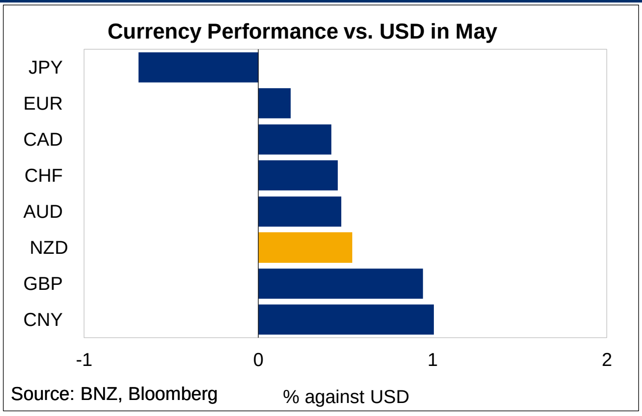
Late in the month, a US trade court declared many of Trump's tariffs imposed this year under the act of emergency were illegal, dealing a major setback to the policy, but his administration won a reprieve when a federal appeals court temporarily froze the decision. Even if the decision is ultimately upheld, the White House can apply other laws to enact tariffs.

After significant market volatility during April, the market was less yippy regarding trade war headlines, becoming more accustomed to Trump's tariff playbook of rolling back initial threats. The rollback of tariffs resulted in some economists revising up their US and China growth forecasts, partially reversing prior downward revisions. Yale's The Budget Lab estimated US consumers still faced an overall average effective tariff rate of 17.8%, the highest since 1934, but down from 27.6% pre the rollback of Chinese tariffs.

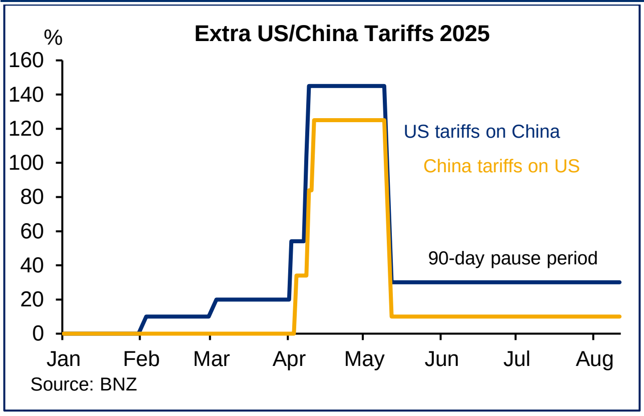
The other key market theme worth highlighting was renewed focus on the US fiscal accounts. The US lost its last triple-A credit rating when Moody's downgraded one notch, bringing it into line with S&P and Fitch Ratings' downgrades to the US back in 2011 and 2023 respectively. The downgrade came just before President Trump managed to get the House to pass his "one big, beautiful bill", by a majority of just one. The bill was handed to the Senate for consideration, before moving back to the House and further modifications are likely required before becoming law.

The bill, by cutting taxes and offering limited cuts to spending, would cement in fiscal deficits of 7% of GDP or higher over coming years and keep Federal debt on a significant upward trajectory. There were increasing signs of anxiety in the bond market from the lack of intent to reduce the large fiscal deficit and wave of future supply.

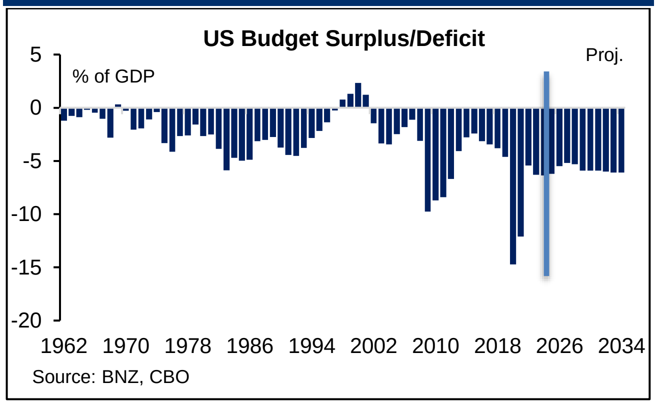
Net currency movements modest



Flip-flopping on US-China tariffs



Market focus on unsustainable US fiscal trajectory



US economic data were mixed, with some consumer and business surveys consistent with much lower levels of activity but other data like the ISM services index and PMIs continuing to show some underlying economic resilience. Growth in non-farm payrolls was a solid 177k in April while the unemployment rate remained steady at 4.2%.

US inflation data were softer than expected, but it was still too early to expect to see much impact from the tariffs. Surveys showed significantly higher inflation expectations, even if market-based measures of inflation expectations remained contained.

The US Federal Reserve left rates on hold for a third straight meeting. The Fed noted that uncertainty about the outlook had increased further and indicated that the risks of higher unemployment and inflation had risen. Chair Powell reiterated that the Fed doesn't need to be in a hurry to adjust rates. Fed speakers throughout the month highlighted the uncertainty caused by the tariffs policy.

US Treasury yields traded wide ranges, with the 10-year rate between 4.12% and 4.62% – the higher rate during the time of anxiety on fiscal policy, as noted. The 10-year rate ended the month up 24bps to 4.40%.

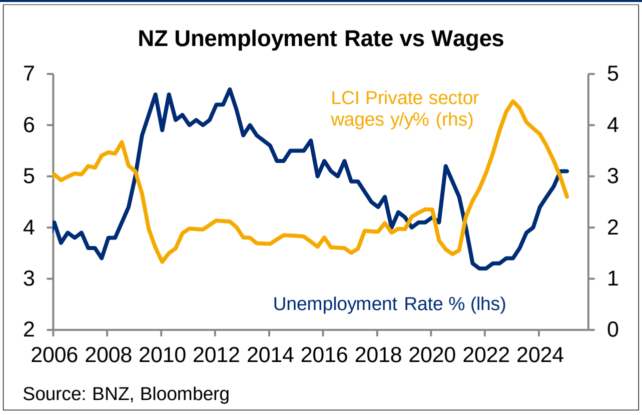
NZ economic data remained patchy, with surprising strength in Q1 retail sales volumes, which lifted 0.8% q/q after the 1.0% lift in Q4. But the services PMI dipped to 48.5 in April, making it sub-50 for 13 of the past 14 months, with January's 50.3 reading the exception. The composite PMI was consistent with only sluggish economic growth. Both business and consumer confidence indices showed falls. NZ's unemployment rate remained surprisingly steady at 5.1% in Q1, but the underlying details were weak, with full time employment and hours worked down for five consecutive quarters. The weak labour market contributed to further moderation in wage inflation.

The RBNZ delivered the widely expected 25bps cut to the OCR, taking it down to 3.25%. This took cumulative rate cuts from August last year to 225bps. Market reaction suggested that the policy update was more hawkish than many expected, with policy guidance shifting to neutral coming as a surprise. Furthermore, the vote to cut was not unanimous, with one MPC member voting to keep policy unchanged. There seemed to be some sympathy with that view, as "some" members noted that leaving policy on hold would allow the committee to better assess the impact of increased economic policy uncertainty and guard against the risk of higher-than-expected inflation from supply side effects of tariffs.

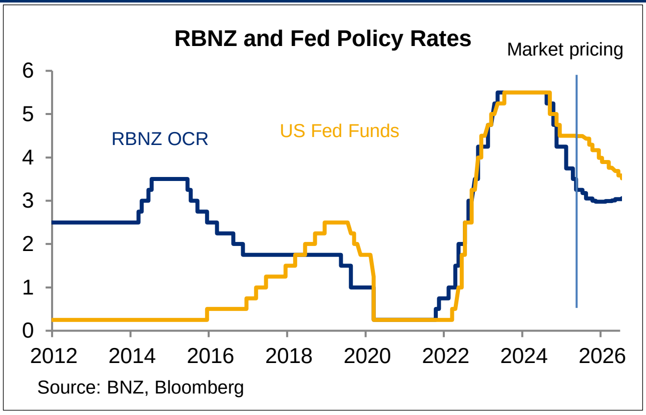
Global forces and the more hawkish RBNZ update resulted in higher swap rates, in the order of 21-25 bps for 2, 5 and 10-year maturities.

Following April's market turmoil, currency markets showed signs of consolidation. NZD/USD traded a range of less than 2 cents and closed the month up ½% to 0.5965. The NZD traded a low of 0.5847 on 13-May, in the aftermath of the joint US-China announcement to roll back punitive tariffs, a period which resulted in the USD finding some temporary support. The NZD traded a fresh 2025 high of 0.6032 on 26-May following a period of scrutiny on US fiscal policy.

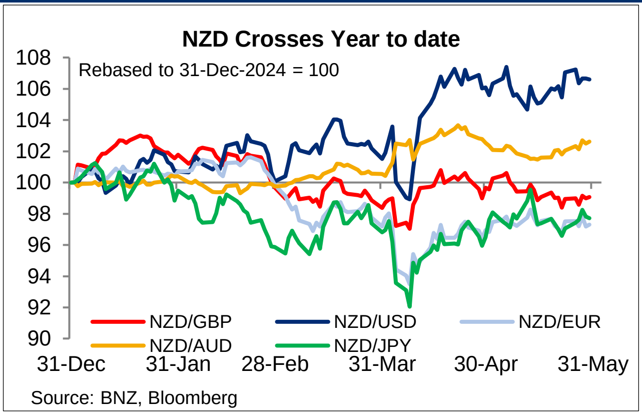
Weaker NZ labour market driving down wage inflation



NZ policy rate moves further below US rate



NZD up against USD and AUD so far this year



Asian currencies were in the spotlight on speculation that the Trump administration was open to a weaker USD and would make exchange rates a feature of upcoming trade talks. Fears of a structurally weaker USD, combined with Taiwan life insurers being only lightly hedged, resulted in some panic buying of TWD. TWD was the strongest of the

Asian currencies, rising 7% for the month. KRW rose nearly 3%, while THB and IDR rose nearly 2%. The HKMA bought USD in record sums to prevent the HKD from breaching the strong edge of the USD peg.

NZD cross movements on the majors were modest. JPY was the weakest of the majors, resulting in NZD/JPY rising just over 1%. The BoJ left policy unchanged, but the updated outlook was dovish. Growth and inflation projections were lowered and the Bank said it expected inflation to be consistent with its 2% goal around the second half of the outlook period, while growth for the current fiscal year was halved to just 0.5%. Governor Ueda attempted to convey a message of raising rates as its price goal is within sight, but he wasn't prepared to give any guidance on timing. Japanese core inflation measures continued to press higher, but the market put more weight on the BoJ's policy stance.

NZD/AUD pushed lower in the first half of the month and reversed course through the second half for little net change at 0.9275. Australian labour market data remained resilient, with the unemployment rate remaining steady at 4.1%. The RBA delivered the widely expected 25bps rate cut to 3.85% but the outlook was more dovish than expected. The final sentence of the policy statement acknowledged both sides of the Bank's dual mandate after previously focusing only on inflation.

NZD/EUR rose modestly to 0.5260. Euro area PMI data were on the soft side, consistent with sluggish growth. In Germany, Merz secured a parliamentary vote to become Chancellor, but only on a second attempt, after he surprisingly fell short of a majority in the first secret ballot. This damaged his reputation and could be seen as a potential warning sign that he shouldn't take support of his coalition partners for granted to pass legislation, including his plans for much easier fiscal policy ahead.

NZD/GBP fell less than ½% to 0.4435. UK CPI inflation data were stronger than expected. The BoE cut its policy rate by 25bps to 4.25%, as expected, but it was a 5-2-2 split decision, with 2 dissents to leave rates unchanged and 2 voting for a larger 50bps cut. This was symbiotic of the uncertainty that central banks around the world are grappling with, given the direction of US policy. Guidance was maintained of "a gradual and careful approach to the further withdrawal of monetary policy restraint remains appropriate".

The Chinese yuan found support from spillover from stronger Asian currencies. China's monthly activity data were mixed in April. Industrial production expanded at a 6.1% from a year ago, which was above consensus estimates and displayed resilience despite the trade tensions. However, retail sales were softer than expected and highlighted fragile consumer sentiment, set against the backdrop of a property market slump.

China's central bank and financial regulators held a briefing to outline policies aimed at supporting the economy given the increasing headwinds from US trade policy. The PBoC announced a 0.5% decrease in the reserve ratio requirement, a 10bp cut to its 7-day reverse repo rate to 1.40%, and said that it will keep FX, bond and stock markets stable. PBoC Governor Pan said the latest measures were due to the uncertain outlook for the global economy amid economic fragmentation and trade tensions. The actions demonstrated a willingness by Chinese policymakers to provide additional support to the economy.

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Monthly Performance Table

Currencies	end-May	end-Apr	Change
NZD/USD	0.5966	0.5934	0.5%
NZD/AUD	0.9274	0.9268	0.1%
NZD/EUR	0.5257	0.5239	0.3%
NZD/GBP	0.4434	0.4452	-0.4%
NZD/JPY	85.93	84.85	1.3%
NZD/CNY	4.300	4.315	-0.3%
TWI	69.2	69.4	-0.3%
AUD/USD	0.6433	0.6403	0.5%
EUR/USD	1.1348	1.1327	0.2%
GBP/USD	1.3456	1.3330	0.9%
USD/JPY	144.06	143.07	0.7%
USD/CNY	7.20	7.27	-1.0%
USD/CAD	1.3740	1.3797	-0.4%
USD DXY	99.33	99.47	-0.1%
Asia dollar index	92.27	90.81	1.6%
Equity Markets			
MSCI AC Wrld, loc.	2,464	2,331	5.7%
MSCI World, loc.	14,158	13,357	6.0%
MSCI EM, USD	3,107	2,979	4.3%
US S&P 500	5,912	5,569	6.2%
Euro STOXX 600	548.7	527.5	4.0%
Germany DAX	23,997	22,497	6.7%
France CAC 40	7,752	7,594	2.1%
UK FTSE 100	8,772	8,495	3.3%
Aust S&P/ASX 200	8,435	8,126	3.8%
Japan Topix	2,802	2,667	5.0%
China CSI 300	3,840	3,771	1.8%
NZX50	12,419	11,903	4.3%
Volatility: VIX	18.57	24.70	-24.8%
3-mth Money Market Futures			
NZD Dec-25	96.88	97.16	-0.28
AUD Dec-25	96.84	96.92	-0.08
USD Dec-25	96.20	96.70	-0.50
EUR Dec-25	98.26	98.36	-0.10
GBP Dec-25	96.18	96.52	-0.33
CAD Dec-25	97.64	97.80	-0.16

NZ Rates	end-May	end-Apr	Change
OCR	3.25	3.50	-0.25
NZ 90day BB	3.32	3.43	-0.11
NZ 2yr swap	3.29	3.06	0.24
NZ 5yr swap	3.67	3.41	0.25
NZ 10yr swap	4.14	3.93	0.21
NZ Govt (4/27)	3.43	3.25	0.18
NZ Govt (5/30)	3.96	3.80	0.17
NZ Govt (5/35)	4.56	4.44	0.12
NZ Govt (5/41)	5.03	4.91	0.12
Global 10 year bond rates			
US	4.40	4.16	0.24
Canada	3.20	3.09	0.11
UK	4.65	4.44	0.21
France	3.16	3.17	-0.01
Germany	2.50	2.44	0.06
Italy	3.48	3.56	-0.08
Spain	3.09	3.11	-0.02
Portugal	2.97	3.00	-0.03
Ireland	2.78	2.79	0.00
Japan	1.49	1.31	0.18
Australia	4.26	4.16	0.09
Commodities (USD)			
WTI Crude	60.79	58.21	4.4%
Brent Crude	63.90	63.12	1.2%
R/B CRB Index	290.4	288.8	0.6%
Gold spot	3,289	3,289	0.0%
Silver spot	32.98	32.62	1.1%
Copper	467.8	456.0	2.6%
Iron Ore	95.64	95.41	0.2%
Thermal coal	100.80	97.50	3.4%
Corn	444.0	475.5	-6.6%
Wheat	534.0	530.8	0.6%
SGX-NZX Dairy WMP	4,010	4,230	-5.2%
SGX-NZX Milk Price '26	9.90	9.86	0.4%

Source: BNZ, Bloomberg

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