11 December 2017

HYEFU/BPS to Shine a Light on Fiscal Path

- **Robertson's speech contained nothing new**
- **HYEFU/BPS to illuminate fiscal policy/costing**
- **ECT/Paymark show spending spark in Nov/Dec**
- **Also due this week: Nov food prices and PMI**
- **Our Q3 GDP pick settled at 0.7% (2.5% y/y)**

Maybe there was something insightful in the Q&A? But the scripted speech by Finance Minister Grant Robertson this morning, to Auckland's Chamber of Commerce, gave nothing away. So for fuller detail, and costing, on the new government's new plans it is eyes down for Thursday's Half-Year Economic and Fiscal Update (HYEFU).

And it's not just the HYEFU. There will be the accompanying Budget Policy Statement – for the government's medium-term intentions, including on spending and debt – to scan, while the government is also supposed to be providing an update of its 100-day plan.

With all of this we will, hopefully be better able to assess New Zealand's fiscal (stimulus) outlook and its implication for the wider economy and financial markets.

Of course, the bones of it have already been made clear by the new government, as well as its commitment to get net debt down to 20% of GDP within 5 years and to keep government spending around the 30% of GDP mark. Yes, the NZ Treasury will probably have trimmed its GDP forecasts for the near term. But it also has scope to bump up its inflation forecasts, which might keep the track for nominal GDP, and hence tax revenue, close to what the Pre-Election forecasts had.

With this, any upside surprises to the bond programme, beyond the higher track Labour has already signalled,

Bond Programme (Gross Issuance $m)

	2017/18	2018/19	2019/20	2020/21	Total
National	7000	7000	7000	6000	27000
Labour	9863	8270	8976	6896	34005
Difference	2863	1270	1976	896	7005

should presumably be kept to a minimum. But we'll be very interested to see this bottom line nonetheless.

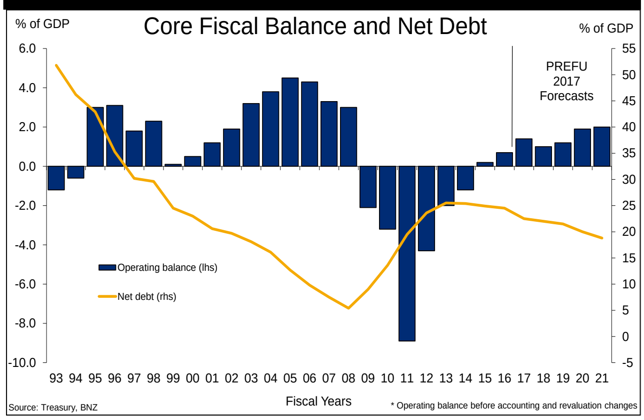
However, just as much, it's the fiscal flesh we are hanging out for on Thursday. This includes confirmation of not just the policies of Labour but also those of the NZ First and the Green parties that have been agreed to and costed. We will be looking for more than the 100-day plan, in other words.

If there are any pressure points in the HYEFU accounts then surely the National party – and especially Steven Joyce – will be in a prime position to ferret them out? So their analysis should be watched for, in their role of keeping the government honest.

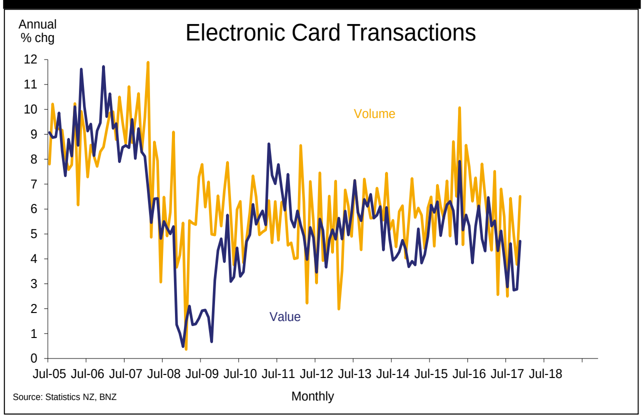
But it's not all fiscal this week. There are a few monthly data reports on offer too. They have begun with this morning's electronic card transactions (ECT) for November. These increased a seasonally adjusted 1.4% (and October's gain was upgraded to 0.7%, from 0.4%). The retail component of this expanded 1.2%, while the core-retail series expanded 0.8%.

These results go a long way to allaying fears that spending volume growth was somehow slowing to a (genuine) crawl. In fact, the latest ECT results, technically

For Reference



Real Spark



speaking, significantly boost the odds of seeing a strong gain in Q4 real retail spending.

To be sure, November's ECT jump was flattered by apparel (+2.7%). It's tempting to discount this as early summer spending because of the unusually hot and dry November we had. However, it's also worth noting that apparel was amongst the weakest performers over August, September and October. So its bounce in November might also have elements of returning to normal about it.

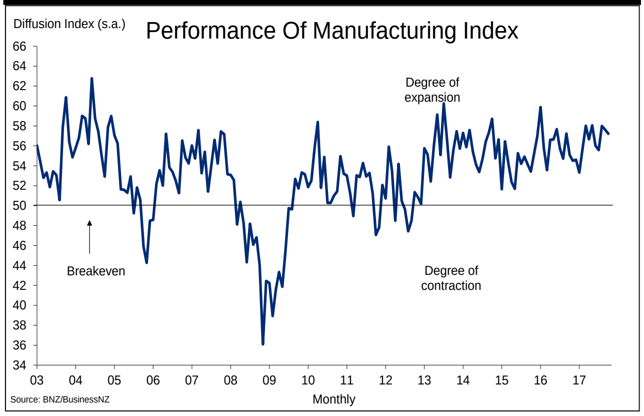
There was also a 6.0% jump in fuel sales in November, in keeping with the approximate 4.0% lift in pump prices during the month.

As for how December (Xmas) spending is shaping up, Paymark is helpfully starting to publish its festive season data. This morning it reported its 4-10 December values were up 7.8% on the same period last year, while the volume of transactions over its network increased 9.0% over the period. These are stronger than the equivalents for total electronic card transactions in November, of 4.7% and 6.5% respectively, sustaining the idea of a rebound from a slow Q3.

For insight into inflation, November's Food Price Index is due Wednesday. We have a 0.4% fall plugged in for this – partly on seasonality. Any major deviation could have implications for our Q4 CPI pick, which currently sits at +0.6% q/q and +2.1% y/y. Incidentally, the RBNZ is gunning for 0.3% and 1.8% respectively.

Friday closes the local data out with the Business NZ/BNZ Performance of Manufacturing Index for November. This will be an important cross-check on the slump we saw in general business confidence in the month – to see if real activity, not just sentiment, is being impacted.

Resilient (?)



Meanwhile, we have settled our September quarter GDP growth estimate at 0.7% (in line with the RBNZ). This is after last week's construction, wholesale and manufacturing figures all proved very close to what we anticipated. A 0.7% increase in Q3 GDP would deliver annual growth of 2.5% – presuming there are no revisions to prior quarters. We say this noting that when the Q3 2017 national accounts are published (21 December), Statistics NZ will also be revising up its view on GDP levels over recent years. The latter may well prove more instructive than the latest quarterly GDP move itself, at least to analysts.

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Global Watch

- **Fed to hike this week, ECB and BoE to sit pat**
- **EU Summit to maintain Brexit attention**
- **EU PMIs to highlight current economic strength**
- **US CPI, retail sales due**
- **China's monthly data dump on Thursday**
- **Business confidence, employment the focus in AU**

Australia: It's another week of potentially market sensitive data starting with the NAB Business Survey on Tuesday, Consumer Sentiment on Wednesday and the monthly labour market report on Thursday. RBA Governor speaks on Tuesday on "An eAUD" at a Payments Summit Conference, an interesting topic though seemingly less market sensitive. The RBA's Chris Kent speaks on the supply of business finance, also on Wednesday at a banking and finance conference.

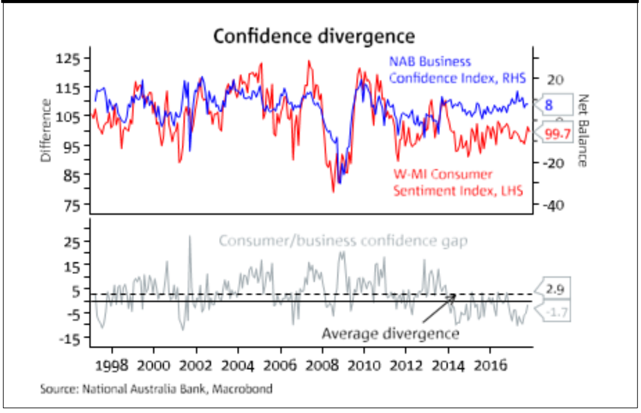
Also be aware that the mid-year Budget update (MYEFO) is due before Christmas, now close after the release this week of the September quarter national accounts.

Expectations for the 2017-18 Underlying Cash balance were surveyed this week by Bloomberg with the current consensus of a deficit of $A26.2bn, down from $A29.4bn at Budget time, benefiting from the improving domestic economy, flowing to higher tax receipts and lower unemployment support benefits.

Again we offer no clues ahead of the release of the NAB Business Survey! We'll remind our readers that Business Conditions hit an all new high in October jumping an impressive 7 points in October, to +21 index points, the highest level since the monthly Survey commenced in 1997. While Business Conditions jumped, Business Confidence index was unchanged in October at +8 index points, marginally above the long-run average.

As for Thursday's Labour Force report, NAB's forecasting models using other labour market indicators points to a best estimate of employment growth of around 15K, with some upside risk. The Labour Force's sample rotation effects do not point to a particular skew for employment.

Chart 2: Confidence divergence narrowing?



For the unemployment rate, NAB's estimate is that the rate is most likely to be unchanged at 5.4%, though sample rotation effects point to the risk of a somewhat higher 5.5% print. The outgoing portion of the sample has an unemployment rate of 4.2% which is lower than the sample as a whole at 5.1% (in original, not seasonally adjusted terms). If the incoming sample has the same as the outgoing, this would be enough to boost the unemployment rate by 0.1% points. Other near-term indicators of unemployment are mixed: SEEK's applications-per-ad remain elevated and have not fallen appreciably, the Roy Morgan measure has been rising in recent months, while consumer unemployment expectations continue to trend down.

This is the mid-quarter month when the Statistician also surveys the level of under-employment and under-utilisation in the labour force survey. This is not part of the weekly survey of economists, but the quarterly NAB Business Survey's finding of more businesses reporting an increasing difficulty finding labour points to a shrinking pool of labour slack and a lower underutilization rate. NAB expects the under-utilisation rate to fall 0.3% points from 14.1% to 13.8%.

Chart 1: Even before last month conditions were strong

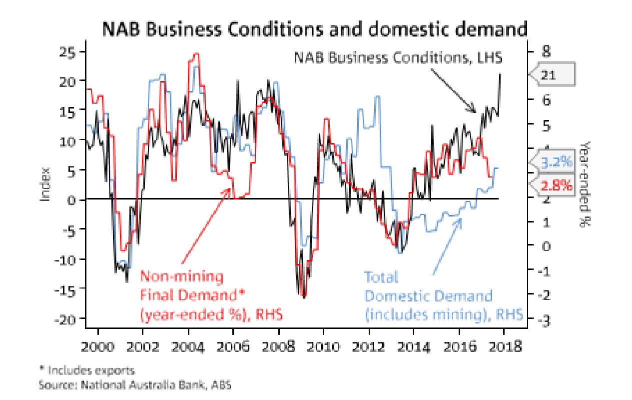
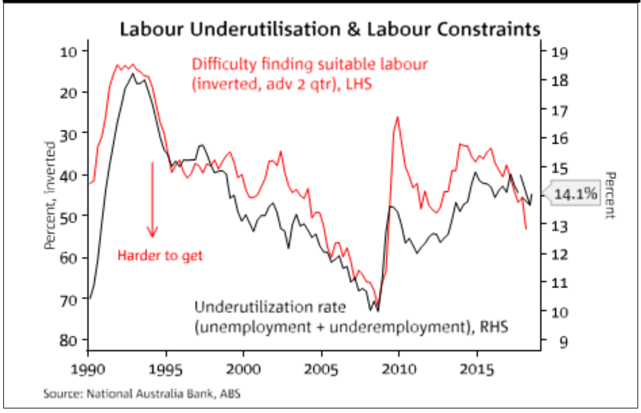


Chart 3: Diminishing labour market slack



China: This week's focus is Thursday's November Retail Sales/IP/Fixed Assets Investment growth reports. Money supply/new lending data is due any day.

US: It's mainly about Wednesday's FOMC's "priced in" rate hike but also on whether there will be any change to their dot plot Fed funds forecasts, and Yellen's presser, likely her last. CPI is released hours before the Fed announcement. Thursday's Retail Sales are also under the spotlight.

Japan: BoJ Governor Kuroda makes a brief speech on Wednesday. Friday's BoJ Tankan report the main data point and set to reveal further growth improvement.

Eurozone: While the ECB will leave rates on hold, it'll be their growth and inflation forecasts that garner interest. Growth is expected to be tweaked higher. The preliminary December PMIs are out three hours before the ECB announcement, likely to remind of the vibrant growth story.

UK: While there's understandable continued Brexit focus into the EU Summit this week, markets will be watching Tuesday's CPI, Wednesday's labour market/earnings report and Retail Sales on Thursday ahead of the BoE meeting.

Canada: Light for data, the main interest being BoC Governor Poloz's speech on Thursday and NAFTA, technical negotiators meeting in Washington on Monday.

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Fixed Interest Market

Reuters: BNZL, BNZM Bloomberg:BNZ

The New Zealand 2 year swap rate remains stuck within a tight trading range, currently around 2.15%. With the RBNZ firmly on hold at present, 2 year swap looks set to remain anchored around currently levels for the next few months.

The 3 month bank bill rate continues to drift to new record lows amid what seems excess liquidity among domestic banks. The current 3 month rate is 1.89%, a few basis points lower on the week. Falling money market rates add some downward pressure to 2 year swap rates at the margin, although probably not enough to push rates out of our expected 2.10% - 2.20% trading range.

Domestically, the highlight last week was RBNZ Acting Governor Spencer's speech "*Low inflation and its implications for monetary policy*". We detected a slight hawkish tilt to the commentary, but the impact on New Zealand rates was very modest. The Labour-led coalition is planning changes to the RBNZ mandate and structure and will appoint a new Governor to take charge next year, so the market will probably place a little less weight on communication from the central bank until then.

Looking ahead, the key event domestically this week is the Treasury's *Half Year Economic and Fiscal Update* (HYEFU). The bond issuance programme is set at $7bn for the current fiscal year as well the next two. The NZDMO will need to revise up its forecast bond issuance programme to take account of the new government's spending plans. We expect it will probably raise annual issuance by around $2bn a year.

For the remainder of the fiscal year, we will probably see an increase in bond tender sizes and we may see a resumption of tenders in January. The DMO also plans to syndicate a new 2029 maturity bond before the end of the fiscal year. With bond issuance set to pick up in the New Year - and presently targeted towards longer maturity debt - we should see some upward pressure on mid to long maturity New Zealand rates in time.

More immediately, there are some lumpy bond maturities coming up this week. Over $5bn of the December 2017 government bond matures, alongside $1bn of NZLGFA bonds and a raft of smaller issues from SSAs and corporates. Although investors won't necessarily reinvest the maturing proceeds immediately in the New Zealand curve, any large upward spike in yields on the back of the HYEFU will probably be met with good demand and therefore dampen the initial impact of any surprise announcement.

US yields were little changed on the week, with Friday's payrolls report (job gains of 228,000 but disappointing wage growth) seen to largely confirm the case for a rate rise this week by the Fed. With a rate rise seemingly all done and dusted, the focus will largely centre on the so called 'dot plot', or Fed members' expectations for rate rises over coming years. At the time of the last forecast in September, most Fed members expected to hike another 3 times in 2018, which would raise the Fed funds rate to 2.25%. This compares to current market pricing of a bit less than 2 hikes.

Short end US rates have trended higher in recent months as economic data has firmed and the market has shifted more towards the Fed's view of rate rises. Meanwhile, longer dated US rates have been largely range-bound amid low global yields and scepticism that the Fed will raise rates materially above 2%. The combination of these factors has seen the US yield curve flatten to levels last seen in 2007. While an 'inverted' yield curve has historically preceded a US recession, it's worth pointing out that the yield curve is some way off that point.

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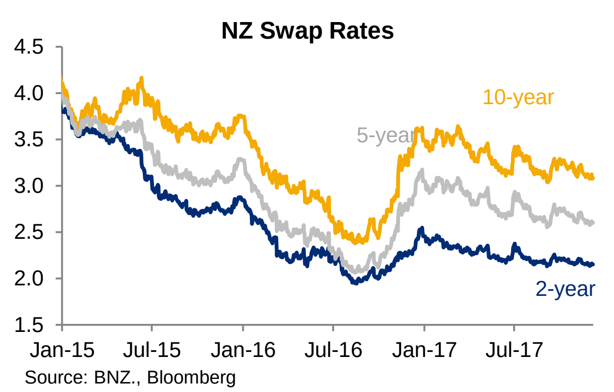
Rates range-bound near Year-to-Date Lows



Source: BNZ., Bloomberg

Current Rates/Spreads and Recent Ranges

	Current	Last 3-weeks range*
NZ 90d bank bills (%)	1.89	1.89 - 1.92
NZ 2yr swap (%)	2.17	2.12 - 2.18
NZ 5yr swap (%)	2.62	2.56 - 2.65
NZ 10yr swap (%)	3.10	3.06 - 3.14
2s10s swap curve (bps)	93	92 - 97
NZ 10yr swap-govt (bps)	29	29 - 37
NZ 10yr govt (%)	2.81	2.72 - 2.83
US 10yr govt (%)	2.38	2.31 - 2.43
NZ-US 10yr (bps)	44	31 - 47
NZ-AU 2yr swap (bps)	27	22 - 29
NZ-AU 10yr govt (bps)	27	19 - 28

*Indicative range over last 3 weeks

Foreign Exchange Markets

Reuters pg BNZWFWDS Bloomberg pg BNZ9

The holiday season already seems to have dampened volatility in currency markets. Last week the NZD traded in a less-than-1-cent range, never trading outside 0.6820-0.6920. Percentage changes for the week on all the ley NZD crosses were less than 1%.

We have just entered week 8 of the broad 0.68-70 range that the NZD has been stuck in. While this is below the 0.71-0.72 range our fair value model estimate has been sitting in for the past month, that estimate has been drifting lower, a reflection of lower NZ commodity prices and a narrowing NZ-US 1 year swap rate. Our risk appetite index is back up to the 80% mark, with much more downside risk than upside risk from here.

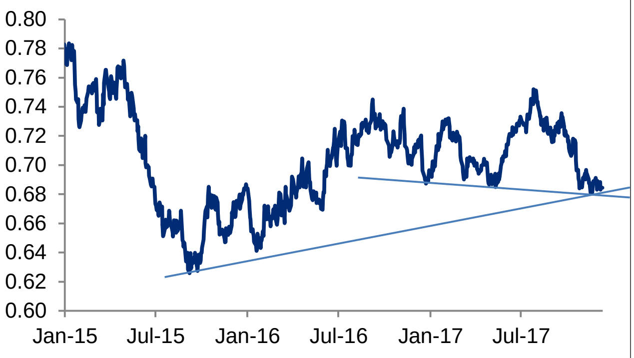
The bottom line is that fair value is likely to continue to drift lower into the New Year. Our forecasts have the NZD largely tracking sideways over the next year, which would help close the gap between spot and fair value.

There is plenty of event risk in the week ahead which could easily see the NZD break out of its familiar range, although at this time of year the appetite for fast-money accounts to put on fresh positions is generally muted. The key releases are towards the end of the week. These include US CPI figures ahead of another likely rate increase by the Fed, followed by ECB and BoE meetings.

The Fed is expected to raise the Fed Funds target range for the third time this year, taking it to 1.25-1.50%, fulfilling the FOMC's median "dotplot" projection for end-2017 that has been in place for a full year now. The market will be more interested in the projection for next year, which is looking to continue to show another three hikes for next year. In the hours ahead of that release, US CPI figures will be released. That could be more important that the Fed announcement if there is a miss relative to expectations, with almost all analysts picking a 0.2% increase for the core CPI.

The ECB and BoE meetings on Thursday night offer the opportunity for some volatility in the NZD crosses. The ECB will be releasing new forecasts, which will likely continue to show a slow return back to near 2% inflation. We suspect ECB President Draghi might push back a little on his overly dovish performance of late-October, which has led to lower euro-area bond yields, which probably wasn't the intention. The risk, then, is that the message is slightly less dovish than previously, boosting EUR, with the year-to-date low for NZD/EUR possibly under threat.

NZD Support Around 0.68 Holding



Source: BNZ, Bloomberg

Cross Rates and Model Estimates

	Current	Last 3-weeks range*
NZD/USD	0.6844	0.6820 - 0.6950
NZD/AUD	0.9111	0.9000 - 0.9130
NZD/GBP	0.5112	0.5040 - 0.5240
NZD/EUR	0.5818	0.5720 - 0.5850
NZD/JPY	77.71	76.30 - 77.80

*Indicative range over last 3 weeks, rounded figures

BNZ Short-term Fair Value Models

	Model Est.	Actual/FV
NZD/USD	0.7170	-5%
NZD/AUD	0.8780	4%

A little bit more progress on Brexit negotiations last week, along with rising expectations of a transitional deal that avoids the cliff-edge scenario for March 2019, should support the current tightening bias for the BoE. The next rate hike isn't fully priced by the market until November 2018. The risk is that tightening expectations are brought forward, leading to a stronger GBP and NZD/GBP making a fresh low for the year.

In NZ, the key focus will be Thursday's fiscal update, which will include the costs of the new government's 100-day plan proposals. The proposed easing of fiscal policy shouldn't surprise and we wouldn't expect it to affect the NZD much, with the global events aforementioned having much more potential to move the market.

In Australia, a speech by RBA Governor Lowe on Wednesday should be along the familiar theme of the RBA being in no rush to raise rates and happy to sit back and see what happens to CPI and wages inflation. Thursday's employment data offer the usual scope for AUD volatility on the day.

NZD/AUD is trading above our short term fair value estimate around AUD 0.88. That has been driven lower by a recent surge in iron ore prices and plunge in NZ business confidence, both factors which we'd discount at present. A cross in the low 0.90s still seems about right, in our view.

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Technicals

NZD/USD

Outlook: Downside risk
ST Resistance: 0.7050 (ahead of 0.7200)
ST Support: 0.6780 (ahead of 0.6675)

The NZD has spent much of the last seven weeks hovering in a 0.68-70 range, with support and resistance just outside of that range. Vulnerability to the downside remains the biggest threat on the charts.

NZD/AUD

Outlook: Trading range
ST Resistance: 0.9170 (ahead of 0.9230)
ST Support: 0.8975 (ahead of 0.8875)

The 0.8860 low in October now seems a distant memory, as the cross range trades around 0.90-0.91. Resistance kicks in just under the 0.92 mark, with support just below 0.90.

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NZ 5-year Swap Rate

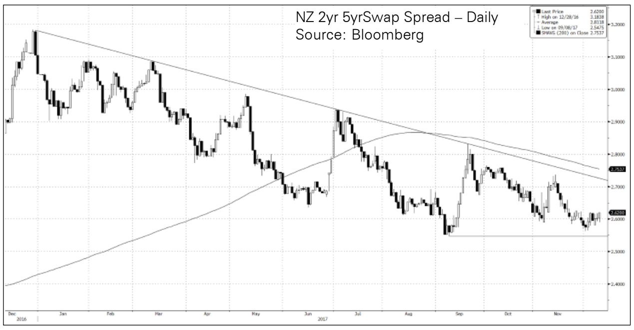
Outlook: Neutral
ST Resistance: 2.73
ST Support: 2.545

Ranges still holding. Resistance now comes in at 2.73 so trade a break of this trendline.

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

Outlook: Neutral
ST Resistance: +54
ST Support: +41

Ranges holding. Trading +54/+41 range with tight stops.



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Key Upcoming Events

	Forecast	Median	Last
Monday 11 December			
NZ, Electronic Card Transactions, Nov	+0.4%	+0.5%	+0.4%
NZ, Finance Minister Robertson Speaks			
Jpn, BSI Business Survey, Q4		+5.8	+5.1
Tuesday 12 December			
Aus, House Prices, Q3 y/y		+8.8%	+10.2%
Aus, NAB Business Survey, Nov			+8
Germ, ZEW Sentiment, December		+18.0	+18.7
UK, CPI, November y/y		+3.0%	+3.0%
US, PPI ex-food/energy, Nov y/y		+2.4%	+2.4%
US, NFIB Small Business Optimism, Nov		104.0	103.8
Wednesday 13 December			
NZ, Food Price Index, Nov	-0.4%		-1.1%
Aus, Lowe Speaks, An eAUD?			
Aus, Consumer Sentiment - Wpac, December			99.7
Jpn, Machinery Orders, October		+2.7%	-8.1%
Euro, Eurozone Employment, Q3 y/y			+1.6%
Euro, Industrial Production, October		flat	-0.6%
Germ, CPI, Nov y/y 2nd est		+1.8%	+1.8%P
UK, Unemployment Rate (ILO), October		4.2%	4.3%
US, CPI ex food/energy, Nov y/y		+1.8%	+1.8%
US, FOMC Policy Announcement	1.50%	1.50%	1.25%

	Forecast	Median	Last
Thursday 14 December			
NZ, Government's HYEFU			
Aus, Employment, Nov	+15k	+19k	+4k
Aus, Unemployment Rate, Nov	5.4%	5.4%	5.4%
China, Industrial Production, Nov y/y		+6.2%	+6.2%
China, Fixed Assets (ex rural), Nov ytd		+7.2%	+7.3%
China, Retail Sales, Nov y/y		+10.3%	+10.0%
Euro, ECB Policy Announcement, Refi	0.00%	0.00%	0.00%
Euro, PMI Manufacturing, Dec 1st est		59.7	60.1
Euro, PMI Services, Dec 1st est		56.0	56.2
UK, Retail Sales vol., Nov		+0.4%	+0.3%
UK, BOE Policy Announcement		0.50%	0.50%
US, Business Inventories, October		-0.1%	flat
US, Markit PMI, Dec 1st est		53.6	53.9
US, Markit PSI, Dec 1st est		54.2	54.5
US, Retail Sales, November		+0.3%	+0.2%
Friday 15 December			
NZ, BNZ PMI (Manufacturing), Nov			57.2
Jpn, Tankan (lge manuf), Q4		+24	+22
Euro, Trade Balance, October s.a.		+€24.3b	+€25.0b
US, Industrial Production, Nov		+0.3%	+0.9%
US, Empire Manufacturing, December		+18.3	+19.4

Historical Data

	Today	Week ago	Month Ago	Year Ago
CASH & BANK BILLS				
Call	1.75	1.75	1.75	1.75
1mth	1.77	1.77	1.77	1.88
2mth	1.83	1.83	1.85	1.96
3mth	1.89	1.90	1.92	2.05
6mth	1.92	1.93	1.94	2.12
GOVERNMENT STOCK				
03/19	1.81	1.80	1.89	2.19
04/20	1.94	1.92	2.03	2.40
05/21	2.08	2.06	2.19	2.57
04/23	2.37	2.34	2.48	2.87
04/25	2.65	2.62	2.75	3.16
04/27	2.80	2.76	2.94	3.30
04/33	3.15	3.12	3.30	3.69
04/37	3.36	3.35	3.50	4.00
GLOBAL CREDIT INDICES (ITRXX)				
Australia 5Y	64	64	68	103
Nth America 5Y	51	52	56	68
Europe 5Y	47	47	52	72

	Today	Week ago	Month Ago	Year Ago
SWAP RATES				
2 years	2.17	2.15	2.21	2.32
3 years	2.34	2.30	2.39	2.53
4 years	2.49	2.45	2.56	2.73
5 years	2.62	2.59	2.71	2.91
10 years	3.10	3.09	3.23	3.46
FOREIGN EXCHANGE				
NZD/USD	0.6842	0.6859	0.6903	0.7192
NZD/AUD	0.9110	0.9026	0.9055	0.9591
NZD/JPY	77.68	77.10	78.43	82.72
NZD/EUR	0.5815	0.5780	0.5917	0.6760
NZD/GBP	0.5112	0.5088	0.5263	0.5671
NZD/CAD	0.8795	0.8691	0.8788	0.9440
TWI	72.8	72.6	73.6	79.0

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