24 April 2017

Let the (Fun and) Games Begin

- RBNZ should move to a clear tightening bias
- But it's likely to resist for as long as it can
- Masters games (then Lions tour) add to tourism
- Migration, trade and building consents due for March
- French politics goes to show NZ's relative centrism

The World Masters Games are well under way in New Zealand this week. We can also see some fun and games playing out between a Reserve Bank doing its best to maintain a 1.75% cash rate low, and a market seeing this as increasingly unjustified with inflation firming as much as it is. At the February Monetary Policy Statement (MPS) we struggled to find anyone who seriously thought there was a chance of further OCR easing (as the Bank then indicated). For the 11 May MPS the question will come on any gambit by the Bank to maintain its neutral stance.

Granted, the Reserve Bank has room to tone down its GDP growth forecasts in its May MPS. But this wouldn't much change the view on the output gap, in our estimation, more an admission that potential growth is not as strong as previously judged. Meanwhile, the trade-weighted exchange rate (TWI) is still about 3% below the level that the RBNZ assumed for Q2 2017. We can also see the labour market data hence, adding to the notion of capacity constraint and inflation.

As for this week's data, Friday's (1:00pm) ANZ business survey will likely keep the pressure on. While this has registered a moderation in confidence over recent months, respondents have maintained a strong outlook regarding their own activity, employment, investment and profitability. With this there have been signs of stretched capacity and a firming intent to raise prices. We expect April's edition to reiterate these themes.

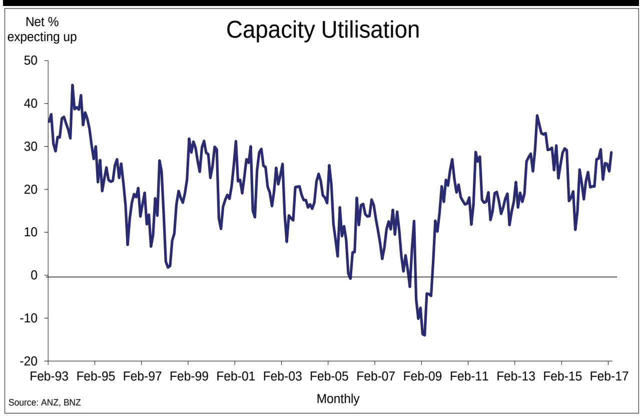
The NZ data begin, however, with Wednesday's migration and tourism figures for March. We haven't seen anything to suggest an obvious fall in net inward migration from its recent record highs. As such, it remains an important factor in our understanding, and forecasting, of the economy. In this vein, note that Statistics NZ publishes the nation's working-age population estimate for the March quarter on Wednesday also. This might shade our computation of the quarter's unemployment rate (as is due 3 May).

As for short-term visitor arrivals in March these might, like they did in February, struggle to post a strong annual gain. But this probably, again, reflects holiday timings – in this case the later timing of Easter this year compared to last. So just watch for a huge result for April, especially with the influx of people for the Masters Games. Indeed, could this event be a bigger deal than New Zealand's hosting of the British and Irish Lions rugby tour scheduled for June/July?

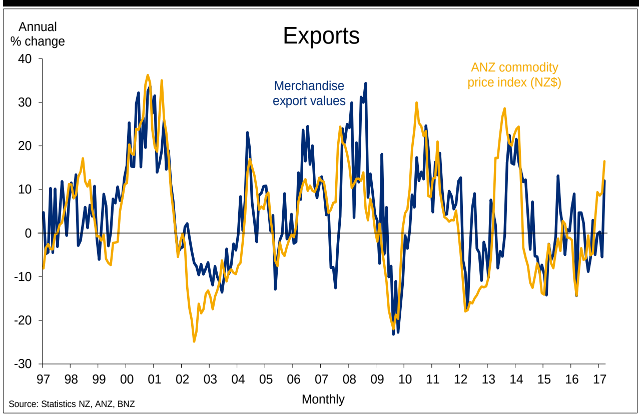
March credit card billings are due Wednesday afternoon (3:00pm).

Regarding Friday's merchandise trade figures, we expect March's exports to be up 12% on year-ago results, aided by dairy prices and meat volumes. And the March quarter summaries, provided by Statistics New Zealand, will indicate whether export volumes stabilised in Q1 (as we expect), after a poor showing in Q4, as well as the pulse of core import volumes. For nominal merchandise imports in March we anticipate annual growth of 5%. This would deliver a monthly surplus of $492m, compared to $189m in March of last year (and market expectations of $370m).

Pressure's On



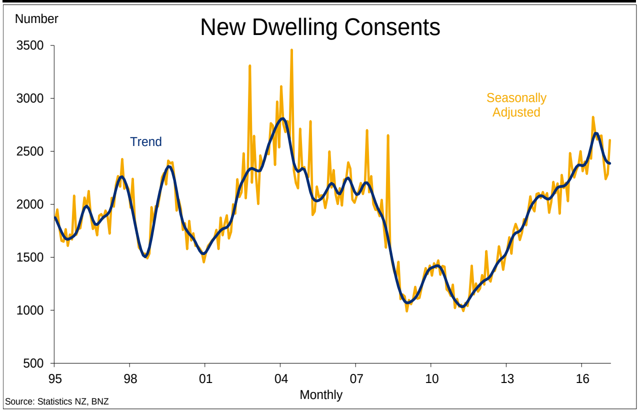
Much Improved



But while the net export story for Q1 is looking improved (after the big drag it exerted in the Q4 GDP accounts) the story around construction is not looking so positive. The 14% jump in residential building consents in February was certainly nice to see, following a patch of weak numbers late last year. Nonetheless, we'll need to see more of this positivity in the March results, due Friday, to be sure the expansion in construction activity hasn't lost its way for the meantime.

In addition to the smattering on local data in this holiday-shortened week, Thursday lunch-time Finance Minister Steven Joyce is scheduled to deliver a speech to the Wellington Chamber of Commerce. We expect this will flesh out more on the policies to expect in next month's Budget. However, it's a moot point on whether he'll give details on the widely anticipated tax cuts. There are certainly surplus funds able to be allocated, on the back of a robust economy. While nothing becomes official until the 25 May Budget is delivered, the prospect of fiscal stimulus will surely be on the RBNZ's radar, for after the 11 May MPS.

A Weak Q1?



And, of course, it's an election year Budget. But even with another tight election result looking likely for September, we are reminded of the way international investors tend not to get too nervous about NZ politics. If it's not centre-right then it's centre-left. Such is the centrism attributed to the Kiwi populace. Yes, there is the argument that any Labour-Greens led government would pull things more left than New Zealand has experienced in a long while. However, this would still rely, presumably, on the support of the centre-right NZ First party.

Compare this all to France's latest Presidential elections, where there was potential for a run-off between a far-right candidate (Le Pen) and a far-left one (Melenchon). As the results (of this first round) came through this morning (NZT), the market patently expressed relief that centrist, Emmanuel Macron, will be the one to run head-to-head against Marine Le Pen on 7 May, and will highly likely win. Still, the distribution of votes in the first round alone highlights how yet another major nation has not a lot of common ground amongst its populace.

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Global Watch

- Aussie CPI Wednesday
- French election aftermath
- US Q1 GDP estimate Friday

Australia

It's another public-holiday shortened week in Australia with ANZAC day on Tuesday (Monday is also likely to be quiet given many take the long-weekend as well). All focus domestically will be on CPI Wednesday and NAB will release a full CPI preview on Monday.

The market consensus for CPI looks for a Headline print of 0.6% q/q which gives an annual rate of 2.2% y/y. If this eventuated, it would be the first time since September 2014 inflation will be back within the RBA's 2-3% target band. NAB sees Headline inflation at 0.7% q/q and 2.4% y/y with possible upside risk coming from prices for education and utilities – especially given the recent surge in gas prices along Australia's eastern seaboard.

Core inflation is expected to remain subdued at 0.5% q/q which gives an annual rate of 1.8-1.9% y/y depending on the underlying core measure used. The RBA's February

Chart 1: Aussie CPI the Focus Domestically

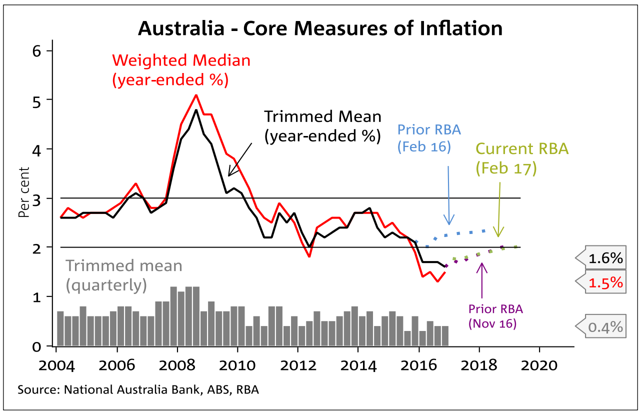


Chart 2: Headline Inflation Expected to be Higher

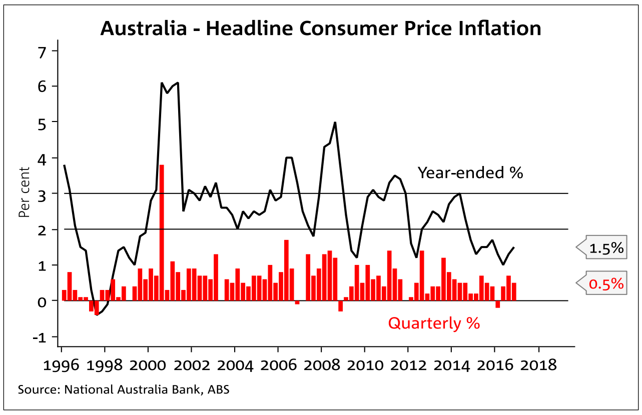
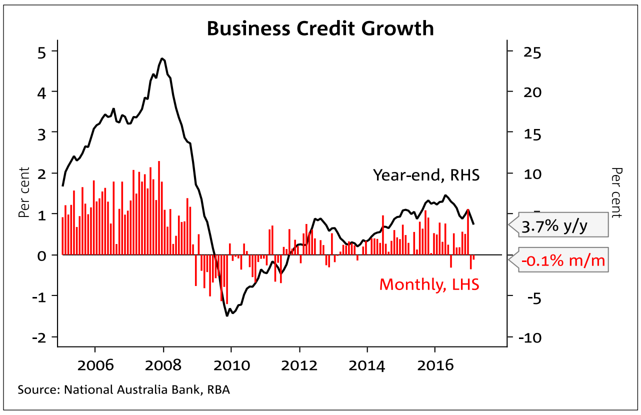


Chart 3: Business Credit Likely to Tick Higher in March



Statement on Monetary Policy implicitly expected a print of 0.4% q/q so such an outcome would be marginally above the Bank's expectation. Nevertheless, core inflation at 0.5% q/q will confirm inflation pressures remain subdued, driven in part by soft wages growth which reflects ongoing spare capacity in the labour market.

RBA Governor Lowe is scheduled to speak Thursday, though this is at a dinner on the Renmibi Global Cities Dialogue so is unlikely to contain much in the way of monetary policy.

There is also plenty of second-tier data with Weekly Consumer Confidence and Skilled Vacancies out Wednesday, Trade Prices Thursday and Credit Statistics Friday. Our pick-up of the second-tier data is the RBA Credit Statistics where focus will be on the pace of investor and business credit growth. The market looks for credit growth to pick-up to 0.5% pace in in March after a number of months of subdued prints due to weakness in business credit. NAB is slightly weaker at 0.4%.

Euro

With the first round in the French Presidential election allaying fears of an extremist outcome, attention now turns to the ECB meets Thursday, where policy is unanimously expected to be on hold. Talk of tapering policy is likely still too early given a lack of inflationary pressures so far - an update on inflation will be available in Friday's flash April CPI figures.

US

Q1 GDP is the most significant release with the market expecting a 1.2% read and marginally above the Atlanta Fed's GDP Now estimate of 0.5%. In the lead up to GDP, Consumer Confidence (Conference Board) is out Tuesday, while Thursday brings Wholesale Inventories and Durable Goods. There is also plenty of second tier data such as the Chicago PMI Friday. Two Fed speakers are scheduled with Kashkari (voter, dove) Monday and Harker (voter, hawk) Friday. Earnings season continues with focus likely on Thursday with Alphabet, Microsoft and Amazon all reporting. Finally, one potential risk event that markets will be bearing in mind is a possible US government shutdown on April 29 if the debt ceiling is not suspended or a continuing funding resolution is passed.

UK

We will need to wait until Friday for the data highlights with Q1 GDP and Gfk Consumer Confidence. The UK PM also hosts EC President Juncker and the EU's Brexit negotiator Barnier on Wednesday.

China

A very quiet week in China with only Industrial Profits Thursday. The following Sunday brings the official Manufacturing and Non-manufacturing PMIs which we will preview in next week's What to Watch.

Japan

The Bank of Japan meets Thursday (firmly on hold) while Friday brings a slew of data including Unemployment, CPI, Retail Sales and Industrial Production. There is some risk of the BoJ needing to push out its inflation forecasts given a lack of domestic inflationary pressures and a stronger Yen.

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Fixed Interest Market

Reuters: BNZL, BNZM Bloomberg:BNZ

NZ's stronger than expected Q1 CPI outturn should help underpin a floor for NZ short-term rates. CPI inflation reached a six-year high of 2.2%. On three of the six core CPI measures the RBNZ has previously referred to, annual inflation is now above 2%, while the average of all six is 1.9%, showing a steadily higher trend after bottoming five quarters ago at 1.0%.

While inflation was a remarkable 0.7 percentage points higher than the RBNZ's February MPS projection, in the March OCR Review, the Bank conceded that inflation would be higher and "variable" over the next year, before settling around 2%. That said, this is the third consecutive quarterly miss to the upside on inflation relative to the RBNZ's forecasts so it is clear that inflationary pressures are higher than the Bank has forecast. The question is, how long can the RBNZ maintain its current policy guidance of rates-on-hold for at least another 2½ years?

The Bank has been successful in keeping a lid on short term rates (and the NZD) by maintaining this guidance. We see small steps as the year develops of the Bank gradually bringing forward the timing of rate hikes. The Bank is still likely a long way from accepting the market's view that rate hikes could come as early as Q1 next year, but the direction of change in the Bank's rate projections should be clear. If the Bank is perceived to be too far behind the curve then eventually higher long term rates and upward pressure on the NZD would prevail anyway, so it makes no sense for the Bank to "game" the market. It'll just take a bit more time for the Bank to accept that the higher inflationary dynamic is sustainable.

Current OIS pricing shows that March 2018 is now fully priced for a 25bps rate hike. Being an OCR review and not an MPS, the Bank is unlikely to initiate a tightening cycle at that meeting so we see market pricing as a toss-up between February and May. BNZ economists err towards May as the first rate hike, with 75bps of tightening through 2018. This rate profile gives a 2-year swap rate fair value of 2.34%, so more or less aligned to current market pricing, with BNZ's view consistent with a slightly later start, but a steeper profile of tightening.

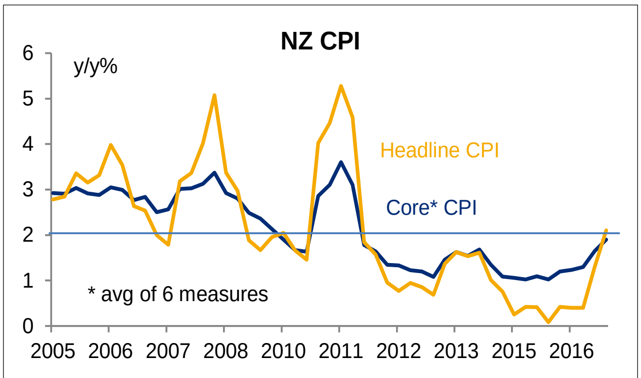
NZ releases this week don't look to be market moving, but Wednesday's Australian CPI will be watched closely. As in NZ, the core and headline CPI measures are expected to rise, with annual increases close to the 2% mark, in line with target. Unlike the last few Australian CPI reports, we wouldn't see another low print as significantly increasing the risk of further rate cuts (unless it is shockingly low). The RBA has signalled little appetite for further easing. Moreover, the market is priced for a flat cash rate for the year ahead, near the least amount of easing priced so far this year. So it's harder to see the CPI report driving a further rally in the Aussie front end.

The long-end of the curve has seen higher rates, as hedges unwind following the market-friendly first round of the French Presidential election vote. Macron is seen to be a convincing winner against Le Pen in the 7 May second round vote.

Fed speakers were out in force last week, suggesting that despite the recent softer US data, policy guidance remained for rate hikes ahead. Words like that lend some support to higher US rates, after their recent tumble. Last Friday Trump said that he would release a tax plan on Wednesday that will include a "massive tax cut" for businesses and individuals. The market will tread warily on this, as plans are one thing and actions are another. But if easier fiscal policy becomes a focus for this week, then that's another factor adding some upside pressure to US (and therefore NZ) rates.

So as the new week begins, we are seeing upside pressure to longer end rates. When we look back on April, rates probably fell too much in the first half of the month. By month-end, we could find ourselves back in the middle of the familiar ranges seen so far this year.

A Rise in NZ Inflationary Pressure



Source: BNZ, Bloomberg

Current Rates/Spreads and Recent Ranges

	Current	Last 3-weeks range*
NZ 90d bank bills (%)	1.97	1.95 - 2.00
NZ 2yr swap (%)	2.36	2.25 - 2.36
NZ 5yr swap (%)	2.92	2.78 - 2.92
NZ 10yr swap (%)	3.40	3.24 - 3.43
2s10s swap curve (bps)	104	96 - 109
NZ 10yr swap-govt (bps)	36	25 - 36
NZ 10yr govt (%)	3.03	2.91 - 3.14
US 10yr govt (%)	2.25	2.16 - 2.39
NZ-US 10yr (bps)	78	69 - 78
NZ-AU 2yr swap (bps)	48	38 - 50
NZ-AU 10yr govt (bps)	49	43 - 54

*Indicative range over last 3 weeks

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Foreign Exchange Markets

Reuters pg BNZWFWDS Bloomberg pg BNZ9

One of the year's big risk events has now passed, with a market-friendly outcome to the first round vote of the French Presidential election. The second round vote has yet to come, of course, but polls give Macron a convincing victory (62% vs. 38%) against Le Pen. The polls were a reliable guide to the first round vote.

So the week begins with a relief-bounce in EUR and the yen under pressure as pre-election hedges unwind. The NZD will start the week with positive risk sentiment providing some support. With French election risk now cleared, we can put through EUR forecast revisions, which will come later in the week. EUR has been overdue for an upgrade, as euro area data remain solid and the ECB outlook for policy normalisation becomes clearer. Our projected path of NZD/EUR will be lower, it is just a case of how much and how fast.

Last week's announcement of a snap election in the UK has also been viewed positively by the market. It avoids the "cliff-edge" scenario after the end of the two-year negotiating period. An upgrade of GBP forecasts would see NZD/GBP revised lower.

NZD/USD has been in a tight trading range of around 0.69-71 over the past seven weeks. We see more chance of a break to the upside than the downside over coming weeks. Geo-political factors have weighed on the NZD. As time passes, the risk of some military action in Korea will likely dissipate. Furthermore, the US bombing of a Syrian airfield that agitated US-Russia relations, proved to be a one-off event. A fading of geo-political risk would be NZD-positive.

It's an action packed economic calendar ahead. Locally the focus will be on Friday's ANZ business outlook survey, which should show robust levels of confidence if the BNZ PMI and PSI are anything to go by, and higher inflation expectations. No real news there.

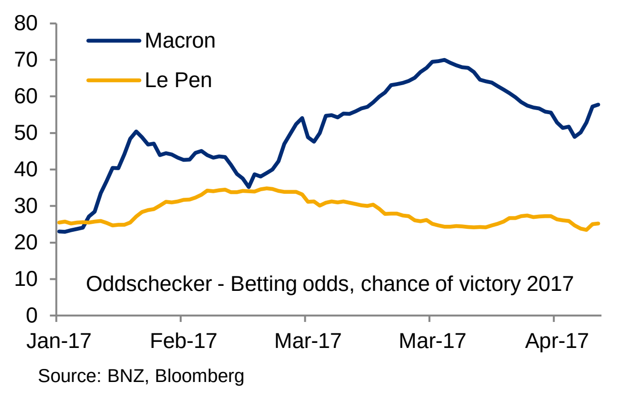
For the AUD, the Q1 CPI release will be the focus. As in NZ, the core and headline CPI measures are expected to rise, with annual increases close to the 2% mark, in line with target. Unless the data significantly surprises, expectations for a steady RBA for a long time and a neutral impact on the AUD should prevail. A test of AUD 0.94 last week after the strong NZ CPI result was rejected last week, but we see an eventual break of that within the next month or two.

A plethora of data hits the US market, with most interest in Friday's employment cost index, for any sign of increased wage inflation, and Q1 GDP, where a soft result is well anticipated. Fed speakers were out in force last week, suggesting that despite the recent softer US data, policy guidance remained for rate hikes ahead. Words like that lend some support to the USD. Last Friday Trump said that he would release a tax plan on Wednesday that will include a "massive tax cut" for businesses and individuals. The market will tread warily on this, as plans are one thing and actions are another. With a plan for a border tax now seemingly dead, it removes a source of potential revenue and USD-upside. Of note, a continuing resolution to avoid a US government shutdown needs to be passed by Friday. One thing we can be sure of is that gridlock in Washington remains a defining feature of the US political landscape.

Elsewhere this week, Thursday's ECB meeting isn't expected to be a show-stopper this week. The market is anticipating a less dovish policy tone in due course, but a significant change to the policy outlook language might have to wait until the June meeting. However, the risks are skewed, and ultimately a shift in ECB policy language would support a more positive EUR backdrop.

Thursday's BoJ meeting should pass with little reaction. Inflation remains well below target, as Governor Kuroda reiterated last week. Any change to BoJ policy remains a distant prospect. A more positive risk backdrop should act as a headwind for the yen over coming weeks, allowing NZD/JPY to recover some lost ground.

Macron Should Cruise to Victory in 2nd Round Vote



Cross Rates and Model Estimates

	Current	Last 3-weeks range*
NZD/USD	0.7041	0.6910 - 0.7050
NZD/AUD	0.9302	0.9180 - 0.9400
NZD/GBP	0.5491	0.5460 - 0.5620
NZD/EUR	0.6459	0.6440 - 0.6620
NZD/JPY	77.70	75.70 - 78.00

*Indicative range over last 3 weeks, rounded figures

BNZ Short-term Fair Value Models

	Model Est.	Actual/FV
NZD/USD	0.7250	-3%
NZD/AUD	0.9150	2%

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Technicals

NZD/USD

Outlook:	Downward channel
ST Resistance:	0.7090 (ahead of 0.7250)
ST Support:	0.6890 (ahead of 0.6860)

Another week has passed with support and resistance levels not really threatened, as the currency trades in a tight range. Strong support kicks in between 0.6860-0.6890. A break of this would open up significant downside risk. Mild short-term resistance comes into play from around 0.7090.

NZD/AUD

Outlook:	Trading range
ST Resistance:	0.9350 (ahead of 0.9400)
ST Support:	0.9150 (ahead of 0.9100)

After a significant fall, support kicked in around the 0.91 mark. As this level hasn't really been threatened over recent weeks, it forms the basis of a stronger support base. The first area of resistance kicks in around 0.9350-0.9400.

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NZ 5-year Swap Rate

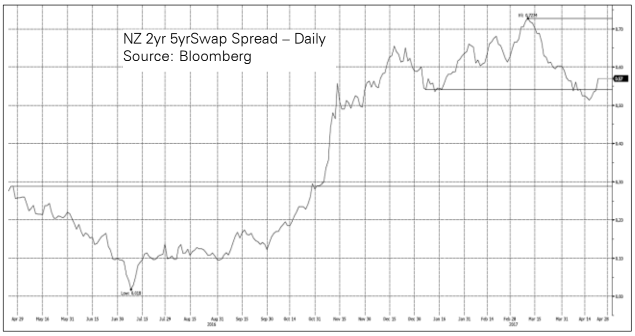
Outlook:	Neutral
ST Resistance:	2.92
ST Support:	2.62

Support held at 2.79, now testing resistance of 2.92. Look for breakout before establishing position.

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

Outlook:	Bearish
ST Resistance:	+72
ST Support:	+53.5

Break of support at 53.5 wasn't held and now forms support. Back in the 53.5 -72 range.



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Key Upcoming Events

	Forecast	Median	Last
Monday 24 April			
China, Leading Index (Conference Bd), March			+1.1%
Germ, IFO Index, April		112.4	112.3
UK, CBI Industrial Trends, April		+6	+8
US, Fed's Kashkari Speaks			
Tuesday 25 April			
NZ, Holiday, ANZAC Day			
US, Shiller Home Price Index, February y/y			+5.9%
US, New Home Sales, March		584k	592k
US, Consumer Confidence, April		123.0	125.6
Wednesday 26 April			
NZ, External Migration, March s.a.			+6,000
Aus, CPI, Q1	+0.7%	+0.6%	+0.5%
Thursday 27 April			
NZ, Finance Minister Joyce Speaks, Pre-Budget			
Aus, Lowe Speaks, Renminbi Dinner			
Aus, Terms of Trade, Q1		+8.5%	+12.2%
China, Industrial Profits, March y/y			
Jpn, BOJ Policy Announcement, Policy Rate		-0.1%	-0.1%
Euro, Economic Confidence, April		108.1	107.9
Euro, ECB Policy Announcement, Main Refi	0.00%	0.00%	0.00%
Germ, CPI, Apr y/y 1st est		+1.9%	+1.6%
UK, CBI Retailing Reported Sales, April		+6	+9

	Forecast	Median	Last
Thursday 27 April cont'd…			
US, Durables Orders, February 1st est		+1.3%	+1.8%
US, International Goods Trade, March		-$65.4b	-$63.9b(P)
Friday 28 April			
NZ, ANZ Business Survey, April			+11.3
NZ, Building Consents, March (res, #)			+14.0%
NZ, Merchandise Trade, March	+$492	+$370m	-$18m
Aus, Private Sector Credit, March	+0.4%	+0.5%	+0.3%
Aus, Producer Prices, Q1 y/y			+0.7%
Jpn, CPI, March y/y		+0.3%	+0.3%
Jpn, Industrial Production, March 1st est		-0.8%	+3.2%
Euro, CPI, Apr y/y 1st est		+1.8%	+1.5%
Germ, Retail Sales, March		flat	+1.8%
UK, GDP, Q1 1st est		+0.4%	+0.7%
US, Employment Cost Index, Q1		+0.6%	+0.5%
US, Mich Cons Confidence, April 2nd est		98.0	98.0P
US, Chicago PMI, April		56.5	57.7
US, Fed's Harker Speaks			
US, GDP, Q1 1st est		+1.1%	+2.1%
Sunday 30 April			
China, PMI (NBS), April		51.7	51.8
China, Non-manufacturing PMI, April			55.1

Historical Data

	Today	Week Ago	Month Ago	Year Ago
CASH & BANK BILLS				
Call	1.75	1.75	1.75	2.25
1mth	1.84	1.84	1.83	2.26
2mth	1.90	1.91	1.89	2.30
3mth	1.97	1.97	1.95	2.32
6mth	2.02	2.02	2.02	2.34
GOVERNMENT STOCK				
12/17	1.80	1.84	1.86	2.03
03/19	2.13	2.10	2.09	2.08
04/20	2.30	2.25	2.34	2.15
05/21	2.44	2.36	2.52	2.21
04/23	2.72	2.65	2.82	2.40
04/25	2.96	2.90	3.13	2.66
04/27	3.02	2.96	3.25	2.80
04/33	3.30	3.27	3.61	3.13
GLOBAL CREDIT INDICES (ITRXX)				
AUD 5Y	85.50	89.33	80.50	134.50
N. AMERICA 5Y	67.12	67.89	61.01	80.28
EUROPE 5Y	74.57	76.68	69.57	73.50

	Today	Week Ago	Month Ago	Year Ago
SWAP RATES				
2 years	2.36	2.29	2.30	2.23
3 years	2.58	2.49	2.56	2.29
5 years	2.92	2.82	2.98	2.49
10 years	3.40	3.31	3.54	2.93
FOREIGN EXCHANGE				
NZD/USD	0.7038	0.7014	0.7017	0.6910
NZD/AUD	0.9312	0.9242	0.9112	0.9007
NZD/JPY	77.45	76.47	79.04	74.89
NZD/EUR	0.6471	0.6592	0.6535	0.6118
NZD/GBP	0.5490	0.5585	0.5665	0.4872
NZD/CAD	0.9489	0.9346	0.9367	0.8966
TWI	76.46	76.34	76.40	73.04

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