20 November 2017

Rewriting Economic History

- **Q3 retail sales likely to sport a hangover**
- **PSI (55.6) like PMI (57.2) robust to political flux**
- **Oct FPI leaves our Q4 CPI pick at 0.6% (2.1% y/y)**
- **Friday's migration figures to confirm further fall?**
- **We view Oct exports/imports bigger than market**
- **Annual accounts set to revise up GDP**

One of the challenges with economic analysis is that history is frequently being rewritten – and in its "facts" not just its interpretation. This is why relying on the recent data is never sufficient. One must also try to get a "sense" for what's going on.

New Zealand's retail trade is a case in point. When their June quarter results were first published, they registered a jump in volume of 2.0%, seasonally adjusted. This was subsequently toned down to an increase of 1.7%, as Statistics NZ rectified some component errors. Then the gain was revised back up, to 1.9%, as the statistical office pre-released a new back-series, to do with a new survey methodology it has moved to.

So what about September quarter retail trade? This is due for publication Thursday. The market's median expectation is for a 0.1% increase in volume. We expect a real drop of 1.0%. With this there is scope to think spending by NZ consumers has been severely rattled, perhaps with reference to the election and such things as weak turnover in the housing market.

But we would sniff at any weakness in Q3 retail volumes as largely a hangover, from turnover in Q2 over-egged by major sports events that New Zealand hosted. The Lions' rugby tour was principally in June and the World Masters Games took place during April. Q3 retail trade will also probably suffer a correction in auto sales, after their ongoing strength in Q2.

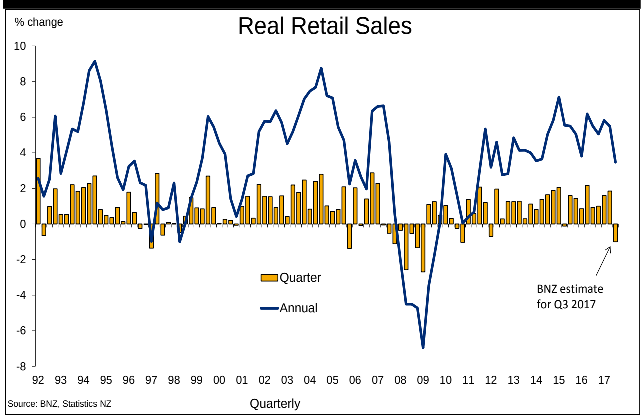
With this up and (likely) down in quarterly retail sales, it's a classic time for taking a step back, taking a breath, to get a sense of the trend in household spending. Doing this suggests there is still a lot of positivity at play.

Consumer confidence, for example, while off a bit in November, remains on the right side of average (according to last week's ANZ Roy Morgan index). While housing turnover is weak, prices remain relatively high (and rising again?), as last week's REINZ data showed. Net inward migration remains exceptionally high, albeit not as lofty as it was some months ago. Most pertinently, however, the labour market is pumping – with strong jobs growth and steady wage gains.

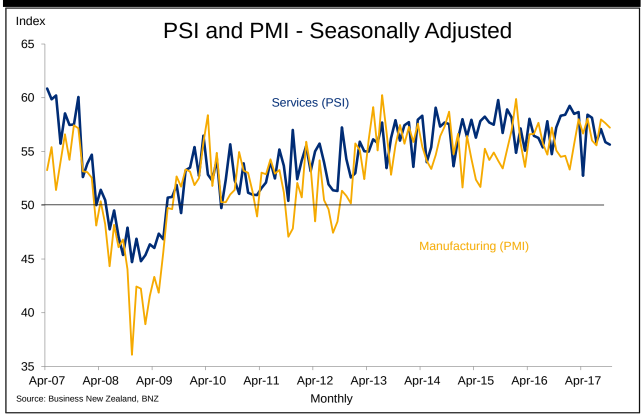
And why not, when the business sector still seems to be chugging forth quite well as well? Witness this morning's BNZ/Business NZ Performance of Services Index (PSI). In printing at 55.6 in October, from 55.9 in September, it proved relatively stout and unperturbed by the recent political flux – just like last week's PMI did, with its 57.2, from 57.6. These were an upbeat start for economic growth in the final quarter of 2017, after what could be a slow Q3 GDP.

Next up this morning we had October's Food Price Index. This fell 1.1%, after easing 0.2% in September. Far from being any genuine deflation, a fair chunk of the decline was seasonal – with some additional unwind from a spike in vegetable prices earlier in the year. Vegetable prices fell 10.2% compared to September. Seasonally adjusted the food price index eased 0.1% in October.

Don't Be Alarmed



Politically Charged



The overall actual 1.1% decline in food prices was very close to our -1.0% pick for the month so has no implications for our Q4 CPI estimate, which remains at +0.6% q/q and 2.1% y/y. This keeps hovering above the Reserve Bank's November MPS forecast, of +0.3% q/q and 1.8% y/y.

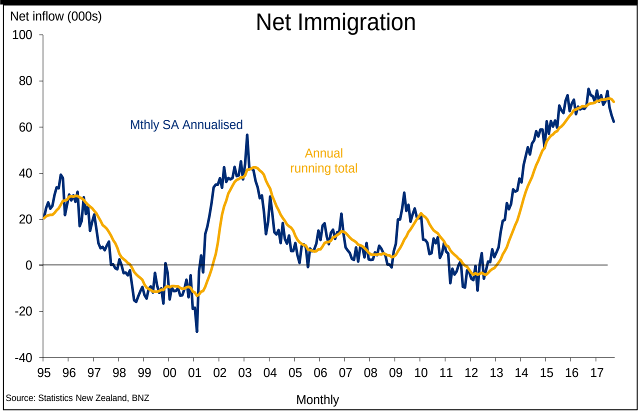
Wednesday's local news begins, in the very early hours, with the latest Global Dairy Trade auction. Current indicators suggest some ups and downs in the details with no clear direction overall. As things stand we think Fonterra remains under pressure with regard to its 2017/18 milk price forecast, currently $6.75. We forecast $6.30. Having said this, developing dry weather could yet support prices and the exchange rate has been abating for some months now.

Later on Wednesday we get to see if the recent moderation in net inward migration, from a peak in June, continued into the month of October. If so, we might effectively be half way to achieving the quantum drop the Labour party has been talking about, without any policy changes having been finalised. As for annual growth in short-term visitor numbers we anticipate October's lot to be similar to September's, namely +3%.

October's merchandise trade figures are due Friday. We anticipate strong annual growth in both exports (+12% y/y) and imports (+10% y/y). Our exports pick mainly reflects primary product prices still well in advance of a year ago, while solid domestic demand underpins imports along with expectations of another aircraft and strong oil imports. For both exports and imports we are a good chunk higher than the market anticipates.

However, we are very close to the market in terms of October's merchandise trade balance. We are looking for deficit of $799m (keeping the annual deficit broadly stable at around $2,910m). The market's expectation is for an October deficit of $760m.

Falling Already



The RBNZ series on new residential lending is also scheduled for Friday, in the afternoon. Perhaps the annual decline in these October figures, like for home sales, won't be as extreme as they were in previous months?

And for those with a deep interest in NZ data, note that the year-to-March 2017 National Accounts are due for publication Friday. To be sure, the market typically ignores these accounts. But note that they are likely to confirm non-trivial upward revisions to levels of GDP in relatively recent history, which might go on to influence thoughts on productivity and potential GDP growth (speed limits), amongst other things. A stronger view on recent NZ GDP history would certainly feel right to us.

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Global Watch

- **Very quiet data week**
- **Yellen, Draghi both speak on Tuesday**
- **RBA's Lowe also talks Tuesday**
- **UK Budget due Wednesday**

Australia
The RBA will again be under the market spotlight this week. Most interest will be in RBA Governor Lowe's speech on Tuesday night to the ABE's economists' forecasting dinner. This dinner was addressed last year by the AG (Economic) Chris Kent who spoke of the economy's transition across states. There's no title at the time of writing but the market would certainly be interested in his assessment of recent wages and inflation reports.

The head of the Bank's Financial Stability Department Jonathan Kearns is speaking at a China-Australia Property Forum while Financial Markets head Marion Kohler is addressing the Australian Securitization Forum, both on Monday morning. The RBA's Assistant Governor (Financial System) Michele Bullock is on a panel on Tuesday morning.

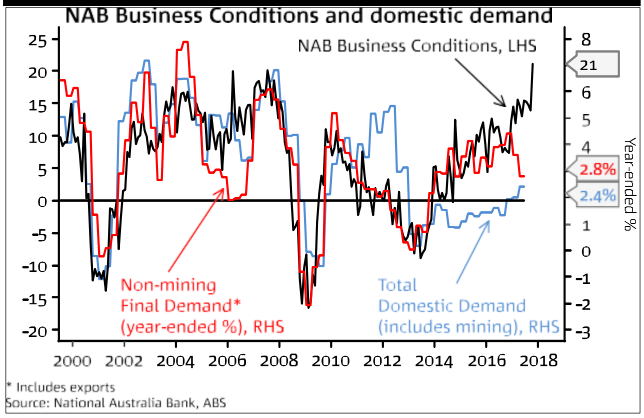
The main data interest will be in Wednesday's Construction Work Done. Last quarter's +9% reading was bloated by the technical inclusion of the Darwin Ichthys Central Processing Facility as "construction", though there was no net GDP impact given it was imported.

The Prelude FLNG platform arrived in Australian waters in July while the Ichthys' Floating Production, Storage and Offloading (FPSO) facility arrived in August.

We expect therefore to see that Q3's estimate was similarly bloated with a headline rise of 14% (though again there will be no impact to GDP from these imports). We will be paying close attention to the LNG-unrelated residential and non-residential building and public sector engineering work done segments that we expect to have supported growth and represent still strong domestic construction patterns. Anecdotally, with a very long period of dry weather in Queensland and NSW, there were minimal interruptions during Q3.

China
No data due.

October aside, still strong business



US
Yellen speaks with ex-BoE Governor King in NY on Tuesday (Noon NZT Wednesday). The FOMC Minutes are due out Wednesday (8am NZT). It's a mostly second tier data schedule with Durable Goods Orders (Wednesday) the pick ahead of the Thanksgiving Day holiday on Thursday and a quieter week's end.

Japan
Very quiet; the October Merchandise Trade report on Monday worth a look.

Eurozone
While it's an almost scant data calendar, there is no shortage of central bank speakers, including Draghi appearing before the European Parliament on Tuesday. Germany releases the breakdown of Q3 GDP (including a possible revision) and the Ifo Survey.

UK
The feature event for markets is Chancellor Hammond's Budget on Wednesday with its forecasts for the economy and public finances as Brexit policies and negotiations are progressed. The data flow includes the CBI surveys and the second estimate of Q3 GDP; the initial estimate was 0.4% q/q/1.5% y/y.

Canada
It's quiet until Retail Sales on Thursday. NAFTA negotiations continue.

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Fixed Interest Market

Reuters: BNZL, BNZM Bloomberg:BNZ

The short end of the yield curve faces downward pressure as domestic liquidity conditions are very easy at present. Last week the 90-day bank bill rate traded down to 1.905%, a record low, taking the spread to OCR down to less than 16bps, while the 30-day rate traded at a spread of just 1bp. T-bill yields and RB bills have recently been bid below OCR. It all points to a domestic banking system flush with cash. Easy funding conditions offshore have seen banks well ahead of plan on their funding targets, while credit growth has been moderating.

A lower cost of carry has helped nudge the 2-year swap rate down to the lower end of its range, at 2.16%. Easy domestic liquidity factors are likely to continue over the next couple of months, raising the probability of the 2-year swap rate making a fresh low for the year, below the early-September level of 2.13%. We previously thought that the 2.15% level might represent the bottom of the range, but flush funding conditions could see new lows re-tested. The slightly more hawkish tone from the RBNZ earlier this month has been put to one side for now, and doesn't really represent a threat for at least a few months.

In the week ahead there's a plethora of second tier NZ data including net migration, retail sales and trade. And after a weak run of falling dairy prices at the GDT auctions, this week's offering might see steadier pricing. But none of these should have much market impact. There's a chance that the Q3 retail sales figure on Thursday surprises the market to the downside (BNZ's estimate of minus 1.0% is well below the median estimate of +0.1%), but with lumpy car sales and the Lions tour distorting the figures, not too much should be read into the volatility.

The key theme at the long end of the curve is the relentless flattening of the US Treasury curve, with the 2s10s spread down to a 10-year low of 62bps. The 10-year rate remains well contained, despite the Fed's clear path towards tightening monetary policy, the tightening labour market, likelihood that the temporary blip down in CPI inflation has now passed, and the increased prospect of higher debt levels as negotiations for tax reform kick into a higher gear.

We see the ECB's QE policy as a massive distortion for the global rates market, keeping the US 10-year rate artificially low as there is only so far that the US-Germany 10-year spread will be stretched. Draghi's dovish taper and lack of commitment to end QE has only served to distort global rates markets for longer than otherwise.

These factors continue to spill over into the local yield curve, keeping NZ 5- and 10-year swap rate near the bottom of their year-to date ranges. With a light global economic calendar, rates should be well contained this week. Across the Tasman, the highlight will be on RBA Governor Lowe's speech tomorrow night. In the US, there will be some moderate interest in the FOMC minutes of the last meeting and a speech by Fed Chair Yellen. The Thanksgiving holiday later in the week should ensure that we end the week on a quiet note.

Rising US short term rates and softer NZ rates continue to put downward pressure on the NZ-US 2-year swap rate, now down to a fresh low for the cycle of 27bps. This is keeping a lid on NZ-US 10-year bond spread, which sits near the 50bps mark. Further Fed rate hikes while the RBNZ remains on hold suggest further downward pressure for the short-term spread. It's therefore hard to see the NZ-US 10-year bond spread blowing out in a hurry, but into 2018 we'll get closer to the RBNZ tightening cycle, while easier NZ fiscal policy will see greater domestic bond issuance and those conditions will offer the best opportunity for the spread to drift out.

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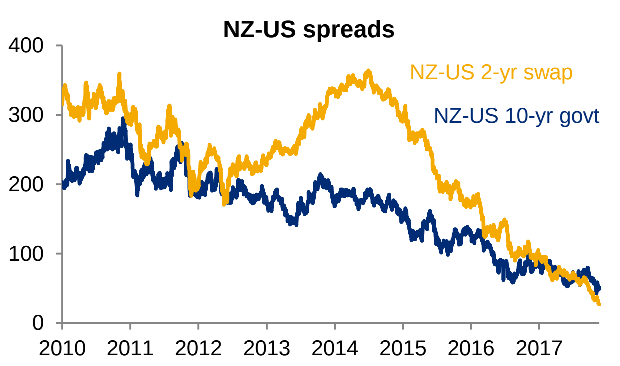
NZ-US Rate Contraction Still Evident



Source: BNZ., Bloomberg

Current Rates/Spreads and Recent Ranges

	Current	Last 3-weeks range*
NZ 90d bank bills (%)	1.92	1.91 - 1.95
NZ 2yr swap (%)	2.16	2.15 - 2.22
NZ 5yr swap (%)	2.65	2.60 - 2.73
NZ 10yr swap (%)	3.14	3.09 - 3.26
2s10s swap curve (bps)	98	93 - 103
NZ 10yr swap-govt (bps)	29	24 - 34
NZ 10yr govt (%)	2.85	2.75 - 2.97
US 10yr govt (%)	2.34	2.30 - 2.41
NZ-US 10yr (bps)	51	43 - 59
NZ-AU 2yr swap (bps)	26	24 - 30
NZ-AU 10yr govt (bps)	29	19 - 32

*Indicative range over last 3 weeks

Foreign Exchange Markets

Reuters pg BNZWFWDS Bloomberg pg BNZ9

The NZD performed poorly last week, falling close to 3% against JPY and EUR, close to 2% against USD and GBP, close to 1% against CAD and about 0.5% against the AUD. There was little in the way of local newsflow or economic data so global forces were clearly in charge.

There is no real satisfactory explanation for the NZD's underperformance. Our risk appetite index was steady last week after falling over the previous couple of weeks (which had made us a little nervous about the path of the NZD). Commodity currencies tended to underperform, suggesting some theme on global growth in play. But NZ dairy prices (whole milk powder futures) actually nudged up last week after recently trending lower.

We wouldn't overplay it, but seasonality might be a factor in the NZD's recent lacklustre performance. NZD/USD has fallen in 9 of the last 10 Novembers. Historically, December is a much better month.

Overall, we are left scratching our heads a bit about last week's poor performance. Certainly, speculative accounts seem to be selling the NZD and so portfolio flows might be the key reason for the underperformance. CFTC data through to last Tuesday showed that net speculative shorts continued to be extended, to their highest level since mid-May. Going by the NZD's underperformance last week, those short positions probably extended further.

The previous year-to-date low of 0.6818 was broken on Friday night and it wasn't until the 0.6780 mark that the NZD found some fresh support, which now becomes a new level of technical support. Our short-term fair value model estimate sits in a USD 0.71-0.72 range, stretching the gap between spot and FV out to 5%. It suggests that the NZD is looking a little oversold. We're hesitant to suggest that the NZD is poised to recover strongly, given the selling pressure that still seems evident by hot money accounts, but at current levels the risks seem skewed towards the upside over coming weeks.

Cross Rates and Model Estimates

	Current	Last 3-weeks range*
NZD/USD	0.6808	0.6780 - 0.6980
NZD/AUD	0.8998	0.8910 - 0.9100
NZD/GBP	0.5153	0.5120 - 0.5320
NZD/EUR	0.5775	0.5740 - 0.6010
NZD/JPY	76.30	76.20 - 79.50

*Indicative range over last 3 weeks, rounded figures

BNZ Short-term Fair Value Models

	Model Est.	Actual/FV
NZD/USD	0.7190	-5%
NZD/AUD	0.8990	0%

Our NZD/AUD model suggests that the cross is close to fairly priced. Better relative commodity prices and business confidence in Australia compared to NZ have helped nudge our fair value estimate lower in recent weeks.

In the week ahead there's a plethora of second tier NZ data including net migration, retail sales and trade. After a weak run of falling dairy prices at the GDT auctions, this week's offering might see steadier pricing.

The Australian economic calendar is light, with most interest on RBA Governor Lowe's speech tomorrow night. The international calendar also looks light, with some interest in the FOMC minutes of the last meeting and a speech by Fed Chair Yellen. The Thanksgiving holiday later in the week should ensure that we end the week on a quiet note.

The UK Budget mid-week won't make for pretty reading, as the economy looks sluggish and public finance figures come under pressure.

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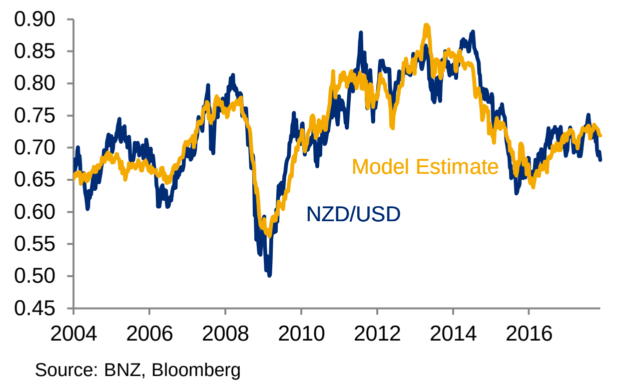
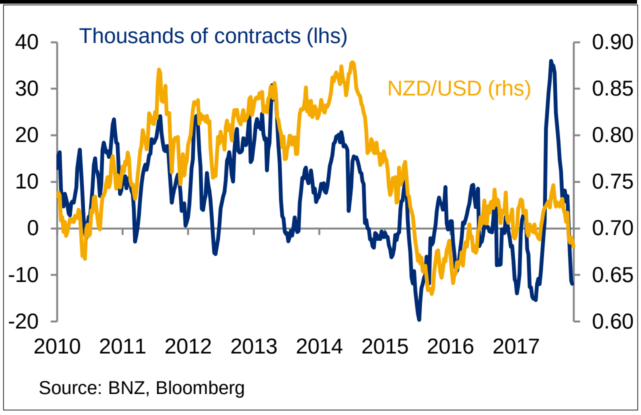
NZD Looking a Little Oversold



Source: BNZ, Bloomberg

Net Spec. Positioning Becoming Extremely Short NZD



Source: BNZ, Bloomberg

Technicals

NZD/USD

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

Strong support at 0.6820 was broken last week, taking the NZD to a fresh low for the year around 0.6780, which becomes the new support level. The June 2016 low of 0.6676 is the following level of support. Resistance is well north of current spot.

NZD/AUD

Outlook: Downside risk
ST Resistance: 0.9170 (ahead of 0.9230)
ST Support: 0.8975 (ahead of 0.8875)

The 0.8975 level remains a weak level of support ahead of 0.8875. Resistance is well north of spot.

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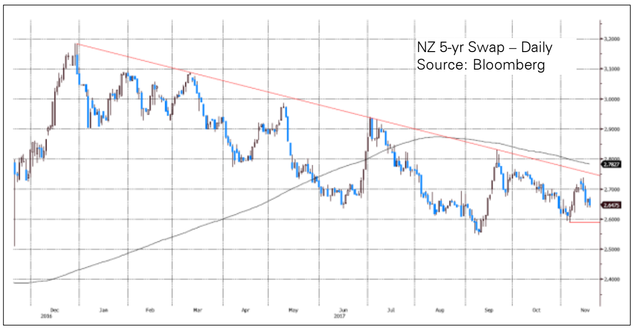
NZ 5-year Swap Rate

Outlook: Neutral
ST Resistance: 2.79
ST Support: 2.58

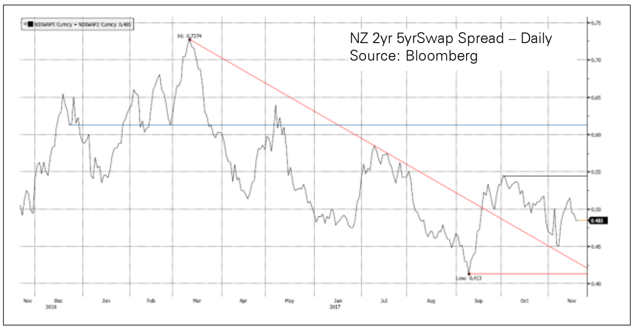
We remain inside ST resistance and support awaiting a break before initiating a new position.



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

Outlook: Neutral
ST Resistance: +62
ST Support: +41

Break of trendline was short-lived. Should +54 be breached expect a move to +62.



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Key Upcoming Events

	Forecast	Median	Last
Monday 20 November			
NZ, Food Price Index, October	-1.0%		-0.2%
NZ, BNZ PSI (Services), October			56.0
Aus, RBA's Kearns/Kohler Speak			
Jpn, Merchandise Trade Balance, October		+¥330b	+¥670b
Germ, PPI, Oct y/y		+2.7%	+3.1%
US, Leading Indicator, October		+0.7%	-0.2%
Tuesday 21 November			
NZ, Credit Card Billings, October			+0.7%
Aus, RBA Minutes, 7 November Meeting			
Aus, Lowe Speaks, ABE Dinner			
Jpn, All Industry Index, September		-0.4%	+0.1%
UK, CBI Industrial Trends, November		+3	-2
US, Existing Home Sales, October		5.40m	5.39m
US, Yellen Speaks			
Wednesday 22 November			
NZ, Dairy Auction, GDT Price Index			-3.5%
NZ, External Migration, October s.a.			+5,190
Aus, Westpac Leading Index, October			+0.08%
Aus, Construction Work Done, Q3	+14.0%	-2.3%	+9.3%
Euro, Consumer Confidence, Nov 1st est		-0.9%	-1.0

	Forecast	Median	Last
Wednesday 22 November cont'd			
US, FOMC Minutes, 1 Nov. meeting			
US, Mich Cons Confidence, November 2nd est		98.0	97.8P
US, Durables Orders, Oct. 1st est		+0.4%	+2.0%
US, Jobless Claims, week ended 18/11		240k	249k
Thursday 23 November			
NZ, Retail Trade, Q3 vol s.a.	-1.0%	+0.1%	+1.9%R
Euro, PMI Manufacturing, Nov 1st est		58.2	58.5
Euro, ECB Minutes, 26 Oct Meeting			
Euro, PMI Services, Nov 1st est		55.2	55.0
Germ, GDP, Q3 2nd est		+0.8%	+0.8%P
UK, CBI Distribution Reported Sales, Nov			+1
US, Holiday, Thanksgiving			
Friday 24 November			
NZ, National Accounts, Year to March 2017			
NZ, Merchandise Trade, October	-$799m	-$760m	-$1,143m
NZ, Residential Lending, October y/y			-21.7%
Germ, IFO Index, November		116.6	116.7
US, Markit PSI, Nov 1st est		55.3	55.3
US, Markit PMI, Nov 1st est		55.0	54.6

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	1.80	1.93
2mth	1.85	1.85	1.87	1.99
3mth	1.92	1.92	1.96	2.04
6mth	1.94	1.94	1.98	2.07
GOVERNMENT STOCK				
03/19	1.86	1.89	1.89	2.10
04/20	2.01	2.03	2.04	2.29
05/21	2.16	2.19	2.19	2.45
04/23	2.45	2.48	2.49	2.74
04/25	2.70	2.75	2.78	2.97
04/27	2.87	2.94	2.96	3.09
04/33	3.23	3.30	3.30	3.43
04/37	3.43	3.50	3.50	3.70
GLOBAL CREDIT INDICES (ITRXX)				
Australia 5Y	68	68	65	113
Nth America 5Y	55	56	53	76
Europe 5Y	52	52	54	81

	Today	Week ago	Month Ago	Year Ago
SWAP RATES				
2 years	2.16	2.21	2.17	2.26
3 years	2.33	2.39	2.35	2.44
4 years	2.50	2.56	2.53	2.61
5 years	2.65	2.71	2.68	2.77
10 years	3.14	3.23	3.21	3.27
FOREIGN EXCHANGE				
NZD/USD	0.6808	0.6903	0.6967	0.7066
NZD/AUD	0.8998	0.9055	0.8925	0.9590
NZD/JPY	76.35	78.43	79.03	78.29
NZD/EUR	0.5776	0.5917	0.5929	0.6648
NZD/GBP	0.5149	0.5263	0.5278	0.5656
NZD/CAD	0.8694	0.8788	0.8811	0.9481
TWI	72.3	73.6	73.8	77.5

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