Global Macro Department – Oil (Underweight)

Date: 7th April 2024

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Fig 1: Three countries account for 40% of Global Oil Production

Oil Production 2023	Million barrels per day
U.S.	12.9
Russia	10.1
Saudi Arabia	9.7
Canada	4.6
Iraq	4.3
China	4.2
Iran	3.6
Brazil	3.4
UAE	3.4
Kuwait	2.7
Other	22.8

Source: Visual Capitalist

Overview of Oil

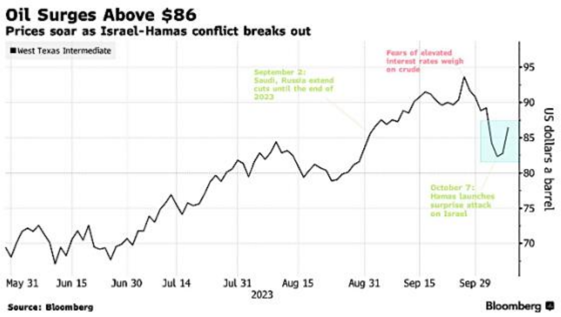
- Crude oil, a linchpin of our global economy, maintains a pivotal status across all industries. Its indispensability as a primary energy source for transportation and a fundamental raw material accentuates its long-lasting relevance in our modern world. The oil market is characterised by a complicated interplay of supply, demand and geopolitical dynamics. It offers both complexities and investment opportunities. Crude oil's refinement yields an array of products, including gasoline, diesel, jet fuel, heating oil, and serves as a foundational component in manufacturing plastics, chemicals, and pharmaceuticals.

- The two most commonly heard terms in oil trading would be West Texas Intermediate (WTI) and Brent Crude. WTI Crude Oil is extracted from fields located in Texas, North Dakota, and Louisiana of the United States. Brent Crude is extracted from the North Sea near Europe; its oil fields include Brent, Forties, and Oseberg. In terms of sweetness, the lower the sulphur content, the sweeter the product is. WTI has a sulphur content of 0.24%, making it quite sweet. On the other hand, Brent has a sulphur content of 0.40%, still under the 0.50% benchmark, and of course, is not as sweet as the WTI oil.

- There are a few ways to trade oil. Firstly, we have futures and options. Oil futures and options contracts are mainly traded on the New York Mercantile Exchange (NYMEX) and the Intercontinental Exchange (ICE) where each contract consists of a thousand barrels. Secondly, we can purchase shares in oil companies like ExxonMobil and Eni or oil exchange traded funds (ETFs). Finally, we can trade oil CFDs. CFDs are popular among traders who want to trade with leverage and without having to buy and own physical barrels of the commodity.

- Moving on to the top importers for oil. In descending order, the top five importers of oil are China, Europe, United States, India and lastly Japan. These five regions combined make up more than 50% of the entire world's crude oil demand. As for the supply side, the top three exporters of oil are United States, Saudi Arabia and Russia. These three nations account for about 40% of the world's oil production (Fig 1).

Fig 2: Oil prices soar as Israel-Hamas conflict breaks out



Source: Bloomberg

Summary of events in the past 6 months

- The conflict between Israel and Hamas is one of the most significant geopolitical risks to oil markets ever since Russia's invasion of Ukraine. On 7 October 2023, oil prices jumped by about 4% to touch the $90 mark for Brent crude oil prices and above $86 for WTI crude oil prices (Fig 2). As of 7 April 2024, exactly half a year since the conflict begun, oil prices have continued to see volatile movement with every piece of news emerging from the region. There are news of Israel's military announcing that it is pulling thousands of soldiers out of the south after months of fierce combat. However, the news is still fresh and we are unable to determine at this point if this move will be sufficiently significant for markets to trade lower.

- The Russian-Ukraine war continues to develop in the background. Red Sea conflicts continues to stress trade routes, potentially leading to longer trade routes that would require greater oil consumption. Additionally, since the beginning of 2024, Ukraine has been launching attacks on Russian oil refineries and infrastructure to further curb the building of Russia's war chest, disrupting more than 15% of Russia's capacity. This is despite U.S. warnings to halt the attacks. Nevertheless, these drone attacks are mostly only able to damage some refinery units, and the refineries that were damaged were fully operational within a matter of weeks.

- As of 15 March 2024, we see US crude and oil inventories were further drawn down for the month of March. Gasoline inventories fell for a seventh consecutive week and were under 231mn barrels (week ending 15 March). Recall that back in November 2023, the US spoke about plans to buy 1.2 million barrels of oil to restock the Strategic Petroleum Reserve (SPR). The SPR had plummeted to historically low inventory levels, posing a potential risk for the US as it may lack adequate reserves to utilize during times of necessity.

- In April 2024, OPEC+ ministers reaffirmed their decision to keep their voluntary cuts until at least end of Q2 2024, despite the chaos in the Middle East rattling global markets. The reason for such drastic supply cuts to push oil prices higher could be because they need an enormous pile of cash to fund their futuristic and expensive sci-fi city called project Neom, while Vladimir Putin's Russia needs to fund their ongoing war with Ukraine. The next OPEC meeting will be held on June 1

China – Are We Reaching the End?

With a vast population of 1.4 billion individuals, an economy valued at $18.5 trillion with one of the swiftest economic expansions recorded in history, the Chinese economy was, and still continue to be a huge driver of oil demand globally.

However, despite an increase in China's crude oil imports in the first two months of 2024, forecasts currently suggest that China's demand for oil is expected to reach its zenith by 2027, followed by a sustained deceleration as the nation aims to put itself at the forefront of energy transition, much like other first world nations.

Some observers believe that China's oil demand growth in the current year may only reach half of the levels observed before the Covid-19 pandemic in 2019, as crucial sectors of the world's second-largest economy grapple with a slowdown. It is improbable for China to revert to its previous model of oil-intensive economic growth this year, given that the construction and automotive industries, which are pivotal drivers of oil demand, are currently showing signs of fatigue.

Similarly, the International Energy Agency mentioned in its report that China will lose its spot to India as the primary driver for global oil demand through 2030.

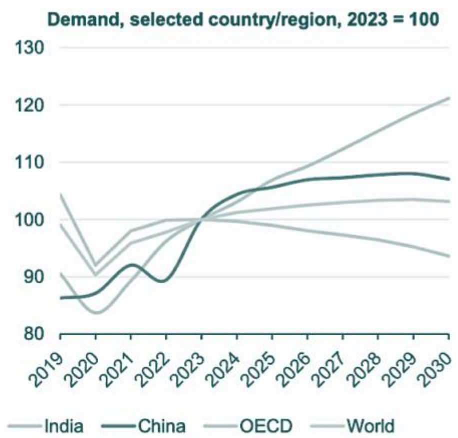
Even within its own borders, the country's largest energy producer, CNPC, mentioned that China's oil demand has entered a low-growth phase as decarbonization starts to eat into consumption of traditional forms of energy. The increased adoption of electric vehicles and liquefied natural gas-powered trucks will offset approximately 20 million tons, accounting for 10% to 12% of the nation's gasoline and diesel consumption this year.

Nonetheless, it is important to note that while China's influence over oil prices will fall with time, its influence at this very moment is still not to be underestimated. Just in March 2024, Oil prices fell nearly 1% due to market scepticism around China achieving its economic growth target given the lack of big-ticket stimulus plans to prop up the country's struggling economy disappointed investors.

If not China, who else will fill in these big shoes?

India – he New Big Brother?

Fig 3: Oil demand forecast



India has demonstrated remarkable economic performance since the start of the century. It saw an average annual GDP growth of 6.8% in the decade leading up to 2020, and swiftly resumed this trajectory following the pandemic. For the third consecutive year, India is poised to achieve the fastest expansion among major economies in 2024, with the International Monetary Fund forecasting its contribution to global economic growth to exceed 16% this year.

This growth is propelled by India's extensive domestic consumer market, abundant low-cost labour force, and favourable demographics. Notably, India surpassed China as the world's most populous country in 2023, just as China's population is entering a phase of structural decline.

India's robust economic growth, along with its dynamic population, rapid urbanization and continued reliance on traditional forms of energy such as oil will undoubtedly propel its influence in global oil markets significantly by 2030 (Fig 3).

Presently, India is the largest developing country in the world. In particular, we are seeing rapid progress in the manufacturing, commerce, transport and agriculture sectors. Most notable, its growth has substantial implications for individual mobility, and consequently, the demand for transportation. The country's remarkable reliance on road fuels for growth is a direct consequence of these escalating needs and the pivotal role of road vehicles in addressing them.

Given that it is still in its initial stage of economic development, its increased demand is also likely to outpace any other nation in the world. It is hence unlikely that the government or any other agencies would come in to introduce regulations or policies to restrict its use of oil. This removes a major risk for oil demand in India.

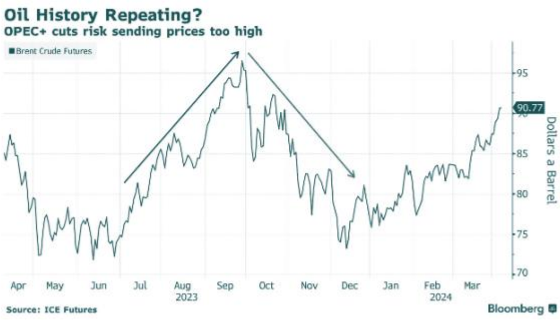
By 2023, India was already the world's second-largest crude oil net importer, having boosted imports by 36% over the past decade to 4.6 mb/d to meet rising refinery intake. Currently, the IEA believes that India is poised to become the primary driver of oil demand growth worldwide in the coming decade.

OPEC+ - Keeping Prices Afloat

In a top-level meeting in early April, OPEC+ ministers led by Saudi Arabia kept their voluntary cuts of about 2.2 mbpd until the end of June, as widely anticipated. These cuts, combined with the alliance-wide 3.66 mbpd cuts (agreed in 2022; to remain until at least end-2024), equal about 5.7% of the world's daily oil demand. However, they failed to materially impact prices as macro uncertainty around heavyweights like China and Germany weighed on demand. That was at least until mid-March 2024, when oil rallied 10% in a matter of weeks with Brent and WTI closing the 1st week of April at $91 and $86.50 respectively.

OPEC+ has argued that their production cuts are necessary to keep the market "in balance". Indeed, there has been a substantial rise in non-OPEC+ production in recent years, from U.S. shale oil production printing record highs yearly, as well as Guyana oil production increasing fivefold from 2020-2023. There has also been new capacity added in Canada, where the TMX pipeline is expected to begin operations in May and triple capacity for its heavy crude by 890 kbpd.

Fig 4: Oil prices last year



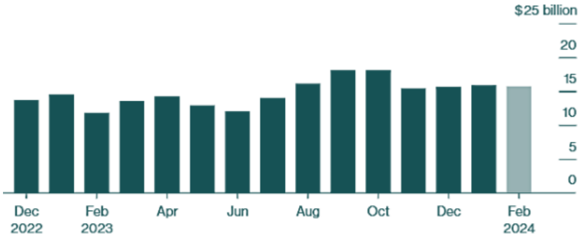
Source: Bloomberg

Nevertheless, some market participants think that OPEC+, in particular its de facto leader Saudi Arabia, is artificially inflating prices to balance members' government budgets. Projections from the International Monetary Fund last October pointed that Saudi Arabia potentially needed crude prices around $91 per barrel to fund its ambitious government spending plans. However, attempts to further inflate prices through measures like extending voluntary cuts past June to the end of the year risks repeating the market dynamics of late-2023. During that period, Brent surged to $97 per barrel on the back of OPEC+ production cuts. Yet, this surge was short-lived as market sentiment swiftly shifted towards concerns over potential 'demand destruction,' and prices tumbled to levels even below $70 (Fig 4).

The IEA forecasted in March that based on the assumption that OPEC+ maintained current production cuts to end-2024, a slight supply deficit is likely. Therefore, all eyes are on the OPEC+ alliance meeting on June 1, where they will give their guidance on whether to extend production cuts at its current level.

Regional Conflicts- A Step Up in Tensions

Fig 5: Russian Oil Export Revenues



Source: Bloomberg

Apart from OPEC+ production cuts, rising tensions in ongoing regional conflicts have been another factor driving oil prices higher in Q1 2024.

<u>Russia-Ukraine</u>

The Russia-Ukraine war reached a pseudo-stalemate in 2023, with both sides struggling to gain ground on the offensive. Russia has had to contend with tighter scrutiny on the G7 price cap on its Urals exports in Q4 2023, which caused total Russian oil and gas revenue to fall to a 3-year low last year. Pressure on exports revenue have continued so far this year, with the increased monitoring of sanctions by Western countries caused some buyers to shun away Russian oil (Fig 5). India, which emerged as Russia's 2nd largest customer in 2023 as they took advantage of the discounted Russian Urals, have toned down their purchases this year.

Ukraine since the beginning of 2024 has successfully launched attacks on Russian oil refineries and infrastructure in an effort to further curb the building of Russia's war chest, disrupting more than 15% of Russia's capacity. Despite U.S. warnings to halt the attacks, Ukraine, who has grown tired of ineffective Western sanctions, have decided to take matters into their own hands. Nevertheless, these drone attacks are mostly only able to damage some refinery units, and the refineries that were damaged were fully operational within a matter of weeks.

The lesser need for domestic crude due to these attacks, combined with peak maintenance season in Russian refineries, has allowed Russia to be able to pledge further production cuts to OPEC+. Russia seems likely to keep this promise, unlike last year when they blatantly overproduced despite Saudi Arabia's best efforts to coerce them. However, production cuts by Russia are unlikely to materially impact global crude supply, as they aim to cut back on crude output rather than export curbs.

<u>Israel-Hamas</u>

In October 2023, a war erupted between Israel and Hamas after Hamas' attack in Southern Israel, sending a brief shock in the oil markets due to its proximity with major oil-exporting nations.

Israel has continued to bombard the Gaza Strip in its efforts to "destroy Hamas once and for all", despite continuously losing international support, even from the U.S., its key ally, which abstained from a UN Security Council vote regarding a resolution on Gaza. Although parties on both sides of the conflict have repeatedly attempted to agree on truce deal like the one last November, no real resolution has been made just yet.

The conflict took another turn for the worse in early April, when 11 people including an Iranian senior commander were killed in an Iranian consulate in Syria. Iran quickly blamed Israel for the attack, and vowed revenge "of the same magnitude and harshness", leading to a spike in oil prices. It is highly uncertain how Iran might retaliate, but as OPEC's 3rd largest producer accounting for about 3% global supply, a direct conflict between Israel and Iran has the potential to tighten global supply and send prices even higher.

Figure 6: WTI Futures Daily Chart

Source: TradingView

Trade Idea: Short WTI Futures

Based on our analysis of demand factors, which include the slowing economic growth in China and the still developing stage of growth in India, we do not see a shortage of crude supply within our time horizon of 1 to 2 months.

Consequently, we attribute the recent bullish rally in oil prices largely to momentum, expecting the market to soon refocus on underlying fundamentals.

Furthermore, it is difficult to justify further upside in prices given the high levels of spare capacity, especially in the Gulf states.

Catalyst:

Apart from the removal of geopolitical risk premium in the oil markets, another catalyst to our trade could be if Saudi Arabia and OPEC+ decide to scale back some of their voluntary production cuts at their upcoming meeting on June 1st.

Technicals:

Examining the technical indicators, oil prices have surged approximately 20% year-to-date, yet the Relative Strength Index (RSI) has entered overbought territory in recent weeks, hovering around 73 (Fig 6). We propose to short WTI front-month futures, entering at the current price level of $86.51. We seek to take profit at $82.50 and stop loss at $90, which are previous key support/resistance levels. These levels guarantee us a good risk reward ratio of 1.15.

Entry: 86.51
Take Profit: 82.50
Stop Loss: 90
Risk Reward Ratio: 1.15

Disclaimer

NUS INVESTMENT SOCIETY

Global Macro Department – Australia (UNDERWEIGHT)

Date: 20th Apr 2024

Analyst

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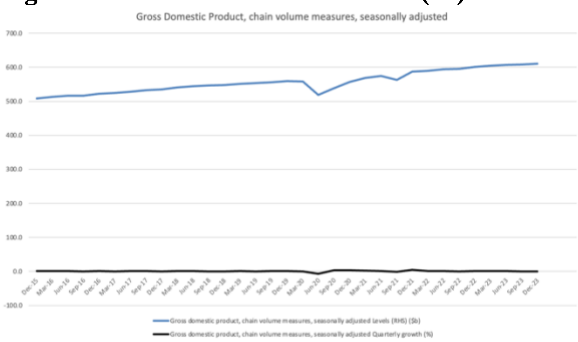
Basic Information

Real GDP (US$)	1484B
M2 (US$)	1963.410B
CPI	136.10
PPI	128
Con. Confidence	82.2
Building Permits	14423
Stock Index	ASX200
Currency	AUD

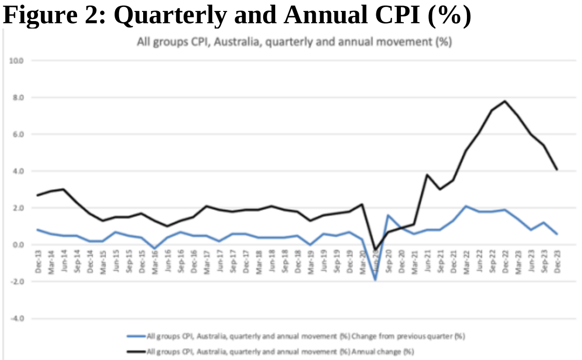
Chart info

Figure 1: GDP Annual Growth Rate (%)



Source: ABS

Figure 2: Quarterly and Annual CPI (%)



Source: ABS

Overview of Australia

- Australia has a mixed market economy that is rich in natural resources. Australia is the 14th largest national economy by nominal GDP and the 22nd largest goods exporter and 24th largest importer. It also has the 2nd largest accessible reserves of iron ore and the 5th largest reserves of coal and significant gas reserves.

- The main contributors to Australia's GDP are the services sector (62.7%) and the mining sector (14.3%). At the height of the mining boom in 2009 – 2010, mining contributed to 8.4% of the GDP. Despite the decline in the mining industry, the Australian economy has remained resilient and did not experience a recession from 1991 until 2020.

- Australia's main export shares by type are: Resources (63.3%), Services (16.5%), Rural (10.8%) and Manufactured (7.2%). Being a resource rich country, Australia's main exports are coal and petroleum gas (34.6%) iron ore (23.5%), gems and precious metals (6.3%) and meat (2.7%). Bulk of their exports are delivered to Asian countries, namely China, Japan and South Korea.

- Australia's main imports are machinery (14%), mineral fuels (13.3%), vehicles (13%), electronics (11.3%) and medical/technical equipment (3.7%). Australia mainly imports from China, US and Japan.

- Australia's economy has significant links with the nations of East and Southeast Asia, especially the ASEAN Plus Three group, with a substantial portion of its exports heading to these regions. China stands out as Australia's foremost trading partner. The nation participates actively in global and regional economic organizations such as APEC, G20, OECD, and WTO. Furthermore, Australia has established free trade agreements with numerous countries, including ASEAN member states, Canada, Chile, China, South Korea, Malaysia, New Zealand, Peru, Japan, Singapore, Thailand, and the United States. Its trade agreement with New Zealand has notably deepened economic ties between the two countries.

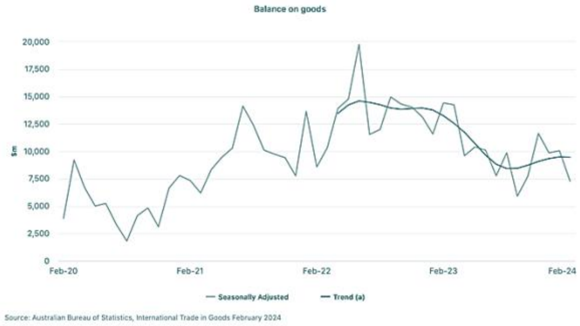
Summary of Events in the Past 6 Months

- Economic growth continues to slow, primally due to weaker household consumption growth as real income growth remains weak. Strong investment continues to provide support for growth.

- The recent dip in GDP per capita has been happening against a backdrop of remarkable population growth, primarily driven by overseas migration. This surge has bolstered both consumer spending and investment, resulting in unexpected tax revenue boosts for the government, which in turn has positively impacted budget outcomes.

- RBA is transitioning to an ample reserves system. This new approach will utilize full allotment repurchase agreement (repo) auctions for open market operations (OMO), expected to enhance cash market activity, potentially raising the cash rate and applying pressure on other money markets.

Figure 3: Balance on Goods



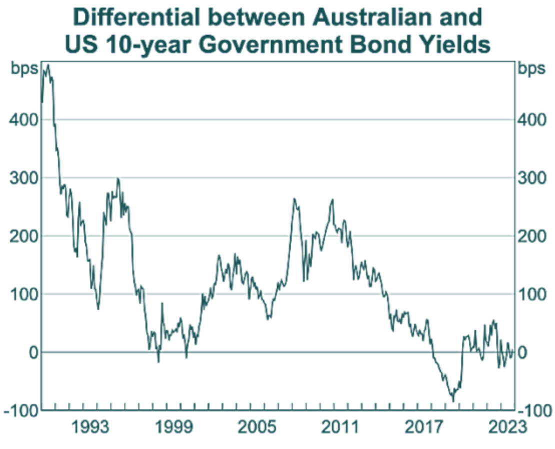
Source: ABS

- In Oct 2023, talks regarding a free trade agreement between the European Union and Australia have broken down. The current Australian administration, led by Albanese, has expressed doubts about reaching an agreement within the current parliamentary term. The Australian government had maintained that any agreement would need to align with the country's interests, particularly emphasizing the need for enhanced market access for its agricultural exporters to the EU market. Both parties have pointed to a lack of flexibility on the other's part as the reason for the stalemate.

Figure 4: Australia Official Cash Rate (%)

Source: RBA

Figure 5: Differential between Australia and US 10y Government Bond Yields (%)



Source: RBA

Figure 6: Unemployment Rate (%)

Source: ABS

RBA's Key Measures

Hold Rates for Now; Expect Cuts Later

The Reserve Bank of Australia (RBA) has decided to maintain its key interest rate at 4.35% during its March 12 meeting, continuing this rate for the third consecutive time and signalling a pause in its rate hikes until at least the end of September. This decision follows a period of aggressive monetary tightening that began in May 2022, during which the RBA increased the cash rate to a 12-year peak of 4.35% through a series of rapid increments.

The RBA's aggressive monetary policy, characterized by its first overnight cash rate (OCR) hike of 25 basis points on May 4, 2022, followed by four consecutive 50 basis point increases until September 2022, aimed at curbing inflation and achieving a sustainable balance between demand and supply in the Australian economy. The central bank's focus on price stability as a foundation for a robust economy and sustained full employment highlights the critical role of monetary policy in economic management. The rapid pace of these increases, leading to heightened mortgage repayments, underscores the RBA's commitment to bringing inflation within target ranges, despite the economic pressures these adjustments impose.

Despite expectations of rate cuts by most other major central banks starting around June, the RBA stands out for not planning mid-year cuts, primarily due to Australia's sluggish economic growth. However, interest rate futures suggest a 25 basis point reduction by the end of September, with at least two rate cuts anticipated in the last quarter of 2024.

In response to the decline in banking system reserves caused by passive quantitative tightening, the RBA is transitioning to an ample reserves system. This new approach will utilize full allotment repurchase agreement (repo) auctions for open market operations (OMO), expected to enhance cash market activity, potentially raising the cash rate and applying pressure on other money markets.

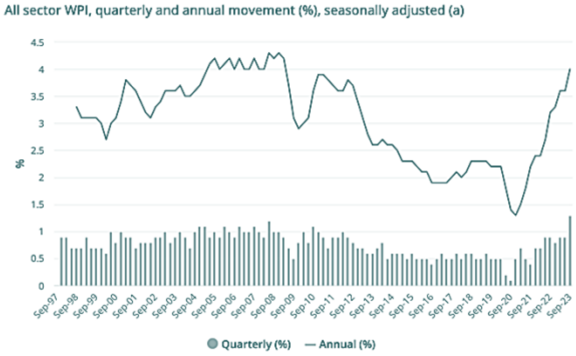
The RBA's latest policy rate increase was in November 2023, under Governor Michele Bullock's leadership, brought the rate to the highest level since November 2011. This move, prompted by persistently high inflation, especially in the service sector, highlights the ongoing challenges the RBA faces in stabilizing prices while fostering economic growth.

Domestic Developments

Population

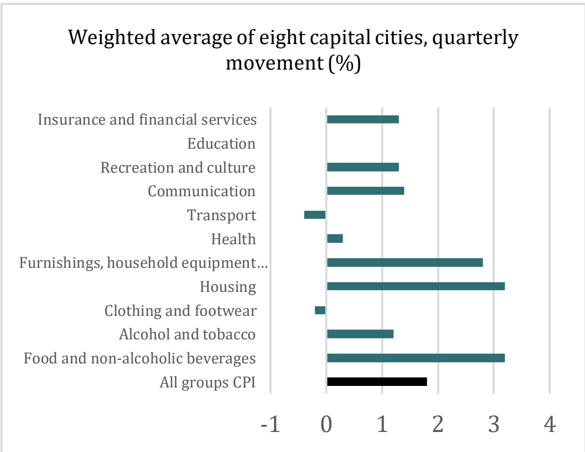
Australia's population experienced a notable growth of 2.5%, reaching 26.8 million by September 30, 2023. This increase has been largely fueled by a significant 60% surge in net overseas migration compared to the prior year, primarily due to a 34% rise in overseas arrivals. These arrivals, most of whom are on temporary visas for employment or education, have substantially contributed to the population growth. A considerable influx of international students and the resurgence of inbound tourism are expected to have positive implications for domestic economic activity in the short term. During the year, Australia welcomed 765,900 migrants while 217,100 left the country, culminating in a net overseas migration of 548,800 individuals.

Figure 7: WPI



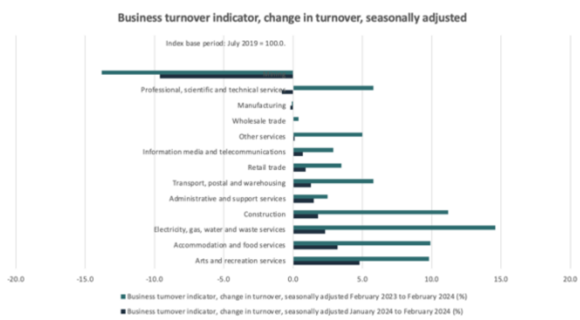
Source: ABS

Figure 8: Main Contributors of Inflation (%)



Source: RBA

Figure 9: Business turnover (%)



Source: ABS

Domestic Growth

Economic growth is anticipated to remain subdued in the near term, impacted by inflation and previous increases in interest rates that dampen demand. Recent updates have modestly downgraded the near-term outlook for GDP growth, attributed to a dimmer perspective on consumer spending. This adjustment reflects expectations of restrained domestic final demand growth. The impact of real income declines over the past years is expected to press down on consumption, especially in the initial half of 2024. Moreover, high construction costs and persistent capacity constraints, notably in skilled trades, are projected to continue to limit new building approvals and investment in dwellings. While growth in non-mining business investment and public investment is expected to decelerate from the notable highs of the past year, investment levels should remain elevated as firms progress through a significant backlog of construction projects.

Despite a slowdown in demand growth, demand levels are still considered strong, currently exceeding the economy's capacity to supply goods and services, which in turn, stokes inflationary pressures. The forecasted period of subdued growth, relative to the trend, is expected to aid in realigning demand with supply within the economy. GDP growth is projected to gradually recover starting later this year, primarily driven by an uptick in household consumption and public demand.

Household consumption growth is expected to return to its pre-pandemic average in the coming year, supported by a revival in real income growth as inflation eases. The household saving ratio is likely to continue its decline in the short term before it starts to gradually increase from mid-2024 onwards, buoyed by the positive shift in real income growth. Furthermore, dwelling investment is anticipated to rise from 2025 forward, fuelled by the earlier strong population growth and elevated prices for existing housing, which are expected to boost demand for new housing.

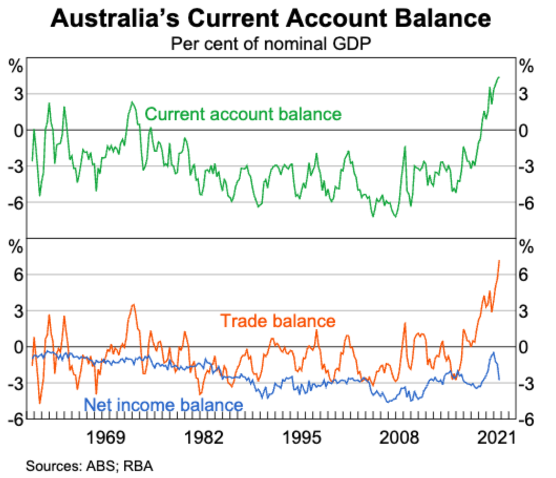
Labor Markets

Labor market conditions are anticipated to soften further, aligning more closely with full employment over the next few years. Employment is expected to continue growing, albeit at a reduced pace compared to last year. The adjustment to the slower growth in economic activity within the labor market is likely to manifest primarily through a decrease in average hours worked, although a slowdown in employment growth is also forecasted. This slowdown is expected to fall below the growth rate of the working-age population temporarily. Additionally, the labor force participation rate is predicted to slightly decrease throughout the forecast period as conditions ease, yet it should remain significantly high.

As employment growth slows and average hours worked decrease, labor underutilisation rates are projected to increase. Since late 2022, both the broader hours-based underutilisation rate and the unemployment rate have risen, reflecting previously tight labor market conditions. A continued increase in these rates is anticipated in the upcoming quarters, driven by slower economic growth. However, the projected underutilisation rates for the next few years are expected to be considerably lower than the typical rates observed over the past five decades.

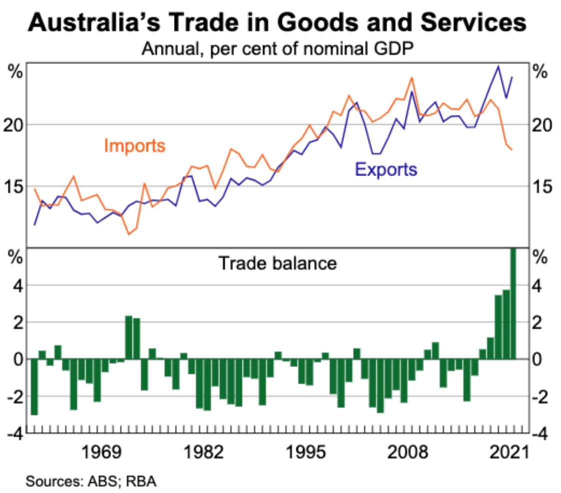
Inflation

Figure 10: Current Account Balance (%)



Source: ABS

Figure 11: Trade Account Balance (%)



Source: ABS

Inflation is on a moderating trend and is projected to align with the target range of 2–3% by 2025, aiming for the midpoint by 2026. The stabilization of inflation for the second consecutive month comes as lower prices for meat and seafood counterbalance the rising costs of rents and automotive fuel. The consumer price index (CPI) saw a year-over-year increase of 3.4% as of February, maintaining the growth rate observed in January and December, slightly below economists' expectations of 3.5%. When excluding volatile items like fresh produce and fuel, core inflation decreased from 4.1% in January to 3.9% in the following month.

Inflation's decline is anticipated to occur slightly faster than previously forecasted. A more rapid decrease in goods price inflation has been observed, attributed to an earlier pass-through of reduced global upstream costs to consumer prices and somewhat weaker domestic demand than expected. The recent dip in fuel prices is set to lower headline inflation in the March quarter, while the scheduled cessation of government electricity rebates in 2024 is expected to introduce some volatility in the trajectory of headline inflation towards the target.

International Developments

Commodities

RBA's Index of Commodity Prices (ICP), which is measured in Special Drawing Rights (SDR) terms, saw a decrease in March by 4.9% on a monthly average basis, following a 1.9% decline in February (revised). The ICP, which has significant components like iron ore (29.5%) and coal (21%), demonstrates a high correlation with iron ore prices, with a coefficient of 0.95. This correlation underscores the impact of iron ore prices on the index's movements. For March 2024, both the rural and non-rural subindices of the ICP saw declines, although the base metals subindex recorded an increase. When converted to Australian dollars, the ICP decreased by 5.1% for the month.

Over the last year, the ICP has fallen by 15.3% in SDR terms, a trend driven by lower prices for thermal coal, iron ore, coking coal, liquified natural gas (LNG), and lithium. Notably, Lithium (Spodumene) was included in the index for the first time during the annual reweighting process. The decrease in Australian dollar terms over the year was slightly lower, at 14%.

Iron ore, as Australia's largest export generating approximately $118 billion annually as of 2021, plays a critical role in the Australian economy, with China being the major market. The price movements of iron ore not only influence the Australian dollar due to its significant contribution to the country's export revenues but also have broader implications on the global mining sector and economic relations. On April 1, 2024, iron ore prices saw a reversal after hitting a 10-month low, buoyed by optimism around China's economic recovery. This optimism helped mitigate the impact of a weakening steel market. The fluctuation in iron ore prices throughout the year highlights the commodity's influence on Australia's financial health, given that it constitutes about a third of the country's total resource and energy export revenues.

Global Outlook

The global economy is poised for a period of below-average growth, with inflation expected to decline toward central bank targets across many economies. Australia's major trading partners are forecasted to see a moderation in year-average GDP growth in 2024, leading to softer demand for Australian exports. The outlook has remained relatively unchanged from three months prior, with robust growth predictions for the United States and high-income East Asian economies balancing out the slower growth in other advanced economies.

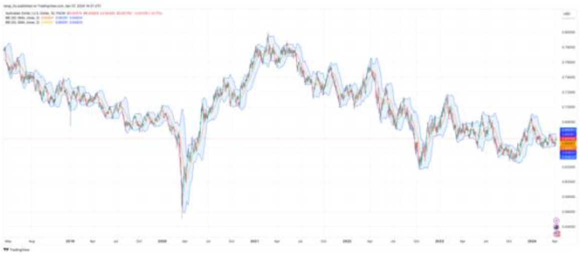
Central banks in advanced economies are predicting that inflation will align with their targets in the next year or so, despite acknowledging potential upside risks. This anticipated reduction in inflation corresponds with expectations for slower economic growth and a slight relaxation in labor market conditions. Consequently, market expectations suggest that policy rates may have reached their peak. GDP growth in advanced economies is set to decelerate significantly this year, due in part to the dampening effects of tighter monetary policy on demand. While forecasts for most G7 economies in 2024 are notably below pre-pandemic average growth rates, the United States is expected to experience only a modest slowdown. From the latter half of 2024, a moderate revival in G7 economic growth is projected, supported by less stringent monetary policy settings in several economies.

China, Australia's largest trading partner, expects a slowdown over the next two years as the services sector's recovery loses momentum and the real estate market remains subdued. The Chinese economy's performance has significant ramifications for the Australian Dollar (AUD), with stronger Chinese economic activity typically boosting demand for Australian exports and consequently, the AUD's value.

Adding to the complexity of the global economic outlook is the geopolitical tension in the Middle East, including the Israel-Palestine conflict, which introduces additional uncertainty. These conflicts carry the risk of disrupting energy supplies, which could exacerbate inflationary pressures.

Global disinflationary trend is expected to resume after a short pause, enabling the Fed and the ECB to initiate rate cuts starting in June, totalling a reduction of 75 basis points this year. A 50% likelihood of a soft landing and a 30% chance of no landing in the US economy are predicted in the next 12 months. The US economy is projected to sustain its expansion, aided by immigration that eases labor market pressures and supports consumption, despite the dwindling extra savings accumulated during the pandemic. Signs of global manufacturing recovery are also becoming apparent.

Figure 12: AUDUSD Daily Chart



Source: TradingView

Trade Idea: Short AUDUSD

The AUD/USD currency pair continues to exhibit a long-term downward trend within a channel established since mid-February 2021. Notably, this trend has been consistently respected, with a brief deviation below the channel's base in the latter half of 2022, now appearing as a statistical outlier.

Fundamental Analysis

The Australian economy is currently navigating a complex set of economic conditions, reflecting significant uncertainty, particularly in its currency valuation. This uncertainty presents a rationale for considering a short position on the Australian dollar against the US dollar.

RBA pointing towards Rate Cuts

In Australia, the labour market has shown remarkable resilience, and the country is experiencing robust migration flows, climbing property prices, and a stock market scaling new heights. These dynamics suggest that the economic impact of the RBA's significant cumulative rate hikes amounting to 4.25 percentage points since 2022 is yet to be fully realized. In its recent meetings, including the last where the cash rate was held at 4.35% for the third consecutive time, the RBA adopted a neutral policy stance. Acknowledging the heightened uncertainty of economic conditions, the central bank has maintained a flexible outlook, not committing to a directional move in interest rates.

Nevertheless, signals point to potential rate cuts by the RBA later in the year, setting it apart from other central banks which are poised to reduce rates as soon as June. This perceived dovishness in the Australian monetary policy context could contribute to a depreciation of the AUD, as global investors might seek more attractive yields in other markets.

Subdued Growth in Australia and Trade Partners

Australia's economic forecast suggests a period of restrained growth, with expectations for continued moderate inflation that traditionally does not bolster currency strength. The Index of Commodity Prices (ICP), especially sensitive to iron ore prices, points to a possible reduction in the Australian dollar's appeal as commodity prices dip, considering the AUD's role as a commodity-linked currency.

The downturn in China, Australia's foremost trading partner, raises concerns for the Australian export sector, specifically for primary commodities such as iron ore and coal. A slowdown in Chinese demand could lead to a consequential softening of the AUD, as the trade dynamic between the two nations is a significant factor in currency valuation.

The broader market sentiment appears cautious, with a trend towards risk aversion, which is usually unfavourable for commodity-based currencies like the AUD. This sentiment has contributed to a stronger US dollar, compounding the pressure on Australian imports by increasing their cost, while also making Australian exports potentially less competitive internationally due to a higher price point.

Recent economic data underscores these challenges. Australia's trade balance has diminished, with the surplus shrinking to 7,280 million AUD in March, noticeably below the anticipated 10,400 million AUD and the previous month's 10,058 million AUD. This decrease is accentuated by a 2.2% drop in exports month-over-month, a stark reversal from the prior increase, indicating waning global demand for Australian goods. Import activity, on the other hand, rose by 4.8%, adding to the trade deficit.

The culminating effect of these factors has been a depreciation in the AUD, as seen in the response to the latest retail sales data and the trade balance report.

Resilient US Economy

During the initial half of 2024, the United States' economy demonstrated characteristics of a 'soft landing' despite the underlying risk of a 'hard landing.' Economic growth indicators have been notably resilient. The manufacturing sector has seen a revival, signalling positive momentum. While some weaknesses have been observed in labor market data, overall, employment figures have remained robust at the macro level. Inflation, however, has presented a more stubborn front than anticipated, persisting at levels above expectations.

Federal Reserve Chair Jerome Powell has indicated the central bank's readiness to lower interest rates, suggesting a proactive stance in response to the nation's economic indicators. It is crucial to note that while the labor market provides a positive narrative, it also warrants vigilance for any unforeseen downturns. The expectation of hard landing risks has not dissipated entirely; rather, their materialization may have been postponed. As a result, the Fed is poised to initiate a series of rate cuts beginning in June, with current projections adjusting to anticipate three cuts totaling 75 basis points throughout the year, down from the previously forecasted five cuts amounting to 125 basis points.

This cautious approach is supported by recent labor statistics. US initial jobless claims witnessed a slight increase, while job cuts reported by US companies also rose modestly in March. The ADP employment change outpaced expectations, with the service sector's performance showing a mild contraction, albeit still indicating expansion. Furthermore, manufacturing activity rebounded more than predicted, adding to a mixed yet cautiously optimistic economic picture.

Corroborating this tempered outlook, March's payroll data exceeded forecasts, with wages showing consistent growth. This patchwork of economic indicators underscores a nuanced environment where the US economy remains on a growth trajectory, albeit accompanied by the Fed's careful navigation of inflationary pressures.

Risk

Global Outlook Affecting Exports and Commodity Prices

The current global economic outlook suggests several factors that could mitigate the bearish sentiment on the Australian dollar, especially regarding export and commodity prices. An unforeseen rebound in global manufacturing, fuelled by policy measures in China, could potentially drive-up demand for Australian commodities. Such a development would likely bolster the AUD, given Australia's status as a significant player in resource exports.

However, while there is potential for commodity prices to rally, particularly for exports like iron ore and coal, the likelihood of sustained high demand is questionable. Notably, China's economic expansion has slowed, a trend evidenced by a notable decline in the property sector and overall sales, hinting at deeper systemic issues that could persist over the coming months. Additionally, geopolitical frictions have the potential to disrupt global supply chains, potentially inflating commodity prices temporarily.

Despite these possible short-term fluctuations, the mitigation of these risks lies in both internal and external aspects of China's economy. The pronounced slowdown in China's property sector and the subdued revival in consumer demand cast a shadow over the possibility of a quick recovery. Furthermore, China's geopolitical tensions, including its relationships with major trading partners, present significant uncertainty that could limit any near-term positive impact on the AUD.

In the case of commodity prices, there was a notable reversal in iron ore prices in early April, the trend appears more of a basis of a long-term decline. This suggests that the recent decline would be the basis of a long-term fall in iron ore prices, causing the overall trajectory for the AUD to decline.

As for the role of the USD, it remains the global safe-haven currency. Amidst geopolitical tensions, investors are likely to seek shelter in the USD, thereby strengthening it against other currencies, including the AUD. This propensity towards the USD in uncertain times further supports the case for a bearish view on the AUD/USD pair over a six-month period.

Overall, while acknowledging the short-term risks that could boost the AUD, the convergence of China's economic challenges, the potential for continued commodity price volatility, and the safe-haven status of the USD build a more compelling case for expecting AUD weakness against the USD in the longer timeframe.

Technicals

In the context of AUD/USD, the use of Bollinger Bands and Exponential Moving Averages (EMAs) for technical analysis suggests a possible bearish outlook, leading to shorting the pair. The Bollinger Bands serve as a measure of market volatility, with prices frequently returning to the mean, represented by the middle band, after touching the outer bands.

The AUD/USD pair is currently displaying a potential bearish setup as it interacts with the upper Bollinger Band. Typically, this contact with the band's upper limits could suggest a market that is overbought, and therefore due for a correction or reversal. In this instance, such a correction would support a move to the downside.

Adding to this, the alignment of EMAs further strengthens the bearish case. The arrangement of EMAs in descending order from the shorter-term to the longer-term — with the shorter-term EMAs positioned above the longer-term ones — indicates a prevailing downward momentum. This descending EMA sequence points to sustained bearish sentiment, as the longer-term EMAs could serve as resistance levels, potentially capping upward moves and exerting downward pressure on the price.

The convergence of these technical indicators — the price nearing the upper range of the Bollinger Band alongside a descending EMA sequence — typically signals to technical traders that the current price might be reaching its peak, with a pullback to lower levels being the next probable move. If the price were to reverse from the upper Bollinger Band and we observe bearish price action, this would further confirm the inclination to short the pair.

Moreover, since oscillators such as the Momentum of value -0.00830 are indicating overbought conditions or a bearish divergence (where price makes a new high but the oscillator does not), this would add credence to the bearish outlook.

Entry: 0.65765
Take Profit: 0.63965
Stop Loss: 0.66765
Reward Risk Ratio: 1.80

Disclaimer

Global Macro Department –New Zealand (UNDERWEIGHT)

Date: 20th April 2024

Analysts

Ho Chung Tat Rangi
Global Macro Analyst
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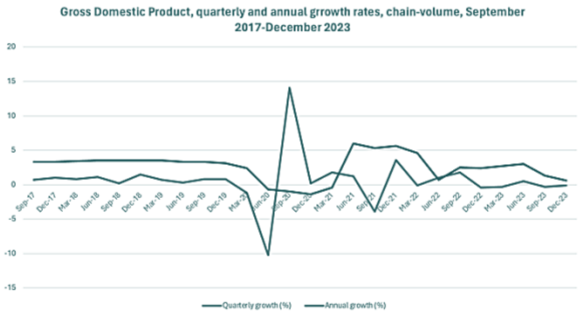
Basic Information

Real GDP (US$)	248B
M2 (US$)	250.997B
CPI	1259
PPI	1371
Con Confidence	94.5
Building Permits	3725
Stock Index	NZ50
Currency	NZD

Chart info

Figure 1: GDP Quarterly Growth Rate (%)



Source: Stats NZ

Overview of New Zealand

- New Zealand has a free-market economy that is also rich in natural resources. New Zealand is the 52nd largest economy in the world by nominal GDP, a sizeable number for a population of 5.123 million and is well-known for its high level of social welfare, government transparency and economic freedom.
- The main contributors to New Zealand's GDP are the services sector (66%) and the goods-producing sector (20%). The country has a very globalized economy and is heavily dependent on international trade for growth.
- Being a resource rich country, New Zealand mainly exports agricultural commodities such as dairy products, meat, forest products, fruit and vegetables, and wine. Dairy is the lead export commodity – in 2022 New Zealand dairy exports totalled approximately US$13.64 billion. Bulk of its exports is delivered to China, Australia and US.
- New Zealand's main imports are vehicles, machinery including computers, electronic machinery and equipment, mineral fuels including oil and plastics. They mainly import from China, Australia and US.
- New Zealand is a member of the APEC, OECD, and WTO. The country has also entered into free trade agreements with ASEAN, Canada, Chile, China, South Korea, Malaysia, Australia, Peru, Japan, Singapore, Thailand and Hong Kong. Its trade agreement with Australia has notably deepened economic ties between the two countries.

Summary of Events in the Past 6 Months

- Labor market conditions are beginning to ease from tight levels. Labor demand as fallen because of contractionary monetary policy and slowing demand.
- Core inflation (excluding food and energy) continues to decline but is higher than headline inflation in many economics, due to high services inflation.
- Mortgage rates have dipped slightly at most terms and term deposit rates have fallen at terms of more than 6 months. Overall, wholesale interest rates at terms of up to 2 years have increased, while rates at terms of longer than 2 years have decreased.

- New Zealand's annual current account deficit was $30.6 billion, 7% of gross domestic product (GDP). This was due to $4.1 billion narrowing of the services deficit, offset by a $2.5 billion widening of the goods deficit and $1.4 billion widening of the primary income deficit.

- Current fiscal policy is more expansionary than in most other advanced economies. The government is running a structural fiscal deficit with its spending-to-GDP ratio higher in FY23/24 following Budget 2023's sizable operating and capital allowances in responses to rising costs and one-off outlays related to the North Island weather events. This, together with weaker-than-expected revenue as economic activity slowed, put off consolidation and resulted in a larger-than-expected positive fiscal impulse.

- Housing prices are stabilizing on the back of strong population growth and residential property related tax policy changes. After a 13 percent decline from 2022Q1 to 2023Q2, housing prices have now stabilized but remained 25 percent above their 2020Q1 level in 2023Q3. Rents were up 7 percent y/y in September 2023, 13 percent higher than in January 2020. As lending conditions tightened, credit growth further slowed in 2023, though household debt remains high, at 165 percent of disposable income in 2023Q2.

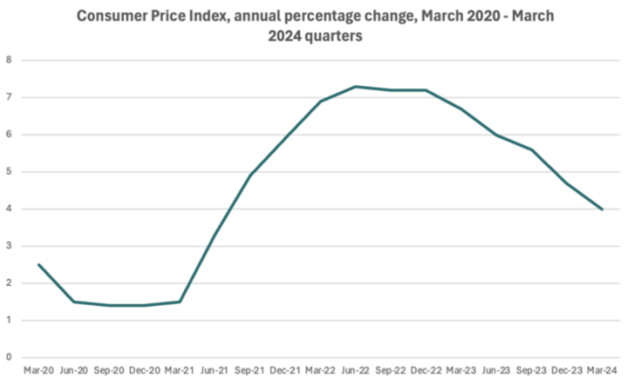
Figure 2: Official Cash Rate (%)

Source: RBNZ

Figure 3: Unemployment Rate (%)

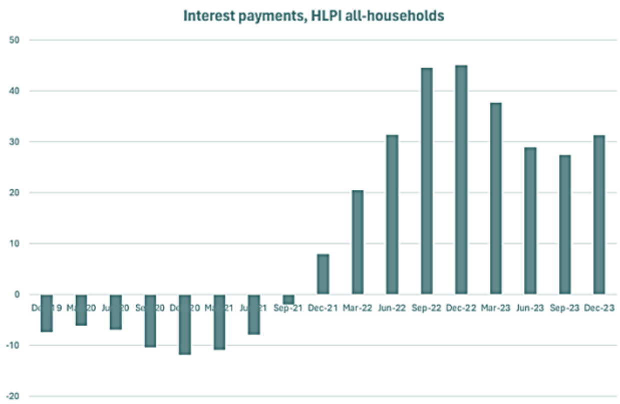
Source: RBNZ

Figure 4: CPI Inflation (%)



Source: RBNZ

Figure 5: Change for interest payments, HLPI all-household groups (%)



Source: Stats NZ

RBNZ's Key Measures

Wait and Observe

In their February 28 meeting, the Reserve Bank of New Zealand (RBNZ) decided to keep the official cash rate (OCR) steady at 5.50%, a level unchanged since May 2023. This decision reflects a cautious approach amid evolving economic conditions, where core inflation and inflation expectations have seen a decline, moving towards a more balanced risk outlook for inflation. Despite these positive signs, headline inflation continues to exceed the RBNZ's target range of 1-3%, limiting the bank's ability to accommodate further inflationary pressures. The decision and subsequent commentary from the RBNZ were perceived as more dovish than expected, leading to a decrease in the value of the New Zealand dollar and a rise in bond prices. Additionally, the RBNZ adjusted its peak cash rate forecast down to 5.6% from 5.7%, signalling a softened stance on future tightening.

Since October 2021, the RBNZ has been at the forefront of reversing pandemic-era monetary stimulus, increasing rates by a total of 525 basis points in an unprecedented move to control inflation. These hikes have significantly decelerated economic growth, with recent indicators suggesting the economy is performing below the central bank's prior expectations. This aligns with a global trend among central banks, including the Federal Reserve, to counter expectations of imminent rate cuts amidst ongoing inflationary concerns.

Despite the downward trend in headline and core inflation rates and inflation expectations, inflation still tops the committee's target band, necessitating a continued restrictive monetary policy to alleviate capacity pressures and ensure inflation returns to within the target range. This stance is consistent with global concerns over inflation, emphasizing the need for sustained policy restriction to achieve target inflation levels. Moreover, the decline in long-term wholesale interest rates since the November statement has exerted downward pressure on domestic rates, contributing to the RBNZ's cautious monetary strategy.

Domestic Developments

Unemployment

Seasonally adjusted unemployment rate slightly increased to 4.0% in the December 2023 quarter, up from 3.9% in the previous quarter. Over the past year, this rate has risen by 0.6 percentage points from 3.4% in the December 2022 quarter. In addition, the underutilization rate, a comprehensive indicator of unused labor capacity, stood at 10.7% in the December 2023 quarter, marking an increase from 10.4% in the preceding quarter and from 9.3% a year earlier.

Inflation

Inflation in New Zealand has remained high despite a tight monetary policy stance, decreasing from a peak of 7.3% year-on-year in Q2 2022 to 4.7% in Q4 2023. This rate still exceeds the RBNZ's target range of 1-3% and is notably higher than that of peer economies. The sluggish reduction in inflation is attributed to various factors including delayed effects from pandemic-related disruptions, domestic food shortages due to weather conditions, tight labor markets, sustained wage pressures, and the impact of migration on rental and housing prices. However, a global trend towards disinflation has contributed to a reduction in headline inflation, though measures like trimmed-mean and non-tradable inflation show more persistence.

Inflation expectations have remained stable, with no signs of a wage-price spiral developing. The annual Consumer Price Index (CPI) inflation fell to 4.7% in the December 2023 quarter, significantly down from its mid-2022 peak but still above the RBNZ’s target. The decrease in inflation during this quarter was more substantial than anticipated, driven by larger-than-expected falls in tradables inflation. Encouragingly, recent decreases in core inflation and business inflation expectations have been noted, though they still surpass the RBNZ's 2% target midpoint. Risks to the inflation outlook are now more balanced, but the capacity to manage unforeseen inflationary pressures remains limited.

The RBNZ projects annual headline CPI inflation to re-enter the target band by Q3 2024 and to reach the 2% midpoint by later in 2025, indicating a cautious approach to returning to the target. This projection underscores a limited flexibility in delaying the achievement of the target midpoint. Although annual house price inflation has been moderate, the outlook for house prices is highly uncertain, influenced by continued high interest rates, a decline in residential investment, and the economic effects of strong net immigration. Despite the decline from its peak, inflation is anticipated to drop below 3% by Q3 2024, reflecting a cautious yet optimistic outlook on the effectiveness of current monetary policy settings in controlling inflationary pressures.

Domestic Growth

New Zealand's economy experienced a 0.3% contraction in the September 2023 quarter, underperforming expectations set in the November Statement. Subsequent revisions to Gross Domestic Product (GDP) data indicate that potential GDP, or the economy's sustainable production capacity, has been overestimated in the past. Consequently, the recalibration suggests only a minor adjustment to the initial estimates of capacity pressures within the economy.

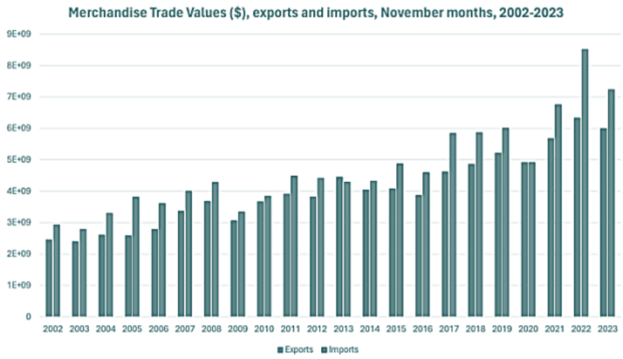
Recent GDP figures reveal a subdued productivity growth rate, hinting at potential long-term constraints on the economy's ability to expand without fuelling inflation. This scenario could cap the sustainable growth rate and emphasize the importance of productivity improvements.

The surge in net immigration has dual economic effects: it bolsters demand, as evidenced by the recent uptick in rent inflation, and enhances the labor supply, thereby increasing economic supply capacity. Businesses have noted an easing in the difficulty of finding workers, reflecting relaxed labor market capacity pressures. Despite these developments, New Zealand's real GDP growth is expected to decelerate to 1.1% in 2024, with prospects of a rebound in 2025.

The broader economic slowdown can be attributed to the RBNZ’s aggressive monetary policy tightening, marked by 525 basis points in rate hikes from October 2021 to May 2023. This policy stance has led to a significant downturn in GDP growth momentum throughout 2023, characterized by declines in private investment and government spending alongside sluggish household consumption growth. The effects of policy adjustments typically manifest with a delay, suggesting that the current slowdown is a direct consequence of previous tightening measures. However, the reopening of borders and a record level of net migration in 2023 have somewhat mitigated supply-side constraints and labor shortages, indicating a mixed economic outlook as evidenced by high-frequency data signalling modest growth in the December quarter.

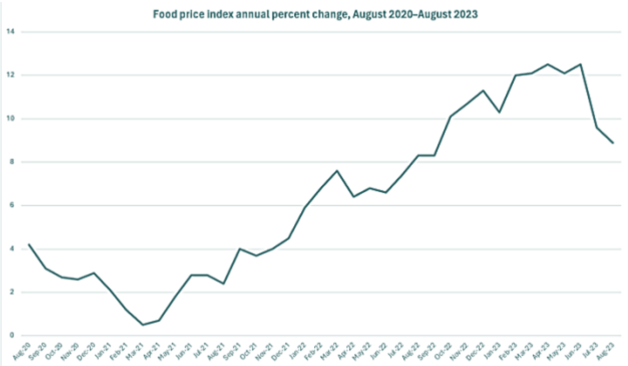
International Developments

Figure 6: Export and Imports Trade Value



Source: StatsNZ

Figure 7: FAO Dairy Price Index



Source: StatsNZ

Unexpected Rise in Commodities Prices

There is a recent upward trend in global dairy prices alongside declining costs for imported goods and services. This shift has led to an enhanced terms of trade for New Zealand, promising higher incomes for the primary sector and a boost in domestic economic activities. However, concerns were raised about international logistical challenges, such as recent disruptions in shipping through the Red Sea and drought conditions near the Panama Canal, which are complicating export logistics and inflating global shipping expenses. Persistent increases in these costs could erode the profitability of New Zealand's exporters and contribute to rising global and domestic inflationary pressures if these conditions continue.

Furthermore, the outlook for China was a focal point of RBNZ's meeting discussion, given its pivotal role in the global economy and its influence on New Zealand's export and import price dynamics. Structural hurdles within the Chinese economy pose significant concerns for its long-term growth trajectory. The slowing potential growth rate is attributed partly to demographic shifts and notably to a marked downturn in productivity growth. The high debt levels, particularly within the property sector, coupled with subdued demand, are identified as the most pressing risks to the downside.

Global Outlook

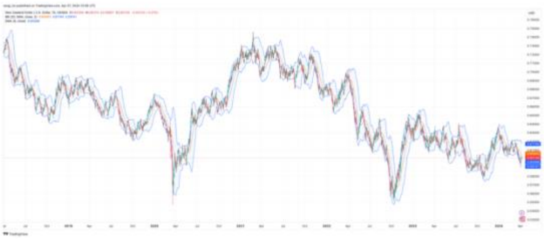
There is a downward shift in global growth across advanced economies, projecting a modest deceleration from the growth rates experienced in 2023. Median forecasts suggest inflation will gradually decrease, yet global growth is expected to slightly underperform relative to last year's figures. A pervasive concern is the potential necessity for central banks to maintain higher policy interest rates for an extended period to achieve inflation targets, a scenario not fully accounted for in current financial market valuations.

Central banks in advanced economies are predicting that inflation will align with their targets in the next year or so, despite acknowledging potential upside risks. This anticipated reduction in inflation corresponds with expectations for slower economic growth and a slight relaxation in labor market conditions. Consequently, market expectations suggest that policy rates may have reached their peak. GDP growth in advanced economies is set to decelerate significantly this year, due in part to the dampening effects of tighter monetary policy on demand. While forecasts for most G7 economies in 2024 are notably below pre-pandemic average growth rates, the United States is expected to experience only a modest slowdown. From the latter half of 2024, a moderate revival in G7 economic growth is projected, supported by less stringent monetary policy settings in several economies.

This economic forecast occurs against a backdrop of escalating geopolitical tensions, posing additional risks to global economic stability. One immediate impact of these tensions is the surge in global shipping costs, which, while contributing to short-term inflationary pressures, is expected to be a temporary price shock. However, there is significant uncertainty regarding the magnitude and persistence of these elevated shipping costs, adding another layer of complexity to global economic projections.

Global disinflationary trend is expected to resume after a short pause, enabling the Fed and the ECB to initiate rate cuts starting in June, totalling a reduction of 75 basis points this year. A 50% likelihood of a soft landing and a 30% chance of no landing in the US economy are predicted in the next 12 months. The US economy is projected to sustain its expansion, aided by immigration that eases labor market pressures and supports consumption, despite the dwindling extra savings accumulated during the pandemic. Signs of global manufacturing recovery are also becoming apparent.

Figure 8: NZDUSD Daily Chart



Source: TradingView

Trade Idea: Short NZDUSD

The New Zealand dollar (NZD) has experienced a temporary respite against the US dollar in early April, reversing the downward trend fuelled by negative sentiment toward the kiwi. My long-term perspective remains bearish on NZD/USD, and as such, I am inclined to enter a short position. My analysis suggests that the recent gains are a correction within a larger bearish trend, and I expect the fundamental weaknesses of the New Zealand economy, coupled with a potentially stronger US dollar, to drive the pair lower in the future.

Fundamental Analysis

Major indicators ahead are expected to continue to be centred around risk sentiment, USD dynamics and the deteriorating growth outlook. I expect to see poorer sentiment in the next 6 months because of several reasons.

Poor Economic Outlook

New Zealand has entered its second technical recession in less than 18 months, with the economy contracting by 0.1% in the October-December period after a 0.3% contraction in the third quarter. The economic decline was more pronounced on a per capita basis, with GDP per capita falling by 0.7% in the last quarter of 2023, according to government data. This recession emerges amidst the RBNZ's intensive efforts to control some of the highest inflation rates in the developed world through significant interest rate hikes, which have consequently dampened economic activity.

Despite experiencing record levels of inward migration, with over 133,000 net arrivals in the past year, the economy has struggled to maintain positive growth. This is particularly alarming considering the country's rapidly expanding population. Additionally, the labor market presents further challenges, with rising unemployment and underutilization rates undermining the NZD. This situation is likely to exert further downward pressure on the NZD due to the weakening economic fundamentals.

Furthermore, New Zealand is witnessing one of the sharpest pullbacks in house prices in the developed world. This would cause the NZD to fall via "the yield channel", where central banks with vulnerable housing would be constrained by how much they can raise rates. It can also be transmitted via the local markets channel, where if these centrals banks did raise rates prioritizing inflation, that would be a drag for local growth and risk market, which in turn could reduce capital flows.

Inflation

The RBNZ continued restrictive monetary policy stance, holding the official cash rate at a 15-year high of 5.5%, signals an ongoing battle against inflation, which at 5.6% year-over-year, remains stubbornly above the target range of 1 to 3%. Despite some easing in headline inflation, core inflation pressures persist due to high non-tradables inflation, driven by capacity constraints and labor market tightness.

Given the current economic landscape, I anticipate that the RBNZ will maintain its official cash rate at the elevated level of 5.5% for at least the next six months. This expectation is grounded in the persistent capacity constraints and labor market tightness impacting the New Zealand economy. These factors contribute to sustained inflationary pressures, particularly in non-tradable sectors, which are less influenced by global market trends and more by domestic economic conditions. The tight labor market, with its higher wage demands, fuels domestic inflation, making it challenging for the RBNZ to ease its monetary policy stance. A high interest rate environment, while intended to curb inflation, can also slow economic growth, potentially leading to a weaker New Zealand dollar against the US dollar.

Resilient US Economy

During the initial half of 2024, the United States' economy demonstrated characteristics of a 'soft landing' despite the underlying risk of a 'hard landing.' Economic growth indicators have been notably resilient. The manufacturing sector has seen a revival, signalling positive momentum. While some weaknesses have been observed in labor market data, overall, employment figures have remained robust at the macro level. Inflation, however, has presented a more stubborn front than anticipated, persisting at levels above expectations.

Federal Reserve Chair Jerome Powell has indicated the central bank's readiness to lower interest rates, suggesting a proactive stance in response to the nation's economic indicators. It is crucial to note that while the labor market provides a positive narrative, it also warrants vigilance for any unforeseen downturns. The expectation of hard landing risks has not dissipated entirely; rather, their materialization may have been postponed. As a result, the Fed is poised to initiate a series of rate cuts beginning in June, with current projections adjusting to anticipate three cuts totaling 75 basis points throughout the year, down from the previously forecasted five cuts amounting to 125 basis points.

This cautious approach is supported by recent labor statistics. US initial jobless claims witnessed a slight increase, while job cuts reported by US companies also rose modestly in March. The ADP employment change outpaced expectations, with the service sector's performance showing a mild contraction, albeit still indicating expansion. Furthermore, manufacturing activity rebounded more than predicted, adding to a mixed yet cautiously optimistic economic picture.

Corroborating this tempered outlook, March's payroll data exceeded forecasts, with wages showing consistent growth. This patchwork of economic indicators underscores a nuanced environment where the US economy remains on a growth trajectory, albeit accompanied by the Fed's careful navigation of inflationary pressures.

Risk

Global Outlook Affecting Exports

New Zealand’s top export destinations include China, Australia, the United States, Japan, and South Korea. The economic health of these nations significantly influences the demand for New Zealand's exports. As China is a major importer of New Zealand’s dairy and meat products, any economic slowdown in China could reduce their demand for these essential commodities. Notably, China's economic expansion has slowed, a trend evidenced by a notable decline in the property sector and overall sales, hinting at deeper systemic issues that could persist over the coming months. Additionally, geopolitical frictions have the potential to disrupt global supply chains, potentially inflating commodity prices temporarily.

Despite these possible short-term fluctuations, the mitigation of these risks lies in both internal and external aspects of China's economy. The pronounced slowdown in China's property sector and the subdued revival in consumer demand cast a shadow over the possibility of a quick recovery. Furthermore, China's geopolitical tensions, including its relationships with major trading partners, present significant uncertainty that could limit any near-term positive impact on the NZD.

Furthermore, if China faces a recession or a significant reduction in consumer spending, it could lead to a decrease in imports from New Zealand, despite the non-discretionary nature of these goods. Australia's economic conditions also play a crucial role. Any downturn in Australia could affect its imports of New Zealand's agricultural and forestry products, given the close trade relations between the two countries.

Technicals

The technical analysis of NZD/USD, considering the Bollinger Bands and Exponential Moving Averages (EMAs), paints a picture of the currency pair's momentum and potential trend reversals. The Bollinger Bands can provide a boundary for where the price may be expected to find support or resistance. A breach outside of the bands can sometimes be a signal for a potential reversal if accompanied by other indicators.

Considering the Bollinger Bands, the NZD/USD pair appears to be overextended as it approaches the upper band, suggesting a potential pullback. The EMAs show a bearish crossover, with the shorter 10-day EMA at 0.60606 positioned below the longer 200-day EMA at 0.66244, indicating a sustained downtrend. Additionally, the Momentum oscillator of value of -0.01228 is in negative territory, reinforcing the bearish bias.

If NZD/USD begins to revert from the upper Bollinger Band, coupled with the bearish EMA crossover and negative momentum, this could provide a favourable setup to enter a short position, targeting the middle or lower band for support levels.

Entry: 0.60250
Take Profit: 0.59950
Stop Loss: 0.60450
Reward Risk Ratio: 1.50

Disclaimer