27 March 2017

The Big Picture

- Friday's business survey in focus
- As RBNZ sounds relaxed about inflation pick-up
- Regional GDP figures due Thursday
- Feb's building consents to rise above Canterbury's drag?
- Sector balance sheet data due Friday

There is a range of big-picture economic reports regarding New Zealand this week. But the only one the market will focus on will be Friday afternoon's ANZ business survey. Recall that February's edition lost a chunk of momentum. But this was principally as agriculture firms became much less optimistic, rather than reflecting a widespread loss of momentum. At heart, the survey remained consistent with annual real GDP growth of at least 3%.

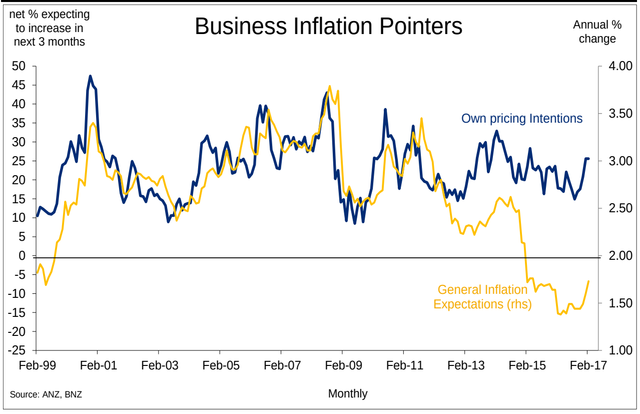
This was one of the many reasons we weren't frazzled by Q4 GDP, which we presumed would be as slow as it was, because of some once-offs. We were pleased to see the Reserve Bank, in its OCR commentary last week, also judged the 0.4% GDP growth in the December quarter as being restrained by transitory factors.

The RBNZ appears to be taking a similar approach to the upcoming CPI figures. The Bank now seems to accept the likelihood of annual CPI inflation printing around, even above, 2% in Q1 2017 (about two years earlier than previously forecast). However, the RBNZ also seems to be looking through this sudden return to the middle of the 1.0 to 3.0% band as reflecting temporary impacts – namely food and fuel. The Bank would seem to be unconvinced annual CPI inflation will stay around 2% for any length of time, even with the lower than expected currency.

We accept the role that higher food and fuel prices will play in the Q1 CPI result. But we also believe core inflation is on a firming trajectory, also closing in on 2% at an annual rate. We also reckon that headline inflation will stay up around 2%, rather than slump again, as base effects drop out. This will, in turn, keep lifting the inflation expectations variables that the Bank attaches a lot of importance to.

It's worth recalling that abating expectations of inflation – as headline CPI inflation was being dented by commodity price capitulation over 2015/16 – was the principal reason the RBNZ cut its cash rate to record lows last year. More precisely, expectations of CPI inflation over the near term were falling (with the Reserve Bank noting throughout that longer-term inflation expectations held up well).

Firming Up



So a rebound in near-term inflation expectations, underpinned by a reversal in commodity price weakness, would seem important – if the Bank was going to apply some semblance of symmetry.

While the Bank's policy response is open to question, inflation expectations measures have certainly been firming up over recent months and quarters. Friday's ANZ business survey has been testimony to this. Its inflation expectations variable continued to rebound in February, hitting 1.73%, while its pricing intentions remained on the firm side, at +25.6. It will be interesting to see how they did in March.

Friday's building consents will be worth checking too. For the month of February these will hopefully show a more definite rebound than they did in January. Any fresh reversal will cast doubt on construction's contribution to GDP growth over the early part of 2017. What's become clear is that consent issuance in Canterbury is weighing on the national figures, but that expansion in other regions is taking up the slack.

Speaking of which, there is also Thursday's (10:45am) Regional GDP report to mention. While these date back to the year ended March 2016, they will, in the least, be useful in demarcating Canterbury's relative ups and downs – if only on a nominal basis.

Economist types will also be interested Friday's (10:45am) Annual Balance Sheet publication from Statistics NZ – traversing households, business and public sectors, and covering the period 2007-15. But we doubt the market will pay any regard to it.

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Global Watch

- Brexit clause expected to be activated Wednesday
- Another slug of Fed speeches
- China PMIs and US PCE deflators the pick of limited data

Australia

A quiet data week ahead with RBA Credit Statistics Friday the likely highlight – is investor credit still running at near APRA's 10% limit? RBA Deputy Governor Debelle speaks Tuesday at an FX Conference in Sydney.

There's no speech title and while no doubt he may well refresh the local FX market audience on the soon-to-be implemented FX Global Code of Conduct, any comments he has on the AUD, the economy and monetary policy will also be closely followed.

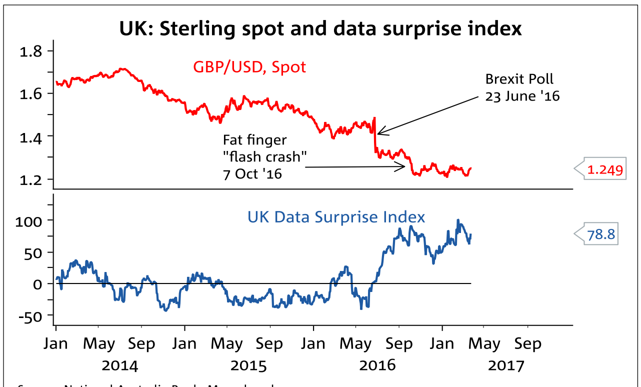
There may be some China-commodities focus with China's Premier Li Keqiang's visit to Australia and then two commodity conferences, one from the FT on Tuesday in Lausanne with the CEOs of Rio and Cargill speaking, then the annual Steel and Iron Ore Conference in Perth on Wednesday with BHP's WA Iron Ore Head Edgar Basto speaking. It is all worth monitoring for any implications for the wider commodity complex including those relevant for New Zealand.

Data wise, Friday's RBA Credit report for February will be watched for what it says about the growth in housing credit, especially investor housing, with recent investor housing approvals in NSW and Victoria showing signs of re-acceleration.

Investor housing credit grew by 0.6% (unrounded it was 0.64%, close to the 0.7% it's averaged over the past three months), an underlying growth that's been pressing back up towards the 10% APRA annualised growth speed limit. Also of interest will be Business Credit that had a large miss in January, down 0.3%, the first decline since last June and following signs of some renewed trend growth in December. NAB looks for some step up in overall Credit growth to 0.4% after last month's lower 0.2% reading. The market consensus is for somewhat faster growth of 0.5%.

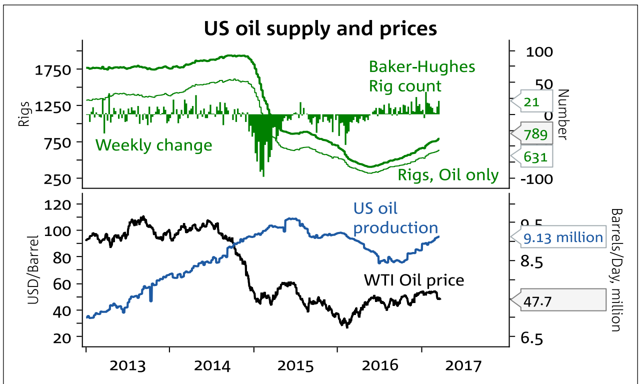
Other releases for the week include the weekly ANZ-Roy Morgan Consumer Confidence reading on Tuesday, HIA New Home Sales for February on Thursday (one of the very few readings on the demand for dwellings), along with quarterly ABS Job Vacancies for the February quarter. Job Vacancies is one of several labour demand indicators pointing to continued employment growth in the near term.

Chart 1: UK economy holding up to date



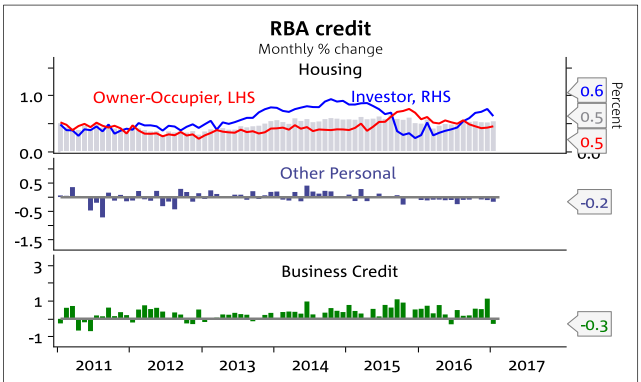
Source: National Australia Bank, Macrobond

Chart 2: US oil producers stepping up



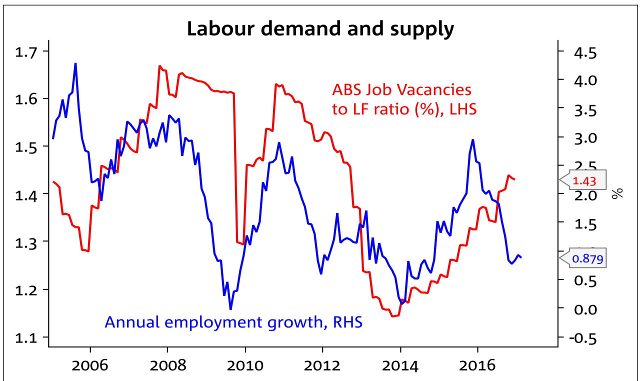
Source: National Australia Bank, Macrobond

Chart 3: Tracking Investor Housing growth



Source: National Australia Bank, Macrobond

Chart 4: Labour demand has been increasing



Source: National Australia Bank, Macrobond

China

Official Manufacturing and Non-manufacturing PMIs for March out Friday, a steady 51.6 Manufacturing print expected.

US

Key data this week include Consumer Confidence and Sentiment, regional Fed Manufacturing Indexes (including the Chicago PMI Friday), and the February Personal Income, Spending, and PCE Deflators report out Friday. Another very solid week of Fed speak with no less than 13 Fed speakers, including Yellen on Tuesday, but any surprises?

Japan

Retail Trade on Wednesday, but real focus on Friday's CPI.

Eurozone

German Ifo Survey Monday and Confidence Surveys Thursday. Germany's CPI is Thursday and for the EZ on Friday.

UK

PM May set to trigger formal Brexit talks on Wednesday 29th and resulting in two years of protracted Brexit negotiations. Revised Q4 GDP on Friday of some interest, otherwise second tier data releases.

Canada

BoC Governor Poloz speaks on Wednesday. January monthly GDP on Friday.

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Fixed Interest Market

Reuters: BNZL, BNZM Bloomberg:BNZ

Last week the RBNZ OCR Review came and went without much fanfare, meeting market expectations. The Bank acknowledged that CPI inflation over the near term would be driven higher by food and import prices, but it saw this impact as temporary. Thus, it maintained a neutral policy stance and the final paragraph was identical to the February Monetary Policy Statement.

None of this surprised the market and OIS pricing remains unchanged, with a 38% chance of a tightening priced in by November this year, and the first full hike priced in by March next year. BNZ economists still see the first hike coming in May 2018, so the market is a little ahead of that, but not significantly so. Thus, a 2-year swap rate around 2.30% is close to fair value assuming the BNZ rate track ahead, which sees three rate hikes next year.

The Q1 CPI release due 20 April will be keenly awaited by the market. The RBNZ now belatedly admits that headline CPI will be close to 2%, something we've highlighted for some time. But more important will be the core measures. An average of 6 annual core CPI measures has lifted from 1.0% to 1.7% over the past 4 quarters. Further upside on this measure over the next quarter or two would certainly bring into question the Bank's view that the OCR can remain unchanged through to late 2019.

Until then, we're unlikely to see much change in pricing at the short end of the curve. At 2.30% and below, paying interest is likely to arise and the 2.40% mark is likely to attract receivers. This week's local data are unlikely to be market moving. The ANZ business outlook survey on Friday has the most chance to move the market, but don't count on it. Slightly higher inflation expectations and confidence indicators remaining above average wouldn't be a surprise.

The 5-year swap rate has been locked in a 2.90-3.10% range all year and we see that holding. The near-term risk is a break to the downside, due to global forces, but we suspect any break wouldn't last for long and borrowers should take advantage to pay fixed rates on any dip in rates.

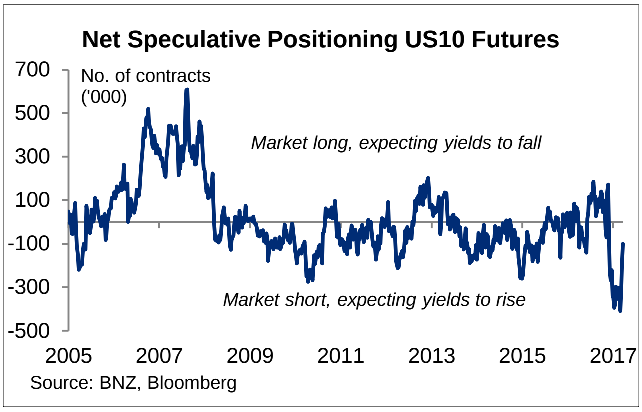
The global economic calendar is fairly light again, with much of the action late in the week. US personal income and spending data that are released alongside the core PCE deflator hold the most interest, but that inflation measure is expected to remain unchanged at 1.7%, providing no smoking gun for the Fed to ramp up its tightening stance. It's another big week on the Fed speaking circuit, but last week's effort didn't trigger much market reaction and neither should this week's offering.

CFTC data show that net short positioning in US10s has been reduced to the smallest level since November. This suggests a lower hurdle rate for US long-rates to test the upper end of the well-established 2.30-2.60% range. We expect an eventual break to the topside, albeit later in the year. We can't see any triggers this week to rock the boat. This implies that NZ long rates should tread their familiar ranges.

The market will be chewing over the failure of Trump to repeal Obamacare, disrupted by a divided Republican party. The focus now turns to the President's tax reform agenda. While getting tax legislation through the House should be a lot easier than the health bill, Trump still needs support from his own party, in particular his colleagues that make up the House Freedom Caucus and are proving to be a thorn in his side. That Caucus opposes any tax reform that adds significantly to the fiscal deficit.

It seems more likely that a massive fiscal stimulus is unlikely. If true, then this reduces the chance that the Fed will be moved to suggest that the Fed Funds rate needs to be on a steeper track than already projected. So while the market has been reducing its short positions in USTs, there has been a good fundamental reason behind this move. The watering down of potential fiscal stimulus reduces the chance that the Fed is behind the curve. This possibly argues for the range-trading environment persisting for longer than previously thought.

Market Has Been Closing Short US10s Positions



Current Rates/Spreads and Recent Ranges

	Current	Last 3-weeks range*
NZ 90d bank bills (%)	1.98	1.95 - 1.99
NZ 2yr swap (%)	2.32	2.27 - 2.36
NZ 5yr swap (%)	2.93	2.90 - 3.09
NZ 10yr swap (%)	3.45	3.42 - 3.65
2s10s swap curve (bps)	114	114 - 128
NZ 10yr swap-govt (bps)	26	23 - 28
NZ 10yr govt (%)	3.19	3.18 - 3.40
US 10yr govt (%)	2.41	2.37 - 2.63
NZ-US 10yr (bps)	78	73 - 82
NZ-AU 2yr swap (bps)	39	27 - 39
NZ-AU 10yr govt (bps)	44	41 - 49

*Indicative range over last 3 weeks

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Foreign Exchange Markets

Reuters pg BNZWFWDS Bloomberg pg BNZ9

The NZD has been showing signs of consolidation after being hammered early in the month. Last week, it traded within a tight one cent range (circa USD 0.6995-0.7090) with the RBNZ OCR review and shenanigans around Trump's health bill (that was eventually pulled) not having much impact.

Against the USD, the early and mid-month level of 0.6890 proved to be an area of decent support. Of course, one factor has been the general USD weakness as the market questions the extent of any forthcoming US fiscal stimulus, but importantly dairy prices have shown signs of consolidation.

The last GDT dairy auction showed signs of increased demand and some unsatisfied bidders even though more supply was offered. The pricing outlook now looks much better than it did two weeks ago, but we're not confident that prices can continue to recover much further. We think a safer bet is to view the dairy market as one of consolidation, or a fairly neutral factor for the NZD over coming months.

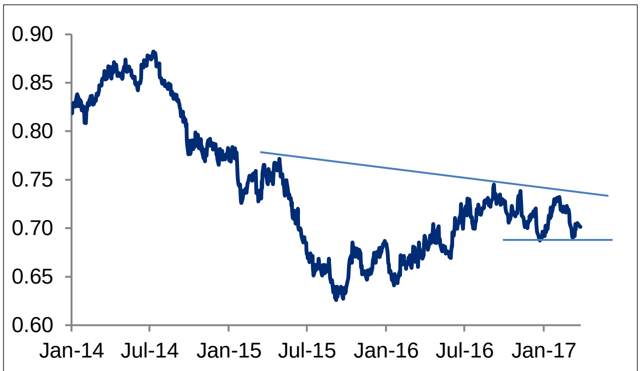
The RBNZ's OCR review came and went without much fanfare, meeting market expectations. The Bank maintained its neutral policy stance, reiterating that "monetary policy will remain accommodative for a considerable period". The RBNZ seems unperturbed by the prospect of annual headline CPI inflation moving up through 2% over the near term, driven by higher food and import prices, as it sees inflation returning to the mid-point over the medium-term. Recall that only six weeks ago the RBNZ didn't think the mid-point would be reached for over two years.

We're aligned with the market's view that inflation will track higher than the RBNZ believes, leading to tighter policy from the first half of next year. The Bank continued to cite "numerous uncertainties" which provides plenty of wriggle room for it to change its view. The Bank has been very careful to espouse a neutral policy stance, which has helped keep a lid on the NZD. The Bank will try to maintain this stance for as long as possible before conceding that rates might need to be raised sometime next year, in the hope that other central banks get closer towards normalising their policies. This is all about trying to avoid any undesired upward pressure on the NZD.

The week ahead is looking to be another quiet one, at least on paper. The key local release will be the ANZ business outlook survey on Friday. This should show confidence indicators remaining above average. The market is likely to be more interested in the inflation gauges. Inflation expectations are likely to continue to shift higher, in line with actual inflation.

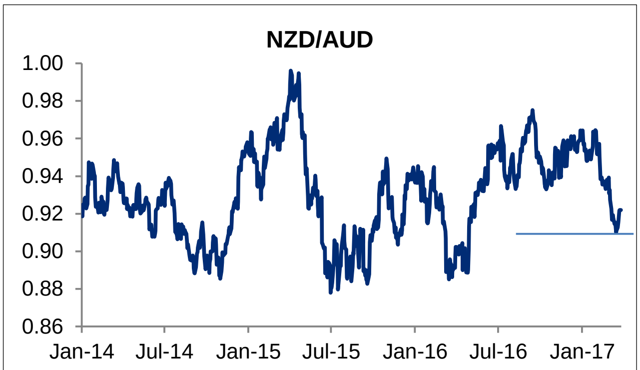
The global economic calendar is light again. US personal income and spending data that are released alongside the core PCE deflator hold the most interest, but that inflation measure is expected to remain unchanged at 1.7%, providing no smoking gun for the Fed to ramp up its tightening stance. Focus will return to GBP as PM May is expected the trigger the Brexit process on Wednesday. In itself, this formal trigger is no big deal but from this point on expect some tough talking from EU leaders to begin.

NZD Supported Just Below USD 0.69



Source: BNZ, Bloomberg

NZD/AUD Due For Recovery After a Big Tumble?



Source: BNZ, Bloomberg

Cross Rates and Model Estimates

	Current	Last 3-weeks range*
NZD/USD	0.7021	0.6890 - 0.7090
NZD/AUD	0.9236	0.9070 - 0.9240
NZD/GBP	0.5623	0.5610 - 0.5740
NZD/EUR	0.6478	0.6470 - 0.6630
NZD/JPY	77.88	77.80 - 80.10

*Indicative range over last 3 weeks, rounded figures

BNZ Short-term Fair Value Models

	Model Est.	Actual/FV
NZD/USD	0.7290	-4%
NZD/AUD	0.9050	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)

The technical picture remains one of a slight downward channel over the past six months. There is decent support just under the 0.69 mark. Short-term resistance levels are a bit more flakey, with more solid resistance not in sight until about 0.7250.

NZD/AUD

Outlook:	Trading range
ST Resistance:	0.9300 (ahead of 0.9400)
ST Support:	0.9100 (ahead of 0.8930)

After a significant fall, it looks like support kicked in around the 0.91 mark. This would need to hold for a few weeks to be sure. Resistance levels are well north of current spot, a reflection of the savage downward break.

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NZ 5-year Swap Rate

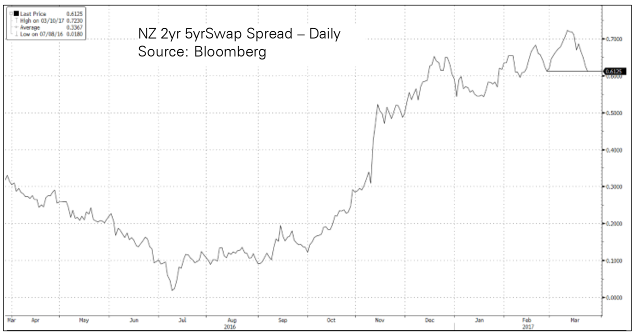
Outlook:	Neutral
ST Resistance:	3.30
ST Support:	2.91

Still neutral. Major support at 2.91 is holding.

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

Outlook:	Steeper
ST Resistance:	+88
ST Support:	+61.25

Sitting right on support at +61.25. Stop on a close through here, otherwise steepening to continue.



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Key Upcoming Events

	Forecast	Median	Last
Monday 27 March			
Jpn, BOJ Summary of Latest Meeting, 15/16 March			
Euro, M3, February y/y		+4.9%	+4.9%
Germ, IFO Index, March		111.1	111.0
US, Fed's Evans/Kaplan Speak			
Tuesday 28 March			
Aus, RBA's Debelle Speaks, FX Week			
US, Consumer Confidence, March		114.0	114.8
US, Shiller Home Price Index, January y/y			+5.8%
US, International Goods Trade, February advance		-$67.2b	-$68.8b
US, Fed's Yellen/George/Kaplan/Powell Speak			
US, Wholesale Inventories, February 2nd est		+0.2%	-0.2%
Wednesday 29 March			
Jpn, Retail Sales, February y/y		+0.7%	+1.0%
UK, PM May Triggers Brexit Proceedings			
US, Pending Home Sales, February		+2.8%	-2.8%
US, Fed's Evans/Rosengren/Williams Speak			
Thursday 30 March			
NZ, Regional GDP, Year to March 2016			
Euro, Consumer Confidence, March 2nd est-5.0P			
Euro, Economic Confidence, March		108.3	108.0
Germ, CPI, Mar y/y 1st est		+1.8%	+2.2%
US, Jobless Claims, week ended 25/03		247k	261k
Thursday 30 March cont'd…			
US, GDP, Q4 3rd est		+2.1%	+1.9%
US, Fed's Mester/Dudley/Kaplan Speak			
Friday 31 March			
NZ, Building Consents, February (res, #)			+0.8%
NZ, Annual Balance Sheets, 2007-15			
NZ, ANZ Business Survey, March			+16.6
Aus, Private Sector Credit, February	+0.4%	+0.5%	+0.2%
China, Non-manufacturing PMI, March			54.2
China, PMI (NBS), March		51.7	51.6
Jpn, CPI, February y/y		+0.3%	+0.4%
Jpn, Industrial Production, February 1st est		+1.2%	-0.4%
Jpn, Household Spending, February y/y (real)		-1.7%	-1.2%
Jpn, Unemployment Rate, February		3.0%	3.0%
Euro, CPI, Mar y/y 1st est		+1.8%	+2.0%
Germ, Retail Sales, February		+0.7%	-0.8%
Germ, Unemployment Rate, March s.a.		5.9%	5.9%
UK, GDP, Q4 3rd est		+0.7%	+0.7%P
US, Mich Cons Confidence, March 2nd est		97.6	97.6P
US, Chicago PMI, March		56.9	57.4
US, Personal Spending, February		+0.2%	+0.2%
Sunday 2 April			
NZ, Daylight Saving Ends, -1hr to +12:00GMT			

Historical Data

	Today	Week Ago	Month Ago	Year Ago
CASH & BANK BILLS				
Call	1.75	1.75	1.75	2.25
1mth	1.85	1.83	1.84	2.30
2mth	1.90	1.89	1.92	2.32
3mth	1.98	1.95	2.00	2.34
6mth	2.01	2.02	2.03	2.34
GOVERNMENT STOCK				
12/17	1.85	1.86	1.87	2.04
03/19	2.12	2.09	2.16	2.11
04/20	2.34	2.34	2.41	2.26
05/21	2.51	2.52	2.57	2.36
04/23	2.79	2.82	2.82	2.59
04/25	3.09	3.13	3.12	0.00
04/27	3.19	3.25	3.23	2.98
04/33	3.55	3.61	3.60	3.30
GLOBAL CREDIT INDICES (ITRXX)				
AUD 5Y	88.11	80.50	84.69	125.80
N. AMERICA 5Y	67.04	61.01	62.65	85.36
EUROPE 5Y	75.14	69.57	75.01	70.08

	Today	Week Ago	Month Ago	Year Ago
SWAP RATES				
2 years	2.32	2.30	2.32	2.24
3 years	2.56	2.56	2.55	2.30
5 years	2.93	2.98	2.93	2.53
10 years	3.45	3.54	3.43	3.02
FOREIGN EXCHANGE				
NZD/USD	0.70	0.7017	0.7197	0.6788
NZD/AUD	0.9219	0.9112	0.9378	0.8933
NZD/JPY	78.1100	79.037	80.745	75.660
NZD/EUR	0.65	0.6535	0.6815	0.6020
NZD/GBP	0.5634	0.5665	0.5775	0.4690
NZD/CAD	0.9399	0.9367	0.9435	0.8840
TWI	76.26	76.40	78.28	72.08

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