JUNE 2024

BSP TREASURY & MARKETS MONTHLY MARKET PULSE

GLOBAL MARKETS

Both equities and fixed income saw positive returns. Developed market stocks rose by 4.5%, and global bonds gained 1.3% amid expectations of summer rate cuts. Growth sectors outpaced Value sectors by 2.4%, and small caps rebounded, matching large caps' returns.

COMMODITIES

Commodity markets witnessed varied performances: oil prices experienced declines, cocoa saw a surge, coffee prices rose, and natural gas climbed, while gold rebounded. These fluctuations were influenced by market dynamics and evolving policy expectations.

FX MARKETS

The AUD gained strength fueled by robust inflation data, signaling potential rate hikes by the RBA, while the PGK experienced fluctuations amid global economic uncertainties. Notably, the kina's depreciation against the USD has accelerated in the last two months.

MONEY MARKETS

Government Bond and T-Bill rates rose due to tighter BPNG monetary policy. Despite strong demand for T-Bills, interest in Government Bonds remained low. This trend is likely to continue due to the Kina's perceived overvaluation and expected depreciation against the USD.

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GLOBAL MARKETS

May saw favorable returns across both equities and fixed income. Investor optimism regarding the economic outlook buoyed risk assets, with developed market stocks yielding a solid 4.5% return for the month.
Global bonds also performed well, generating positive returns of 1.3%, as markets anticipated summer rate cuts, albeit with some disparity in timing between the US and Europe.
Growth sectors benefited from expectations of declining interest rates, outperforming Value sectors by 2.4 percentage points.
Small cap stocks rebounded, achieving returns of 4.6%, aligning closely with their large cap counterparts.
While oil prices retreated from April peaks, broader commodity indices still posted gains of 1.8%, supported by robust global demand and ongoing geopolitical tensions in the Middle East and Ukraine.

US

Despite the continued resilience of the US economy, recent data released in May indicated some signs of moderation, notably in capital spending and home sales which exhibited sideways trends. However, a notable highlight for the month was the Flash Purchasing Managers' Index (PMI) data, revealing a rise in both the manufacturing component to 50.9 and services to 54.8. Additionally, following a decline in April, US equities experienced a robust rebound in May, achieving monthly returns of 5.0%, buoyed by stronger-than-anticipated first-quarter earnings results across various sectors.

GLOBAL MARKETS

Europe

In Europe, the latest PMI data indicates a positive trajectory in economic activity. While the services sector remains robust, there are also indications of a rebound in manufacturing. First-quarter GDP growth stood at 0.3% quarter-over-quarter, affirming steady expansion. Moreover, corporate profits surpassed expectations, adding to the positive outlook. This reacceleration, coupled with comparatively modest valuations, is garnering increased interest from international investors. European equities, excluding those from the UK, saw a return of 3.6% in May, while UK equities returned 2.4%.

Asia

Encouraging signs of progress are evident across Asian economies, albeit with certain reservations. Chinese economic data consistently exceeds expectations, coinciding with a resurgence in the equity market. However, the recovery's depth is somewhat uncertain due to persistent weaknesses in domestic demand, necessitating a reliance on robust export growth. Unresolved challenges in the real estate sector further raise doubts about the sustainability of the Chinese economic rally.

In Japan, while currency depreciation typically benefits the export-heavy equity market, the current exceptionally low levels of the Japanese yen are beginning to adversely affect consumer sentiment. Consequently, Japanese stocks performed weakly regionally in May, with returns of only 1.2%.

Diverging Regional Economies

As regional economies increasingly diverge, central bank policies are following suit. In the US, inflationary pressures in the services sectors persist, despite a modest slowdown in headline and core inflation rates to 3.4% and 3.6% year-over-year respectively. The May FOMC meeting minutes underscored concerns about disinflation progress, diminishing expectations for an immediate rate cut. Conversely, in the eurozone, the ECB remains confident in its disinflationary path, supported by moderated wage growth. Headline and core inflation accelerated to 2.6% and 2.9% year-over-year respectively in May, prompting the ECB's signal for rate cuts in June. UK headline inflation declined to 2.3% year-over-year in April, while services inflation remained high at 5.9%, delaying prospects for a Bank of England rate cut in June. Meanwhile, the Bank of Japan faces unique challenges, as rate hikes are needed to bolster a weak currency without jeopardizing reflation. This divergence in monetary policies is expected to contribute to volatility in government bond markets, yet bonds continue to serve as both income and diversification in portfolios.

FOREIGN EXCHANGE MARKETS

PGK/USD

Foreign exchange market turnover surged for the third consecutive month, reaching K4.95 billion in May, a 22% increase and the busiest month of the year to date. The central bank's heightened market activity was a significant factor, with the Bank of Papua New Guinea (BPNG) intervening with a year-high US$190 million which included US$50 million offered to Authorized Foreign Exchange Dealers (AFEDs) through its inaugural foreign exchange auction. It is anticipated that the FX auction method will replace traditional interventions and occur on a more frequent basis.

Although outstanding market foreign exchange orders have decreased, they remain above one billion Kina. FX inflows from exporters, especially from the mining sector, typically help reduce market orders at month-end. However, approaching financial year-ends for some businesses are expected to elevate order volumes gradually.

The pace of the Kina's depreciation against the US dollar, termed the "crawl," has almost doubled over the last two months, with declines of 20 basis points in April and 21 basis points in May (9.6% annualized rate of depreciation), compared to an average monthly decline of 11 basis points in the preceding three months (5.1% annualized).

PGK/AUD

The PGK reached its highest point against the AUD at 0.4060 early in the month, later declining to a low of 0.3897 on May 20th. By the end of the month, the PGK concluded at 0.3930 against the AUD.

AUD/USD

The Australian dollar surpassed $0.666, nearing its four-month high of $0.67 on May 15th, propelled by diverging monetary policies between the Reserve Bank of Australia (RBA) and the Federal Reserve. In the US, slowing inflation and lower-than-expected personal spending compounded weak economic data following the downward revision of Q1 GDP.

Conversely, robust inflation figures in Australia have heightened expectations for further RBA interest rate hikes, with the latest monthly CPI showing a 3.6% annual increase. However, the AUD's gains were restrained by a contraction in Chinese manufacturing and slower construction, impacting import demand from Australia’s main commodity consumer.

Market sentiment suggests minimal chances of an RBA rate cut this year, with a slight possibility of another hike due to ongoing domestic inflation. However, current interest rates may limit domestic demand. Upcoming data, expected Wednesday, project a modest 0.2% economic expansion for the March quarter, marking the third consecutive quarter of below-average growth.

FOREIGN EXCHANGE MARKETS

PGK/USD

PGK/USD

In May, the PGK/USD rate experienced a cumulative depreciation of 21 basis points, settling at 0.2608. The rate of depreciation of the PGK against the USD, referred to as the "crawl," has intensified over the past two months.

PGK/AUD

PGK/AUD

The PGK peaked at 0.4060 against the AUD early in May, dropped to 0.3897 on May 20th, and closed the month at 0.3930.

MONEY MARKETS

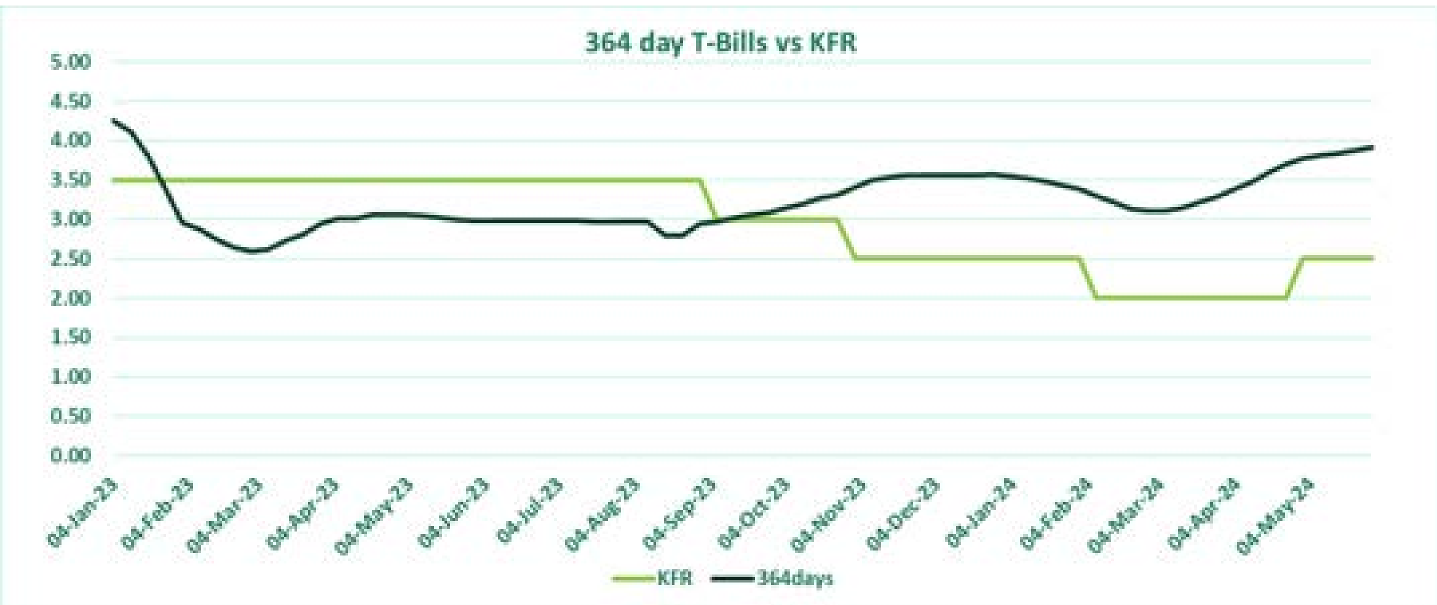
The prevailing trend observed last month, characterized by rising interest rates on Government Bonds and Treasury Bills, persisted throughout May.

Despite Treasury Bill auctions registering predominantly oversubscribed responses during the month, the demand for Government Bonds (GIS) remained subdued, marking the third consecutive auction where subscriptions fell short of expectations.

Investors responded to the tightening monetary policy stance articulated by the Bank of Papua New Guinea (BPNG) by placing higher bids in the auctions throughout the month.

This trend is anticipated to persist in the upcoming months, particularly given the perceived overvaluation of the Kina. Furthermore, the currency is expected to continue its gradual depreciation trajectory against the US dollar over the medium term.

Auction	Central Bank Bills					Treasury Bills					
Date	7	14	28	63	91	28	63	91	182	273	364
Previous	2.00								1.97	-	3.70
01-May-24	2.50								2.18	-	3.77
08-May-24	2.50								2.28	-	3.81
15-May-24	2.50								2.29	2.45	2.84
22-May-24	2.50								2.30	-	3.88
29-May-24	2.50	-	-	-	-				2.30	2.46	3.92
Movement	0.50	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.33	2.45	0.18



COMMODITIES

Brent Crude Oil

Brent crude oil futures fell by 3% to under $79 per barrel on Monday, hitting a four-month low after OPEC+ announced plans to gradually ease oil production cuts. The group intends to phase out voluntary cuts of 2.2 million barrels per day over the next year, starting in October. By December, over 500,000 barrels per day are expected to return to the market, with a total of 1.8 million barrels per day by June 2025. OPEC+ will also maintain additional cuts of 3.6 million barrels per day until the end of 2025. Oil prices have faced downward pressure due to demand uncertainties and concerns over prolonged high interest rates from the US Federal Reserve, potentially dampening economic growth and reducing oil demand.

Natural Gas

US natural gas futures surged by over 5% to surpass $2.7 per million British thermal units (MMBtu) on Monday, continuing a 30% increase observed in May, driven by escalating demand coinciding with the onset of summer temperatures. Projections suggest sustained high demand due to intense western heat anticipated through the first half of June. Furthermore, gas flow to liquefied natural gas (LNG) export facilities, notably the Freeport LNG plant in Texas, has increased. However, prices faced a decline of over 6.5% last week as some drillers ramped up gas extraction, heightening concerns of oversupply. The latest report from the Energy Information Administration (EIA) indicates that gas stockpiles are approximately 26.5% higher than the seasonal average.

Gold

Gold prices rose to $2,340 per ounce on Monday, recovering slightly from the previous session's two-week low of $2,330 and remaining within 3.5% of its record high. Increased expectations of monetary policy easing by major central banks bolstered demand for the non-yielding metal. US manufacturing data from ISM indicated a faster contraction than anticipated in May, while the price gauge slowed, reinforcing expectations of multiple rate cuts by the Federal Reserve this year and enhancing gold's attractiveness. Furthermore, the European Central Bank is anticipated to lower interest rates this week to initiate its easing cycle, with similar moves expected from the Bank of Canada and the People’s Bank of China by the end of the third quarter.

Copper

Copper futures declined sharply to around $4.6 per pound from their May 20th peak of $5.2 due to weak near-term demand outweighing speculative momentum. A surprise contraction in manufacturing activity, indicated by May's Purchasing Managers' Index (PMI), underscored subdued domestic demand for industrial goods and raised concerns about oversupply, fueled by increased scrap usage boosting refiner output. This resulted in warehouse delivery prices falling below London Metal Exchange (LME) prices for the first time since 2017, indicating reduced physical demand. Despite this, copper prices remain 20% higher year-to-date, bolstered by its vital role in energy storage and data infrastructure, and optimism about Chinese stimulus measures. Miners are now prioritizing mergers and acquisitions over new projects due to the high costs of expanding supply.

COMMODITIES

Coffee

Arabica coffee futures surged to $2.3 per pound, marking fresh 5-week highs, propelled by mounting concerns surrounding adverse weather conditions in Brazil and Vietnam, the world's leading coffee producers. The Buon Ma Thuot Coffee Association reported a significant decrease in rainfall for this month in Vietnam's Dak Lak province, a critical coffee-growing region, projected to be 50% lower than the previous year. Furthermore, Somar Meteorologia highlighted the prolonged absence of rainfall in Brazil's Minas Gerais region, responsible for approximately 30% of the country's arabica crop, now enduring its fourth consecutive week without precipitation.

Cocoa

Cocoa futures surged, reaching approximately $9,800 per tonne in late May, the highest level since April's end, driven by heightened concerns regarding global supply constraints and robust demand. The International Cocoa Organization (ICCO) revised its projections, forecasting a global cocoa deficit of 439,000 metric tons for the 2023/24 season, a notable increase from its February estimate of 374,000 MT and nearly six times larger than the 74,000 MT deficit recorded in 2022/23. Despite record cocoa prices, grinding activities in importing nations remained strong, leading the ICCO to raise its global grindings estimate to 4.86 million tons, up from the initial forecast of 4.78 million tons. Conversely, recent data revealed a decline in cocoa arrivals at ports in Ivory Coast, the top cocoa producer, reaching 1.508 million MT by June 2nd, marking a 28.3% decrease compared to the previous year's figures. Notably, cocoa futures had surged to over $12,000 in mid-April, propelled by poor harvests in key West African producing regions.

Palm Oil

In May 2024, palm oil prices experienced notable fluctuations. Initially, concerns over supply shortages due to adverse weather conditions in major palm oil-producing regions drove prices upward. However, these gains were mitigated by weakening demand stemming from economic uncertainties in key importing countries, causing prices to retreat from their peaks. Additionally, fluctuating currency exchange rates and trade tensions further contributed to market volatility, adding to the price swings observed throughout the month. Despite this volatility, palm oil prices increased by 358 MYR per metric tonne or 9.62% since the beginning of 2024, as indicated by trading on a contract for difference (CFD) tracking the benchmark market for this commodity.

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