19 June 2017

Steady As She Goes

- RBNZ to reiterate steadiness at OCR review
- As positives and negatives weighed
- Our Feb-hike call looking too soon?
- Even with OCR presently half its neutral level?
- PSI/PMI each signal above-trend growth

We expect that the Reserve Bank will stick with its steady-as-she-goes tone at Thursday's OCR review, while leaving its cash rate at a record low of 1.75%. To be sure, there has been some key news that the 11 May Monetary Policy Statement (MPS) hadn't figured on. But the ups and the downs are probably offsetting in respect to OCR baselines.

Real Q1 GDP growth of 0.5%, for instance, clearly undershot the Reserve Bank's expectation of 0.9%. The Bank has demonstrated sensitivity to shortfalls in recent historical GDP outturns, in the way they translate into "output gap" judgements. The trade-weighted exchange rate (TWI), meanwhile, has been tracking a few per cent higher than the May MPS assumed. And the Bank has often expressed concern about the currency's supposed overvaluation. International oil prices have continued to wobble their way lower, which will take the edge off near-term headline CPI outcomes.

There have also been marginal increases in retail interest rates over the last month or two to note, although, with respect to mortgages, more for floating rates than the fixed-term rates that are by far the more popular these days.

Pushing the other way, the late-May Budget made official a weighty fiscal stimulus in prospect, and the terms-of-trade are probing new long-term highs. These have been big deals for us, certainly. The Budget, in particular, was instrumental in the upgrades we've recently put through our macro-economic forecasts. We now forecast GDP growth of 3.1% for calendar 2018 and 2.4% for 2019. Pre-Budget these were 2.5% and 1.8% respectively. We also note that the commodity income tailwind is coming from much more than the dairy industry now – which in total is probably at least as much as the Reserve Bank was thinking for its May MPS.

And as much as the local growth indicators are upbeat, in general, so are the global indicators still improving, overall. With this, we think it's fair to say that central banks are continuing to be subject to a rising tide, budging them along the dove-hawk spectrum.

Last week's Bank of Canada rhetoric toward a tightening bias was a good example. However, we also saw more voters for rate increases at the last Bank of England meeting, the ECB ruling out its long-held rate cut optionality (and with some internal dissent in the direction of exit strategy), and the US Federal Reserve carrying on with the early days of policy normalisation. Thoughts about further easing from the RBA, meanwhile, have faded, as Australia's economic data have held up, and have been robust regarding its labour market.

But with the RBNZ probably seeing reason to stick with its May MPS reserve this week, the focal point for whether the Bank might move to a clear (and nearer) tightening bias, or not, practically shifts to the August MPS. But that event is still a ways away.

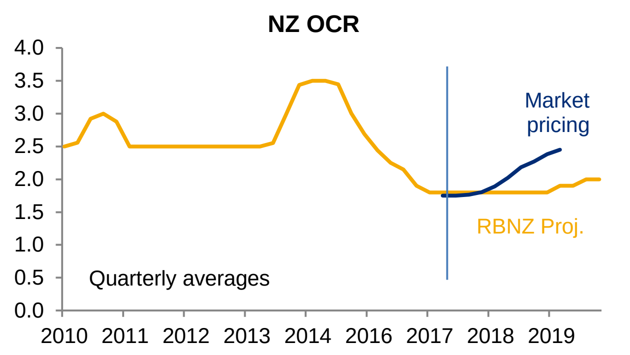
Market pricing on the OCR, meanwhile, still sees the next move as a hike, although this has drifted out to August 2018. Even so, this is well before the Bank's signalled first rate hike (while the Bank also emphasised, at the time of its May MPS, an equal chance of a rate cut as a hike, as its next move).

Of course, it wasn't too many months ago that the market was champing for a first rate hike before the end of this year, based on the data it was seeing and assessing. We always thought that was too soon, given the mind-set the Reserve Bank appeared to be in. And so market pricing has drifted well into calendar 2018 with its first hike.

Still, we brought forward our rate hike call into February 2018 (from May 2018) in our preview of the May MPS. This was in the belief, broadly shared by the market, that the Bank would probably signal a rate hike for not as far ahead as previously. In the event, the Bank held its line.

With this, and the data-flow, we are still monitoring the case for shifting our rate hike call back out, but have not made any decisions on this as yet.

Differing Views, Still



Source: BNZ, Bloomberg

The other context to Thursday's OCR review is not so much the marginal news since the last RBNZ meeting, but where interest rates are currently positioned relative to the state of the economy. We are still struggling to reconcile the fact we have policy interest rates down at levels that are normally seen in, or reserved for, times of recession, when we are seeing still-positive growth indicators, increasing signs of a lack of supply, and annual CPI inflation back up well within the 1.0 to 3.0% band.

In this vein, the RBNZ published a very useful economic review article last week, which included the Bank's estimates of the neutral nominal Official Cash Rate. To be sure, these were nothing new. But they did highlight a wide range of estimates, and a central tendency that had continued its long drift lower, now appearing closer to 3.50%, than 4.00% a year or two ago. While we can believe this, it also infers the present OCR, of 1.75%, is half its neutral level.

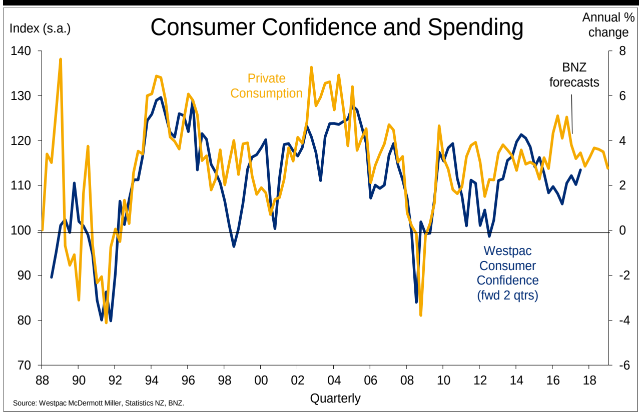
With respect to the coming week's NZ data, it has begun with this morning's Westpac McDermott Miller (WMM) consumer confidence report for the June quarter. In increasing to 113.4, from 111.9 in March, it nudged further above its long-term average of 108.0. We judge a seasonally adjusted outcome of 113.5, from 110.2.

Interestingly, the current conditions component eased to 110.5, from 111.2, amid some sign from the survey of spending restraint, especially in Auckland (according to Westpac). However, expectations, overall, improved to 115.4, from 112.4. Westpac also noted the fall in the proportion intending to use a $10,000 windfall to pay down debt – continuing a downward trend.

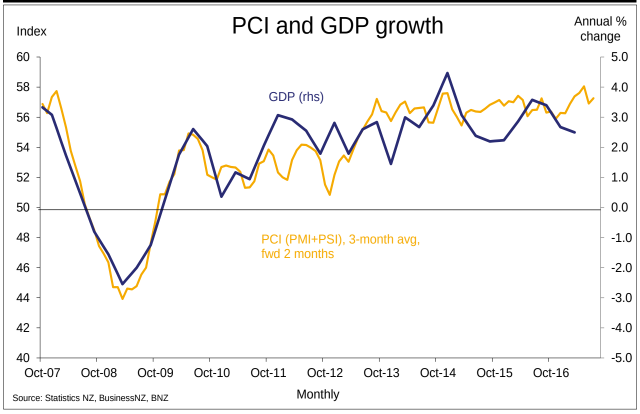
Also note that this WMM measure of consumer confidence has far under-predicted household consumption expenditure of late (5% at a real annual rate).

As for this morning's Performance of Services Index (PSI) it turned out it had a bungee cord tied firmly around its ankles. Having dropped precipitously to 53.2 in April, it bounced all the way back up to 58.8 in May. This down-and-up pattern was expressed in all the principle components – aside from employment, which simply cruised along above its long-term average. The latter was

Positive Messages



Pressing On



one of the many reasons we judged the dip in the broader PSI during April to be noise rather than signal. Nonetheless, we were relieved to see the PSI return with such a vengeance in May. We'll take a (seasonally adjusted) result of 58.8 any day of the week.

As such, May's PSI joins the PMI (58.5) in being clearly above average. This gives us confidence that GDP growth will strengthen as much as we think it will in Q2, following the slowdown we expected, and got, for Q1.

Tuesday delivers the ANZ Roy Morgan read on consumer confidence. For the month of June this will be a cross-check on today's WMM index. Just note that the ANZ-RM index tends to out-perform the WMM measure in the good times and closes the gaps on the down legs.

The latest dairy auction is scheduled to take place in the very early hours of Wednesday morning. The balance of indicators suggests little change in the GDT Price Index at this event following six consecutive gains.

By the time we get Thursday's International Travel and Migration data for May, namely 10:45am, any revelations from that morning's OCR review will have hopefully been absorbed by the market. While the net inflow of migrants to New Zealand looks to be peaking, it's doing so at a record high level, and with scant sign of imminent abatement. But we'll continue to watch for any cracks beginning to appear.

With respect to short-term arrivals, their 22% jump in April, from a year prior, reflected holiday timings and the hordes for the Masters Games. Still, we don't expect May's numbers to fall on their face. Indeed, we estimate them to post annual percentage growth in the high single digits, as a sense of underlying growth in short-term visitor arrivals. May's credit card billings are also lined up for release Thursday (3:00pm).

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Global Watch

- Very quiet data week
- Focus on post-FOMC Fed speakers
- RBA and BoJ minutes, speakers to note
- EU and Japan PMIs due Friday

Australia

RBA Governor Lowe speaks on a panel Monday, followed Tuesday by the RBA Minutes. Data-wise a quiet week with only ABS Q1 House Prices out on Wednesday.

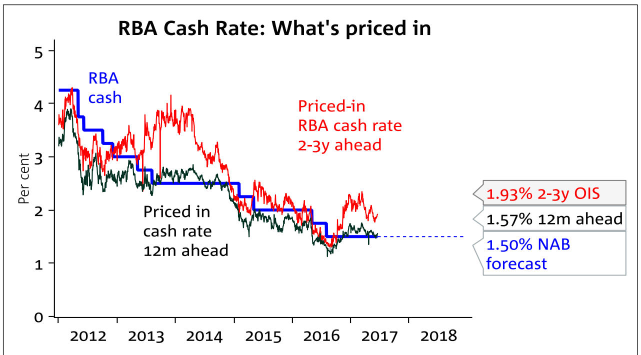
The Statistician's measure of Q1 House Prices is now largely outdated by the much more up to date CoreLogic data where prices data is already available for mid-June.

The highlight is likely to be remarks by RBA Governor Lowe at a Leadership Forum event in Canberra on Monday (9.45am AEST). The Conference program has titled the session as *State of the economy: global and national*, covering an array of big economic issues.

What will drive global economic trends and shape growth over the next few years? What contribution will the US, China and the rest of Asia make? How will Brexit affect Europe's growth? What are the options for monetary policy? What are the implications of these trends for Australian businesses and for the Australian budget?

The RBA Minutes of this month's meeting are also released on Tuesday. That Board meeting produced another "no change" decision on the cash rate as the RBA weighs up an economy still growing within its potential against lingering growth concerns over the housing market. NAB continues to expect the cash rate to remain on hold for the foreseeable future.

Chart 1: RBA Expected To Remain On Hold



Source: National Australia Bank, Macrobond
OIS is Overnight Indexed Swaps, where the interest payment is compounded from the (overnight/daily) central bank rate

China

The May Property prices report due Monday is the pick in a quiet week. There are two key events to follow for China watchers with the Beijing Community Party Congress on Monday possibly containing hints about the National Party Congress due later in the Autumn. Also, the People's Bank of China is hosting the Lujiazui Shanghai financial industry event on Tuesday-Wednesday with key central bank-regulatory officials discussing China financial reform.

US

An absence of top tier data will increase the focus on several post-FOMC speakers. These include the NY Fed's Bill Dudley on Monday, voter Charles Evans on Tuesday, and key Fed Governor Fischer speaking in Amsterdam on Tuesday, though this event is closed to the press. Another event to watch might be Treasury Secretary Mnuchin delivering a welcome address at an Investment Summit in Washington on Tuesday. Another is Part I of the Fed's annual bank stress tests, set for release Thursday. Existing Home Sales (Wednesday) and New Home Sales (Friday) the data picks with weekly Jobless Claims (Thursday).

Japan

Central bank focus with the April BoJ Minutes (Wednesday), Governor Kuroda speaking that afternoon too. Deputy Governor Iwata is speaking on Thursday. The main data points are Monday's Trade and Friday's Nikkei Manufacturing PMI.

Eurozone

The key data comes on Friday with the Preliminary PMIs for June. EU leaders meet Thursday.

UK

Continued focus on forming Government the main interest in a light data week.

Canada

The main interest for Canadian economy watchers comes later in the week with the release of Retail Sales on Thursday and CPI on Friday. Oil continues as the major focus for the Canadian dollar.

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Fixed Interest Market

Reuters: BNZL, BNZM Bloomberg:BNZ

After the RBNZ's surprisingly dovish May MPS we thought that the 2-year swap rate range over subsequent months would head down to 2.15-2.25%. That has been the case so far, and as we await the June OCR Review due this Thursday, we are close to the mid-point of that range.

The OCR Review is expected to pass with little market reaction. Current pricing suggests that while the market sees the balance of risk skewed towards the next move being a hike rather than an easing, the first full rate hike isn't priced until August 2018, some distance away.

Since the Bank's May MPS, the NZ TWI is some 3% higher and oil prices are more than 5% lower. Q1 GDP data released last week undershot the RBNZ's forecast of 0.9% q/q. On a more positive note for inflationary pressure, the Budget offered a range of stimulatory policies, and NZ's terms of trade are running hot. These data will see some minor tweaks here and there but importantly, the Bank's final paragraph on the policy outlook is expected to remain unchanged, with monetary policy likely to "remain accommodative for a considerable period". Such commentary shouldn't stir the market and we'd be surprised if short rates moved by more than 1-2bps following the release.

With NZ's short end rates firmly anchored by unchanged monetary policy expectations, the yield curve is being driven by US forces. The run of disappointing US economic data continues, with last week's soft CPI data raising a big question mark over the outlook for Fed policy. While the Fed didn't waver from delivering a fourth rate hike this cycle and kept its economic and rate projections little changed (4 more rate hikes through to the end of next year), we probably need to see a rebound in inflation before the Fed moves again.

The market is sceptical of inflation picking up and the Fed delivering on further rate hikes, reflected in a flat US curve through to 2-years and traders happy to add to net-long positions in US 10-year futures, which sit at their longest level in ten years. This makes the market vulnerable to positive US data surprises. We think that further downside in US long bond rates will be much harder to come by from here, and we expect higher rates in the second half of the year.

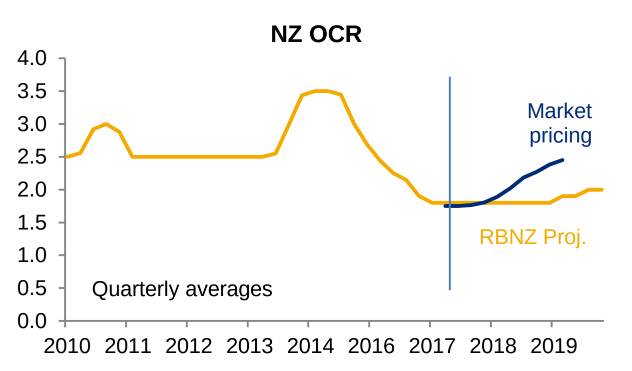
The Fed outlined more information regarding its plans for balance sheet normalisation. This process could well commence as soon as September, beginning with not reinvesting $10bn of maturing assets ($6bn of Treasuries and $4bn of MBS). Initially, any impact on US Treasuries should be imperceptible, but once the programme ramps up to $50bn per month a year into the process, the upside risk to UST rates from this balance sheet reduction policy should be clearer.

Also of note, last week saw a more hawkish vibe from other central banks as well, with the Bank of England showing a 5-3 split committee, with 3 members voting in favour of a hike. The Governor and Deputy Governor of the Bank of Canada indicated a bias to tighten policy. And while the BoJ dodged the question, it was clear that it has scaled back its JGB purchases considerably since its yield curve control policy came into effect. The so-called annual ¥80 trillion asset purchase target is now only a theoretical possibility, with the run-rate nearer ¥30 trillion over recent months.

These developments suggest we're at a major turning point in global central bank policy. The days of keeping global policy rates as close as practical to zero for many central banks are drawing to a close. Rates will remain low for an extended period, but the flags are being raised.

The coming week should see tight ranges, with a sparse global economic calendar and only a handful of Fed speakers providing much interest.

Rates on Hold For Some Time, Before Tightening



Source: BNZ, Bloomberg

Current Rates/Spreads and Recent Ranges

	Current	Last 3-weeks range*
NZ 90d bank bills (%)	1.94	1.93 - 1.97
NZ 2yr swap (%)	2.20	2.16 - 2.24
NZ 5yr swap (%)	2.68	2.64 - 2.74
NZ 10yr swap (%)	3.15	3.10 - 3.23
2s10s swap curve (bps)	96	94 - 99
NZ 10yr swap-govt (bps)	39	38 - 45
NZ 10yr govt (%)	2.76	2.68 - 2.83
US 10yr govt (%)	2.15	2.10 - 2.25
NZ-US 10yr (bps)	61	53 - 61
NZ-AU 2yr swap (bps)	37	34 - 50
NZ-AU 10yr govt (bps)	36	32 - 43

*Indicative range over last 3 weeks

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Foreign Exchange Markets

Reuters pg BNZWFWDS Bloomberg pg BNZ9

Soft economic data continue to weigh on the USD. The CPI came in weaker than expected for the third consecutive month, with annual core inflation down to a two-year low of 1.7%. The Fed got its fourth rate hike this cycle out of the way, but we probably need to see a bounce back in inflation before the Fed moves again. We expect that to occur before the end of the year, leaving the Fed on track to hike again in either September or December.

The precipitous fall in the economic surprise indicator over recent months highlights how one-sided the dataflow has been in the US. We don't think this trend will continue, with financial conditions actually easier than when the Fed began the tightening cycle, so we see some support for growth (and inflation). A turnaround in the dataflow would help reignite the USD.

The soft USD sees NZD/USD up around 0.7250, close to an area of technical resistance. We think upside from here will be much harder to come by. That said, it's hard to get bearish when our fair value model estimate still has a 0.75 handle, supported by high risk appetite and (still) rising NZ commodity prices. We expect a consolidation phase to ensue over the coming month.

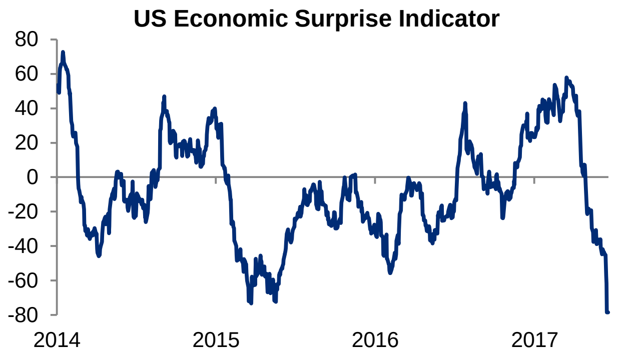
Strong terms of trade have also supported the NZD on the crosses. We aren't expecting much in the way of further gains this year. NZD/AUD is expected to hover around the 0.95 mark, plus or minus a cent or two. We still like EUR on the back of evolving ECB language towards less monetary accommodation as the year progresses, meaning downside potential for NZD/EUR. The weak GBP already reflects the poor outlook for the UK. And we expect NZD/JPY to largely range trade from here.

We don't expect much currency action this week, with a sparse global calendar. Locally, we have the RBNZ OCR review, a GDT dairy auction and smattering of second-tier economic releases. In the US a few Fed speakers hit the circuit, while the few economic releases are unlikely to be market moving. Europe sees the release of provisional PMI data for June.

The RBNZ's OCR Review is expected to pass with little fanfare. The market currently respects the Bank's view that policy will be on hold for a considerable period. Indeed, current market pricing suggests that the first rate hike is not fully priced until August 2018, more than a year away.

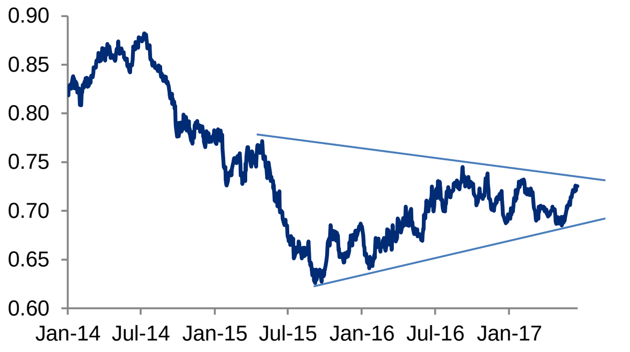
Since the Bank's May MPS, the NZ TWI is some 3% higher and oil prices are more than 5% lower. Q1 GDP data released last week undershot the RBNZ's forecast of 0.9% q/q. On a more positive note for inflationary pressure, the Budget offered a range of stimulatory policies, and NZ's terms of trade are running hot. These data will see some minor tweaks here and there but importantly, the Bank's final paragraph on the policy outlook is expected to remain unchanged, with monetary policy likely to "remain accommodative for a considerable period". Such commentary shouldn't stir the market.

US Economic Data Surprising Heavily to the Downside



Source: BNZ, Bloomberg

NZD Near Technical Resistance



Source: BNZ, Bloomberg

Cross Rates and Model Estimates

	Current	Last 3-weeks range*
NZD/USD	0.7254	0.7060 - 0.7320
NZD/AUD	0.9517	0.9470 - 0.9620
NZD/GBP	0.5683	0.5470 - 0.5730
NZD/EUR	0.6473	0.6280 - 0.6490
NZD/JPY	80.45	78.00 - 80.60

*Indicative range over last 3 weeks, rounded figures

BNZ Short-term Fair Value Models

	Model Est.	Actual/FV
NZD/USD	0.7550	-4%
NZD/AUD	0.9420	1%

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Technicals

NZD/USD

Outlook:	Downward channel
ST Resistance:	0.7260 (ahead of 0.7350)
ST Support:	0.7100 (ahead of 0.6970)

The NZD has edged up further and is trading close to technical resistance around 0.7260. The bigger picture remains of a downward channel from September, with a series of lower highs from that point on, so resistance levels become stronger the higher the NZD nudges up. The first area of support cuts in around the 200-day moving average of 0.7100, while stronger support cuts in closer to the 0.6970 mark.

NZD/AUD

Outlook:	Trading range
ST Resistance:	0.9600 (ahead of 0.9650)
ST Support:	0.9400 (ahead of 0.9270)

The 0.96-0.9650 zone represents an area of strong technical resistance , a level it has rarely breached over the past couple of years. Given the recent strong run, support levels are well south of current spot.

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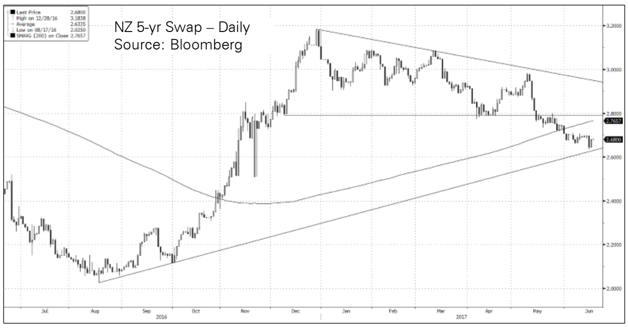
NZ 5-year Swap Rate

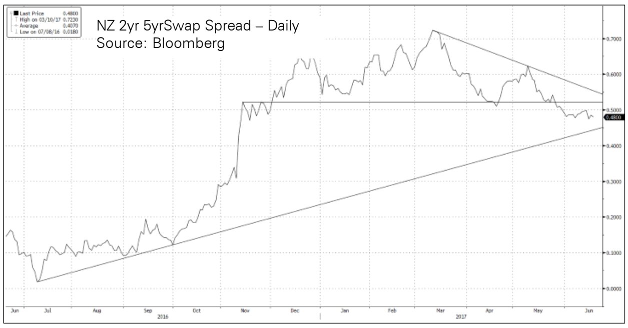
Outlook:	Lower
ST Resistance:	2.795
ST Support:	2.635



Break through 200 day moving average signals a move to trendline support coming in at 2.635 now.

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

Outlook:	Flatter
ST Resistance:	+56.5
ST Support:	+45



Still expect to move to trendline support that comes in now at +45.

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Key Upcoming Events

	Forecast	Median	Last
Monday 19 June			
NZ, WMM Consumer Confidence, Q2			111.9
NZ, BNZ PSI (Services), May			52.8
Aus, Lowe Speaks, Panel Discussant			
China, Property Prices, May			
Jpn, Merchandise Trade Balance, May		+Y43b	+Y482b
US, Fed's Dudley/Evans Speak			
Tuesday 20 June			
NZ, ANZ-RM Consumer Confidence, June			123.9
Aus, House Prices, Q1 y/y	+9.5%	+8.9%	+7.7%
Aus, RBA Minutes, 6 June Meeting			
China, Leading Index (Conference Bd), May			+1.2%
Germ, PPI, May y/y		+2.9%	+3.4%
US, Fed's Fischer/Rosengren Speak,			
US, Current Account, Q1 s.a.		-$123.6b	-$112.4b
Wednesday 21 June			
NZ, Dairy Auction, GDT Price Index			+0.6%
Aus, Westpac Leading Index, May			-0.12%
Jpn, BOJ Minutes, 26/27 Apr Meeting			
Jpn, All Industry Index, April		+1.6%	-0.6%
US, Existing Home Sales, May		5.55m	5.57m

	Forecast	Median	Last
Thursday 22 June			
NZ, RBNZ OCR Review	1.75%	1.75%	1.75%
NZ, External Migration, May s.a.			+5,780
NZ, Credit Card Billings, May			+0.9%
Euro, Consumer Confidence, June 1st est		-3.0	-3.3
Euro, ECB Economic Bulletin			
UK, CBI Industrial Trends, June		+7	+9
US, Fed's Powell Speaks, Senate Committee			
US, Leading Indicator, May		+0.4%	+0.3%
Friday 23 June			
Euro, PMI Services, June 1st est		56.1	56.3
Euro, PMI Manufacturing, June 1st est		56.8	57.0
US, Fed's Mester Speaks			
US, Markit PMI, June 1st est		52.9	52.7
US, New Home Sales, May		591k	569k
US, Markit PSI, June 1st est		53.5	53.6
Monday 26 June			
Jpn, BOJ Summary of Latest Meeting, 15/16 June Meeting			
Germ, IFO Index, June			114.6
US, Chicago Fed Nat Activity Index, May			+0.49
US, Durables Orders, May 1st est			-0.8%

Historical Data

	Today	Week Ago	Month Ago	Year Ago
CASH & BANK BILLS				
Call	1.75	1.75	1.75	2.25
1mth	1.84	1.85	1.87	2.29
2mth	1.89	1.89	1.93	2.34
3mth	1.93	1.94	1.99	2.40
6mth	1.98	1.99	2.01	2.39
GOVERNMENT STOCK				
12/17	1.81	1.80	1.81	2.10
03/19	1.94	1.94	1.94	2.08
04/20	2.10	2.09	2.15	2.10
05/21	2.19	2.18	2.32	2.11
04/23	2.46	2.45	2.61	2.17
04/25	2.67	2.65	2.83	2.37
04/27	2.77	2.76	2.93	2.51
04/33	3.08	3.06	3.23	2.80
GLOBAL CREDIT INDICES (ITRXX)				
AUD 5Y	83	85	82	127
N. AMERICA 5Y	62	60	63	79
EUROPE 5Y	57	59	63	78

	Today	Week Ago	Month Ago	Year Ago
SWAP RATES				
2 years	2.20	2.20	2.21	2.30
3 years	2.38	2.39	2.42	2.33
5 years	2.68	2.69	2.77	2.46
10 years	3.15	3.17	3.29	2.82
FOREIGN EXCHANGE				
NZD/USD	0.7255	0.7207	0.6868	0.7045
NZD/AUD	0.9518	0.9569	0.9296	0.9563
NZD/JPY	80.45	79.53	77.82	75.00
NZD/EUR	0.6476	0.6433	0.6285	0.6270
NZD/GBP	0.5680	0.5656	0.5328	0.4969
NZD/CAD	0.9585	0.9695	0.9417	0.9005
TWI	78.19	77.80	75.09	75.46

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