21 August 2017

Migrants Vote New Zealand First

- PREFU a focal point for election promises
- Gyrating polls leave NZ First with firmer sway
- July's tourism and migration not quite as rapid
- Expected goods trade deficit positive underneath
- Memo: LVR restriction about financial stability

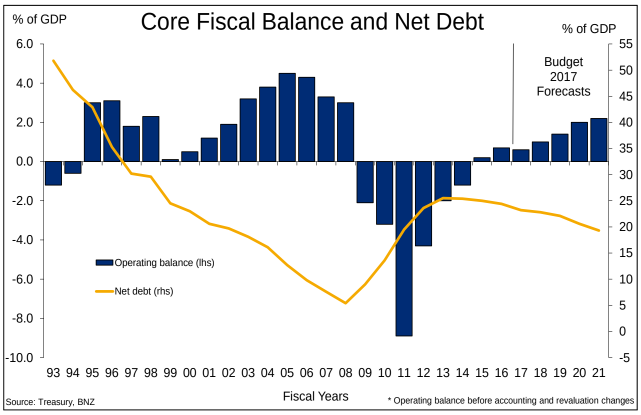
Coming exactly one month before the General Election, Wednesday's pre-Election Economic and Fiscal Update (PREFU) will serve as the new reference point for party policy costings. Not that the PREFU baselines should look much different to those of the Budget, of only three months ago. So expect to see a similarly solid track of surpluses.

Will this week's PREFU announce any material new policy initiatives? To be sure, the meaty stuff is normally left to the Budget and, to some extent, the December updates. Nonetheless, given that next month's election is looking tighter by the day, it will be worth looking out for any new policy with the PREFU, just in case. In the least, there might be more allocation of money to specific ends, rather than leaving it as a general provision.

Generally speaking, the PREFU will be a platform for the government to reiterate its Budget initiatives – including the significant Family Incomes Package planned to start 1 April 2018 – but also an opportunity for opposition parties to say how they will manage the surpluses differently.

With respect to the outcome of next month's election, while the polls have been lurching around – with a noticeable resurgence in support for the Labour Party – the central message, for the most part, remains the same. Neither National nor Labour are looking likely to command a majority in the House. New Zealand First, meanwhile, is increasingly laying claim to the balance of power and the pundits are increasingly split as to which way it will go.

May the Election Battle Begin



One view is that the friendship of NZ First's Winston Peters and Shane Jones with Labour's now Deputy Leader, Kelvin Davis, will swing NZ First to Labour. The other is that Peters is, at heart, and from historical fact, more politically aligned with National, and he will go with the party with the most seats in the House (which is still likely to be National).

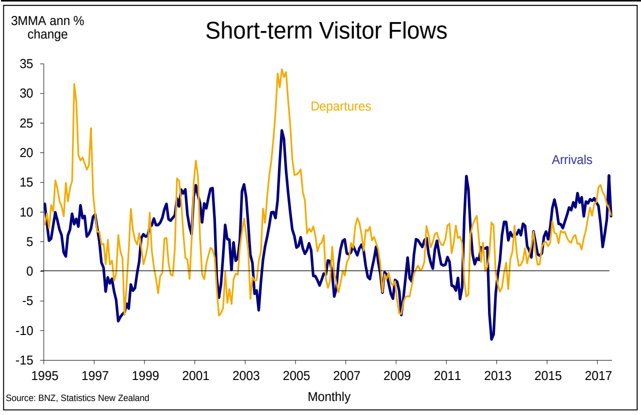
Importantly, from a markets' perspective, it is unlikely that either National or Labour will kowtow to NZ First. So policy analysis comes down mainly to the policy prescriptions of the major parties. As for international investors, in particular, they tend to be more concerned about big lurches to the left or right, rather than leanings to the centre-left or centre-right. So the range of likely outcomes still limits the potential degree of market reaction, to our mind.

In respect to this week's local economic data, it has begun with this morning's International Travel and Migration report for the month of July. This showed a predictable slowing in short-term visitor arrivals after the great boost provided by the Lions rugby tour during June (+17% y/y). Still, with July's arrivals up 4% on their level of a year ago, there is obviously a solid undercurrent to the tourism industry. This helps guard against the idea of an air pocket in Q3 GDP, after the boost that the Lions, and the Masters Games (of April), provide to Q2 GDP growth.

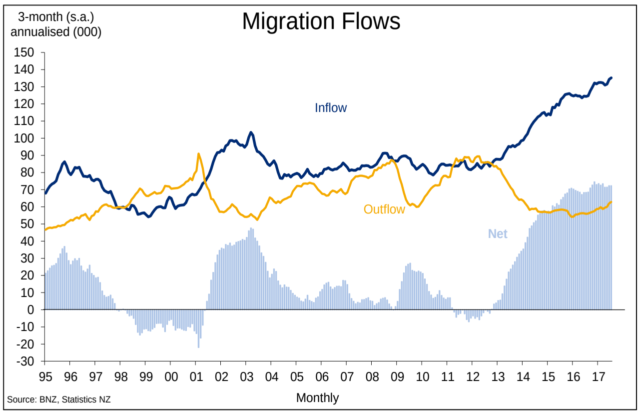
At the same time, the number of NZ residents taking short-term trips abroad was still running strongly above year-ago levels (+9%). Nevertheless, this was not as rapid as earlier in the year, when its annual expansion hit 16%. The drain on local spending is thus lessening.

There were also signs of abatement, from very strong rates, in July's net inward migration result. It eased to

Give and Take



Peaking



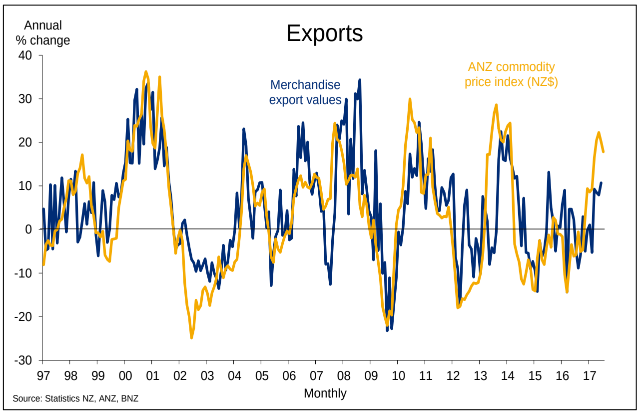
5,810, in seasonally adjusted terms, from its record high level of 6,340 in June. A peak appears to be forming, albeit at an exceptionally high level. While the migrant departure rate is very gradually trending higher (from a low point around late 2015, early 2016), migrant arrivals are broadly maintaining their margin over them.

The NZ economic figures continue this afternoon with July's credit card billings.

Turning to Thursday's data, with July's commodity export prices 18% above year-ago levels (in $NZ terms) we might yet be too pessimistic in estimating a 12% lift in goods exports over the period. For merchandise imports we estimate a 6% gain y/y (noting there was a lump of aircraft importation in July last year). This would deliver a monthly deficit of $135m – good enough to lessen the annual trade deficit to $3.44b, from $3.66b in June.

Later on Thursday (3:00pm) the RBNZ is scheduled to publish July's new residential lending by the local banking sector. If the recent correspondence of lending to (LVR-impacted) house sales is any guide, then we should expect to see an annual rate of decline similar to what we saw for June, namely -25%.

Positive Signs



And speaking of the LVR restrictions, the recent debate about relaxing/removing them seems to have overlooked the fact that they are first and foremost about protecting the financial system (such is the want of macro-prudential policy). The Reserve Bank made this clear when introducing them. The policy is designed to enforce buffers, while slowing lending; not to kill house price inflation per se. The Bank said it expected the LVR policy to have only a small and temporary impact on house price inflation. So it is confusing to hear the RBNZ now feeding the public's perception that the LVR policy is "working", in that house price inflation is abating.

While the Reserve Bank hasn't outlined the conditions under which it will relax/abolish the LVR restrictions, we have to ask; how is any new buyer/lender less exposed to losses than they were 6, to 12, to 36 months ago, given house prices are at such high levels (albeit dribbling off a bit in some areas)?

But where the call for LVR relaxation/removal would seem to have more immediate information context is in signalling that the housing market is now genuinely cooling, even if mainly in Auckland.

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Global Watch

- Central Bank symposium in focus
- Yellen, Draghi speak on Friday
- It's a very quiet data week
- US durable orders, some PMIs to watch
- Japanese CPI due

Australia: It is a very quiet week for Australian data with only second-tier prints; Weekly Consumer Confidence Tuesday and Job Vacancies Wednesday. The following week brings meatier domestic pieces, including construction and capital expenditure expectations, in the lead up to Q2 GDP on September 6.

As for consumer confidence on Tuesday, it is likely to remain subdued (Chart 2). NAB's view is that it will be difficult to see a material rise in consumer confidence until wage growth starts to lift, especially given rising energy costs.

China: Mostly quiet in China also with only Industrial Profits on Sunday.

US: Central bank talk will take centre stage with the Jackson Hole Symposium Thursday through Saturday. The topic is on "Fostering a Dynamic Global Economy" and Fed Chair Yellen is talking on Friday on financial stability.

Datawise it is mostly quiet with Durable Goods and Capital Goods Orders on Friday the highlight (note Durable Goods Orders are expected to fall sharply by 5.8% on lower aircraft orders, but the core measure is expected to rise by 0.5%). Other data worth watching include Markit PMIs Wednesday (note the more important Manufacturing ISM is on September 1) and Jobless Claims Thursday (note these are at their 2nd lowest level since 1973!). As for political developments that could impact markets, renegotiation talks on NAFTA amongst trade representatives occur Saturday and President Trump is holding a campaign rally in Arizona on Tuesday.

Japan: An important week for Japan with the CPI Friday the likely highlight. The market looks for a slight pick-up with a 0.1% m/m increase expected for the core from 0.0% previously. Other data points worth noting include the All Industry Activity Index Monday and the Nikkei PMI Thursday.

Eurozone: The ECB President's speech at the Jackson Hole Symposium has preoccupied markets, but reports now suggest he will stick to a narrow script (time still to be confirmed). President Draghi also speaks on Wednesday in Germany. The more important data points include the ZEW Tuesday, PMIs for August on Wednesday and Germany's IFO Friday.

UK: A mostly quiet week datawise with only a second read on GDP Thursday scheduled. The market looks for an unrevised 0.3% q/q increase.

Canada: Also a quiet week with only Retail Sales Tuesday of note – the market looks for a 0.3% increase.

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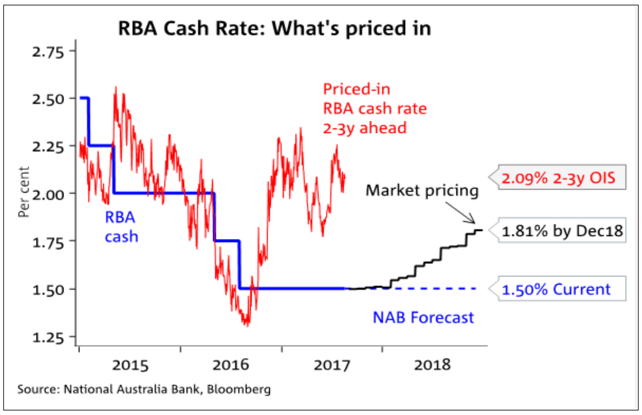
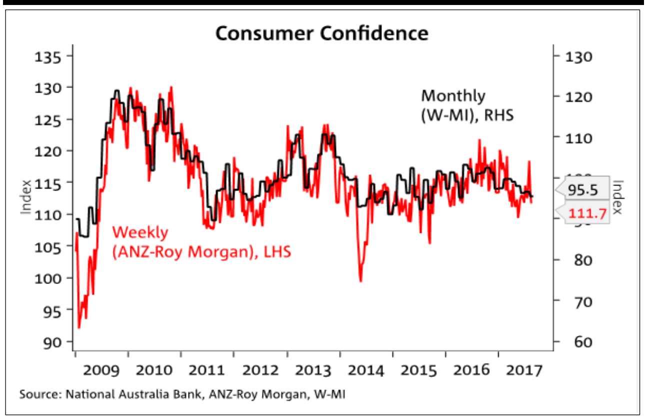
Markets Pricing an RBA Rate Hike by Nov-18



Consumer Confidence Likely to Remain Subdued



Fixed Interest Market

Reuters: BNZL, BNZM Bloomberg:BNZ

The NZ rates curve had a pretty uneventful week last week, with a lack of data to generate much attention, the short end underpinned by the prospect of unchanged monetary policy for an extended period and US 10-year Treasury rates little changed for the week.

NZ's 2-year swap rate has traded in a tight 2.15-2.20% range since the RBNZ's August Monetary Policy Statement. The market remains alert to the timing of the first rate hike in the cycle, but with the first full hike not priced until November 2018, it's going to take a big shift in expectations to wake up the short end of the curve.

There are few domestic data releases this week to impact market pricing. Indeed we have to look out about four weeks, when Q2 GDP data are released, to find much on the calendar to interest us. Over the next month, we'll be watching local political developments closely, ahead of the 23 September general election, but given the likely close race and coalition negotiations in the subsequent weeks, we don't see the market reacting much to this event for a while yet.

Global forces will remain in the driving seat for some time and this week looks to be another quiet one. The focus will be on the annual Jackson Hole symposium hosted by the Kansas City Fed. While in the past this event has resulted in market moving speeches by Central Bank heads, that isn't always the case. Sources suggest that the ECB's Draghi's speech will steer clear of any major policy announcement, while Fed Chair Yellen's speech will be focused on financial stability.

Last week the Fed's Dudley commented that rising asset prices suggested the Fed likely needed to do more to tighten financial conditions. If Yellen echoes these thoughts then that could help lift US rates. We continue to think that the market under-prices the risk of further Fed hikes, with the curve pricing in not much more than one full rate hike through to the end of next year. We still think that another rate hike as soon as December this year remains a live bet.

US retail sales and consumer sentiment both came in much stronger than expected last week. The impact on rates of these releases was drowned out by US domestic political shenanigans. The prospect of Trump getting his pro-growth agenda back on track diminished as business leaders, Republican colleagues, and various others distanced themselves from the President, after his poor judgement in responding to racial violence in Virginia. The end-of-week ousting of Trump's Chief Strategist Bannon provided a glimmer of hope that some order might return to the Administration and get the policy agenda back on track.

If those negative US political forces dissipate, then the path of least resistance is for higher US rates, based on an improving dataflow and Fed hikes remaining on the agenda. This would spill over into the NZ curve, so we continue to see the risks skewed towards higher, not lower rates through to the end of the year.

At the long end of the curve, traders are on tenterhooks as they await the possible announcement of syndication of a new 2029 government bond. Time is running out to get this issue out before the election, otherwise the issue would likely need to be delayed until the next government is formed, later in the year. Anticipation of this issue is already seeing some volatility in swap spreads and creates some short term trading opportunities.

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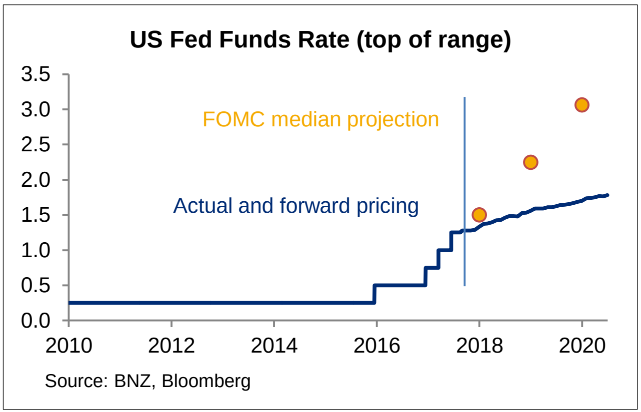
Market Highly Skeptical About Future Fed Rate Hikes



Current Rates/Spreads and Recent Ranges

	Current	Last 3-weeks range*
NZ 90d bank bills (%)	1.94	1.94 - 1.96
NZ 2yr swap (%)	2.18	2.15 - 2.24
NZ 5yr swap (%)	2.64	2.61 - 2.78
NZ 10yr swap (%)	3.13	3.12 - 3.32
2s10s swap curve (bps)	96	96 - 109
NZ 10yr swap-govt (bps)	30	27 - 36
NZ 10yr govt (%)	2.83	2.78 - 3.04
US 10yr govt (%)	2.19	2.16 - 2.32
NZ-US 10yr (bps)	64	55 - 75
NZ-AU 2yr swap (bps)	26	26 - 35
NZ-AU 10yr govt (bps)	21	17 - 32

*Indicative range over last 3 weeks

Foreign Exchange Markets

Reuters pg BNZWFWDS Bloomberg pg BNZ9

There was little change in the NZD last week, with NZD/USD beginning and ending the week around 0.7315 and all the key cross rates moving less than 1%.

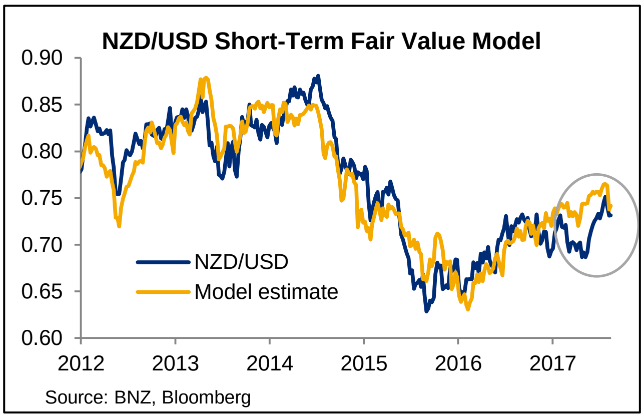
Local drivers were largely absent with the two biggest factors being strong US retail sales data, which supported the USD, while political forces were a negative force for the USD. The prospect of Trump getting his pro-growth agenda back on track diminished as business leaders, Republican colleagues, and various others distanced themselves from the President, after his poor judgement in responding to racial violence in Virginia. The end-of-week ousting of Trump's Chief Strategist Bannon provided a glimmer of hope that some order might return to the Administration and get the policy agenda back on track.

FOMC minutes were interpreted as dovish or negative for the USD, as the committee openly debated the causes of the low inflation environment and prospects for a return to the 2% target. To our mind, they didn't change the outlook for US monetary policy and we still see the market under-pricing the chance of a December rate hike.

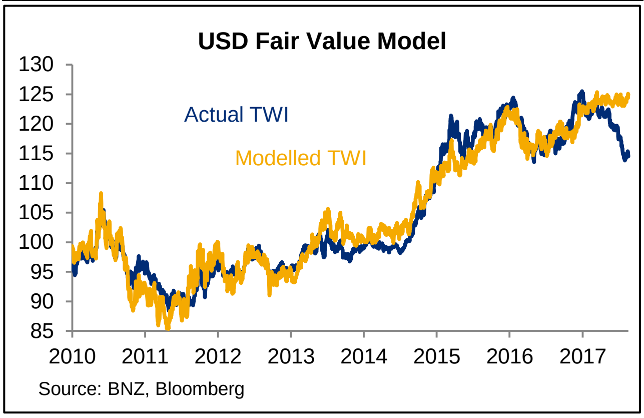
On paper, the week ahead looks quiet on the data front, with few top tier releases. Certainly, domestic data and the pre-election fiscal update shouldn't be market moving. The focus will be on the annual Jackson Hole symposium hosted by the Kansas City Fed. While in the past this event has resulted in market moving speeches by Central Bank heads, that isn't always the case. Sources suggest that the ECB's Draghi's speech will steer clear of any major policy announcement, while Fed Chair Yellen's speech will be focused on financial stability.

Last week the Fed's Dudley commented that rising asset prices suggested the Fed likely needed to do more to tighten financial conditions. If Yellen echoes these thoughts then that could help lift US rates and support the USD.

NZD Valuation Gap Now Effectively Closed…



…but USD TWI remains significantly oversold



But unless that symposium provides some nuggets to trade on, it may come down to more US political noise to bring some life to the FX market. In the absence of that, it could be an uneventful week ahead.

Our short term fair value models suggest no significant valuation gap regarding the NZD at present. But the USD TWI remains significantly "over-sold" as political factors have weighed on the currency and traders are net short USD.

CFTC positioning data showed some trimming of NZD positions in the week through to 15 August (25k contracts vs the peak of 35k a couple of weeks earlier), but net long positioning remains at a historically high level, keeping the NZD vulnerable to the downside on any negative news.

On fundamentals, we stick with our expected USD recovery story through to the end of the year which makes us negative on the NZD. Risk appetite has fallen over recent weeks, but it still remains above-average, which could act as another downward force on the NZD.

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Cross Rates and Model Estimates

	Current	Last 3-weeks range*
NZD/USD	0.7314	0.7220 - 0.7480
NZD/AUD	0.9223	0.9190 - 0.9390
NZD/GBP	0.5685	0.5580 - 0.5710
NZD/EUR	0.6219	0.6160 - 0.6360
NZD/JPY	79.94	79.10 - 83.00

*Indicative range over last 3 weeks, rounded figures

BNZ Short-term Fair Value Models

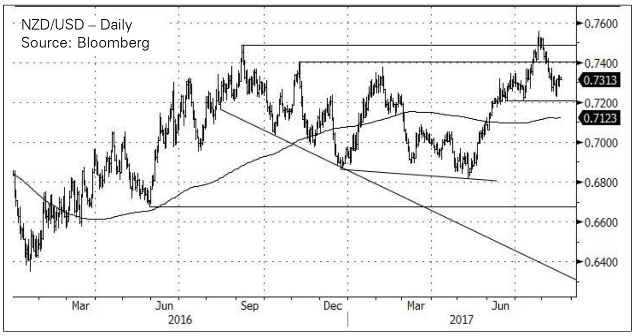
	Model Est.	Actual/FV
NZD/USD	0.7420	-1%
NZD/AUD	0.9170	1%

Technicals

NZD/USD

Outlook: Down
ST Resistance: 0.7400 (ahead of 0.7490)
ST Support: 0.7200 (ahead of 0.7100)

The air proved thin above 0.74, despite reaching as high as 0.7550 in late July, so we'd put resistance at the 0.74 mark again. The bigger threat on the chart is a test of support around 0.72. A breakdown through that level opens up significant downside potential.



NZD/AUD

Outlook: Trading range with downside risk
ST Resistance: 0.9400 (ahead of 0.9500)
ST Support: 0.9200 (ahead of 0.9100)

The 0.92 mark is approaching and offers some key technical support. A break of this opens up the 0.91 area and a long way down to any technical support thereafter. Resistance levels are some distance away from spot and start to come into play from 0.94 upwards.

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NZ 5-year Swap Rate

Outlook: Neutral
ST Resistance: 2.68
ST Support: 2.61

Very close to a breakout here. Trade a break, below 2.61 opens up 2.51% above 2.68 opens up 2.85.

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

Outlook: Steeper
ST Resistance: +58
ST Support: +45

Still expect move steeper stop on break of +45.

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Key Upcoming Events

	Forecast	Median	Last
Monday 21 August			
NZ, Credit Card Billings, July			+0.2%
NZ, External Migration, July s.a.			+6,350
Jpn, All Industry Index, June		+0.4%	-0.9%
US, Chicago Fed Nat Activity Index, July		+0.10	+0.13
Tuesday 22 August			
China, Leading Index (Conference Bd), July			+1.6%
Germ, ZEW Sentiment, August		+15.0	+17.5
UK, CBI Industrial Trends, August		+9	+10
Wednesday 23			
NZ, PREFU			
Euro, PMI Manufacturing, August 1st est		€56.3	€56.6
Euro, PMI Services, August 1st est		€55.4	€55.4
US, New Home Sales, July		610k	610k
US, Markit PSI, August 1st est		54.9	54.7
US, Markit PMI, August 1st est		53.4	53.3

	Forecast	Median	Last
Thursday 24 August			
NZ, Merchandise Trade, July	-$135m	-$200m	+$242m
NZ, Residential Lending, July y/y			-25.1%
Euro, Consumer Confidence, August 1st est		-1.8	-1.7
UK, GDP, Q2 2nd est		+0.3%	+0.3%P
UK, CBI Distribution Reported Sales, August			+21
US, Jobless Claims, week ended 19/08		236k	232k
US, Existing Home Sales, July		5.56m	5.52m
All, Jackson Hole Conference			
Friday 25 August			
Jpn, CPI, July y/y		+0.4%	+0.4%
Germ, GDP, Q2 2nd est		+0.6%	+0.6%P
Germ, IFO Index, August		115.5	116.0
US, Durables Orders, July 1st est		-6.0%	+6.4%
All, Jackson Hole Conference			

Historical Data

	Today	Week Ago	Month Ago	Year Ago
CASH & BANK BILLS				
Call	1.75	1.75	1.75	2.00
1mth	1.81	1.86	1.81	2.09
2mth	1.88	1.91	1.89	2.16
3mth	1.94	1.95	1.96	2.23
6mth	1.99	2.00	2.00	2.19
GOVERNMENT STOCK				
12/17	1.79	1.78	1.81	1.76
03/19	1.87	1.89	1.96	1.74
04/20	2.01	2.03	2.19	1.74
05/21	2.14	2.18	2.34	1.74
04/23	2.43	2.49	2.62	1.84
04/25	2.70	2.74	2.83	1.99
04/27	2.84	2.90	2.94	2.12
04/33	3.22	3.28	3.28	2.45
GLOBAL CREDIT INDICES (ITRXX)				
AUD 5Y	76.88	76	81	103
N. AMERICA 5Y	62.37	58	58	72
EUROPE 5Y	58.53	52	54	67

	Today	Week Ago	Month Ago	Year Ago
SWAP RATES				
2 years	2.18	2.19	2.25	1.96
3 years	2.34	2.36	2.47	1.98
5 years	2.65	2.69	2.82	2.08
10 years	3.14	3.21	3.34	2.41
FOREIGN EXCHANGE				
NZD/USD	0.7309	0.7408	0.7316	0.7197
NZD/AUD	0.9221	0.9342	0.9387	0.9398
NZD/JPY	79.89	82.07	82.65	72.88
NZD/EUR	0.6218	0.6287	0.6405	0.6448
NZD/GBP	0.5678	0.5678	0.5607	0.5576
NZD/CAD	0.9202	0.9367	0.9295	0.9327
TWI	77.20	78.28	78.35	76.43

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