

People's Bank of China surprises market with yuan devaluation

- The People's Bank of China surprised financial markets when it devalued the yuan last week.
- The NZD and AUD were very sensitive to last week's developments in China, and weakened in response to the yuan news.
- This week's GlobalDairyTrade event is a big focus – we may finally see a lift in prices as the market responds to lower volumes.

Phew, the All Blacks beating the Wallabies helps make it feel like the world is back spinning on its proper axis. Unfortunately, a win for the Silver Ferns in the Netball World Cup was not to be. Both games over the weekend demonstrated once again what great rivals Australia and New Zealand are on the sports fields. Australian and New Zealand firms compete with each other on the global stage, but the broader economies are perhaps better described as inter-connected rather than rivals. Last week's currency movements demonstrated how both economies are very sensitive to developments in China.

The People's Bank of China surprised financial markets when it devalued the yuan by 2% against the US dollar on Tuesday. That change was followed up with small changes to the yuan's value on Wednesday and Thursday. Currencies with a large trading exposure to China, like the New Zealand and Australian dollars, fell against the US dollar. Its worth remembering that dairy prices have already adjusted to weaker Chinese demand, and so have other commodity prices. The yuan devaluation last week was tiny compared with the commodity price changes over the past year. But the move does show that China's central bank is serious about stimulating the economy, including trying to counter the effects of the yuan's link to the strengthening USD dollar. So far this year, China's authorities have moved to stimulate economic activity by cutting interest rates, lifting capital works spending and now devaluing the currency. Markets generally expect more policy stimulus in China over the coming months. More interest rate cuts are likely. And further devaluations now look to be an option for China's central bank if the USD's rise continues.

On the local data front last week NZ Q2 retail sales volumes was the highlight. Sales were weaker than expected, with volumes lifting by only 0.1% over the June quarter. As expected, categories which received a strong Q1 boost in spending from high tourist numbers softened in Q2 (read more [here](#)). Nonetheless, the weaker result highlights the downside risks to the NZ economic outlook at the moment. This retail sales report is an important part of our GDP forecasting: GDP is likely to record below-trend growth for the second consecutive quarter over Q2. On a more positive note, the Business NZ Manufacturing PMI did dip 1.6 to a reading of 53.5 last week. But the sector is still in expansionary territory, and the PMI reading was the second best out of the last four months (readings above 50 indicate expansion). The Performance of Services Index out today similarly points to expansion for the service sector. And REINZ housing data for July were strong: the last time July sales turnover were this high was 2005.

The US data calendar in the coming week is relatively busy, with updates on housing and inflation. The minutes from the July Fed meeting may give some more indications about the timing of the expected rate rise and how gradual the rate rise profile will be. Minutes from the Reserve Bank of Australia are also due this week. The key local event will be Tuesday night's GlobalDairyTrade event (discussed below). Consumer confidence and migration data are also due on Thursday and Friday respectively.

Click here for:

Foreign Exchange

- NZD lower on yuan devaluation and weaker retail trade report, we maintain a downward bias.

Interest Rates

- NZ interest rates finish a volatile week unchanged.

Week Ahead

- Global Dairy Trade is the key event, net migration and tourist arrivals data take focus on Friday.

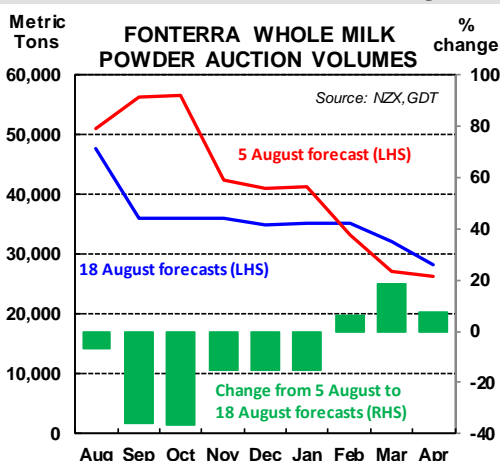
Week in Review

- Q2 retail trade volumes softer than expected, but monthly card spending remains encouraging.

Global Calendars

- US CPI and FOMC meeting minutes are this week's key releases, RBA meeting minutes also out.

Chart of the Week: Material changes in dairy volumes on offer at auctions



We expect NZ production this season to on par with last season, if not fall. In a similar vein, Fonterra has factored in a fall in production of 2%.

With that in mind, since the 5 August auction, Fonterra has reduced the volume of whole milk powder it intends to sell via the auctions over the next 12 months by 12%.

In response to market conditions (i.e. prices), Fonterra has also changed the timing around when it sells the product, reducing the volumes particularly over September and October.

Fonterra has earmarked the balance of the lower volumes its value add products.

NZX dairy futures made further hefty gains last week in response to these developments, and point to a lift at Tuesday's GDT auction.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6540	0.6611	0.6540	0.7505	0.8486	DOWN	0.6420	0.6620
NZD/AUD	0.8869	0.8931	0.8815	0.9635	0.9099	DOWN	0.8800	0.9000
NZD/JPY	81.27	82.23	81.12	88.86	86.98	DOWN	80.50	82.50
NZD/EUR	0.5884	0.6024	0.6001	0.6570	0.6349	FLAT	0.5800	0.6000
NZD/GBP	0.4178	0.4268	0.4182	0.4863	0.5083	DOWN	0.4100	0.4250
TWI	70.3	70.4	69.4	77.7	80.3	DOWN	69.20	71.60

^Weekly support and resistance levels * Current is as at 10.00 am Monday; week ago as at Monday 5pm.

The NZD fell last week in reaction to the People's Bank of China (PBoC) move to devalue the yuan against the USD. The initial move on Tuesday caught global financial markets by surprise, and the resulting heightened uncertainty created a significant amount of volatility during mid-week trading. However, by the weekend financial markets had largely settled down with the PBoC indicating further devaluations were unlikely. On Friday, with weaker NZ retail trade result added further downward pressure to the NZD.

A key event for the NZD this week is the global dairy trade auction – the market is likely to be anticipating an improvement given the lift in dairy futures last week. If the dairy price lift fails to materialise or underwhelms, the NZD /USD could test the recent support level around 0.6450.

On balance we expect the NZD to remain range bound, but have a slight downward bias as we also expect the USD to remain well supported this week. US inflation data and the FOMC meeting minutes will be under scrutiny as market participants remain divided on a September or December commencement to the Fed tightening cycle.

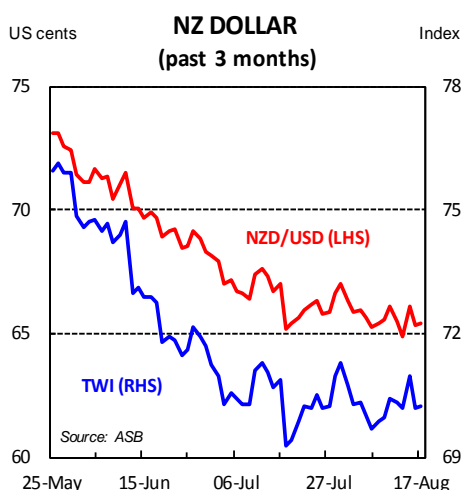
Short-term outlook:

Key data

Date

Time (NZT)

Market



RBA meeting minutes

18/8

1.30 pm

-

Global Dairy Trade Auction

18/8

overnight

-

US CPI - %mom

20/8

12.30 am

+0.2%

FOMC meeting minutes

20/8

6.00 am

-

NZ Net Migration

21/8

10.45 am

-

Key events for currencies this week: NZD: Global Dairy Trade (Tues); Net Migration (Fri). AUD: RBA meeting minutes (Tues). USD: CPI (Wed), FOMC meeting minutes (Thurs). CNY: Property Prices (Tues). JPY: Trade Balance (Tues). UK: CPI (Tues), Retail Sales (Thurs).

Medium-term outlook:

Last Quarterly Economic Forecasts

In July we updated our NZD forecasts to more fully take into account our expectation of deeper OCR cuts, as well as updating forecasts for other key exchange rates. We forecast the **NZD/USD** to reach a low of 0.61 in early 2016. The NZD will come under further pressure as the RBNZ continues to cut the OCR to a low of 2.5% in the second half of 2015. The interest rate market is already factoring in much of that move, though there is still scope for the NZD to fall slightly further from recent levels. Dairy prices have come under further pressure, softening the Terms of Trade. NZ economic growth will slow over 2015, reinforcing the NZD downtrend, before recovering in 2016.

The USD is set to remain firm and strengthen further as low commodity prices generate a lift in the US Terms of Trade and markets adjust to the prospect of the US Federal Reserve lifting interest rates in December. While the risks are balanced around the exact timing of the first Fed rate rise, the prospect of an actual Fed interest rate rise is in stark contrast to actual RBNZ interest rate cuts.

We expect the **AUD/USD** to decline further to a low of 0.70 in early 2016. Australia's economy will experience an extended period of below-trend GDP growth. Australia's Terms of Trade will remain under pressure from expanded commodity supply and slower demand from China's slowing property sector. We expect the **NZD/AUD** to range trade over the next year around an anchor of 0.87-0.88.

The NZD/GBP will gravitate to 0.40 over the next year: the BoE is inching towards lifting interest rates from zero. We see scope for some **limited moderation of NZD/EUR to 0.58** this year. Eurozone growth is accelerating, and – fingers crossed – the Greek situation remains contained and some of the recent euro underperformance reverses. We expect **NZD/JPY to soften to 78-80**.

Interest Rate Market

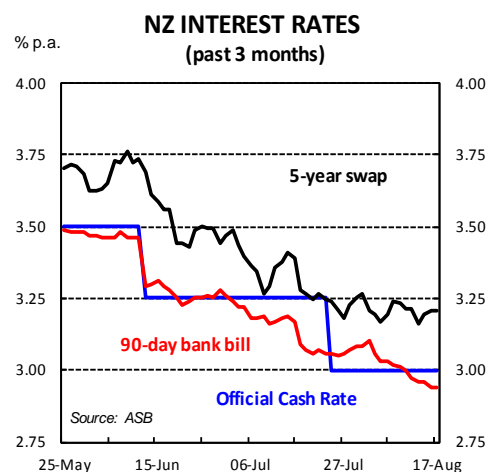
Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	3.00	3.00	3.25	3.50	3.50	FLAT
90-day bank bill	2.94	3.00	3.07	3.63	3.69	DOWN
2-year swap	2.92	2.93	2.91	3.63	4.09	FLAT/DOWN
5-year swap	3.21	3.21	3.27	3.71	4.43	FLAT/UP
5-year benchmark gov't stock	2.71	2.72	2.82	3.24	3.93	FLAT/UP
NZSX 50	5696	5865	5853	5757	5078	FLAT/DOWN

^Weekly support and resistance levels * Current is as at 10.00 am Monday; week ago as at Monday 5pm.

Interest rate markets were impacted by financial market volatility in the wake of the surprise yuan devaluations from the People's Bank of China (PBoC). Most interest rates remain unchanged, despite some volatility across the week with rates temporarily dipping lower on the back of market uncertainty and risk aversion triggered by the PBoC moves. Meanwhile, 90-day interest rates continue to decline as the prospect of a lower OCR (we expect 25 basis point cuts in September and October) increasingly dominate within this 90-day window.

Beyond the temporary gyrations caused by Chinese intervention, the key theme in interest rate markets remains the upcoming Fed meeting in September. Market participants currently see a 40-50% chance of the Fed commencing its tightening cycle at the next meeting on September 18th.

Short-term outlook:



Key data

	Date	Time (NZT)	Market
RBA meeting minutes	18/8	1.30 pm	-
Global Dairy Trade Auction	18/8	overnight	-
US CPI - %mom	20/8	12.30 am	+0.2%
FOMC meeting minutes	20/8	6.00 am	-
NZ Net Migration	21/8	10.45 am	-

Comment: On the domestic front it's a relatively quiet week ahead. The Global Dairy Trade auction is the key event from a domestic focus. However, as long as dairy prices stabilise or lift, we don't expect this to be a major game changer from the RBNZ's perspective.

Longer-end yields will remain a function of offshore moves, and on this front US inflation and FOMC meeting minutes will be closely watched as market participations are currently undecided on the September vs December rate hike. We continue to expect a steepening in the NZ yield curve over the rest of the year.

Medium-term outlook:

Last Quarterly Economic Forecasts

The RBNZ cut the OCR 25 basis points in [July](#) as widely expected, following June's initial 25 basis point rate cut and bringing the OCR to 3%. The RBNZ signalled that further rate cuts are likely, and we expect two further 25 basis point rate cuts in September and October to bring the cash rate to 2.5%.

One key factor prompting the rate cuts from the Reserve Bank has been the weaker dairy outlook. We revised our milk price forecast for the 2015/16 season twice in July, from \$5.70 to \$4.50, while Fonterra has lowered its milk price forecast to \$3.75. In addition, weak dairy auction prices highlight that price recovery remains elusive in the near term. A second consecutive year of low milk prices presents a threat to the dairy sector. Savings from the strong 2013/14 season milk price helped this sector through the weaker 2014/15 season. However, with another year of low dairy cashflows looking likely, the dairy sector and the broader economy are now more exposed and vulnerable to the decline in income. Given the recent milk price weakness, the RBNZ is likely to further trim its domestic spending outlook.

Along with the weaker dairy outlook, business and consumer confidence have declined and inflation pressures remain very subdued. Inflation is currently below the RBNZ's target band. While the RBNZ expects inflation to lift back toward 2% over the next two years, the risks are still skewed to the downside. Domestically-generated inflation pressures have remained muted, reflecting healthy competition and lack of capacity pressures in the broader economy. The fall in the NZD will lift tradable inflation, but even here the pass through of the NZD to inflation appears to be relatively muted.

While the near-term outlook is fragile, the 2016 outlook is now looking healthy. The 100 basis point reduction in the Official Cash Rate, along with the substantial depreciation in the NZD, will provide significant monetary support to the NZ economy. How business and consumer confidence reacts in the next few months will likely to be key in the RBNZ's assessment on how many further cuts it will deliver.

Key international data for the week ahead

Data/Event	Date	Time (NZT)	Previous	Market expects	ASB expects
US Housing Starts, July, 000s	18/8	12:30am	1174k	1186k	-
RBA Minutes	18/8	1:30pm	-	-	-
US CPI, July, %mom	19/8	12:30am	+0.3%	+0.2%	+0.2%
FOMC Minutes	20/8	11:30pm	-	-	-

The international data for the week begins in the **US** with the **Housing Starts data** release. US housing starts and sales appear to be stalling as mortgage costs move higher, in line with higher bond yields.

Following this, we jump across the Tasman later on Tuesday when the **RBA minutes are released**. It is expected that the easing bias will be maintained in the RBA's minutes with neutral comments on the AUD. Further, the minutes should indicate that the unemployment rate has peaked recently as labour demand picked up.

On Wednesday, we head back to the US for the release of **US CPI**. US inflation remains relatively benign and only a small rise is expected. Further, the recent fall in oil prices could keep headline figures low in 2016.

Finally, the **US Fed's Federal Open Market Committee meeting minutes** on Thursday rounds out a relatively US-centric week. Interest will revolve around the Fed's assessment of global deflation risks, especially following weaker oil prices and the CNY devaluations last week. As a result, these minutes should provide a bit more colour on what the FOMC is thinking regarding the timing of the first rate increase.

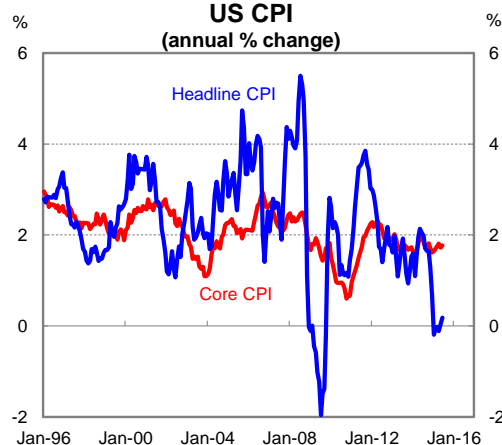
US HOUSING SECTOR
(rebased Jan 2001 = 100)



LABOUR MARKET TRENDS



US CPI
(annual % change)



NZ Data Preview: a look at the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
GlobalDairyTrade Auction, % change	18/08	Overnight	-9.3%	-	-
ANZ Roy Morgan Consumer Confidence, July	20/08	1:00pm	113.9	-	-
International Travel and Migration, July, net migration	21/08	10:45am	4,800	-	5,000

The main focus for the week will be Tuesday night's **GlobalDairyTrade auction**. We expect dairy prices to rise at the auction. Futures pricing suggest a rise for whole milk powder of more than 10% at the time of writing.

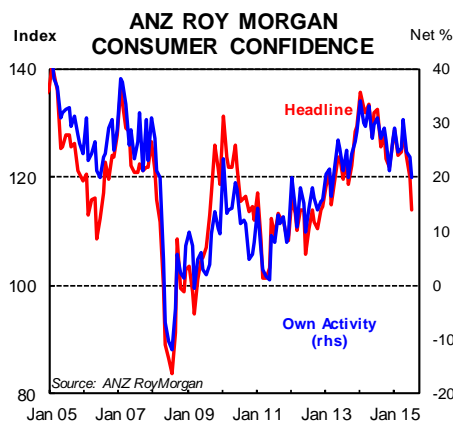
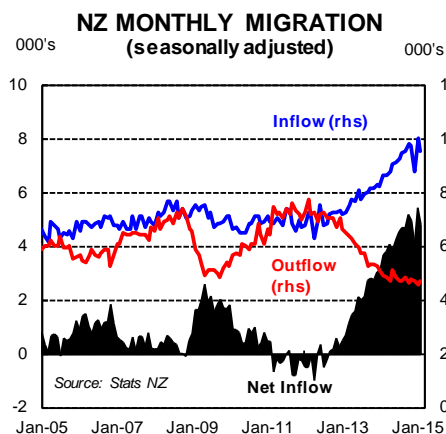
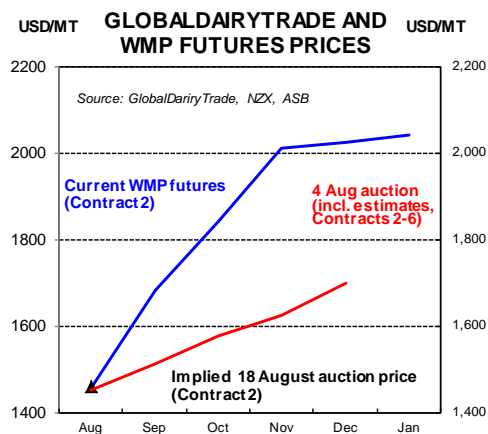
Markets have begun to bid prices higher on the likelihood that NZ production will fall this season compared to last. Moreover, with Fonterra reducing by a third the forecast WMP volume on offer at this auction, the price lift may not stop there.

However, a risk is that the Chinese currency devaluations and associated market uncertainty over the past week spills over to dairy markets, and puts a spanner in the works of the long-awaited lift in dairy auction prices.

The **Producer Price indices** (Wednesday) do not attract much attention, because the indices are released after the Consumer Price Index in July.

Consumer confidence eased to its lowest level in three years in the last ANZ-Roy Morgan Consumer Confidence Survey. Worries about the economy seem to be weighing on sentiment, but consumers remain more confident about their own household's situation. Lower interest rates should provide some offset to the broader concerns about the economy over the coming months, although it may be too early to see a pickup in Thursday's survey.

Record tourist arrivals have been a great story for the economy over the past year, but it has been overshadowed to a certain extent by the dairy sector's woes. We expect another strong month of arrivals in the July data released on Friday. **Permanent and long-term migration** figures are also due on Friday. We expect the pattern of the past year to remain in place. High inflows and low outflows are combining to see net inflows of close to 5,000 people each month.



Data Recap: weekly recap

Data	Date	Actual	Market forecast	ASB Forecast
Electronic Card Transactions, July, %mom	11/08	+0.4%	+0.5%	+0.2%
Business NZ Manufacturing PMI, July	13/08	53.5	-	-
Retail Trade Survey (volumes), Q2, %qoq	14/08	+0.1%	+0.5%	+0.5%

It was a relatively quiet week for domestic data releases last week, with the main event, the Q2 retail trade survey, not released until Friday.

The week kicked off with **Electronic Card Transactions (ECT) data for July**. ECT spending was slightly stronger than we had anticipated at 0.4% mom (ASB forecast 0.2%). The slowdown in consumer spending growth was most apparent in consumables, durables and fuel. Durables spending is typically tied to new housing construction and house sales, and the slowdown may reflect softer growth in housing construction over the past few months.

Following this on Thursday was the **Business NZ PMI**. While this dipped slightly, it remains above 50 and is still firmly in expansionary territory. Furthermore, all sub-indices read above 50, printing to expansion in production (55.9) and employment (50.8).

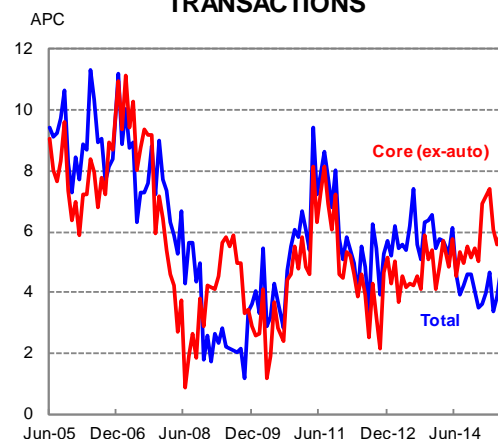
Finally, the week finished with the **Q2 retail trade survey results**. Despite a weaker-than-expected result, this followed the strong boost to Q1 spending that the Cricket World Cup provided, and therefore is a positive result. However, this does suggest that spending growth peaked in Q1 2015 and is now slowing to more moderate levels.

However, this survey did point to continued soft inflation. Ignoring the impacts of fuel prices, the **retail trade deflator actually fell by 0.3%**, indicating that consumers are still getting a relatively good bang for their buck on core spending.

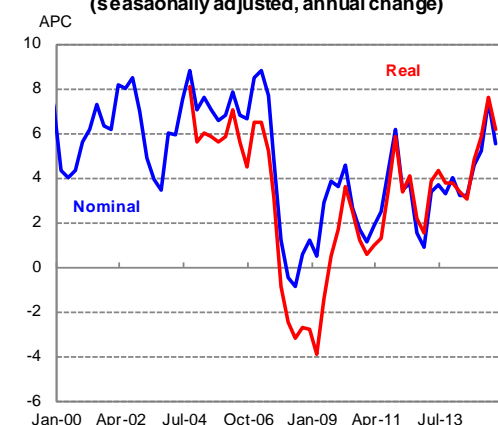
Going forward, the gradual improvement in the labour market, low interest rates and strong migration and tourist inflows will underpin spending. On balance, we **expect spending growth to be modest over the remainder of 2015**, in contrast to the earlier surge in spending growth, particularly over Q1.

We continue to expect the RBNZ to cut the OCR by 50bp by the end of the year - 25bp apiece in September and October respectively.

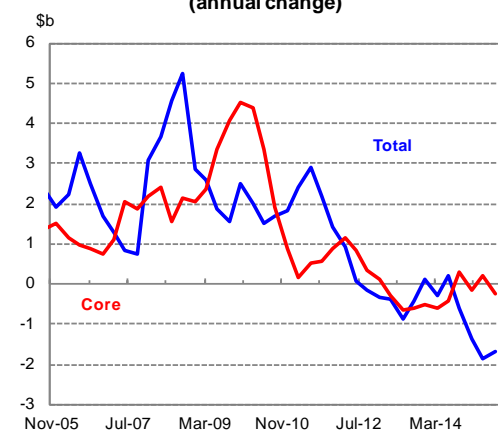
RETAIL ELECTRONIC CARD TRANSACTIONS



EX-AUTO RETAIL SALES (seasonally adjusted, annual change)



Retail Trade Deflator (annual change)



Global Data Calendars

Calendar - Australasia, Japan and China

Date	Time (NZT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Tue 18 Aug	13:30	AU	RBA August Meeting Minutes					
	13:30	AU	New motor vehicle sales	Jul	m%ch	3.8	~	~
		NZ	Global Dairy auction			-9.3		
Wed 19 Aug	11:50	JN	Trade balance adjusted	Jul	¥bn	-251.7	~	~
	13:00	AU	Skilled vacancies	Jul	m%ch	-0.9	~	~
	18:00	JN	Machine tool orders	Jul F**	y%ch	1.6	~	~
	10:00	NZ	ANZ job advertisements	Jul	m%ch	-0.6	~	~
Thu 20 Aug	13:00	NZ	ANZ consumer confidence index	Aug	Index	113.9	~	~
Fri 21 Aug	10:45	NZ	Net migration	Jul	~	4,800	~	~
	15:00	NZ	Credit card spending	Jul	m%ch	0.3	~	~

*P = Preliminary

**F = Final

Calendar - North America & Europe

Date	Time (UKT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 17 Aug	10:00	EC	Trade balance	Jun	€bn	21.2	~	~
	13:30	US	Empire manufacturing	Aug	~	3.9	4.8	~
	15:00	US	NAHB housing market index	Aug	Index	60.0	61.0	~
Tue 18 Aug	09:30	UK	CPI	Jul	m%ch	0.0	~	~
					y%ch	0.0	~	~
	13:30	US	Housing starts	Jul	'000	1,2	1,190	~
Wed 19 Aug	13:30	US	Building permits	Jul	'000	1,337	1217	~
	09:00	EC	Current account	Jun	€bn	3.4	~	~
	10:00	EC	Construction output	Jun	m%ch	0.3	~	~
Thu 20 Aug	13:30	US	CPI	Jul	m%ch	0.3	0.1	~
	13:30	US	CPI ex food and energy	Jul	m%ch	0.2	0.2	~
	19:00	US	U.S. Fed releases minutes from July 28-29 FOMC meeting					
	07:00	GE	PPI	Jul	m%ch	-0.1	~	~
Fri 21 Aug	09:30	UK	Retail sales ex auto fuel	Jul	m%ch	-0.2	~	~
	15:00	US	Existing home sales	Jul	mn	5.5	5.4	~
	15:00	US	Leading index	Jul	%	0.6	0.2	~
	13:30	CA	CPI	Jul	m%ch	0.4	~	~
Fri 21 Aug	13:30	CA	CPI core	Jul	m%ch	0.3	~	~
	13:30	CA	Retail sales	Jun	m%ch	1.0	~	~
	14:45	US	Markit US manufacturing PMI	Aug P*	Index	53.8	~	~
	15:00	EC	Consumer confidence	Aug A**	~	-7.1	~	~

*P = Preliminary

**A = Advance

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