11 September 2017

Peeking into Q3 GDP and CPI

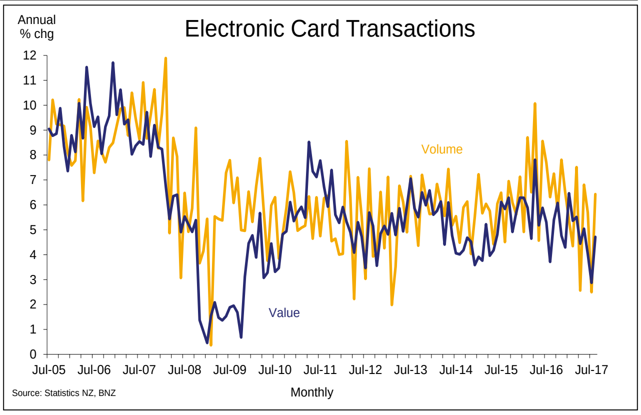
- We estimate Q2 GDP lifted 0.8% (2.5% y/y)
- 0.1 under RBNZ/Treasury expectations
- August ECT leave likelihood of Q3 retail fall
- But as hangover to sports-mad Q2
- Awaiting Sept. consumer conf., August PMI
- While August FPI to fill in on CPI inflation

Will it be a case of the early bird catches the worm? Voting opens today for the 23 September General Election. But with the polls still not conclusive, rather than us conjecturing on the (coalition) outcome, and everything it might entail for our economic views, we'll stick with the local data reports on offer this week. There are four of them, of the monthly variety, and they will give us a peek into GDP, and the CPI, for the September quarter.

This is after having settled our estimate for Q2 GDP growth at 0.8% (2.5% y/y). This, by the way, is a fraction under the 0.9% expansion expected by the Reserve Bank, with regard to its August Monetary Policy Statement, and Treasury with respect to its Pre-election Economic and Fiscal Update. The outcome is due for publication 21 September, two days before the day of the election.

We had, for a good while, estimated a 0.9% advance in Q2 GDP too. However, last Friday's manufacturing figures inferred output growth for the industry not as hefty as we had figured on. June quarter building activity, in slipping 0.5%, was also a relative disappointment (rather than any concern). Still, there is enough else providing substance to our Q2 GDP pick. This includes a big bounce in primary production, sustained expansion in the services sectors, as well as a jump in retail spending.

Better Actually

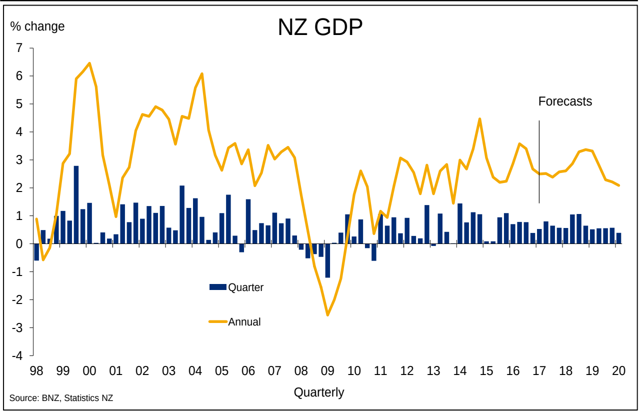


Not that we are mapping the 2.0% lift in Q2 retail volumes one-for-one into spending by NZ consumers. A good chunk of it, we presume, reflected the significant sports events New Zealand hosted in the June quarter – namely the World Masters Games (April) and UK and Irish Lions' rugby tour (mainly June). This will, in turn, boost services exports (which include spending by international visitors) in the GDP accounts. We figure consumption expenditure by locals increased 0.8% in Q2, for an annual increase of 3.8%.

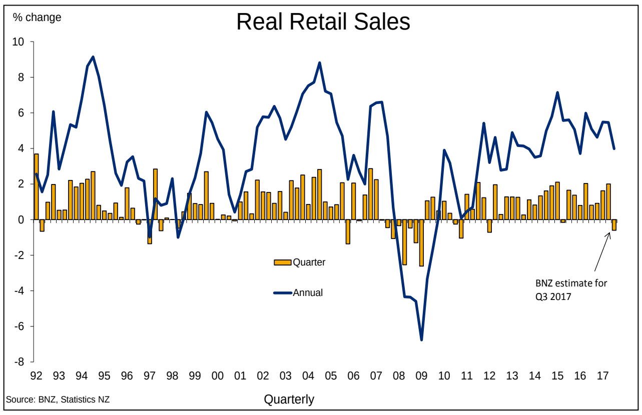
With respect to how retail spending is faring in the September quarter, this morning's electronic card transactions (ECT) for August were instructive. They increased a seasonally adjusted 0.6%. We expected 0.8%.

Bloomberg doesn't poll for this total, rather confines its canvassing to the retail component of the ECT data (for

Poised for a Pick-up



Post Q2 Sports Madness



whatever reason?). For this the market was going for +0.5%, whereas the outcome slipped 0.2%, after a 0.6% decrease in July. Even broadening attention to the total ECT result, its 0.6% increase simply reversed the percentage fall it registered in July. This makes it even more likely that Q3 retail volumes will ease back (we are picking -0.6%).

If all of this sounds disconcerting, it shouldn't. Importantly, it needs to be viewed in the context of the outsized jump we saw in retail volumes in Q2, of 2.0%, which was no doubt boosted by the aforementioned sports events. It was no surprise, in this vein, that the hospitality component of the monthly ECT continued to abate in August, having spiked 2.1% in June.

A contraction in real retail spending in Q3 would weigh on GDP calculations, of course. But this is not a new narrative, for us at least, or the start of any rot. As we've said, it doesn't mean local consumers are losing their spending impetus. Just that visitor spending is reverting to its (strong) trend, after event-related surfeit in Q2.

In this regard, we point out that consumer confidence has been doing rather well over recent months (as the housing market supposedly flattens off – at least in Auckland – and the election looms large). But will there be any cracks appearing in Thursday afternoon's ANZ Roy Morgan reading for September? We'll also cast an eye on the survey's inflation expectations, which have been easing over recent months.

As well as robustness in consumer sentiment, the other reason to not get too glum over the latest slippage in electronic card transactions is simply that their volume content was looking more robust than their nominal amount. Transaction numbers in August were up 6.4% on the same month last year, for example, whereas transaction values were up 4.7% on this basis.

For more insight into September quarter economic activity, we are due August's Performance of Manufacturing Index on Friday morning. The context is that its outcome in July, of 55.4, was marginally lower than June's 56.0 but still firmly above its long-term average of 53.3. Anything similar in August would thus indicate sustained solid momentum.

As for consumer inflation in the September quarter, Wednesday's August Food Price Index (FPI) will have a technical say in this, for which we anticipate a slight fall (-0.1%). This effectively continues a price unwind in the FPI, on a seasonally adjusted basis, following a spike higher early in the year, based on inclement weather. Any non-trivial deviation in August's FPI outturn could have implications for our Q3 CPI estimate, which currently sits at +0.3% q/q, which would leave its annual inflation rate at +1.7%.

Now, what was that about the election…?

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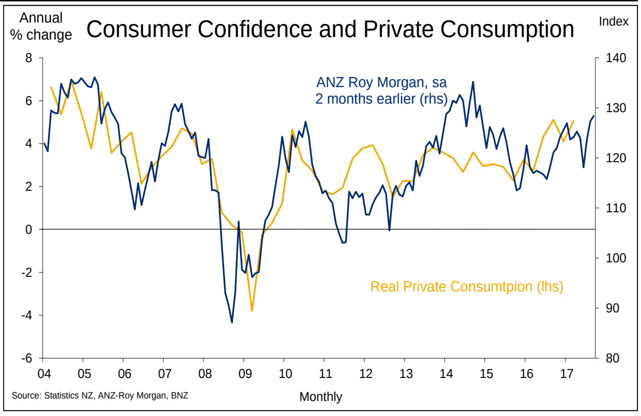
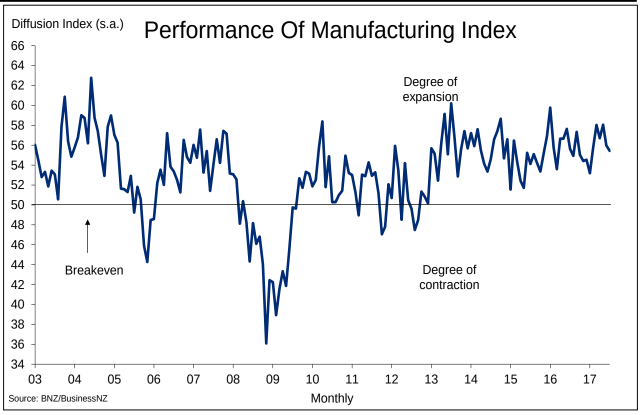
Strong



A Repeat (Solid) Performance?



Global Watch

- Aussie labour market report a key focus
- NAB survey to provide momentum guide
- US core inflation to rise

Australia

Tuesday, Wednesday, and Thursday sees three key reports on the economy. It starts on Tuesday with the release of the NAB Business Survey for August. That's followed on Wednesday with the Westpac-Melbourne Institute monthly Consumer Sentiment survey, then Thursday's ABS Labour Force release for August.

RBA Deputy Governor Guy Debelle also speaks on Thursday morning at a Workshop at King and Mallesons, a legal firm. There's no speech title available but with the RBA Board meeting now out of the way, and Debelle having restricted his recent public remarks to less market sensitive matters, this event gives him free rein to offer any views on the economy, monetary policy, the financial markets, or even on the AUD should he wish to do so.

As far Tuesday's NAB Survey, no hints here! But we can remind readers of the still strong run for Australian business evident in the July Survey when business conditions and confidence both saw improvements. Business conditions rose by 1 point to hit +15, the highest level for the series since early 2008 and three times its long run average level. There was, however, a renewed divergence across industries as the improvement was driven primarily by professional services, while retail and wholesale softened considerably – again highlighting competitive pressures in retail and the difficulties facing households. (We also saw this reflected in a weaker Retail Trade report for July released this week.)

To get the latest reading on consumer spirits, first there is the weekly ANZ-Roy Morgan Consumer Confidence reading out Tuesday. The weekly survey is running close to its long term average (since it began in 2010). In contrast, the monthly WMI measure has been pushing lower over recent months and in August was running around 5% below its long term average

Another strong labour market report should be on its way. In July, employment was better than expected, up 27.9k in the month. The unemployment rate fell to 5.6%, from an upwardly revised 5.7%, and is tracking along the RBA's August SoMP forecast track. How quickly the unemployment rate falls towards the 5% NAIRU is likely to determine the timing and pace of policy normalisation. We expect to see a steady unemployment rate in August, but with trend employment running ahead of the breakeven 15k a month required to keep the unemployment rate unchanged, the trend in the unemployment rate should be lower in time.

Chart 1: Domestic economy picks up

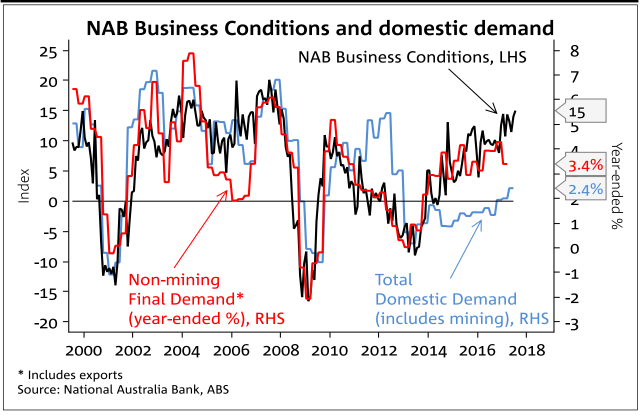


Chart 2: Business recruiting further

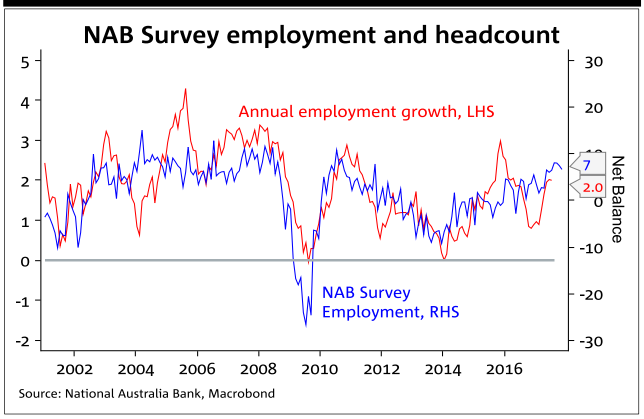


Chart 3: Business more confident, consumers wary

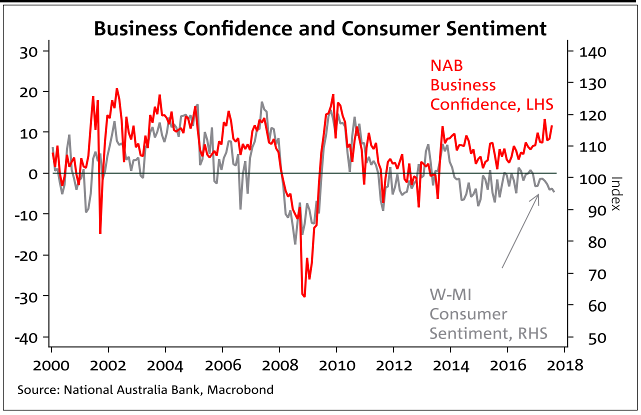
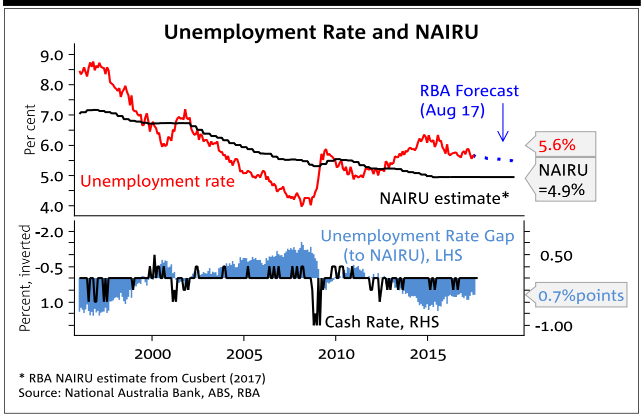


Chart 4: Still looking for improvement



Leading indicators of employment such as from job advertising and the NAB Survey's Employment index also point to the likelihood of another solid month for employment growth. NAB's model, which is based on these factors, points to growth of over 20K. As for the sampling, sample rotation effects are neutral this month with the outgoing having a similar employment-to-population ratio as the sample as a whole.

Note though that the positive growth headline from a solid employment read is likely to be buttressed with the possibility of a pick-up in full-time employment from sample rotation effects.

China

The real interest this week will be on Thursday's August growth reports with the consensus looking for 6.6% annual growth in industrial production and 10.5% growth in retail sales.

Inflation is back in focus with the market looking for a rise in Thursday's headline August CPI to 0.3% from last month's 0.1%. Core inflation is expected to rise from 0.1% to 0.2%. Friday's Retail Sales is expected to reveal slower headline growth and less heady "control group" (core) sales growth of 0.3%. The NFIB Small Business Optimism Index is out Monday with industrial production and consumer sentiment coming at the end of the week.

Japan

A quiet week for Japan with final July Industrial Production for August worth a look.

Eurozone

The Bundesbank's Weidmann and the ECB's Nuoy speak this week: Weidmann on monetary policy and Nuoy on shadow banking. Some second tier data are also due.

UK

Tuesday's CPI and labour market report come ahead of the BoE meeting that should come and go without too much market fanfare with no policy change tipped.

Canada

It's a quiet data week with just the two house price releases due. The BoC's Deputy Governor Schembri and Senior Deputy Governor Wilkins hold an inflation target workshop on Thursday.

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Fixed Interest Market

Reuters: BNZL, BNZM Bloomberg:BNZ

Last week we raised the question, are we at a turning point in US 10-year Treasury yields (with the US 10-year rate around 2.10%)? It was an appropriate question to ask after the trend decline in rates, but the market returned a swift "no" to the question, with the rate reaching as low as 2.015% on Friday. It remains hard to shake the bullish sentiment on bonds, with US-North Korea sabre-rattling in the background and the devastating impact of the twin hurricanes Harvey and Irma.

The shifting of the debt ceiling showdown to mid-December removed the immediate tail-risk of a missed US debt repayment. But it also complicated the call for a December Fed rate hike along with the resignation of Fed vice-chair Fischer. These two factors alongside the twin hurricanes certainly reduce the chance of the Fed delivering another hike this year. Rebuilding Texas and Florida communities in the aftermath of the hurricanes will ultimately prove to be inflationary, but likely volatility in US data over the next few months will provide some cover for the doves to suggest delaying further rate hikes.

This week's US CPI data will be important. Core inflation has surprised to the downside for several months in a row. Another downside miss would add to bullish sentiment to US bonds, while an in-line result might be seen as a turning point in inflation momentum.

The pricing of the Fed Funds curve shows very little further tightening priced in. One now has to look out to early 2019 before the next full 25bp rate hike is priced. That seems much too little in the context of a US economy growing above trend. It certainly doesn't seem appropriate to abandon our call for further Fed hikes in the years ahead, which ultimately should put upward pressure on US rates. But some patience is likely required.

Market pricing now suggests that the RBNZ will be hiking ahead of the next move by the Fed. But lower global rates have clearly spilled over into the NZ curve, including at the short end. A November 2018 rate hike by the RBNZ is priced in, but only just. Last week the 2-year swap rate fell below the bottom of the tight 2.15-2.20% trading range it has been stuck in over the past month. We still think that range remains appropriate, and the break proved only temporary.

NZ longer term rates remain at the whim of global forces as well. Last week the NZ 5-yr and 10-year swap rates made fresh lows for the year, at 2.55% and 3.03% respectively. We've seen some increased interest in corporate paying activity, as is understandable with such low rates, but this has been readily soaked up as global forces remain in the driving seat. Local data this week are all second-tier and not likely market moving.

Last week's indicators firmed up our expectation for a decent Q2 GDP figure due 21 September, with a 0.8% q/q gain for the production-based measure and an even better result for the expenditure-based measure.

Locally, the build-up to the 23 September general election will remain a distraction. As we said last week, fiscal policy is going to be easier no matter what the make-up of the next government. The details of policy matter and we won't have a clearer idea of that for some time. We see any possible knee-jerk reaction to election prospects as an opportunity "to take the other side" in anticipation of a reversal. Economics should prevail over politics.

In Australia, employment data on Thursday is the key economic release this week. NZ-Australia rate spreads have been narrowing on the growing belief that any RBA policy tightening will come sooner than previously expected. We're not convinced this trend has a lot further to run but it's probably a little too early to fight this trade.

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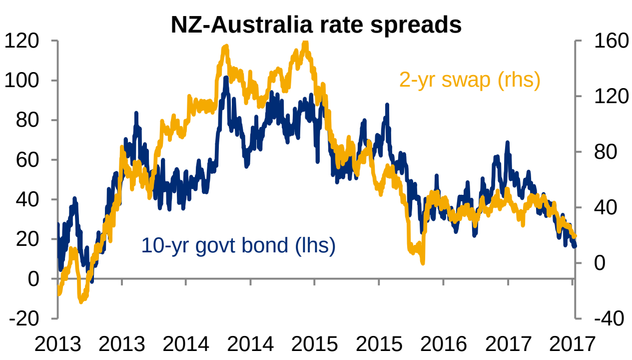
NZ-Australia Rate Spreads Getting Tight



Source: BNZ., Bloomberg

Current Rates/Spreads and Recent Ranges

	Current	Last 3-weeks range*
NZ 90d bank bills (%)	1.94	1.94 - 1.97
NZ 2yr swap (%)	2.16	2.12 - 2.20
NZ 5yr swap (%)	2.58	2.55 - 2.67
NZ 10yr swap (%)	3.06	3.03 - 3.17
2s10s swap curve (bps)	91	89 - 98
NZ 10yr swap-govt (bps)	28	23 - 28
NZ 10yr govt (%)	2.78	2.74 - 2.95
US 10yr govt (%)	2.05	2.01 - 2.22
NZ-US 10yr (bps)	73	67 - 77
NZ-AU 2yr swap (bps)	20	16 - 27
NZ-AU 10yr govt (bps)	17	16 - 27

*Indicative range over last 3 weeks

Foreign Exchange Markets

Reuters pg BNZWFWDS Bloomberg pg BNZ9

The key theme last week was the underperforming USD, down for seven consecutive days and breaking through key levels of technical support on various indices. Twin hurricanes Harvey and Irma didn't help, and neither did the resignation of Fed vice-chair Fischer. It all adds up to a more volatile set of data releases in the US over coming months and muddying the Fed's policy decisions. The market now sees another Fed tightening as a distant prospect.

NZD/USD closed the week up 1½% at 0.7265. While technical indicators for the USD look ominous and pose the risk for further significant downside pressure, for other reasons like fundamentals and (very short) positioning we think that the USD can hang in there around current levels, suggesting NZD/USD consolidates around its current level over coming weeks.

This week's US CPI data will be important. Core inflation has surprised to the downside for several months in a row. Another downside miss would be another blow to the USD, while an in-line result might be seen as a turning point in inflation momentum. Near-term US data will be distorted by the twin Hurricanes, but ultimately the rebuilding effort will exert inflationary forces on the economy.

NZD/AUD looks to have consolidated around 0.90 so far in September. Interestingly, we may have seen the first wobbles in the strong run for metal prices. That spectacular run over the past few months has been instrumental in driving the outperformance of the AUD and sending NZD/AUD down from 0.95 to 0.90. Zinc, copper and nickel prices all fell by over 3% at the end of last week. If this is the start of the unwinding of the strong rally in hard commodities, then that would help NZD/AUD gain some traction. It's an area we'll be watching closely over coming weeks.

The key economic release in Australia this week is employment data on Thursday, which provides its usual opportunity to generate some AUD volatility. NZ economic releases this week are all second-tier. Political developments will hog the local spotlight and we continue to run the line that any knee-jerk NZD reactions provide short-term trading opportunities. On fundamentals, we don't see any obvious implications for the NZD under the most likely coalition government scenarios.

Elsewhere, UK CPI data are released ahead of the Bank of England's policy decision later in the week. We don't see the data or the no-change decision altering the direction of GBP. GBP has perked up during September as Brexit negotiations begin to get some traction. There is some event risk around GBP early this week as lawmakers vote on a UK Brexit bill. Over the weekend, Brexit Secretary Davis warned UK lawmakers that if they block a key piece of domestic legislation on Monday, it may lead to a "chaotic" departure from the European Union.

There are few key economic releases in the euro area and Japan this week. EUR has had a strong run ahead of the ECB's likely tapering of its asset purchase programme from early next year. We're still in the dark about the details of that, and the ECB continues to tightly control its communication of its plans, to avoid spooking the market. We're still bearish on NZD/EUR, but a pause in its downward wouldn't come as a surprise.

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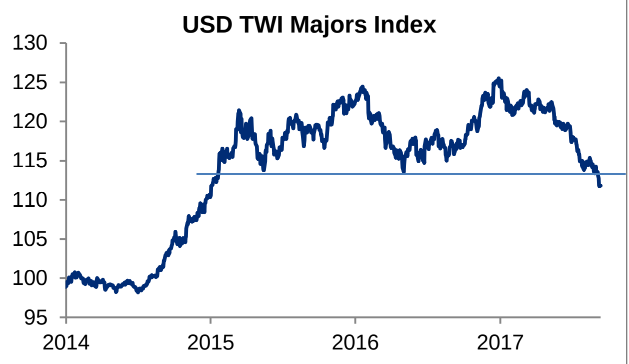
USD Down Through Technical Support



Source: BNZ, Bloomberg

Cross Rates and Model Estimates

	Current	Last 3-weeks range*
NZD/USD	0.7255	0.7130 - 0.7340
NZD/AUD	0.9009	0.8970 - 0.9240
NZD/GBP	0.5500	0.5500 - 0.5690
NZD/EUR	0.6035	0.5990 - 0.6210
NZD/JPY	78.59	78.10 - 80.10

*Indicative range over last 3 weeks, rounded figures

BNZ Short-term Fair Value Models

	Model Est.	Actual/FV
NZD/USD	0.7540	-4%
NZD/AUD	0.9080	-1%

Technicals

NZD/USD

Outlook: Down
ST Resistance: 0.7350 (ahead of 0.7400)
ST Support: 0.7200 (ahead of 0.7135)

We put initial support around 0.72 ahead of the 200-day moving average of 0.7135. A breach of the latter would open up significant downside risk. An area of resistance is building around 0.7350.

NZD/AUD

Outlook: Down
ST Resistance: 0.9075 (ahead of 0.9150)
ST Support: 0.8975 (ahead of 0.8875)

Some consolidation through September is providing a little more clarity on technical levels. Initial support and resistance in a 0.8975-0.9075 range is visible, although only just. A break to the downside would open up significant downside risk and remains the greater threat at this juncture.

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NZ 5-year Swap Rate

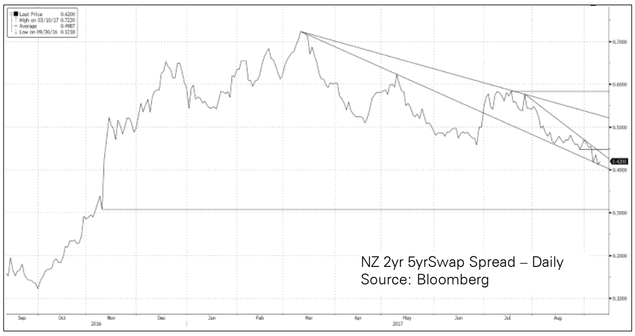
Outlook: Neutral
ST Resistance: 2.63
ST Support: 2.51

Break of 2.61 last week saw market lower but we have not reached the 2.51 target yet. Once again, support and resistance levels are quite tight and trade a break.

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

Outlook: Neutral
MT Resistance: +59
MT Support: +31

Stopped on the break of +45, await indicator to initiate new position.



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Key Upcoming Events

	Forecast	Median	Last
Monday 11 September			
NZ, Electronic Card Transactions, August	+0.8%	+0.5%	-0.7%
Jpn, Machinery Orders, July		+4.1%	-1.9%
Tuesday 12 September			
Aus, NAB Business Survey, August			+12
UK, CPI, August y/y		+2.8%	+2.6%
US, NFIB Small Business Optimism, August		104.9	105.2
US, JOLTS Job Openings, July		5,975	6,163
Wednesday 13 September			
NZ, Food Price Index, August	-0.1%		-0.2%
Aus, Consumer Sentiment - Wpac, September			95.5
Jpn, BSI Business Survey, Q3			-2.0
Euro, Industrial Production, July		+0.1%	-0.6%
Euro, Eurozone Employment, Q2 y/y			+1.5%
Germ, CPI, Aug y/y 2nd est		+1.8%	+1.8%P
UK, Unemployment Rate (ILO), July		4.4%	4.4%
US, PPI ex-food/energy, August y/y		+2.1%	+1.8%
Thursday 14 September			
NZ, ANZ-RM Consumer Confidence, September			126.2
Aus, Unemployment Rate, August	5.6%	5.6%	5.6%
Aus, Employment, August	+21k	+19k	+28k
Aus, RBA's Debelle Speaks			

	Forecast	Median	Last
Thursday 14 September cont'd			
China, Industrial Production, August y/y		+6.6%	+6.4%
China, Retail Sales, August y/y		+10.5%	+10.4%
Germ, Bundesbank's Weidmann Speaks			
UK, RICS Housing Survey, August		flat	+1%
UK, Retail Sales vol., August		+0.2%	+0.3%
UK, BOE Policy Announcement	0.25%	0.25%	0.25%
US, Jobless Claims, week ended 09/09		300k	298k
US, CPI ex food/energy, August y/y		+1.6%	+1.7%
Friday 15 September			
NZ, BNZ PMI (Manufacturing), August			55.4
Euro, Trade Balance, July s.a.		+€20.3b	+€22.3b
Euro, Labour Costs, Q2 y/y			+1.5%
US, Business Inventories, July		+0.2%	+0.5%
US, Industrial Production, August		+0.1%	+0.2%
US, Retail Sales, August		+0.1%	+0.6%
US, Mich Cons Confidence, September 1st est		95.0	96.8
US, Empire Manufacturing, September		+18.0	+25.2
Monday 18 September			
NZ, BNZ PSI (Services), August			56.0
China, Property Prices, August			
US, NAHB Housing Index, September		67	68

Historical Data

	Today	Week ago	Month Ago	Year Ago
CASH & BANK BILLS				
Call	1.75	1.75	1.75	2.00
1mth	1.83	1.85	1.84	2.12
2mth	1.88	1.90	1.89	2.18
3mth	1.94	1.96	1.97	2.24
6mth	1.99	2.02	1.99	2.24
GOVERNMENT STOCK				
03/19	1.87	1.84	1.90	1.92
04/20	1.98	1.99	2.03	1.96
05/21	2.10	2.13	2.16	2.00
04/23	2.38	2.42	2.45	2.12
04/25	2.63	2.67	2.70	2.31
04/27	2.77	2.83	2.84	2.44
04/33	3.12	3.21	3.22	2.77
04/37	3.35	3.45	3.46	3.05
GLOBAL CREDIT INDICES (ITRXX)				
Australia 5Y	70	70	79	100
Nth America 5Y	60	57	60	73
Europe 5Y	54	55	56	70

	Today	Week ago	Month Ago	Year Ago
SWAP RATES				
2 years	2.15	2.16	2.16	2.05
3 years	2.30	2.33	2.33	2.08
4 years	2.44	2.48	2.48	2.14
5 years	2.57	2.61	2.63	2.21
10 years	3.05	3.10	3.13	2.57
FOREIGN EXCHANGE				
NZD/USD	0.7253	0.7162	0.7287	0.7353
NZD/AUD	0.9009	0.9015	0.9281	0.9718
NZD/JPY	78.60	78.58	79.89	74.89
NZD/EUR	0.6035	0.6021	0.6186	0.6544
NZD/GBP	0.5499	0.5538	0.5621	0.5514
NZD/CAD	0.8814	0.8892	0.9270	0.9589
TWI	75.4	75.2	77.1	78.1

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