17 August 2015

There Is Still Much to, Like, Like

- PMI/PSI still expanding well at 53.5/56.5
- Consistent with 3% annual GDP growth
- Dairy prices likely to further dent the Q2 PPI
- But a bounce at this week's dairy auction?
- Immigration/tourism likely strong for July

Since the GFC, we have tended to have confidence in the New Zealand economy's ability to work through various travails, when some others have been prone to tout recession. Like during Canterbury's earthquakes. Like during the various near death experiences of the Eurozone. Like over the strong exchange rate cycle the NZ economy has endured. At the risk of sounding impossibly young – using the word "like" in every sentence – we still think there is a lot to like about New Zealand's underlying resilience, and prospects.

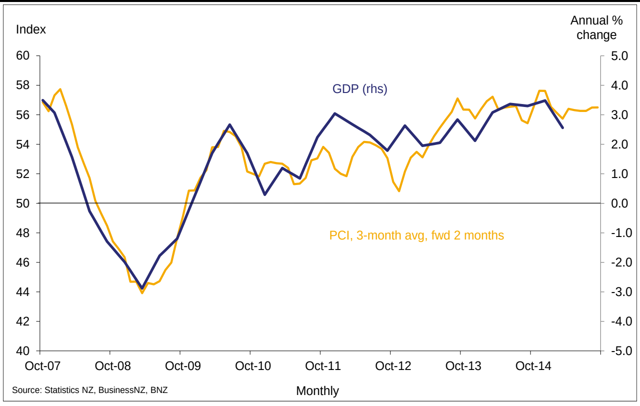
To be sure, we're facing a potentially bumpy period ahead, what with slumping dairy prices, Canterbury's reconstruction activity showing signs of peaking and China's economy demonstrably losing momentum. It could yet conspire to sour the NZ economy. We are monitoring those risks. However, for the moment, we can see enough else to keep the local economy expanding, as a base case.

The latest Performance of Services Index (PSI) certainly remained consistent with an economy growing at a decent rate. While its July reading of 56.5 was lower than those of June (58.1) and May (57.9), those prior couple of months were about the strongest we've seen post GFC. A level of 56.5 is relatively solid for an index that has averaged 53.7 since inception (April 2007). Also resilient was last week's PMI result, of 53.5. This, along with the PSI, indicates that GDP is running along at an approximate 3% annual pace.

Turning to Wednesday's early morning GDT dairy auction, we note the broader backdrop for international dairy prices remains poor. Having said this, there has been a glimmer of light at the end of the tunnel. This has taken the form of the recent upward move in dairy futures on the NZX platform. Fonterra has also just announced it will be holding back some of its supply to the GDT auction for the next while (diverting it to other, less-transparent, means of selling). What we wonder, however, is how NZD might react to any rebound in dairy prices?

While there are quirks with the way dairy prices are measured in the NZ Producer Price Indexes (PPI), we suspect they will be a further suppressing influence on

PCI and GDP growth



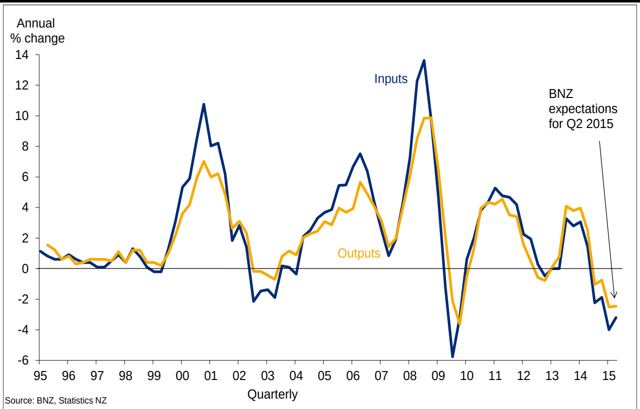
Source: Statistics NZ, BusinessNZ, BNZ

the headline results for the June quarter. These are due 10:45 Wednesday morning, as part of the new quarterly Business Price Indexes report. We'd guess a 0.4% decline in the PPI outputs index (-2.4% y/y) and a 0.2% quarterly slip in inputs (-3.2% y/y).

The Business Prices report will also contain the Q2 Capital Goods Price Index (CGPI). This, we think, will more clearly show the impacts of the recent NZD correction, making imports dearer. This, along with ongoing inflation in the price of newly constructed buildings, could well push annual inflation in the total GCPI above 3%. There is inflation in the economy. It's just not at all obvious within the constructs of the CPI, as an average.

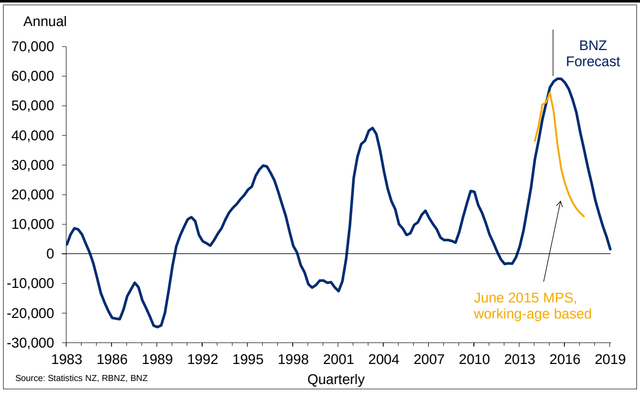
With employment intentions from the various business surveys looking less positive nowadays, we reckon Thursday's (10:00am) ANZ job advertising series will continue to struggle along. As for Thursday afternoon's

Producer Prices

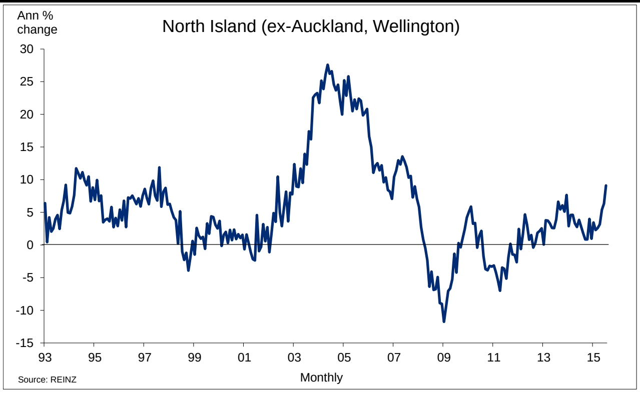


Source: BNZ, Statistics NZ

Net Immigration



REINZ Stratified House Price Index



ANZ Roy Morgan consumer confidence reading, note that it had already abated to a barely average 113.9 in July. There is a still a lot to support household sentiment. But there are increasing weights now coming to bear, and not just from the dairy industry.

Net inward migration was a seasonally adjusted +4,800 in June – so still near all-time highs. However, there have been signs that a peak might be forming, even that a turning point is approaching. July's data, due Friday 10:45am, will help test this view. What's clear is that just about everyone is forecasting a clear drop in net immigration, starting now. This includes the RBNZ. However, the Bank might be forced to moderate the decline it expects in migration, compared to what it forecast in its June Monetary Policy Statement. This, in turn, might help hold up its GDP forecasts, when a lot else is calling for the RBNZ to moderate its view on economic growth.

A slower than anticipated fall in net immigration would also have obvious ramifications for the housing market (as if there wasn't enough pumping up the market already, including ever-falling mortgage rates). And what struck us from last week's REINZ data for July was the strength in sales and prices outside of Auckland and Christchurch now.

Short-term visitor arrivals, meanwhile, are still very much on the rise. We'd guess a July total up in the region of 6% on a year ago, as part of Friday's International Travel and Migration release. While China has been, and still is, a driving force in this regard, arrivals from the Americas looked to be doing particularly well in July.

The data week ends with Friday's 3:00pm credit card billings. We'd be surprised if these were in any way weak, given the robustness we've already witnessed in July's electronic card transactions. The latter, of course, left us thinking the spending trends are still fairly positive. Indeed, that retail trade volumes will probably see a strong lift in Q3, after the technical pause they recorded for Q2. It's one of a number of things that we still like the look of, in respect to the economy's wherewithal for growth.

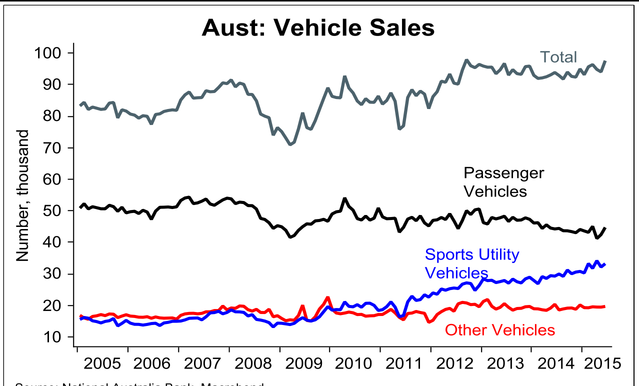
craig_ebert@bnz.co.nz

Global Watch

Australia

It's a very quiet week ahead both locally and offshore. For Australia, on the data front there is only a few second tier reports with the likes of the weekly ANZ-Roy Morgan Consumer Sentiment index on Tuesday, along with July motor vehicle sales, followed by the Westpac Leading Index and Skilled Vacancies for July, followed Thursday by the monthly FX transactions data from the RBA. None of these reports is likely to draw too much interest though motor vehicle sales would be an obvious candidate for small business spending in the wake of the Federal May Budget's $20,000 immediate depreciation write-off provision.

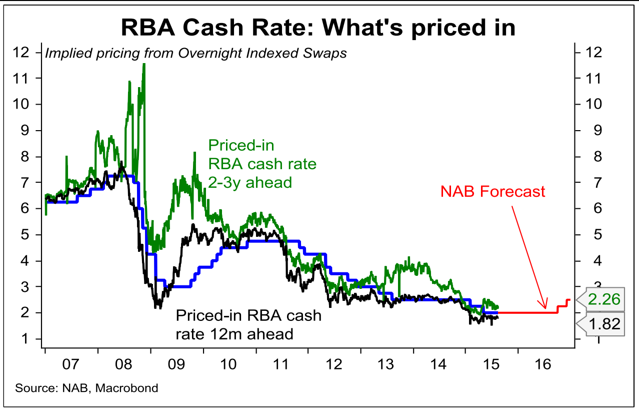
No Change In Vehicle Sales Trends In June



Source: National Australia Bank, Macrobond

As for the RBA Board Minutes, these usually draw a lot of market attention, the market looking for additional detail about the Bank's thinking on the economy and monetary policy leaning. In this mid quarter month, the post-Board Media Release has already been followed by the August Statement on Monetary Policy with its forecasts and 71 pages of international and domestic developments, and recent speeches by top officials. We will be on the lookout for any clues in the Minutes, but more than likely, any such potential nuggets will be few and far between. The market is continuing to price in the 70-75% possibility of an easing over the next nine to 12 months.

Market Still Pricing Near Term Monetary Easing Bias



Source: NAB, Macrobond

China

It's a very light week as far as China is concerned, though Tuesday's July major cities Property prices report will garner some interest. Thursday's August MNI Business Indicator (survey of listed companies on the Shanghai and Shenzhen exchanges) receives very little attention, though we note it weakened again in July, falling back below 50 to 48.8, the lowest since April.

US

There are several key monthly data due starting with housing focus from the NAHB Housing Market Index on Monday, Housing starts/permits Tuesday, and Existing Home Sales on Thursday. A key focus will be Wednesday's July CPI, followed by the August Philly Fed and July Leading Index Thursday. Two Fed speeches are scheduled, with monetary dove, Minneapolis Fed President Kocherlakota (non-voter) and centrist San Francisco Fed president Williams (voter) both speaking on Thursday. Williams' views are aligned usually with Fed Chair Yellen and any comments on rate lift off timing will be seized upon.

Japan

GDP on Monday will draw most of the market's interest, with the market expecting that growth contracted by 0.5% q/q after Q1's 1.0% gain. Japan's latest monthly reports on Trade and All Industry Activity Index are due Wednesday.

Euro

Trade Monday, Current account Wednesday, and Consumer Confidence Friday, though none is expected to draw too much attention.

UK

Inflation and retail sales reports are both due and under the spotlight, the CPI/PPI (and ONS House prices) are due Tuesday, followed by Retail Sales and CBI Trends Thursday, and Public sector borrowing on Friday.

Canada

It's scant as far as Canadian reports are concerned this week with a dearth of releases ahead of the key Retail sales and CPI reports due on Friday.

david.degaris@nab.com.au / tapas.strickland@nab.com.au

Fixed Interest Market

Reuters: BNZL, BNZM Bloomberg:BNZ

This week's GDT dairy auction has potential to impact on NZ short-end yields, in the backdrop of a smattering of 2nd tier domestic data releases. We would not be surprised to see a modest bounce in prices at auction this week, given Fonterra's recent announcements to reduce volumes and a recent tick up in futures pricing. Whether this would mark the start of stabilisation after the recent plunge in dairy prices remains to be seen. However, it could be enough to prompt a small bounce in NZ short-end yields.

But we still believe the current 2.83-3.00% range in NZ 2-year swap will ultimately be broken to the downside. We anticipate the RBNZ cutting the OCR by 25bps at its Sept 10th and Oct meetings. This will take the cash rate back to its historical trough of 2.50%. This would likely see the market move to price a sub-2.50% OCR and 2-year swap trade down toward 2.70%.

We also have our eye on the latest LGFA auction this Wed. This will come hot on the heels of last week's NZDMO auction of NZGBs which attracted solid demand. It also follows last Friday's data that showed non-resident holdings of NZGBs remained at 69.7% in July (well above long-term average). This week's auction will be the latest test of demand, not only for LGFA issuance, but for NZD rates product more broadly. So far, it appears demand for product remains strong despite the declining NZD.

Across the Tasman, the RBA will release its Minutes tomorrow. But these have been somewhat superseded by the RBA's recent Statement of Monetary Policy. They are therefore unlikely to provoke a sharp response from markets. The market currently prices around a two-thirds chance of another 25bps rate cut by mid next year. Our NAB colleagues see it as more likely the RBA will remain on prolonged 'hold' with its cash rate at 2.00%.

We see a bias for higher US yields this week. CFTC data show speculative long positions in US 10-year yields remain intact. This, combined with yields being near range-lows suggests Treasuries are more likely to respond to stronger than expected data and/or hawkish Fed commentary this week. Amidst a handful of US data this week we would look to Wednesday night's CPI print and FOMC Minutes (28-29 July meeting).

The Fed's Minutes may shed further light on two key changes in the last statement. First was the Fed's assessment that labour underutilisation had "diminished somewhat" since the start of the year. More crucially the Fed inserted, the now famous, "some" into its assessment of how much more improvement in labour market conditions it was looking for. Although the Minutes relate to a meeting conducted prior to recent Chinese currency ructions, they could shed more light on whether a September rate hike is likely. Any suggestion it is, would likely prompt US yields higher, as the market is far from fully pricing this outcome.

In addition, two Fed members, Williams and Kocherlakota are scheduled to speak this week. With both historically seen as having dovish leanings, signs they are warming up for a rate hike would have the potential to prompt higher US yields. We continue expect higher US yields and a flatter US curve approaching the first Fed rate hike in almost seven years.

Higher US long yields will add steepening pressure to the NZ curve as NZ long-end yields move higher in sympathy, while NZ short-end yields remain anchored by RBNZ rate cut expectations. We continue to look for NZ 2-10s swap curve steepening through to year-end within a 70-125bps range.

change (bps)	90 day bills	12/17 NZGB	04/27 NZGB	2yr swaps	10yr swaps	2yr/10yr swaps (bps)
10-Aug-15	3.01%	2.61%	3.36%	2.89%	3.65%	76
17-Aug-15	2.94%	2.61%	3.33%	2.88%	3.64%	76
Change (bps)	**-7**	**0**	**-4**	**-1**	**-1**	**0**

kymberly_martin@bnz.co.nz

Key Fixed Interest Views

Category		19-Aug-15	Tactical (1w)	Strategic (6-12mth)	Comments
NZ Money Markets	OCR	3.00%	→	↓	We expect the RBNZ to cut the OCR to 2.75% at its Sept 10 meeting and to 2.50% at its Oct meeting.
NZ Swap Yields	2y	2.88%	→	↗	2.83-3.00% range of past 6 weeks to ultimately be broken to downside. But GDT auction poses greatest risk of higher yields this week.
	5y	3.17%	→	↗	Support for yields appears to be forming above the 3.11% level.
	10y	3.64%	↗	↑	Yields to take their cue from US long yields where we see the bias for a drift higher.
NZ Swap Curve	2s-10s	76bps	↗	↑	Over the medium-term we continue to expect steepening of the NZ curve within a 70-125bps range.
NZ Bond Yields	NZGB 2027s	3.32%	↗	↑	Some modest upward pressure on yields may be felt this week though solid demand dynamics should limit any sell-off.
NZ-AU Swap Spreads	2y	76bps	→	↘	Near-term consolidation likely, though further narrowing is expected medium-term as RBNZ cuts cash rate closer to RBA's.
NZ Swap-Bond Spread	2027s ASM	43bps	↗	→	Solid relative demand for NZGBs likely to see spreads remain in upper half of 25-55bps range.
US Bond Yields	10y	2.20%	↗	↑	US CPI data and Fed funds commentary are most likely drivers of yields this week. We see bias for higher yields.
NZ-US Bond Spread	NZ-US 2027s	111bps	↘	↓	Compression likely on any US-led global sell-off in bonds.
NZ-AU Bond Spread	NZ-AU 2027s	38bps	→	→	Spreads are likely to be lower by year-end but no immediate catalyst to break recent range of 30-50bps.

Foreign Exchange Markets

Reuters pg BNZWFWDS Bloomberg pg BNZ9

Last Monday, we were quite confident of a relatively subdued week in global markets, based on the rather low-level nature of data scheduled to be released that week. Any notions of a quiet week were shattered by China's surprise devaluation on Tuesday.

The initial reaction amongst market participants was rather panicky, with calls of a currency war (i.e. competitive devaluation) abounding. However, even with just four trading days under the new regime, it is becoming clear that China's authorities have little appetite for further material depreciation, at least in the near-term, for fear of creating disorder. They have allowed the CNY's fix (around which CNY can trade +/- 2%) to be market-determined, but will still intervene in the spot market to maintain stability. As seen in Chart 1, that effort looks relatively successful.

NAB's Head of Asia Markets Strategy, Christy Tan, sees some further CNY weakness ahead, but on the back of market factors such as a slowing Chinese economy. The PBOC's decision last week saw CNY weaken by 5%. We see a less-than-5% further depreciation in CNY over the course of the next 18 months.

Greater flexibility in China's exchange rate is important to note, since it will have a bearing not just on NZD/CNY but also NZD/USD. The surprise CNY devaluation on 11 August saw NZD and AUD weaken in line with other Asian currencies. Both AUD and NZD have long been considered proxies for exposure to Asia, thanks to their strong trade linkages. Last week's events were a timely reminder of that, as China moves closer to a fully-flexible exchange rate.

Barring another major global surprise, we have a similar outlook for NZD/USD today as we did a week ago. With support at 0.65 still proving trenchant, and the data calendar offering little likelihood of that being sustainably broken, we favour NZD to gain this week. Supportive factors include the odds that dairy prices will stabilise or even bounce in this week's auction, and a market looking to shed some of its long-held NZD/USD short positions (but increasingly looking to do so).

raiko_shareef@bnz.co.nz

Charts of the week

Chart 1: Yuan Stabilising After Surprise Devaluation

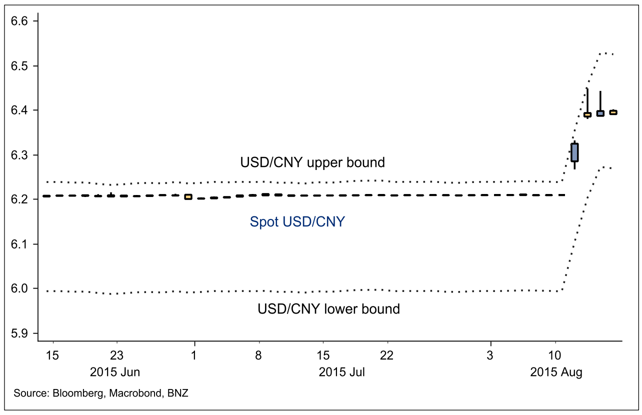
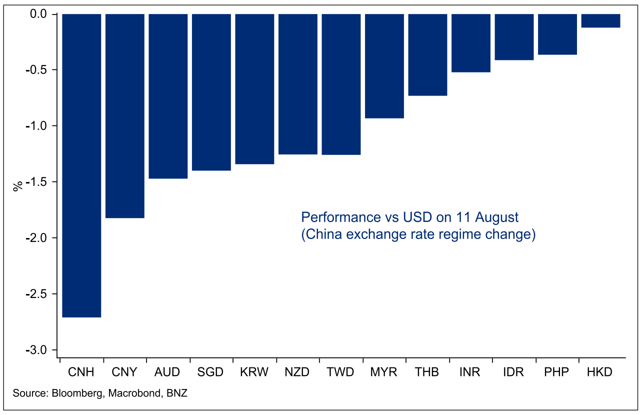


Chart 2: AUD, NZD Reprise Roles As Asia Proxies



NZD Weekly Outlook

	Current	Week ahead	Year ahead	Momentum[1]	Outlook
NZD/USD	0.6536	↗	↘	Negative	Barring another surprise like China's exchange rate shift last week, we expect NZD/USD to gain modestly on the risk of higher dairy prices and a surfeit of investors who remain short.
NZD/AUD	0.8869	→	↘	Neutral	The RBA Minutes, this week's AU highlight, are unlikely to shed fresh light on policy issues, after a slew of top-tier speeches from RBA officials over recent weeks. A range-bound week for the cross.
NZD/GBP	0.4180	→	↘	Negative	A number of interesting data points due from the UK this week, including inflation and retail sales. Careful attention will be paid to core inflation, which will guide the BoE's hiking prospects.
NZD/EUR	0.5888	↗	→	Negative	A very uninspiring week for data in Europe, which should leave EUR a mid-pack performer. It does seem inclined to drift higher, but only modestly. We pick the cross to gain slightly.
NZD/JPY	81.31	↗	↘	Neutral	With Q2 GDP already out of the way this week, there is little left on the Japanese data calendar. Another range-bound week beckons, which should allow the cross to drift higher.

Short-term Fair Value[2]				Risk Appetite[3]			NZ Commodity Prices (SDR)[4]		
NZD/USD:	0.7341	NZD/AUD:	0.8724	60%	weekly Δ -3%	monthly Δ -5%	154	weekly Δ -1.2	monthly Δ -1.2

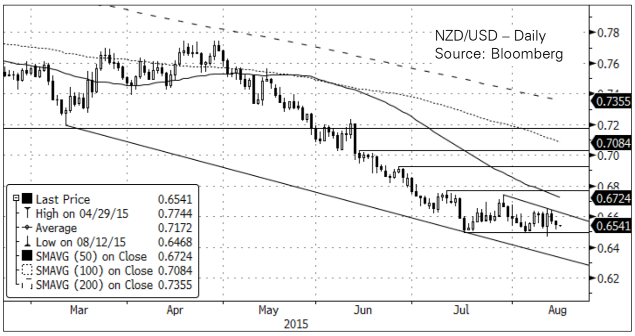
[1]According to our momentum model [2]According to our short-term fair-value models [3]According to our Risk Appetite Index (where 100 = risk-loving) [4]ASB Commodity Price Index
Source: BNZ, Bloomberg, ASB

Technicals

NZD/USD

Outlook:	Buy the dip
ST Resistance:	0.6630 (ahead of 0.6720)
ST Support:	0.6500 (ahead of 0.6330)

NZD/USD's promising start last week came to naught. The 0.65 level continues to provide support, with the market yet to see a close below that. Should that occur, the next downside target is 0.6330.

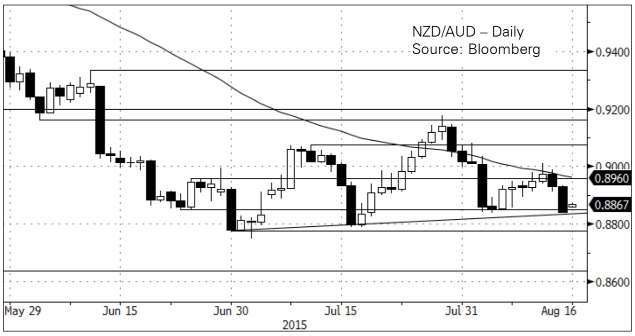


NZD/AUD

Outlook:	Play the range
ST Resistance:	0.8960 (ahead of 0.9070)
ST Support:	0.8780 (ahead of 0.8640)

The cross closed at important support at 0.8840 on Friday night, but has since rebounded. That support looks at risk this week, and we would be wary of a test of the broad 0.8780 – 0.9170 that has prevailed since June.

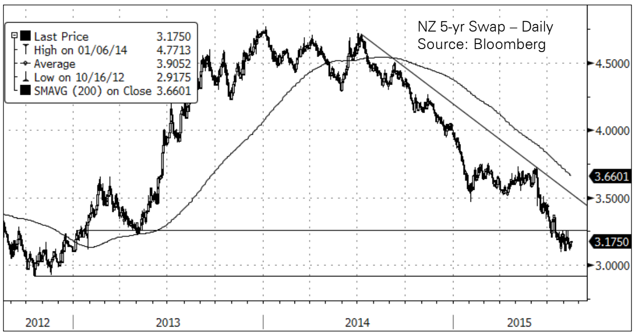
raiko_shareef@bnz.co.nz



NZ 5-year Swap Rate

Outlook:	Lower
MT Resistance:	3.43
MT Support:	2.92

Short-term resistance at 3.25 held again last week. We still expect a move lower to 2.92 but should 3.25 be breached, that will signal the rally has run out of steam and we will head higher.

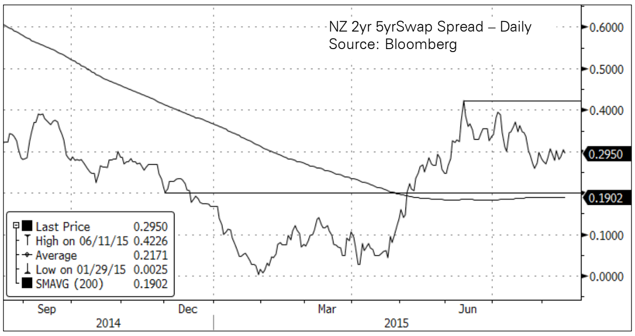


NZ 2-year - 5-year Swap Spread (yield curve)

Outlook:	Steeper
ST Resistance:	+43
ST Support:	+20

Still expect steepening but with support at +29 now breached we risk a move to +20 first. Should we close below +20, the steepening will be brought into question.

pete_mason@bnz.co.nz



Key Upcoming Events

	Forecast	Median	Last
Monday 17 August			
NZ, BNZ PSI (Services), July			58.2
Jpn, GDP, Q2 1st est		-0.5%	+1.0%
Euro, Trade Balance, June			+€18.8b
US, Empire Manufacturing, August		+4.50	+3.86
US, NAHB Housing Index, August		61	60
Tuesday 18 August			
Aus, RBA Minutes, 4 Aug Meeting			
China, Property Prices, July			
UK, CPI, July y/y		flat	flat
US, Housing Starts, July		1,186k	1,174k
Wednesday 19			
NZ, PPI Outputs, Q2 y/y	-2.4%		-2.5%
NZ, Dairy Auction			-9.3%
Aus, Westpac Leading Index, July			flat
Jpn, Merchandise Trade Balance, July		-¥53.0b	-¥69b
Jpn, All Industry Index, June		+0.4%	-0.5%
US, FOMC Minutes, 28/29 July meeting			
US, CPI ex food/energy, July y/y		+1.8%	+1.8%

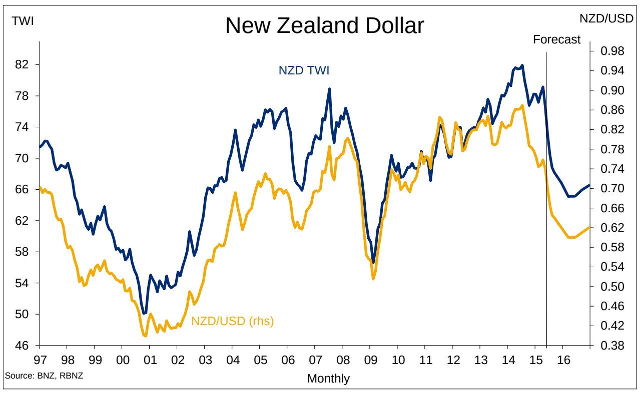
	Forecast	Median	Last
Thursday 20 August			
NZ, ANZ-RM Consumer Confidence, August			113.9
NZ, ANZ Job Ads, July			-0.6%
Germ, PPI, July y/y		-1.3%	-1.4%
UK, CBI Industrial Trends, August		-10	-10
UK, Retail Sales vol., July		+0.4%	-0.2%
US, Existing Home Sales, July		5.43m	5.49m
US, Leading Indicator, July		+0.2%	+0.6%
US, Philly Fed Index, August		+7.0	+5.7
US, Jobless Claims, week ended 15/08		272k	274k
Friday 21 August			
NZ, External Migration, July s.a.			+4,800
NZ, Credit Card Billings, July			+0.3%
Euro, Consumer Confidence, August 1st estimate		-6.9	-7.1
Monday 24 August			
China, PMI (Caixin), August 1st est			47.8
Euro, PMI Manufacturing, August 1st est			52.4
Euro, PMI Services, August 1st est			54.0
US, Markit PMI, August 1st est		53.8	53.8

Historical Data

	Today	Week Ago	Month Ago	Year Ago
CASH & BANK BILLS				
Call	3.00	3.00	3.25	3.50
1mth	3.06	3.09	3.21	3.65
2mth	2.98	3.05	3.20	3.66
3mth	2.9	3.00	3.18	3.67
6mth	2.89	2.94	3.09	3.76
GOVERNMENT STOCK				
12/17	2.61	2.58	2.74	3.86
03/19	2.64	2.63	2.79	3.96
04/20	2.72	2.71	2.92	4.04
05/21	2.74	2.76	2.98	4.11
04/23	2.97	3.00	3.13	4.20
GLOBAL CREDIT INDICES (ITRXX)				
AUD 5Y	102.0	100.31	100.67	90.50
N. AMERICA 5Y	76.25	75.00	69.58	64.64
EUROPE 5Y	67.75	65.66	67.63	70.43
SWAP RATES				
2 years	2.88	2.89	2.99	4.08
3 years	2.96	2.96	3.07	4.24
5 years	3.17	3.17	3.33	4.44
10 years	3.64	3.65	3.86	4.70

	Today	Week Ago	Month Ago	Year Ago
FOREIGN EXCHANGE				
NZD/USD	0.6543	0.6616	0.6714	0.8460
NZD/AUD	0.8877	0.8922	0.9033	0.9121
NZD/JPY	81.32	82.171	82.225	86.369
NZD/EUR	0.590	0.6029	0.6038	0.6311
NZD/GBP	0.418	0.4267	0.4332	0.5043
NZD/CAD	0.857	0.8684	0.8525	0.9280
TWI	70.31	70.42	70.87	79.30

NZD Outlook



Contact Details

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

Craig Ebert
Senior Economist
+(64 4) 474 6799

Doug Steel
Senior Economist
+(64 4) 474 6923

Kymberly Martin
Senior Market Strategist
+(64 4) 924 7654

Raiko Shareef
Currency Strategist
+(64 4) 924 7652

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

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
Global Head of Research
+(61 2) 9237 1406

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

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

Skye Masters
Head of Interest Rate Strategy
+(61 2) 9295 1196

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