AUD Quarterly Update

moneycorp

28th December 2018

Overview

Q4 Overview: There was a lot to influence the Australian dollar in the fourth quarter; domestic and international politics, ongoing trade tensions, a resolute Reserve Bank of Australia and a mixed economic picture all contributed to a measure of volatility.

Michael Turnbull replaced after by-election: A by-election in Australia to replace Prime Minister Malcolm Turnbull, delivered an independent to fill his shoes. It means Scott Morrison's coalition has lost its one-seat majority. However, the new MP voted in after Turnbull's departure said she would not go against the government in a confidence vote so the Aussie was not unduly troubled. It was 0.4% lower against sterling on the day, unchanged against the Swiss franc and US dollar but there was no long term influence due to a change at the top.

Reserve Bank of Australia holds steady: Headline inflation slowed to 1.9% in the third quarter, in line with forecasts. The Reserve Bank of Australia kept its benchmark cash rate unchanged at 1.5% in October and its statement offered no hint that an increase is in the pipeline. The statement knocked the Aussie back a little but it was still fractionally ahead on the day. Whilst it effectively amounted to no change in market guidance, the reminder in the statement that the rate is unlikely to change this year dented the Aussie slightly. The RBA held to this promise and the rate remained unchanged throughout the quarter. There was a bigger impact from the US Federal Reserve decision this quarter. A widely-telegraphed increase to its benchmark interest rate was accompanied by an unexpectedly hawkish statement, which hinted at two more rate hikes next year and another in 2020. Investors worried that the Fed might be going too far, and that it could have a braking effect on the global economy which would reduce demand for commodities.

Good news and bad news on the US-China trade war: News that Chinese data beat expectations despite the ongoing tussle over tariffs seemed to help the Australian dollar, which has been weighed down by the ongoing trade dispute. In addition, a lull in the equity rout helped risk appetite in general. There was a lot of news and some discussion but very little concrete action regarding the trade war this quarter, but it's clear that the Aussie is influenced by the situation. A comment from president Trump that America could get "a great deal" on trade even though China isn't yet ready for a deal meant that the Australian dollar moved higher, eventually adding a quarter of a cent against sterling. However, reports of a trade deal between Washington and Beijing looked ever less plausible as the White House failed to spell out what had been agreed. Further strong economic numbers from China proved positive for the Australian dollar. However, the Aussie has been volatile and struggling due to the potential impact of the US-China trade war. If no resolution can be found, there could be longer term implications to the dispute which ripple across world trade.

Domestic data highlight employment as a positive: At the beginning of the quarter, Australia's unemployment rate held steady at 5.0%, the lowest level since 2012, as the number of people in work increased to 33,000 in October, higher than the expected number of 20,000. There had been some hope that the numbers would increase the bullish outlook of the RBA in the future, but while Guy Debelle, deputy governor of the Reserve Bank of Australia, said in a speech that the Australian "labour market is in pretty good shape" he offered no pointer towards tighter monetary policy. The numbers still spelled good news for the Aussie as investors focused on that number rather than the monthly addition of 5.6k jobs, which was fewer than forecast and it proved good news for the Australian dollar. It wasn't all good news. Business and consumer confidence were both softer than expected. Construction work completed was down by 2.8% in the third quarter, a far cry from the expected 1.0% increase. Private capital expenditure - business investment - also fell by 0.5%, having been forecast to increase by 1.0%. To complete the triangle of disappointment, new home sales fell 0.8% in October. Australian mortgage lending was up by a useful 2.2% in October even as it was reported that house prices had fallen by 1.5% in the third quarter. New home sales increased by a useful 3.6% in November and 37k jobs were created in the same month, though that was not enough to prevent unemployment ticking up to 5.1%.

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NZD Quarterly Update

Overview

Q4 Overview: For the New Zealand dollar, the future looks bright. Despite some tough times, NZD has outperformed all G10 currencies over the past four months. A strong set of GDP, CPI and jobs data has been priced in, and together with a less dovish central bank, currently has the edge over its Australian currency, which is weighed by political risk. Having come close to a three-year low at the beginning of October it rebounded by 6.5% against the Greenback in November. Some 0.7 percentage points of that recovery came in a single week, as the Kiwi strengthened by two and a half cents against sterling.

Hostage to the fortunes of Brexit and the US-China trade war: Much like its Australian cousin, the Kiwi dollar is feeling the effects of the ongoing trade war between the US and China. The impact is slightly stronger for the Kiwi than the Aussie, perhaps due to the reliance on exports and the smaller economy making the trade war environment a large concern. Hope for a resolution to the trade dispute assisted the kiwi and in addition, more positive news on Brexit was also good for the kiwi, although this benefit waned as the good news dissipated. The Kiwi is dependent heavily on US-China relations and commentary from Chinese Premier Li Keqiang suggesting they were looking at resolving trade disputes lifted NZD due to commodity and China links. However, optimism about a trade agreement between the US and China faded as the White House failed to spell out any details. Turmoil in global equity and bond markets sapped investors' appetite for risk. A gentler tone on trade from the White House worked in the NZ dollar's favour but the kiwi took a hit when China reported weaker-than-expected figures for retail sales and industrial production.

A mixed picture emerges from statistics: New Zealand's consumer price index for the third quarter put inflation at 1.9%, appreciably above the 1.7% consensus forecast. Employment in New Zealand was up by 1.1% in the third quarter and the rate of unemployment fell from 4.5% to 3.9%. The numbers were well ahead of what had been fairly pessimistic forecasts. October's strong manufacturing performance index results and investors rumoured to be thinking twice about the central bank cutting interest rates both helped boost NZD for a time. However, the picture remains mixed. A quarterly increase of 0.4% in retail sales for Q3 looked pale at the side of the 1.3% rise in the second quarter. Third quarter manufacturing sales were down by 1.6%. Electronic card retail sales, an early indicator of the broader sales picture, were down by 0.4% in November. ANZ's monthly inflation gauge slipped from 2.9% to 2.8% and food prices fell 0.6% on the month. Its biggest problem was third quarter gross domestic product, which expanded by 0.3%. New Zealand's economy was supposed to have grown by twice that much in Q3, and investors' reaction was to mark down the Kiwi.

Reserve Bank of New Zealand take a stance on capital reserves: The monetary policy statements from the Reserve Bank of New Zealand (RBNZ) held no surprises and did not affect the Kiwi. The bank confirmed in a statement that it "expect[s] to keep the OCR at [1.75%] through 2019 and into 2020". However, the RBNZ did manage to ruffle a few feathers and cause a dip in the kiwi with the announcement that banks would have to hold larger capital reserves. The RBNZ stance could raise borrowing costs and slow the economy.

Trade: The trade deficit widened in October, as imports increased more quickly than exports. The terms of trade index, which measures the relationship between imports and exports, deteriorated to -0.3%. The fortnightly GDT index of milk prices had a positive effect at some points, but continues to cause fluctuations. ANZ's commodity price indicator fell 0.6% in November. On balance the numbers did not work well for the Kiwi. Commodity-oriented currencies like the NZ dollar have been having a tough time in recent months, but the Kiwi appears to be getting off lightly compared to others, including the Australian dollar. This is because the main exports of New Zealand are agricultural, not the raw materials and energy used in manufacturing.