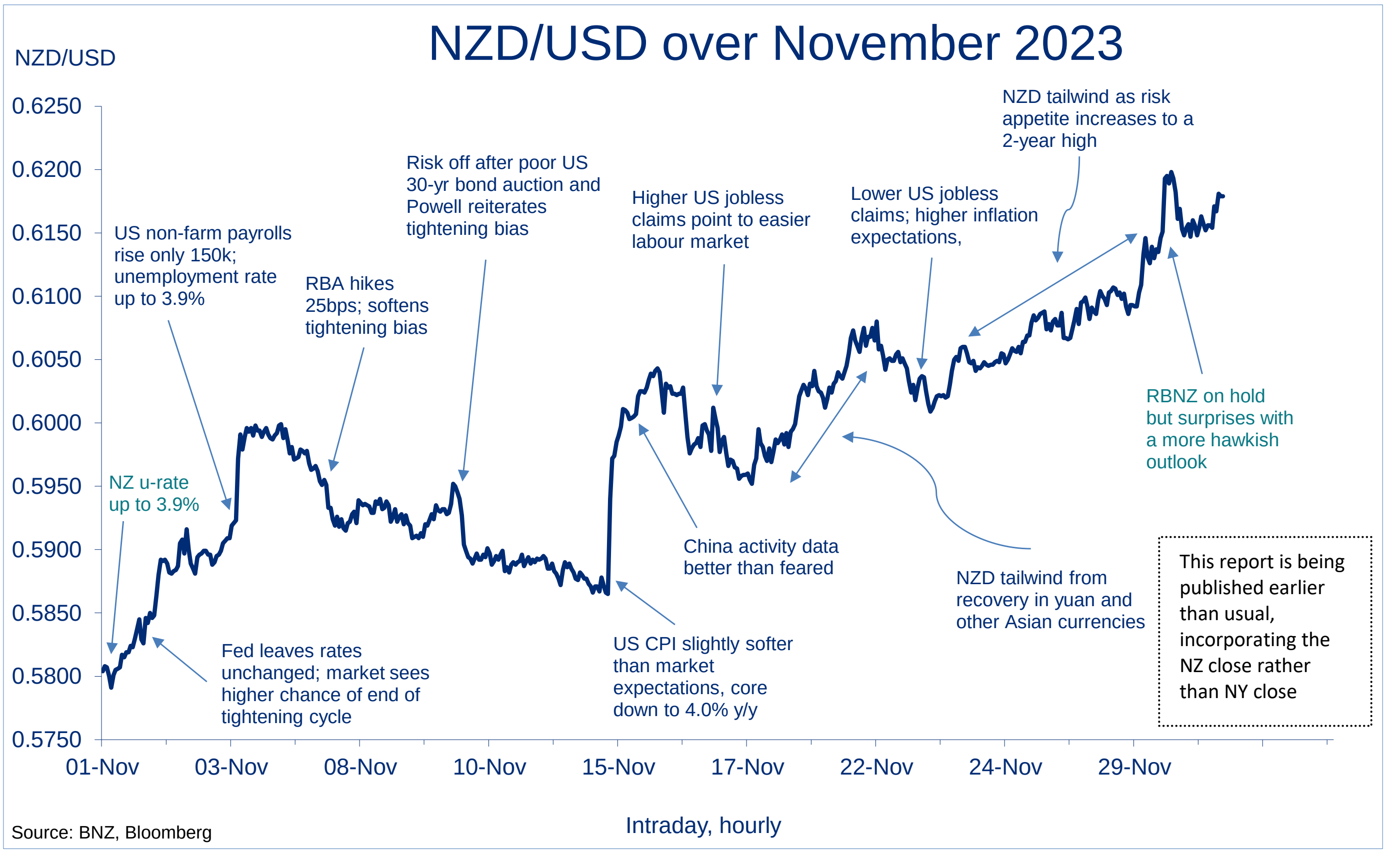
Research

# Financial Markets Wrap

30 November 2023

## November Nirvana

- **The market embraced a view that the tightening cycle was over for most major central banks**
- **This fuelled increased risk appetite, to its highest level in two years, alongside big falls in global interest rates**
- **The NZD outperformed, with a gain of 6% against the USD and gains on all the key crosses**




| Quick Outlook | | November ranges |
|---|---|---|
| **NZD/USD** | Increased conviction on the end of Fed tightening cycle means that the NZD has likely moved into a higher 0.60-0.64 trading range. Seasonally, December is the strongest month. Beginning of USD downturn cycle gives us a constructive outlook for the NZD next year. | 0.5790 – 0.6205 |
| **NZD/AUD** | Frustratingly range-bound on NZ-AU rate differential gyrations, but a relatively weaker NZ economy versus Australia should eventually lead to a weaker cross rate. Support is around 0.9150, but ultimately we see the risk of another push downward to 0.90. | 0.9140 - 0.9325 |
| **NZD/GBP** | Both UK and NZ economic outlooks are sluggish and both central banks look to be on hold for some time. We don't have a strong directional bias and see some consolidation in the cross near current levels. | 0.4770 - 0.4880 |
| **NZD/EUR** | As above, both euro area and NZ economic outlooks are sluggish and both central banks look to be on hold for some time. We see some consolidation in the cross near current levels. | 0.5470– 0.5635 |
| **NZD/JPY** | BoJ policy stance continues to hinder yen performance and it looks like negative short rates are here to stay until early next year.  Cross remains vulnerable to significant downside pressure over the medium-term. Timing remains uncertain. | 87.6 – 91.2 |

The key theme for November was the market embracing a view that the tightening cycle was over in the US and mostly elsewhere. This drove lower global rates and a significant improvement in risk appetite, alongside strong gains in world equities, reversing the trend over previous months. In currency markets, the USD was the main casualty. The NZD outperformed, appreciating to its highest level in nearly four months.

Early in the month, the Fed left its target range for the Fed Funds rate at 5.25-5.5% for the second consecutive meeting. While a tightening bias remained, the Fed acknowledged tighter financial conditions. Chair Powell kept the option open for a further possible hike, but the market was comforted by the fact that he didn't overplay the strength of economic data over the previous quarter.

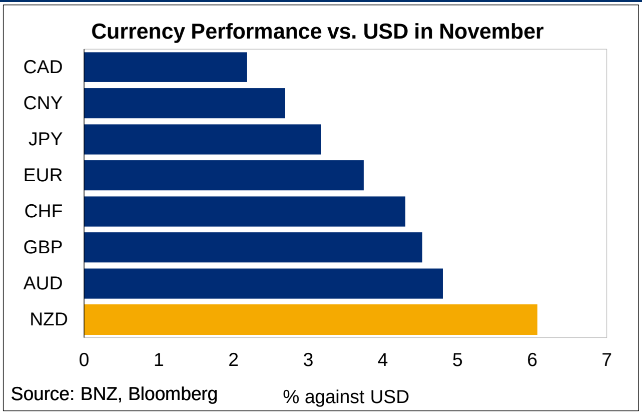
As the month progressed, Citigroup's US economic surprise index turned down, as the dataflow came in generally weaker than expected. Nonfarm payrolls increased just 150k in October, alongside downward revisions, seeing the unemployment rate increase to 3.9%, its highest level in nearly two years. Average hourly earnings increased 4.1% y/y, the smallest increase since mid-2021. Importantly, inflation data came in softer, with the core CPI falling to 4.0%, the weakest in two years and the breakdown included softer services sector inflation. PPI inflation came in well below estimates.

All this played to the view that the Fed's tightening cycle was over and focus turned to the scope of easier policy next year. The market priced in little chance of hikes over the next two meetings, a first full rate cut from May next year and more than 100bps of cuts for 2024. Market dynamics were similar across other key regions, with little chance of further hikes priced for the euro area, UK, Canada and NZ, and easing cycles beginning around Q2 or Q3 next year.

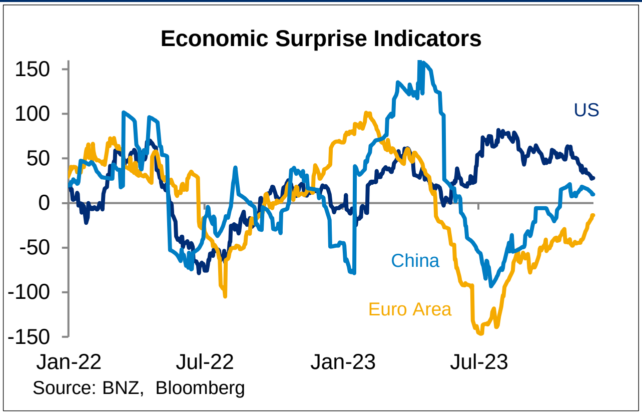
With another day of trading left, the US 10-year rate was down over 65bps for the month, with a smaller 45bps fall for the 2-year rate. Supporting the long-end led rally in Treasuries, at its quarterly refunding announcement, the US Treasury said it would slow the pace at which it issues longer-dated debt, signalling that it was sensitive to the prior surge in yields, reflecting the market's concern over bond supply.

NZ's economic data flow remained soft. The performance of services index fell to 48.9 in October, making it four of the past five months in contractionary territory. When combined with the poor PMI, the data raised the chance of GDP contracting over the second half of this year. NZ labour market data were weaker than expected, with a 0.2% fall in employment in Q3 driving a 0.3 percentage point lift in the unemployment rate to 3.9%, its highest level in more than two years. The data conveyed a picture of labour market tightness abating and this leading to weaker private sector wage inflation. The unadjusted private sector LCI wage measure rose 1.1% q/q, the weakest quarter in nearly two years.

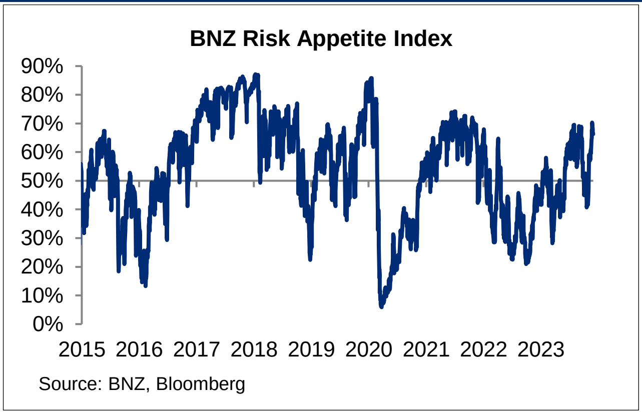
All majors stronger against a weak USD; NZD outperforms



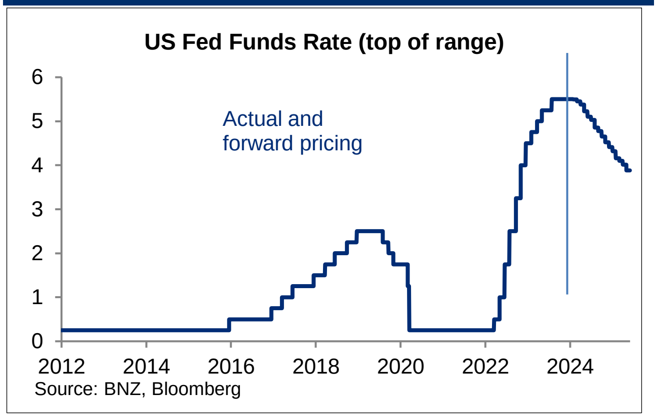

Convergence of economic surprise indices




Risk appetite index recovers to a two-year high




Market prices a turn in US monetary policy in 2024



As universally expected, at its 29 November meeting the RBNZ left the OCR at 5.5%, the level it has been left at since the last hike in May but the Bank surprised the market with a hawkish outlook. The RBNZ produced a set of forecasts raising the chance that further tightening could be required. The Bank seemed to put a lot of weight on the recent strength in migration, and that adding more to demand pressures on the economy than supply, with the Bank now seeing asymmetric risks to the inflation outlook. The rate track showed a slightly higher peak in the OCR of 5.7% and a roughly six-month delayed start to any easing cycle, with a full rate cut now not projected until mid-2025.

Market reaction to the RBNZ's outlook was muted to the extent that it was deeply sceptical of the Bank's projections. At month-end, the market was pricing in little chance of any further rate hikes and at least two rate cuts by the end of next year. Global forces predominated and NZ rates fell substantially over the month, with the 2-year swap rate down 43bps to 5.16% and the 10-year swap rate down a massive 70bps to 4.74%.

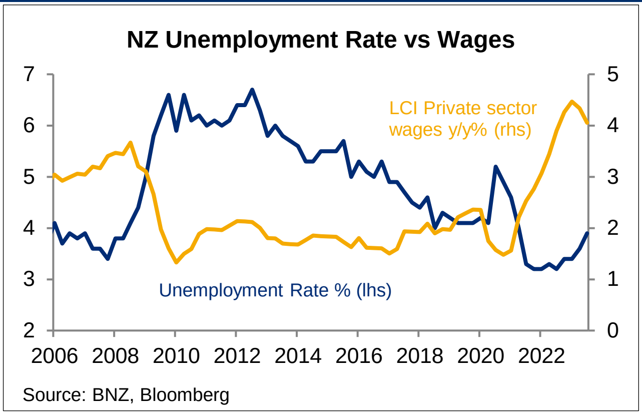
In currency markets, the USD showed a hefty, broadly based, fall with the DXY index down over 3½% for the month, reflecting expectations that the Fed was finished tightening, the softening in US economic data giving a sense that the country was losing its exceptionalism, and higher risk appetite, reducing safe-haven flows. Custodians State Street and BNY Mellon suggested investors were dumping the dollar at its fastest pace in a year, unwinding significantly long positions.

BNZ's risk appetite index hit its highest level in two years at 70% towards the end of the month. This was a supporting factor for the NZD and AUD. In addition, a positive turnaround in sentiment in CNY was a tailwind, supported by an improved China economic dataflow and further incremental government policies aimed at supporting the beleaguered property market. Despite notable yuan appreciation, the PBoC continued to set the CNY reference rate stronger than market estimates, a signal that the central bank was happy to guide the currency stronger. USD/CNY fell over 2½% from above 7.30 to 7.12.

The NZD's low for the month of 0.5789 was on 1st November and the high of 0.6208 was reached in the immediate aftermath of the RBNZ's MPS late in the month. Of the key majors we closely follow, the NZD was strongest, rising over 6% for the month.

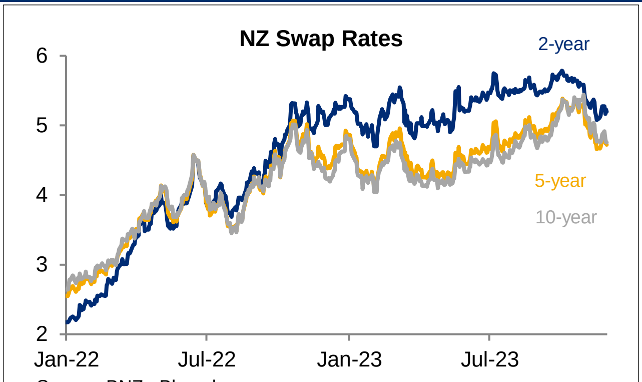
With similar drivers, the AUD was also strong, up about 5%. NZD/AUD was up about 1%. The RBA increased its policy rate by 25bps to a 12-year of high of 4.35% but the accompanying statement seemed to temper the RBA's tightening bias, outlining 'whether further tightening is required to ensure that inflation returns to target in a reasonable timeframe will depend on the data and the evolving assessment of risks'. Later in the month, newly appointed Governor Bullock came across hawkish, noting that the remaining inflation challenge was increasingly

NZ unemployment rate up to two-year high



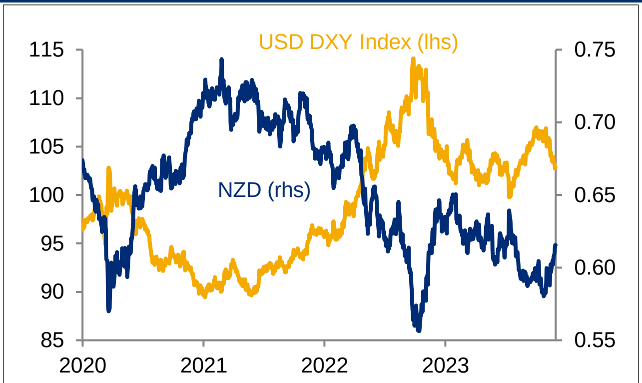

Source: BNZ, Bloomberg

Rates fall significantly from recent peak



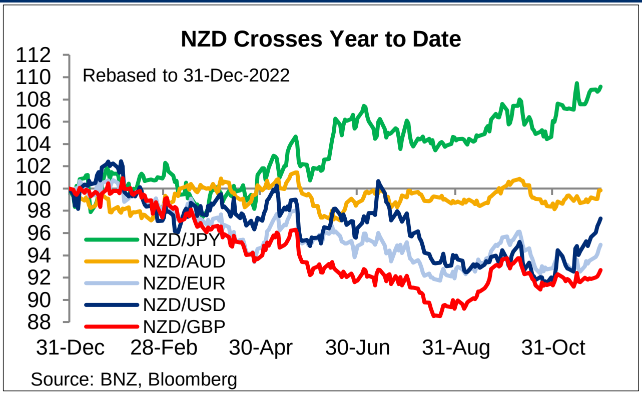

Source: BNZ., Bloomberg

USD turns down over past month; NZD picks up




Source: BNZ, Bloomberg

NZD/JPY up YTD; NZD/AUD flat; other NZD crosses lower




Source: BNZ, Bloomberg

homegrown and demand driven, with tighter monetary policy being the right response if demand exceeded supply.

CAD underperformed, given its strong links to the weak USD and not helped by further falls in oil prices. Despite the lower global rates backdrop, JPY was also on the soft side of the ledger, with messaging from the BoJ suggesting a very cautious approach to unwinding the Bank's ultra-easy policy stance. During the month, NZD/JPY traded at a fresh 8-year high of 91.2, before ending the month up 3% near 91.

EUR and GBP made strong gains against the USD, but the prevailing higher risk appetite backdrop supported modest lifts in NZD/GBP and NZD/EUR cross rates. With data suggesting near zero growth and inflation fast heading lower, the market priced little chance of any further tightening by the ECB or BoE. The first easing for the ECB was priced for Q2 next year, and for Q3 for the BoE.

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This report is being published earlier than usual, incorporating the NZ close rather than NY close

## Monthly Performance Table

| | end-Nov | end-Oct | Change | | end-Nov | end-Oct | Change |
|---|---|---|---|---|---|---|---|
| **Currencies** | | | | **NZ Rates** | | | |
| NZD/USD | 0.6178 | 0.5825 | 6.1% | OCR | 5.50 | 5.50 | 0.00 |
| NZD/AUD | 0.9303 | 0.9192 | 1.2% | NZ 90day BB | 5.62 | 5.64 | -0.02 |
| NZD/EUR | 0.5631 | 0.5508 | 2.2% | NZ 2yr swap | 5.16 | 5.58 | -0.43 |
| NZD/GBP | 0.4865 | 0.4794 | 1.5% | NZ 5yr swap | 4.69 | 5.31 | -0.63 |
| NZD/JPY | 90.84 | 88.30 | 2.9% | NZ 10yr swap | 4.74 | 5.44 | -0.70 |
| NZD/CNY | 4.403 | 4.262 | 3.3% | | | | |
| TWI | 70.9 | 69.4 | 2.2% | NZ Govt (4/25) | 5.23 | 5.57 | -0.34 |
| AUD/USD | 0.6641 | 0.6337 | 4.8% | NZ Govt (5/28) | 4.75 | 5.36 | -0.61 |
| EUR/USD | 1.0971 | 1.0575 | 3.7% | NZ Govt (4/33) | 4.89 | 5.55 | -0.67 |
| GBP/USD | 1.2700 | 1.2150 | 4.5% | NZ Govt (5/41) | 5.13 | 5.76 | -0.63 |
| USD/JPY | 147.04 | 151.70 | -3.1% | | | | |
| USD/CNY | 7.12 | 7.32 | -2.6% | **Global 10 year bond rates** | | | |
| USD/CAD | 1.3579 | 1.3875 | -2.1% | US | 4.27 | 4.93 | -0.66 |
| USD DXY | 102.81 | 106.66 | -3.6% | Canada | 3.51 | 4.06 | -0.56 |
| Asia dollar index | 92.62 | 90.14 | 2.8% | UK | 4.09 | 4.51 | -0.42 |
| | | | | France | 3.00 | 3.43 | -0.43 |
| **Equity Markets** | | | | Germany | 2.43 | 2.80 | -0.37 |
| MSCI AC Wrld, loc. | 1,891 | 1,757 | 7.6% | Italy | 4.17 | 4.73 | -0.55 |
| MSCI World, loc. | 10,813 | 10,022 | 7.9% | Spain | 3.43 | 3.88 | -0.45 |
| MSCI EM, USD | 2,530 | 2,352 | 7.6% | Portugal | 3.06 | 3.49 | -0.43 |
| US S&P 500 | 4,551 | 4,194 | 8.5% | Ireland | 2.81 | 3.23 | -0.42 |
| Euro STOXX 600 | 459.1 | 433.7 | 5.9% | Japan | 0.68 | 0.94 | -0.26 |
| Germany DAX | 16,166 | 14,810 | 9.2% | Australia | 4.38 | 4.93 | -0.55 |
| France CAC 40 | 7,268 | 6,886 | 5.5% | | | | |
| UK FTSE 100 | 7,423 | 7,322 | 1.4% | **Commodities (USD)** | | | |
| Aust S&P/ASX 200 | 7,072 | 6,781 | 4.3% | WTI Crude | 77.91 | 81.02 | -3.8% |
| Japan Topix | 2,364 | 2,254 | 4.9% | Brent Crude | 82.95 | 87.41 | -5.1% |
| China CSI 300 | 3,497 | 3,573 | -2.1% | R/B CRB Index | 275.4 | 281.2 | -2.0% |
| NZX50 | 11,330 | 10,758 | 5.3% | Gold spot | 2,044 | 1,984 | 3.0% |
| Volatility: VIX | 12.98 | 18.14 | -28.4% | Silver spot | 24.98 | 22.85 | 9.3% |
| | | | | Copper | 380.5 | 364.9 | 4.3% |
| **3-mth Bill Futures** | | | | Iron Ore | 130.38 | 122.33 | 6.6% |
| NZD Mar-24 | 94.37 | 94.23 | 0.14 | Thermal coal | 127.85 | 121.10 | 5.6% |
| AUD Mar-24 | 95.53 | 95.37 | 0.16 | Corn | 475.5 | 493.0 | -3.5% |
| USD Mar-24 | 94.83 | 94.63 | 0.20 | Wheat | 588.5 | 585.3 | 0.6% |
| EUR Mar-24 | 96.21 | 96.17 | 0.03 | SGX-NZX Dairy WMP | 3,235 | 3,155 | 2.5% |
| GBP Mar-24 | 94.83 | 94.74 | 0.09 | SGX-NZX Milk Price '24 | 7.90 | 7.81 | 1.2% |
| CAD Mar-24 | 94.81 | 94.52 | 0.29 | | | | |

Source: BNZ, Bloomberg

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