The Month Ahead – April 2023

Concerns around the global banking sector dominated financial markets in March, with one closely-watched measure of volatility hitting its highest level in about six months.

The reaction to the uptick in volatility saw bonds in demand, as yields dipped to multi-month lows. However, despite the unease, US equity markets have, at least for now, avoided a significant sell-off, with the S&P 500 Index about flat on the month (as of 24 March) and the NASDAQ 100 Index higher by more than 3%.

Looking ahead, the banking sector, and any further jitters, will be top-of-mind as investors and deposit holders remain on edge. Furthermore, it's a busy month in New Zealand with our central bank navigating ongoing inflation concerns with an economy that is deteriorating.

Breaking this down is ANZ Investments' Month Ahead.

Inflation is still the challenge, but banking sector woes have ramifications

About a week ago, the US Federal Reserve (the Fed) met for the first time since the failure of two US banks. With fears of contagion, but still inflation worries, the question was, how would policymakers balance these two issues that are pulling monetary policy in different directions.

In assessing the Fed's decision, it appears the number one issue remains inflation, with the Committee saying that "some additional policy firming may be appropriate" to bring inflation back to 2%, adding that it remains "highly attentive to inflation risks".

Nevertheless, the Fed said one of the fallouts of the recent bank failures has been tighter credit conditions, which they said would likely weigh on economic activity and hiring. But in regards to the overall banking sector, the Fed stressed its confidence in the system, saying it is "sound and resilient" – a sign contagion is unlikely, at least in their eyes.

From a financial markets perspective, we feel the Fed has just one more interest rate hike to go in the cycle, assuming there isn't a firming in economic data. And for this reason, we prefer to be overweight fixed interest, believing that US government bond yields have peaked.

RBNZ expected to slow the pace of interest rate hikes; inflation data in focus

On 5 April, the Reserve Bank of New Zealand (RBNZ) meets, where it is expected to raise the Official Cash Rate (OCR) by 25 basis points, to 5%, which would mark its eleventh-straight interest rate hike and would see the OCR at its highest level in more than a decade.

Although the battle against inflation continues, growth is starting to wane, and business and consumer confidence remains tepid, at best. Economic data showed that New Zealand's economy contracted by a bigger amount than expected in the final quarter last year, while the prior quarter's figures were also downgraded.

Moreover, some leading indicators are reaffirming our view that the domestic economy is worsening, with the housing market continuing to decline, and consumption slowing. Nevertheless, we still see a 25 basis point hike as likely, and a central bank that remains steadfast in its fight against inflation.

Later in April, inflation figures for the first quarter will be released and this could be the catalyst for a shift in monetary policy. After more than 400 basis points of interest rate hikes, the central bank is hoping a slowing in demand has cooled inflation, and if this shows up in the data then we could be closer to the terminal rate – the rate where the OCR is expected to peak.

RBA could pause as policymakers see signs of a slowing economy

Across the Tasman, the Reserve Bank of Australia (RBA) could be the latest major central bank to pause its tightening cycle, when it meets on 4 April.

Earlier in the month, interest rate markets were all but pricing in another 25 basis point hike, but after the minutes from March's RBA meeting were released, the probability of a hike has fallen. The minutes showed that policymakers were juggling conflicting signals on the health of the economy amid the rapid rise in interest rates.

"The staff's most recent forecasts assumed that consumption growth would remain subdued for some time, but it was possible that growth could slow by more than expected given very low levels of consumer confidence", the minutes said.

Given this, it appears the RBA could be willing to look through inflation – to some degree at least – and focus on how the economy can handle the cumulative effect of the interest rate rises put in place over the past 12 months or so.