10 April 2017

The More Things Change (for the RBNZ)

- More potential changes to/for the RBNZ
- But unlikely to alter monetary policy judgements
- March ECT to inform on Q1 retail volumes
- March PMI due Thursday
- We expect March Food Price Index fell 0.2%

There will be some potentially interesting changes at, and for, the Reserve Bank of New Zealand over the next twelve months or so. However, we don't believe any of it will cause the Reserve Bank to act that much differently to what it would under the status quo. Or, at least, it shouldn't. One thing that will not change, we believe, is the commitment to inflation targeting/control.

There will definitely be a new Governor come March 2018, however, and at least one new Deputy Governor. By then a new Policy Targets Agreement (PTA) would have been formulated for the new Governor's consideration. This is a grand opportunity for the RBNZ and Treasury to work away in the background, to iron out any wrinkles that are perceived to reside in the current PTA, while clearing up any misunderstandings of it as well.

Already, Treasury has just announced it will be conducting a review into the Bank's decision-making process. Finance Minister, Steven Joyce, has stated that "there's no specific plan for any change".

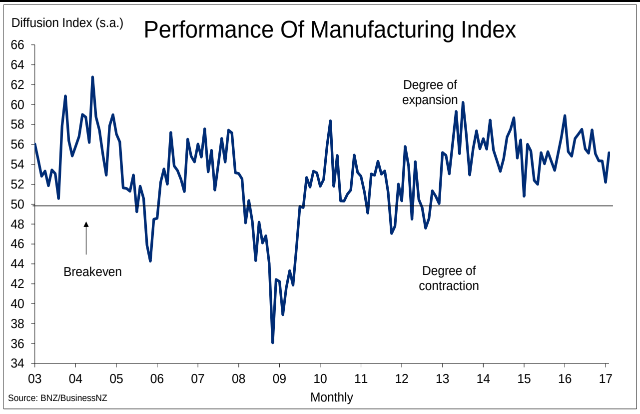
And today Opposition Finance spokesperson, Grant Robertson, will outline the Labour Party's intention to introduce, explicitly, an employment target into the Reserve Bank's mandate, and a committee-based decision making process, including non-RBNZ staff. His talk takes place over lunch-time and involves a panel discussion.

Many would argue that "full employment" targets are implicit to the Reserve Bank's current modus operandi, as it attempts to massage, via interest rates, the aggregate demand side of the economy to be in line with supply. But what is full employment, exactly? If it bears any resemblance to the Reserve Bank's Labour Utilisation Composite Index then the Official Cash Rate should be rising. And as Steven Joyce mentioned today, New Zealand has one of the very highest employment rates in the world at present.

On a committee-based approach, the Bank would argue it already has such a thing in the Governor's committee that Graeme Wheeler initiated. Having more than four RBNZ personnel would unlikely tilt the balance. Having outside members on the OCR setting committee might make a difference, but the details would need knowing.

In any case, it's the trade-offs in monetary policy that are always the most important. And these involve a lot of

Still Holding Up?



judgement, which is fine…so long as central banks articulate a consistent framework for this (and people can make up their own minds about whether the Bank is choosing the right path or not).

As for the immediate economic data, it officially begins with Tuesday's electronic card transactions. They have been very bumpy over prior releases, but with a decent trend, still. We expect this to be maintained, with a 0.3% increase in March's transaction values, seasonally adjusted. This would be enough to infer a pick-up in the rate of growth in retail trade volumes through Q1. The market anticipates a 0.5% increase in the retail component of the ECT.

Thursday afternoon, some folk might be starting to sneak away from work, in the hope of beating the Easter rush out of town. However, there should be no excuses for missing the morning's March Performance of Manufacturing Index. Fingers crossed it can hold up around the decent level it recovered to in February, namely 55.2.

Just after that, at 10:45am, we get the March Food Price Index. We expect this to fall 0.2%, after its effectively strong result, of +0.2%, in February. The March FPI outturn will help finalise our pick for the Q1 CPI (due 20 April), which is currently pitched at 0.9%. This would boost annual CPI inflation to 2.1%, from 1.3% (and 0.4% back in Q3 2016).

Meanwhile, we await the Real Estate Institute's residential figures for the month of March. They might yet be delayed until after Easter. But they will certainly be important for gauging what's going on in the housing market, nationally, as well as for the new quality-controlled (SPAR) price indices likely to be debuted (in place of the Stratified home price indices).

craig_ebert@bnz.co.nz

Global Watch

- AU Employment, NAB Survey due along with the RBA financial stability report
- Yellen speaks on Tuesday morning NZT
- CPI's due in China, UK, US

Australia

It's an Easter shortened week in Australia (Friday and the following Monday are public holidays). The major data pieces of data are the NAB Business Survey Tuesday, Monthly W-MI Consumer Confidence Wednesday and the official Employment figures Thursday. Finally, the RBA releases its semi-annual Financial Stability Review Thursday.

As always with the NAB Survey, we provide no hints. We note the survey has a strong relationship with non-mining activity in the economy.

Chart 1: NAB Survey Tracks Non-Mining Activity Closely

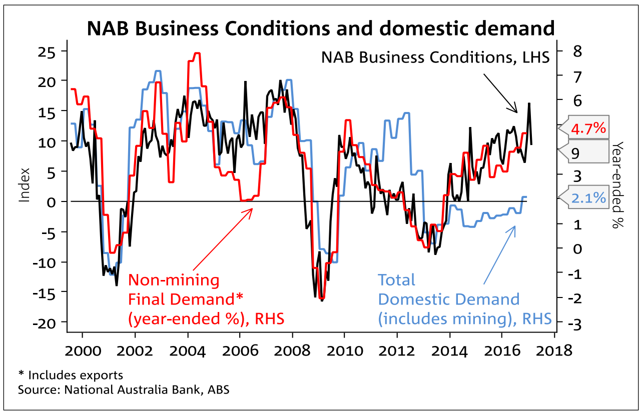
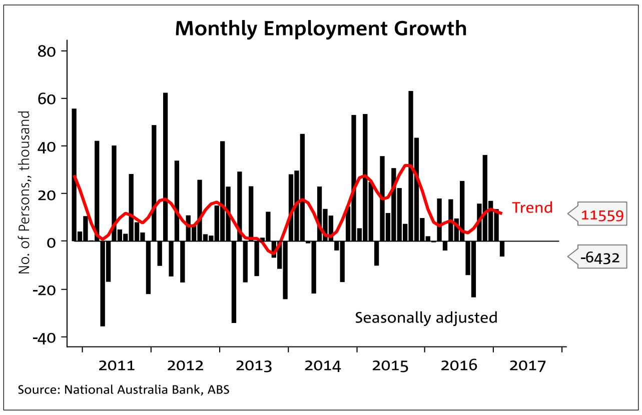


Chart 2: Aussie Employment Growth Was Weak in Feb



Last month the survey did decline to +9 from a stellar +16 in January, but the read was still well above its long-run average of +5.

Employment on Thursday will take on greater than usual importance. Last month the unemployment rate rose to 5.9% and Australia lost 6.4k jobs on net (Chart 2 and 3). A clear break has now emerged between the official employment figures and leading indicators such as the NAB business survey which has also led many to doubt the official employment figures (Chart 4). How this divergence resolves itself will be crucial for the outlook for rates.

The RBA Governor recently described the labour market as "pretty soft" and that "we will want to see an improvement here before we can be confident that growth in the overall economy is strengthening". The RBA (like the market) is holding faith to "forward-looking indicators [that] still point to continued growth in employment over the period ahead".

For this month, NAB (and the market) are looking for employment growth of 20k in February. For the unemployment rate, NAB looks for a decline to 5.8%, while the market expects this will be unchanged at 5.9%.

Chart 3: Unemployment Still Too High

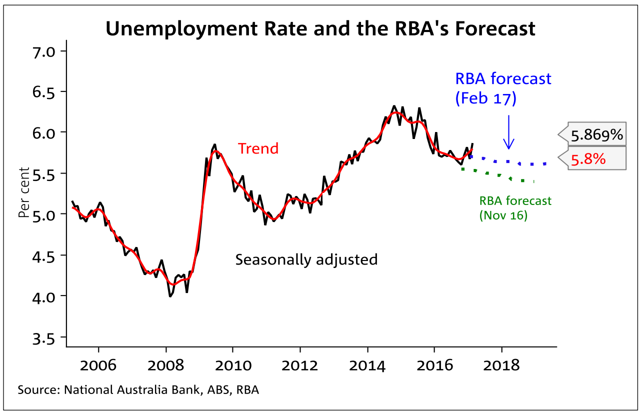
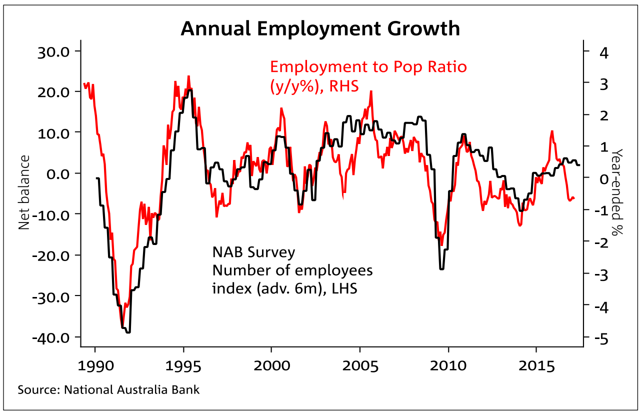
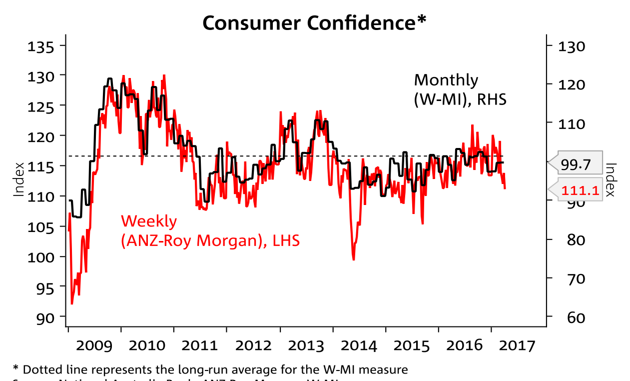


Chart 4: Employment Undershooting Leading Indicators



The other major data release worth watching is Monthly W-MI Consumer Confidence Wednesday. In recent weeks, the weekly measure of confidence has drifted lower and the monthly version will help confirm if this trend is real or mere weekly volatility.

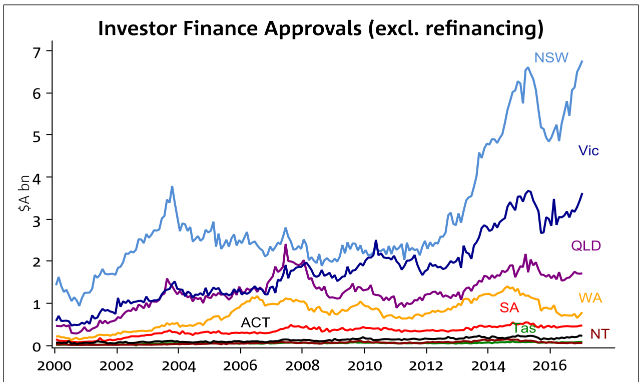
Chart 5: How Far Will Monthly Consumer Confidence Fall?



* Dotted line represents the long-run average for the W-MI measure
Source: National Australia Bank, ANZ-Roy Morgan, W-MI

There is also plenty of second tier data including Housing Finance Monday, Weekly Consumer Confidence Tuesday and Consumer Inflationary Expectations Thursday. Our pick of the second-tier data is Housing Finance. It is worth noting that this data pre-dates the new round of macro prudential changes. Bloomberg surveys the change in the number of owner-occupier loan approvals for this release. NAB looks for a 1.4% decline, weaker than the market consensus of a 0.2% rise. More interest is likely to be in the investor split, where investor finance approvals rose 4.3% in January (annualizing at 27.5%!), with most of that rise concentrated in NSW and Victoria (Chart 6).

Chart 6: Investor Activity Remains High in NSW and Vic



Source: NAB, ABS

Finally, the RBA releases its Financial Stability Review Thursday. The Review is not market moving, but given the RBA's concerns around the housing market and household debt, it will be worth a read.

China

Key events are the CPI Wednesday and Trade Balance Thursday.

US

Fed Chair Yellen on Monday (Tuesday 8.00am NZT) is the clear highlight and she is speaking off-the-cuff in a Q&A event in Michigan. The market will be closely noting her thoughts on shrinking the balance sheet and whether she sees this as defacto tightening which could cause the Fed to pause raising rates. Datawise, Retail Sales and the CPI Friday are worth noting, but we remind readers that Friday is also a holiday in the US with the equity market closed and the bond market closing at noon. Other pieces of data in the week include the Fed's Labour Market Conditions Index Monday, JOLTS and NFIB Small Business Optimism Tuesday, and Uni Mich Consumer Confidence Thursday.

Japan

The key releases are the Current Account Balance Monday, Machine Tool Orders Tuesday and Industrial Production Friday. BoJ Governor Kuroda speaks Monday.

Eurozone

Industrial Production and ZEW Tuesday are the most significant.

UK

An important week with CPI Tuesday, and Employment/ Unemployment Wednesday.

Canada

BoC Meeting Wednesday (firm on hold) takes centre stage in a quiet data week.

Tapas.Strickland@nab.com.au

Fixed Interest Market

Reuters: BNZL, BNZM Bloomberg:BNZ

NZ rates saw fresh lows for the year last week, driven by lower global rates, with the US attack on Syria adding to the downside pressure on US rates. That move was quickly reversed as it became clear that the missile attack was more in the nature of a warning shot than the beginning of an outright war. That said, the warning shot has added an extra dimension to the current geo-political risk environment, namely deterioration in US-Russia relations. It is far too early to jump to any conclusions but suffice to say that events in Syria will be added to the watchlist over coming weeks and months.

Friday's price action proved that the US labour market and outlook for US monetary policy remain a key driver of the rates market. A fresh 10-year low in the US unemployment rate adds to the case for further rate Fed tightening this year. We think that the balance of risk has shifted towards rate hikes in June and September, with the Fed pausing in December as it moves towards reducing the size of its balance sheet from late-2017.

Increased confidence about the near-term US monetary policy outlook doesn't seem to have had much of an adverse effect on the longer end of the curve. US 10-year Treasuries remain in the lower half of the well-established 2.30-2.60% range. The 10-year rate still hasn't closed below the 2.30% mark since late-November, adding to the strength of that level of technical support. Short positioning in US10s continues to be pared back. That has reduced the hurdle rate for any sell-off in the face of fresh adverse news for the bond market. But given increased geo-political risk, we don't see the top end of the range threatened over coming weeks.

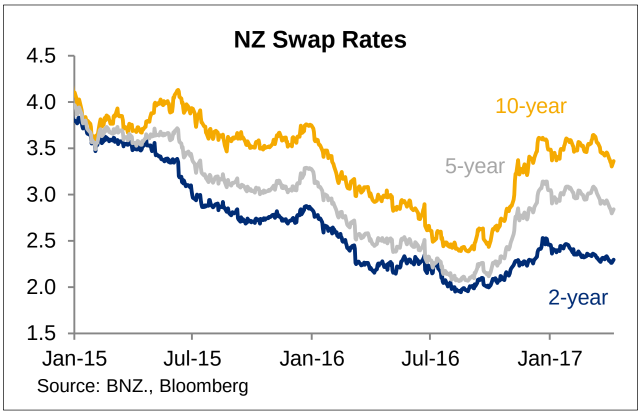
The key US releases this week – CPI and retail sales – are at the end of the week. We don't see them as strong enough to affect Fed rate hike expectations for this year. A key takeout from the labour market report was the absence of any increase in wage inflation over the past year, despite the unemployment rate falling from 5.0% to 4.5% over that time.

Turning to NZ, the RBNZ's guidance of accommodative monetary policy for a "considerable period" is doing wonders in keeping downside pressure on NZ short term rates even in the face of some positive local drivers. Whole milk dairy futures rose by 8% last week while the NZD TWI continues to probe fresh lows for the year. The QSBO showed intensifying pressures on the labour market as a possible source of future inflationary pressure. With that backdrop, one would normally have expected upside pressure to local rates, but the market is paying some respect to the RBNZ's policy guidance.

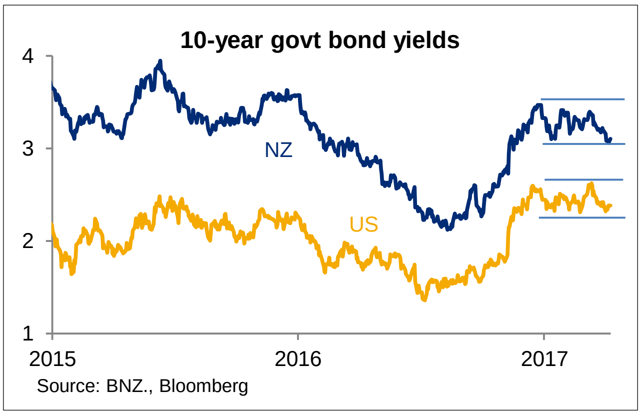
There are only second tier NZ releases over the coming week but the Q1 CPI release on 20 April will be a test of how well short rates are anchored. We think that the short end of the curve will be well anchored for now, but as the year progresses and more data confirm a rising inflationary impulse, then the pressure will be for a modest uptrend in short-end rates.

NZ-US long end spreads remain tightly range bound and look set to remain that way, so the long end of the local rates curve remains at the mercy of US rates. We have been suggesting a hedge-on-dips strategy for borrowers all year and the recent fall in rates to the lower end of the recent range presents such an opportunity.

Bottom of the Range?



Tightly Bound



Current Rates/Spreads and Recent Ranges

	Current	Last 3-weeks range*
NZ 90d bank bills (%)	1.97	1.95 - 2.00
NZ 2yr swap (%)	2.29	2.25 - 2.34
NZ 5yr swap (%)	2.84	2.78 - 2.95
NZ 10yr swap (%)	3.36	3.29 - 3.51
2s10s swap curve (bps)	107	105 - 121
NZ 10yr swap-govt (bps)	26	23 - 28
NZ 10yr govt (%)	3.10	3.05 - 3.24
US 10yr govt (%)	2.38	2.27 - 2.50
NZ-US 10yr (bps)	72	72 - 81
NZ-AU 2yr swap (bps)	42	27 - 43
NZ-AU 10yr govt (bps)	51	41 - 51

*Indicative range over last 3 weeks

jason.k.wong@bnz.co.nz

Foreign Exchange Markets

Reuters pg BNZWFWDS Bloomberg pg BNZ9

The NZD remains in a consolidation phase, with the TWI around the 76 mark and trading in a very tight range over the past four weeks. Further signs of a tightening US labour market alongside a Fed intent on tightening monetary policy sees the USD back in favour and the NZD within a cent of the 0.6860-0.6890 support zone that has been in place since mid-December.

The surprise US attack on a Syrian airfield on Friday has added another dimension to the backdrop. A significant deterioration of US-Russia relations as a result of the attack would be negative for risk appetite and negative for the NZD. It's a risk that is difficult to quantify at this stage and we keep a watching brief on this development. Of note, the lack of NZD downside as the reports came through of the attack, especially compared to the AUD, confirmed that positioning in the NZD is already short. The latest CFTC report showed the largest number of net short NZD positions since mid-January, which itself was the largest short positioning since mid-2015. This reduces the hurdle rate for a near-term bounce in the NZD on any positive surprise.

Of note, dairy prices (whole milk powder) have recovered half of their big loss from mid-February to early-March. The NZX May future is back above USD 3000 per tonne, a 15% recovery. Prices were boosted at the end of last week as the market believed that widespread flooding in the North Island would have a negative impact on milk production.

While the NZD seemed to be negatively impacted by the big fall in dairy prices, the currency hasn't budged in response to the lift in dairy prices. It could reflect that the market is not particularly confident in the recovery in dairy prices – certainly our house view is that dairy pricing based on supply/demand conditions ought to be fairly flat over the rest of 2017. Or it could reflect that other factors are weighing on the NZD.

The NZD's underperformance this year has also gone against the grain of supportive risk appetite conditions. Our risk appetite index based on the VIX index, emerging market sovereign spreads and the US high yield spread remains well in risk-loving territory and not far off its recent 2½ year high.

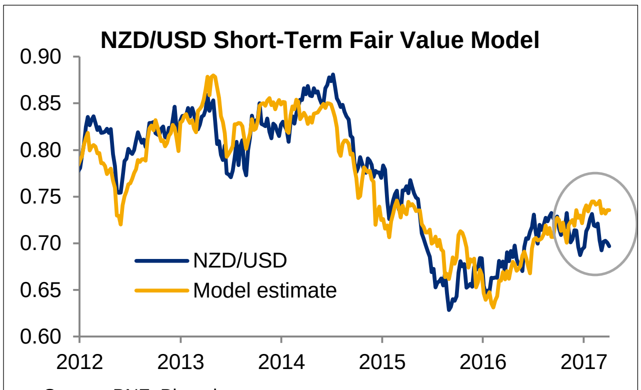
From a fundamental perspective then, based on commodity prices and risk appetite, the NZD looks oversold. Our current fair value estimate has been tracking in a 0.73-0.74 zone for the past month. Given our belief that the NZD will face some downward pressure in the second half of the year, we don't expect the valuation gap to close completely, but the hurdle rate for a cent or two bounce in the NZD over coming months is fairly low.

The balance of risk also favours some recovery in the NZD/AUD cross rate. Our end-June target remains at just under AUD 0.95. The sharp fall in the cross from 0.96 to 0.91 from February through to mid-March wasn't justified on fundamental factors, in our view, so the recovery should be seen in that context.

In the shortened holiday week ahead, local data releases are second-tier and unlikely to be market moving. Australia's employment release on Thursday always offers the opportunity for some intra-day volatility on the AUD crosses. There has been a lot of attention recently on the Australian housing market, debt levels, and APRA's fresh macro prudential measures to protect the banking system. These themes will get more attention this week after the RBA publishes its six-monthly financial stability report on Thursday. While not necessarily market-moving, the spotlight on these sorts of issues facing the Australian housing market isn't particularly supportive for the AUD.

The key US releases – CPI and retail sales – are at the end of the week. The USD is probably more sensitive to any inflation than real economic activity surprise. Further signs of core CPI inflation trending higher would be USD-supportive.

NZD Still Looking Oversold



Source: BNZ, Bloomberg

Cross Rates and Model Estimates

	Current	Last 3-weeks range*
NZD/USD	0.6937	0.6930 - 0.7070
NZD/AUD	0.9248	0.9110 - 0.9290
NZD/GBP	0.5608	0.5570 - 0.5710
NZD/EUR	0.6560	0.6460 - 0.6580
NZD/JPY	77.25	76.70 - 79.60

*Indicative range over last 3 weeks, rounded figures

BNZ Short-term Fair Value Models

	Model Est.	Actual/FV
NZD/USD	0.7350	-6%
NZD/AUD	0.9030	2%

jason.k.wong@bnz.co.nz

Technicals

NZD/USD

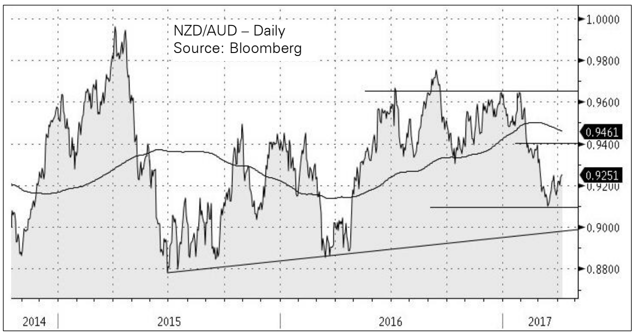
Outlook: Downward channel
ST Resistance: 0.7090 (ahead of 0.7250)
ST Support: 0.6890 (ahead of 0.6860)

The NZD is approaching an area of strong support between 0.6860-0.6890. A break of this would open up significant downside risk. 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. This would need to hold for a few weeks to be be sure. The first area of resistance kicks in around 0.9350-0.9400.

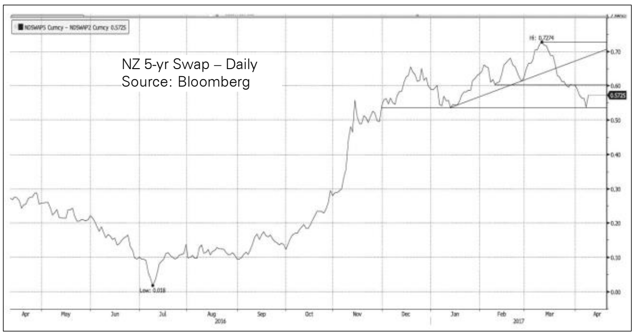


jason.k.wong@bnz.co.nz

NZ 5-year Swap Rate

Outlook: Neutral
ST Resistance: 2.89
ST Support: 2.80

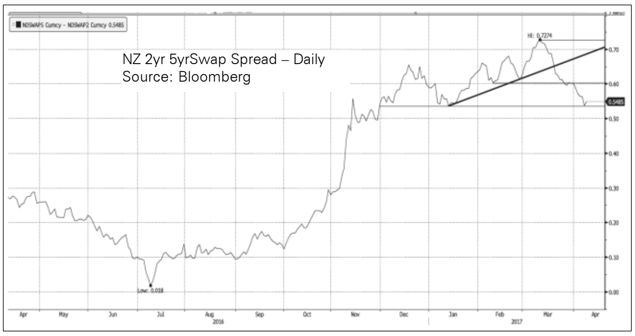
Break through support at 2.89 which now becomes resistance. Remain neutral with next support at 2.80.



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

Outlook: Neutral
ST Resistance: +72
ST Support: +53.5

ST support held at 53.5. Remain neutral.



pete_mason@bnz.co.nz

Key Upcoming Events

	Forecast	Median	Last
Monday 10 April			
NZ, Opposition Finance Spokesperson Robertson, Monetary Framework			
Aus, Housing Finance, February	-1.4%	flat	+0.5%
Jpn, Eco Watchers Survey (outlook), March		50.7	50.6
US, Yellen Speaks, Univ.of Michigan			
Tuesday 11 April			
NZ, Electronic Card Transactions, March	+0.3%	+0.5%	-1.0%
Aus, NAB Business Survey, March			+7
Euro, Industrial Production, February		+0.1%	+0.9%
Germ, ZEW Sentiment, April		+14.5	+12.8
UK, CPI, March y/y		+2.3%	+2.3%
US, NFIB Small Business Optimism, March		104.9	105.3
US, Fed's Bullard/Kashkari Speak			
US, JOLTS Job Openings, February			5,626
Wednesday 12 April			
Aus, Consumer Sentiment - Wpac, April			99.7
China, CPI, March y/y		+1.0%	+0.8%
China, PPI, March y/y		+7.5%	+7.8%
Jpn, Machinery Orders, February		+3.7%	-3.2%
UK, RICS Housing Survey, March		+22%	+24%
UK, Unemployment Rate (ILO), February		4.7%	4.7%
US, Fed's Kaplan Speaks			
Can, BOC Policy Announcement		0.50%	0.50%

	Forecast	Median	Last
Thursday 13 April			
NZ, Food Price Index, March	-0.2%		+0.2%
NZ, BNZ PMI (Manufacturing), March			55.2
Aus, Employment, March	+20k	+20k	-6k
Aus, Financial Stability Review			
China, Trade Balance, March		+CNY76b	-CNY60b
Germ, CPI, Mar y/y 2nd est		+1.6%	+1.6%P
US, Mich Cons Confidence, April 1st est		96.5	96.9
US, PPI ex-food/energy, March y/y		+1.8%	+1.5%
Friday 14 April			
NZ, Holiday, Good Friday			
US, Retail Sales, March		-0.1%	+0.1%
US, Business Inventories, February		+0.3%	+0.3%
US, CPI ex food/energy, March y/y		+2.3%	+2.2%
Monday 17 April			
NZ, Holiday, Easter Monday			
China, Fixed Assets (ex rural), Mar ytd		+8.8%	+8.9%
China, Industrial Production, Mar y/y		+6.3%	+6.0%
China, Retail Sales, Mar y/y		+9.7%	+10.9%
US, Empire Manufacturing, April			+16.4
US, NAHB Housing Index, April			71

Historical Data

	Today	Week Ago	Month Ago	Year Ago
CASH & BANK BILLS				
Call	1.75	1.75	1.75	2.25
1mth	1.75	1.91	1.85	2.29
2mth	1.75	1.95	1.93	2.31
3mth	1.75	2.00	1.99	2.34
6mth	1.75	2.04	2.04	2.34
GOVERNMENT STOCK				
12/17	1.85	1.84	1.87	1.94
03/19	2.10	2.12	2.20	2.02
04/20	2.29	2.31	2.45	2.14
05/21	2.43	2.45	2.61	2.24
04/23	2.75	2.76	2.89	2.47
04/25	3.03	3.06	3.19	2.70
04/27	3.13	3.17	3.32	2.85
04/33	3.48	3.52	3.71	3.19
GLOBAL CREDIT INDICES (ITRXX)				
AUD 5Y	84.35	84.25	83.03	135.25
N. AMERICA 5Y	65.43	66.19	59.82	75.54
EUROPE 5Y	74.32	73.64	69.39	73.98

	Today	Week Ago	Month Ago	Year Ago
SWAP RATES				
2 years	2.29	2.32	2.36	2.18
3 years	2.50	2.56	2.62	2.25
5 years	2.85	2.93	3.03	2.48
10 years	3.37	3.45	3.56	2.97
FOREIGN EXCHANGE				
NZD/USD	0.69	0.7004	0.7024	0.6890
NZD/AUD	0.9244	0.9173	0.9252	0.8979
NZD/JPY	77.2600	77.980	80.000	77.007
NZD/EUR	0.66	0.6563	0.6622	0.6049
NZD/GBP	0.5605	0.5582	0.5718	0.4846
NZD/CAD	0.9301	0.9329	0.9400	0.8983
TWI	75.77	75.98	76.85	72.89

Contact Details

Stephen Toplis
Head of Research
+(64 4) 474 6905

Craig Ebert
Senior Economist
+(64 4) 474 6799

Doug Steel
Senior Economist
+(64 4) 474 6923

Kymberly Martin
Senior Market Strategist
+(64 4) 924 7654

Jason Wong
Currency Strategist
+(64 4) 924 7652

Main Offices

Wellington
60 Waterloo Quay
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Phone: +(64 4) 473 3791
FI: 0800 283 269

Auckland
80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Phone: +(64 9) 976 5762
Toll Free: 0800 081 167

Christchurch
111 Cashel Street
Christchurch 8011
New Zealand
Phone: +(64 3) 353 2219
Toll Free: 0800 854 854

National Australia Bank

Peter Jolly
Global Head of Research
+(61 2) 9237 1406

Alan Oster
Group Chief Economist
+(61 3) 8634 2927

Ray Attrill
Global Co-Head of FX Strategy
+(61 2) 9237 1848

Skye Masters
Head of Interest Rate Strategy
+(61 2) 9295 1196

Wellington

Foreign Exchange	+800 642 222
Fixed Income/Derivatives	+800 283 269

Sydney

Foreign Exchange	+(61 2) 9295 1100
Fixed Income/Derivatives	+(61 2) 9295 1166

London

Foreign Exchange	+(44 20) 7796 3091
Fixed Income/Derivatives	+(44 20) 7796 4761

New York

Foreign Exchange	+1 212 916 9631
Fixed Income/Derivatives	+1 212 916 9677

Hong Kong

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