20 April 2017

Contents

Economic Outlook

For a good while, we've been talking about a higher inflation pulse showing its hand, as soon as now. Today's Q1 CPI backed up our view. Its key message was that core inflation is rising, indeed has poked above 2% on some annual measures. That is more important than the fact headline inflation jumped to 2.2% y/y, from 1.3% in Q4 (and 0.4% back in Q3). That said, higher headline CPI inflation is likely to bolster inflation expectations (and wage negotiations). The bigger question is whether CPI inflation will hold this firmly (even go up further?) or sag anew. The RBNZ seems to think the latter. We plump for the former. We believe the key data reports over the coming fortnight – the 28 April ANZ business survey and the 3 May Q1 labour market reports – will back up our view, that CPI inflation is firming from a fundamental perspective, rather than being once-off in nature. This entails growing pressure on the economy's resources.

Interest Rate Outlook and Strategy

Swap rates have lifted from year-to-date lows over the past week. Today's higher inflation figures support the idea that NZ 2-year swap rates are finding a base, in punching back above 2.30% today. A move up to 2.50% is possible over the coming months on domestic, global and technical grounds. We see a later start to the RBNZ tightening cycle than the market, but a higher terminal rate than currently priced. This suggests that the front end of the NZ curve is too flat. In addition, given the break of ranges in global long end rates, a front end steepener is lower risk than a standard 2y10y. We think the likes of 1y3y or 1y1y/2y1y have plenty of room to steepen up if the RBNZ continues to signal a neutral stance in the face of inflation at target.

Currency Outlook

NZD/EUR strength relative to our long-run fair value estimate of EUR 0.55 reflects NZ's relatively strong terms of trade and the ECB's highly accommodative monetary policy stance. Using a simple short-term model we can explain the current spot rate around EUR 0.66. Our projections show the cross holding up at, or above, current spot over the next six months, before facing headwinds and ending the year closer to EUR 0.64. The balance of risk is skewed to the downside over the medium-term, reflecting the likely strength of EUR once the ECB normalises monetary policy. The timing of ECB rate hikes is important, but uncertain. An offsetting factor is ongoing euro-area political risk, with the focus likely to turn to Italy late this year or early next year after the French Presidential elections are out of the way.

Core Inflation More Than Apples

- Inflation highest since 2011
- Significantly higher than RBNZ forecasts
- Higher inflation doesn't look like an aberration to us
- Core measures push above 2%
- Questions how long OCR can stay at 1.75%

Consumers Price Index - 2017 Q1

	Actual	Mkt Pick	Feb MPS	Q4
CPI - qtly % chg	**+1.0**	+0.8	+0.3	**+0.4**
CPI - ann % chg	**+2.2**	+2.0	+1.5	**+1.3**

The key message from today's consumer price inflation figures is that core inflation is rising and has poked above 2% on some measures. That is more important than the headline annual inflation rate jumping up to 2.2% in Q1, or the specifics around which prices rose this particular quarter. That said, higher headline inflation is relevant to the extent that it is likely to influence inflation expectations. Keep watch for indicators on the latter over coming months and quarters.

Today's inflation figures were higher than market expectations; expectations that had already been shunted higher over recent months. It was only a couple of short months ago that we felt alone picking materially higher annual inflation for this quarter. In the end, Q1's result surpassed the market's 2.0% expectation and our 2.1% estimate. Annual inflation has lifted to its highest level since 2011.

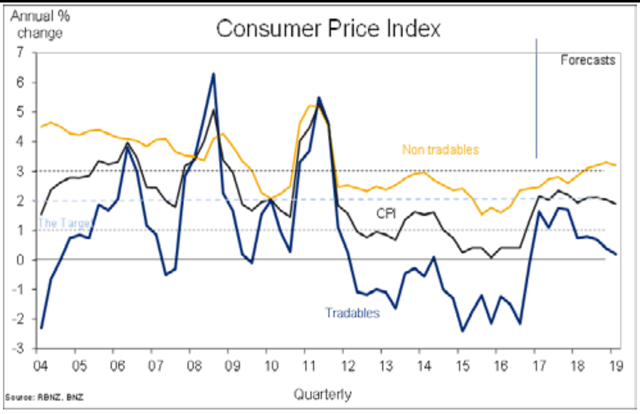
It is a similar story for the RBNZ. While the Bank acknowledged a likely higher CPI in its March OCR review, the degree of lift was probably still a surprise on the day. In any case, the Bank will have to build today's higher starting rate of inflation into its full set of forecasts for its May MPS, compared to the 1.5% it expected for this quarter when it published its February MPS.

At its March OCR Review, the RBNZ said 'Headline CPI will be variable over the next 12 months due to one-off effects from recent food and import price movements, but is expected to return to the midpoint of the target band over the medium term'. That is the Bank effectively saying that it will look through near term results driven by 'one-offs', seeing them as an aberration.

We are not convinced the higher inflation is an aberration. Indeed we expect annual inflation to be about 2% or above over the coming year or two. This outlook is materially higher than the RBNZ had forecast back in February.

The bank will also have to factor in a materially lower NZD than was included in its previous projections. Even after this morning's pop higher, at 76.7, the NZ TWI sits nearly 3% below where the RBNZ projected to average

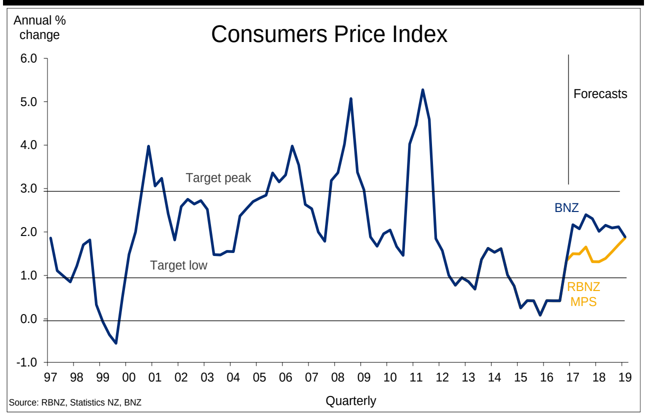
Watch Rising Non-Tradable (and Core) Inflation



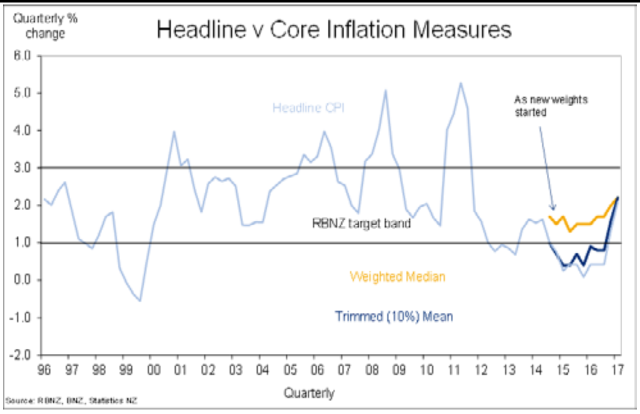
through Q2. It is important to note that this has occurred without weakness in key primary export product prices indicating a genuine easing in monetary conditions from the external channel. This mix adds upside to the Bank's previous tradable inflation forecasts. So too will the indirect effects of global inflation pushing higher including the likes of higher producer price inflation in China (even after adjusting oil and currency movements). All this as tradable annual inflation has just printed its first meaningfully positive result in five years.

Tradable annual inflation increased to 1.6% in Q1, its highest result since 2011. It was only six months ago that the Bank was projecting another negative result for this quarter. If nothing else, this illustrates the speed of potential change in this component and in itself cautions against over reacting to it in a knee-jerk fashion. This seems to be the RBNZ logic, especially as it sees heightening uncertainty overseas. But equally, we need to be aware of the positive undercurrents stemming from offshore especially as it has been the (deflating) tradable component that has been generally holding the CPI low over much of the past five years. Of course, the RBNZ has little direct and sustainable influence on tradable inflation. But it still matters. Higher current inflation is important in its own right, whatever the cause, as it can influence the likes of inflation expectations and wage negotiations.

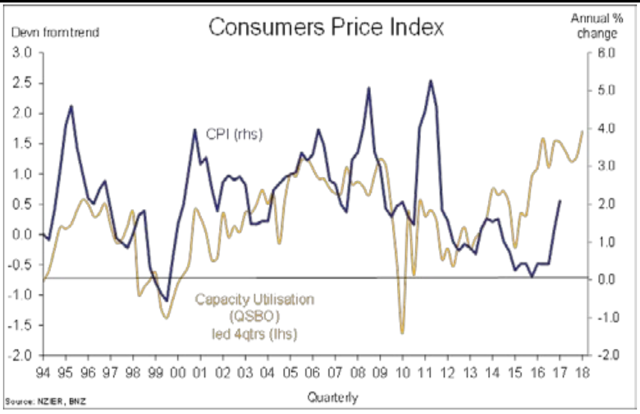
Inflation Outlook Higher Than RBNZ Projections



Core Inflation Jumps



Capacity Pressures Evident



Inflation can beget inflation, in other words. It is this dynamic that we think needs careful monitoring. It is easy to imagine inflation expectations continuing to edge higher given today's result.

Importantly, inflation seems to be becoming more broad-based over and above the particular moves this quarter such as strong, and expected, gains in petrol, food and cigarettes and tobacco (the latter on the back of an increase in excise duty). Indeed, some of these may not be all 'one-off' in nature.

Take food for example, no doubt some of the gains might be undone in time like the big jump in apple prices in January that has already unwound. Incidentally, there is potential for some other near term sharp food price increases as the impact of recent storms are felt, but, in our view, there is some genuine upward food price pressure stemming from the combination of offshore pricing and currency movements that is still to show up at the grocery store this year.

The more salient point is that core inflation is rising and even edging above 2% on some measures. For example, annual inflation at the 10% trimmed mean level was 2.2%, up from 1.6%, while the weighted median also rose to 2.2% from 2.0%. The exception to higher core inflation measures was annual CPI excluding food and energy that remained at 1.6% in Q1. We await the factor models that the RBNZ publishes around 3pm this afternoon for further guidance on core inflation.

Housing related annual inflation remained steady at 3.3%, with accelerating rents offsetting some deceleration elsewhere. More generally, non-tradable inflation rose to 2.5%, up from 2.4% in the previous quarter and higher than the RBNZ's 2.3% forecast. The RBNZ is less likely to look through higher core inflation and the non-tradable surprise.

In the first instance, the RBNZ may well feel relieved that inflation has lifted back to around the mid-point of the target band after being below it for so long. And the Bank will also be wary that recent GDP growth undershot expectations and retail interest rates have been pushing higher independent of the OCR. In other words, not all recent data have been pointing to more inflationary pressure ahead. But today's figures do ask serious questions of the RBNZ's view that it will hold the OCR steady until late 2019. Indeed, on today's inflation figures, and clear and increasing pressure on existing capacity evident from the likes of the latest Quarterly Survey of Business Opinion, our own view of a May 2018 OCR lift off from very low levels could even be a tad late but we will stay there for now. The RBNZ may still see uncertainty overseas, but the domestic inflation picture is starting to press.

Understandably, higher inflation (including core) has seen the market build in an earlier tightening by the RBNZ than it had yesterday. Not a major change, given the market has already been pricing interest rate hikes significantly before the RBNZ has indicated. For example, the 2-year swap rate lifted around 4bps shortly after the data. Meanwhile, the NZD/USD rose around 40 pts to around 0.7040. Both moves seem a fair response to today's information.

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Global Upturn Meets a More Mixed Australia

- Signs of global pick-up continue
- In spite of increased geo-political risks
- Australia's contrasting pressures leave RBA on hold

Global

The global economic upturn has ridden out geo-political shocks coming from Brexit and the risk of US policy U-turns in the wake of President Trump's election victory. The latest business surveys show very positive sentiment across the big advanced economies, recent data on global industrial output and trade shows the upturn continuing into 2017 and fear of global deflation has gone as modest price pressure returns. The main disappointment has been the big emerging economies which are key drivers of commodity demand. Central banks appear more relaxed about the outlook, with the period of maximum policy stimulus probably now behind us as the US Fed focuses on gradually lifting interest rates and the others see little need to take any new measures to boost demand. Politics still presents the main risk to our forecast acceleration in global growth from 2016's 3% rate to around 3½% by 2018 with the focus shifting to the series of elections due in Western Europe through the next year, especially those in France and Italy where anti-Euro populist parties have been polling strongly.

The improved outlook for the global economy has been reflected in increases in major equity markets, bond yields and commodity prices. This is not withstanding a recent pause, in part due to renewed uncertainty around the scale and timing of any US fiscal stimulus, and the prospect for increased oil production. Central banks in the big advanced economies have gone about as far as they plan to in easing monetary policy. The Fed is already raising rates, the Bank of England appears unlikely to further expand its asset purchase program, the ECB's monthly asset buying will slow from €80 billion to €60 billion starting this month, and the Bank of Japan is in wait and see mode.

After settling around 3% yoy through the first three quarters of 2016, global growth picked up to 3.2% yoy in December, mainly because of an upturn in big advanced economies. Reflation in the big advanced economies goes beyond the acceleration in output growth, with price pressures also lifting modestly. Meanwhile, the pick-up in inflation in the big emerging market economies has been more marked, driven by higher energy and raw material prices. The global upturn has continued into 2017 with the rate of expansion in the volumes of both world trade and industrial output ramping up through to January 2017 according to the CPB measure. Business survey results are available up to March and they show the lift in activity through late 2016 continuing into this year.

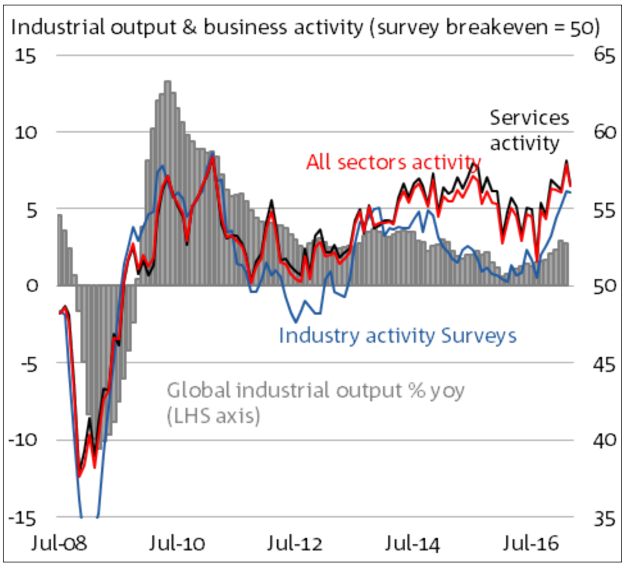
The big advanced economies that have seen the clearest evidence of faster growth. The trend in most of that data continued to be positive into early 2017. Quarterly industrial growth has lifted and the upturn in export volume growth is even stronger. The monthly business surveys have been positive for the first three months of 2017, with industrial measures showing a particularly marked lift that appears highly synchronised across the big advanced economies. Services industries make up the bulk of output in all advanced economies and they tend to be much less cyclical. Consequently, it is only to be expected that the current upturn in service sector business surveys looks less pronounced than for manufacturing. At the same time, recent survey readings are higher than for manufacturing, pointing to the former's faster rate of growth.

Economic growth in the emerging markets stagnated through last year, largely reflecting the absence of additional growth momentum in the biggest economies. That does not mean that the cyclical upturn being experienced in advanced economy output and the lift in global inflation has not been helping activity in some emerging market economies. The rate of growth in both industrial output and export volumes in the emerging market economies picked up through late last year and the upturn has carried over into 2017. The arc of export-driven East Asian economies stretching from South Korea to Singapore has seen a sharp upturn in industrial output and exports, a rebound connected to the parallel improvement in world trade. Higher global commodity prices have also boosted export revenues and national income in the many big primary producing emerging market economies.

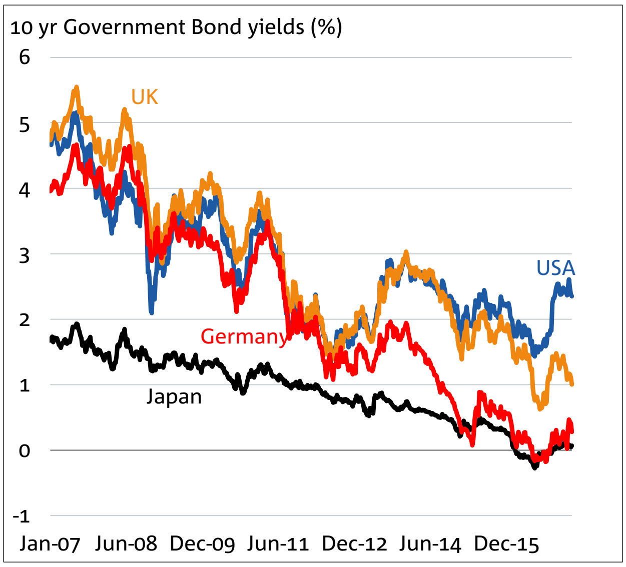
The business surveys suggest that global reflation is set to continue. By contrast, our global leading indicator of economic activity shows acceleration in growth to mid-year, but conditions dip a little after that – although it appears too early to call a pause in the growing pace of reflation. We expect the pace of global growth to quicken from 3% in 2016 to 3.3% in 2017 and then rise further to 3.5% in 2018. Our first estimate of growth for 2019 sees it coming back to around 3.3% as the US gets nearer to full capacity and Fed rate hikes bear down on growth, the Euro-zones cyclical upturn fades a little and Chinese growth continues its trend slowing. The most obvious risk hanging over this fairly positive global outlook comes from an array of geo-political risks, although so far the world economy has navigated these risks with surprisingly little impact.

For more detail on the global outlook, please see the Forward View – Global, released earlier today.

Upturn Continues Into 2017

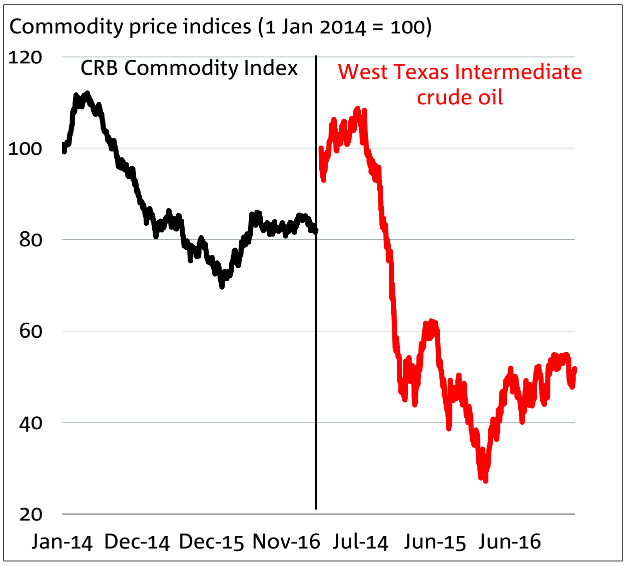


Rise in Yields Partially Unwound

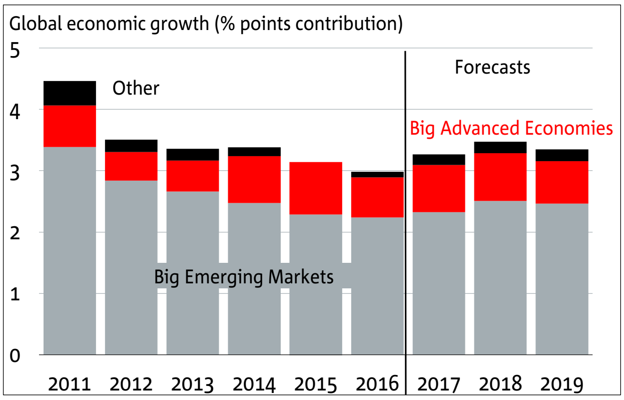


Positive Signs in Key Regions

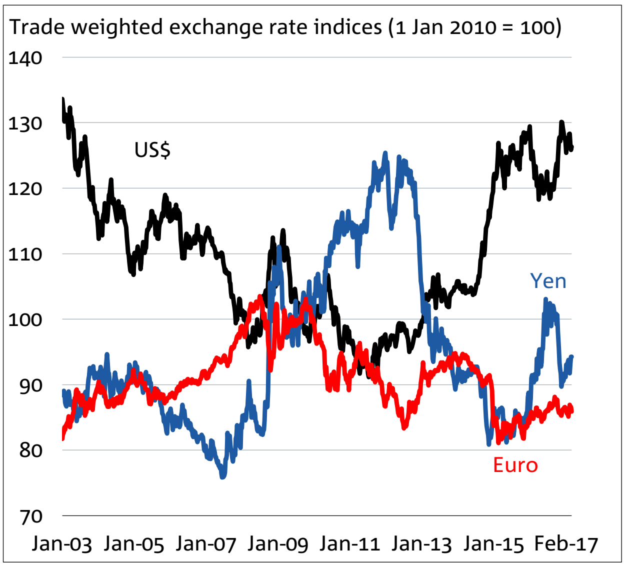
Commodity Prices Take A Pause



Growth Upturn Set to Continue



Some Unwinding of Trump $US Gain



Australia

Economic growth is expected to oscillate through 2017, with partial indicators suggesting very modest growth in Q1, Q2 heavily affected by Cyclone Debbie and then Q3 and Q4 forecast to surge on LNG exports, a rebound in cyclone-affected coal exports and reduced drag from mining investment (GDP growth forecast at 2.3% in annual average terms). Momentum will slow through 2018 as dwelling construction and LNG exports both peak (growth at 2.8% in annual average terms but slowing to 2.3% in through the year terms by Dec-18). Household spending will remain subdued amidst low household income growth, while business investment improves and solid government spending provides an offset. A moderate recovery in domestic demand is then expected in 2019. Against a backdrop of below-target inflation and elevated unemployment, policy makers are unlikely to address their concern about household balance sheets via interest rates, with further macro-prudential measures possible. We expect the RBA to remain on hold for an extended period, before some small hikes in late 2019 as domestic demand improves.

In March, the NAB Monthly Business Survey results pointed to an overall healthy economy that is gaining momentum, at least in the near-term. Business conditions hit +14, their highest level since the GFC, although there is likely that Cyclone Debbie introduced some upward bias to the outcome (skewing the sample away from affected firms). Meanwhile, confidence was relatively muted, easing to +6, but still at solid levels. Capacity utilisation rose in the month, while the Survey's indicator of capital expenditure improved on already solid levels.

While it is too early to accurately gauge the impact of Cyclone Debbie (which hit North Queensland on March 28), early estimates suggest a decline in coal exports of 15-20 mt, which will reduce nationwide coal exports by approximately 20% in chain volume terms in Q2, subtracting approximately 2.5ppt from total exports and 0.3ppt from Q2 GDP before rebounding in Q3. Tourism exports and revenue will also be affected in the coming months, although rebuilding may support measured GDP growth over the longer term. Damage to crops is estimated to raise headline inflation by 0.1-0.2ppt in Q2 via higher fruit and vegetable prices but will not impact core inflation.

Notwithstanding the impact of Cyclone Debbie, the trade sector is expected to add to GDP growth in 2017, supported by LNG exports, but becoming neutral for growth in 2018 as LNG exports flatten off. Higher commodity prices have helped the trade balance move into surplus, and a current account surplus is likely in Q1, but the terms of trade are expected to peak in Q1 2017 before declining gradually through 2017 and 2018.

Employment rebounded by a surprisingly strong 61K in March. The unemployment rate remained steady at 5.9%, as the participate rate bounced to 64.8% from 64.6%. Full time employment rose 74.5k, while part time employment fell by 13.6k. The biggest employment gains were in Queensland, up 28.8k, consistent with improving business conditions, especially in mining. Note the data pre-date cyclone Debbie, so next few months' results could show some mixed impacts. New South Wales employment also rose by a strong 23.3k, reversing losses earlier this year. We expect NSW employment to continue to improve given robust business conditions. Victoria again recorded strong jobs growth, while WA also improved on improved mining conditions. While the ABS series have been volatile, and weaker than other leading indicators, this month's results close some of the gap and are more encouraging.

	Calendar Year				
	2015	2016	2017-F	2018-F	2019-F
Domestic Demand (a)	1.3	1.6	2.3	2.4	2.7
Real GDP (a)	**2.4**	**2.5**	**2.3**	**2.8**	**2.6**
Terms of Trade (a)	-11.6	-0.4	17.3	-5.9	-4.5
Employment (a)	2.0	1.5	1.2	1.5	1.6
Unemployment Rate (b)	6.0	5.7	5.8	5.7	5.5
Headline CPI (b)	1.7	1.5	2.4	2.1	2.2
Core CPI (b)	2.0	1.6	1.8	1.8	2.0
RBA Cash Rate (b)	2.00	1.50	1.50	1.50	2.00
$A/US cents (b)	0.73	0.72	0.70	0.70	0.73

(a) annual average growth, (b) end-period, (c) through the year inflation

Retail turnover fell 0.1% m/m in February after rising 0.1% in January. Year on year data was slightly more encouraging, up 2.7%. Clothing and footwear as well as household goods were the worst performers in February, perhaps related to the weather or the closure of some clothing chains in the month, while department stores and food retailers grew. The NAB Online Retail Sales Index slowed in trend terms to 0.3% m/m in February, down from 0.5% in January. Meanwhile, the retail industry continues to show poor results in the NAB Monthly Business Survey, lagging well behind all other major industries – reflecting a combination of subdued demand, fierce competition and margin compression. We continue to expect a lacklustre outlook for household consumption, reflecting subdued wages growth, and elevated levels of household debt.

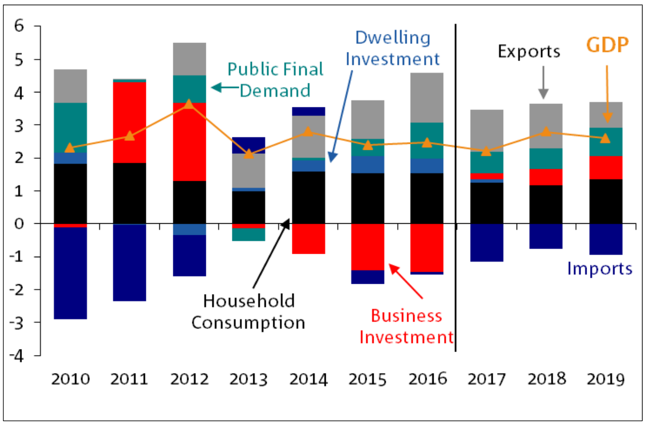
Aside from the NAB Business Survey, timely indicators of capital expenditure remain fairly muted despite more favourable business conditions. Despite the jump in February, the value of non-residential building approvals has looked relatively lacklustre since spiking around mid-2016. Trend approvals were down another 3.3% in the month, to be 6.8% lower over the year. In contrast, the value of capital goods imports has risen nearly 5% in the first two months of the year, to be 17.6% higher over the year to February – suggesting solid investment in equipment. Leads on the longer-term outlook tend to be mixed with investment expectations from NAB's Business Survey holding up, while the ABS Capex Survey suggests the non-mining investment recovery may stall.

New residential building approvals have come off their highs, but the trend has recently turned positive again. That is a surprise development given expectations for more supply constraint in light of growing settlement risk and over-supply concerns (namely for CBD apartments) – suggesting the construction cycle may extend a little longer than expected. Meanwhile, it is too soon to know how recent policy announcements from APRA (the most noteworthy relating to interest-only loans) will affect the market, although a modestly negative impact is anticipated. Even so, the market has been performing much better than expected, prompting an upward revision to our property prices forecasts for 2017 (see the Q1 Quarterly Residential Property Survey for more detail).

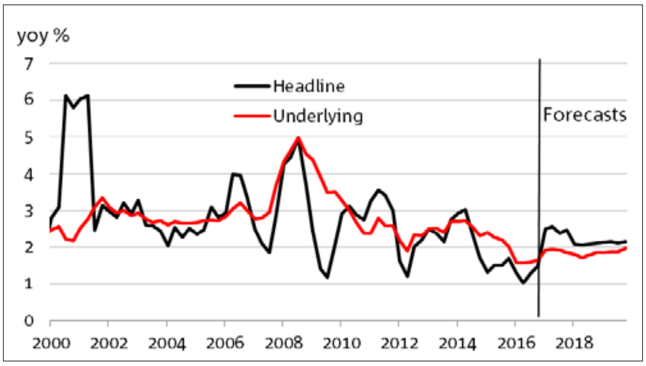
Against a backdrop of below-target inflation and elevated unemployment, policy makers are unlikely to address their concerns about household balance sheets via interest rates, with further macro-prudential measures possible. We expect the RBA to remain on hold for an extended period, before some small hikes in late 2019 as domestic demand starts to improve. The AUD has gradually depreciated since late March, particularly in trade weighted terms. We maintain our projection for the AUD/USD to reach 0.70 by year-end.

For more detail on the Australian outlook, please see the Forward View – Australia, released yesterday.

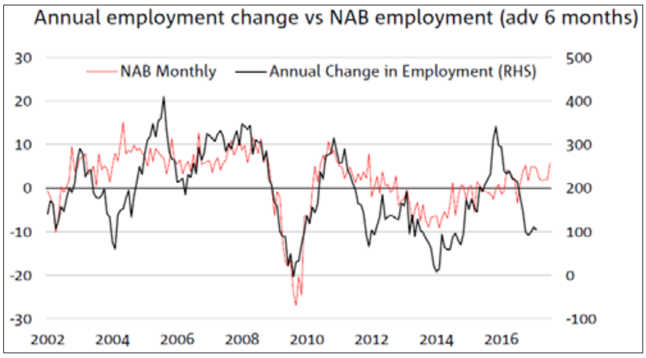
Real GDP Outlook



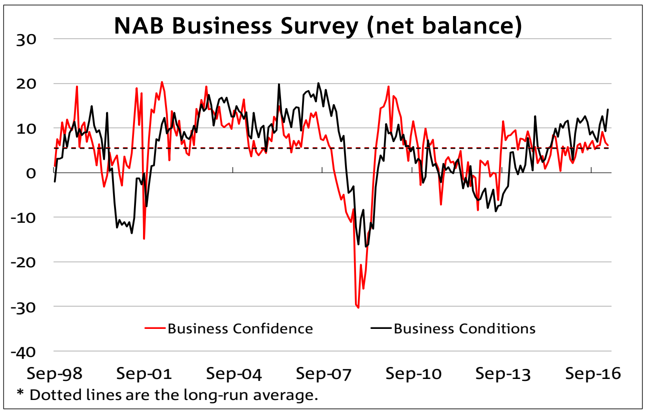
NAB's Inflation Forecasts



Leading Indicators Much Stronger Than Official Employment



Generally Stronger



* Dotted lines are the long-run average.

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Carbon and Commodities

- Commodity prices across the board have fallen over the last fortnight after recent periods of strength.
- OPEC has once again registered high compliance to the Algiers production agreement, and is signaling and extension of the agreement.
- However US inventories remain near record highs, and the Rotary Rig count continues to increase rapidly each week.
- Copper prices have fallen below the key $5650 mark on fund selling, driving prices to a 4 month low.

Commodity	US$	Change (daily US$)	Change (Fortnight)	Change (Month)	Change (Year)
Brent Crude	53.08	-1.75	-2.01%	4.16%	34.62%
WTI Crude	50.58	-1.77	-0.88%	6.84%	35.75%
Copper	5,553	-104.98	-4.65%	-6.33%	10.91%
Zinc	2,536	23.21	-5.64%	-11.18%	40.46%
Aluminium	1,894	12.33	-2.51%	-1.16%	18.97%
Tin	19,815	346.97	-1.39%	-3.08%	13.75%
Nickel	9,296	30.60	-5.15%	-8.19%	-0.70%

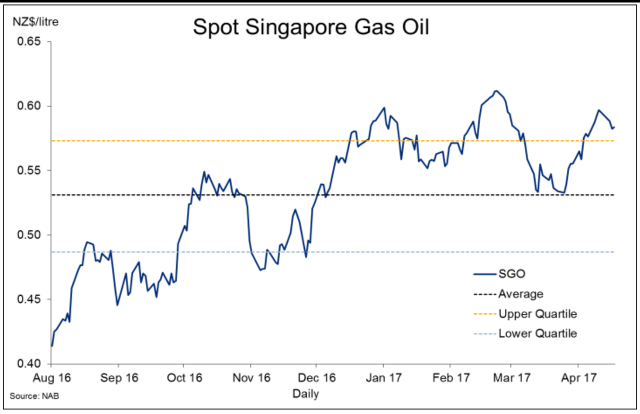
Crude oil prices have traded a 10% range over the last month, finding support from OPEC demonstrating significant resolve to the Algiers production agreement, with near 100% compliance to the 1.2 million barrel/day agreed production cuts. Saudi increased production somewhat in March but this was offset by increased cuts from UAE and other OPEC members. In addition Libyan daily production fell by 200k barrels, impacted by militant unrest, labour disputes and ISIS disruptions at key export facilities. OPEC is likely to extend the current agreement after the 6 month expiry, but with modifications to the agreed quotas.

The US oversupply conditions continue without respite, with crude inventories remaining near record highs over 530 million barrels, and ongoing increases in the Baker Hughes rig count – which is now at 683, more than double the 316 recent lows a year ago (showing an increased appetite for exploration and production spend). US production is steady at just below 9 million barrels per day, but increases in price above production breakevens will encourage more expensive producers to turn the tap on.

Overall, crude oil prices are likely to be trapped within a $45-55, until expected global demand growth outstrips supply growth later in the year, and is able to significantly correct the current global glut.

Copper prices have fallen below the key $5650 support on fund selling, despite substantial Chinese demand for concentrate and ore imports, and ongoing supply disruptions from labour disputes at several of the largest mines globally. There is danger that prices enter a post Trump victory gap between $4900 and $5450 which could see a technically driven acceleration in price weakness.

Singapore Gas Oil (NZ$/litre)



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NZD/EUR: A Couple of Big Unknowns

- NZD/EUR strength relative to our long-run fair value estimate of EUR 0.55 reflects NZ's relatively strong terms of trade and the ECB's highly accommodative monetary policy stance. Using a simple short-term model we can explain the current spot rate around EUR 0.66.
- Our projections show the cross holding up at, or above, current spot over the next six months, before facing headwinds and ending the year closer to EUR 0.64.
- The balance of risk is skewed to the downside over the medium-term, reflecting the likely strength of EUR once the ECB normalises monetary policy. The timing of ECB rate hikes is important, but uncertain. An offsetting factor is ongoing euro-area political risk, with the focus likely to turn to Italy late this year or early next year after the French Presidential elections are out of the way.

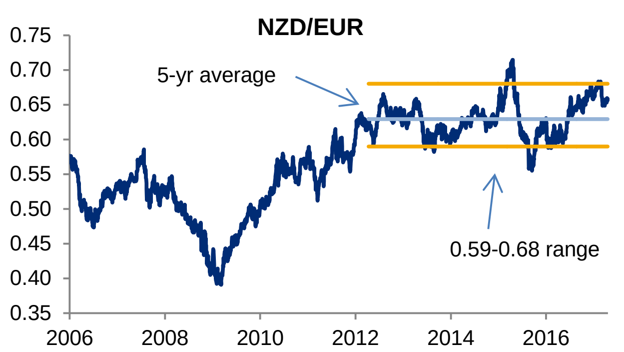
NZD/EUR Past its Peak?

NZD/EUR has been range-bound over the past five years, spending much of the time within a range of about EUR 0.59-0.68, with only very brief excursions outside that range. The average spot rate over the past five years has been just under EUR 0.63.

Earlier this year, it looked like the cross was on a roll, with EUR 0.70 threatened, but the combination of less concern that far-right candidate Marine Le Pen would win the upcoming French Presidential election and a generally under-performing NZD has since seen the cross rate fall to around the EUR 0.66 mark. Some emerging evidence of debate within the ECB about the extent of future monetary policy accommodation has provided a supporting role in dragging NZD/EUR lower from February highs of around EUR 0.6850.

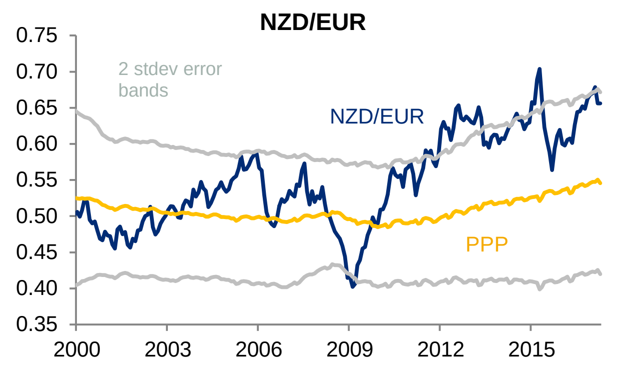
While our near-term view is that the NZD could lift a cent or two over coming months, our projections ultimately have the cross lower, ending the year around EUR 0.64. We view the balance of risk to this projection skewed to the downside, and see further depreciation in 2018.

NZD/EUR in Top Half of 5-year Trading Range



Source: BNZ, Bloomberg

NZD/EUR Expensive on Long-Term Model



Source: BNZ

Taking a longer-term perspective the NZD/EUR cross rate, it is very expensive. Our purchasing power parity estimate has been drifting higher over time (a reflection of our modelling framework which uses a 15-year moving average filter) and currently sits around EUR 0.55. Thus the current spot rate is some 19% "over-valued" or equivalent to 1.7 standard deviations higher than long-term "fair-value". With the exception of 2015, the cross rate has been hovering around the plus two standard deviations mark versus fair value for much of the past eight years. With this in mind it is important to understand the explanation behind this trend.

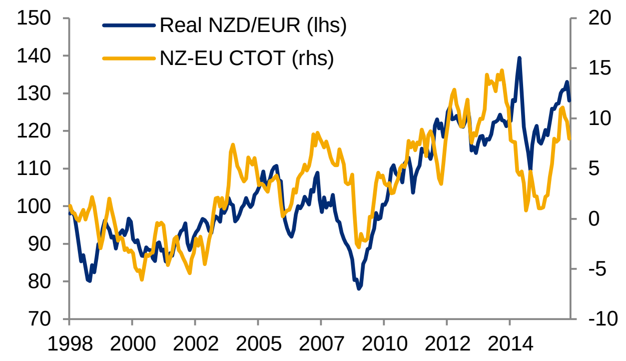
NZ Terms of Trade and Rate Spread Explain the High Cross

Strength in NZ's terms of trade relative to the euro-area (EA) and relative NZ-EA interest rates go a long way in explaining the apparent high value of the NZD/EUR exchange rate. This is illustrated in the next two charts, which show the real NZD/EUR exchange rate against relative NZ/EA commodity terms of trade and NZ-EA short term interest rates over the past twenty years.

NZ's terms of trade relative to the euro area are very strong, down from the peak of a few years ago but still well above average.

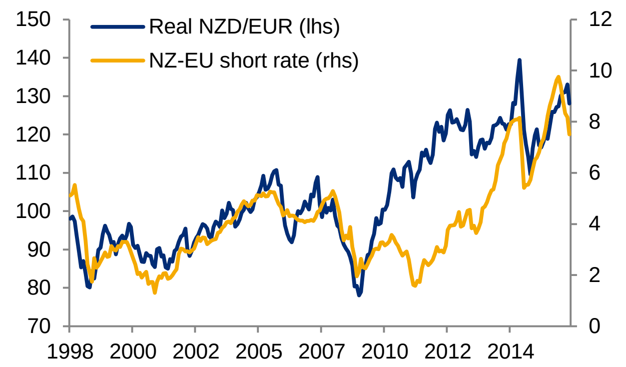
On the relative interest rate measure we use the 1-year swap rate for NZ and the shadow short rate for the euro as measured by the RBNZ's Krippner. We have to use the shadow short rate for the euro area as the relationship between the rates differential and the exchange rate broke down after the ECB pushed rates to zero and into negative territory and embarked on its quantitative easing policy. There was a period between 2010-2012 when the cross rate was much higher than explained by relative interest rates, but that might be explained by the European debt crisis, the focus on Greece at that time and concern about the euro-area breaking up.

Relative Terms of Trade can Explain the High Cross



Source: BNZ, Bloomberg

Relative Interest Rates can Explain the High Cross



Source: BNZ, Bloomberg

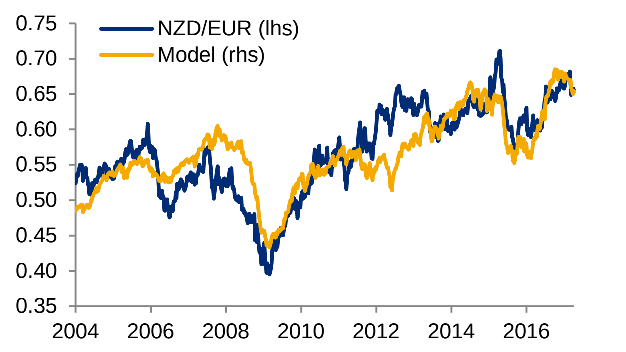
The current shadow short rate sits at minus 5.5% (not a typo!), suggesting that the NZ-EA short rate spread is around 750bps. This is indicative of how easy the ECB's current monetary policy stance is, with its ongoing bond buying programme artificially holding down yields right across the curve.

Short-Term NZD/EUR Fair Value Model

We constructed a simple NZD/EUR fair value model along the same lines as our NZD/USD model. NZD/EUR is positively correlated with our risk appetite index, NZ export commodity prices and the NZ-EA short rate spread. With a standard error of 6.8%, the fit isn't as good as our NZD/USD model which has a standard error of 4.2%. With a bit of tweaking, the fit of the model could probably be improved, but that wasn't the point of the exercise. Our main interest lies in what the model says about the cross rate when ECB monetary policy normalises.

The model suggests that current fair value for the cross rate is close to EUR 0.65. This means that current above-average levels of risk appetite, strong NZ terms of trade and very easy EA monetary policy justify the current rich pricing of the NZD/EUR exchange rate relative to our long-term fair value estimate.

NZD/EUR Close to Fairly Priced on Short-term Model



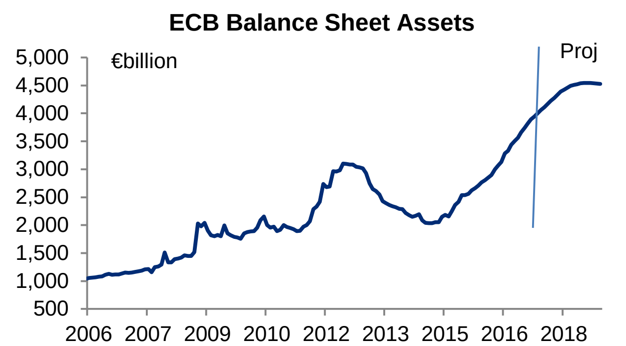
Source: BNZ, Bloomberg

As noted above, the ECB's monetary policy stance is highly accommodative. The central bank has been expanding its balance sheet at a rapid rate. Its current policy is to continue to buy bonds at a pace of €60bn per month through to the end of the year. While it hasn't indicated what happens after the end of the year, it is widely assumed that the ECB will taper its bond purchases. If we assume a gradual taper, then the ECB's balance sheet would start to flatten out by about mid-2018.

There remains some debate within the ECB about whether interest rates could or should be raised ahead of the end of its quantitative easing policy. Higher policy rates (the deposit rate is currently minus 0.4% and the lending rate is just above zero) and less bond purchases would have a significant impact on the yield curve and, in particular, the shadow short term rate. For example, a modest 40bps increase in the ECB deposit rate would see the shadow short rate rise in the order of over 550bps. The quantum of this highlights how distortionary the ECB's current monetary policy stance is on the yield curve and the euro.

We can use the model to show the impact on NZD/EUR fair value of the ECB beginning to normalise monetary policy, along with our view of gradual RBNZ policy tightening from May 2018. For illustrative purposes we assume the shadow short rate rises in a linear fashion from minus 550bps to zero between end-June 2017 and

Nearing the end game for ECB balance sheet expansion



Source: BNZ, Bloomberg

end-June 2018 and onwards to +0.25% by the end of 2018. For RBNZ policy, we assume that the 1-year swap rate gradually rises, consistent with our assumed 75bps of OCR hikes beginning May-2018.

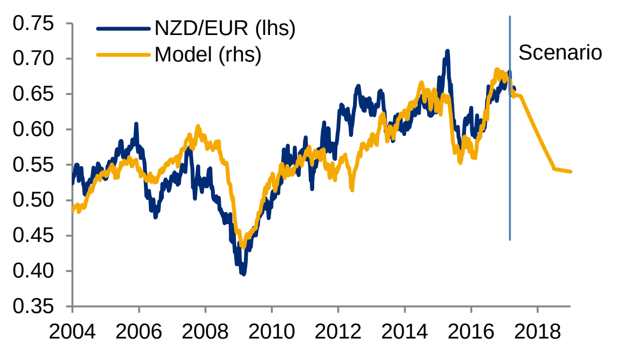
We also assume that risk appetite drifts slowly down to its average level of 50%, while NZ commodity prices remain unchanged.

The model says that under this scenario the NZD/EUR cross rate heads steadily lower through to the end of next year, reaching around EUR 0.54, or close to our long-term fair value estimate. The message is that ECB monetary policy has had a significant impact on the euro and a change in policy stance is likely to have a significant positive impact on the common currency.

A big question is whether the ECB will be ready to change its policy stance later this year. While activity indicators in the euro area have recovered nicely over the past year and headline inflation recently reached 2%, core CPI inflation remains subdued at 0.7% y/y. The ECB wants to be confident that underlying inflation pressures are rising before considering changing its policy stance.

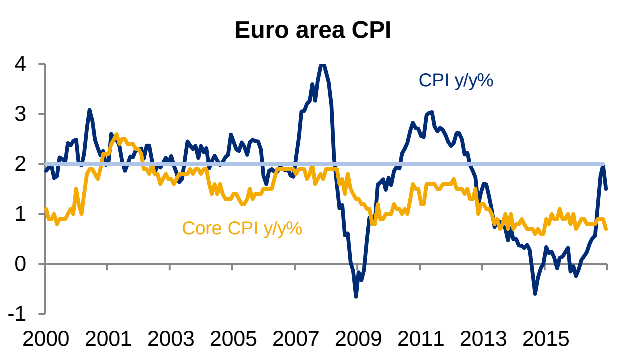
Thus, while NZD/EUR could come under significant downward pressure as the ECB changes its policy stance, the timing of the ECB kicking off that process remains highly uncertain.

Scenario With ECB Beginning to Normalise Policy



Source: BNZ, Bloomberg

Euro-area Core CPI Inflation Still Very Low



Source: BNZ, Bloomberg

Another important consideration is that if the EUR surged ahead on the back of a change in policy, then the ECB might be forced to rein in its normalisation process. To that extent, the large and steady fall in NZD/EUR explained by the model is unlikely to prevail in practice. Any fall in NZD/EUR is likely to be at a more moderate pace, as EUR strength feeds back into the ECB's reaction function.

Political Risk Overhangs EUR

The other important factor for the euro is political risk. The immediate risk event is the French Presidential election, with the first round on 23 April and the two highest polling candidates going into a head-to-head battle on 7 May.

Support for the top four candidates is separated by only six percentage points. A bad scenario would be far-left (Melenchon) and far-right (Le Pen) candidates winning the first round of voting, making the second round vote a choice between two highly unappealing candidates for centrist voters. However, the most likely scenario is centre-left Macron facing Le Pen in the second round and Macron winning the race. Oddschecker has Macron at a 53% probability to win the race, well ahead of Le Pen at 23%, a distant second. That would be a euro-positive outcome relative to current pricing, while either a Melenchon or Le Pen victory would be significantly euro-negative.

After the French elections, Germany's Federal elections in September become the next focal point for euro area political risk. But we think that Italy's general election, which must be held sometime before May 2018 is a much more important risk event. The timing of the election could be late this year or, more likely, early next year.

The combination of the ECB tapering its bond purchases next year and Italian government upheaval, with the euroskeptic 5-Star-Movement likely to win a significant portion of the vote, could be significantly negative for Italian government bonds. This the last thing the country needs, with its underperforming economy, high government debt levels and banking system in a precarious state. Italy's woes could have a significant impact on the euro if talk of a euro-area break-up re-emerges.

Summarising the Outlook

We see ECB monetary policy and euro-area political risks as the two key forces on the NZD/EUR cross rate over the next couple of years. The starting point is a cross rate that is well above our long-term fair value estimate, with the ECB's highly accommodative policy stance a key factor behind that. Strong NZ terms of trade are an additional positive factor, and we see this dynamic prevailing, but this factor isn't a key influence on our projections.

Our short term projections have the cross at or slightly above current spot over the next couple of quarters, before heading on a downward path from later this year through 2018. Our projections, which ultimately see NZD/EUR lower at around 0.63-0.64, are a bit of a half-way house affected by two opposing forces. If we put more weight on ECB rate normalisation then that could easily see the cross heading into the high 0.50s and breaking decisively outside of the bottom end of the 5-year range. But political risks are likely to overhang the euro-area until at least Italy's elections are out of the way. Furthermore, the cessation of ECB bond purchases particularly for vulnerable countries like Italy might not have a happy ending and euro-area break-up risks could easily rise and overhang the euro. This risk limits the downside projection for NZD/EUR currently embedded in our projections.

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FX Momentum Model

Mixed NZD positions

- The model has been neutral on NZD/USD for the past month. Given the tight range the NZD has traded in over that time, both long and short triggers are not too far away from spot. The model is long NZD/AUD and NZD/EUR. Short positions in NZD/GBP and NZD/JPY entered more than six weeks ago have been highly profitable.

Mixed USD positions

- The model went long GBP/USD after the UK PM called a snap election. The model has been short USD/JPY for the past month and has just gone long USD/CAD. Other USD positions are neutral.

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BNZ Foreign Exchange Momentum Model

Our momentum model is used primarily as an indicator of speculative account activity, as opposed to a trading tool. The model provides some indication of the levels at which speculative accounts may be entering into long or short positions in the major currencies. It can also provide a steer on how basic trend following/momentum accounts are positioned.

The basic trading algorithm our model uses is as follows:

1. Buy if the price breaks above recent ranges, or sell if it breaks below recent ranges.
2. In exiting a position, the model uses a trailing stop. The stop is set at the previous10-day high or low, but with an additional adjustment factor that sets a wider stop when markets are more volatile.

Together, these two conditions constitute the core of any momentum model, whose central premise is that a break outside of a range indicates that the price will continue in the direction of the break. A couple of extra conditioning filters have been added to our momentum model to try to stop the model reacting to false breaks.

FX Momentum Model Positions

20-Apr-17

Currency pair	Position	Entry date	Entry level	Mkt	Return	Stop	Long trigger	Short trigger
NZD/USD	Neutral	20-Mar-17	0.7068	0.7038			0.7068	0.691
NZD/AUD	Long	07-Apr-17	0.9282	0.9372	1.0%	0.9197		
NZD/EUR	Long	13-Apr-17	0.6583	0.6568	-0.2%	0.6512		
NZD/GBP	Short	03-Mar-17	0.5722	0.5506	3.8%	0.5624		
NZD/JPY	Short	24-Feb-17	80.67	76.67	5.0%	77.47		
AUD/USD	Neutral	13-Apr-17	0.7587	0.7510			0.7680	0.7473
AUD/JPY	Short	21-Mar-17	85.85	81.81	4.7%	83.92		
DXY	Neutral	03-Apr-17	100.60	99.81			101.34	98.86
EUR/USD	Neutral	18-Apr-17	1.0689	1.0716			1.0906	1.0570
GBP/USD	Long	18-Apr-17	1.2615	1.2782	1.3%	1.2409		
USD/JPY	Short	21-Mar-17	111.69	108.94	2.5%	111.58		
USD/CHF	Neutral	31-Mar-17	1.0015	0.9981			1.0107	0.9814
USD/CAD	Long	19-Apr-17	1.3456	1.3479	0.2%	1.3295		

Notes: This portfolio represent hypothetical, not actual, investments. Reported returns do not include the cost-of-carry.
All trades are entered and exited at triggered levels

The BNZ OIS-ter: Reduced Hike Expectations Excluding NZ

- Since our last report three weeks ago, short-term interest rate curves have flattened, with NZ a rare exception. Increased geo-political risk, some softer data including a shocking weak CPI, and reduced expectations for fiscal stimulus have seen rate hikes priced out of the US curve to the extent that only one full rate hike is now priced in for the remainder of 2017.
- That tailwind from lower US rates has spilled over into other curves. In the UK, a stronger GBP after the announcement of a snap election has aided the push lower in rates. Soft euro area CPI data have helped flatten the euro-area curve.
- Stronger dairy prices and higher CPI inflation have helped anchor the NZ OIS curve. The risk of tighter policy rises from late this year, with the first full rate hike by the RBNZ priced into the curve by March 2018. Meanwhile, the OIS curve in Australia is now very flat.

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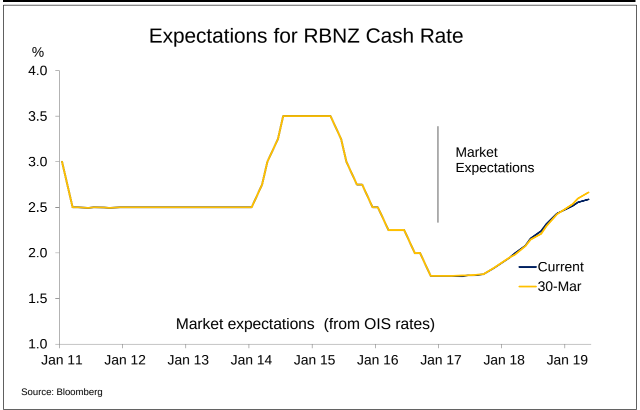
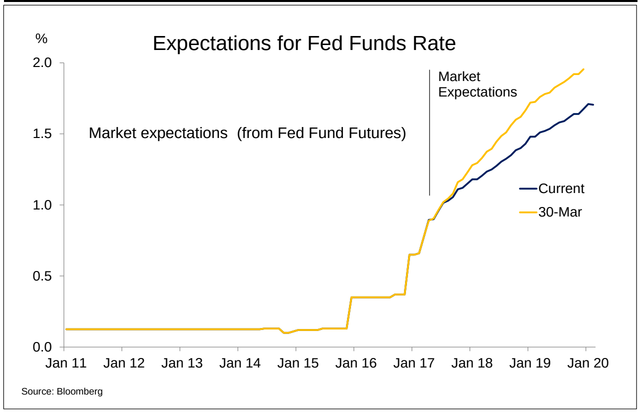
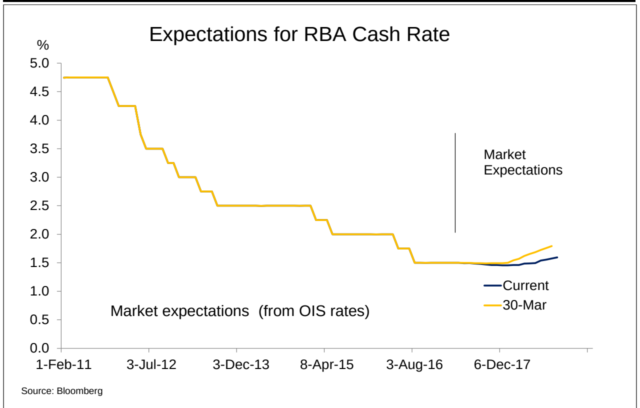
New Zealand



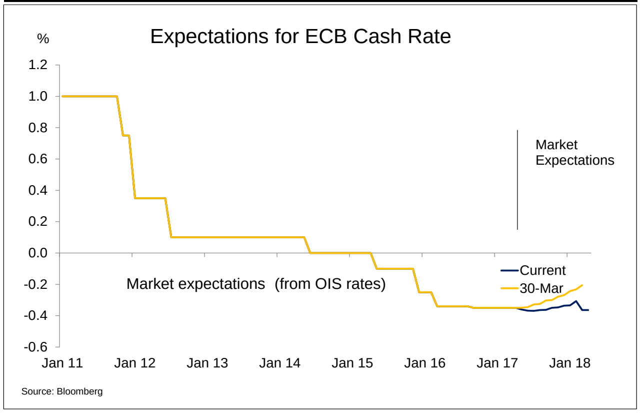
United States



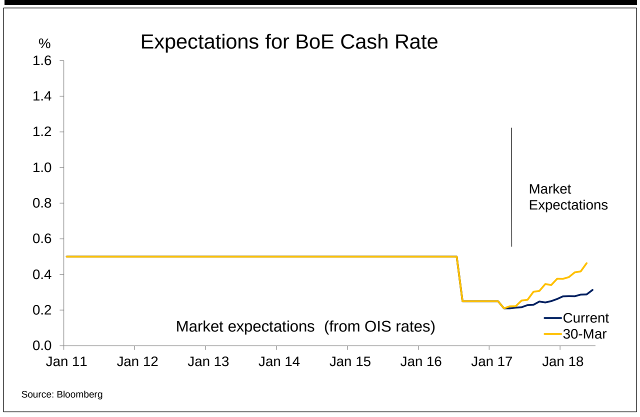
Australia



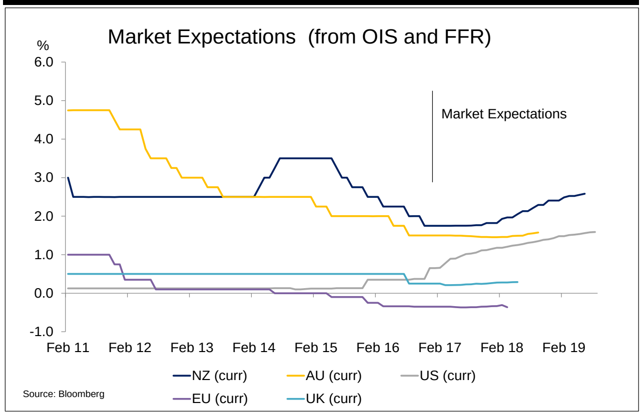
Eurozone



United Kingdom



Cross Country



Interest Rate Strategy: Are NZ Front End Rates Too Low?

- Tactically, we think the 2y swap rate will move back up towards 2.50% in the coming months.
- BNZ looks for a later start to tightening, but a higher terminal OCR than the market.
- The OCR outlook and our medium term view on global yields point to a steeper front end curve. We like 1y3y or 1y1y/2y1y steepeners.

NZ 2y Swap Finding a Base

Swap rates across the NZ curve have lifted from year-to-date lows over the last week. After reaching 2.27%, the 2y swap has rebounded to 2.34%, but is still well under the 2.47% high reached in January.

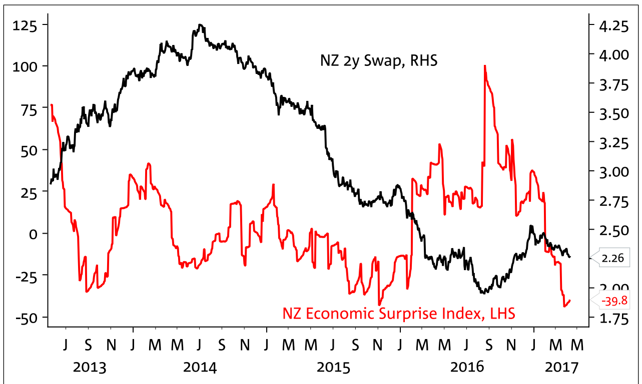
The earlier rally followed a move lower in global bond yields and the RBNZ's message that rates are on-hold for an extended period. Ahead of the CPI, some disappointment in NZ economic data also played a role.

We think the 2y rate is near a base and a retracement back to at least 2.50% in the next couple of months is likely. We see domestic, global and technical catalysts for this move.

Prior to the CPI, other recent NZ data have tended to disappoint (including Q1 GDP), although in our economists' view growth is still on a firm footing. However, expectations appear to have shifted to a point where it will become harder for data to undershoot. The NZ economic data surprise index reached the lowest level since 2013 (Chart 1).

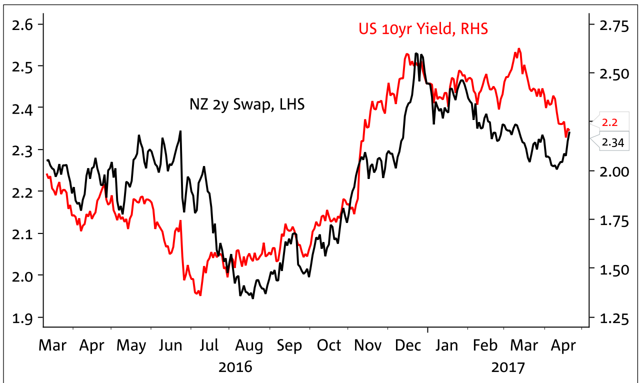
BNZ views CPI inflation as likely to hold around 2% - the middle of the RBNZ's target band. The RBNZ have been indicating that it doesn't think the lift in Q1 CPI will be sustained and this could limit paying in the NZ front end for the time being. But we think ultimately the RBNZ will have to capitulate on its view for the first OCR hike in H2 2019 and move closer to the market.

Chart 1: NZ Economic Data Surprise Index vs 2y Swap



Source: National Australia Bank, Macrobond

Chart 2: NZ 2y Swap vs US 10yr



Source: National Australia Bank, Macrobond

The global rally in rates had been a key factor keeping NZ front end rates low. However, as Chart 2 shows, over the last week, the 2y rate had started pushing higher in the face of new lows in US yields. We think this reflects profit-taking on earlier received positions ahead of the CPI (popular given carry in NZ front end and RBNZ's dovish messages).

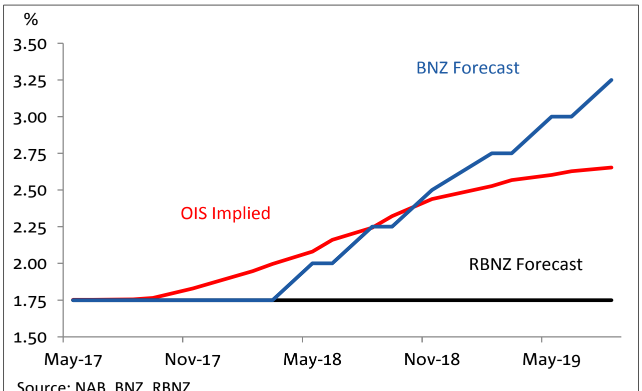
Looking ahead, global rates direction will still be a key driver of the NZ front end. We ultimately see US 10yrs breaking higher and reaching 2.75%, but this looks more like a risk for later in the year. US 10yrs have broken under the well-worn 2.30-2.60% range. There's a risk the rally extends, but we don't anticipate it will go too much further. Technically, the 2.15% area is important.

Our technical analyst David Coloretti notes that momentum in NZ 2y swap failed to confirm the recent move to 2.25% (2.245% was a 50% retracement level). A weekly close above 2.3175% would confirm a base is in place on a medium term timeframe.

RBNZ Outlook: Higher Terminal OCR, But Delayed Lift-Off

The RBNZ's message has been neutral and it sees rate hikes as a relatively distant prospect (and still say that cuts are a risk). As Chart 3 shows, this view contrasts with the market, which prices 8.5bp (34% chance) of tightening by the end of 2017 and a cumulative 66bp of hikes by the end of 2018. BNZ economists see a later start to the RBNZ tightening cycle than the market, but a higher terminal rate than currently priced. They see the first hike in May 2018 and 75bp of tightening by the end of 2018. The OIS curve implies an OCR 37bp lower than BNZ's forecast by the middle of 2019.

Chart 3: RBNZ OCR Outlook



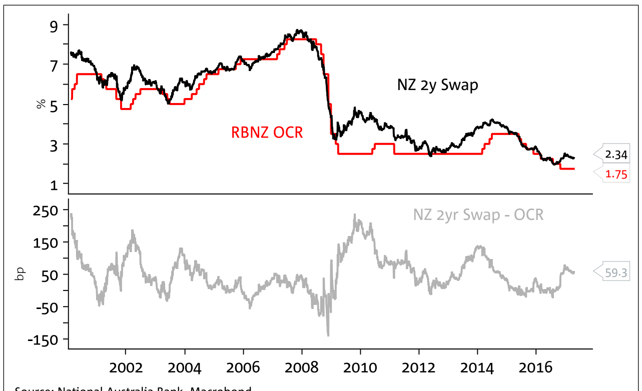
Source: NAB, BNZ, RBNZ

The Big Picture: Short End Rates to Rise Much Higher, But Later

Because we see RBNZ tightening as more of an issue for next year, the bulk of the cyclical rise in front end swaps is likely to be delayed. A key issue, in the view of BNZ economists, is that NZ inflation is likely to hold around the middle of the band (2%) for much of the year ahead. However, the RBNZ will be slow to change its guidance.

How high can the 2y swap rate get to? Chart 4 shows the current 2y swap rate at 59bp over the OCR is around its long term average. However, ahead of previous tightening cycles the spread traded to well over 100bp. To be sure, every cycle is different and the spread is also influenced by global bond moves. For instance, a year out from the 2014 tightening cycle the 2y-OCR spread reached 135bp, but this coincided with the US “taper tantrum” (US 10yrs hit 3.0%). Still, the historical comparison does show the 2y swap rate has plenty more upside if the market gets sight of a genuine tightening cycle. We think the current 1y forward 2y rate of 2.76% looks low compared to our view for a terminal OCR rate in the cycle of over 3% and the potential for higher global yields down the track. Stronger paying pressure from mortgages and other fixed rate lending is also likely to pick up as the OCR lift-off gets closer.

Chart 4: NZ 2y Swap vs OCR



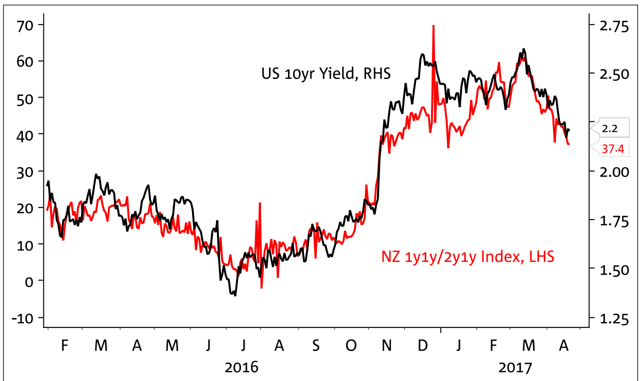
Source: National Australia Bank, Macrobond

Front End Steepeners an Alternative to Outright Paying

Our view that OCR tightening is delayed, but will go to a higher level suggests the front end of the NZ curve is too flat. In addition, given the break of ranges in global long end rates, a front end steepener is lower risk than a standard 2y10y. We think the likes of 1y3y or 1y1y/2y1y have plenty of room to steepen up as the RBNZ continues to signal a neutral stance in the face of inflation at target. Another advantage of steepeners over outright paid positions is the lower roll down cost if expressed via forwards, rather than spot. The 6M to 2Y forward 1y and 2y swap rates costs 3-5bp per month to pay (1y1y most expensive to pay). A 1y1y/2y1y steepener rolls down at +3.7bp/month, while a 1y3y spot steepener costs around 0.6bp per month.

The 1y1y/2y1y spread is back near early Nov lows at 38bps (Chart 5). We would consider this steepener on a move back to around 30-35bps – this is a level that preceded most of the big sell-off in global rates and re-pricing of the RBNZ in November.

Chart 5: NZD 1y1y/2y1y vs US 10yr Yield



Source: National Australia Bank, Macrobond

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NZ Economic Review

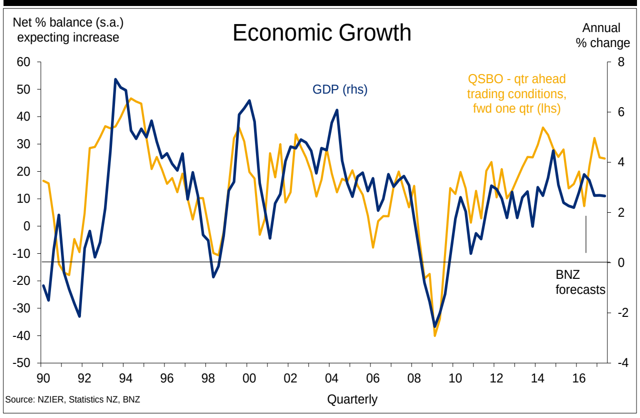
Building Consents (Feb) – 31 March
The 14% jump in residential building consents in February was nice to see, following weaker numbers late last year. Nonetheless, we'll need to see more of this to be sure the expansion in construction activity hasn't lost its way (after what could be a rough-looking Q1 for the industry).

Annual Balance Sheets (2007-15) – 31 March
We welcome these more-comprehensive and up-to-date institutional balance sheet data from Statistics NZ, especially with regard to the business sector. What's most interesting, however, is what household balance sheets look like right now, after the very latest phase of strong house price inflation.

ANZ Business Survey (Mar) – 31 March
Net confidence fell to an average-looking +11 in March, from +17 in February and +22 back in December. Yet respondents' expectations for real-economy indicators remained above trend. This gave us even more confidence that the slowdown we saw in Q4 GDP was transitory. The survey's inflation expectations variable continued to float back up, with 1.83%. Its pricing intentions stayed on the firm side, at +23 (from +26). This series has proved a good pointer to the pick-up that was confirmed in today's Q1 CPI inflation.

QSBO (Q1) – 4 April
Inflationary pressures continue to mount. That was the central theme in this NZIER Quarterly Survey of Business Opinion. Pricing intentions firmed up, labour shortages became more severe, and capacity utilisation hit an all-time high. A net 29% of respondents said they expected to increase their selling prices – the highest since September 2014 and consistent with annual CPI inflation of well over the important 2.0% mark. The QSBO's trading conditions series stayed quite strong, suggesting that the rebound in GDP growth we forecast for H1 2017 might yet be too conservative. The sting in the tail is that inflation pressures are looking likely to morph into actual inflation and higher interest rates.

Upside Pressure



QVNZ & Barfoot Housing Reports (Mar) – 5 April
The March summaries from Quotable Value NZ and (Auckland-centric) Barfoot and Thompson indicated mixed, rather than softening, conditions in the housing market. This could be read as a sign of resilience, in the wake of the LVR policy tightening that occurred over H2 2016, and with gossip that Auckland prices were definitely coming off now. Still, there were clear signs the market is not as heated as it was, in many areas.

ANZ Job Ads (Mar) – 5 April
Put a saddle on it. The 1.6% lift in March maintained the very strong trend momentum that this job advertising series has possessed for a long while now.

ANZ Commodity Export Prices (Mar) – 5 April
This commodity price index increased 0.4% in March – again a bit better than we imagined. Following its 2.0% gain in February its annual increase was 23.0%, from 20.9%. Converted into local currency the price index was 16.5% higher than a year ago, after 9.2% y/y in February. This robustness suggests, by the way, that New Zealand's merchandise terms of trade, as per the OTI series, could be close to reclaiming a record high.

Crown Financial Accounts (Feb) – 6 April
The NZ government's operating account is looking more and more positive. For the 8 months to February 2017 it registered a core (OBEGAL) surplus of $1.4b, compared to expectations (as per December's HYEFU) of $0.5b. This continues to set a positive basis for the projections of the 25 May Budget.

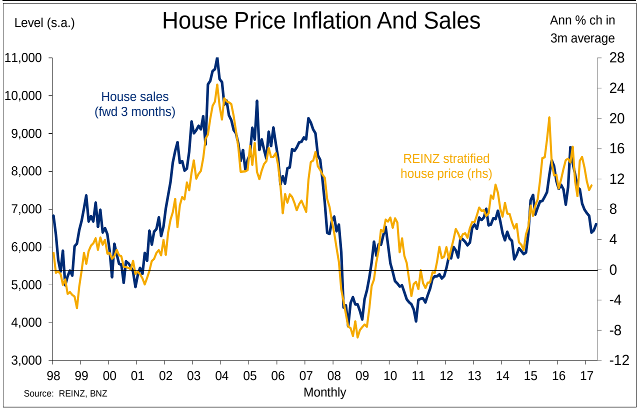
Electronic Card Transactions (Mar) – 11 April
Electronic Card Transactions rose 0.5% from February, fractionally above what we expected. We still estimate Q1 retail volumes expanded 0.9%, having slowed to 0.6% in Q4. However, there are risks that it might not pick up by that much. New quarterly versions of the (monthly) ECT data, provided by Statistics NZ, showed a slower rate of nominal expansion than we are working off. And as today's CPI inferred, there was more in the way of retail price inflation in the March quarter.

BNZ Manufacturing PMI (Mar) – 13 April
What a difference a couple of months make. Having slowed right down to 53.2 in January, New Zealand's Performance of Manufacturing Index (PMI) surged to a very strong 57.8 in March. While the recent rebound has been in all the right places, it's new orders that have stood out head and shoulders. From 58.2 in February (and 53.5 back in January) they soared to 64.3 in March – the strongest reading since 2004. This is a good sign that production, whose index strengthened to 60.4 in March, will sustain its strong momentum. And this is converting into jobs. The PMI employment index improved to 53.4 in March, comfortably above its long-term norm of 50.5.

REINZ House Report (Mar) – 13 April
While the Real Estate Institute did debut its new quality-adjusted House Price Indices, they left us none the wiser on trends in the housing market. This is partly because there were no time series made available. All we got was the fact that the new HPI was flat in March, compared to February, for an annual 10.0%. This comprised a 0.3% fall in Auckland (8.3% y/y) and a 0.6% rise ex-Auckland (13.0% y/y).

REINZ sales were, at 8,504 in March, down 10.7% on March 2016. This was not as soft as we imagined, and was a lesser annual fall than we saw in February (-14.2%). We judged from this a seasonally adjusted advance of 2.6% in the month's sales.

Resilient (To Tighter LVR Screws)



The regional stories remain interesting. While there has been much talk of Auckland prices now coming off, there was still no jarring evidence of this in the data. There had been a big drop in Auckland's Stratified home price index back in January, which had us wondering. But this has since recovered its poise.

While the prognosis of New Zealand's housing market remains crucial to our macro outlook, recent data are still not sending any strong signals, one way or the other. This leaves us hanging a bit, as March is the peak activity time, and the market will get less and less liquid as we head into winter.

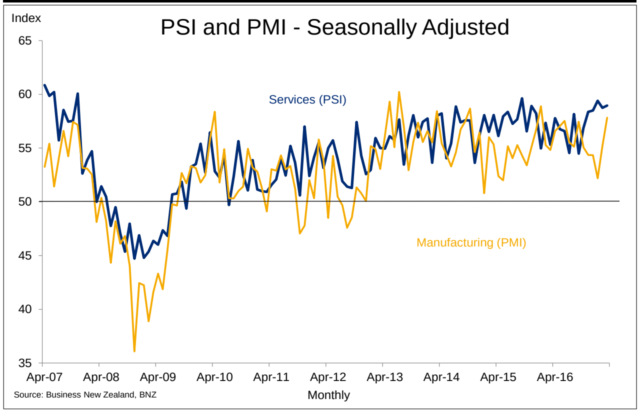
Food Price Index (Mar) – 13 April
The March Food Price Index eased 0.3%, much as we thought. Aside from affirming our Q1 CPI pick, this set annual food price inflation at 1.3% in the month. This is biased higher over coming months, in our opinion, owing to global indicators as well as cyclonic weather in New Zealand and Australia of late, which will likely hamper some food production.

GDT Dairy Auction – 19 April
Following a 1.6% gain at the 5 April auction, the dairy price index improved a further 3.1% at this event. This keeps alive the potential for Fonterra to revise up its 2016/17 milk price forecasts from its present $6.00.

Note also that Fonterra is due to make its first forecast for the next season (2017/18) before the end of May.

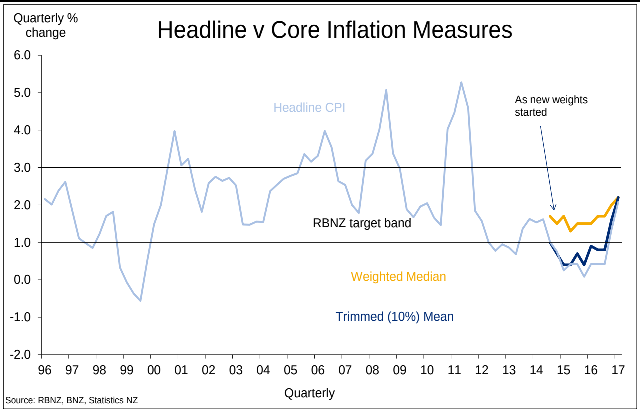
BNZ Services PSI (Mar) – 19 April
New Zealand's Performance of Services Index (PSI) has been persistently strong over the past few months. It's been a bit like a stuck record, set on high volume. In fact, March's 59.0 result was marginally higher than February and enough to pull the PSI 3-month average up to 59.0, its highest level since the first three months of the survey way back in 2007. Just like in its Performance of Manufacturing Index cousin, very strong new orders in the PSI stood out, even among a generally strong set of details. It bodes well for higher sales ahead for the services sector.

Brothers in Arms



CPI (Q1) – 20 April
The key message from today's consumer price inflation figures is that core inflation is rising and has poked above 2% on some measures. That is more important than the headline annual inflation rate jumping up to 2.2% in Q1, from 1.3% in Q4, or the specifics around which prices rose this particular quarter. That said, higher headline inflation is relevant to the extent that it is likely to influence inflation expectations. Keep watch for indicators on the latter over coming months and quarters. For further discussion on this please see our lead article in today's BNZ Strategist.

Core Blimey!



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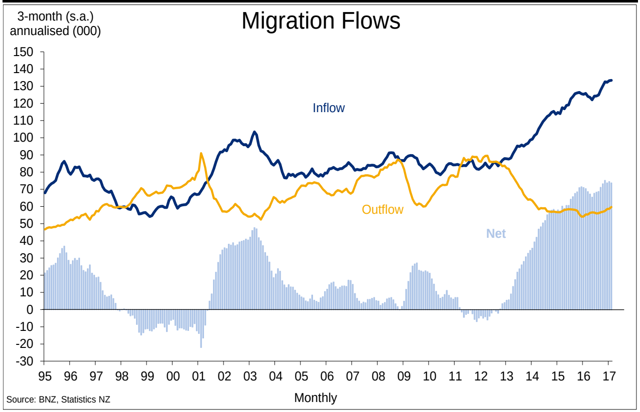
NZ Upcoming Data/Events

ANZ-RM Consumer Confidence (Apr) – 21 April
Anything still embedded in the 120s would be fine by us.

Holiday (ANZAC Day) – 25 April

Int'l Travel and Migration (Mar) – 26 April
We haven't seen anything to indicate a softening in the net inward migration numbers to New Zealand. As such, they remain an important driver of our macro-economic variables and forecasts thereof.

Possibly Peaking, But at a Record Level



As for short-term visitor arrivals for March these might, like they did in February, struggle to post a strong annual gain. But this probably reflects the later timing of Easter this year compared to last. Note: we expect April's annual growth in visitors to be strong, aided by New Zealand's hosting of the World Masters Games in the month.

Finance Minister Joyce Speaks – 27 April
This luncheon speech, to the Wellington Chamber of Commerce, will most likely flesh out more of the policies to expect in the 25 May Budget. There are certainly some surplus funds able to be allocated.

Merchandise Trade (Mar) – 28 April
We expect March's merchandise exports to be up 7% on year-ago results. But the March quarter summaries, provided by Statistics, will give the broader steer as to whether export volumes stabilised in Q1, after a poor showing in Q4, led by primary products. For nominal merchandise imports in March we anticipate annual growth of 4%. This would deliver a monthly surplus of $322m, compared to $189m in March of last year.

Building Consents (Mar) – 28 April
The 14% jump in residential building consents in February was nice to see, following weaker numbers late last year. Nonetheless, we'll need to see more of this to be sure the expansion in construction activity hasn't lost its way (after what could be a rough-looking Q1 for the industry).

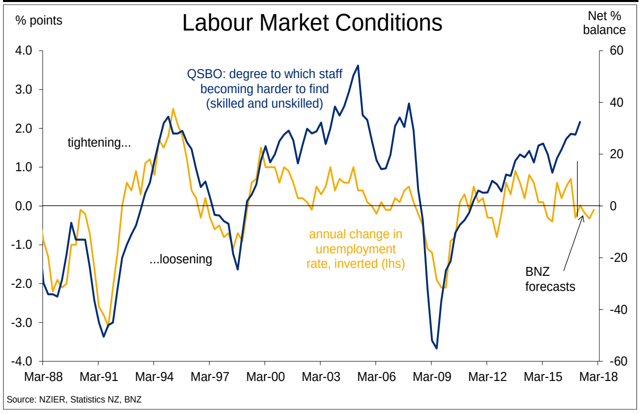
ANZ Business Survey (Apr) – 28 April
While this business survey has registered a moderation in confidence over recent months, respondents have maintained a strong outlook regarding their own activity, employment, investment and profitability. With this there have been signs of stretched capacity and a firming intent to raise prices. We expect April's edition to reiterate these themes.

GDT Dairy Auction – 3 May
While we wouldn't want to push recent price momentum too far, for too long, we also have to respect it for the meantime.

QVNZ Housing Report (Apr) – 3 May
More mixed messages in this, or some clarity emerging about which way the housing market is going, and where?

Labour Market Reports (Q1) – 3 May
Steady as she goes (forth). We expect the Household Labour Force Survey to show steady employment growth in the March quarter (+0.7%); a steady unemployment rate (5.2%) and; a relatively steady participation rate (70.6%, from 70.5%). We also anticipate the private Labour Cost Index to still be running at an annual pace of 1.6% in Q1. Steady.

A Tightening



ANZ Job Ads (Apr) – 4 May
These latest job advertising numbers will be a useful follow-on from the Q1 labour market data of the day before.

ANZ Commodity Export Prices (Apr) – 4 May
The way things are going so far in April we'd conjecture another small positive in the world price index. Dairy prices alone are supportive, but meat and forestry prices have also maintained a positive bent.

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Quarterly Forecasts

As at 20 April 2017

Key Economic Forecasts

Quarterly % change unless otherwise specified

Forecasts

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
GDP (production s.a.)	1.0	0.7	0.8	0.8	0.4	0.7	0.7	0.7	0.6	0.6
Retail trade (real s.a.)	1.3	0.9	2.2	0.7	0.6	0.9	0.8	0.6	0.5	0.7
Current account (ytd, % GDP)	-3.4	-3.1	-2.9	-3.0	-2.7	-2.7	-2.7	-2.9	-2.9	-3.3
CPI (q/q)	-0.5	0.2	0.4	0.3	0.4	1.0	0.2	0.7	0.3	0.7
Employment	1.1	1.2	2.4	1.3	0.8	0.7	0.7	0.6	0.5	0.4
Unemployment rate %	4.9	5.2	5.0	4.9	5.2	5.2	5.2	5.2	5.3	5.4
Avg hourly earnings (ann %)	2.5	2.5	2.1	1.6	1.1	1.2	1.2	2.1	2.8	2.9
Trading partner GDP (ann %)	3.2	3.1	3.3	3.2	3.5	3.4	3.4	3.6	3.4	3.4
CPI (y/y)	0.1	0.4	0.4	0.4	1.3	2.2	2.0	2.4	2.3	2.0
GDP (production s.a., y/y))	2.2	2.8	3.5	3.3	2.7	2.7	2.7	2.6	2.7	2.6

Interest Rates

Historical data - qtr average Forecast data - end quarter		Cash	Government Stock 90 Day Bank Bills	5 Year	10 Year	Swaps 2 Year	5 Year	10 Year	US Rates Libor 3 month	US 10 yr	Spread NZ-US Ten year
2016	Mar	2.45	2.55	2.60	3.05	2.50	2.80	3.30	0.60	1.90	1.15
	Jun	2.25	2.35	2.20	2.60	2.25	2.45	2.90	0.65	1.75	0.85
	Sep	2.10	2.30	1.90	2.25	2.05	2.15	2.45	0.80	1.55	0.70
	Dec	1.85	2.10	2.40	2.95	2.25	2.65	3.10	0.90	2.10	0.80
2017	Mar	1.75	2.00	2.70	3.25	2.35	3.00	3.50	1.15	2.50	0.80
Forecasts											
	Jun	1.75	2.00	2.70	3.30	2.40	3.00	3.60	1.30	2.50	0.80
	Sep	1.75	2.00	2.75	3.30	2.50	3.05	3.60	1.40	2.50	0.80
	Dec	1.75	2.00	2.75	3.25	2.60	3.05	3.55	1.60	2.50	0.75
2018	Mar	1.75	2.10	2.80	3.25	2.80	3.10	3.55	1.60	2.50	0.75
	Jun	2.00	2.40	3.10	3.55	3.10	3.40	3.85	1.90	2.75	0.80
	Sep	2.25	2.65	3.20	3.60	3.20	3.50	3.90	2.10	2.75	0.85
	Dec	2.50	2.90	3.30	3.65	3.40	3.60	3.95	2.40	2.75	0.90
2019	Mar	2.75	3.15	3.35	3.65	3.50	3.65	3.95	2.55	2.75	0.90
	Jun	3.00	3.40	3.40	3.70	3.60	3.65	3.95	2.80	2.75	0.95

Exchange Rates (End Period)

	USD Forecasts EUR/USD	USD/JPY	GBP/USD	NZD/USD	AUD/USD	NZD Forecasts NZD/EUR	NZD/JPY	NZD/GBP	NZD/USD	NZD/AUD	TWI-17
Current	1.06	109	1.26	0.70	0.76	0.66	76.4	0.56	0.70	0.93	76.4
Jun-17	1.05	114	1.25	0.71	0.75	0.68	80.9	0.57	0.71	0.95	78.5
Sep-17	1.04	116	1.24	0.70	0.73	0.67	81.2	0.56	0.70	0.96	78.7
Dec-17	1.04	118	1.22	0.67	0.70	0.64	79.1	0.55	0.67	0.96	76.1
Mar-18	1.05	120	1.20	0.68	0.70	0.64	81.0	0.56	0.68	0.96	76.7
Jun-18	1.06	120	1.21	0.68	0.70	0.64	81.6	0.56	0.68	0.97	76.9
Sep-18	1.08	122	1.22	0.69	0.70	0.63	83.6	0.56	0.69	0.98	77.2
Dec-18	1.10	122	1.22	0.69	0.70	0.63	84.2	0.57	0.69	0.99	77.4
Mar-19	1.11	120	1.25	0.71	0.70	0.64	84.6	0.56	0.71	1.01	78.7
Jun-19	1.12	118	1.25	0.71	0.71	0.63	83.8	0.57	0.71	1.00	78.7
Sep-19	1.13	116	1.27	0.72	0.72	0.64	83.5	0.57	0.72	1.00	79.0
TWI Weights						0.1135	0.0635	0.0456	0.1398	0.2073	

Source for all tables: Statistics NZ, Bloomberg, Reuters, RBNZ, BNZ

Annual Forecasts

As at 20 April 2017

	March Years					December Years				
	Actuals		Forecasts			Actuals		Forecasts		
	2015	2016	2017	2018	2019	2015	2016	2017	2018	2019
GDP - annual average % change										
Private Consumption	3.1	2.8	4.7	2.7	2.1	2.9	4.3	3.2	2.2	1.7
Government Consumption	3.1	2.7	2.4	2.1	1.0	2.6	2.3	2.5	1.1	1.0
Total Investment	6.8	2.5	6.1	5.7	4.2	2.1	5.6	6.0	4.7	2.2
Stocks - ppts cont'n to growth	0.5	-0.3	0.1	0.1	0.0	-0.3	0.2	0.2	-0.1	0.0
GNE	3.9	2.4	4.9	2.9	2.4	2.1	4.8	3.3	2.5	1.7
Exports	4.3	5.5	1.3	1.8	3.9	6.8	1.6	1.0	3.8	4.1
Imports	7.4	2.1	6.0	3.8	3.7	3.6	4.2	4.7	3.7	3.2
Real Expenditure GDP	3.1	3.4	3.7	2.4	2.4	3.1	3.9	2.4	2.5	1.8
GDP (production)	**3.4**	**2.4**	**3.0**	**2.6**	**2.4**	**2.5**	**3.1**	**2.7**	**2.5**	**1.8**
GDP - annual % change (q/q)	*3.1*	*2.8*	*2.7*	*2.6*	*2.2*	*2.2*	*2.7*	*2.7*	*2.4*	*1.5*
Output Gap (ann avg, % dev)	0.8	0.8	1.1	1.2	1.1	0.8	1.1	1.2	1.2	0.8
Household Savings (gross, % disp. income)	1.8	1.2	0.3	0.8	0.1					
Nominal Expenditure GDP - $bn	240.8	250.4	265.4	281.1	292.9	247.4	261.2	277.8	289.9	300.6
Prices and Employment - annual % change										
CPI	0.3	0.4	2.2	2.0	1.9	0.1	1.3	2.3	2.1	1.7
Employment	3.2	2.0	5.2	2.2	1.5	1.4	5.8	2.5	1.6	1.2
Unemployment Rate %	5.4	5.2	5.2	5.4	5.7	4.9	5.2	5.3	5.6	5.8
Wages - ahote	2.6	2.5	1.2	2.9	3.0	2.5	1.1	2.8	2.9	2.8
Productivity (ann av %)	-0.1	0.3	-2.5	-0.2	0.7	0.1	-1.6	-1.0	0.6	0.5
Unit Labour Costs (ann av %)	2.2	2.5	4.6	2.8	2.4	2.6	3.6	3.6	2.4	2.6
External Balance										
Current Account - $bn	-8.5	-7.8	-7.1	-9.3	-12.3	-8.3	-7.1	-8.2	-12.0	-12.6
Current Account - % of GDP	-3.5	-3.1	-2.7	-3.3	-4.2	-3.4	-2.7	-2.9	-4.1	-4.2
Government Accounts - June Yr, % of GDP										
OBEGAL (core operating balance)	0.2	0.7	0.4	1.2	1.8					
Net Core Crown Debt (excl NZS Fund Assets)	25.1	24.6	24.2	23.4	21.7					
Bond Programme - $bn	8.0	7.0	8.0	7.0	7.0					
Bond Programme - % of GDP	3.3	2.8	3.0	2.5	2.4					
Financial Variables (1)										
NZD/USD	0.75	0.67	0.70	0.68	0.71	0.67	0.70	0.67	0.69	0.73
USD/JPY	120	113	113	120	120	122	116	118	122	114
EUR/USD	1.08	1.11	1.07	1.05	1.11	1.09	1.05	1.04	1.10	1.14
NZD/AUD	0.97	0.90	0.92	0.96	1.01	0.93	0.96	0.96	0.99	1.00
NZD/GBP	0.50	0.47	0.57	0.56	0.56	0.45	0.56	0.55	0.57	0.57
NZD/EUR	0.69	0.61	0.66	0.64	0.64	0.62	0.67	0.64	0.63	0.64
NZD/YEN	89.9	76.0	79.2	81.0	84.6	82.1	81.7	79.1	84.2	83.2
TWI	78.3	72.2	76.5	76.7	78.7	73.2	78.1	76.1	77.4	79.6
Overnight Cash Rate (end qtr)	3.50	2.25	1.75	1.75	2.75	2.50	1.75	1.75	2.50	3.50
90-day Bank Bill Rate	3.63	2.42	1.98	2.08	3.13	2.74	2.03	2.00	2.88	3.88
5-year Govt Bond	3.20	2.45	2.70	2.80	3.35	2.90	2.75	2.75	3.30	3.50
10-year Govt Bond	3.35	2.95	3.25	3.25	3.65	3.45	3.35	3.25	3.65	3.80
2-year Swap	3.55	2.30	2.35	2.80	3.50	2.80	2.40	2.60	3.40	3.75
5-year Swap	3.65	2.60	3.00	3.10	3.65	3.15	3.00	3.05	3.60	3.80
US 10-year Bonds	2.05	1.90	2.50	2.50	2.75	2.25	2.50	2.50	2.75	2.75
NZ-US 10-year Spread	1.30	1.05	0.75	0.75	0.90	1.20	0.85	0.75	0.90	1.05

(1) *Average for the last month in the quarter*

Source for all tables: Statistics NZ, EcoWin, Bloomberg, Reuters, RBNZ, NZ Treasury, BNZ

Calendar

	Forecast	Median	Last
Friday 21 April			
NZ, ANZ-RM Consumer Confidence, April			125.2
Euro, PMI/PSI, April 1st est		56.0/55.9	56.2/56.0
UK, Retail Sales vol., March		-0.5%	+1.4%
US, Existing Home Sales, March		5.60m	5.48m
US, Markit PSI/PMI, April 1st est		53.2/53.7	52.8/53.3
Monday 24 April			
China, Leading Index (Conference Bd), March			+1.1%
Germ, IFO Index, April			112.3
UK, CBI Industrial Trends, April			+8
Tuesday 25 April			
NZ, Holiday, ANZAC Day			
US, Shiller Home Price Index, February y/y			+5.9%
US, New Home Sales, March		590k	555k
US, Consumer Confidence, April			125.6
Wednesday 26 April			
NZ, External Migration, March s.a.			+6,000
Aus, CPI, Q1			+0.5%
Thursday 27 April			
NZ, Finance Minister Joyce Speaks, Pre-Budget			
Aus, Terms of Trade, Q1			+12.2%
Aus, Lowe Speaks, Renminbi Dinner			
China, Industrial Profits, March y/y			
Jpn, BOJ Policy Announcement, Policy Rate			-0.1%
Euro, ECB Policy Announcement,	0.00%	0.00%	0.00%
Euro, Economic Confidence, April			107.9
Germ, CPI, Apr y/y 1st est			+1.6%
UK, CBI Retailing Reported Sales, April			+9
US, Durables Orders, February 1st est		+1.2%	+1.8%
US, International Goods Trade, March advance			-$64.8b(P)
Friday 28 April			
NZ, Merchandise Trade, March	+$322		-$18m
NZ, Building Consents, March (res, #)			+14.0%
NZ, ANZ Business Survey, April			+11.3
Aus, Private Sector Credit, March			+0.3%
Jpn, CPI, March y/y			+0.3%
Jpn, Industrial Production, March 1st est			+3.2%
Euro, CPI, Apr y/y 1st est			+1.5%
UK, GDP, Q1 1st est			+0.7%
US, Fed's Harker Speaks			
US, Chicago PMI, April		57.0	57.7
US, Employment Cost Index, Q1		+0.6%	+0.5%
US, GDP, Q1 1st est		+1.2%	+2.1%
Sunday 30 April			
China, PMI (NBS), April			51.8
China, Non-manufacturing PMI, April			55.1
Monday 1 May			
US, Construction Spending, March			+0.8%
US, Personal Spending, March		+0.2%	+0.1%
US, ISM Manufacturing, April			57.2

	Forecast	Median	Last
Tuesday 2 May			
Aus, RBA Policy Announcement	1.50%	1.50%	1.50%
China, PMI (Caixin), April			51.2
Jpn, BOJ Minutes, 15/16 Mar Meeting			
UK, Markit/CIPS Manuf Survey, April			54.2
Wednesday 3 May			
NZ, Dairy Auction, GDT Price Index			+3.1%
NZ, QVNZ House Prices, April			+12.9%
NZ, LCI Priv Ord Wages, Q1 y/y	+1.6%		+1.6%
NZ, HLFS Unemployment Rate, Q1	5.2%		5.2%
Euro, GDP, Q1 1st estimate			+0.4%
US, ADP Employment, April			+263k
US, FOMC Policy Announcement, Upper Bound			1.00%
US, ISM Non-Manuf, April			55.2
Thursday 4 May			
NZ, ANZ Comdty Prices (world), April			+0.4%
Aus, International Trade, March			+$3.57b
Aus, Lowe Speaks, Economic Society			
China, Services PMI (Caixin), April			52.2
UK, Markit/CIPS Services, April			55.0
US, Factory Orders, March			+1.0%
US, International Trade, March			-$43.6b
Friday 5 May			
Aus, Qtly Monetary Statement			
US, Non-Farm Payrolls, April			+98k
Monday 8 May			
Aus, Building Approvals, March			+8.3%
Aus, NAB Business Survey, April			+6
China, Trade Balance, April			+CNY164b
Germ, Factory Orders, March			+3.4%
Tuesday 9 May			
NZ, RBNZ 2yr Inflation Expectations, Q2			+1.92%
Aus, Retail Trade, March			-0.1%
Germ, Industrial Production, March			+2.2%
Wednesday 10 May			
NZ, Electronic Card Transactions, April			+0.5%
Aus, Consumer Sentiment - Wpac, May			99.0
China, CPI, April y/y			+0.9%
Jpn, BOJ Summary of Latest Meeting, 26/27 Apr			
Thursday 11 May			
NZ, RBNZ MPS	1.75%	1.75%	1.75%
Euro, ECB Economic Bulletin			
UK, Industrial Production, March			-0.7%
UK, BOE Policy Announcement	0.25%	0.25%	0.25%
Friday 12 May			
NZ, BNZ PMI (Manufacturing), April			57.8
Euro, Industrial Production, March			-0.3%
Germ, GDP, Q1 1st est			+0.4%
US, CPI ex food/energy, April y/y			+2.0%
US, Retail Sales, April			-0.2%

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