29 January 2018

Taxing Times

- **RBNZ will feel justified in maintaining OCR forecast**
- **As we look to the 8 Feb MPS for inklings**
- **Not to overlook the 7 Feb labour data**
- **Tax revenue strong but varied in detail**
- **This week's data many but monthly**

Last week's December quarter CPI result added to the prospect of the RBNZ sitting on its hands. Right the way out to February next year – as is now our base case. However, we haven't altered our view that the Bank will, in due course, be forced to normalise its Official Cash Rate, in keeping with its view on what a "neutral" short-term interest rate looks like.

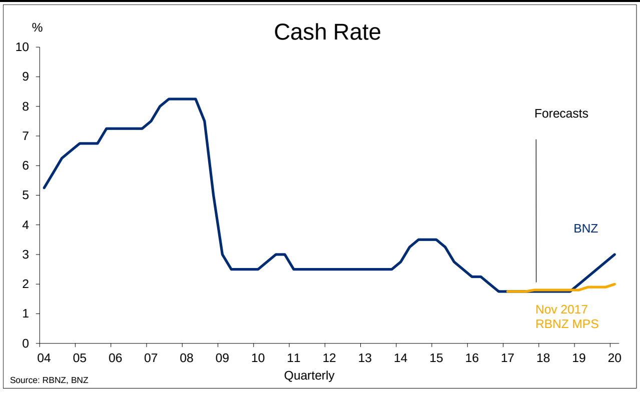
For the next while, however, we can't see much that will make the Bank feel pressured. We had already forecast the CPI would undershoot RBNZ expectations (with the Q4 outturn simply making this more obvious). We are also softer on GDP growth in Q4 2017 and Q1 2018 than the November Monetary Policy Statement (MPS) figured on. Meanwhile, the currency is nudging a bit above the Bank's assumptions.

However, these things need to be balanced by;

- strong indications that the economy's resources are getting more and more stretched (with reference to January's Quarterly Survey of Business Opinion)
- pricing intentions having spiked with respect to 2018
- government policies that promise to boost wage inflation, and not just by way of minimum wage increases directly
- a broader fiscal stimulus in train (not all of which the RBNZ was able to factor into its November MPS)
- housing market inflation perhaps not being as tempered as the Bank forecasts
- firming in the global growth and inflation pointers, including higher commodity prices

So, we expect the Reserve Bank will largely stick with the OCR forecasts it inferred in November. While the net news since then might argue for a softer track, at the margin, this is balanced by the fact there is already a strong precautionary (risk-reward) element to the OCR setting, as well as the Bank's purported flexibility about getting inflation to the mid-point of its 1.0 to 3.0% target band. In this, the RBNZ is in a similar spot to the RBA.

A Timing Issue

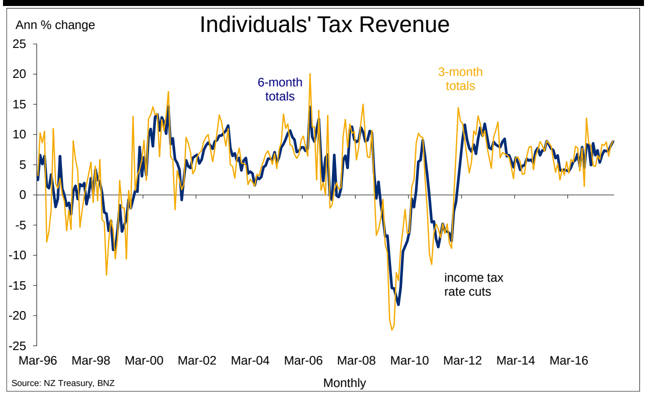


The market certainly hasn't backed off its view of there being a first rate-hike sooner than the central bank itself has indicated. However, it has, like we have, deferred the timing to early-2019.

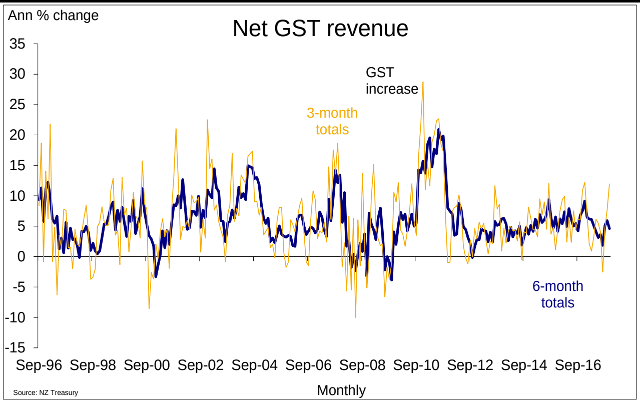
Before the next MPS, the only NZ data which could potentially cause a stir are those regarding the December quarter labour market. These are due 7 February, so will obviously not be incorporated in the 8 February MPS. Sure, they can be volatile. But they may yet be instructive. As an aside, Statistics NZ publishes the Q4 working-age population figures this Wednesday, which, if they surprise enough (and they have been noisy of late), could influence our call on the quarter's unemployment rate.

New Zealand's labour market is certainly steaming – if one consults the latest tax data. November's lot – published by NZ Treasury last Thursday – showed individuals' income tax (largely PAYE) continuing to knock on the door of 10%

Pumping



Rebounding

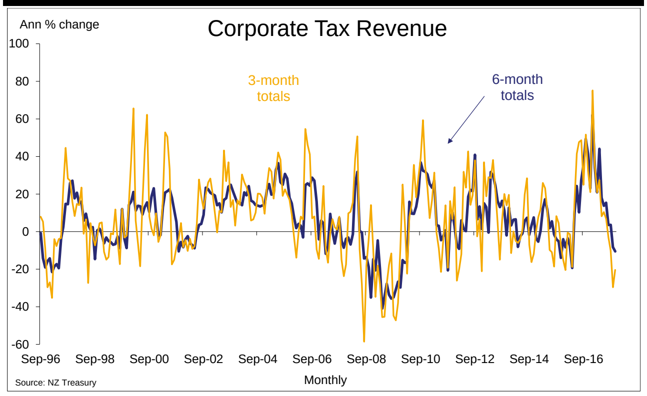


at an annual pace. This tells us that either employment growth is still booming, or wage inflation is higher than the official measures convey, or both. There is also likely a bit of fiscal creep to acknowledge, as nominal wage increases tip folk into higher tax brackets, meaning average tax rates edge up.

Annual growth in GST, meanwhile, has recovered to a strong pace over recent months. This is consistent with the near non-existent inflation in retail prices (as per the CPI) and the acceleration in retail volume growth that we are picking for Q4, after its slow Q3.

Corporate tax, however, has turned negative, y/y, albeit after a veritable surge over 2016 and the first half of 2017. This fits with other indications that profitability is starting to fray at the edges (and with some of the new government policies likely to reinforce this process).

Not So Hot



Overall, November's tax take was up 7.0% on a year ago, or 6.4% stronger when comparing the three months to November 2017 with the same period a year prior. This is a positive indication on economic growth into the end of 2017, and will also aid Budget thoughts at the margin.

As for this week's NZ data, it is all of the monthly variety. Nevertheless, it will still give us a steer on how the economy was doing into the end of 2017, and feeling in the New Year.

Tomorrow's merchandise trade figures will probably still look robust, with the balance likely sneaking back into surplus (+$43m) for December, in our view. This is after the $1,193m deficit posted in November, which was, recall, aggravated by large aircraft imports. We anticipate December's exports will be 13% up on a year ago – aided by dairy prices and meat volumes – while imports growth settles down to 12% y/y.

The market consensus is slightly higher than us on both exports and imports but nets to a December trade deficit of $125m.

Friday's migration figures will also be on the radar. These will help judge if the net inflow is still coming down from its 2016 peak, after the last couple of months showed some resistance. December's short-term visitor arrivals will probably be slightly higher than year-prior levels.

Friday morning's building consents could reasonably go either way, after their strong bounce in November. We certainly expect construction activity to keep expanding over the near term.

Friday afternoon's ANZ Roy Morgan consumer confidence index for January will also be worth scoring. While it was still relatively solid in December, with 121.8, it has declined every month since a peak of 129.9 in September (soon before the General Election).

Thursday's ANZ job ads for December will give a sense of how employers were playing things as the new government revealed more of its stripes, but also as the holiday period beckoned.

There are also some credit data on the plate this week. This afternoon's new residential lending figures for December will probably remain on the back foot, in keeping with the subdued home sales reported, while the month's broader household, business and agriculture lending statistics are due for inspection Wednesday.

craig_ebert@bnz.co.nz

Global Watch

- **No change expected from Fed this week**
- **Payrolls, ISM and PCE deflator to watch**
- **AU CPI and business confidence in focus**
- **EU expected to see solid growth and low inflation**
- **PMIs due in China and the UK**

Australia

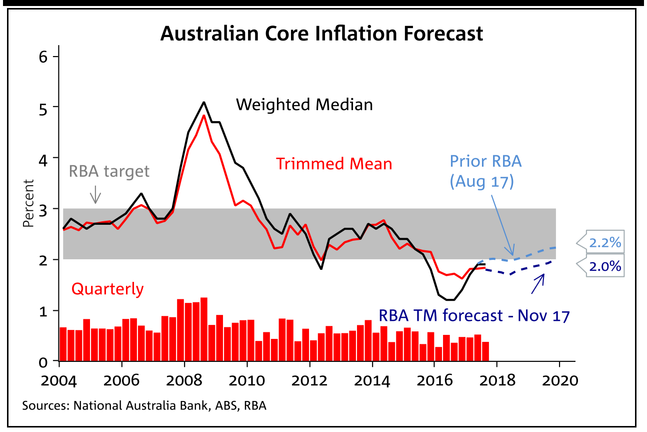
The upcoming Q4 CPI release on Wednesday is the key piece of data for the week. NAB's forecast is for 0.75% q/q (2.0% y/y) for headline and 0.45% q/q (1.9% y/y) for core rates of inflation.

This view is a touch above market consensus (0.7% q/q) for headline. Strong growth in the prices of petrol (8% q/q) and vegetables (9% q/q) are expected to boost headline inflation this quarter. While initially our models indicated some upside risk to our forecasts, the weakness in NZ's CPI print (especially tradable inflation) has tempered those risks.

The forecast for the core rates of inflation are in line with market consensus and RBA expectations. So expect another CPI print around the 0.4 to 0.5 range, an outcome unlikely to change the RBA's view on the path of core inflation moving gradually toward 2%.

The NAB monthly business survey is released on Tuesday, and will be watched by markets. [There are no hints in what we say below!] Business confidence has been improving in trend terms for a time now, but it's only recently that we've seen consumer sentiment noticeably close the gap.

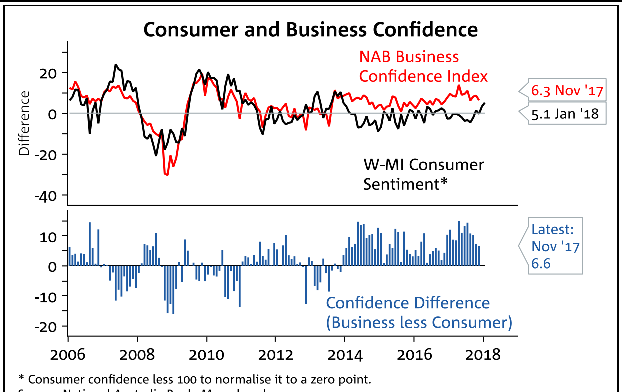
Core Inflation Slowly Rising



Sources: National Australia Bank, ABS, RBA

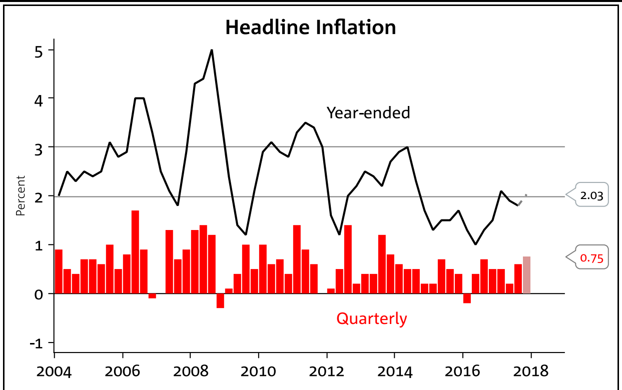
This week we turn your attention to one of our favourite measures in the NAB survey: capacity utilisation. Capacity utilisation measures how intensively firms are using their capital and labour. The chart below suggests that the NAB measure is something of a leading indicator of the unemployment rate.

Consumer Sentiment Closing The Gap



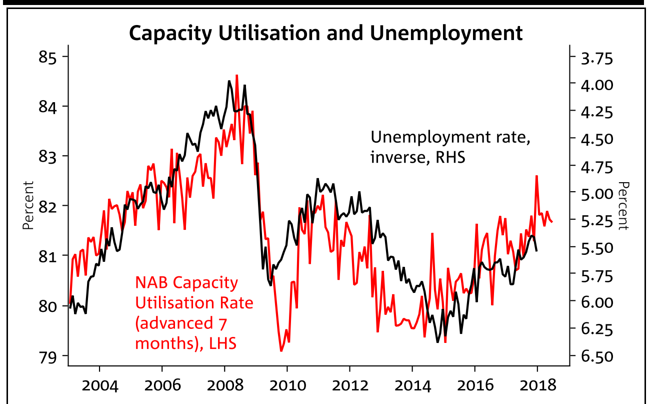
* Consumer confidence less 100 to normalise it to a zero point.
Source: National Australia Bank, Macrobond

Headline Inflation Is Expected To Pick Up



Sources: National Australia Bank, ABS

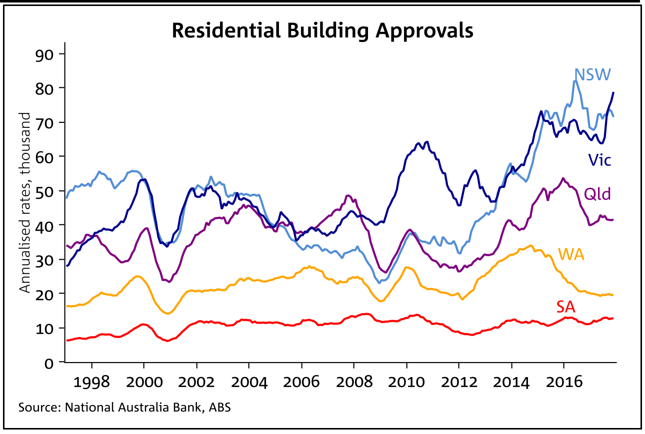
Capu Suggests Further Decline In Unemp.



Source: National Australia Bank, ABS

Building approvals are expected to be weaker in December after a substantial November spike. NAB is forecasting a decline of 8%, payback after the 11.7% rise in November. While building approvals remain below their peak in 2016, they have picked up recently, led by a large number of approvals in Victoria.

Victorian Surge Expected To Reverse



US

No change in rates is expected from the Fed, with no forecast update nor press conference, even though this is Yellen’s last meeting before Jerome Powell takes the chair. The Fed meeting is unlikely to result in a change in policy, or guidance and markets are expecting a fed hike at the March meeting. Market watchers will also be following personal income and PCE data on Monday, ISM Manufacturing survey (which has been robust of late) on Thursday and the all-important jobs data on Friday.

Eurozone

On Tuesday, Q4 GDP is released and the market will be looking for signs of ongoing robust economic growth. German CPI also comes out on Tuesday, and market watchers will look
at it as a leading indicator for the Eurozone CPI estimate on Wednesday.

China

Chinese PMIs print this week, with the official manufacturing and non-manufacturing PMI on Wednesday and the Caixin China manufacturing PMI on Thursday.

Canada

The markets will be watching November GDP on Wednesday, particularly given the recent BoC rate hike.

UK

Minimal data this week. PMIs are due later in the week.

alex.stanley@nab.com.au

Fixed Interest Market

Reuters: BNZL, BNZM Bloomberg:BNZ

NZ interest rates moved lower last week, and the curve steepened, after NZ CPI surprised to the downside. The market had been starting to get excited about the prospect of RBNZ hikes this year (August had been 50% priced and November fully-priced earlier in the week), but the weak NZ CPI saw those expectations get pushed back. The market now prices August as a 20% chance and has pushed back the first hike until February next year, in line with BNZ economists' revised outlook.

NZ 2 year swap rose to a 4 month high of 2.27% earlier last week, but has since fallen almost 10bps. As we outlined in our Weekly last week, we had been targeting 2.3% as a level to get tactically long 2 year swap. But realistically the downside surprise in CPI will probably define a lower range in the near-term. We now think 2 year swap will mostly settle in a 2.10% - 2.20% range for the coming few months. While further moves higher in global rates could drag the NZ front-end up with it, we would expect the market to remain sceptical about RBNZ hikes until more concrete evidence of inflation emerges. We would now see a move in the 2 year swap towards 2.25% (i.e. a short-term move above our expected trading range) as an opportunity to set tactical received positions.

The NZ curve steepened last week as the front-end outperformed after CPI. We retain a steepening bias, as we see more upside to global rates and we expect the front-end to remain relatively anchored.

NZ spreads to other markets continued to compress last week after the CPI, with NZ 3 year swap trading under the US and Australian equivalents. NZGBs out to 2023 are now trading under US Treasury yields, with the 10 year spread (using the NZGB 2027s) at just 24bps. Further compression in front-end spreads seems quite likely if global data continues to accelerate, as we would expect the NZ front-end to remain relatively sticky around current levels in the midst of the CPI. In that environment, longer-dated spreads can also compress but we would expect the moves to be less pronounced.

In the week ahead, there's little domestically that's likely to move NZ rates markets. We'll need to wait for the following week when we receive the NZ labour market report and the RBNZ's February MPS meeting (the last under current interim Governor Grant Spencer).

RBA's core measures of inflation. Our NAB economists are close to consensus, looking for 0.7%/0.8% on the headline measure and 0.4%/0.5% on core. With the market already fully-pricing an RBA rate rise by November, we think the Australian rates market will be more sensitive to a downside surprise.

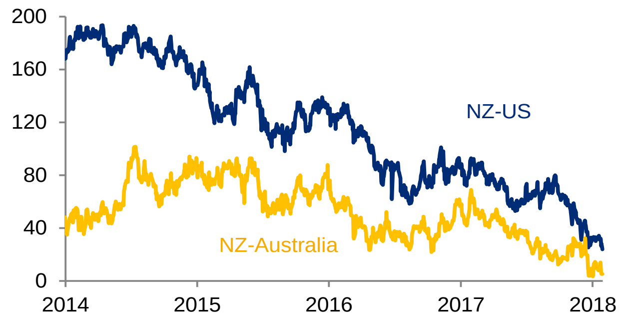
In the absence of any key domestic data this week, the tone is likely to be set offshore. In Australia, we receive CPI on Wednesday with the market likely to focus on the

In the US, we don't expect the FOMC meeting on Thursday morning to cause much reaction, with a March hike already near fully priced. We'll need to wait for the minutes later in the month for the more interesting discussion around the outlook for the Fed Funds rate.

US non-farm payrolls are released on Friday with the focus once again likely to be on average hourly earnings. Amid a synchronised global upswing, US tax cuts and easy financial conditions, the missing ingredient for a further sell-off in US bonds is a pick-up in US inflation. We suspect the market will react more strongly to an upside surprise in wage inflation given this backdrop.

Meanwhile in Europe, the highlight will be core inflation, which has been reasonably steady around 1% over recent years. The low level of core inflation in Europe has been the main reason why the ECB has retained emergency levels of monetary stimulus despite the strengthening economic recovery. One of the major risks to bond markets this year is that European inflation finally starts to surface and the market brings forward ECB tightening expectations. But it will likely be some months yet before any trend up in core inflation is detectable.

NZ spreads to offshore continue to compress



Source: BNZ., Bloomberg

Current Rates/Spreads and Recent Ranges

	Current	Last 3-weeks range*
NZ 90d bank bills (%)	1.88	1.87 - 1.89
NZ 2yr swap (%)	2.18	2.17 - 2.27
NZ 5yr swap (%)	2.71	2.66 - 2.80
NZ 10yr swap (%)	3.25	3.13 - 3.31
2s10s swap curve (bps)	107	96 - 107
NZ 10yr swap-govt (bps)	35	32 - 36
NZ 10yr govt (%)	2.90	2.80 - 2.99
US 10yr govt (%)	2.66	2.48 - 2.67
NZ-US 10yr (bps)	24	24 - 34
NZ-AU 2yr swap (bps)	7	7 - 18
NZ-AU 10yr govt (bps)	5	5 - 14

*Indicative range over last 3 weeks

nick.smyth@bnz.co.nz

Foreign Exchange Markets

Reuters pg BNZWFWDS Bloomberg pg BNZ9

A key influence on the NZD last week was the shockingly low NZ Q4 CPI result of 0.1% q/q and 1.6% y/y, with the RBNZ's preferred core inflation measure remaining steady at 1.4%. This now means that an RBNZ hike later this year is unlikely and the NZD fell accordingly, down against all the major currencies except the USD for the week.

The other key influence on currency markets was the USD continuing to trend down, falling for the seventh consecutive week on the key indices. President Trump's imposition of tariffs on imported solar panels and washing machines added to a weak tone as it raised the spectre of the US going down the path of trade protectionism. Furthermore, Treasury secretary Mnuchin commented that a weaker USD would be good for trade, going against the "strong dollar" policy usually adopted by the US government. These comments saw the USD take another lurch down.

Against a weak USD, the NZD hit a 5-month high of 0.7438, before the CPI figures saw the NZD much lower. In terms of our short-term model, higher NZ commodity prices have more than offset lower NZ interest rates, seeing fair value nudge up to around USD 0.73.

The near-term outlook is uncertain, with sentiment for the USD likely to be the key factor in whether the NZD makes a new high for the year or settles a couple of cents lower. Sentiment for the USD is very poor and technical support factors have been broken. However, other technical indicators point to the USD being oversold, increasing the chance of a near-term bounce, which would see a weaker NZD.

For the week ahead, there are no top tier data on the local calendar to rattle the market but Australia has its turn for the CPI. A weak NZ result can often mean a weak Australian result as well, so watch out for a possibly weaker-than-expected result that could end up NZD/AUD positive. The market doesn't seem to have taken much note of this risk, as the AUD closed above USD 0.81, its highest level since mid-2015, taking NZD/AUD near the bottom of its range this year.

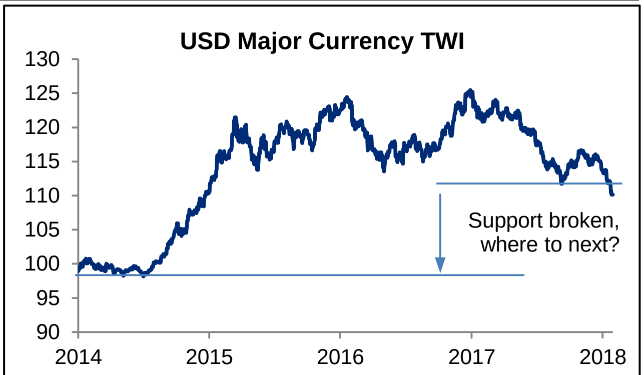
CPI data are also released for the euro-area. EUR has been strong this year as the market looks forward to the ECB ending its asset purchase programme. While the CPI data could have a short term impact on EUR on any surprise, we think the ECB is keen to end its emergency policy settings regardless and this lies behind our view for a weaker NZD/EUR this year.

On paper it's a big week in the US, but the data might take a back seat to other forces, like Trump's state of the nation speech Wednesday afternoon, NZ time. The FOMC is expected to make little change to its policy statement on Thursday morning (a rate hike is only 2% priced), keeping its powder dry for March (95% priced). We have more interest in the minutes of the Statement in a couple of weeks where we might see some discussion of the weak USD and how many members, if any, add another rate hike to their central forecast for 2018.

The US employment report rounds out the week on Friday night, where we should see more evidence of solid employment growth and a lift in wage inflation. Ahead of that, employment cost and ISM data are released. On their own the data and the FOMC Statement should support the USD in theory, but as we know sentiment for the greenback has been very poor over recent weeks.

While the USD can easily lose more ground against EUR and GBP this year, we aren't willing to throw in the towel on our call for a weaker NZD/USD by mid-year and year-end.

USD Remains Under Pressure



Source: BNZ, Bloomberg

Cross Rates and Model Estimates

	Current	Last 3-weeks range*
NZD/USD	0.7345	0.7140 - 0.7440
NZD/AUD	0.9059	0.9060 - 0.9220
NZD/GBP	0.5193	0.5140 - 0.5370
NZD/EUR	0.5911	0.5880 - 0.6050
NZD/JPY	79.83	79.60 - 81.60

*Indicative range over last 3 weeks, rounded figures

BNZ Short-term Fair Value Models

	Model Est.	Actual/FV
NZD/USD	0.7310	0%
NZD/AUD	0.8980	1%

jason.k.wong@bnz.co.nz

Technicals

NZD/USD

Outlook:	Trading range
ST Resistance:	0.7370 (ahead of 0.7440)
ST Support:	0.7130 (ahead of 0.7055)

The key 0.7370 resistance level broke but new resistance was met at 0.7440, near the September high. Both these levels remain key resistance levels, with the currency back down through them. There's a fair gap down to any support, with the 200-day moving average of 0.7130 of some interest.

NZD/AUD

Outlook:	Trading range
ST Resistance:	0.9230 (ahead of 0.9400)
ST Support:	0.9040 (ahead of 0.8975)

jason.k.wong@bnz.co.nz

NZ 5-year Swap Rate

Outlook:	Higher
ST Resistance:	2.93
ST Support:	2.67

Still expect move higher trendline support now comes in at 2.67.

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

Outlook:	Steeper
ST Resistance:	+72
ST Support:	+48

Breaking higher expect a move towards +72. Trendline support now comes in at +48.

pete_mason@bnz.co.nz

Key Upcoming Events

	Forecast	Median	Last
Monday 29 January			
NZ, Residential Lending, December y/y			-16.6%
NZ, Holiday - partial, Auckland Anniv.			
US, Personal Spending, December		+0.4%	+0.6%
Tuesday 30 January			
NZ, Merchandise Trade, December	+$43m	-$125m	-$1,193m
Aus, NAB Business Survey, December			+6
Jpn, Household Spending, December y/y		+1.5%	+1.7%
Jpn, Unemployment Rate, December		2.7%	2.7%
Euro, GDP, Q4 1st estimate		+0.6%	+0.6%
Euro, Economic Confidence, January		116.2	116.0
Germ, CPI, Jan y/y 1st est		+1.7%	+1.7%
US, Consumer Confidence, January		123.0	122.1
Wednesday 31 January			
NZ, Credit Aggregates, Dec (household y/y)			+6.3%
Aus, CPI Trimmed Mean, Q4	+0.5%	+0.5%	+0.4%
Aus, CPI Weighted Median, Q4	+0.5%	+0.5%	+0.3%
Aus, Private Sector Credit, December	+0.4%	+0.5%	+0.5%
Aus, CPI, Q4	+0.8%	+0.7%	+0.6%
China, Non-manufacturing PMI, January		55.0	55.0
China, PMI (NBS), January		51.5	51.6
Jpn, Industrial Production, Dec 1st est		+1.5%	+0.5%
Euro, Unemployment Rate, December		8.7%	8.7%

	Forecast	Median	Last
Wednesday 31 January*...continued*			
Euro, CPI, Jan y/y 1st est		+1.3%	+1.4%
Germ, Retail Sales, December		-0.4%	+1.8%
US, Chicago PMI, January		64.0	67.6
US, FOMC Policy Announcement, Upper Bound		1.50%	1.50%
US, ADP Employment, January		+185k	+250k
Thursday 1 February			
NZ, ANZ Job Ads, January			-0.3%
Aus, Building Approvals, December	-8.0%	-7.6%	+11.7%
Aus, CoreLogic HPI, December			-0.4%
Aus, Terms of Trade, Q4			
China, PMI (Caixin), January		51.5	51.5
UK, Markit/CIPS Manuf Survey, January		56.5	56.3
US, Productivity (non-farm), Q4 saar 1st est		+1.0%	+3.0%
US, Construction Spending, December		+0.4%	+0.8%
US, ISM Manufacturing, January		58.6	59.7
Friday 2 February			
NZ, ANZ-RM Consumer Confidence, January			121.8
NZ, External Migration, December s.a.			+5,610
NZ, Building Consents, December (res, #)			+10.8%
Aus, Producer Prices, Q4 y/y			+1.6%
US, Factory Orders, December		+1.2%	+1.3%
US, Non-Farm Payrolls, January		+180k	+148k

Historical Data

	Today	Week Ago	Month Ago	Year Ago
CASH & BANK BILLS				
Call	1.75	1.75	1.75	1.75
1mth	1.80	1.78	1.79	1.83
2mth	1.84	1.83	1.83	1.91
3mth	1.88	1.88	1.88	1.99
6mth	1.90	1.93	1.93	2.06
GOVERNMENT STOCK				
03/19	1.78	1.81	1.79	2.36
04/20	1.95	2.04	1.88	2.58
05/21	2.15	2.24	2.03	2.75
04/23	2.43	2.51	2.24	3.04
04/25	2.70	2.77	2.53	3.32
04/27	2.90	2.98	2.72	3.41
04/33	3.24	3.29	3.06	3.75
04/37	3.39	3.44	3.24	4.08
GLOBAL CREDIT INDICES (ITRXX)				
Australia 5Y	55	55	60	92
Nth America 5Y	45	47	49	66
Europe 5Y	43	44	45	72

	Today	Week Ago	Month Ago	Year Ago
SWAP RATES				
2 years	2.18	2.25	2.22	2.44
3 years	2.38	2.46	2.39	2.69
4 years	2.56	2.63	2.55	2.89
5 years	2.71	2.78	2.68	3.05
10 years	3.25	3.30	3.14	3.56
FOREIGN EXCHANGE				
NZD/USD	0.7343	0.7328	0.7105	0.7285
NZD/AUD	0.9061	0.9141	0.9101	0.9645
NZD/JPY	79.81	81.28	80.02	82.89
NZD/EUR	0.5912	0.5976	0.5916	0.6812
NZD/GBP	0.5191	0.5239	0.5263	0.5834
NZD/CAD	0.9039	0.9118	0.8914	0.9557
TWI	74.9	75.2	74.1	79.7

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

Jason Wong
Senior Markets Strategist
+64 4 924 7652

Nick Smyth
Interest Rates Strategist
+64 4 924 7653

Main Offices

Wellington
Level 4, Spark Central
42-52 Willis Street
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Toll Free: 0800 283 269

Auckland
80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Toll Free: 0800 283 269

Christchurch
111 Cashel Street
Christchurch 8011
New Zealand
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
Head of FX Strategy
+61 2 9237 1848

Skye Masters
Head of Fixed Income Research
+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