The Weekly Snapshot

11 July

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

Equity markets were up again last week, despite a strong jobs report in the US, which suggests the US Federal Reserve (the Fed) may remain aggressive in its battle to combat inflation. The S&P 500 Index rose 1.9% over the week, while technology stocks outperformed, with the NASDAQ 100 Index up 4.5%.

Other key overseas markets also finished higher, with the German DAX Index up 1.7%, Japan's Nikkei 225 Index up 2.2% and the Australian ASX 200 Index up 2.1%.

New Zealand shares also had a good week, with the NZX 50 Index up 3.4%, as the market appeared to benefit from investors 'buying the dip' and some buying in those companies that could benefit from border reopening (all remaining border restrictions will be removed at the end of the month). Amongst the stronger contributors to the market's performance were Fisher & Paykel Healthcare, Spark, Air New Zealand and Auckland Airport.

We used last week's rally to reduce our overweight to international equities ahead of what could be a bumpy earnings season.

Bond yields generally drifted lower over the week, but jumped higher on Friday given the strong US employment report. The US 10-year yield rose 19 basis points to finish the week at 3.08%. New Zealand bond yields drifted lower though, with the 10-year bond down 7 basis points to finish the week at 3.62%.

What's happening in markets

Jobs growth in the US accelerated at a faster-than-expected pace in June, indicating that the main pillar of the US economy remains strong. Nonfarm payrolls increased by 372,000, higher than the 250,000 expected, while the unemployment rate was unchanged at 3.6%. The strong number does little to back up suggestions the US economy is heading for a recession; if America is hiring and pay is rising, it means the Fed must do more to cool the economy and prices. As a result, the Fed is likely to press ahead with another 75 basis point hike in July.

Staying in the US, minutes from the last meeting of the Fed (where it lifted interest rates by 75 basis points for the first time since 1994) were released, and they showed that the central banks is focused on inflation, with the goal of keeping longer-run expectations consistent with the 2% objective. Markets took the minutes very much in their stride given the amount of economic data that has come out since the meeting – and with longer run inflation expectations showing some signs of easing.

Elsewhere, in Australia, the Reserve Bank of Australia lifted its cash rate by 50 basis points to 1.35%, its third straight month of hikes and marking 125 basis points of tightening since May. The central bank flagged more rate hikes ahead as it struggles to contain surging inflation:

"The Board expects to take further steps in the process of normalising monetary conditions in Australia over the months ahead. The size and timing of future interest rate increases will be guided by the incoming data and the Board's assessment of the outlook for inflation and the labour market. The Board is committed to doing what is necessary to ensure that inflation in Australia returns to target over time"

What's on the calendar

The market will be fixated on US Consumer Price Index (CPI) data this week, as the next key data point that could significantly move interest rate pricing. Headline inflation is expected to come in at 8.8% (versus 8.6% in May), but with oil and commodity prices having fallen recently, the market is probably expecting that this could represent a peak in the inflation cycle – and may look through the headline number.

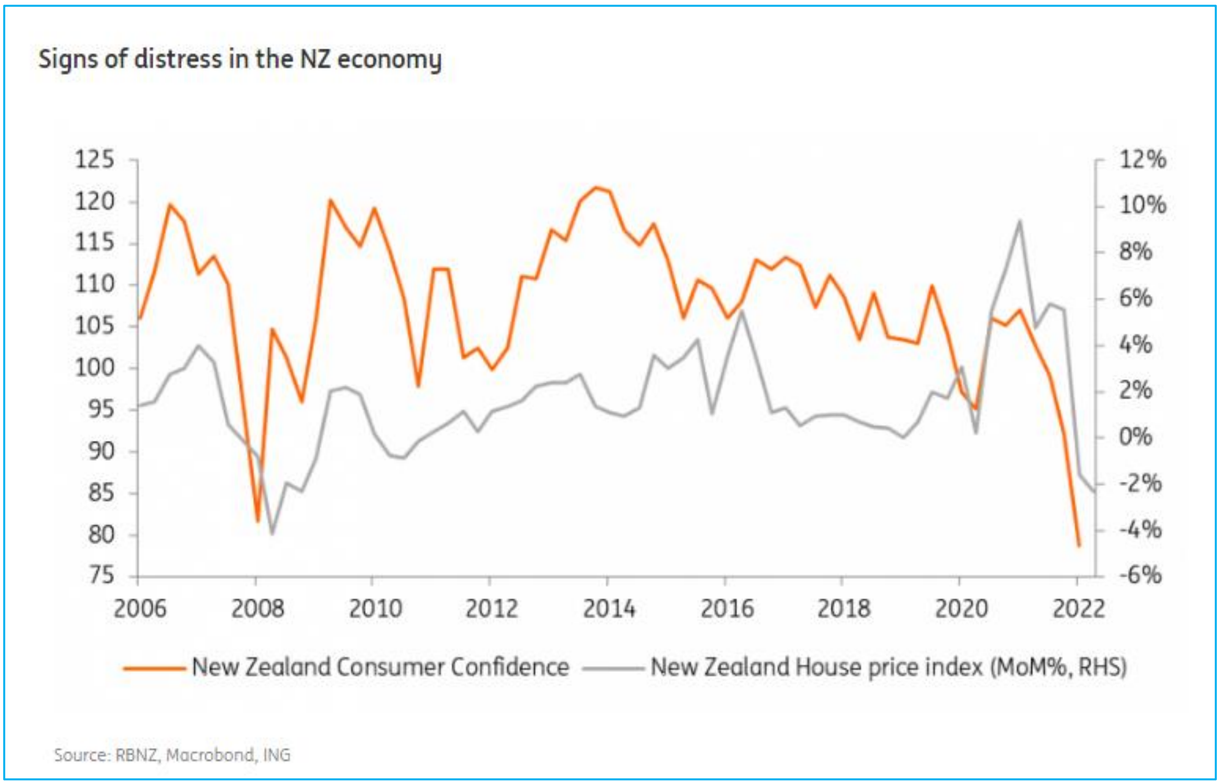
The Reserve Bank of New Zealand (RBNZ) will meet again on Wednesday this week and another 50 basis points of tightening seems likely. But a weaker housing markets and a deteriorating economic picture suggest the RBNZ may need to recalibrate its hawkish message soon (see chart below). Meanwhile, the Bank of Canada will also meet this week. It raised interest rates by 50 basis points to 1.5% last time around, and had signalled further hikes ahead. With the country's CPI rising to 7.7% in May (up from 6.8% in April), it's likely to raise rates by at least 50 basis points.

The start of the second-quarter earnings seasons could also mean markets are in for a bumpy ride. The large US banks are amongst the first to report. And finally, the market will likely be interested in China's second-quarter GDP number, which could make for interesting reading given that economic output would have been negatively affected by COVID lockdowns across the country.

Chart of the week

Second-quarter GDP in New Zealand showed a surprise contraction, consumer confidence has fallen to its lowest level on record and business confidence is back to its 2020 levels. Meanwhile, house prices continue to head lower.

It's fairly bleak reading ahead of the RBNZ meeting this week, but it appears to remain committed to combating inflation, and a third consecutive 50 basis point hike this week seems more than likely. However, markets will be paying close attention to its accompanying comments. While the RBNZ may need to acknowledge a worsening outlook, it's unlikely to do this now - given that Q2 inflation will be published a few days after the meeting – and it won't want to risk its efforts to tame inflation too soon.



Here's what we're reading

The biggest argument in finance right now – the definition of a recession: https://awealthofcommonsense.com/2022/07/the-biggest-argument-in-finance-right-now/

Dollar cost averaging through some of the most difficult periods in market history: https://ofdollarsanddata.com/in-defense-of-dollar-cost-averaging/