17 September 2018

GDP Preview and the Week Ahead

- **Q2 GDP likely reasonable; we estimate +0.6%**
- **Even with dent from substantial maintenance**
- **Primary (and processing), services, seen positive**
- **Should keep growth above RBNZ expectations**
- **PSI questions growth ahead**
- **Q2 current account deficit to be flattered by revisions**
- **Dairy auction to add downward pressure to milk price forecast**

Thursday's Q2 GDP report will hold most attention across the domestic data on show this week. Despite its usual historic date stamp, this week's growth figures will be important from a few different perspectives.

First, they will show how well (or not) the economy is holding up in the face of deep business pessimism. Business confidence has been negative since last year's election, easily long enough to start influencing growth in the second quarter of this year if it were to.

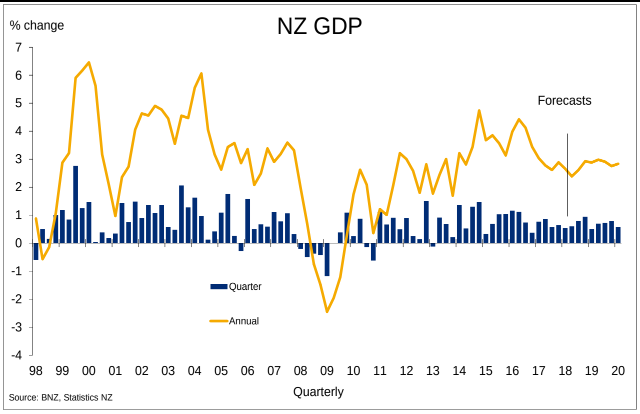
Second, the GDP figures will reveal the economy's momentum ahead of fiscal stimulus entering the system in the second half of the year (and before business confidence weakness intensified).

Third, the data will help inform how much slack there is (or isn't) in the economy with its subsequent implications for core inflation and RBNZ policy. And that is where market's focus will be sharpest. Recall the RBNZ in its August MPS included a scenario of slower growth that saw the OCR cut 100 basis points. While this scenario referred to 2019 growth, the starting point and momentum will be important as the market assesses the probability of this scenario coming to pass.

That might be fine in theory, but the problem could be in deciphering signal from noise in this quarter's national accounts as various idiosyncratic influences make their mark as they so often do quarter to quarter. Indeed, this time around shapes up to be worse than normal in this regard.

Our estimate of Q2 GDP growth is 0.6%, albeit on the cusp of rounding up to 0.7% which illustrates where the risks to our forecast lie. Our expenditure based estimates sits at 0.7%. Putting our risk assessment another way, we would be more surprised by a 0.4% than a 0.8%. Early market polls had 0.7%, but have since nudged up to 0.8%. Our slightly below consensus call is not a nod to weak business confidence. Rather, it reflects transitory

Holding Up



major maintenance and repair at a couple of large operations that is expected to dent manufacturing activity in the quarter (and boost growth in next quarter). We see annual growth easing to 2.4%, from 2.7% in Q1.

The hit to the headline growth figures from this would be more apparent if it were not for an expected offsetting surge in primary processing on the back of primary production bouncing back strongly from prior adverse weather. Indicators for meat and dairy processing were very strong for the quarter, while forestry is expected to bounce back after a weak first quarter (all of which is expected to support strong exports). Fundamentally, growth is expected to be underpinned by elevated construction work, firm retail and buoyant activity in the services sector, the latter indicated by a solid lift in hours worked over the period.

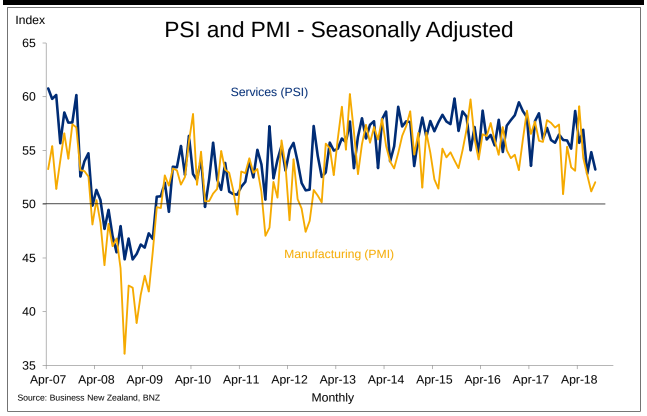
Importantly, it seems unlikely that GDP will fall short of the RBNZ expectation of a 0.5% gain. But if it were to, it may simply be because the Bank has not fully accounted for the net drag from the above distortions – the details will be important. On the other hand, if GDP prints above the Bank's forecasts, it could suggest that underlying growth is tracking even stronger given the above one-offs. An outcome lower than RBNZ projections would encourage market thoughts of a lower OCR in future, while a higher result would allay such thinking at least for the near term.

But the potential for some very large movements in some individual components with the GDP figures, as discussed above, suggest wider forecast error bounds than usual for this quarter. At the least, it cautions against jumping to conclusions from the headline figures.

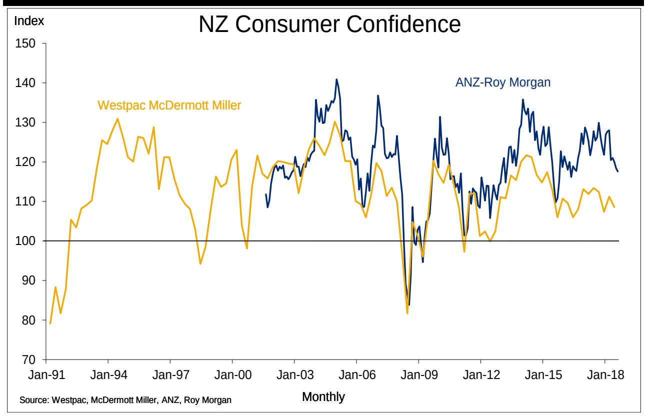
In the bigger picture, we think growth has been holding up reasonably well to date. But we remain alert to the idea that could change. This morning's Performance of Services Index is the latest reason to pause for thought. It slowed to 53.2 in August from 54.8 in July. The three month average has eased to 53.6, to now sit well below last year's average of 57.1. The employment index was flat for the third consecutive month. But it is not clear if this is primarily due to a levelling off in labour demand or supply side factors like difficulty in finding labour, the rising cost of labour, or uncertainty around work place relations. Understanding the various dynamics and the balance of such influences is important from a macroeconomic point of view, given the different implications they have for inflationary pressures.

In any case, if such PSI levels, in combination with subdued readings in the Performance of Manufacturing Index like we saw last week, continue, it will question our growth forecasts heading into 2019. On a more positive note, the PSI's new orders index remained healthy, offering some prospect of improvement, as does the fiscal stimulus coming through. In this regard, Wednesday morning's WMM consumer confidence index will be worth monitoring. It stood at a reasonable 108.6 in Q2. Will it continue to hold u, in contrast to business confidence?

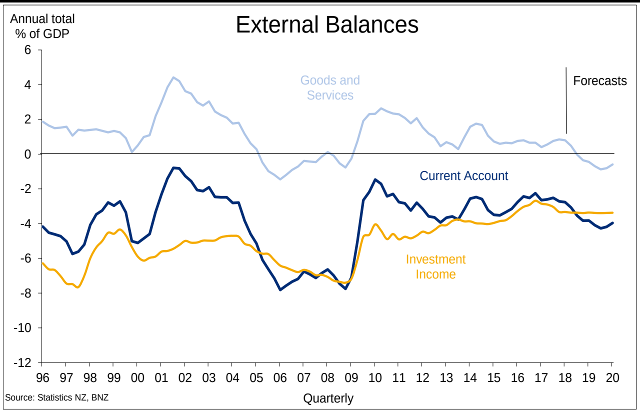
Growth Warning



Still Reasonable?



Deficit To Narrow On Revisions, But Trends Deteriorating



On Wednesday we get Q2 Balance of Payments data which could yet shade our thinking for GDP via its import and export components. Also of interest will be the inclusion of historical revisions to services exports, which we estimate will reduce the annual current account deficit as a share of GDP by around 0.4%. So we expect an annual deficit of 2.7% of GDP, which would be smaller than the previously published 2.8% for Q1, even though the deeper undercurrents are shifting toward an expanding deficit. The market expects the external deficit to edge out to 2.9% of GDP.

Other data out this week will give pointers to both growth and the external balance. Wednesday morning's dairy auction is expected to show another fall, perhaps in the order of 2%, which would extend the recent slide and fit with our view that the terms of trade is set to ease from a very high level. Another fall in dairy prices would reinforce the downward pressure that we already judge to be on Fonterra's 2018/19 milk price forecast of $6.75. Friday's migration statistics will be viewed to see if the recent gradual downtrend in net migration has continued into August, with the short-term visitor figures assessed for further support to the external accounts. Short term visitor arrivals are likely to show annual growth of around 5%, so still pretty good.

Also, keep an eye out for the Tax Working Group's interim report that may be released before the week is out as much for the options that it canvasses as for any firm recommendations that it proposes.

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Global Watch

- **Eurozone, Canadian and Japanese CPIs centre-stage**
- **Hurricane Florence batters the US**
- **Brexit negotiations remain keenly followed**
- **BOJ likely unmoved**
- **RBA minutes due**

Australia

There's little on the economic calendar for the week ahead. The only mildly interesting release is hedonic (quality-adjusted) house prices for the June quarter, on Tuesday. This is now only of historical value given CoreLogic has already released its monthly report for house prices for August.

The full RBA minutes will be released this week but are unlikely to provide any new insights. However, we do reiterate that financial markets seem to be overly-focused on housing at present, at the expense of looking at the positive developments occurring in such sectors as mining, infrastructure and defence.

The RBA's Chris Kent might make some comment of interest in the Q&A following his speech on Wednesday. The speech itself doesn't seem directly policy relevant, being on "Money Creation" but might shed some light on the Bank's views on the current evolution of the growth rates of credit and M3.

US

Focus is likely to be on the extent of the storm damage from Hurricane Florence, while markets will be looking for any further developments on the US-China trade front. Housing Starts are out on Wednesday and will be of some interest given the slowing in a number of housing indicators since June. The Markit PMIs are published on Friday, though these do not typically drive much of a reaction given the market focuses more on the ISMs that are out in two weeks' time.

Japan

The main focus will be on Friday's August CPI. Also of interest is the August Trade report, on Wednesday, and the Nikkei PMI, for September, on Friday. The Bank of Japan meets but no change in stance is expected

UK

Brexit negotiations continue to dominate UK markets and this Wednesday the PM travels to Salzburg to meet EU leaders to discuss simplifying the process towards a Brexit withdrawal agreement. We do not expect much in the way of hard detail but the meeting should pave the way for EU leaders to meet in October and formally agree to some simplification ahead of a deal in November. UK CPI data for August is released on Wednesday. Annual CPI inflation is expected to ease 0.1% to 2.4%. Retail sales for August are due on Thursday and are likely to ease back after robust, weather-boosted sales in July.

Eurozone

The highlight in the EZ data calendar is likely to be flash German and French manufacturing and service sector PMIs for September. Final Eurozone CPI data for August should show headline inflation pulled back to 2.0%. Trade data for July, due Tuesday, might reveal some further trade tariff impact given the slump in German factory orders. The EZ trade surplus has eased to close to a three-year low. ECB President Draghi speaks in Berlin on Wednesday on the topic "Making Europe's union work".

EU leaders assemble in Austria on Wednesday for a Summit to discuss Brexit. Chief negotiator Barnier is briefing EU affairs ministers in Brussels on Tuesday.

Canada

The CPI on Friday dominates the week with markets looking for a headline reading of 3.0% y/y and a core trimmed CPI increase of 2.1%. A core print in excess of 2.0% should keep the BoC on track to hike rates in October. Markets are currently 89% priced for a rate hike. An on-consensus or above print would likely see interest rates rise given BoC Deputy Governor, Wilkins, said, at the BOC's last meeting, that officials had debated whether to accelerate the pace of potential hikes before finally choosing to stick to their current gradual path. Retail Sales are also on Friday, while progress on a NAFTA agreement will be closely watched.

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A Global And Australian Economic Perspective

Global growth reached its highest rate since September 2011 in Q2 2018, but has likely peaked. Our global leading indicator points to a slowing in the second half of 2018. Moreover, underneath this solid headline reading, growth has become less synchronised across countries. This will become more obvious in the second half of the year due to a major deterioration in financial conditions in certain EM economies. Contagion across the range of EM economies has so far been limited, but remains a concern against a backdrop of ongoing trade tensions. Reinforcing the expected slowing in growth is the gradual tightening in monetary policy underway across both advanced and EM economies, the fading over time of this year's US fiscal stimulus and growing supply constraints. Overall, we expect global growth to peak this year at 3.8%, before easing over 2019 (3.7%) and 2020 (3.5%). US/China trade tensions represent the major risk to the global outlook.

- There have been some downward moves in commodity prices in recent months. While this might in part reflect US dollar strength, the larger falls have been in base metals such as copper, which can be more sensitive to the economic outlook and risk sentiment.

- With advanced economy growth above trend and unemployment rates moving close to, or below, estimates of full employment, the major advanced economy central banks are looking to tighten policy. However, this is happening only gradually as inflation pressures are generally muted, although core inflation in the US is now at the Fed's 2% long-term target.

- There has been a major deterioration in financial conditions in certain EM economies, such as Argentina and Turkey. Contagion across the range of EM economies is so far limited but remains a concern against a backdrop of ongoing trade tensions. US Federal Reserve rate increases often put pressure on EM central banks to also lift rates, as they seek to avoid capital outflows and consequently pressure on their currency, and this is again the case. While, outside of Turkey and Argentina, the increase in EM rates so far this year is relatively modest, it still represents a tightening in policy which may be expected to weigh on growth.

- The latest data confirm that major advanced economy growth rebounded strongly in Q2 after a soft patch in Q1. This was led by the US, but Japan, the UK and Canada all experienced stronger growth, with only Euro-zone missing out with growth unchanged from Q1. However, outside of the US, the annual growth rate has declined. Across the advanced economies, monetary policy is still relatively loose and so supportive of above trend growth, while fiscal policy has also turned more supportive, particularly in the US. While growth should remain above trend, the pace is likely to ease - monetary policy will become less stimulative over time and this year's US fiscal stimulus impact will soon fade. Unemployment rates continue to trend down suggesting that supply will be an increasing constraint.

- Despite the growing uncertainty around international trade, economic growth in the big emerging markets edged higher in Q2 2018 – to 6.1% yoy (from 6.0% in Q1). Growth has accelerated since the end of 2015 (when it dipped below 5.0%), The main contributor to the upturn was India, where growth accelerated to 8.2% yoy (from 7.7% in Q1). In contrast, both Chinese and Brazilian growth eased.

- The uptick in growth in emerging markets, combined with the modest turn-around in advanced economies, has driven global economic growth to its highest rate since September 2011 (at around 4.0% yoy). That said, we maintain our view that global growth is near its peak for the current cycle, with growth set to slow in coming years. This will be largely driven by slowing trends in advanced economies, as US fiscal stimulus fades and monetary policy gradually tightens in the face of intensifying capacity constraints. In contrast, emerging market growth is expected to remain relatively stable – with India and non-China East Asia remaining strong, while a modest slowing in China is offset by a recovery in Latin America.

- Trade tensions are a major risk for the global economy; in particular, the future of NAFTA and the prospect of escalating US/China tariffs. Although the US has reached agreement with Mexico on changes to NAFTA and is currently in discussions with Canada, there is no certainty an agreement will be reached. Meanwhile, the US is expected to announce tariffs on up to $200b of imports from China, though the extent and timing of action is uncertain. If China retaliates (as it has indicated it will do), President Trump has threatened further tariffs that would essentially encompass all of China's exports to the US. Threatened US tariff measures on Chinese imports (and retaliatory Chinese action) represent a substantial downside risk to the outlook although a range of factors, including the fiscal and monetary policy response, would shape the overall impact.

- For more detail on the global outlook, please see the Forward View – Global.

Australia: The release of the Q2 national accounts confirmed that the economy has grown at a strong pace over the last year, with notable growth in government infrastructure spending, and a surprisingly resilient household sector. Exports have also risen, as expected. Growth in the business sector has been a little more mixed, with weakness in the non-mining sector evident *in Q2. In contrast, investment in the mining sector rose. While the economy has grown more strongly than expected over the first half, the outlook is broadly unchanged. However, downside risks have abated with business conditions rebounding in August. Growth is expected to continue at above trend rates (at 3.3% in 2018 before slowing in 2019 and 2020). Rising commodity exports, public infrastructure investment and a recovery in non-mining business investment are expected to drive growth. Our outlook for the consumer remains weaker, given the headwinds faced by the household sector. The cooling in the housing market is also likely to see some weakness in dwelling investment over the next few years. While growth has been strong, inflationary pressure has remained weak, suggesting there is some time to go for the rise in output growth (and tightening labour market) to feed through to inflation pressures more broadly – though recent data have showed some signs of a pick-up. For now, we have left our outlook for rates unchanged, but the risk remains that rate hikes could well be delayed.*

- Outcomes in the business sector have been mixed recently, but the outlook remains positive. Both the national accounts and ABS Capex Survey suggested weakness in the non-mining sector in Q2, and looking forward, the capex intentions for 2018/19 imply some further weakness. The NAB Monthly Business Survey saw a broad-based improvement in the month, with a rebound in conditions and forward orders, as well as a lift in actual capex; confidence did ease however. Overall, the survey continues to suggest conditions in the business sector have remained positive into the second half of 2018 – and our outlook for a lift in business investment over the next two years stands. Capacity utilisation remains high, profitability remains strong and the large pipeline of public infrastructure investment is likely to provide some additional spill-overs to the non-mining sector. Further, the drag from falling mining investment is likely to wane as the last of the large LNG projects enters production.

- Dwelling prices continued their correction August, falling a further 0.4%. The declines were led by Melbourne and Perth, while Sydney continued to ease at a more moderate monthly pace. The other capitals and regional areas have continued to hold up better, though did not experience the rapid run up in prices that occurred in the two largest cities. Dwelling investment in the national accounts rose in Q2 with a solid increase in investment in new dwellings offset by a decrease in alterations and additions. We expect some weakness in dwelling investment going forward, as the housing market continues to cool, though it is likely to be volatile and will likely remain at a high level with a relatively large pipeline of work in train.

- Consumption indicators continue to paint a mixed picture of the household sector. Consumption recorded a reasonable outcome (0.7% q/q) in the Q2 national accounts, but continued to outpace growth in household income. The savings ratio thus fell to 1%. We expect consumption growth to slow slightly, with the household sector continuing to face headwinds from weak wage growth, a high debt burden and slower growth in household wealth. More recently, the ABS measure of retail sales was flat in July after a run of stronger-than-expected results.

- The labour market continued to show strength in August with employment increasing by 44k and a rise in the participation rate. This saw the unemployment rate remain unchanged at 5.3% in the month and it appears that the decline over recent months has been sustained. Looking forward, the outlook for the labour market remains positive. The NAB survey employment index held at well above average levels in August – implying employment growth of over 20k per month for the next six months - which points to further declines in the unemployment rate as growth in employment continues to outpace that of the working-age population. Surveyed wage costs also rose in August, and while this is not a pure wage measure, it provides some further evidence that wage pressures are gradually beginning to build.

- Net exports made a small contribution to growth in Q2. While export growth slowed, it remained robust and broad-based with all sub categories contributing. Resource exports are sharply higher over the year. More recently, the trade surplus narrowed in July with a slight pull-back in iron ore exports (which recorded a strong outcome in the previous month) while imports of intermediate goods rose.

- Prices for iron ore have remained range bound in the high US$60s while, coking coal prices have moved higher over the past month. The NAB Rural Commodities Index was up 0.8% in August, with grain, lamb and wool prices on the rise, but cattle and dairy lower. Continued drought conditions in the east are likely to see elevated grain prices but lower cattle prices.

- Our USD/AUD model continues to suggest a fundamental value estimate in the mid-70c range. Though continued strains in emerging markets as well as ongoing China-US trade tensions have seen the Aussie trade closer to US70c in recent weeks. We expect the Aussie to trend gradually lower over the next few years, with widening interest rate differentials and lower commodity prices.

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Fixed Interest Market

Reuters: BNZL, BNZM Bloomberg: BNZ

NZ swap rates were modestly higher last week, although they again lagged the moves in US rates. All eyes are on NZ GDP released this week.

For the record, we expect a 0.6% rise in Q2 GDP, slightly higher than the 0.5% RBNZ August MPS forecast. Bloomberg shows a 0.8% consensus forecast.

If we're right on GDP (i.e. a 0.2% downside surprise vs. consensus) we would expect to see a modest decline in NZ rates. We don't think a 0.6% GDP release would be the 'smoking gun' for the market to extend rate cut pricing (which currently stands at 11bps by mid-2019). But it could see the market pare back future OCR rate hikes.

In terms of the risks around our base case, we continue to think the market will be more sensitive to a downside surprise in GDP. While it's always hard to generalize with GDP because it can be knocked around by idiosyncratic factors, if GDP were below 0.5%, we would expect a strong market reaction and increased speculation of possible rate cuts. Conversely, we don't think a stronger GDP print, on its own, will do much to change the market's mind-set that the balance of risks is skewed towards a cut over the next year. We think it would take a succession of stronger data prints to see the market price-out the risk of rate cuts.

US Treasury yields rose again last week, with the 10 year yield ending Friday close to 3%. There continues to be only modest spill-over from US Treasury yields to the longer-end of the NZ curve; over the past fortnight the US 10 year yield is approximately 15bps higher, over which time the NZ 10 year swap rate is up 3bps.

We think the break-down in correlation between the NZ and US 10 year rates is related to two factors. First, monetary policy is divergent between the NZ and the US: the Fed is raising rates and the RBNZ is not. Second, the rise in the US rates has been driven by growing Fed rate hike expectations, as opposed to an increase in the 'term premium' on US bonds; historically, it is term premium-driven moves higher in US rates (such as during the 'taper tantrum') that tend to transmit internationally, including to NZ.[1]

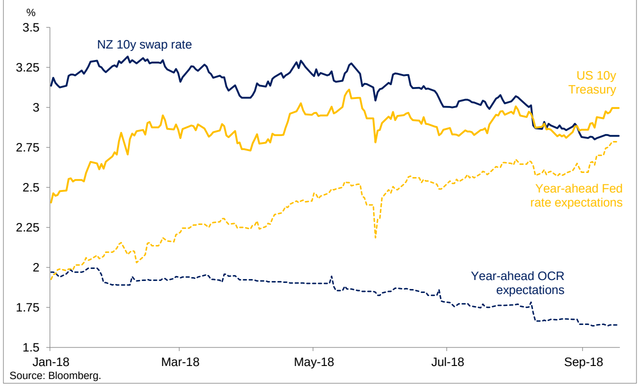
NZ inflation-indexed bonds (also known as 'linkers') performed very strongly last week; real yields fell around 12bps while the 10y 'breakeven inflation rate' increased 15bps (see chart). Despite the rising breakeven inflation, to around 1.35%, it remains well below the midpoint of the RBNZ's 1-3% inflation target range. We expect some further pick-up in breakeven inflation in the coming months, in line with an increase in domestic inflation (our initial expectation is that headline CPI inflation will pick-up to 1.8% in Q3, when the data are released next month).

There is little offshore data likely to move the market this week. The main focus is the 27 September FOMC meeting, and in particular the Fed's rate projections.

[1] One can think of the term premium as reflecting investors' appetite for taking duration risk. When investors demand more of a premium to hold longer-dated Treasury bonds, over and above the expected path of the Fed funds rate over the next 10 years, they typically demand a greater premium in other global bond markets, including NZ. Currently, the US 10 year term premium is historically low, at around -50bps. See our previous note on NZ and US de-coupling for more information.

NZ and US 10 year rates have remained little correlated

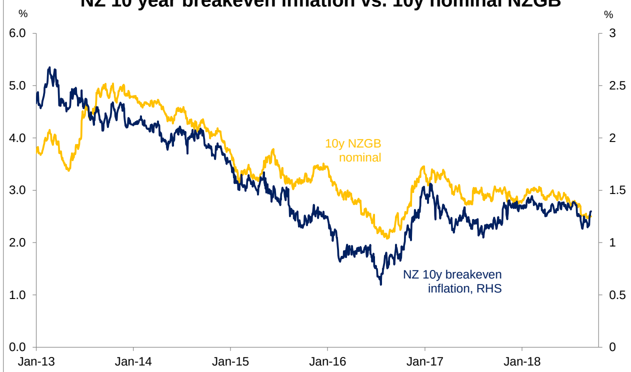
NZ and US 10 year rates and year ahead central bank expectations



Source: Bloomberg.

NZ breakeven inflation has picked up, but still at low levels

NZ 10 year breakeven inflation vs. 10y nominal NZGB



Source: BNZ, Bloomberg. Bond yield and breakeven linearly interpolated.

Current Rates/Spreads and Recent Ranges

	Current	Last 3-weeks range*
NZ 90d bank bills (%)	1.88	1.88 - 1.92
NZ 2yr swap (%)	2.00	1.96 - 2.04
NZ 5yr swap (%)	2.33	2.27 - 2.39
NZ 10yr swap (%)	2.84	2.79 - 2.90
2s10s swap curve (bps)	85	83 - 85
NZ 10yr swap-govt (bps)	29	25 - 30
NZ 10yr govt (%)	2.55	2.51 - 2.61
US 10yr govt (%)	3.00	2.83 - 3.00
NZ-US 10yr (bps)	-44	-44 - -24
NZ-AU 2yr swap (bps)	-3	-5 - 2
NZ-AU 10yr govt (bps)	-5	-6 - 6

*Indicative range over last 3 weeks

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Foreign Exchange Markets

Reuters pg BNZWFWDS Bloomberg pg BNZ9

Last week the NZD traded in a tight 1-cent range between about 0.65-0.66, with the market remaining on tenterhooks as it awaited any news on President Trump's next move on Chinese import tariffs. A fresh low of 0.6501 was reached, but the currency closed the week near the middle of the range.

We are still none the wiser about Trump's next move, but there have been snippets of news on this front. Mid last week the US extended an invitation to China to resume US-China trade talks, but Chinese officials are reported likely to decline this offer if Trump goes ahead with further tariffs. Over the weekend the WSJ reported that Trump is expected to impose 10% import tariffs, rather than 25%, on $200b of Chinese goods early this week.

The net balance of this news is slightly NZD-positive. A lower tariff impost would reveal that Trump is sensitive to the negative implications of significant import tariffs that the public consultation highlighted. The fact that Trump is prepared to continue to negotiate with China on trade should also be taken positively.

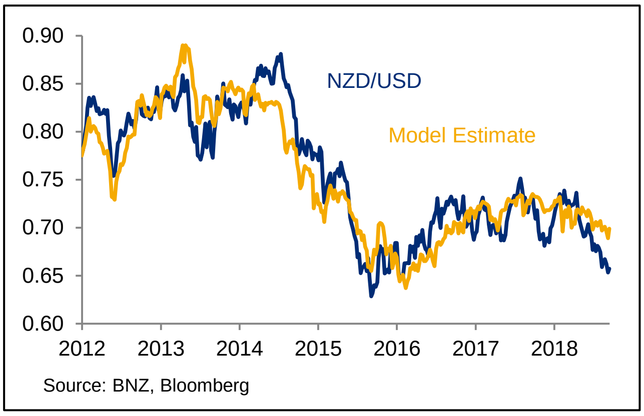
We'll be watching closely this week for any official announcement, but if it is true that tariffs of "only" 10% will be imposed then this would reduce the near-term threat that we previously saw of the NZD lurching down to fresh lows below 0.65.

Our short-term fair value model estimate sits just below 0.70, suggesting that the current "discount" for the NZD is around 6%. A discount of 5-6% has been in play for the past couple of months, reflecting negative sentiment for the NZD as the US-China trade war has been simmering and emerging market currencies have come under pressure.

This week on the economic calendar, the NZ Q2 GDP report on Thursday will be the local highlight. The consensus is picking growth of 0.8% q/q, higher than the RBNZ's pick of 0.5%. If that's the case it should allay some fears that the NZ economy is falling into a hole. Indeed, we think that special factors held down growth in Q2 so the current quarter (Q3) is looking even better. It would be a reminder that hard data are more important than "soft" indicators like business confidence which have recently weighed on NZD sentiment. Less focus on business sentiment and more focus on actual activity indicators would help close up the discount between the NZD and our fair value estimate.

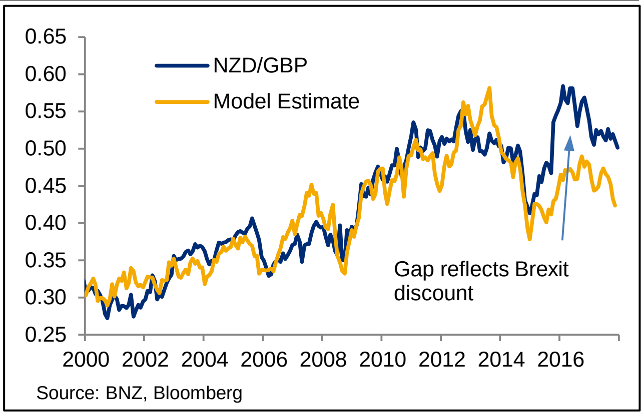
The global economic calendar is fairly light this week. The details of news on tariffs will be keenly awaited. Apart from that, headlines on Brexit negotiations will continue to influence GBP. NZD/GBP was down 1% last week as a more optimistic tone prevailed around Brexit, with the UK looking like moving closer to securing a Brexit deal with the EU. This supported GBP and with the market still heavily short-GBP further positive developments could easily see NZD/GBP weaken further. Hypothetically, our fair value NZD/GBP estimate, if not for Brexit, sits at 0.43!

NZD FV Declining, but Discount is Still Unusually Large



Source: BNZ, Bloomberg

If Not For Brexit, NZD/GBP Would Be Closer to 0.43



Source: BNZ, Bloomberg

Cross Rates and Model Estimates

	Current	Last 3-weeks range*
NZD/USD	0.6555	0.6500 - 0.6720
NZD/AUD	0.9160	0.9070 - 0.9210
NZD/GBP	0.5014	0.4990 - 0.5220
NZD/EUR	0.5638	0.5610 - 0.5750
NZD/JPY	73.44	72.30 - 75.10

*Indicative range over last 3 weeks, rounded figures

BNZ Short-term Fair Value Models

	Model Est.	Actual/FV
NZD/USD	0.6990	-6%
NZD/AUD	0.9050	1%

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Technicals

NZD/USD

Outlook: Downside risk

ST Resistance: 0.6720 (ahead of 0.6850)

ST Support: 0.6500 (ahead of 0.6400)

Over the last few months we've seen a period of lower lows, which continues to suggest ongoing downside risk for the NZD. Support last week came in 0.65. A break of that opens up 0.64.

NZD/AUD

Outlook: Trading range

ST Resistance: 0.9230 (ahead of 0.9400)

ST Support: 0.9050 (ahead of 0.8950)

Trading aimlessly over the past few weeks. Resistance sits just over 0.92. Beyond that level, there is little resistance ahead of 0.94.

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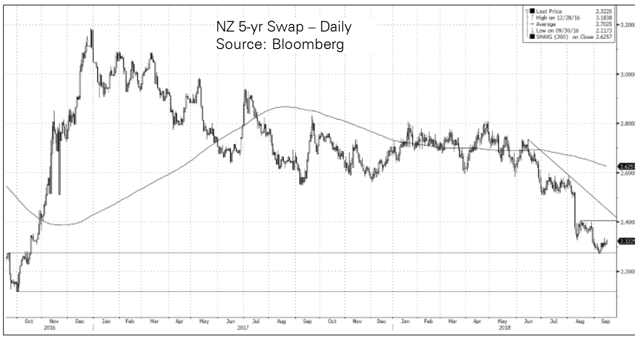
NZ 5-year Swap Rate

Outlook: Neutral

ST Resistance: 2.41

ST Support: 2.275

2.275 is now support. Trade a break of 2.41/2.275 on closing basis.



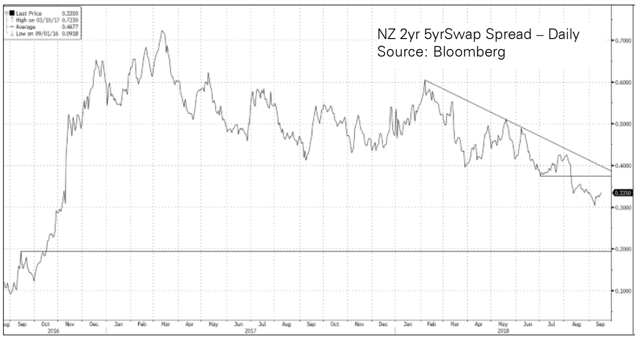
NZ 2-year - 5-year Swap Spread (yield curve)

Outlook: Flatter

ST Resistance: +37.5

ST Support: +20

Expect move to +20 target, stop on a move back through +37.5.



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Quarterly Forecasts

Forecasts as at 17 September 2018

Key Economic Forecasts

Quarterly % change unless otherwise specified — Forecasts (shaded)

	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
GDP (production s.a.)	0.8	0.9	0.6	0.6	0.5	0.6	0.8	0.9	0.5	0.7
Retail trade (real s.a.)	1.6	1.6	0.3	1.3	0.3	1.1	1.2	1.2	0.7	0.6
Current account (ytd, % GDP)	-2.6	-2.6	-2.5	-2.7	-2.8	-2.7	-3.2	-3.5	-3.5	-3.7
CPI (q/q)	1.0	0.0	0.5	0.1	0.5	0.4	0.8	0.5	0.6	0.4
Employment	1.1	-0.1	2.2	0.4	0.6	0.5	0.5	0.5	0.6	0.5
Unemployment rate %	4.9	4.8	4.6	4.5	4.4	4.5	4.4	4.3	4.2	4.2
Avg hourly earnings (ann %)	1.1	1.2	2.0	3.1	4.0	3.3	2.9	3.0	2.8	3.4
Trading partner GDP (ann %)	3.5	3.7	4.0	3.9	4.1	4.1	3.9	3.9	3.8	3.7
CPI (y/y)	2.2	1.7	1.9	1.6	1.1	1.5	1.8	2.2	2.3	2.3
GDP (production s.a., y/y))	3.0	2.8	2.6	2.9	2.7	2.4	2.6	2.9	2.9	3.0

Interest Rates

Historical data - qtr average Forecast data - end quarter	Cash	Government Stock 90 Day Bank Bills	5 Year	10 Year	Swaps 2 Year	5 Year	10 Year	US Rates Libor 3 month	US 10 yr	Spread NZ-US Ten year
2017 Jun	1.75	1.95	2.45	2.95	2.25	2.80	3.25	1.25	2.20	0.75
Sep	1.75	1.95	2.45	2.95	2.20	2.70	3.20	1.30	2.20	0.75
Dec	1.75	1.90	2.35	2.90	2.20	2.65	3.15	1.60	2.40	0.40
2018 Mar	1.75	1.90	2.40	2.95	2.20	2.70	3.20	2.20	2.85	0.10
Jun	1.75	2.00	2.35	2.90	2.25	2.70	3.15	2.35	2.90	-0.06
Forecasts										
Sep	1.75	1.95	2.15	2.75	2.00	2.45	3.05	2.40	3.10	-0.35
Dec	1.75	1.95	2.25	2.90	2.00	2.55	3.20	2.65	3.25	-0.35
2019 Mar	1.75	1.95	2.40	2.95	2.20	2.70	3.25	2.85	3.25	-0.30
Jun	1.75	2.05	2.60	3.20	2.40	2.70	3.25	3.20	3.50	-0.30
Sep	2.00	2.30	2.85	3.35	2.70	2.70	3.25	3.45	3.50	-0.15
Dec	2.25	2.55	3.05	3.50	3.00	2.90	3.50	3.45	3.50	0.00
2020 Mar	2.50	2.80	3.20	3.60	3.20	2.90	3.50	3.20	3.50	0.10
Jun	2.75	2.95	3.35	3.60	3.20	2.90	3.50	3.20	3.50	0.20
Sep	2.75	2.95	3.40	3.60	3.20	3.15	3.65	3.20	3.50	0.25

Exchange Rates (End Period)

USD Forecasts

	NZD/USD	AUD/USD	EUR/USD	GBP/USD	USD/JPY
Current	0.65	0.71	1.16	1.30	111
Sep-18	0.67	0.73	1.15	1.25	109
Dec-18	0.68	0.75	1.18	1.26	110
Mar-19	0.68	0.75	1.22	1.28	108
Jun-19	0.69	0.75	1.22	1.30	106
Sep-19	0.69	0.75	1.25	1.34	104
Dec-19	0.69	0.75	1.30	1.40	102
Mar-20	0.70	0.75	1.32	1.43	100
Jun-20	0.69	0.74	1.34	1.46	99
Sep-20	0.68	0.74	1.36	1.49	98
Dec-20	0.67	0.73	1.38	1.52	98

NZD Forecasts

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	TWI-17
Current	0.65	0.92	0.56	0.50	72.5	71.3
Sep-18	0.67	0.92	0.58	0.54	73.0	72.6
Dec-18	0.68	0.91	0.58	0.54	74.8	72.9
Mar-19	0.68	0.91	0.56	0.53	73.4	72.1
Jun-19	0.69	0.92	0.57	0.53	73.1	72.6
Sep-19	0.69	0.92	0.55	0.52	71.8	71.9
Dec-19	0.69	0.92	0.53	0.49	70.4	71.3
Mar-20	0.70	0.93	0.53	0.49	70.0	71.9
Jun-20	0.69	0.93	0.52	0.47	68.3	70.9
Sep-20	0.68	0.92	0.50	0.46	66.6	69.6
Dec-20	0.67	0.92	0.49	0.44	65.7	68.7
TWI Weights	14.0%	20.7%	10.3%	4.8%	6.8%	

Source for all tables: Statistics NZ, Bloomberg, Reuters, RBNZ, BNZ

Annual Forecasts

Forecasts as at 17 September 2018	March Years					December Years				
	Actuals		Forecasts			Actuals		Forecasts		
	2017	2018	2019	2020	2021	2016	2017	2018	2019	2020
GDP - annual average % change										
Private Consumption	5.5	3.8	2.9	2.3	1.7	5.1	4.4	2.8	2.6	1.8
Government Consumption	1.9	4.9	2.1	1.8	1.7	1.6	4.6	2.7	1.8	1.7
Total Investment	5.6	3.9	4.6	3.7	3.8	6.4	3.5	4.6	4.1	3.6
Stocks - ppts cont'n to growth	-0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.3	-0.1	0.0
GNE	4.8	4.0	3.4	2.6	2.2	4.7	4.2	3.7	2.7	2.2
Exports	0.7	3.9	3.7	4.4	3.8	1.6	2.3	3.4	4.8	3.9
Imports	5.1	7.0	5.5	3.2	2.5	3.4	6.7	6.5	3.6	2.4
Real Expenditure GDP	3.6	3.1	2.7	2.9	2.6	4.1	3.0	2.7	3.0	2.7
GDP (production)	**3.7**	**2.7**	**2.7**	**2.9**	**2.6**	**4.0**	**2.8**	**2.6**	**2.9**	**2.7**
GDP - annual % change (q/q)	*3.0*	*2.7*	*2.9*	*2.8*	*2.4*	*3.4*	*2.9*	*2.9*	*2.8*	*2.5*
Output Gap (ann avg, % dev)	1.0	0.6	0.4	0.4	0.2	1.1	0.7	0.4	0.4	0.3
Household Savings (% disp. income)	-2.8	-1.8	-3.4	-3.5	-2.6					
Nominal Expenditure GDP - $bn	270.3	286.4	299.0	315.4	327.9	266.1	283.4	294.9	311.6	325.1
Prices and Employment - annual % change										
CPI	2.2	1.1	2.3	2.2	2.1	1.3	1.6	2.2	2.0	2.1
Employment	5.7	3.1	2.1	1.6	1.6	5.8	3.7	2.1	1.9	1.6
Unemployment Rate %	4.9	4.4	4.2	4.3	4.2	5.3	4.5	4.3	4.2	4.2
Wages - ahote	1.1	4.0	2.8	3.9	3.4	1.1	3.1	3.0	3.8	3.6
Productivity (ann av %)	-1.9	-0.8	-0.3	1.0	1.0	-0.8	-1.4	-0.6	0.7	1.1
Unit Labour Costs (ann av %)	3.8	3.9	3.8	2.6	2.4	2.7	4.0	4.3	2.8	2.4
External Balance										
Current Account - $bn	-7.2	-7.9	-10.4	-11.4	-13.2	-6.0	-7.7	-10.2	-12.0	-12.5
Current Account - % of GDP	-2.6	-2.8	-3.5	-3.6	-4.0	-2.2	-2.7	-3.5	-3.8	-3.8
Government Accounts - June Yr, % of GDP										
OBEGAL (core operating balance)	1.5	1.2	1.0	1.5	1.5					
Net Core Crown Debt (excl NZS Fund Assets)	21.7	20.8	20.6	19.7	18.3					
Bond Programme - $bn	8.0	8.0	8.0	9.0	9.0					
Bond Programme - % of GDP	3.0	2.8	2.7	2.9	2.7					
Financial Variables [1]										
NZD/USD	0.70	0.73	0.68	0.70	0.68	0.70	0.70	0.68	0.69	0.67
USD/JPY	113	106	108	100	98	116	113	110	102	98
EUR/USD	1.07	1.23	1.22	1.32	1.38	1.05	1.18	1.18	1.30	1.38
NZD/AUD	0.92	0.94	0.91	0.93	0.92	0.96	0.91	0.91	0.92	0.92
NZD/GBP	0.57	0.52	0.53	0.49	0.44	0.56	0.52	0.54	0.49	0.44
NZD/EUR	0.66	0.59	0.56	0.53	0.49	0.67	0.59	0.58	0.53	0.49
NZD/YEN	79.1	77.0	73.4	70.0	65.7	81.6	78.7	74.8	70.4	65.7
TWI	76.5	74.8	72.1	71.9	69.4	78.1	73.6	72.9	71.3	68.7
Overnight Cash Rate (end qtr)	1.75	1.75	1.75	2.50	2.75	1.75	1.75	1.75	2.25	2.75
90-day Bank Bill Rate	1.98	1.93	1.95	2.78	2.87	2.02	1.88	1.95	2.53	2.95
5-year Govt Bond	2.70	2.35	2.40	3.20	3.45	2.75	2.30	2.25	3.05	3.40
10-year Govt Bond	3.25	2.95	2.95	3.60	3.85	3.30	2.80	2.90	3.50	3.80
2-year Swap	2.30	2.25	2.20	3.20	3.40	2.40	2.20	2.00	3.00	3.40
5-year Swap	3.00	2.70	2.70	3.50	3.75	3.00	2.65	2.55	3.35	3.70
US 10-year Bonds	2.50	2.85	3.25	3.50	3.50	2.50	2.40	3.25	3.50	3.50
NZ-US 10-year Spread	0.75	0.10	-0.30	0.10	0.35	0.80	0.40	-0.35	0.00	0.30

[1] *Average for the last month in the quarter*

Source for all tables: Statistics NZ, EcoWin, Bloomberg, Reuters, RBNZ, NZ Treasury, BNZ

Key Upcoming Events

	Forecast	Median	Last
Monday 17 September			
NZ, BNZ PSI (Services), August			55.1
Euro, CPI, August y/y 2nd est		+2.0%	+2.1%P
US, Empire Manufacturing, September		+23.0	+25.6
Tuesday 18 September			
Aus, House Prices, Q2 y/y		-0.7%	+2.0%
Aus, RBA Minutes, 4 Sep Meeting			
US, NAHB Housing Index, September		66	67
Wednesday 19 September			
NZ, Balance of Payments, Q2	-2.7%	-2.9%	-2.8%
NZ, WMM Consumer Confidence, Q3			108.6
NZ, Dairy Auction, GDT Price Index	-2.0%		-0.7%
Aus, RBA's Kent Speaks, Money Creation			
Jpn, Merchandise Trade Balance, August		-¥483b	-¥231b
Jpn, BOJ Policy Announcement, Policy Rate		-0.1%	-0.1%
UK, CPI, August y/y		+2.4%	+2.5%
US, Current Account, Q2 s.a.		-$103.3b	-$124.1b
US, Housing Starts, August		1,235	1,168k

	Forecast	Median	Last
Thursday 20 September			
NZ, GDP, Q2	+0.6%	+0.8%	+0.5%
Euro, Consumer Confidence, Sept 1st est		-2.0	-1.9
UK, Retail Sales vol., August		-0.2%	+0.7%
US, Existing Home Sales, August		5.38m	5.34m
US, Leading Indicator, August		+0.5%	+0.6%
US, Philly Fed Index, September		+15.8	+11.9
US, Jobless Claims, week ended 15/09		210k	204k
Friday 21 September			
NZ, External Migration, August s.a.			+4,720
NZ, Credit Card Billings, August			-1.1%
Jpn, CPI, August y/y		+1.1%	+0.9%
Jpn, All Industry Index, July		+0.1%	-0.8%
Euro, PMI Manufacturing, Sep 1st est		54.5	54.6
Euro, PMI Services, September 1st est		54.4	54.4
US, Markit PMI, September 1st est		55.0	54.7
US, Markit PSI, September 1st est		55.0	54.8

Historical Data

	Today	Week ago	Month Ago	Year Ago
CASH & BANK BILLS				
Call	1.75	1.75	1.75	1.75
1mth	1.82	1.83	1.79	1.84
2mth	1.85	1.86	1.84	1.88
3mth	1.89	1.92	1.91	1.94
6mth	1.95	1.95	1.95	1.99
GOVERNMENT STOCK				
03/19	1.71	1.71	1.74	1.94
04/20	1.64	1.63	1.69	2.10
05/21	1.67	1.67	1.75	2.24
04/23	1.89	1.89	1.96	2.57
04/25	2.15	2.17	2.23	2.85
04/27	2.37	2.37	2.41	3.00
04/29	2.55	2.55	2.57	
04/33	2.73	2.73	2.74	3.35
04/37	2.88	2.88	2.89	3.58
GLOBAL CREDIT INDICES (ITRXX)				
Australia 5Y	70	73	74	
Nth America 5Y	56	58	61	56
Europe 5Y	60	61	71	50

	Today	Week ago	Month Ago	Year Ago
SWAP RATES				
2 years	2.00	1.98	2.04	2.23
3 years	2.09	2.07	2.14	2.41
4 years	2.20	2.18	2.26	2.58
5 years	2.33	2.31	2.39	2.73
10 years	2.84	2.83	2.88	3.24
FOREIGN EXCHANGE				
NZD/USD	0.6552	0.6526	0.6641	0.7263
NZD/AUD	0.9159	0.9173	0.9057	0.9123
NZD/JPY	73.41	72.52	73.09	81.01
NZD/EUR	0.5636	0.5628	0.5786	0.6076
NZD/GBP	0.5012	0.5009	0.5192	0.5384
NZD/CAD	0.8541	0.8590	0.8662	0.8929
TWI	71.5	71.5	72.0	76.1

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