The Weekly Snapshot

28 November 2022

ANZ Investments brings you a brief snapshot of the week in markets

Global equity markets trended higher as risk sentiment continues to improve following the weaker-than-expected US inflation reading a few weeks ago. Despite attempts by US Federal Reserve (Fed) governors to maintain their hawkish rhetoric on interest rates, equity markets are expecting the Fed to dial back on their aggressive stance.

The S&P 500 Index finished a shortened week (due to the Thanksgiving holidays) up 1.6%, while technology stocks fell behind slightly, although the NASDAQ 100 Index still returned 0.7%. New Zealand shares underperformed, with the NZX 50 Index broadly unchanged, as the Reserve Bank of New Zealand (RBNZ) delivered a jumbo 0.75% rate hike.

It was another good week for bond markets. Minutes from the previous meeting of the Fed suggested that its interest rate-setting committee may begin to ease up on aggressive rate hikes. Bonds, which tend to underperform when interest rates are rising, performed well on the prospect that interest rates may be closer to a peak. The yield on the US 10-year government bond fell 13 basis points to finish the week at 3.70%. It was a similar story in New Zealand, where the yield on the equivalent government bond fell 7 basis points to 4.12%, despite jumping higher on Wednesday following the RBNZ's announcement.

What's happening in markets?

The RBNZ raised the Official Cash Rate (OCR) by 75 basis points to 4.25%. It is the single biggest increase in the OCR and takes the key interest rate to its highest level since the Global Financial Crisis. Its statement struck a hawkish tone, saying the OCR "*needs to reach a higher level, and sooner than previously indicated, to ensure inflation returns to within its target range over the medium term*".

The challenge the RBNZ is facing at the moment is that the cumulative effects of the interest rate hikes – 400 basis points since the middle of last year – have yet to slow aggregate demand.

> ***"Because the New Zealand economy is starting from a position of very high inflation and acute labour shortages, an economic contraction is likely. Any fiscal or monetary policy actions that try to offset this with further stimulus will ultimately lead to a longer period of high inflation, with higher interest rates subsequently needed to control inflation and return the economy to a more sustainable path."***

The RBNZ's highly-anticipated economic projections (which accompanied its statement) painted a sombre outlook for the domestic economy. The neutral rate – the rate at which the central bank expects the OCR to peak – has increased sharply to 5.5%, suggesting further rate hikes lie ahead, meaning mortgage rates will have to climb further, stretching household budgets even more.

Adrian Orr, RBNZ Governor, admitted the central bank was essentially looking to engineer a recession.

> ***"The peak to trough decline in the level of GDP is expected to be about 1 percent. In the central projection, this recession is assumed to be spread over several quarters, although there is uncertainty about the timing."***

Meanwhile, global attention really seemed to be on the Fed as we approach its next meeting on December 14-15. Equity markets have enjoyed a good run following a weaker than expected October inflation print in, which has since been accompanied by weaker producer prices and services inflation.

Last week the rally was briefly halted on the back of hawkish rhetoric from Fed officials, who warned that there is still much heavy lifting ahead to bring down persistently high inflation. However, the market looked through this, focusing instead on the possibility of a downshift to a 50 basis point hike at its next meeting. Evidence of this was provided following the release of the minutes from its last meeting, the key point being that the majority of its members believe it is now appropriate to slow the tightening cycle.

Geopolitics remained in the limelight, with Russia again hitting Ukraine's infrastructure assets with a barrage of missile and drone strikes. Meanwhile, attention turned to the Covid situation in China. The government had relaxed strict lockdown restrictions a few weeks ago, but last week saw the country record its highest number of daily Covid cases (35,000) since the pandemic began.

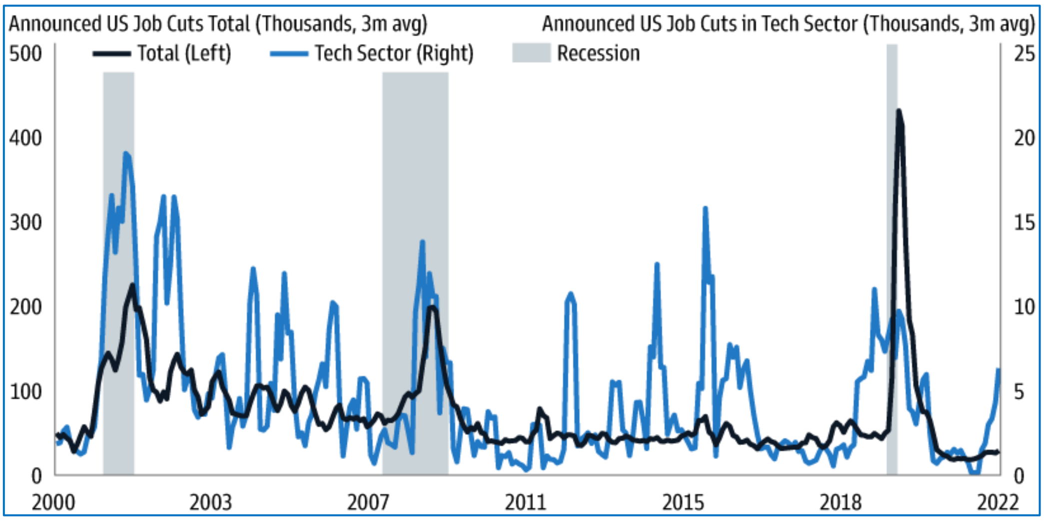
What's on the calendar

US jobs data and the Fed's preferred measure of inflation are both on the cards this week. During October the US economy added 261,000 new jobs, although the unemployment rate rose to 3.7%. Expectations for November are for 200,000 new jobs to have been created and a slight further uptick in the unemployment rate. Meanwhile, October's PCE inflation reading (the personal consumption expenditures price index, excluding food and energy) is due out on Thursday. In the year to September the price index was up 5.1%. This week's reading will no doubt be closely watched following the weaker CPI reading of a few weeks ago.

Elsewhere, in Europe, all eyes will be on eurozone CPI, where many will be keen to see if the recent easing in energy prices will flow through to overall pricing pressures.

Chart of the week

As mentioned above, the latest US jobs report showed that the economy added 261,000 new jobs in October. However, job cuts and pauses on hiring are beginning to flow across the technology sector in particular, which boasts some of the most valuable companies in the world. Amazon, Meta and Twitter have all announced layoffs. That's got to be bad news for the US economy as a whole.



Here's what we're reading

It's not just Twitter. The labour force is thinking differently now:
https://www.mauldineconomics.com/connecting-the-dots/its-not-just-twitter

Which is worse: Inflation or unemployment?
https://ritholtz.com/2022/11/which-is-worse-inflation-or-unemployment/