1 May 2017

Labour Market Powering Through the Crosswinds

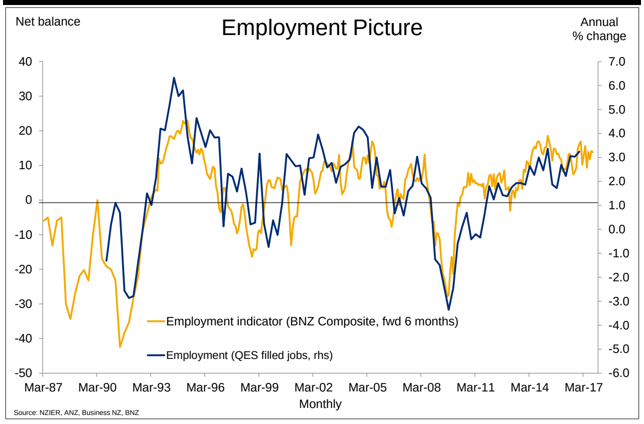
- HLFS to continue its jagged improvement in Q1
- But needs cross-checking with QES and LCI reports
- RBNZ inflation expectations survey now due Friday
- Dairy price recovery levelling off?
- April's QVNZ housing report…another mixed one?

The market focus for the coming week will be the trio of March quarter labour market reports. These are due Wednesday (10:45am). Of course, the Household Labour Force Survey (HLFS) is usually seen as the top dog amongst these. But because its quarterly results have been so volatile of late it's even more reason to cross-check the HLFS results against those of the accompanying Quarterly Employment Survey (QES) and Labour Cost Indexes. All considered, we expect to see still-solid jobs momentum, a fair to middling unemployment rate, but with LCI (wage) inflation still lagging a bit for the meantime.

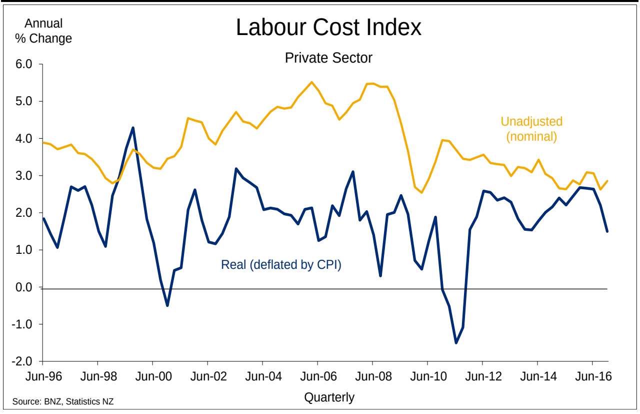
Some of the jaggedness in the HLFS harks back to a change in methodology at the June quarter 2016 release, when there looked to be a levels jump in its employment and participation rate series. Still, this brought them more into line with international norms. The unemployment rate series appeared less affected by the method changes, but has nonetheless been bouncing around a bit over recent quarters.

With all of this in mind, our guess is that the HLFS showed still-solid employment growth in the March quarter, of 0.8% (5.4% y/y); a steady unemployment rate at 5.2% and; sustained strength in the participation rate (70.6%, from 70.5%). These are close to market expectations, which are +0.8%, 5.1%, and 70.5% respectively.

Solid Momentum



Hardly Weak



If we look at the various staffing-constraint indicators we track, we get the distinct impression the jobless rate should be on a declining trajectory, indeed should probably drop in Q1 2017. However, we find it technically difficult to generate this, without estimating ongoing jumpiness in the participation rate and employment series in the quarter. So we won't be so bold.

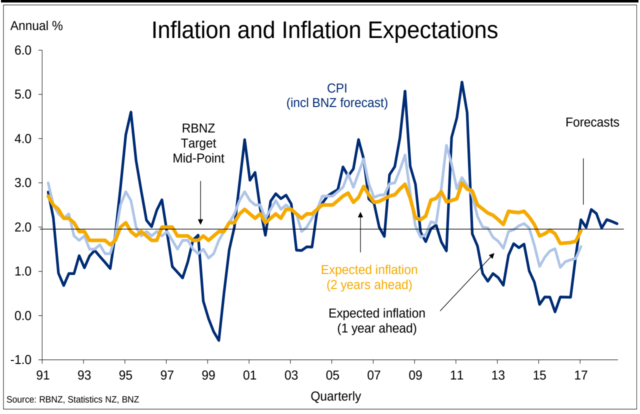
If we are not so sure about what figures the HLFS will throw up for the March quarter, we are confident about the broad trajectory of New Zealand's labour market. Based on the staffing indicators we look at we get a clear sense of above-average momentum.

The QES employment (filled jobs) series has not been subject to methodology changes and so has provided a smoother interpretation of what's going on, in our opinion. For example, it posted annual growth of 3.2% in Q4 2016, whereas the HLFS, including its step-jump in Q2 2016, did all of 5.8%.

The QES data will also provide a useful cross-check on March quarter economic activity, including with its paid-hours series. We mention this as we have reservations about how well Q1 GDP will do (even though we expect growth to be firm over calendar 2017 as a whole). This relates particularly to construction activity but also merchandise export volumes. Will QES paid-hours be consistent with the 0.7% we expect for Q1 GDP?

We'll also check on the HLFS hours-worked series in this respect, although, again, cognisant of the rocky ride it's been on from a statistical point of view.

Inflation Low Passing



The other important cross-check on Wednesday's HLFS outcomes will come via the Labour Cost Indexes. We anticipate the private-sector LCI to still be running at an annual pace of 1.6%. This is based on a quarterly outturn of 0.4% (in keeping with the market view). The lack of wage and salary inflation has been a point of debate, and no doubt a part of the Reserve Bank's reservation about the core inflation pulse.

However, we would make a few points here. First of all, nominal wage inflation is not as weak as much of the press tends to convey (usually with sole reference to the headline LCI data). The unadjusted Labour Cost Index, for example, inflated 2.9% last year. In real terms it's been running relatively robustly over recent years, consistent with a tightened labour market.

And if it has been low-running CPI inflation that has been keeping wage claims contained for now – rather than, say, high immigration – then we might expect nominal wage inflation to head properly higher over the coming year and next, as cost of living compensation claims get traction. While it's too early to expect this dynamic to be showing in Wednesday's Q1 wage and salary data, we think it's something to bear in mind for later in the year.

This is especially as we believe annual CPI inflation will stay around, even above, 2% for the foreseeable future, rather than fade away again as some seem to believe.

As for the "consensus" view on CPI inflation, we can reference the Reserve Bank's quarterly survey of expectations. This was to be published 12 May but the Bank has just notified us that it will now be coming out Friday this week (at the usual time of 3:00pm). While this survey asks about a host of key macro-economic variables, it is respondents' views on CPI inflation expectations that tend to hog the limelight. The last edition had the key 2-year-ahead CPI annual inflation expectation up at 1.92%, from 1.68%. We would expect it to remain close to the magic 2.00% level, especially as the survey was conducted post the Q1 CPI result. The 1-year-ahead expectation will surely increase from its last reading, of 1.56%.

The remainder of the NZ data for the week are lesser in the pecking order. There will, of course, be some interest in this afternoon's new residential lending figures, given focus on the hot housing market and the RBNZ credit policy measures aimed at it. We expect ongoing moderation in March's new lending, following on from February's annual decline of 15.2%.

This will tie into Wednesday morning's (5:00am) QVNZ housing report for April, from which further mixed messages would not be a surprise.

Very early Wednesday morning is the latest auction on the Global Dairy Trade platform. While we respect recent price momentum, we wouldn't want to push it much, if any, further.

As for Thursday's ANZ commodity prices for April, however, we would conjecture another small positive, in the world price index. The recent wriggles higher in dairy auction prices alone are supportive, but meat and forestry prices have also maintained a positive bent.

ANZ job ads are scheduled for Thursday (10:00am). Being for April these will be a useful follow-on from the Q1 labour market data of the day before. Forging higher should be the common theme.

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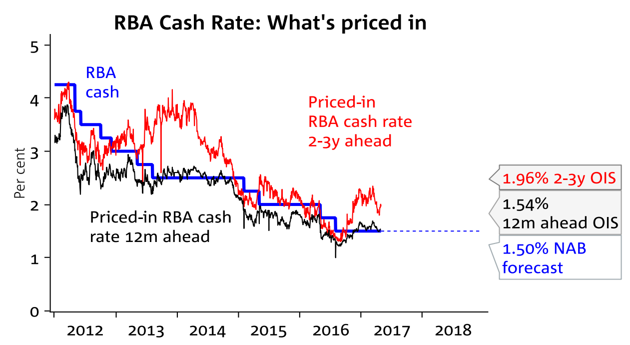
Global Watch

- US ISMs, Payrolls, the FOMC meets
- Yellen (and other Fed speakers) Friday
- RBA focus with the Board, Lowe speech and Quarterly Statement
- France holds its Presidential election on Sunday

Australia

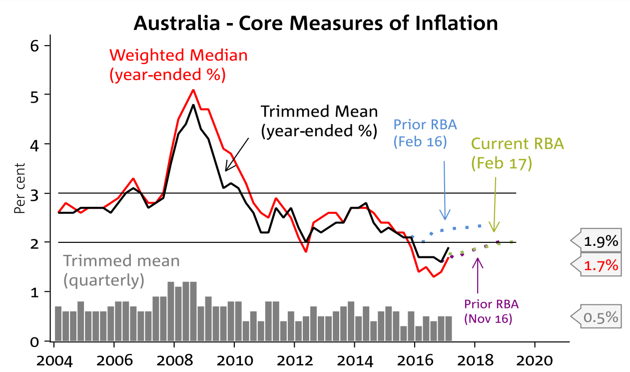
It's full focus back on the central bank, starting Tuesday with the RBA Board. The Board now has the (admittedly limited) benefit of one more upbeat labour market report as a partial counter to choppier readings so far this year, reports that followed other indicators of the economy and the labour market continuing to show more resilience. As a result, expect a still overall mixed to an uncertain assessment of the labour market. While no analyst is picking any rate change from the central bank on Tuesday (and virtually no change is priced in), analysts and the market will be looking for nuances from the Bank on the balance of risks.

Chart 1: Neutral to Mild Tightening Market Bias



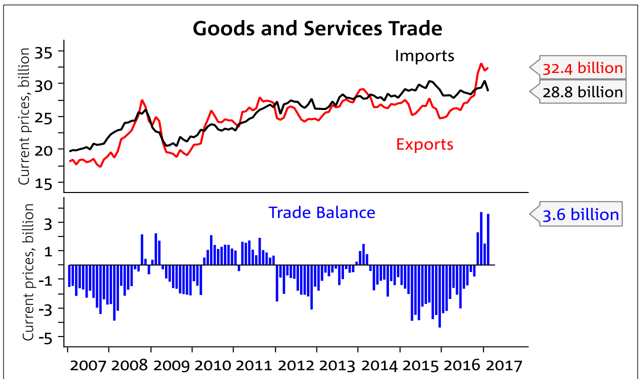
Source: National Australia Bank, Macrobond
OIS is Overnight Indexed Swaps, where the interest payment is compounded from the (overnight/daily) central bank rate

Chart 2: Q1 Core Inflation a Tad Above RBA Forecast



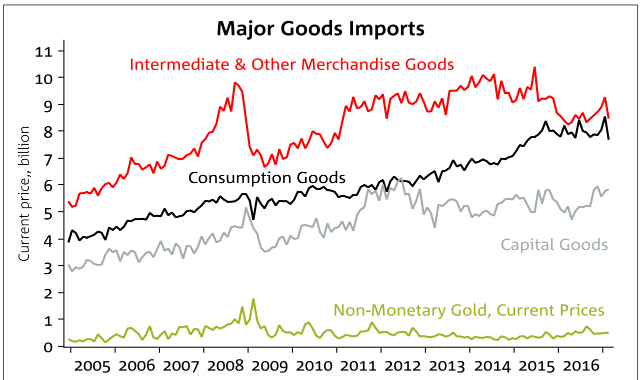
Source: National Australia Bank, ABS, RBA

Chart 3: Trade Account Still in Surplus



Source: National Australia Bank, ABS

Chart 4: Irregular Import Readings in Jan/Feb



Source: National Australia Bank, Macrobond

Friday sees the release of the Bank's quarterly Statement on Monetary Policy, with special interest not only in the more detailed outlook for monetary policy, but also any changes to the Bank's economic forecasts. Last week's Q1 CPI report was not materially different from the RBA's forecast track. If anything, core inflation was running only marginally higher than the RBA's track. It's within the bounds of uncertainty, especially given the Bank's near term forecasts are rounded to the nearest quarter of a per cent and wider ranges disclosed for the medium to longer term. Governor Lowe speaks Thursday on Household debt, Housing prices and Resilience.

The main data interest will be the March trade report, out Thursday. This completes the goods and services trade balance for the March quarter, allowing for a tentative estimate of the likely real net exports contribution to GDP for the quarter.

For the monthly outcome, imports in January look to have been skewed up then reversed in February, making interpretation of recent readings problematic. Bulk export commodity volumes (and prices) likely held up in March and we look for a still solid trade surplus in the month ahead of Cyclone Debbie volume and price impacts in April and May.

There's also a smattering of other data releases, starting Monday with the AiG PMI Manufacturing release (L: 57.5), along with the full April CoreLogic Home Values Index report, the monthly CPI gauge, and the RBA Commodity Price Index for April out later in the day. Completing the data week is the AiG PSI Services Index on Wednesday, HIA New Home Sales on Thursday and the PCI Construction Index on Friday.

China

The Caixin PMIs are out on Tuesday (Manufacturing) and Thursday (Non-manufacturing and Composite indexes).

US

A big week ahead, even aside from the continuing focus on Washington. The March PCE deflators and ISM Manufacturing reports are due on Monday, ADP Employment and Non-manufacturing ISM Wednesday, ahead of Payrolls Friday after the FOMC announcement on Thursday morning (NZT). No rate change is widely expected from the Fed. There's no forecast update this meeting, nor Yellen press conference, but she speaks on Friday, along with other Fed speakers, including two tonight.

Japan

There'll be some interest in the BoJ's March 15-16 Minutes and a speech from Governor Kuroda on Tuesday. Quiet for major data.

Eurozone

Quiet for data this week apart from the first cut of GDP out Wednesday and Draghi's speech on Thursday. Monday is May Day holiday. French Presidential candidates Macron and Le Pen face off in a televised debate on Wednesday ahead of Sunday's election.

UK

It's the May Day bank holiday on Monday, most data interest will be in the PMIs, starting with the Manufacturing index out Tuesday.

Canada

The main interest comes at the end of the week with the April labour market report on Friday along with the IVEY Manufacturing PMI.

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Fixed Interest Market

Reuters: BNZL, BNZM Bloomberg:BNZ

This week sees the release of the last inputs that will feed into the RBNZ's forecasts ahead of next week's Monetary Policy Statement. The HLFS and QES are expected to show steady wage inflation and a steady unemployment rate. Unless they significantly surprise, market reaction should be minimal. Last quarter's RBNZ 2-year inflation expectations figure jumped up by 24bps to 1.92%. The odds favour another lift towards 2% in Friday's update.

The weakness of the NZD cannot be ignored as the RBNZ finalises its forecasts. The TWI has slumped by 6% over the past three months and is currently over 5% lower than assumed by the RBNZ for the June quarter. We see the fall in the NZD as largely driven by portfolio flows, and against the supporting economic fundamentals of better global economic growth momentum and NZ commodity prices holding up over the past quarter.

With this in mind, the weaker NZD adds around 0.5% to the inflation outlook over the next 12-18 months relative to the RBNZ's projections. Add to that, actual CPI inflation has been running ahead of RBNZ forecasts for the past three quarters and the Q1 miss was a particularly large 0.7%. It all adds up to the RBNZ being no more dovish than it was in February/March and the question now is how close does the Bank move towards the prevailing market view of rate hikes ahead from early next year? A little closer, but still far away would be our expectation.

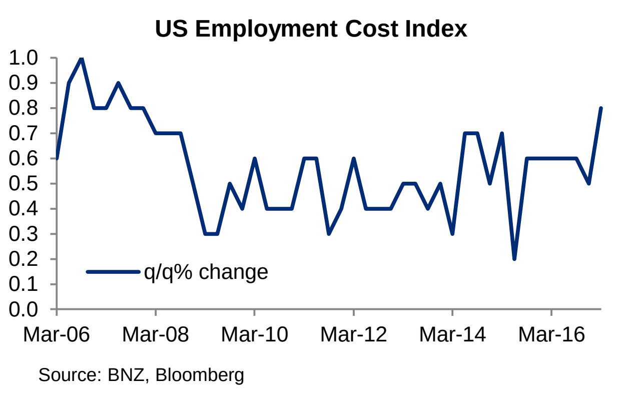
Until the RBNZ gives the nod to higher inflationary pressure, the 2-year swap rate will remain well anchored around 2.30-2.35%. Market pricing for hikes remains well ahead of RBNZ expectations and will likely remain that way even after any forecast revisions by the Bank. But a less dovish tone by the Bank next week could set the scene for a drift higher in short-term rates over coming months.

With regards to US Treasury rates, which influence NZ longer term rates, we would ignore the soft reading of Q1 GDP of just an annualised 0.7%, with well-known issues with seasonal adjustment. We would also ignore the sabre-rattling tone of President Trump with regards to North Korea. The chance of military conflict on the Korean peninsula seems very low to us, with strong incentives for all countries – North/South Korea, China or the US – to maintain the status quo.

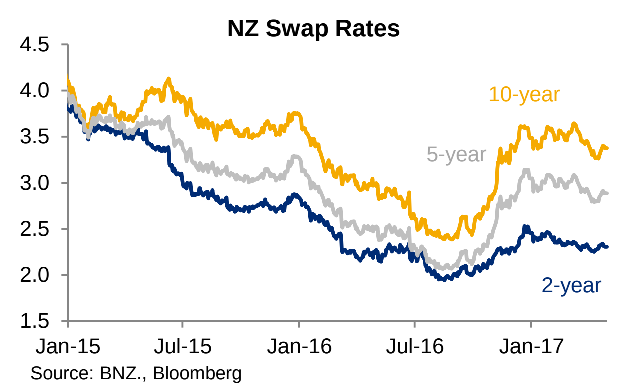
Higher wage inflation – note last week's stronger employment cost reading – and the tight US labour market are worthy of attention. Friday's US employment report should provide further evidence of wage inflation at or above recent rates. Ahead of that, Thursday's FOMC meeting is likely to keep alive the prospect of a June rate hike and a number of Fed speakers out in force late in the week are likely to support that view. We see the balance of risk weighted towards higher US treasury rates by the end of the week. Market pricing is still complacent regarding Fed hikes this year, with only 35bps of hikes priced in.

Higher US rates would directly feed into the NZ curve. The NZ 5-year swap rate is trading near the top of its range for the past few weeks, but we wouldn't be surprised to see a 3-handle revisited over coming weeks. The same view holds for the NZ-10 year swap rate, where we see the path of least resistance being a move back up towards 3.50%.

Highest US Wage Inflation Since the GFC



Range-Trading; We See Upside Bias Ahead



Current Rates/Spreads and Recent Ranges

	Current	Last 3-weeks range*
NZ 90d bank bills (%)	1.99	1.95 - 1.98
NZ 2yr swap (%)	2.31	2.25 - 2.36
NZ 5yr swap (%)	2.89	2.79 - 2.92
NZ 10yr swap (%)	3.38	3.24 - 3.41
2s10s swap curve (bps)	107	96 - 108
NZ 10yr swap-govt (bps)	33	25 - 36
NZ 10yr govt (%)	3.05	2.91 - 3.11
US 10yr govt (%)	2.28	2.16 - 2.36
NZ-US 10yr (bps)	76	69 - 78
NZ-AU 2yr swap (bps)	48	41 - 50
NZ-AU 10yr govt (bps)	47	43 - 53

*Indicative range over last 3 weeks

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Foreign Exchange Markets

Reuters pg BNZWFWDS Bloomberg pg BNZ9

With another month past it's time to look at the scoreboard and it doesn't look flash for the NZD. It underperformed (again) last month, falling alongside other commodity currencies. For the past three months the NZD has been the worst performer by far, down over 6% on a TWI basis, and for the year to date it is competing with the CAD to be the biggest loser.

The extent of NZD weakness has surprised us, given the global backdrop. Global activity indicators remain on a rising trend. Risk appetite remains as high as ever, but the NZD correlation with this index has been insignificantly different from zero so far this year. Global commodity prices have softened, but NZ prices have held up this year.

The market respects the RBNZ's neutral policy guidance (at least when we consider the next six months), but inflation pressures are clearly increasing and have been stronger than expected. Nothing this year has budged us from our view that the Bank's next move will be to tighten policy and probably from May next year, ahead of most other central banks.

To be sure, our projection has been for the NZD to weaken this year and end 2017 around 0.67, but that was meant to be in the context of a much weaker global backdrop and a risk appetite index closer to 50% than the current still-high 80%. Either the NZD has moved well ahead of that view or it is due for some recovery over coming months. Our current fair value estimate is around 0.7450, indicative of the break in correlation between the NZD and fundamental factors. The approximate 8% gap between spot and fair value is the largest since the depths of the GFC back in March 2009. Net short speculative positioning in the NZD is the largest since July 2015. The "fast" money has been on the right side of the trade, but that also sets up a low hurdle rate for a rebound in the NZD.

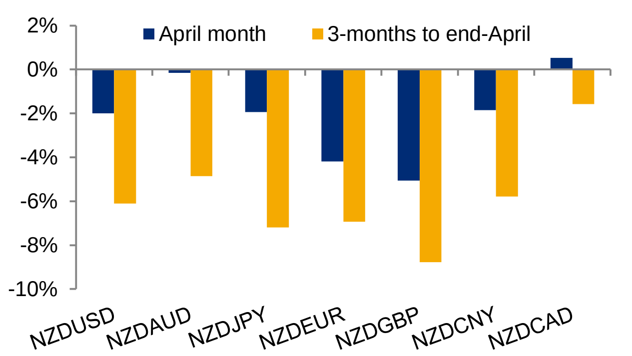
The NZD has fallen to an area of strong technical support around 0.6850. A sustained break of that opens up about two more cents of downside risk where the next area of technical support cuts in. All that said, a reversal of sentiment for the NZD would open up potential for a significant bounce. If we discount our fair value estimate in light of the potentially weaker 2H17 global environment, then perhaps 0.70-71 seems like a fairer level for now, well north of current spot.

It's another action-packed week on the economic calendar. The key local releases are the HLFS and QES labour market indicators. They are expected to show steady wage inflation and a steady unemployment rate and are the final key releases ahead of the 11 May RBNZ MPS. With the market more focused on global news, these data releases and the GDT dairy auction should pass without much market reaction mid-week.

With the RBA likely on hold for an extended period, its next announcement Tuesday afternoon and statement on monetary policy on Friday should pass with little reaction as well. We still see the RBNZ raising rates ahead of the RBA which should be positive for NZD/AUD, but not until later in the year, in anticipation of possible policy adjustments in 2018.

The US calendar is full, with the FOMC expected to keep rates unchanged but keep alive the prospect of another rate hike next month. The wage indicators in Friday's employment report are the most important to watch and they are expected to show wage inflation either at or above the prior month's reading. Ahead of that release, spending, income and ISM indicators are released. At the end of the week, a number of FOMC members hit the speaking circuit, which provides another source of potential volatility to the USD as we round out the week.

NZD Significantly Underperforms Over Last 3 Months



Source: BNZ, Bloomberg

Cross Rates and Model Estimates

	Current	Last 3-weeks range*
NZD/USD	0.6864	0.6850 - 0.7050
NZD/AUD	0.9188	0.9160 - 0.9400
NZD/GBP	0.5305	0.5300 - 0.5610
NZD/EUR	0.6290	0.6270 - 0.6620
NZD/JPY	76.40	75.70 - 78.00

*Indicative range over last 3 weeks, rounded figures

BNZ Short-term Fair Value Models

	Model Est.	Actual/FV
NZD/USD	0.7450	-8%
NZD/AUD	0.9190	0%

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Technicals

NZD/USD

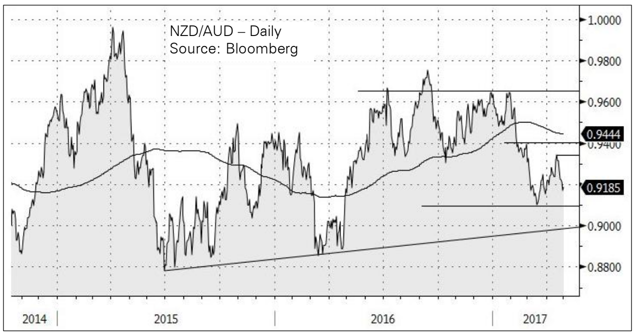
Outlook:	Downward channel
ST Resistance:	0.7090 (ahead of 0.7250)
ST Support:	0.6850 (ahead of 0.6675)

Current spot is close to technical support at last week's low of 0.6850. A break of this opens up about 2 cents of downside potential. Mild short-term resistance comes into play from around 0.7090.

NZD/AUD

Outlook:	Trading range
ST Resistance:	0.9350 (ahead of 0.9400)
ST Support:	0.9150 (ahead of 0.9100)

After a significant fall, support kicked in around the 0.91 mark. As this level hasn't really been threatened over recent weeks, it forms the basis of a stronger support base. The first area of resistance kicks in around 0.9350-0.9400.



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NZ 5-year Swap Rate

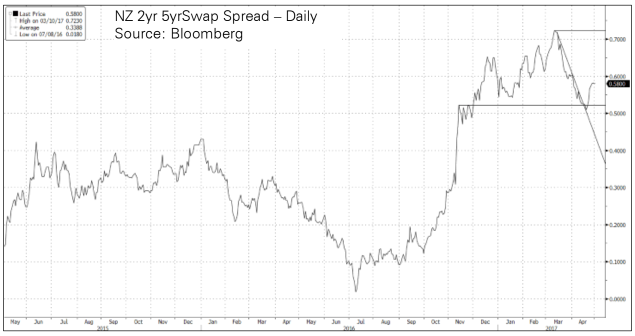
Outlook:	Neutral
ST Resistance:	3.02
ST Support:	2.79

Mid range at present and await a breakout. Should we test support at 2.79 I would initiate a paid position with tight stop.

NZ 2-year - 5-year Swap Spread (yield curve)

Outlook:	Bearish
ST Resistance:	+72
ST Support:	+52.5

Break of support at 52.5 wasn't held and now forms support. Back in the 52.5-72 range.



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Key Upcoming Events

	Forecast	Median	Last
Monday 1 May			
NZ, Residential Lending, March y/y			-15.2%
Aus, Inflation Gauge (Melbourne Institute), April y/y			+2.2%
US, Construction Spending, March		+0.5%	+0.8%
US, Personal Spending, March		+0.2%	+0.1%
US, ISM Manufacturing, April		56.5	57.2
Tuesday 2 May			
Aus, RBA Policy Announcement	1.50%	1.50%	1.50%
China, PMI (Caixin), April		51.3	51.2
Jpn, BOJ Minutes, 15/16 Mar Meeting			
Euro, Unemployment Rate, March		9.4%	9.5%
UK, Markit/CIPS Manuf Survey, April		54.0	54.2
Wednesday 3 May			
NZ, QVNZ House Prices, April			+12.9%
NZ, Dairy Auction, GDT Price Index			+3.1%
NZ, HLFS Unemployment Rate, Q1	5.2%	5.1%	5.2%
NZ, LCI Priv Ord Wages, Q1 y/y	+1.6%		+1.6%
Euro, GDP, Q1 1st estimate		+0.5%	+0.4%
US, ADP Employment, April		+180k	+263k
US, ISM Non-Manuf, April		55.8	55.2
US, FOMC Policy Announcement, Upper Bound		1.00%	1.00%

	Forecast	Median	Last
Thursday 4 May			
NZ, ANZ Job Ads, April			+1.6%
NZ, ANZ Comdty Prices (world), April			+0.4%
Aus, Lowe Speaks, Household/Houisng			
Aus, International Trade, March			+$3.57b
China, Services PMI (Caixin), April			52.2
Euro, PMI Services, April 2nd est		56.2	56.2P
Euro, Retail Sales, March		+0.1%	+0.7%
UK, Markit/CIPS Services, April		54.5	55.0
US, Factory Orders, March		+0.4%	+1.0%
US, Durables Orders, March 2nd est		+0.7%	+0.7%P
US, International Trade, March		-$44.5b	-$43.6b
US, Productivity (non-farm), Q1 saar 1st est		flat	+1.3%
US, Jobless Claims, week ended 29/04		250k	257k
Friday 5 May			
NZ, RBNZ 2yr Inflation Expectations, Q2			+1.92%
Aus, Construction PMI (AiG), April			51.2
Aus, Qtly Monetary Statement			
US, Yellen/Fischer Speak			
US, Non-Farm Payrolls, April		+190k	+98k
US, Unemployment Rate, April		4.6%	4.5%

Historical Data

	Today	Week Ago	Month Ago	Year Ago
CASH & BANK BILLS				
Call	1.75	1.75	1.75	2.25
1mth	1.86	1.84	1.85	2.25
2mth	1.92	1.90	1.90	2.29
3mth	1.99	1.97	1.98	2.33
6mth	2.02	2.02	2.01	2.31
GOVERNMENT STOCK				
12/17	1.81	1.80	1.85	2.10
03/19	2.07	2.13	2.12	2.14
04/20	2.28	2.30	2.34	2.23
05/21	2.43	2.44	2.51	2.28
04/23	2.71	2.72	2.79	2.47
04/25	2.96	2.96	3.09	2.76
04/27	3.04	3.02	3.19	2.91
04/33	3.29	3.30	3.55	3.23
GLOBAL CREDIT INDICES (ITRXX)				
AUD 5Y	81.69	85.50	88.11	131.75
N.AMERICA 5Y	64.09	67.12	67.04	74.42
EUROPE 5Y	66.55	74.57	75.14	71.55

	Today	Week Ago	Month Ago	Year Ago
SWAP RATES				
2 years	2.31	2.36	2.32	2.23
3 years	2.54	2.58	2.56	2.29
5 years	2.89	2.92	2.93	2.51
10 years	3.38	3.40	3.45	3.01
FOREIGN EXCHANGE				
NZD/USD	0.6868	0.7038	0.7039	0.6861
NZD/AUD	0.9178	0.9312	0.9219	0.8894
NZD/JPY	76.41	77.45	78.11	76.29
NZD/EUR	0.6300	0.6471	0.6498	0.6090
NZD/GBP	0.5309	0.5490	0.5634	0.4738
NZD/CAD	0.9377	0.9489	0.9399	0.8699
TWI	74.80	76.46	76.26	72.53

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Fixed Income/Derivatives	+1 212 916 9677

Hong Kong

Foreign Exchange	+(85 2) 2526 5891
Fixed Income/Derivatives	+(85 2) 2526 5891