Market Update to 31 January 2025

February 2025

What happened in January

Australia/New Zealand

- New Zealand's inflation continued to moderate as expected, holding steady at 2.2% year-on-year in the fourth quarter. This data is likely to prompt the Reserve Bank of New Zealand (RBNZ) to cut the Official Cash Rate (OCR) by a further 0.5% to 3.75% on 19 February this year. The RBNZ still considers the current OCR to be in restrictive territory and expects the long-term 'neutral' level to be between 2.5% and 3.5%.
- In Australia, inflation rose by less than forecast, coming in at 3.2% year-on-year in the fourth quarter, down from 3.5% in the previous quarter. This is an encouraging sign for the Australian economy, which has been battling persistent inflation pressures. These figures open the door for a potential rate cut when the Reserve Bank of Australia (RBA) meets on 18 February, which has remained at 4.35% since November 2023.

China

- The race for AI dominance is well underway, with Chinese startup DeepSeek developing an AI model comparable to the most advanced models, such as ChatGPT, at a fraction of the cost. DeepSeek's models reportedly required less than USD $6 million to train, compared to over USD $100 million for similar models, and requires 20 to 50 times less computing power to run than ChatGPT. While the true costs and development process of DeepSeek's models are yet to be verified, its success has raised questions about the necessity of the billions of dollars being poured into AI investment.
- China's economy expanded by 5.4% in the fourth quarter, up from 4.6% in the third quarter, surpassing market expectations. A series of economic stimulus measures helped drive growth, enabling China to meet its 5% annual growth target.

U.S.A

- Donald Trump has confirmed the introduction of 25% tariffs on imports from Canada and Mexico, with energy imports from Canada facing a lower 10% tariff starting on 1 February. Together, China, Mexico, and Canada accounted for 43% of total U.S trade or 1.3 trillion worth of goods. Trump has acknowledged that Americans may experience economic hardship as a result but insists it is a necessary price to pay.
- However, Trump has agreed to delay the tariffs on Canada and Mexico for one month after both countries committed to strengthening border security by deploying 10,000 personnel and implementing additional measures to monitor the border and combat drug trafficking. For now, U.S. tariffs on Canada will be paused for at least 30 days.
- The Federal Reserve decided to leave interest rates unchanged at a range of 4.25% to 4.5% in January, following three consecutive 0.25% cuts since September. This decision was influenced by inflation stalling slightly above target, strong economic growth, low unemployment, and Trump's polices and their potential economic impact. Federal Reserve Chair Jerome Powell emphasised that the Fed is in no hurry to adjust its policy stance, particularly as the economy remains strong.

Middle East War

- A ceasefire agreement has been reached in Gaza after 15 months of war, which has resulted in the deaths of nearly 50,000 Palestinians and the destruction or approximately 60% of buildings in Gaza, with reconstruction costs estimated at USD $40 billion.
- As part of the deal, Hamas will release all 33 Israeli hostages, while Israel will release all 1,900 Palestinian hostages. Additionally, all Israeli forces will withdraw from central Gaza, allowing displaced Palestinians to return to northern Gaza.

Asset class performance to 31 January 2025

	NZ Fixed Income	Global Fixed Income	NZ Shares	Australian Shares	Global Shares	Global Property
Month	-0.1%	0.7%	0.1%	4.6%	3.5%	2.2%
3 months	-0.1%	-0.8%	2.7%	5.1%	4.2%	-3.1%
One year	5.5%	1.0%	3.6%	19.0%	20.9%	4.2%

Source: MorningStar

Equities

Global equities have had a strong start to the year, rising over 3% for the month despite some periods of volatility caused by DeepSeek and Trump's tariffs. Initially, U.S. big tech reacted negatively to DeepSeek's announcement, leading to declines in Nvidia, Meta, and Google. However, all except Nvidia have since recovered their losses. Nvidia remains down 20% following the news, suggesting the market expects lower demand for its high-end chips, as DeepSeek has demonstrated the ability to achieve strong AI performance using weaker chips.

If fully implemented, Trump's tariffs are expected to create volatility in equities, as they typically drive-up inflation and slow economic growth. If businesses pass the higher costs on to consumers, demand will decline, while if companies absorb the costs, profit margins will suffer—both scenarios leading to less attractive earnings reports. Additionally, tariffs will strengthen the U.S. dollar, impacting the 28% of S&P 500 revenue generated from international sales, as a stronger dollar reduces the value of those earnings.

U.S. fourth-quarter earnings season is well underway, with four of the "Magnificent 7" companies having reported so far. Apple, Microsoft, and Meta delivered strong results, exceeding estimates for both earnings per share and revenue. For the quarter, S&P 500 earnings are on track to grow by approximately 12%, which, if achieved, would mark the fastest pace of growth since 2021.

Fixed income

U.S. and NZ benchmark 10-year bond yields have been trending higher since October 2024, rising nearly 0.8% and 0.5% respectively, despite both central banks cutting interest rates by 1%. This is largely due to the continued strength of the U.S. economy and Trump's inflationary policies, which have led markets to price in fewer rate cuts in the U.S for 2025 than previously anticipated.

- The US 10-year bond yield closed the month at 4.5% down 0.1%.
- The NZ 10-year bond yield closed the month at 4.5%, up 0.1%.

New Zealand Dollar to 31 January 2025

	NZD/USD	NZD/EUR	NZD/JPY	NZD/AUD
Month	-0.1%	0.9%	-1.3%	0.4%
3 months	-6.1%	-0.6%	-4.0%	-0.1%
One year	-8.8%	-3.5%	-3.2%	-2.9%
Closing Price	0.56	0.54	87	0.91

Source: Bloomberg

Overview

It was a volatile month for the New Zealand Dollar (NZD), with its movements largely dictated by shifts in the US dollar, which has been highly sensitive to Trump-related headlines. The NZD's recent weakness has been driven by the strong performance of the US economy and Trump's presidency causing the Federal Reserve to pause rate cuts, while New Zealand's economy remains weak and is quickly lowering interest rates to boost the economy.

Outlook

The USD is expected to remain the key driver of the NZD, with forecasts pointing to further USD strength due to robust US economic performance and Trump's inflationary policies. Additionally, the Reserve Bank of New Zealand (RBNZ) is expected to cut interest rates by another 1.25% this year, whereas the Federal Reserve is anticipated to hold off on any rate cuts in 2025. ASB and BNZ forecast the NZD/USD exchange rate to hover around 0.55–0.56.

Looking ahead

New Zealand/Australia

- The New Zealand economy is emerging from a challenging 2024, with hopes of some economic recovery in 2025. It is expected that the RBNZ will reduce the OCR by 0.5% to 3.75% on 19 February, followed by a further 0.75% in cuts later in the year. Hopefully, this will provide the much-needed stimulus to drive growth in the New Zealand economy, which is expected to grow around 2% in 2025.
- Following positive inflation data in Australia, the Reserve Bank of Australia (RBA) is expected to cut its interest rate for the first time since 2020, reducing it by 0.25% to 4.1%, with projections indicating a year-end rate of around 3.5%. Similarly, the Australian economy is forecast to grow by approximately 2% in 2025.

China

- China is expected to maintain its 5% growth target in 2025 through additional rate cuts and further support for its property market. As in 2024, China will be focused on boosting domestic demand, which has remained sluggish since the property sector collapse.
- During Trump's last term, tariffs reduced China's GDP by 1.5%. However, since then, China has diversified its trading partnerships, with the U.S. now accounting for only 40% of China's trade balance, compared to 80% in 2018. As a result, Trump's proposed 10% tariff on Chinese imports is unlikely to have a significant impact on China's economy, as exports to the U.S. generate less than 3% of China's GDP.

United States

- There is ongoing debate about the extent to which tariffs will increase inflation and slow economic growth, as the details continue to evolve. Current estimates suggest that if a 25% tariff is imposed on all Canadian and Mexican imports and a 10% tariff on Chinese imports, U.S. inflation could rise by nearly 1%, while GDP may decline by approximately 1%. However, Canada and Mexico, whose economies are more reliant on the U.S., are expected to be worse off, with both projected to lose around 2% of GDP, putting both economies into a recession. For now, tariffs have been paused for 30 days, as Canada and Mexico are cooperating with Trump and strengthening border protections. Hopefully, this will mark the end of tariff threats, as the failure to reach a permanent agreement would be detrimental to all economies involved.

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