The Month Ahead – June 2023

It was a mixed May for global equity markets, with the tech sector continuing to outperform, which has seen the NASDAQ 100's year-to-date gains top 25%, while several other benchmarks were either side of unchanged. Meanwhile, New Zealand markets were modestly lower as investors digested the implications of a further 25 basis point increase in interest rates and the central bank's suggestion that the hiking cycle had ended.

June sees the US Federal Reserve (the Fed) and some European central banks meet, and in New Zealand, some economic data will show whether or not the cumulative interest rate hikes are slowing economic growth.

Breaking all this down is ANZ Investments' Month Ahead.

Fed decisions down to the wire

The Fed meets on 14 June, where according to interest rate markets, it is almost a toss-up as to whether the central bank will lift the fed funds rate.

Since the Fed's prior meeting, interest rate markets have been leaning towards a Fed pause after Fed Chair Jerome Powell said they are moving to a "data-dependent" approach going forward, and with inflation trending lower, markets took that to mean a pause for June.

However, in the latter stages of May, some hawkish rhetoric and an upside surprise to some key pricing data have seen the decision move closer to a toss-up.

Firstly, James Bullard, the St. Louis Fed President, said in a speech that the resilience of the US economy warrants further monetary tightening if it is to get on top of inflation.

"I'm thinking two more moves this year, not exactly sure where those would be. But I've often advocated sooner rather than later", he said.

Then on 26 May, economic data showed the US core personal consumption expenditures (PCE) price index rose 0.4% in April and 4.7% on an annual basis, both were higher than expected. The core PCE is the Fed's preferred measure of inflation, and the uptick could suggest there is more policy tightening to be done.

As of 29 May, interest rate markets are pricing in a 55% chance the Fed lifts the fed funds rate by a further 25 basis points.

European central banks not ready to pause

Meanwhile, in Europe, the European Central Bank (ECB) and Bank of England (BoE) both appear set to continue their policy tightening as inflationary pressures remain stubborn across the continent.

Eurozone inflation moved higher in April, while in the UK, annual inflation dropped below 10% to 8.7%, driven largely by a decline in energy prices. Nevertheless, the 8.7% reading was well ahead of consensus and saw the probability of a rate hike shoot up, with interest rate markets now expecting the BoE's key policy rate to surpass 5% later this year.

Did the New Zealand economy enter a technical recession?

In June, New Zealand Gross Domestic Product (GDP) data for the first quarter of 2023 is released, which could show the economy entered a 'technical' recession – characterised by two consecutive quarters of negative growth.

We use the word 'technical', because many would perceive a recession as a broad-based deterioration in the overall economy. And with the unemployment rate at a near-record low and wages rising, it would be difficult to conclude – at least for now – that the economy is in a broad-based decline.

Nevertheless, back-to-back quarters of negative growth is not something to shrug off, and should we begin to see the labour market slow, it may be that the growth numbers foreshadowed the start of an overall worsening of the domestic economy.

We remain defensive against an uncertain backdrop

At a tactical level, we remain relatively defensively positioned, which reflects our view that the global economy is slowing and the cumulative effect of interest rate rises over the past 12 months are still feeding through to the economy. These higher interest rates, coupled with a tightening of credit conditions, are making it more challenging for businesses, while household finances are being squeezed. Even though inflation is well off its highs in many major countries, it still sits at uncomfortable levels.

Given all this, we remain overweight to both international and domestic fixed interest, while we maintain an underweight to global equities.