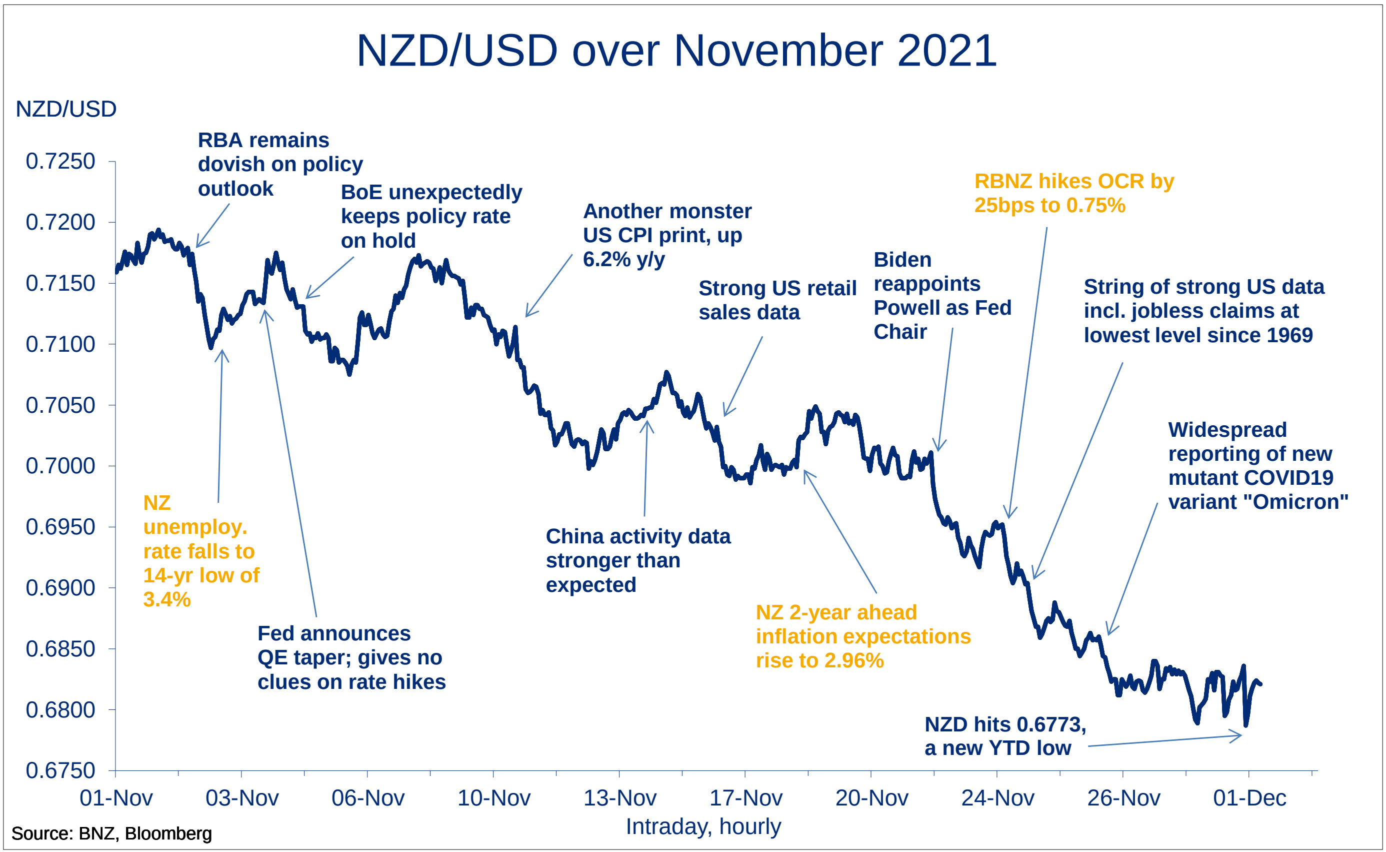
1 December 2021

NZD tumbles through November

- **The NZD and AUD were slammed during November, both recording fresh lows for the year. NZD/USD fell almost 5%**
- **This reflected USD strength on positive US data surprises, a more hawkish pivot by the Fed, and lower risk appetite**
- **NZ rates fell, even with a second RBNZ rate hike, as the market priced in a less aggressive tightening profile**



	Quick Outlook	November ranges
NZD/USD	Facing multiple headwinds at the moment, both global and domestic. Could easily fall to fresh lows for the year if data shows the Omicron variant to be deadlier and vaccine resistant. Otherwise, the NZD is already weak and seasonal factors for December are positive.	0.6775 – 0.7200
NZD/AUD	Trading close to the 0.95 mid-point of our near-term projections. Near-term, Australia's economy looks better placed coming out of COVID19 restrictions while NZ-AU rate spreads close to peaking. Risk is weighted towards downside pressure through the year ahead.	0.9520 – 0.9695
NZD/GBP	Current level consistent with our 0.51-0.53 projections. UK economy adjusting (not well) to the new reality of Brexit. Lingering risk for GBP over dispute with EU over Withdrawal Agreement.	0.5095 – 0.5305
NZD/EUR	Projections still consistent with consolidation around the 0.60 mark. Headwinds for both NZD and EUR, the latter from new lockdown restrictions and ongoing dovish ECB rhetoric.	0.5990 – 0.6225
NZD/JPY	Being a risk appetite proxy, how the risk around Omicron plays out will determine near-term performance. Otherwise, seen as sticky within a 75-80 range.	76.7 – 82.2

The NZD trended lower through November, against a backdrop of numerous positive US economic surprises that proved USD-supportive, with a more hawkish pivot from Fed policy makers thrown into the mix. NZ rates were mainly lower as the market priced in a less aggressive tightening path from the RBNZ. World equities hit fresh highs, before the discovery of a new COVID19 variant Omicron reined in risk appetite. Global rates were moderately lower despite ongoing positive inflation surprises that saw G7 inflation at a thirty-year high.

After commodity currencies outperformed in October, the opposite occurred through November, with the NZD and AUD leading the downward charge. Both were hit by a number of global and domestic forces.

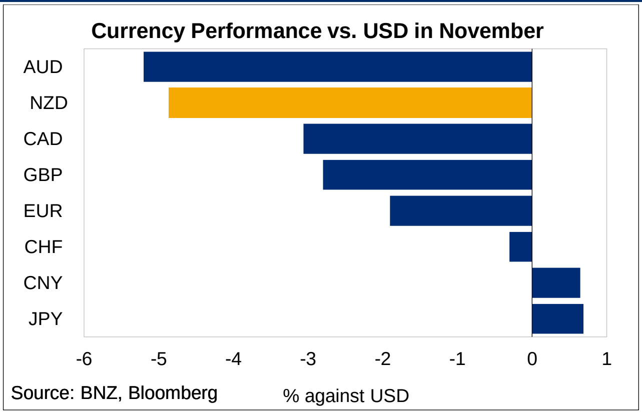
The USD showed some strong upward momentum with the DXY and BBDXY indices hitting their highest levels since July 2020. This move was supported by a series of strong US data releases, including non-farm payrolls, initial jobless claims falling to their lowest level since 1969, the ISM services index rising to a record high, and retail sales, to name a few. Inflation continued to surge ahead, with US PPI for final demand reaching 8.6% y/y and another CPI shocker, with the headline rate up to 6.2% y/y and core inflation at 4.6% y/y, both at their highest level in three decades.

The data clearly called into question the Fed's "transitory" narrative, and the market brought forward the expected timing of hikes in the Fed Funds rate. The Fed announced a tapering of its QE programme, reducing bond buying at a pace of $15bn per month to end the programme in June 2022, but it was prepared to adjust the pace of purchases if warranted by changes in the economic outlook. The ink was hardly dry before a number of FOMC members, including Chair Powell and vice-Chair Clarida, argued for a faster taper, that would give optionality to earlier rate hikes next year.

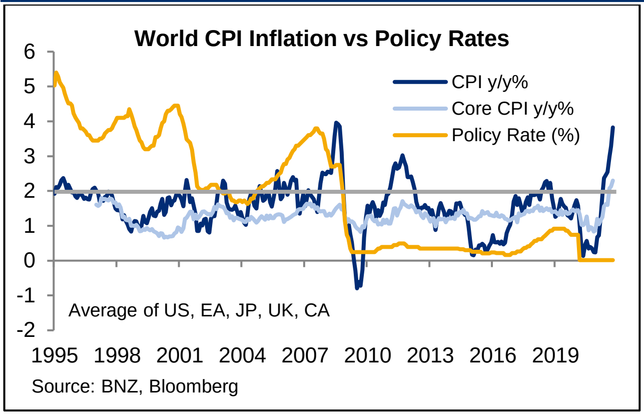
COVID19 remained in the spotlight as the Delta variant spread through Europe, leading to some countries to redeploy temporary lockdown restrictions to contain the spread. This negatively impacted the euro to the extent that it pushed out the path of the region's economic recovery, against the backdrop of the strong US economy. Late in the month, the market was rattled by a report from South Africa of a new variant of the virus, named Omicron by the WHO, that contained a significant number of mutations from the original version of the virus including, notably, a large number on the spike protein. It will take a few weeks of monitoring to determine whether or not Omicron is more transmissible, deadlier and vaccine-resistant than the Delta variant.

High inflation wasn't confined to the US, with Germany CPI inflation hitting 6.0% y/y, the euro area at 4.9% y/y and UK inflation reaching 4.2% y/y. China PPI inflation surged to a 26-year high of 13.5% y/y. The bond market seemed to accept the view that the surge had a transitory element,

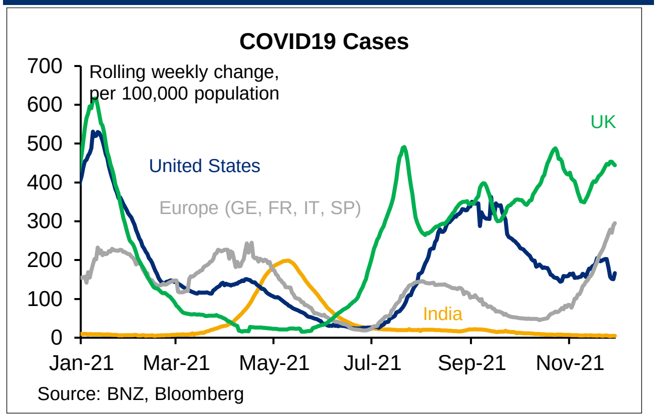
Commodity currencies underperform in November



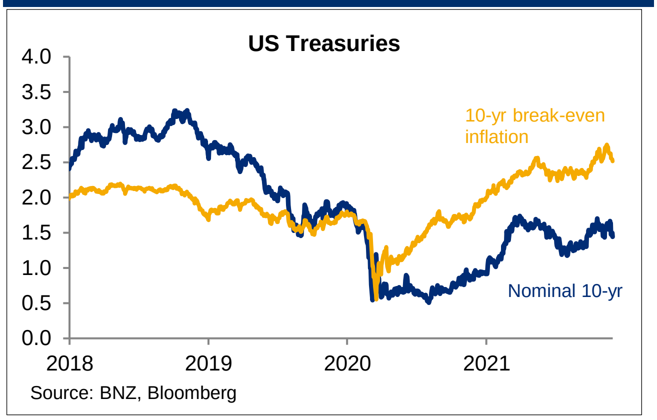
Policy remains easy despite inflation up to 30-year high



Europe's fourth COVID19 wave its biggest yet



US 10-year rate well-contained despite higher inflation



with global rates across much of the curve lower for the month. The US 2-yr rate was a rare exception, up 7bps for the month. The US 10-year rate fell 11bps to 1.45%.

Domestically, Q3 labour market data were much stronger than expected, with strong employment growth driving the unemployment rate down to a 14-year low of 3.4%. The RBNZ's MPS didn't throw up any surprises, given the backdrop of significant inflationary pressure and employment above its maximum sustainable level, with a widely anticipated 25bps hike and a long, regular series of hikes projected through next year and into 2023. The Bank noted that the OCR would likely need to be raised above its neutral rate, seen to be about 2%, and projected a terminal OCR of 2.6%.

Going into the meeting, the market had priced in a 35% chance of a larger 50bps hike. Furthermore, the revealed preference by the RBNZ was that hikes of 25bps increments were much preferable to 50bps. The natural response was a decent fall in rates, post-MPS, led by the short end of the curve.

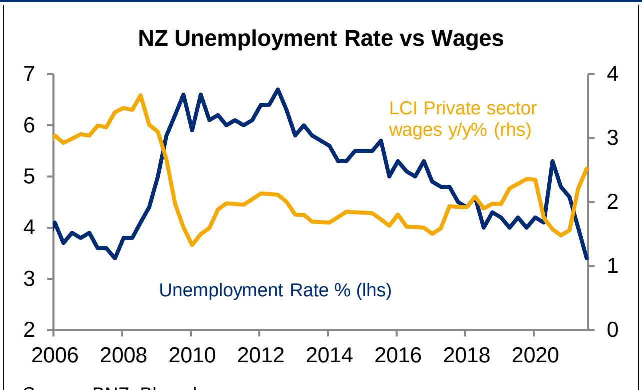
Ahead of the MPS, NZ's 2-year swap rate had reached as high as 2.48%, but it eventually ended the month down 11bps at 2.15%, as the market priced in a less aggressive rate hike track, albeit one that still sees the OCR at about 2¼% by the end of next year. Importantly, for the real economy, mortgage rates continued their steady upward path, with the key 2-3 year fixed rates up about 180bps since July despite only 50bps of OCR hikes so far, reflecting the steepness of the short-end rates curve.

The 10-year NZGB rate closed the month down 16bps to 2.42%, outperforming the 4bps drop in the 10-year swap rate to 2.70%. There were signs that offshore investors were interested in the NZ bond market again, after the recent widening in NZ-global rate spreads and the significant policy tightening already priced into the curve.

The NZD struggled throughout the month against the backdrop of strong upward momentum in the USD, the pricing out of some aggressive rate hikes that had been built into the curve, and weaker risk appetite. The path of the NZD continued to diverge from higher NZ commodity prices, with the latter reaching a record high on the ASB NZ export commodity price index, measured in SDR terms. Dairy prices continued to surge ahead, with the annual increase in the GDT dairy auction price index approaching 40%. Milk payout futures for FY22 reached the $9 mark.

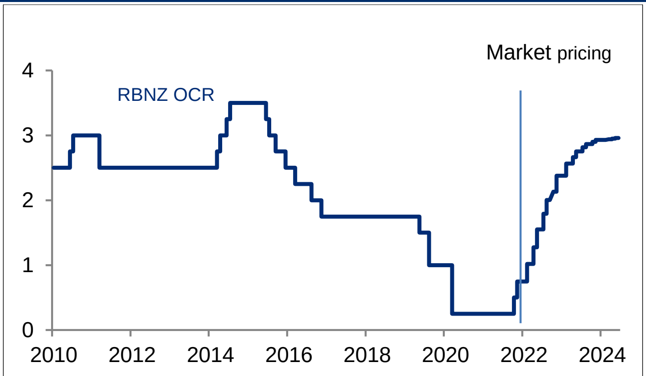
Late in the month the NZD hit a fresh year-to-date low of 0.6773, following market nerves around the reporting of the new Omicron variant and the potential reduction in current vaccine efficacy. The NZD closed the month down almost 5% to 0.6820, showing chunky falls on all the key crosses, apart from NZD/AUD, which oscillated between 0.9520-0.9695 and closed the month slightly higher at 0.9570.

Tighter NZ labour market evident



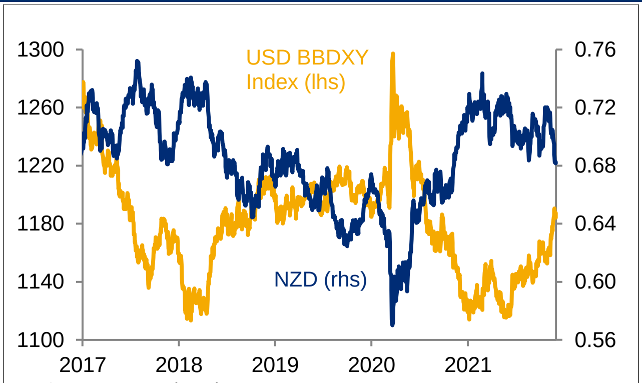
Source: BNZ, Bloomberg

Market well-priced for long series of rate hikes



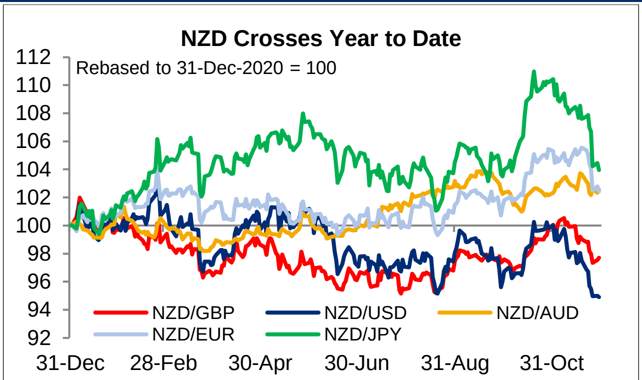
Source: BNZ, Bloomberg

Strong upward momentum for USD



Source: BNZ, Bloomberg

NZD still higher year-to-date vs AUD, EUR and JPY



Source: BNZ, Bloomberg

RBA Governor Lowe continued to push back on market expectations of hikes from next year, saying that it was "extremely unlikely", supporting a decent fall in Australian rates across the curve. However, the Bank abandoned its yield-curve-control policy to keep the 3-year rate suppressed and conceded that it was plausible that a lift in the cash rate could be appropriate in 2023.

USD strength saw EUR, GBP and JPY break some key levels. USD/JPY broke above 115, before lower risk appetite at the end of the month saw the yen strengthen. NZD/JPY fell by 5½% to 77.2. EUR dipped below 112 at one point and NZD/EUR fell by about 3% to 0.6020. ECB members pushed back on market pricing for hikes as soon as next year, with most downplaying higher inflation as transitory and projecting it to fall back towards 2% next year.

GBP temporarily went sub 1.32. NZD/GBP fell by about 2% to 0.5130. The Bank of England surprised the market by not delivering a 15bp hike to kick off a tightening cycle, with Governor Bailey wanting to see more labour market data after the end of the furlough scheme before proceeding.

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Monthly Performance Table

	end-Nov	end-Oct	Change
Currencies			
NZD/USD	0.6822	0.7171	-4.9%
NZD/AUD	0.9571	0.9538	0.3%
NZD/EUR	0.6018	0.6201	-3.0%
NZD/GBP	0.5130	0.5242	-2.1%
NZD/JPY	77.20	81.74	-5.6%
NZD/CNY	4.343	4.593	-5.4%
TWI	73.4	76.0	-3.5%
AUD/USD	0.7127	0.7518	-5.2%
EUR/USD	1.1338	1.1558	-1.9%
GBP/USD	1.3299	1.3682	-2.8%
USD/JPY	113.17	113.95	-0.7%
USD/CNY	6.36	6.41	-0.6%
USD/CAD	1.2779	1.2388	3.2%
USD BBDXY	1182.66	1160.50	1.9%
Asia DXY	107.85	107.89	0.0%
Equity Markets			
MSCI AC Wrld, loc.	1,847	1,878	-1.6%
MSCI World, loc.	10,416	10,568	-1.4%
MSCI EM, USD	2,927	3,052	-4.1%
US S&P 500	4,567	4,605	-0.8%
Euro STOXX 600	463.0	475.5	-2.6%
Germany DAX	15,100	15,689	-3.8%
France CAC 40	6,721	6,830	-1.6%
UK FTSE 100	7,059	7,238	-2.5%
Aust S&P/ASX 200	7,256	7,324	-0.9%
Japan Topix	1,928	2,001	-3.6%
China CSI 300	4,832	4,909	-1.6%
NZX50	12,719	13,100	-2.9%
Volatility: VIX	27.19	16.26	67.2%
3-mth Bill Futures			
NZD Jun-22	98.12	97.81	0.31
AUD Jun-22	99.68	99.31	0.37
USD Jun-22	99.55	99.56	-0.01
EUR Jun-22	100.49	100.39	0.10
GBP Jun-22	99.09	98.80	0.29
CAD Jun-22	98.71	98.60	0.11

	end-Nov	end-Oct	Change
NZ Rates			
OCR	0.75	0.50	0.25
NZ 90day BB	0.86	0.80	0.05
NZ 2yr swap	2.15	2.26	-0.11
NZ 5yr swap	2.62	2.63	-0.01
NZ 10yr swap	2.70	2.74	-0.04
NZ Govt (4/25)	2.04	2.21	-0.17
NZ Govt (4/27)	2.21	2.35	-0.15
NZ Govt (4/29)	2.34	2.48	-0.14
NZ Govt (5/31)	2.42	2.58	-0.16
Global 10 year bond rates			
US	1.45	1.56	-0.11
Canada	1.57	1.72	-0.15
UK	0.81	1.03	-0.22
France	0.01	0.27	-0.26
Germany	-0.35	-0.11	-0.24
Italy	0.97	1.17	-0.20
Spain	0.40	0.61	-0.21
Portugal	0.33	0.52	-0.19
Ireland	0.11	0.33	-0.22
Japan	0.05	0.09	-0.04
Australia	1.69	2.09	-0.40
Commodities (USD)			
WTI Crude	66.18	83.57	-20.8%
Brent Crude	70.57	84.38	-16.4%
R/B CRB Index	219.2	237.7	-7.8%
Gold spot	1,775	1,783	-0.5%
Silver spot	22.84	23.90	-4.5%
Copper	427.8	436.8	-2.1%
Iron Ore	102.53	104.10	-1.5%
Thermal coal	152.00	223.45	-32.0%
Corn	567.5	576.3	-1.5%
Wheat	787.3	785.0	0.3%
NZX Dairy WMP	4,250	3,925	7.6%
NZX Milk Payout '22	9.01	8.63	4.4%

Source: BNZ, Bloomberg

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