

Financial Markets Wrap

1 November 2023

Commodity currencies underperform in October

- The NZD fell 3% in October, the worst of the key majors, against a backdrop of underperforming commodity currencies
- Risk appetite was a drag for the NZD, with equity and bond markets showing negative returns for a third successive month
- The USD was broadly stronger, but after an early October peak showed no further gain despite positive economic releases



Quick Outlook		October ranges
NZD/USD	Some tentative signs of a base forming, with the USD struggling to push higher in response to usual USD-positive forces. We have a 0.60 end-Q4 target, consistent with a 0.58-0.62 trading range developing. Assumes no significant escalation in the Middle East conflict.	0.5775 – 0.6055
NZD/AUD	Fall from 0.94 deserved, against the backdrop of further likely RBA hike(s). Some support around 0.9150, but ultimately we see another push downward to 0.90, with Australia's expected outperforming economy versus NZ leading to further NZ-AU interest rate narrowing.	0.9150 - 0.9410
NZD/GBP	Both UK and NZ economic outlooks are sluggish and both central banks look to be on hold for some time. Some consolidation in the cross near current level seems appropriate.	0.4770 - 0.4930
NZD/EUR	Both euro area and NZ economic outlooks are sluggish and both central banks look to be on hold for some time. Some consolidation in the cross near current level seems appropriate.	0.5475– 0.5710
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.	86.8 – 89.9

For the third successive month, global equity markets and bond markets posted negative returns, with global rates reaching fresh cycle highs, the market accepting a likely higher-for-longer rates backdrop. Not helping the cause, US economic data continued to positively surprise. Adding to the case of weaker risk appetite, geopolitical risk increased in the Middle East, with Israel and Hamas at war. Commodity currencies underperformed, with the NZD down nearly 3%, making it the worst of the key majors.

It was a case of wash, rinse, and repeat for financial markets in October, with another month of higher and steeper yield curves on the back of solid US economic releases and a sense that policy rates would need to be maintained “higher for longer”. Strong US releases included a bumper non-farm payrolls report (+336k in Sept, with upward revisions), and GDP rising an annualised 4.9% in Q3, a remarkable achievement so late in the tightening cycle. Initial jobless claims fell below 200k to their lowest level since January. The September CPI print was slightly higher than expected and core measures continued to convey a stickier inflation backdrop, even if the ex-food and energy measure fell to 4.1% y/y, a fresh two-year low.

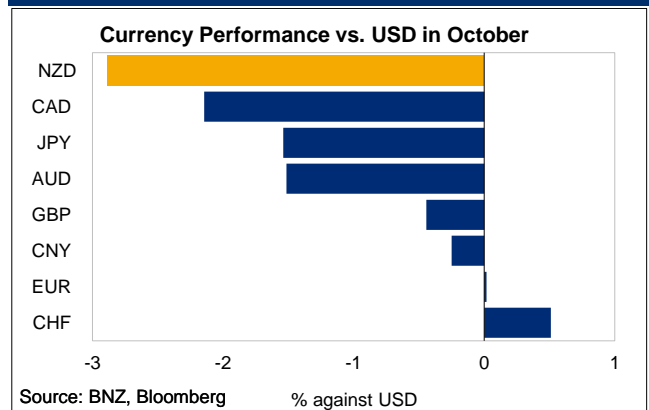
Despite the strong data, there was a seemingly coordinated message from Fed officials that the recent tightening in financial conditions was doing some of the work to support a weaker inflation trajectory. This was backed up by Fed Chair Powell in a talk at the Economic Club of NY, who reiterated that message and repeated that the Fed would be proceeding carefully.

In a volatile month, the US 10-year rate traded a 50bps range and recorded a high of just under 5.02%, its highest level since 2007. It was another month of higher and steeper curves, with the 2-year rate up 4bps and the 10-year rate closing 36bps higher at 4.93%. The NZ rates market showed steeper curves as well, but with lower short end rates, with 2-year swap down 14bps to 5.58% and the 10-year rate up 26bps to 5.44%. NZGBs showed similar movements.

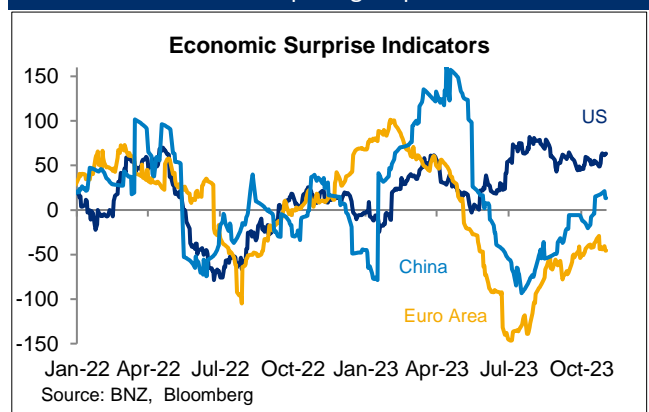
Early in the month, the RBNZ left the Official Cash Rate unchanged at 5.5%, with the accompanying statement suggesting little change in the Bank’s assessment from the August MPS. While noting ‘interest rates are constraining economic activity and reducing inflationary pressure as required’, there was a suggestion, at the margin, that rates may need to stay elevated for longer than it had previously forecast. This was a dovish surprise for those who were picking another rate hike in November and some backtracking in those views contributed to lower short-end rates.

Further contributing to lower NZ short-end rates, and lower NZ-Australia and NZ-US rate spreads, NZ’s Q3 CPI report showed notably lower annual inflation of 5.6% compared to the RBNZ’s estimate of 6.0%.

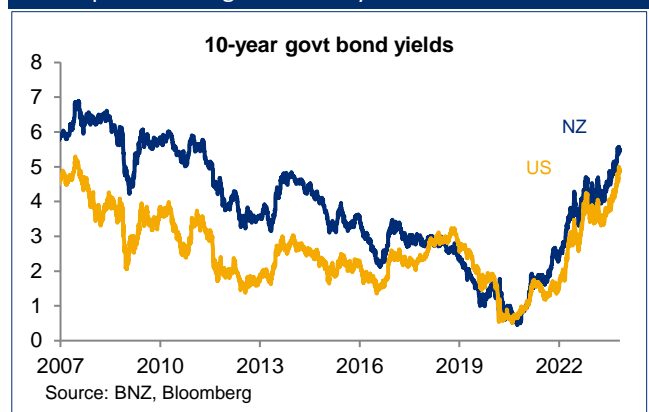
USD broadly stronger; commodity currencies underperform



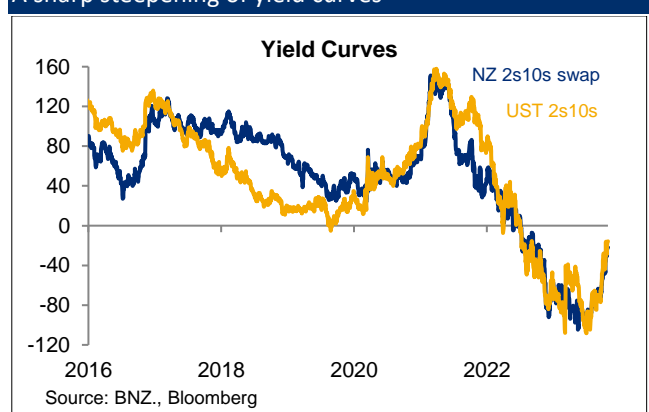
US economic data still surprising on positive side



Rates up to fresh highs for the cycle



A sharp steepening of yield curves



All key core inflation measures conveyed a picture of weaker underlying inflation pressure, although with the average of them at around 5.3% y/y, inflation remained uncomfortably high. NZ's quarterly survey of business opinion conveyed a picture of the economy struggling to grow and a marked easing in capacity pressures, particularly with regards to the labour market, portending a sharp lift in the unemployment rate.

In currency markets, the USD was broadly stronger and, early in the month, the DXY index traded at a fresh high for the year of 107.3, supported by the outperforming US economy and lower risk appetite. Of note, the USD peaked on the 3rd of the month and, even though the US dataflow continued to positively surprise, and risk appetite fell further on rising geopolitical risk, the USD didn't manage to rise any further, suggesting a market already heavily long-USD.

The NZD traded a high of 0.6056 on 11 October and a fresh year-to-date low of 0.5774 on 26 October and an overall near-3% fall for the month to 0.5825, making it the worst performer of the key majors we track, exaggerated by the currency's inexplicable strength towards the end of September. Weaker risk appetite and lower NZ rate spreads against Australia and the US contributed to performance. There was no sustained reaction to the election result, the change of government being in line with the pre-election polls.

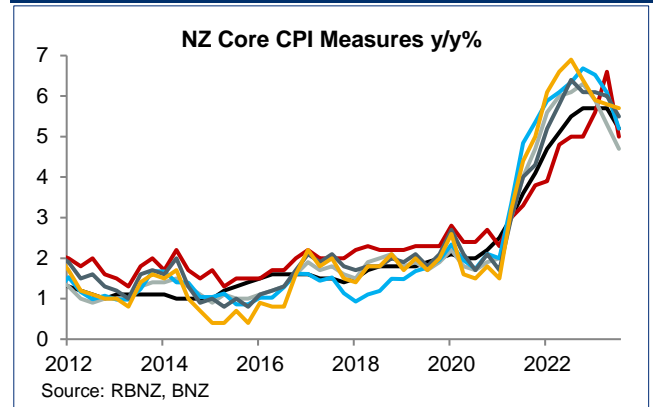
Commodity currencies underperformed on weaker risk appetite and concerns about the outlook for the global economy on a higher-for-longer rates backdrop. Brent crude traded as high as USD94 per barrel, supported by increased geopolitical risk in the Middle East. But analysts didn't see a case for sustained strength unless Iran was brought into the conflict and Brent crude ended the month 8% lower around USD87. Of relevance to NZ's terms of trade, dairy prices continued to recover strongly, after the significant tumble through to August.

NZD/AUD fell 1½% to 0.9190, a move supported by lower NZ-Australia rate spreads. While the RBA left policy unchanged again, the meeting minutes conveyed that the Bank had a "low tolerance for a slower return of inflation to target than currently expected" and Governor Bullock said the Bank "will not hesitate to raise the cash rate further if there is a material upward revision to the outlook for inflation". Q3 CPI inflation positively surprised, with the trimmed mean of 1.2% q/q, some three-tenths above the RBA's August projection. This saw the market price in a good chance of a November rate hike.

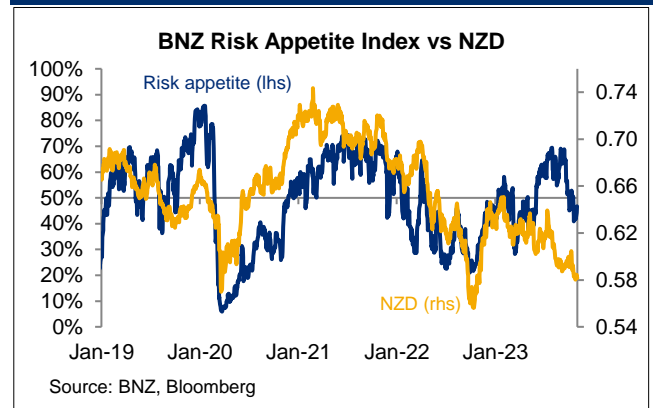
The Chinese yuan showed some stability with USD/CNY spending most of the month hovering just over the 7.30 mark, helped by the heavy hand of the PBoC and, for a change, some better data releases that suggested the economy was bottoming out.

The yen was weak, even though the BoJ made another step away from its yield curve control policy at the end of the month. USD/JPY pushed up through 150 with no sign

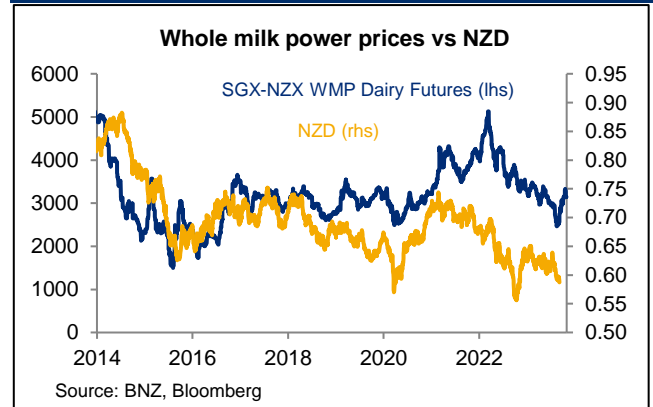
All NZ core CPI inflation measures heading lower



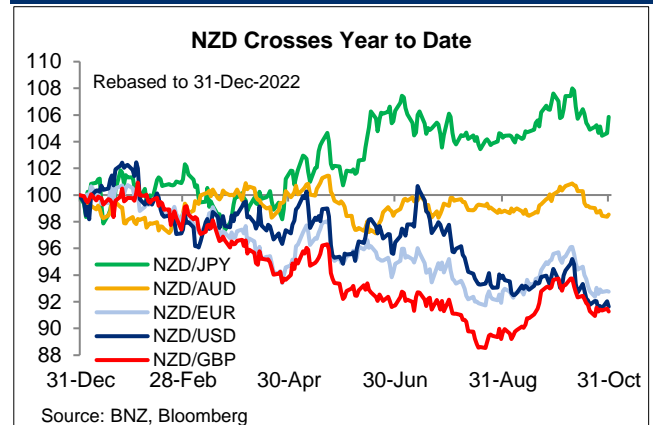
Weaker risk appetite a drag on the NZD



A strong bounce in dairy prices off their lows



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



of official intervention. The BoJ will no longer strictly cap the 10-year JGB at 1%, allowing some market freedom to trade above that level. Despite the weak yen, NZD/JPY still fell 1½% to 88.3.

NZD/EUR and NZD/GBP fell in the order of 2½-3% to just over 0.55 and just under 0.48 respectively. Euro area growth and inflation figures were weaker than expected, with a small contraction in the economy in Q3 and CPI inflation falling to 2.9% y/y. The ECB left rates unchanged and continued to convey a message that enough tightening had likely been done this cycle.

GDP data for July/August also painted a picture of a struggling UK economy, with odds-on that the economy contracted in Q3 following GDP growth of just 0.1% in Q2. Wages and CPI inflation data suggested signs of easing inflationary pressures, supporting a view of the BoE likely being on hold at its November meeting.

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Monthly Performance Table							
	end-Oct	end-Sep	Change		end-Oct	end-Sep	Change
Currencies				NZ Rates			
NZD/USD	0.5825	0.5998	-2.9%	OCR	5.50	5.50	0.00
NZD/AUD	0.9192	0.9322	-1.4%	NZ 90day BB	5.64	5.74	-0.10
NZD/EUR	0.5508	0.5672	-2.9%	NZ 2yr sw ap	5.58	5.72	-0.14
NZD/GBP	0.4794	0.4915	-2.5%	NZ 5yr sw ap	5.31	5.23	0.09
NZD/JPY	88.30	89.58	-1.4%	NZ 10yr sw ap	5.44	5.18	0.26
NZD/CNY	4.262	4.377	-2.6%				
TWI	69.4	71.1	-2.4%	NZ Govt (4/25)	5.57	5.74	-0.17
AUD/USD	0.6337	0.6434	-1.5%	NZ Govt (5/28)	5.36	5.28	0.08
EUR/USD	1.0575	1.0573	0.0%	NZ Govt (4/33)	5.55	5.31	0.24
GBP/USD	1.2150	1.2204	-0.4%	NZ Govt (5/41)	5.76	5.53	0.23
USD/JPY	151.70	149.37	1.6%				
USD/CNY	7.32	7.30	0.2%	Global 10 year bond rates			
USD/CAD	1.3875	1.3578	2.2%	US	4.93	4.57	0.36
USD DXY	106.72	106.17	0.5%	Canada	4.06	4.02	0.04
Asia dollar index	90.14	90.43	-0.3%	UK	4.51	4.44	0.07
				France	3.43	3.40	0.03
Equity Markets				Germany	2.80	2.84	-0.03
MSCI AC Wrld, loc.	1,757	1,806	-2.7%	Italy	4.73	4.78	-0.06
MSCI World, loc.	10,022	10,290	-2.6%	Spain	3.88	3.93	-0.05
				Portugal	3.49	3.58	-0.09
US S&P 500	4,194	4,288	-2.2%	Ireland	3.23	3.24	-0.01
Euro STOXX 600	433.7	450.2	-3.7%	Japan	0.94	0.76	0.18
Germany DAX	14,810	15,387	-3.7%	Australia	4.93	4.49	0.44
France CAC 40	6,886	7,135	-3.5%				
UK FTSE 100	7,322	7,608	-3.8%	Commodities (USD)			
Aust S&P/ASX 200	6,781	7,049	-3.8%	WTI Crude	81.02	90.79	-10.8%
Japan Topix	2,254	2,323	-3.0%	Brent Crude	87.41	95.31	-8.3%
China CSI 300	3,573	3,690	-3.2%	R/B CRB Index	281.2	284.5	-1.2%
NZX50	10,758	11,296	-4.8%	Gold spot	1,984	1,849	7.3%
Volatility: VIX	18.14	17.52	3.5%	Silver spot	22.85	22.18	3.0%
				Copper	364.9	373.8	-2.4%
3-mth Bill Futures				Iron Ore	122.33	114.94	6.4%
NZD Mar-24	94.23	94.02	0.21	Thermal coal	121.10	160.10	-24.4%
AUD Mar-24	95.37	95.55	-0.18	Corn	478.8	476.8	0.4%
USD Mar-24	94.63	94.63	0.00	Wheat	556.3	541.5	2.7%
EUR Mar-24	96.17	96.05	0.12	SGX-NZX Dairy WMP	3,155	2,965	6.4%
GBP Mar-24	94.74	94.62	0.12	SGX-NZX Milk Price '24	7.85	7.54	4.1%
CAD Mar-24	94.52	94.33	0.19				
Source: BNZ, Bloomberg							

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