3 October 2013

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Economic Outlook

As Graeme Wheeler has reiterated, "OCR increases will likely be required next year". So how prepared is New Zealand for the ending of cheap money? We think reasonably well, given the evidence of rebalancing. However, it's only when the cheap money's actually withdrawn that underlying health is revealed. New Zealand certainly looks like being one of the first (developed countries at least) to probe the path back to normal rates, starting early next year. We suspect it will be a bumpy ride. But trying to avoid it might only make it a much more painful exercise later down the track. As for the upcoming data, next Tuesday's QSBO will surely up the ante on the growth, and inflation, fronts, while any housing market data will be seized upon for gauging the early impacts of the LVR restrictions, now in place. Re the 16 October Q3 CPI, we believe it will increase 0.8% (1.2% y/y), in line with RBNZ expectations.

Interest Rate Outlook and Strategy

The RBNZ, most recently through speeches and a local newspaper op-ed, has emphasised that current OCR settings are likely to change with the NZ cash rate set to move upwards, starting 2014. This is part of the policy normalisation process we have long anticipated, but which is now coming into focus. So no real news but certainly affirmed by the Reserve Bank. We maintain our view that the central bank will raise rates by 25bps in March next year from the historic low of 2.50% currently in place. And we continue to expect a 4.50% peak by mid-2015 – at least 6 months earlier than the September MPS projected. Still, for now we hold a tactical receive 2y swap position to benefit from carry as the US budget and debt ceiling uncertainty weighs on sentiment. We have shifted the stop to 3.50%, our original entry point.

Currency Outlook

In our last update, we outlined our expectations for the NZD/USD to shift up into a higher trading range in the wake of the US Fed's tapering 'baulk'. So far, this view has broadly played out. The NZD/USD has spent the past couple of weeks bobbing around in a 0.8200-0.8400 range. Medium-term NZD/USD fundamentals remain supportive and we haven't changed our year-end 0.8350 forecast. However, for exporters and those exposed to a rising currency, the next few weeks may well present opportunities to access the NZD at lower levels. This reflects the growing uncertainty and prospect of risk aversion as the deadline to raise the US debt ceiling approaches. A NZD/USD pullback below 0.8000 would seem likely under this scenario, with the NZD/JPY likely to suffer even more.

When the Cheap Money Ends

- How prepared is NZ for normalized rates?
- There is good evidence of deleveraging
- But has it been nearly enough?
- Borrowers still largely on floating/short rates
- Asset prices prone to even slight yield rises

As RBNZ Governor, Graeme Wheeler, reiterated in September, "OCR increases will likely be required next year". So how prepared is the New Zealand economy for the ending of cheap money? In theory, it should be good and ready. Businesses and households have certainly had a good many years to sort their balance sheets and cash flow, following the excesses that built up over 2003-07 and the 2008/09 recession that (naturally) followed. Economic confidence is riding high, so we should reasonably expect an attitude of "Remove the stimulus? Bring it on".

The reality is, however, that it's only when the cheap money is actually withdrawn that the true health of an economy, and its financial system, is revealed. The recent global convulsions over the potential for just a tiny tapering of the Fed's QE programme (leave alone actual policy rate rises from zero) have been a reminder of this. This is not an argument for baulking, by the way, more a warning about not letting the system become too dependent on overly cheap funding in the first place.

From New Zealand's perspective, there has certainly been reasonable evidence of rebalancing over recent years. Private sector debt ratios have trended down. The household savings rate looks substantially recovered. The current account deficit has shrunk, as has the nation's "imbalance sheet" with the rest of the world regarding cross-border investment.

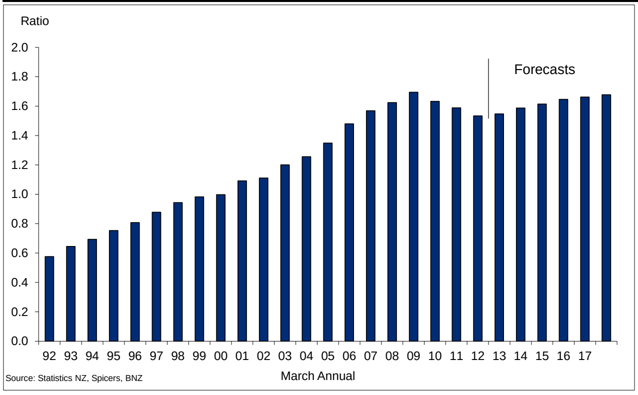
However, has the economy's rebalancing been enough? We're not entirely convinced that it has. Running what we'd call "normal" interest rates through everything doesn't leave us feeling supremely confident. But failing to do this only increases the chances of it being a much more painful exercise later down the track.

Households

The household sector has clearly been through a period of deleveraging over recent years. Post its 2007 peak of exuberance, household credit growth slowed dramatically, to a crawl, and the household savings rate bounced back from the negative. Borrowing against housing wealth, in order to spend up large on consumption goods and services, withered.

However, when all was said and done, household debt as a proportion of disposable income reversed only a fraction of the increase it registered over the period of upswing, 2003-07. And, over the last 18 months or so, household

Total "Household" Debt to Disposable Income



credit growth has rebounded (to a most recent 5.5% annual pace) – to the point of pushing the debt ratios back up.

Sure, this has coincided with renewed house price inflation. However, the salient question is how well founded has the recent surge in house prices been? It certainly hasn't been justified by the economic fundamentals that it tends to follow over long stretches – such as incomes, rents, and construction costs. On this basis, the RBNZ has every reason to point out that NZ house prices are clearly over-valued. The Governor is right to worry about the end-game on this.

But what's to bring house prices back to trend? While there are hopes that the recently instituted LVR restrictions will do the trick, we're not so sure – at least not in a sustained or complete fashion. The more powerful, and permanent, correction mechanism might well have to come from normalized interest rates.

Returning interest rates back to average will certainly increase debt servicing costs, giving households a better sense of the relatively high debt loads they continue to carry, overall. To be sure, debt servicing costs have dropped noticeably from their heights of 2007/08.

Household Debt Service Costs

“Short-term” Mortgage Book

However, they are not exactly low by historical standards, even though interest rates are. So a return of rates to back to normal will definitely put the squeeze on.

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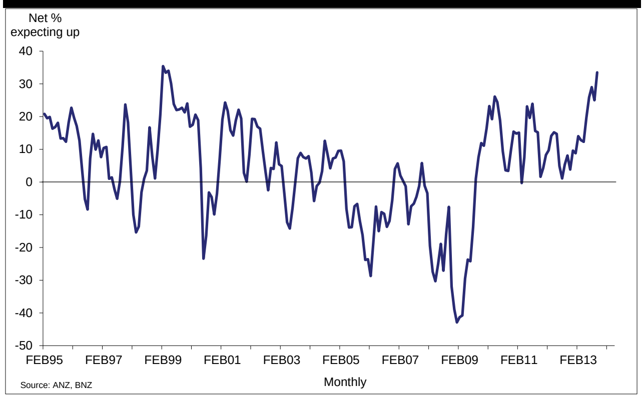
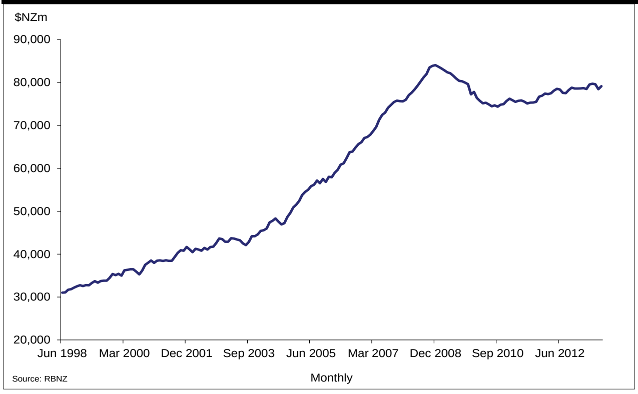
This is reinforced by the fact households are still predominantly loaded into either floating or very short-term mortgages. Yes, there has been some shifting into longer-term fixed mortgages over the last 6-12 month, but nothing material. As of August, 93% of mortgages (with NZ registered banks) were of duration of less than 2 years. About half of this was straight floating. This suggests a lot of pinch when OCR increases come into play – especially with longer-term mortgage rates already a good chunk higher than short-term ones, giving people “nowhere to run”.

Profit Expectations



Business Credit



Business

By and large, New Zealand’s business sector is not viewed as being vulnerable the way the household sector is with regard to debt and interest rates. Indeed, there are indications that it’s in fine fettle – balance-sheet wise, and in terms of profitability. The strong performance of the NZ share-market alludes to this, as do the various business surveys of late.

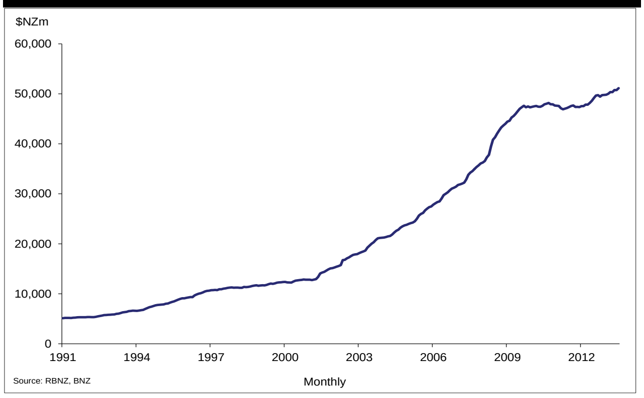
However, we still have to wonder the degree to which businesses, especially those of small to medium size, are taking currently low interest rates for granted. Time will tell.

Rural

The rural sector is also in relatively good shape, economic all speaking, particularly so the dairy sector given its record payout in view for this season. However, it’s also true this is where debt has continued to ramp up. Farming debt is roughly 40% higher than it was going into the 2008/09 recession, namely \$52b versus \$37b. That’s equivalent to around 25% of nominal GDP.

And, much like the household sector, much of this debt is floating rather than fixed – two-thirds of it, in fact (as at June 2013). Sure, this is where the cheaper rates have been. But, by the same token, this is where the biggest upward adjustments are likely to come. Bear this in mind in the context of rural profitability, including the dairy sector (whose debt now stands at \$33b, more than double what it was in 2006).

Agricultural



Government

The NZ government can largely be forgiven for still being in an operating deficit and the custodian of much higher debt than was the case immediately before the 2008/09 recession. For a start, when it took office in late-2008 it was lumbered with the prospect of a "decade of deficits". Such was the disproportion of the spending programme that had been built up by the previous administration, which became clear once the economic tide was ebbing. Then there was the string of serious earthquakes to hit Canterbury over 2010/11, which the public accounts and balance sheet shouldered directly and indirectly.

The main issue for the government in a rising rate environment is its rollover schedule, given upcoming new net issuance will be limited by the projected return to operating surplus by 2014/15 (if not sooner?).

There is also, of course, the issue of how the private economy, and thus tax revenue, copes with higher interest rates. But this should be a largely self-regulating process, in that rate rises will tend to be in keeping with economic performance.

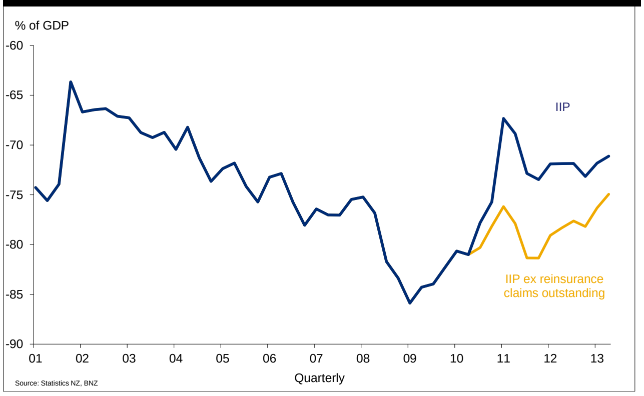
International funding

While government funding should not be any problem in a rate-rising environment (given the strong public balance sheet) neither should the economy's more general, international, funding requirements be an issue. New Zealand has certainly proved itself as a good credit, through and post the GFC.

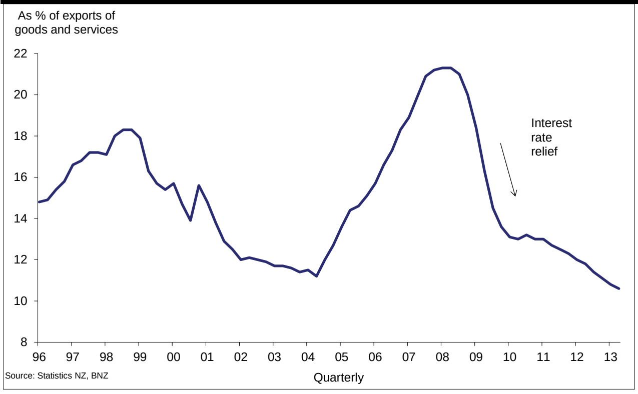
What's more, some chunk of New Zealand's international funding needs will be "naturally" drawn from the earthquake insurance payouts from foreign reinsurers, for the very purpose of the reconstruction work that needs to be done in Canterbury. This insurance money has accrued to a grand total of $18.7b, with $10.5b of this settled (but not necessarily spent) to date.

This has helped reduce New Zealand's international investment position (IIP). However, even without it, the nations' IIP as a proportion of GDP has shrunk to 74.9%, from a peak of 85.9% in early 2009, as yet another sign of deleveraging.

Net International Investment Position



Foreign Debt Servicing



Still, we also need to bear in mind New Zealand's current account will be increasing over the next couple of years, to a greater than normal proportion (to GDP). This will include higher interest payments to non-residents who have funded New Zealand's expansion over recent times, particularly the housing market, via the local banking sector. Increased payments will reflect the scheduled rise in NZ interest rates (not global rates), given almost all of New Zealand's foreign debt is swapped back into NZ dollars for risk-management purposes.

Asset Price Revaluation

Of course, the other more general thing to watch during a rate normalization phase is the behaviour of asset prices. These can become as complacent as cash-flow during periods of unusually low interest rates. Again, people using long-term rates are going to be less exposed to those using short-term rates as the basis of pricing assets.

While a 200 basis point increase in a discount rate, as an example, might not seem that much, it is when the starting rate is 5%.

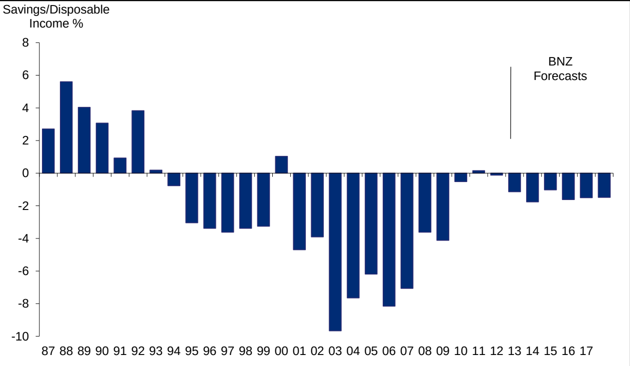
The good news is that only the housing market looks clearly out of whack with economic fundamentals at the moment, whereas during the 2003-07 it was pretty much everything, including commercial property and farms. Still, all asset types appear to be based on yields that bear a closer resemblance to presently low short-term rates than where interest rates will probably get to over the next couple of years. Watch this space.

Saving Private Savings

As an aside, we should also like to put a word in for savers. Remember them? They have surely borne the brunt of recent monetary policy biases, having to swallow relatively low deposit rates, and much less besides after tax and inflation.

Yet everyone agrees that we need to save more. Even Graeme Wheeler said so in a speech earlier this year to NZ manufacturers, in the course of saying a higher national savings rate will help take pressure off the exchange rate, no less. Maintaining low interest rates doesn't help in this respect.

Household Savings Ratio



Source: Statistics NZ, BNZ

Meantime, however, all and sundry will probably keep seeing monetary policy solely through the lens of the almighty borrowers, home owners, the debt they are carrying, and those who have chosen to ride the ups and downs of the currency. A shame, but true.

International lessons

Finally, it seems worth recalling a few recent international examples of economies and financial systems that became complacent during times of easy money, only to feel the backlash when rates had to rise. For instance, the way;

• Large tracts of Asia became dependent on cheap (and abundant) money in the 1990s as they "imported" relatively low US interest rates, in effect, by way of their exchange rates fixings to the US dollar

• Peripheral Europe – private and public – gorged on overly cheap money upon being admitted to the Eurozone tent. What was good for Germany was not good for Greece

• Many Americans leveraged into mortgages with extremely cheap short-term rates, underwritten by Greenspan's 1.0% cash rate and slow reversal

In these cases (and many more besides) it was only when rates were forced to return to appropriate levels – typically based on broader economic considerations – that the excesses were finally called to account

Of course, the world has needed extremely easy monetary policy over recent times – but partly because of the over-easy policy over the prior cycle. Likewise, it's fair to say that money needs to be cheap for as long as it takes. There are risks in withdrawing stimulus too soon. We get that. But it's also true that central banks have a habit of giving too much for too long. This can engender complacency and false reprieve amongst businesses, households, banks and financial markets, to the point of perpetuating a problem, not being any solution.

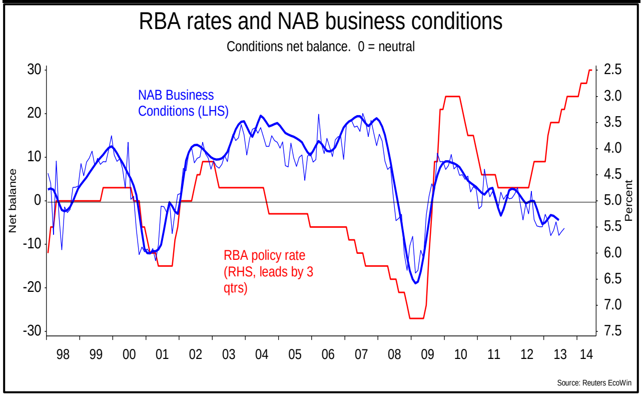
In some ways, then, the true test is yet to come. Importantly, New Zealand looks likely to be one of the first (developed countries at least) to probe the path back to normal, with OCR increases beginning next year. We suspect it will be a bumpy ride. But trying to avoid it might only make it a much more painful exercise later down the track.

craig_ebert@bnz.co.nz

NAB delays RBA call: next rate cut now February

- Recent RBA statements suggest the central bank is comfortably on hold and we have decided it is more likely that the next easing of policy will be delayed until February
- However, the big picture remains intact with the economy expected to underperform over the year ahead, more so for domestic demand, leading to rising unemployment
- Higher unemployment and the commensurate downward pressure on inflation will be the triggers for a further easing by the RBA but probably not until early 2014
- We still do not see upward movements in the cash rate until 2015

Domestic business activity not responding to rate cuts so far



For months NAB's view has been that the RBA would react to a softening economy ahead and come back with more monetary accommodation. That big picture view remains firmly intact.

Indeed, our analysis suggests that the economy will slow, with GDP growth softening to around 2% by the end of the year, rising to a still sub-trend 3% by the end of 2014. Private domestic demand is even worse in our forecasts, slipping to about 1¼% by the end of 2013 and likely to be near flat through 2014. GDP is stronger only because net exports will keep rising, as new resources projects come on stream with substantial contributions to annual GDP of about 1.8 percentage points through 2014. With the Federal Government shedding jobs, this is a recipe for rising unemployment, which, in our view, will peak at 6¾% in the second half of 2014. Higher unemployment means slower wages growth and, in turn, downward pressure on underlying inflation. Essentially, this evolution of the economy will convince the RBA of the need for a more accommodative monetary policy stance.

While this big picture story remains well and truly in place, the RBA's recent statements have indicated that Board members are comfortable enough with recent developments and there is no imminent interest rate cut coming.

Yesterday's post meeting statement noted that business and consumer confidence had improved but said it was too early to judge how persistent this will be (and we would add, to what extent this leads to stronger activity). The statement also noted that savers were moving out of declining returns in low-risk assets. That is in keeping with the view that the traditional transmission mechanism of monetary policy may be starting to gain traction. While not the same thing as worrying about a housing bubble, clearly the extent to which house price inflation accelerates will be watched carefully. Both of these 'new' comments are consistent with the RBA waiting for a while before considering any further easing.

Accordingly, we have decided to delay our rate cut call from November to February, allowing the RBA time to pause and watch the data. With the big picture still unmoved, we continue to see a cut coming but right now there is no rush.

As the chart above shows, to date the domestic economy has not responded to the lower nominal cash rate. Part of that story may reflect the impact of a still high currency on monetary conditions.

Looking ahead, the labour market data, our own NAB survey and the inflation and wages reports coming up will be important pointers to the timing of the next cut but right now, it looks likely that there will be no further monetary accommodation until next year.

robert.j.henderson@nabcapital.com

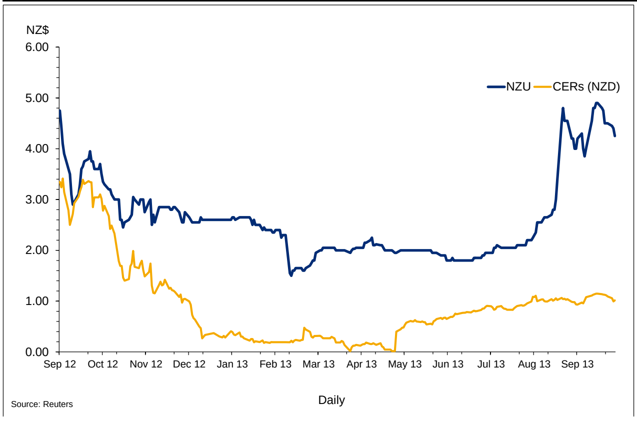
Carbon and Commodities

- European carbon market eyes formation of German Government. Quarter end profit taking and weaker German electricity prices see prices slump
- NZUs retreat from highs
- Thawing Middle Eastern tensions sees energy markets unwind risk premium
- Metals continue to eye Chinese growth and inventory overhang. US Government shutdown spooks metals market.

Carbon		Change ($)	Change (Fortnight)	Change (Month)	Change (Year)
EUA Dec 13(€)	5.28	-0.30	-5.38%	17.59%	-32.65%
CER Dec13 (€)	0.63	-0.11	-14.86%	8.62%	-70.42%
NZU (NZ$)	4.15	-0.75	-15.31%	-1.19%	10.67%

All eyes in the European carbon market are on Germany and the likely makeup of Angela Merkel's new coalition government. Germany has, thus far, declined to officially lean one way or the other when it comes to support for the 'back-loading' plan to boost European carbon prices. Chancellor Merkel has backed the proposal in principle, and the market widely expects the new Government to formally support the move in coming weeks. Market price action of late has been determined by 'old school fundamentals' rather than political machinations. Coal and German electricity prices have provided direction for the European market for the last couple of weeks, and quarter-end profit taking saw prices correct 7% earlier in the week.

NZUs vs CERs

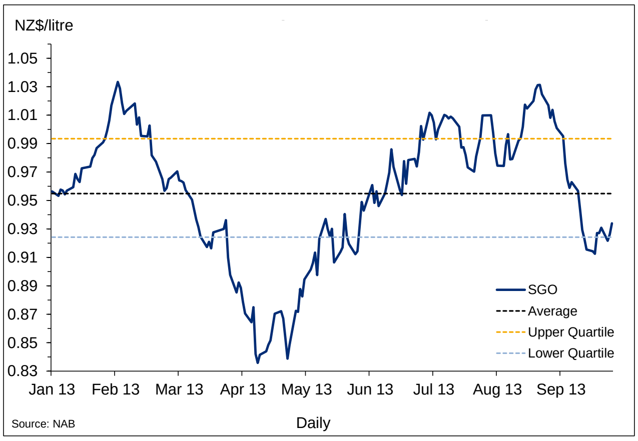


The local market has been quiet over the last fortnight, with price retreating from recent highs. NZUs briefly retested the $5.00 level, but have drifted off, with both sides of the market taking a step back to reassess the situation. Switching from NZUs to ERUs is rumoured to be continuing, and makes sense for current compliance year obligations (after all, why surrender an NZU at $4.50 when you can surrender an ERU for 45c?).

Recent market commentary has focussed on a perceived overhang in the local market based on estimates of emission registry account holdings and offshore unit surrender data. While it is undoubtedly true that NZUs have been eschewed for cheaper offshore units (offshore units accounted for over 95% of all units surrendered for the 2012 compliance year), it does not necessarily hold that those NZUs remaining in accounts will come to market. Post 1989 forest owners with liabilities expected to crystalise beyond 2015, for example, have little choice but to hold (or buy) NZUs for harvest obligations in the future. Likewise, emitters with a longer-term, pragmatic view of the NZ ETS will happily hold NZUs for the post-2015 period. There will of course be a price level at which supply to market increases, however I disagree with the assumption that large account holdings will put downward pressure on prices.

Commodities	US$	Change ($)	Change (Fortnight)	Change (Month)	Change (Year)
Brent Crude	109.12	-1.57	-1.42%	-4.58%	-1.95%
WTI Crude	103.94	-4.33	-4.00%	-2.71%	13.11%
Copper	7,279.00	94.85	1.32%	0.22%	-12.53%
Zinc	1,890.15	20.30	1.09%	-1.14%	-9.91%
Aluminium	1,838.15	53.15	2.98%	0.39%	-12.59%
Tin	22,824.00	-171.00	-0.74%	7.46%	13.81%

Spot Singapore Gas Oil



Chinese growth continues to be the main focus for base metals, though the on-going story of potential inventory overhangs in warehouse financing deals has been getting some airtime. Given the long lag times to extract stock from warehouses the chance of the market being flooded with stock is slim. The US Government shutdown has spooked the metals market, with falls of up to 2% in some metals.

paul_white@bnz.co.nz

The US Debt Ceiling & the NZD

- The USD outlook is plagued with uncertainty as we head into negotiations over the US debt ceiling
- The likelihood that nervousness and risk aversion begins to rise means the NZD is subject to near-term downside risk. This is concentrated more on NZD/JPY than NZD/USD
- Still, medium-term NZD/USD fundamentals remain supportive and we haven't changed our year-end 0.8350 forecast

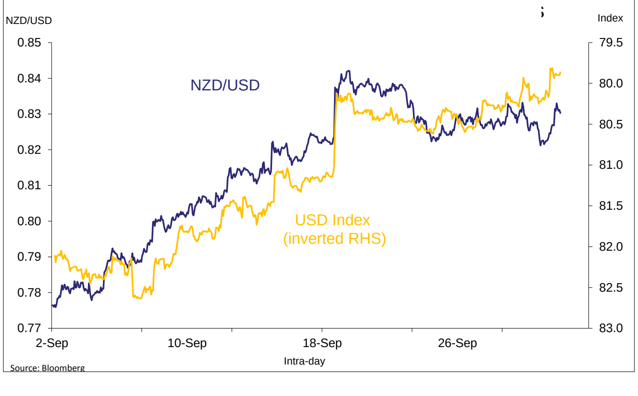
In our last update, we outlined our expectations for the NZD/USD to shift up into a higher trading range in the wake of the US Fed's tapering 'baulk'. So far, this view has broadly played out. The NZD/USD has spent the past couple of weeks bobbing around in a 0.8200-0.8400 range.

However, for exporters and those exposed to a rising currency, the next few weeks may well present opportunities to access the NZD at lower levels.

Local inflation figures unlikely to excite
Looking out over the coming fortnight, Q3 CPI is one of the four local data release with any notable market moving capacity. We expect a 0.8% quarterly inflation outturn, which would place annual inflation back inside the RBNZ's target band for the first time since June 2012. Still, our forecast is bang in line with the RBNZ's, so an on-expectations result probably wouldn't ruffle the kiwi's feathers. Outside of the CPI, a string of activity data including NZIER business confidence, the BNZ PMI, and REINZ housing data will all likely reinforce the strongish NZ economic recovery that underpins our year-end 0.8350 NZD/USD forecast.

It's (still) all about the US
Most of the direction for the NZD/USD has come from the US and USD side in recent weeks (see chart). We suspect this will remain the case in the near-term as we enter a critical, yet highly uncertain, period for US budget negotiations.

NZD/USD & the USD Index – Past Two Months



The market has so far taken a fairly sanguine view about the impact of the US government shutdown currently underway. This seems appropriate given the limited impact of past shutdowns. The late 1995 episode for example lasted around three weeks and resulted in a hit to US GDP growth of no more than 1%.

Debt ceiling 102: here we go again
The looming debt ceiling is a different story. On current estimates, the US Treasury will run out of cash shortly after 17 October. This is problematic given a Social Security payment of around US$25b is due on 1 November, and perhaps more importantly an interest payment of around US$30b is due on 15 November. A failure to raise the ceiling in time to meet this interest payment could technically constitute a US government default. The potential damage to the US economy would be huge.

It's fair to say that the shutdown debacle hasn't exactly filled investors with confidence that Congress will be able to get its act together in time to raise the debt ceiling in a timely manner. So what does it all mean for markets? Unfortunately, the implications are far from clear.

Modern history of US fiscal shenanigans would suggest Treasuries and the USD will attract 'safe-haven' demand as uncertainty rises and risk aversion takes hold. Once a (typically last minute) compromise deal is reached, market volatility will then settle down again and risk appetite will return to normal. This was broadly the run of events during the negotiations over the 2011 debt ceiling debate, and the less unsettling late 2012 'fiscal cliff' episode.

If this scenario did play out, the NZD would be friendless due to its high-beta status and sizeable current account deficit. We doubt the NZD/USD sell-off would be as large as 2011's more than 10 cent decline, but a pullback below 0.8000 would appear probable. As an illustrative example, if the VIX index (a risk aversion proxy) were to spike from 16% to 40%, as we saw in 2011, the NZD/USD 'fair-value' estimate from our short-term valuation model would plunge to 0.7600.

However, there are a couple of complicating factors this time around. First, no one is really sure what would happen to the USD if the US was put into default. One can make a case for any number of reactions.

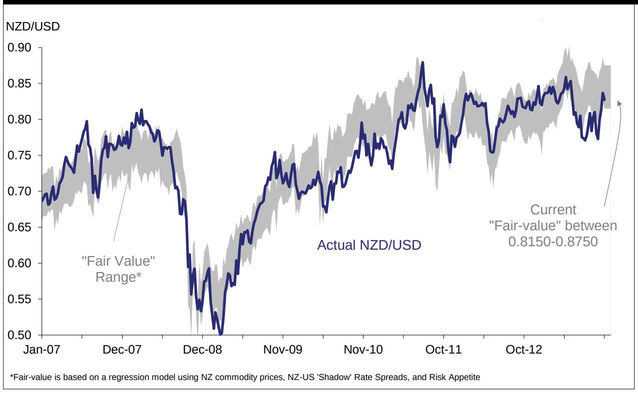
Second, the outlook for monetary policy is both more finely balanced than during previous fiscal fights, and more important as a driver of currency markets. Even if we saw widespread risk aversion and flight to safety flows, the typically defensive USD may not rally if the market pushed Fed tapering expectations back into 2014.

This suggests to us it would be the JPY, rather than the USD, than would outperform in the event the debt ceiling debacle does unnerve investors. A NZD/JPY back at 75.00, then, is probably the higher probability risk than a NZD/USD back at 0.7500.

NZD fundamentals still positive

Abstracting from near-term prognostications, we note that medium-term cyclical fundamentals remain broadly supportive of the NZD/USD.

NZD/USD Relative To Short-term "Fair Value"



We recently updated our short-term valuation model, having received the latest US 'shadow short rate' (SSR) data from the RBNZ's Krippner. Not surprisingly, the SSR has become more negative in the wake of the September Fed meeting, falling to -6.3%. Plugging this into our model lifts our short-term NZD/USD 'fair-value' range slightly to 0.8150-0.8750.

Summary

While the USD implications are fairly uncertain, the upcoming Congress scrap over the debt ceiling is a downside risk to the NZD/USD to the extent investors' tolerance for 'risk' is compromised. However, we'd view this as an opportunity for exporters to buy the dip, assuming (as we do) that the US does not get placed into outright default, and a compromise is eventually reached. Medium term NZD/USD fundamentals are supportive and our year-end forecast remains 0.8350.

mike_s_jones@bnz.co.nz

FX Momentum Model: Still short USD, watching AUD/NZD

The USD has continued to struggle over the past fortnight, as Fed tapering expectations have been pushed back and US bond yields have slipped lower. Our momentum model remains mostly short the greenback, having turned bearish in the wake of the dovish September FOMC meeting.

– The model's short DXY position has so far returned 1.2%. The break below key support at 80.00 has seen the model shift the stop/loss on this position down to 80.65.
– The model has retained several other negative USD positions including a EUR/USD long from 1.3427 (trailing stop raised to 1.3462), short USD/CHF from 0.9163 (stop/loss 0.9139), and long GBP/USD from 1.5435 (take profit at 1.5956). In addition, a short USD/JPY position was initiated on Monday on the break down through 97.76 (stop/loss 99.57).

Notably, the negative USD view is expressed mostly against the major currencies; the model is now more neutral on the 'commodity currencies'.

– The model's take-profit trigger on its NZD/USD long was hit on yesterday's brief pullback to 0.8206 (market now 0.8320). It would need to see a break above 0.8436 (September's high) to go long again.
– The model was also carted out of its USD/CAD short at 1.0341 and is now neutral.
– On AUD/USD, the model has held onto its long position by the skin of its teeth. Momentum accounts will likely remain keen buyers of the Aussie as long as the currency holds above 0.9281. Note though that the model is close to re-entering an AUD/NZD short (trigger at 1.1211).

mike_s_jones@bnz.co.nz

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 and stop the model reacting to false breaks.

FX Momentum Model Positions

3-Oct-13

Currency pair	Position	Entry date	Entry level	Mkt	Return	Stop	Long trigger	Short trigger
DXY	Short	18-Sep-13	80.90	79.90	1.2%	80.65		
EUR/USD	Long	18-Sep-13	1.3427	1.3581	1.1%	1.3462		
USD/JPY	Short	30-Sep-13	97.76	97.36	0.4%	99.57		
EUR/JPY	Neutral	30-Sep-13	131.61	132.21			134.95	129.91
USD/CHF	Short	18-Sep-13	0.9163	0.9027	1.5%	0.9139		
GBP/USD	Long	07-Aug-13	1.5435	1.6224	5.1%	1.5956		
GBP/JPY	Long	02-Sep-13	154.67	157.95	2.1%	157.11		
AUD/USD	Long	09-Sep-13	0.9233	0.9387	1.7%	0.9281		
AUD/JPY	Neutral	27-Sep-13	91.69	91.39			94.45	90.65
NZD/USD	Neutral	03-Oct-13	0.8206	0.8328			0.8436	0.7856
NZD/JPY	Neutral	30-Sep-13	80.61	81.08			83.68	78.37
AUD/NZD	Neutral	02-Oct-13	1.1413	1.1270			1.1629	1.1211
USD/CAD	Neutral	02-Oct-13	1.0341	1.0337			1.0516	1.0182

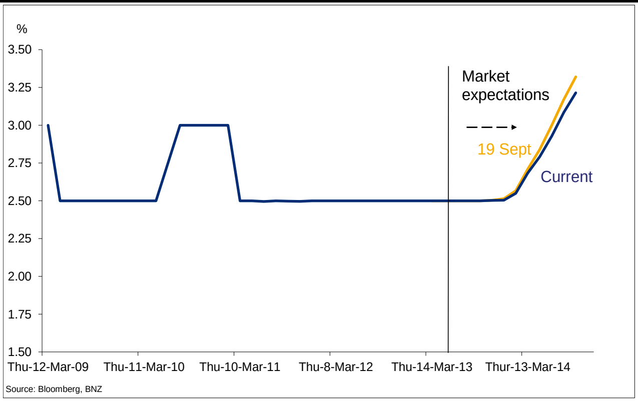
Notes: This portfolio represent hypothetical, not actual, investments. Reported returns do not include the cost-of-carry. All trades are entered and exited at triggered levels

The BNZ OIS-ter: Fish 'n' Chip Paper

- The RBNZ, most recently through speeches and a local newspaper op-ed, have emphasised that current OCR settings are likely to change with the NZ cash rate likely to move upwards in 2014. This is part of the policy normalisation process long anticipated by the market. So, no real news, in effect, but it does reinforce the RBNZ's view on the matter.
- The market currently prices around a 75% chance of a 25bp hike in March 2014. A mild reduction from the 85% chance ascribed two weeks ago. The market sees the OCR being around 75bps higher in a year's time
- We maintain our long-held view that the RBNZ will raise rates by 25bps in March next year from the historic low of 2.50%. We see the OCR 125bps higher by 12 months' time
- This week's RBA Statement conveyed the central bank to be quite comfortably on hold for now as it sees how the current lift in house prices along with business and consumer confidence plays out.
- The market and our NAB colleagues continue to see the RBA on an easing bias.
- The prices currently prices a 20% chance of a 25bp cut in November, with a 50% chance of a cut by February next year.
- Our NAB colleagues continue to see enough economic weakness ahead to prompt a rate cut, but have delayed the timing of the forecast 25bp cut to February 2014 from November 2013 previously.
- Little rate activity is expected from other central banks in the coming 12 months. With the majority of developed market cash rates below 1.00% the market is rather focused on the potential for tweaks to alternative policy measures such as quantitative easing and macro-prudential tools.

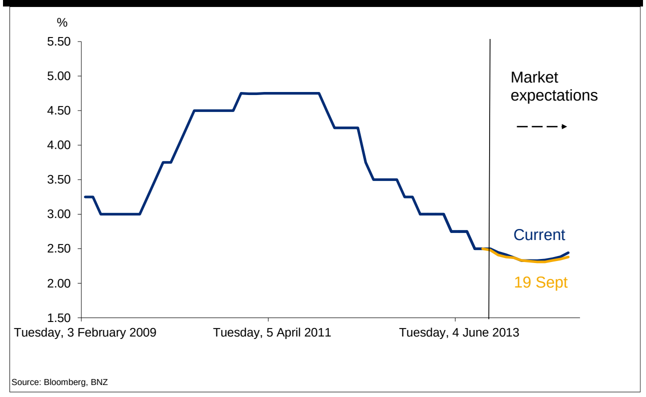
New Zealand

RBNZ Cash Rate Expectations (Derived from OIS Rates)



Australia

RBA Cash Rate Expectations (Derived from OIS Rates)



doug_steel@bnz.co.nz

Key Fixed Interest Views

Strategy	Australia	New Zealand
Duration	Neutral on outrights as bond yields continue to hold towards lower end of broader ranges. The two week rally in UST10's has corrected in the past few days with bond investors seemingly quite sanguine about the US Federal Government shutdown. UST10's at 2.65% versus what we expect will be a 2½-3% range for now. Aussie bonds basically following and we prefer to wait until valuations become stretched in either direction before establishing positions. Some front-end pre-pricing in recent days as the RBA's statement yesterday implied a good deal of comfort right now. NAB economists have officially delayed the next 25bps rate cut to February. For front-end trades, we continue to hold OIS flatteners via paid Nov 13 and received Feb 14 positions. A 25bps cut by February now priced at 68% and would start to receive outright Feb when below 50:50. Trade: Receive Feb14 OIS vs pay Nov13 OIS remains open.	The expectation of OCR hikes next year continues to be supported by the macro data, with economic expansion presenting the prospect of inflation lifting from its current low ebb. US uncertainty has resulted in receiving interest in 2y swap which has helped absorb paying pressures from mortgage activity. LVR rules and the delay in tapering has put carry trades back in play and we remain comfortable with our 2y swap receive recommendation. Longer dated NZGB are still looking attractive relative to offshore counterparts with the 2020 bond the standout value on the curve. Trade: Tactically receive 2y swap to benefit from carry. Shift stop to 3.50%, our original entry point.
Curve	We maintain our view that curves are entering into a range trading environment and as such continue to look for opportunities to enter flattening trade as this has positive carry and roll. 3/10 futures curve has flattened to +97.5bps on RBA re-pricing and UST10's being lower. We've missed entry levels for now and rather than chase it prefer to target back above 115bps before considering entering flattening trades again.	The receive 2y5y10y swap butterfly remains the trade to watch. Relative to the US and Australia this NZ fly has failed to compress and we see the 5y NZ swap playing catch up particularly if yields continue to rally. Trade: We are watching the 2y5y10y swap butterfly to receive.
Swap spreads	We still see the EFP box flattening over the near term, but given current market uncertainty range trading is likely to be theme for now. The lack of asset swapping and longer dated ACGB issuance should help 10y EFP compress while corporate activity should keep paying pressure in 3y swap. Trade: Receive EFP box trade is open.	With Q4 issuance already reflected in longer dated NZGB yields, a US budget/debt resolution over the coming weeks should help NZGBs perform against swap. At 30bps, entering a 10 swap spread widening trade is still attractive. We see a 25-55bps range containing this spread over the coming year. Trade: Entered 10y swap spread widening at 29bps.
Semi-government spreads	The start of the new financial year for domestic banks should result in an eventual pickup in demand, but in our view we still need to see a further 5-10 bps widening in spreads to benchmark (and to swap) before recommending long positions. The sweet spot remains around mid-dated maturities, preferably between 2017-2019 where carry and roll is most attractive ranging from 4 to 5bps per month. Trade: SAFA May 21/TCV June 20 is open.	Month end buying has helped LGFA spreads performed in the past week. Near term any widening in spreads on the back of global risk-off sentiment is seen as limited and should be treated as an opportunity to invest. Target 105bps as an entry level for a LGFA-NZGB21 spreads compression trade. Trade: If LGFA-NZGB21s rise above 105bps spreads relative value would be fairly compelling.
Bills Libor	The grind higher in the 5 to 10 year part of the curve looks to be coming to an end as corporate paying eases for now and the US shutdown hinders flow. Until a US resolution is reached the bias is for spreads to move back towards the lower end of the recent ranges (26bps in 5y and 36bps in 10y).	n/a
Yield differentials	The 10y AU-US spread differential is practically unchanged at 128bps (using US T futures) meanwhile fair value based on 2 year forward implied cash rate has remained hovering around 155-160bps. We retain our bias for a wider spread and we look for a dip below 120 to enter a widening trade.	The NZ-AU10y bond differential has performed in the week, compressing from 75bps to be currently at 68bps. Market uncertainty is likely to keep the spread volatile and we would target a move above 75bps to enter this compression trade.

- Bullet 1

For a full discussion of views please see today's edition of 'Aussie and Kiwi Fixed Income Strategy'

kymberly_martin@bnz.co.nz / skye.masters@nab.com.au

Money Market Strategy

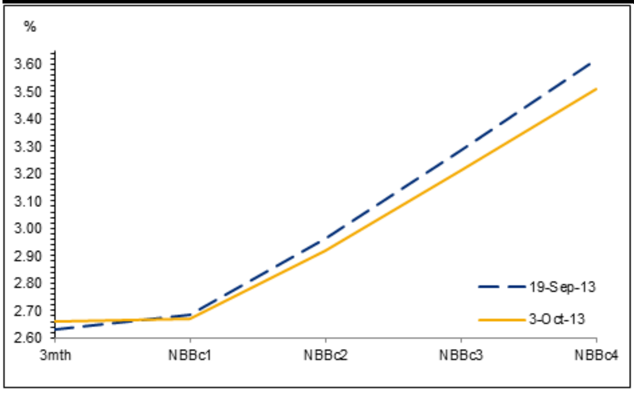
- US government shuts down
- Wheeler hawkish on housing
- RBA on hold at 2.50%

Markets have seen a persistent rally across the past fortnight with the NZ market largely following cues from offshore. US 10yr treasuries now trade at 2.64% following the inability of the Republicans and Democrats to come to an agreement surrounding “Obamacare”. Whilst concerns stemming from the associated government shutdown do not appear to have had a major impact upon the market thus far, this standoff sets a bad precedent for debt ceiling negotiations later this month. Locally these developments could see the Bills-OIS spread push out, of particular note was 3 month bills-OIS setting at 17.25 earlier this week. This was significantly higher than the fairly stable range seen across the past 6 months. However this cannot be fully attributed to the US government shutdown, as
year end selling of bank bills was apparent in the BKBM rate-set.

In regards to market pricing, January meeting run OIS now trades at 2.55% and we still favour holding a long position in the front end here. Furthermore, the March meeting run which has widely been forecast to see the first hike from the RBNZ now only prices a 75% chance of a hike. We favour getting borrowed at these levels particularly following a hawkish article from Graeme Wheeler this week whereby he expressed particular concern regarding house price pressure. As such our view is that this rally provides a good opportunity to position ourselves with a curve steepener.

Finally this week the RBA left its cash rate unchanged at 2.50% confirming the markets view that the central bank

NZ 3mth Bill and BBC Futures



is content with the current level of monetary stimulus. The market now prices only 17bps of cuts from the RBA finishing in April next year.

Looking forward all eyes will be on how the US government shutdown unfolds. As such we prefer playing the back end of the NZ bank bill futures curve from the short side.

Suggested trading ranges:

Mar-14: 97.02-97.09

Jun-14: 96.74-96.82

george_hollobon@bnz.co.nz

Global Credit Strategy

- The US government is in partial shutdown mode (of non-essential parts of its operations) and turmoil continues to embrace the Italian political landscape, but global credit markets remain well bid overall.
- These are very fragile times though. Even if we claw a resolution to the US budget and Italian political fiasco, there are myriad other obstacles ahead to re-test global investor nerves. Is it surprising that market volumes are light and investors maintain a degree of caution?
- No capitulation on the part of global credit investors, but the buoyant momentum that characterised risk assets earlier this year has faded a tad in recent sessions.
- Bundesbank President warns of the distortion in risk asset pricing while sovereign debt is seen as 'risk free' by regulators. Calls for healthier banking system.
- That Australian / NZ corporate credit offers a defensive, safe haven asset, particularly at times of uncertainty, is a theme that we expect to persist as the market continues to price in the myriad potential event risks ahead.

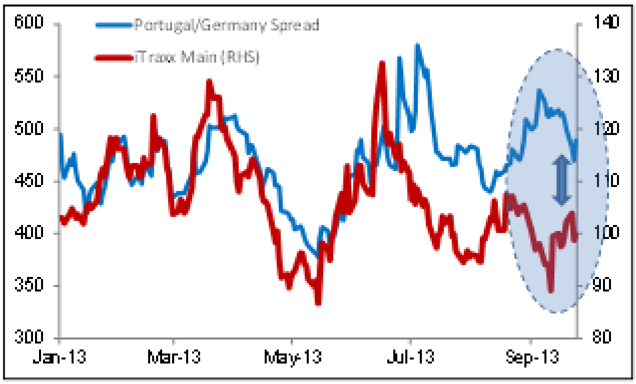
Die Another Day

The US government is in partial shutdown mode (of non-essential parts of its operations) and turmoil continues to embrace the Italian political landscape, but global credit markets are holding up reasonably well.
Resilient, economically insulated, fundamentally divorced from sovereign risk? Label it what you will, but the global credit market has so far appeared almost immune to the macroeconomic gyrations around it; set to Die Another Day.

To be fair though, neither event should be classed as 'new' news, so it is perhaps not surprising that global credit markets are taking both in their stride. Equities have come under some pressure in recent trading sessions, but global risk assets continue to outperform (at least for now).

The question is really whether risk asset markets are being a little too complacent towards the standoff in Washington and assuming too easily that a solution is achievable, and soon. Should spreads really be holding in as well as they are? We would question how the political deadlock can be resolved and how the bitter taste created by this affair will then not carry further negative implications for the debt ceiling debate that will follow later this month.

From a fundamental credit perspective, the fact that the US lost its AAA rating during the last debt fiasco probably means that the politicians feel more confident in standing their ground; by definition the risk of a rating downgrade is not what it once was. But from a global credit market sentiment perspective such a prospect will likely do little to enhance risk appetite and global credit market performance. The longer the House and the Senate fail to find a solution and the more imminent becomes the risk of breaching the debt ceiling, surely the greater must be the risk to business and consumer confidence, economic activity and by extension risk tolerance.



Source: National Australia Bank, Bloomberg, (data as of 02/10/13)

As such, these are very fragile times and even assuming the markets manage to claw their way through the current US and Italian uncertainty over the coming days, we will then have to navigate the next – potentially even more significant – hurdle; the possible breaching of the US debt ceiling later this month. And even beyond all this of course, we will still have to return to the debate about 'tapering' in the coming months, which could further impact the dynamics of the global credit market space as investors react and reposition into what will then be a higher yield structure.

So, while the demand/supply technicals of global credit markets should continue to underpin the bid for spread product as we head into Q4 2013, we are unlikely to face a linear grind tighter in spreads over the coming months. All of the above looks set to re-test the nerve of global risk asset investors at various times going forward, keep volatility elevated and keep a cap on market liquidity.

Live and Let Die

Global credit market valuations have remained fairly well underpinned through the recent escalation of market volatility. While both the iTraxx Main and the investment grade cash ER00 index have experienced periods of volatility and have traded within a reasonably broad 40-50bp range since January this year, both indices are now trading back close to where they were at the beginning of the year. Indeed, it could be argued that the current uncertainty surrounding the US budget and debt ceiling outlook, coupled with the political polemic in Italy has actually created a fillip for investor demand for fundamentally sound corporate credit spread product as it is seen as a more attractive buy and hold option relative to government debt markets. In the context that underlying government yields remain low for now (tapering assumptions and medium term ramifications aside) and that there is no expectation of a meaningful rise in corporate default rates, then we would expect the incremental yield on offer from global credit spread product to remain a key factor in fixed income investors' asset allocation strategies over the remainder of this year, albeit with an increasingly idiosyncratic and bottom-up driven bias.

While we expect global credit investors to look to remain (fully) invested in corporate risk going forward therefore – a condition that, in addition to the aforementioned technical backdrop, will be encouraged by the lack of liquidity and re-investment opportunities in the secondary credit arena – at the same time, we do expect investors to use attractively-priced (primary market) liquidity to fine-tune risk exposure. Current dubiety surrounding US and European politics as well as the broader macroeconomic growth outlook should increasingly see fundamental credit quality carry a greater weighting in investment strategies than headline yield alone. We note that the current question marks over the US, Italy and global growth have combined to dampen global credit market sentiment somewhat over the past couple of months. There is by no means any apparent risk of capitulation on the part of the global credit investors, but we do note that the buoyant momentum that characterised risk assets earlier this year has faded a tad in recent sessions.

According to data from Trace, the US bond-price tracking/reporting system, volumes traded in US sub-investment grade product have fallen recently more sharply than at any stage since the onset of the GFC back in 2008. The decline seems all the more apparent given the insatiable, if not complacent bid for spread product that was driving spreads tighter and quality curves flatter in 1H 2013. Subsequent uncertainty over the direction of Fed monetary policy – and the timing of the scaling back of QE – combined with the still fledgling nature of global economic recovery has more recently eroded investor conviction in risk positioning across the quality curve. This may well keep broad risk market volumes anchored during Q4, with investors' focus increasingly honed on credit fundamentals; management structure, business model, cash flow and earnings quality, as well as liquidity.

Thunderball

Meanwhile we would conjecture that sovereign credit risk continues to warrant careful analysis on a broader basis. Eurozone peripheral corporate credit risk has rallied strongly over the past year, from arguably oversold levels previously, as Euro convertibility risk has faded thanks to the ECB's conventional and non-conventional policy measures to support the region. However, with sovereign debt now effectively treated by European regulators as risk-free thanks to the Troika backstop bid, the price being attributed to underlying risk profiles has now become increasingly distorted. Jens Weidmann, German Bundesbank President said as much this week when he suggested that current market interest rates likely don't reflect the true degree of sovereign risk being held by investors (banks). Moreover, with weak peripheral nations being bailed out – and re-bailed out – by the Troika, Mr Weidmann suggests that large sovereign bond positions being accumulated on banks' balance sheets could actually be negative in the medium term for the real economy due to the implied crowding out of bank lending. By definition, those (European) banks that have amassed a high exposure to strained peripheral Eurozone debt, in anticipation of significant capital appreciation as the Eurozone region recovers, have had to reduce their lending to the private sector by up to a similar amount. This, at a time of course when lending to the private sector is held by many as the ultimate path towards fuelling sustainable economic growth. The risk to the market in all this is therefore two-fold. That on the one hand the sovereign investment may not perform as expected, while at the same time private sector lending remains crippled. As such, we are cognisant that moves to create a healthier banking system, with better diversified risk exposures, could see sovereign debt back under the spotlight and back under selling pressure, with any associated write-downs. Any attempt by the Euro elite to have sovereign debt effectively risk-weighted as adequately as corporate debt, while perhaps sensible from a long-term perspective, could therefore tend to trigger a seismic reaction across global credit markets in the short-term.

Diamonds Are Forever

An on-going bid for corporate credit risk, combining a bias for fundamental credit strength, incremental yield and a limited duration exposure, should continue to favour a robust allocation by global credit portfolio managers towards Australian credit risk and we would advocate adjusting portfolio weightings more in favour of this sector on any marked widening in valuations. Indeed, throughout the recent gyrations surrounding the US and Italy, we have seen consistent demand for short-dated Australian financial and non-financial corporate paper, as well as New Zealand dollar corporate credit, both from domestic and off-shore investors.

The perception that Australian/NZ corporate credit offers a defensive, safe haven asset, particularly during times of uncertainty, is a theme that we expect to persist as the market continues to price in the myriad potential event risks ahead. "Pay attention 007".

simon.ballard@eu.nabgroup.com

Credit Market News

ASB NZ printed a NZ$50m 3.5yr FRN at BKBM+73bps.

Rentenbank printed A$200m of 04/2024 bonds at ACGB+52bps.

IADB printed A$200m of 10/2018 bonds at ACGB+70.25bps.

The government announced a restructure plan for unrated state-owned coal miner **Solid Energy**. The government will inject NZ$25m into the company (in the form of preference shares) in exchange for the NZ$286m bank debt and NZ$95m bond holders taking a combined NZ$75m haircut (or 20%) on these debts, receiving non-voting preference shares in exchange for the haircut. The government will also a give the company a NZ$50m working capital loan, NZ$50m mortgage and NZ$30m standby loan.

ANZ (Parent) printed a EUR1b 3yr FRN at 3mE+33bps, or about BKBM+81bps.

Tasman District Council received a AA/A-1+ rating from S&P.

Kiwibank called its NZ$60m LT2 which was due to roll 30 September 2013.

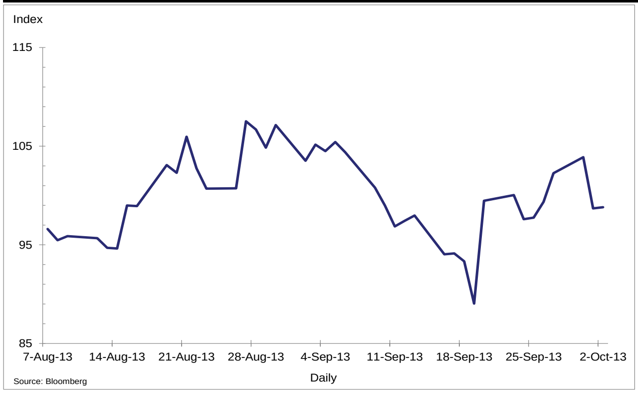
Christchurch International Airport (BBB+) printed NZ$50m of a new retail 8 year bond at swap+147.5bps (was higher of 6.25% or swap+145bps).

Meridian Energy registered its IPO prospectus, giving listing guidance of $1.50 - $1.80 but with a retail cap of $1.60. The offer period runs from 30 September to 18 October with a final listing date on the NZX and ASX on Tuesday, 29 October.

tasmin_wilding@bnz.co.nz

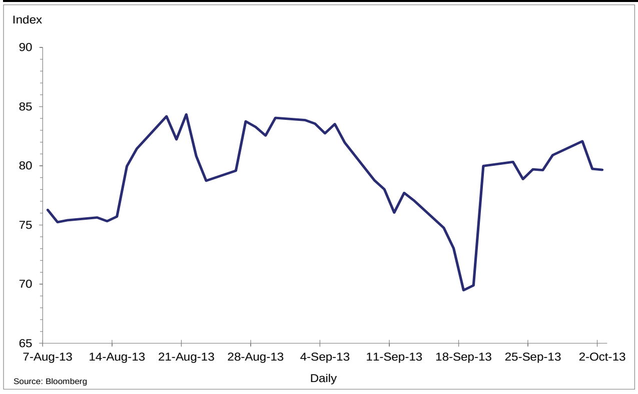
Global Credit Indices

iTraxx Europe Investment Grade Index



iTraxx Europe Crossover Index

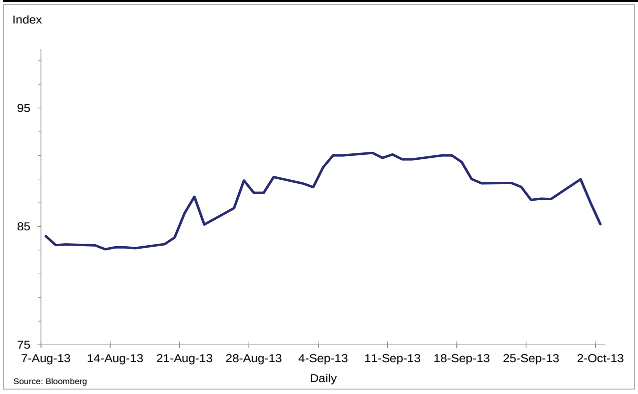
CDX North America Investment Grade Index



CDX North America High Yield Index

iTraxx Australia Index

iTraxx Western Europe Sovereign Index

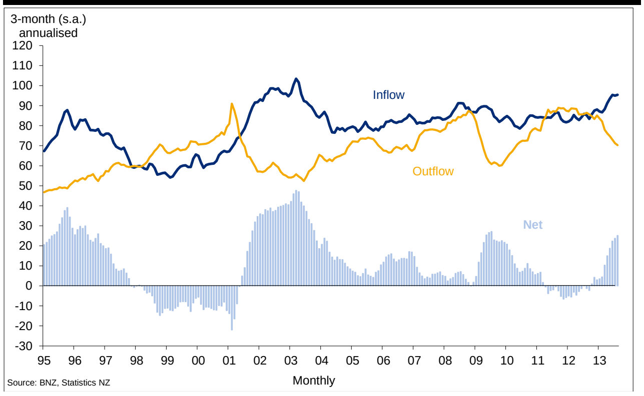


NZ Economic Review

Int'l Travel and Migration (Aug) – 20 September

After adjusting for seasonal effects, migration flows delivered a net addition of 2,100 people into the country during August. That was similar to July's +1,970 and June's +2,220. Current flows annualise to around +25,000, which is a solid rate of net immigration. This continues to reflect more arrivals and fewer departures, although there are early signs of some stabilisation consistent with a levelling out of the monthly net gains.

Migration Flows

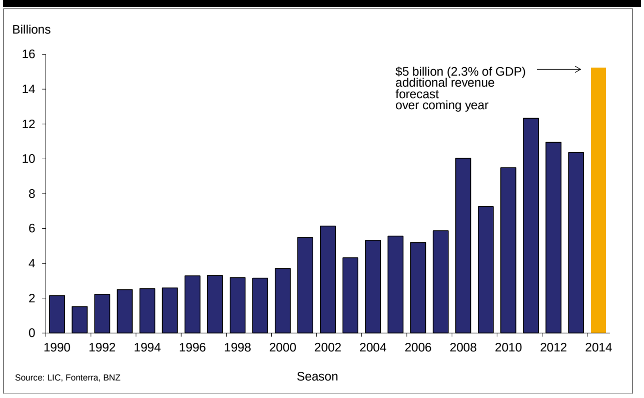


As for short-term visitor numbers these continued to track higher in their recent quiet achieving way, up 6.2% y/y. Meanwhile, NZ residents travelling overseas, short-term, hit a record in August, up 6.0% y/y.

Fonterra Milk Price – 24/25 September

Fonterra, on 24 September, lifted its forecast milk price for the current 2013/14 milking season by 50c to $8.30 per kilogram milksolids. Compared to the previous season's milk price, which Fonterra finalised at $5.84 on 25 September, it reinforces the truly massive lift in revenue that the dairy industry is sizing up over the coming 12 months.

Dairy Revenue Proxy



Merchandise Trade (Aug) – 25 September

The $1,191m August trade deficit was wider than the $700m deficit expected by the market, as a result of exports undershooting and imports overshooting expectations. But it was not as bad as it looked, with imports boosted by a large drilling platform.

Building Consents (Aug) – 30 September

Residential building consent numbers increased a seasonally adjusted 1.4% in August, following a 3.4% decline (revised from -0.8%) in July. Annual growth slowed to 16% from 28%. The value of non-residential consents dipped to -2% y/y from the +20-30% annual pace established over the March-July period. All a bit disappointing, but no genuine worry given that the moves are within the usual bounds of volatility and the lead indicators remain very strong.

ANZ Business Survey (Sep) – 30 September

This survey continues to suggest above-trend growth ahead, with emerging capacity pressures. Net confidence lifted to +54.1 from +48.1 and firms' own activity expectations increased to +45.3 from +43.3. Pricing intentions held up at +29.9 consistent with CPI inflation tracking higher from its current low ebb.

Credit Aggregates (Aug) – 30 September

The credit aggregates returned to the front foot in August, after having some softer elements in July. Household credit expanded 0.5% seasonally adjusted, nudging its annual growth to 5.4% from 5.2%. Its housing component moved higher still to 5.7%. This is a reasonable clip (before the potential disruption from the RBNZ's LVR policy introduction). Meanwhile, business credit annual growth lifted to 2.1% from 1.1%, while agriculture chugged up to 4.1% from 4.0%. For more on this, see the lead article in today's Strategist.

Global Dairy Trade Auction – 2 October

Global dairy prices rose an average 2.4% at this auction. More bidders and a lift in those left unsatisfied underscores the current fundamental strength in the international dairy market. Prices are 54% higher than a year ago.

ANZ Commodity Export Prices (Sep) – 3 October

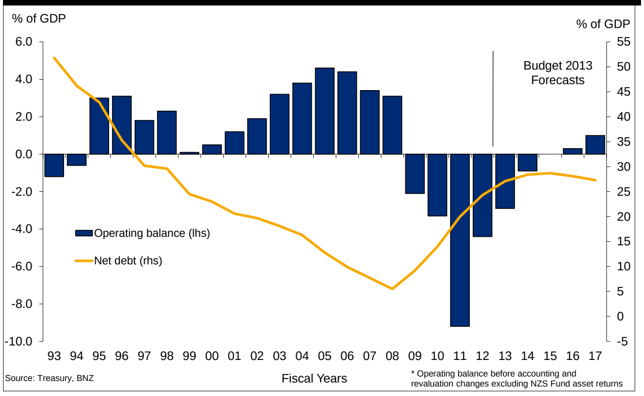
World prices for New Zealand's main primary product exports rose 0.9% in September, according to this ANZ index. While a stronger NZD took a bit of gloss off the NZ dollar denominated prices, which fell 1.1% in the month, prices are still up 24% on a year ago. With the exception of aluminium, world and NZ dollar prices for all major categories are well up on a year ago. This highlights the positive commodity price story supporting the overall favourable economic outlook across growth, terms of trade, external and fiscal accounts.

doug_steel@bnz.co.nz

NZ Upcoming Data/Events

Crown Financial Statements (Jun) – 7 October
These full June-year crown accounts should better Budget projections given the 11 months to May figures, released way back in July, were firmly above plan. While fiscal consolidation represents a headwind to the economy in that growth may have been faster than otherwise, there is also causality running the other way with a growing economy generating more tax revenue supporting smaller deficits. A strong growth outlook will help the government attempts to achieve its target of returning to surplus by 2014/15.

Core Fiscal Balance and Net Debt



QVNZ Housing Report (Sep) – 7 October
Regardless of other changing factors, all upcoming housing information will be trawled through for impact or otherwise of the RBNZ's high loan-to-value lending restrictions – both before and after the restrictions came into place on 1 October. The QVNZ commentary will be more important in this regard, while its annual house price inflation measure remains frothy.

QSBO (Q3) – 8 October
We anticipate the QSBO to step up a gear, at least, in Q3, from an already solid pace it set in Q2. This should show up in the various indicators of confidence and activity as well as investment and employment intentions.
Such things would fit with other indicators and the strong 1% increase we have on the board for Q3 GDP. Important for RBNZ policy will be indicators of pressure on resources such as capacity utilisation and firms' difficulty of finding labour as gauges to medium term inflation. These have already been flashing amber, so signs of more tightness here can only reinforce, and perhaps intensify, the RBNZ's latest rhetoric around the need to lift interest rates next year. Watch for higher cost expectations and pricing intentions too.

Electronic Card Transactions (Sep) – 9 October
We have pencilled in a 0.3% increase in September's electronic card transactions. We think the underlying spending pulse is stronger than that, it is just August's +0.8% seems a tough act to follow (even with the lower North Island digital switch probably boosting TV sales in September).

BNZ Manufacturing PMI (Sep) – 10 October
The Performance of Manufacturing Index has been decisively upbeat through 2013, and increasingly so. We have seen nothing to fundamentally change this story in September. Anything close to August's 57.5 would firmly support our positive Q3 leanings for the sector, GDP-wise.

Food Price Index (Sep) – 11 October
We anticipate a largely-seasonal 0.8% decline in September's Food Price Index. This would not stop a solid positive quarterly food price contribution to Q3 CPI.

BNZ Services PSI (Sep) – 14 October
The Performance of Services Index cooled a bit in August, to 53.2 from 58.2. Although still clearly expansionary, August saw the lowest monthly reading for the year and employment was dead-even at 50.0. September will help assess whether the slowdown in August was a blip or something a bit more meaningful.

Global Dairy Trade Auction – 16 October
The international dairy market is very strong with prices at the previous auction 54% higher than a year ago.
With signs of more unsatisfied demand at the previous auction, it is a positive signal for prices to at least remain firm at this event.

CPI (Q3) – 16 October
Our current Q3 CPI inflation estimate sits at +0.8% q/q to give +1.2% y/y, the same as the RBNZ's published forecast. We will finalise our view post September's food price figures due 11 October. Annual inflation looks like stepping back into the RBNZ's 1% to 3% target band. The more important point is that annual inflation has passed its lows and we think will trend higher from here.

ANZ-RM Consumer Confidence (Oct) – 17 October
More public discussion around high loan-to-value house lending restrictions and the prospect of higher interest rates next year could dent confidence a bit in October. But, then again, a 10 cent per litre drop in petrol prices would have been welcomed. Fundamentally, we think a strengthening economy and labour market should keep confidence around August's healthy 119.0 level.

doug_steel@bnz.co.nz

Quarterly Forecasts

Forecasts as at 3 October 2013

Key Economic Forecasts

Quarterly % change unless otherwise specified

	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
GDP (production s.a.)	0.4	0.3	1.6	0.4	0.2	1.0	1.0	1.0	0.6	0.5
Retail trade (real s.a.)	1.1	-0.2	1.8	0.9	1.7	0.9	0.8	0.7	0.7	0.7
Current account (ytd, % GDP)	-4.3	-4.3	-4.7	-4.5	-4.3	-4.6	-4.3	-4.3	-4.3	-4.7
CPI	0.3	0.3	-0.2	0.4	0.2	0.8	-0.3	0.5	0.3	0.9
Employment	0.0	-0.4	-0.9	1.7	0.4	0.4	0.5	0.7	0.7	0.6
Unemployment rate %	6.8	7.3	6.8	6.2	6.4	6.3	6.3	6.1	5.9	5.8
Avg hourly earnings (ann %)	2.9	3.0	2.6	2.3	2.4	2.2	3.2	3.2	3.8	3.4
Trading partner GDP (ann %)	3.7	3.2	3.6	3.0	3.3	3.4	3.6	3.8	3.6	3.7

Forecasts

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
2012 Dec	2.50	2.65	2.85	3.50	2.65	3.05	3.70	0.30	1.70	1.80
2013 Mar	2.45	2.65	3.05	3.70	2.90	3.40	4.00	0.30	1.95	1.75
Jun	2.50	2.65	3.00	3.50	2.95	3.45	4.05	0.25	2.00	1.55
Sep	2.50	2.65	4.15	4.70	3.45	4.45	5.00	0.30	2.70	2.00
Forecasts										
Dec	2.50	2.70	4.20	4.80	3.70	4.50	5.10	0.30	3.00	1.80
2014 Mar	2.75	3.10	4.15	4.65	4.00	4.50	5.00	0.30	2.75	1.90
Jun	3.25	3.60	4.10	4.55	4.20	4.50	4.95	0.30	2.70	1.85
Sep	3.75	3.95	4.20	4.55	4.50	4.70	5.05	0.30	2.75	1.80
Dec	4.00	4.20	4.45	4.80	4.65	4.90	5.25	0.30	3.00	1.80
2015 Mar	4.25	4.45	4.80	5.20	4.70	5.15	5.60	0.60	3.25	1.95
Jun	4.50	4.70	5.00	5.45	4.80	5.40	5.85	0.75	3.50	1.95
Sep	4.50	4.70	5.30	5.80	4.70	5.50	6.00	0.90	4.00	1.80
Dec	4.50	4.70	5.30	5.90	4.50	5.45	6.00	1.20	4.25	1.65
2016 Mar	4.50	4.70	5.35	5.95	4.30	5.35	6.00	1.70	4.50	1.45
Jun	4.50	4.70	5.35	5.95	4.30	5.35	6.00	2.20	4.75	1.20

Exchange Rates (End Period)

USD Forecasts

	EUR/USD	USD/JPY	GBP/USD	NZD/USD	AUD/USD
Current	1.3585	97.33	1.6228	0.8308	0.9382
Dec-13	1.3300	103.00	1.6000	0.8350	0.9200
Mar-14	1.3100	104.00	1.5900	0.8200	0.9000
Jun-14	1.2900	106.00	1.5500	0.8000	0.8800
Sep-14	1.2700	107.00	1.5300	0.7800	0.8600
Dec-14	1.2500	108.00	1.5200	0.7600	0.8400
Mar-15	1.2400	106.00	1.5100	0.7500	0.8300
Jun-15	1.2300	104.00	1.5000	0.7300	0.8200
Sep-15	1.2200	102.00	1.4900	0.7100	0.8100
Dec-15	1.2000	100.00	1.4800	0.7000	0.8100
Mar-16	1.2000	100.00	1.4700	0.6800	0.8300

NZD Forecasts

	NZD/EUR	NZD/JPY	NZD/GBP	NZD/USD	NZD/AUD	TWI
Current	0.6116	80.86	0.5120	0.8308	0.8855	77.0
Dec-13	0.6278	86.01	0.5219	0.8350	0.9076	79.0
Mar-14	0.6260	85.28	0.5157	0.8200	0.9111	78.4
Jun-14	0.6202	84.80	0.5161	0.8000	0.9091	77.5
Sep-14	0.6142	83.46	0.5098	0.7800	0.9070	76.5
Dec-14	0.6080	82.08	0.5000	0.7600	0.9048	75.4
Mar-15	0.6048	79.50	0.4967	0.7500	0.9036	74.6
Jun-15	0.5935	75.92	0.4867	0.7300	0.8902	72.8
Sep-15	0.5820	72.42	0.4765	0.7100	0.8765	71.0
Dec-15	0.5833	70.00	0.4730	0.7000	0.8642	70.1
Mar-16	0.5667	68.00	0.4626	0.6800	0.8193	67.7
TWI Weights	0.2578	0.1534	0.0610	0.3003	0.2275	

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

Forecasts

Forecasts
as at 3 October 2013

	March Years					December Years				
	Actuals		Forecasts			Actuals		Forecasts		
	2012	2013	2014	2015	2016	2011	2012	2013	2014	2015
GDP - annual average % change										
Private Consumption	2.5	2.3	3.9	2.8	1.8	2.0	2.4	3.6	3.1	2.0
Government Consumption	1.8	0.4	0.0	0.0	0.6	2.0	0.5	-0.2	0.3	0.2
Total Investment	2.3	7.1	9.7	8.9	3.8	3.3	6.5	8.2	10.1	4.8
Stocks - ppts cont'n to growth	0.5	-0.4	0.3	-0.1	-0.1	-0.4	0.2	0.1	0.0	-0.1
GNE	3.2	2.3	4.5	3.6	2.0	2.5	3.0	3.5	4.2	2.3
Exports	3.0	3.0	-1.4	4.6	4.3	2.7	2.6	0.5	3.0	4.3
Imports	6.1	0.7	4.6	6.6	3.1	6.5	2.1	3.6	6.3	4.2
Real Expenditure GDP	2.3	2.9	2.6	2.8	2.3	1.3	3.2	2.5	3.1	2.2
GDP (production)	**1.9**	**2.7**	**2.9**	**2.9**	**2.3**	**1.4**	**2.7**	**2.8**	**3.2**	**2.2**
GDP - annual % change (q/q)	*2.8*	*2.7*	*3.2*	*2.1*	*2.6*	*2.5*	*3.4*	*2.6*	*2.6*	*2.5*
Output Gap (ann avg, % dev)	-0.5	0.1	0.7	1.1	1.0	-0.7	-0.1	0.6	1.2	1.0
Household Savings (gross, % disp. income)	3.2	2.3	1.7	2.5	2.0					
Nominal Expenditure GDP - $bn	206.1	211.0	222.7	230.6	239.5	204.5	209.3	220.0	228.6	237.0
Prices and Employment - annual % change										
CPI	1.6	0.9	1.2	2.4	2.8	1.8	0.9	1.1	1.9	2.8
Employment	0.9	0.3	2.0	2.4	1.1	1.6	-1.3	3.0	2.6	1.4
Unemployment Rate %	6.8	6.2	6.1	5.5	5.5	6.3	6.8	6.3	5.6	5.4
Wages - ahote	3.8	2.3	3.2	3.5	3.8	2.8	2.6	3.2	3.6	3.8
Productivity (ann av %)	0.8	2.5	0.9	0.4	0.7	0.0	2.7	0.9	0.8	0.2
Unit Labour Costs (ann av %)	2.8	0.4	1.5	3.3	3.0	3.8	0.4	1.4	2.6	3.4
External Balance										
Current Account - $bn	-7.8	-9.5	-9.7	-13.6	-15.8	-7.4	-9.8	-9.5	-12.2	-16.3
Current Account - % of GDP	-3.8	-4.5	-4.3	-5.9	-6.6	-3.6	-4.7	-4.3	-5.3	-6.9
Government Accounts - June Yr, % of GDP										
OBEGAL (core operating balance)	-4.4	-2.8	-0.4	0.2	1.0					
Net Core Crown Debt (excl NZS Fund Assets)	24.3	27.0	27.8	27.9	26.6					
Bond Programme - $bn	15.0	14.0	10.0	8.0	7.0					
Bond Programme - % of GDP	7.4	6.6	4.5	3.5	2.9					
Financial Variables (1)										
NZD/USD	0.82	0.83	0.82	0.75	0.69	0.77	0.83	0.84	0.76	0.70
USD/JPY	82	95	104	106	102	78	84	103	108	102
EUR/USD	1.32	1.30	1.31	1.24	1.24	1.32	1.31	1.33	1.25	1.22
NZD/AUD	0.78	0.80	0.91	0.90	0.87	0.76	0.79	0.91	0.90	0.87
NZD/GBP	0.52	0.55	0.52	0.50	0.46	0.49	0.52	0.52	0.50	0.47
NZD/EUR	0.62	0.64	0.63	0.60	0.56	0.58	0.63	0.63	0.61	0.57
NZD/YEN	67.7	78.5	85.3	79.5	70.3	59.9	69.5	86.0	82.1	71.3
TWI	73.0	76.1	78.4	74.6	69.4	68.6	74.3	79.0	75.4	70.3
Overnight Cash Rate (end qtr)	2.50	2.50	2.75	4.25	4.50	2.50	2.50	2.50	4.00	4.50
90-day Bank Bill Rate	2.74	2.65	3.12	4.45	4.70	2.69	2.66	2.70	4.20	4.70
5-year Govt Bond	3.56	3.09	4.15	4.78	5.33	3.18	2.93	4.20	4.45	5.31
10-year Govt Bond	4.17	3.72	4.66	5.20	5.97	3.91	3.54	4.80	4.81	5.88
2-year Swap	3.07	2.92	4.00	4.70	4.30	2.74	2.70	3.70	4.65	4.50
5-year Swap	3.79	3.47	4.49	5.17	5.37	3.35	3.12	4.50	4.90	5.43
US 10-year Bonds	2.16	1.94	2.75	3.25	4.50	1.97	1.70	3.00	3.00	4.25
NZ-US 10-year Spread	2.01	1.78	1.91	1.95	1.47	1.94	1.84	1.80	1.81	1.63

(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 4 October			
China, Services PMI (HSBC), September			52.8
Jpn, BOJ Policy Announcement	0.10%	0.10%	0.10%
Monday 7 October			
NZ, Crown Financial Statements, 12m-to-June 2013			
NZ, QVNZ House Prices, September			+8.5%
Aus, Construction PMI (AiG), September			43.7
Jpn, BOJ Economic Report			
US, (pending) Construction Spending, September		+0.4%	+0.6%
US, (pending) Factory Orders, August		+0.2%	-2.4%
US, (pending) Non-Farm Payrolls, September		+180k	+169k
Tuesday 8 October			
NZ, QSBO, Q3			+23
Aus, ANZ Job Ads, September			-2.0%
Jpn, Eco Watchers Survey (outlook), September			51.2
Jpn, Trade Balance (BOP basis), August			-¥943b
Germ, Trade Balance, August			+€16.1b
Germ, Factory Orders, August			-2.7%
UK, RICS Housing Survey, September			+40%
UK, BRC Retail Sales Monitor, Sept y/y			+1.8%
US, International Trade, August			-$39.1b
Wednesday 9 October			
NZ, Electronic Card Transactions, Sept	+0.3%		+0.4%
Aus, NAB Business Survey, September			
Aus, Consumer Sentiment - Wpac, October			110.6
Jpn, BOJ Minutes, 4/5 Sept Meeting			
Germ, Industrial Production, August			-1.7%
UK, Trade Balance, August			-£3.1b
UK, Industrial Production, August			flat
US, FOMC Minutes, 17/18 August Meeting			
Thursday 10 October			
NZ, BNZ PMI (Manufacturing), September			57.5
Aus, Employment, September			-11k
Jpn, Machinery Orders, August			flat
Euro, ECB Monthly Bulletin			
UK, BOE Policy Announcement	0.50%	0.50%	0.50%
Friday 11 October			
NZ, Food Price Index, September	-0.8%		-0.5%
US, Mich Cons Confidence, Oct 1st est			77.5
US, Retail Sales, September			+0.2%
Saturday 12 October			
China, Trade Balance ($US), September			+$28.52b
Monday 14 October			
NZ, BNZ PSI (Services), September			58.1
Aus, Housing Finance, August			+2.4%
China, CPI, September y/y			+2.6%
Euro, Industrial Production, August			-1.5%

	Last
Tuesday 15 October	
Aus, RBA Minutes, 1 October Meeting	
Germ, ZEW Sentiment, October	+49.6
UK, CPI, September y/y	+2.7%
US, Empire Manufacturing, October	+6.29
Wednesday 16 October	
NZ, CPI, Q3	+0.2%
NZ, Dairy Auction	+2.4%
Aus, Westpac Leading Index, August	+0.6%
UK, Unemployment Rate (ILO), August	7.7%
US, CPI ex food/energy, September	+1.8%
US, Beige Book	
US, NAHB Housing Index, October	58
Thursday 17 October	
NZ, ANZ-RM Consumer Confidence, October	118.8
NZ, ANZ Job Ads, September	-1.4%
Aus, NAB Business Survey, Q3	
Euro, Trade Balance, July	+€17.3b
UK, Retail Sales vol., September	-0.9%
US, Philly Fed Index, October	+22.3
US, Housing Starts, September	891k
US, Industrial Production, September	+0.4%
Friday 18 October	
China, GDP, Q3 y/y	+7.5%
US, Leading Indicator, September	+0.7%
Monday 21 October	
NZ, External Migration, September s.a.	+2,100
Jpn, Merchandise Trade Balance, September	-¥960b
US, Existing Home Sales, September	5.48m
Tuesday 22 October	
China, Property Prices, September	
China, Leading Index (Conference Board),	+0.7%
September Wednesday 23 October	
Aus, CPI, Q3	+0.4%
China, MNI Business Sentiment, October	
Euro, Consumer Confidence, Oct 1st estimate	-14.9
UK, BOE Minutes, 10 October Meeting	
Can, BOC Policy AnnouncemenT	1.00%
Thursday 24 October	
NZ, Merchandise Trade, September	-$1,191m
China, PMI (HSBC), October 1st est	50.2
Euro, PMI Manufacturing, Oct 1st est	51.1
US, New Home Sales, September	421k
Friday 25 October	
Jpn, CPI, September y/y	+0.9%
Euro, M3, September y/y	+2.3%
UK, GDP, Q1 1st est	+0.7%
US, Durables Orders, September	+0.1%

Contact Details

BNZ Research

Stephen Toplis
Head of Research
+(64 4) 474 6905

Craig Ebert
Senior Economist
+(64 4) 474 6799

Doug Steel
Economist
+(64 4) 474 6923

Mike Jones
Strategist
+(64 4) 924 7652

Kymberly Martin
Strategist
+(64 4) 924 7654

Main Offices

Wellington
60 Waterloo Quay
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Phone: +(64 4) 473 3791
FI: 0800 283 269
Fax: +(64 4) 474 6266

Auckland
80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Phone: +(64 9) 976 5762
Toll Free: 0800 081 167

Christchurch
81 Riccarton Road
PO Box 1461
Christchurch 8022
New Zealand
Phone: +(64 3) 353 2219
Toll Free: 0800 854 854

National Australia Bank

Peter Jolly
Head of Research
+(61 2) 9237 1406

Alan Oster
Group Chief Economist
+(61 3) 8634 2927

Rob Henderson
Chief Economist, Markets
+(61 2) 9237 1836

Ray Attrill
Global Co-Head of FX Strategy
+(61 2) 9237 1848

Wellington

Foreign Exchange	+800 642 222
Fixed Income/Derivatives	+800 283 269

Sydney

Foreign Exchange	+(61 2) 9295 1100
Fixed Income/Derivatives	+(61 2) 9295 1166

London

Foreign Exchange	+(44 20) 7796 3091
Fixed Income/Derivatives	+(44 20) 7796 4761

New York

Foreign Exchange	+1 212 916 9631
Fixed Income/Derivatives	+1 212 916 9677

Hong Kong

Foreign Exchange	+(85 2) 2526 5891
Fixed Income/Derivatives	+(85 2) 2526 5891