NEW ZEALAND ECONOMICS
MARKET FOCUS

23 May 2016

INSIDE

NZ ECONOMICS TEAM

Cameron Bagrie
Chief Economist
Telephone: +64 4 802 2212
E-mail: Cameron.Bagrie@anz.com
Twitter @ANZ_cambagrie

Philip Borkin
Senior Economist
Telephone: +64 9 357 4065
Email: Philip.Borkin@anz.com

David Croy
Senior Rates Strategist
Telephone: +64 4 576 1022
E-mail: David.Croy@anz.com

Mark Smith
Senior Economist
Telephone: +64 9 357 4096
E-mail: Mark.Smith2@anz.com

Sam Tuck
Senior FX Strategist
Telephone: +64 9 357 4086
E-mail: Sam.Tuck@anz.com

Kyle Uerata
Economist
Telephone: +64 4 802 2357
E-mail: kyle.uerata@anz.com

Con Williams
Rural Economist
Telephone: +64 4 802 2361
E-mail: Con.Williams@anz.com

Sharon Zöllner
Senior Economist
Telephone: +64 9 357 4094
E-mail: Sharon.Zollner@anz.com

THE WORM HAS TURNED (FOR NOW)

ECONOMIC OVERVIEW

While we still have further RBNZ easing as our base case, we see little near-term urgency to cut and the market is increasingly coming around to the same view. There are challenges (low inflation being the big one), but the economy doesn't appear to need further stimulus (demand is solid and we think inflation is turning) or kerosene on the housing fire right here and now. The Budget is the key event this week and we expect it to paint a respectable picture, with New Zealand remaining in the top echelon of economies from a fiscal perspective. The April trade balance is expected to show a surplus of similar size to that seen in March.

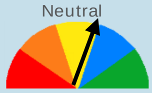
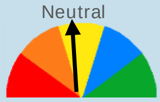
INTEREST RATE STRATEGY

While short-end rates are now pricing a much less aggressive OCR easing profile, we still see upside risks in the near-term as the market debates the terminal OCR and comes to grips with a more realistic outlook for Fed policy. The house view remains that the Fed will hike by 25bps in June and December and for US bond yields to continue moving higher over the course of the year. Against this backdrop, our tactical view remains that there is no hurry to rush back into received positions. However, we remain strategically bullish on the New Zealand bond market on a spread view, expecting further gradual spread compression. The recent flattening of the curve has run its course, and we now look for the curve to steepen. We expect a reduction in the NZGS bond programme at the Budget, reinforcing the value offered by NZGS.

CURRENCY STRATEGY

NZD/USD is in a tug-of-war as both the local and US markets reassess central bank outlooks, to be now more in tune with our house view (no-change RBNZ in June and a Fed hike in June/July). This dynamic looks set to continue given a) we do not expect USD strength to be as overt this time, as USD strength is an area the Fed is concerned about; and b) the RBNZ will remain dovish despite our expectation of no change. Momentum is still pointing toward NZD/AUD having the potential to grind higher, and we are wary of RBA Governor Stevens on Tuesday. Markets expect Stevens to express reluctance to ease further, which leaves NZD/AUD vulnerable topside if he fails to deliver which is where we view the risk.

THE ANZ HEATMAP

Variable	View	Comment	Risk profile (change to view)
GDP	2.4% y/y for 2017 Q1	While growth momentum looks reasonable now, tighter financial conditions suggest a more moderate backdrop over 2H 2016.	
Unemployment rate	5.3% for 2017 Q1	The unemployment rate should continue to trend lower. Wage inflation is contained, but a turn may be in sight.	
OCR	1.75% by Mar 2017	A further 50bps of cuts out to early 2017, despite housing, with the global scene and NZD strength key drivers.	
CPI	1.4% y/y for 2017 Q1	Lower petrol prices and further ACC levy cuts from July expected to keep headline inflation low this year. Core inflation measures to remain historically low.	

ECONOMIC OVERVIEW

SUMMARY

While we still have further RBNZ easing as our base case, we see little near-term urgency to cut and the market is increasingly coming around to the same view. There are challenges (low inflation being the big one), but the economy doesn't appear to need further stimulus (demand is solid and we think inflation is turning) or kerosene on the housing fire right here and now. The Budget is the key event this week and we expect it to paint a respectable picture, with New Zealand remaining in the top echelon of economies from a fiscal perspective. The April trade balance is expected to show a surplus of similar size to that seen in March.

FORTHCOMING EVENTS

Overseas Merchandise Trade – April (10:45am, Wednesday, 25 May). We expect a monthly trade surplus of around $100m, with seasonally adjusted export values retracing some of their recent weakness.

Budget Economic & Fiscal Update (2:00pm, Thursday, 26 May). We expect 'respectability' to be a key take-away from the Budget, with economic projections painting a reasonable picture, and the fiscal numbers continuing to show gradual improvement. The policy agenda will again be of the 'small tweaks' variety rather than lurching significantly in a new direction.

WHAT'S THE VIEW?

The market is now far less enthusiastic about the OCR moving lower immediately. Pricing for a June cut has fallen from around 80% two weeks ago to around 25% now. And while it is only us and one other within the economist community calling for no change in June, you can bet your bottom dollar more will change if market pricing stays where it is. A rate cut is now only 56% priced by August, which is consistent with our view of the risk profile. We put the odds of a move in August at 60%. In other words, we still lean towards expecting a cut, but are hardly dogmatic about it.

We still struggle to see the urgency for the OCR to move lower and it seems the market is coming around to the same view. Yes, inflation expectations are low and the unemployment rate has ticked up. However, there are stark realities on the other side:

- **Housing is booming.** Pouring more fuel on that fire hardly makes sense. While financial stability and monetary policy are separate in theory, their impacts clearly overlap.
- There is **little sign of weakness** across the economy outside of dairy.
- We are starting to see **signs of demand-pull inflation in anything housing-related**, and non-tradable inflation has surprised on the upside for the past two quarters. **Wage inflation is also showing tentative signs of lifting.**
- **Oil prices have risen** and this will more than negate the deflationary impact of a higher NZD in the near term. Dairy prices are being dragged along for the ride, though levels remain less than stellar.
- **The global scene looks far less worrisome than** three months ago; we doubt the tranquillity will last but we'll take it for now. Prospects for the Fed hiking are taking some pressure off the NZD/USD, although a higher NZD/AUD is not helping.
- **Dairy is a problem, but housing looks the bigger one now.** The RBNZ has been bouncing between the two over the past few years.
- The political pressure argument has been turned on its head. We typically shy away from it, though some think it is relevant to monetary policy decision-making. But we'll still offer our two cents worth: **with housing affordability now front and centre, the RBNZ is doing the Government few favours by cutting rates and fuelling more speculative fire!**

That combination would typically see us scorching any notion of rate cuts altogether. However, we're still picking a lower OCR, but further down the track. There are a few reasons for that:

- **Credit growth is outstripping deposit growth at a time when there is little appetite to raise offshore funding profiles.** Credit growth needs to slow and deposit growth needs to rise. **More intense competition for deposits is around the corner.** Monetary policy is therefore going to have to ease simply to stop retail rates moving up (although arguably higher mortgage rates are exactly what the housing market needs).
- **The global scene; we're expecting more fireworks, particularly with the market now starting to re-entertain prospects of the Fed lifting rates before too long.** Of course, the Fed won't want to create volatility and unease, but it is going to have to bite the bullet at some point. Financial markets need to be progressively taken off the low interest rate opioids. Detox isn't fun but it's necessary for long-term health.
- **The NZD is going to continue frustrating the RBNZ for a while yet.** As we've noted time and

ECONOMIC OVERVIEW

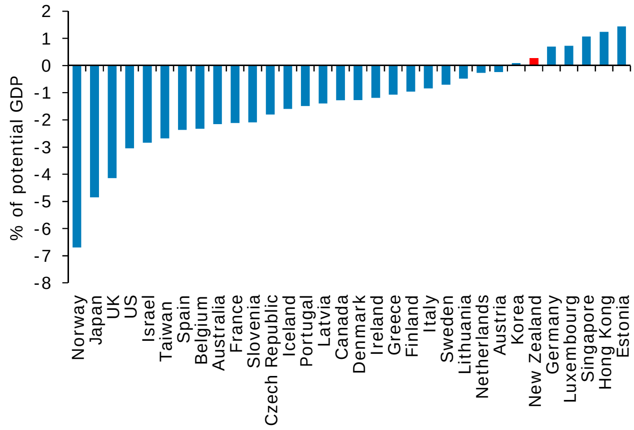
time again, monetary policy is now implicitly being expressed through currencies and that makes them divergent from localised fundamentals. In that world there will be pressure for interest rates to converge to keep exchange rates within acceptable bounds. The performance of the NZX and commercial property market (declining cap rates) is reflective of an insatiable thirst for yield, any yield, in a world of more and more negative rates. **And those flows are NZD supportive.**

The Budget is clearly the big domestic event of the week, and we expect 'respectability' to be a key take-away. These days, few surprises (particularly PR-negative ones) tend to be left to Budget Day itself, making Budgets typically relatively uneventful affairs. That said, we wouldn't completely rule out a few "goodies" being left for the day itself (last year the big "surprises" were the announcement of a child hardship package, but also the removal of the $1,000 KiwiSaver kick-start – news that was held back to the day itself not because it would provide nice headlines but to prevent a last-minute stampede). The market will also be interested in the near-term fiscal stance, given its implications for monetary policy at the margin. The Minister of Finance has already signalled that it will be a little more expansionary in the near term than previously signalled, but tighter overall (i.e. in the medium term) given an increased focus on debt repayment. That will be consistent with interest rates remaining low for longer.

The policy agenda will again be of the 'small tweaks' variety rather than lurching significantly in a new direction. Just as in last year's Budget, social policy initiatives will likely take up the majority of any new spending plans (health and education particularly – these are the areas of government spending most associated with population growth pressures). We suspect the projections will show the Government hitting (or getting pretty close to) its 20% net debt target by 2020 (in the Half-Year Update, net debt was forecast at 24% of GDP in 2020). The scheduled bond tender programme is likely to be revised down a touch.

As a result, the Budget will reinforce that New Zealand remains in the top echelon of economies from a fiscal perspective. The IMF recently estimated New Zealand's structural budget balance (a cyclically-adjusted balance that removes temporary influences) at +0.3% of GDP for 2015 – which leaves New Zealand as one of the few developed economies running a structural surplus (figure 1). New Zealand's net debt (at less than 26% of GDP currently), is also low relative to many international peers. Australia, on the other hand, is estimated to have a structural budget deficit of over 2% of GDP, although its debt starting point is low.

FIGURE 1. IMF ESTIMATES OF GOVERNMENT STRUCTURAL BUDGET BALANCE (2015)



Source: IMF

This puts New Zealand in a somewhat unusual situation globally in that there is actually a 'rainy day' coffer to respond to shocks over coming years (although of course like many nations we face serious long-term fiscal challenges associated with population ageing). In fact, if we had a wish-list it would actually include that fiscal policy turn a little more expansionary to take some pressure off monetary policy, which is clearly grappling with some challenging inflation versus financial stability tensions at present. This is certainly not to say we are wishing for a broad-based, unsustainable spend-up; it's more about driving targeted spending to help with pressure points.

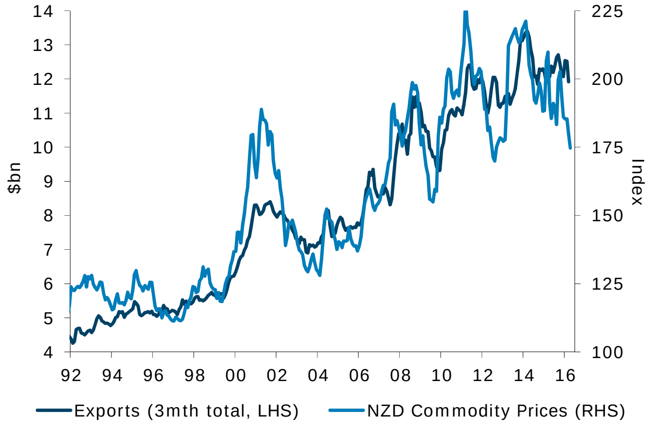
Beyond the Budget, it is a reasonably quiet week for data, with Overseas Merchandise Trade figures for April the only release due. There is a reasonable amount of uncertainty, but **we expect a broadly similar monthly trade surplus as seen in March** (circa $100m). One of the notable observations within the March figures was the sharp fall in seasonally adjusted export values. They plunged 17% m/m following an 8.5% m/m fall in February. From a quarterly perspective, the message is admittedly not as bad, with values down just 1.2% q/q. Nevertheless, the March result saw seasonally adjusted export values fall to their lowest level since December 2009.

Weaker prices for some components look to have played some role. But the main driver of this weakness was actually sharply lower dairy and meat export volumes. Both have now fallen for four consecutive months. When assessing the factors behind movements in primary export volumes there are always issues with inventories, domestic production and global conditions to consider. But we suspect recent weakness, at least in part, reflects

ECONOMIC OVERVIEW

some of the domestic headwinds now evident in milk production (as farmers embark on a cost-cutting binge) and an unwinding of earlier meat export strength as stock were sent to slaughter on an expectation of a severe El Nino weather event.

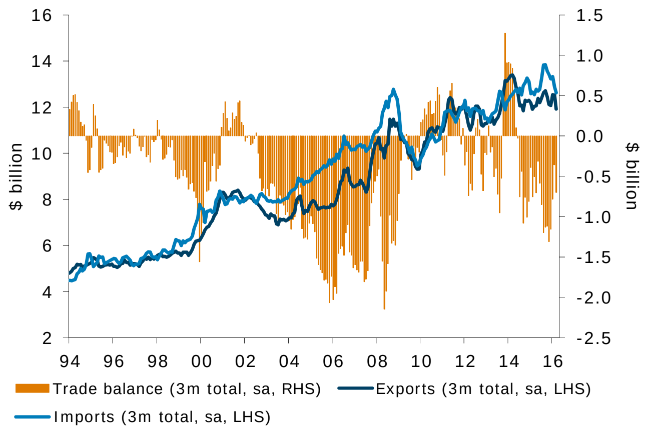
FIGURE 2. NZ EXPORTS AND COMMODITY PRICES



Source: ANZ, Statistics NZ

We expect export values to recover some lost ground in April. Without being interpreted as sounding bullish, we don't believe the lowest export values in over six years are indicative of the state of the export sector overall, and some retracement of this recent weakness is expected. That said, weaker NZD commodity prices certainly present a key headwind to New Zealand's overall trade performance. Together with global oil prices also now lifting off lows, this combination culminates in our expectation that the terms of trade will fall by a further 10% or so over 2016. It is therefore unsurprising that we expect ongoing deterioration in New Zealand's trade performance over the course of the year.

FIGURE 3. OVERSEAS MERCHANDISE TRADE



Source: ANZ, Statistics NZ

LOCAL DATA

RBNZ Survey of Expectations – Q2. One and two-year-ahead inflation expectations rose slightly to 1.22% and 1.64%, from 1.09% and 1.63% respectively.

GlobalDairyTrade Auction Results. The GDT-TWI rose 2.6%, with whole milk powder prices lifting 3.0%.

PPI – Q1. Input and output prices fell 1.0% q/q and 0.2% q/q respectively (-0.9% y/y and +0.1% y/y).

ANZ Job Ads – April. Total job advertising lifted 1.7% m/m (sa) – the third consecutive increase.

ANZ-Roy Morgan Consumer Confidence – May. Headline confidence eased 4 points to 116.2. The Current Conditions and Future Conditions indices fell by 4 points and 3 points to 119.3 and 114.3 respectively.

International Travel & Migration – April. A seasonally adjusted net inflow of 5,520 migrants was seen. This is still strong, but in annualised terms the three-month average has eased to 67.4k from a recent peak of close to 72k.

INTEREST RATE STRATEGY

SUMMARY

While short-end rates are now pricing a much less aggressive OCR easing profile, we still see upside risks in the near-term as the market debates the terminal OCR and comes to grips with a more realistic outlook for Fed policy. The house view remains that the Fed will hike by 25bps in June and December and for US bond yields to continue moving higher over the course of the year. Against this backdrop, our tactical view remains that there is no hurry to rush back into received positions. However, we remain strategically bullish on the New Zealand bond market on a spread view, expecting further gradual spread compression. The recent flattening of the curve has run its course, and we now look for the curve to steepen. We expect a reduction in the NZGS bond programme at the Budget, reinforcing the value offered by NZGS.

THEMES

- Market pricing for the June RBNZ *MPS* moves further in favour of “on hold”, in line with our view.
- The US market has re-priced radically in the wake of the Fed minutes and several speeches – and we think it has further to run.
- Collectively, higher US interest rates and an on-hold outlook locally portends of a parallel shift higher in the yield curve, with a steepening bias, and an ongoing narrowing in geographic spreads.
- This week’s Budget should be well received by the market, with a reduction in bond issuance mildly reducing the supply burden.
- Yields remain close to all-time lows, and while there is short term pressure for them to rise, they remain high by global comparison.

PREFERRED STRATEGIES – INVESTORS

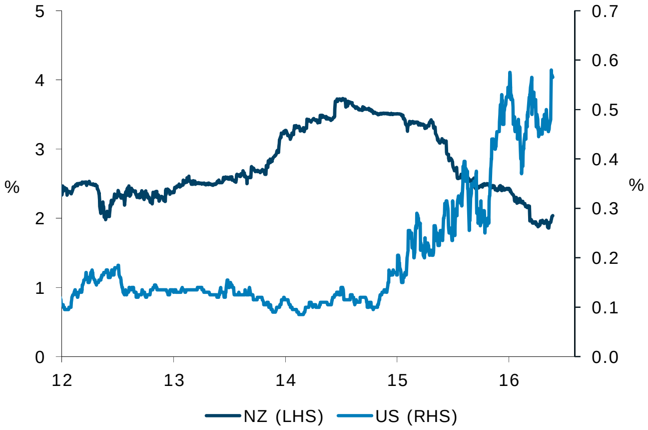
KEY VIEWS – FOR INVESTORS		
GAUGE	DIRECTION	COMMENT
Duration	Neutral/short	Yields set to drifty mildly higher this week. NZ cheap on global relative basis, and we prefer duration in NZ than in the US.
2s10s Curve	Steeper	Enough cuts priced in, but long end still biased mildly higher.
Geographic 10yr spread	Narrower	Divergent policy biases argue for gradual narrowing.
Swap spreads	Neutral/wider	Budget to signal reduced NZGS supply, hedge paying ongoing.

COME JOIN THE CLUB!

Regular readers will recall that we changed our OCR forecast a little over a week ago, calling for no change to the OCR in June.

We favour a move in August, although put the odds no higher than 60%. By then, there will be significant new information on the table with which to make a more informed decision – Q2 CPI, Q1 GDP, Q2 HLFS, several more reads on the housing market; and of course, clarity on the global scene – Fed policy, the “Brexit” vote, Chinese growth and the like. We have seen at least one more analyst join the no cut in June call in the past week, coinciding with another shift in market pricing (figure 1).

FIGURE 1: SIX MONTH AHEAD CASH RATE EXPECTATIONS



Source: ANZ, Bloomberg

While we think the risk profile means that cuts are more likely than not over time, and will be enough for the RBNZ to maintain an easing bias in June, the market is asking how set in stone should expectations of a follow-up cut be. We don’t think the data validates a move anytime soon, and while markets will be mindful of what is around the corner, there is little for it to run aggressively with amidst global stability, rising oil prices and a less extreme NZD. Such price action needs to be respected. The consequences of the market shifting its view from “when will the RBNZ deliver the next cut?” to something like “will the RBNZ deliver a sixth cut?” is significant. At the moment, the market is pricing in a terminal OCR a shade *below* 2% (currently around 1.99%). That’s a big change on where things stood ten days ago before the markets started to price in more realistic expectations (figure 1) for the Fed (recall that we expect the Fed to hike in June, and again in Q4).

MORE UPSIDE TO COME

Despite the move to date, risks remain that the market has more upside movement to go yet. This is largely based on our assessment of market positioning (long/received), potential for pay-side pressure (mortgage and corporate) and our expectation that upcoming data (including the

INTEREST RATE STRATEGY

Budget) will be in pretty good shape. In our view, the first phase of the adjustment (which is now basically complete) is a shift in the terminal rate from something deeper than the RBNZ has projected to something in line with that projection (i.e. one more cut). The second phase is all about determining if another cut is necessary – and we are about to enter this phase. We still think more cuts will be delivered, but timing is everything and we think the market won't be entertaining the notion aggressively for a while yet.

We think that the global risk profile is sufficiently downwardly skewed (China, "Brexit", over-leveraging, housing bubbles etc) to keep a third phase (which would be all about debating if the next move is a cut or a hike) at bay. But we're wary of it anyway. Anyhow, the upshot is we think the adjustment underway at the short-end has further to go, and we're in no hurry to play from the long/received side again at this juncture.

This week's Budget is likely to be fairly well received by the market. Dovetailing into our earlier theme of the market becoming more constructive on the outlook for the economy, we expect an upgraded set of growth and fiscal forecasts, and a lower funding requirement. We expect bond issuance to be cut by $1bn per annum over the projection period, taking some pressure off the supply pipeline. While pretty marginal, it all helps, especially with regular syndicated issuance taking the pressure off regular tender issuance volumes. Against a backdrop of bottoming out US bond yields and a more stable outlook for the OCR, we would expect swap spreads to be under renewed pressure to rise in coming weeks as hedgers step up and pay.

MILD STEEPENING BIAS

With the short-end biased higher and the US market debating the possibility of a June/July hike from the Fed, we expect the whole term structure of interest rates to be under upward pressure this week, albeit with a mild steepening bias. This is largely because we think there's a limit to how quickly the short-end can re-price, but there's blue sky above US Treasury bond yields. There is plenty of scope for geographic spreads to absorb much of the rise in US yields, and let's not forget how high New Zealand yields are by global standards. This should keep a lid on bearish sentiment.

It is also worth noting the recent trend for governments and fiscal authorities around the world to issue ultra-long bonds of late, with recent issuance of 100 year bonds by the likes of Ireland, Belgium and Mexico. We doubt the local market is ready for such a tenor – but the NZDMO has been eager to extend the duration of its debt portfolio, and it would seem to make sense to target a longer duration for future benchmark bonds. Such issuance typically adds to the steepening bias.

PREFERRED STRATEGIES – BORROWERS

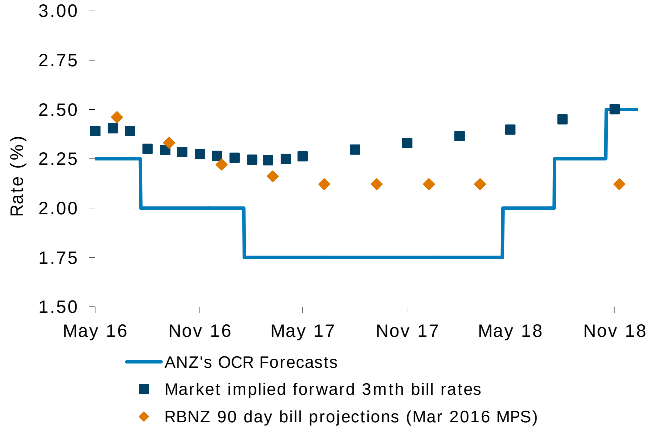
Local long-term rates remain close to historical lows, so it is obviously still cheap to fix. With very little separating the 5 year swap and the OCR, and the curve set to steepen, we are more inclined to add to hedges now than we were a couple of weeks ago. However, with the global risk profile still skewed lower, and credit spreads introducing uncertainty to all-up funding costs, we prefer to employ options-based strategies.

KEY VIEWS – FOR BORROWERS		
GAUGE	**VIEW**	**COMMENT**
Hedge ratio	Majority hedged	Options preferred so as to maintain exposure to lower floating interest rates.
Value	Cheap	More upside risk emerging.
Uncertainty	Elevated	Watch credit spreads.

MARKET EXPECTATIONS

Odds of a near-term RBNZ rate cut have shifted markedly over the past week, with the odds of a June cut pared back from around 50/50 to closer to 75/25. That seems fair for now, but we'd expect there to be further slippage (and for the market to price in a higher terminal OCR) on confirmation of no change next month.

FIGURE 2: ANZ OCR FORECAST VS MARKET-IMPLIED FWD 3MTH BILL RATES AND RBNZ 90-DAY PROJECTION



Source: ANZ, Bloomberg

CURRENCY STRATEGY

SUMMARY

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TABLE 1: KEY VIEWS

CROSS	WEEK	MONTH	YEAR
NZD/USD	↔	Awaiting catalysts	Profile still lower
NZD/AUD	↔	Room to test higher	Remain above long-run averages
NZD/EUR	↔	Still in range	Political risks for EUR
NZD/GBP	↔	Brexit risks easing	GBP resurgence
NZD/JPY	↔/↑	Oversold?	JPY returning to averages

THEMES AND RISKS

- Fed normalisation is being talked up by Fed speakers. USD reaction to date has been tame.
- Brexit probabilities and European political developments shaping the GBP and EUR still.
- Global activity indicators are expected to pick up this week. More broadly, we expect data flow to show the world continues to grow steadily.
- RBA Governor Stevens gives a speech to the Trans-Tasman Business Circle. This will be key for NZD/AUD as it approaches the top of its range.

TABLE 2: KEY UPCOMING EVENT RISK

EVENT		WHEN (NZST)	IMPACT RISK
EUR	Markit PMIs	Mon 20:00	NZD/EUR ↓
USD	Markit PMI (mfg)	Tue 01:45	NZD/USD↔/↑
EUR	Consumer confidence	Tue 02:00	NZD/EUR ↔/↑
AUD	RBA Stevens	Tue 15:05	NZD/AUD ↓
USD	Richmond Fed	Wed 02:00	NZD/USD ↑
NZD	Trade balance	Wed 10:45	NZD ↓
AUD	Skilled vacancies	Wed 13:30	NZD/AUD ↓
EUR	German IFO	Wed 20:00	NZD/EUR ↑
USD	Markit PMI (svcs)	Thu 01:45	NZD/USD ↓
CAD	BoC	Thu 02:00	NZD/CAD ↓
NZD	Budget	Thu 14:00	NZD ↑
GBP	Q1 GDP (second)	Thu 20:30	NZD/GBP ↑
USD	Durable goods	Fri 00:30	NZD/USD ↑
JPY	National & Tokyo CPI	Fri 11:30	NZD/JPY ↓
USD	Q1 GDP	Sat 00:30	NZD/USD ↓
USD	Chair Yellen Radcliff award	Sat 05:15	NZD/USD ↔

EXPORTERS' STRATEGY

Exporters should remember recent strength; NZD/USD direction is dependent on USD direction, which remains uncertain in the short term.

IMPORTERS' STRATEGY

We are at a level where NZD/AUD importers can begin to build hedging. NZD/USD importers should already be relatively fully hedged – if not, await better levels.

DATA PULSE

The USD strengthened modestly after the Fed minutes showed that "most" FOMC members considered June to be a live meeting. The data, however, was more mixed, with the May Empire and Philadelphia Fed activity surveys both weaker than expected. Housing data, April CPI and industrial production were all positive.

NZD remained supported against non-USD crosses as the data continued to show a resilient economy. The GDT lifted, ANZ job ads strengthened for a third consecutive month, net migration was another annual record, and while ANZ consumer confidence eased, the outright level remained solid.

GBP jumped as polls lowered the market's Brexit odds. UK data has recovered from recent softness; employment was solid and retail sales were strong, although CPI unexpectedly declined. **EUR fell** as the ECB minutes showed the ECB closing ranks.

AUD eased, closing through its 200dma despite an attempt higher, as the RBA minutes showed little bias. Employment and Q1 wages were still relatively solid.

USD/JPY rallied with USD, despite Japanese Q1 GDP being unexpectedly strong.

TABLE 3: NZD VS AUD: MONTHLY GAUGES

GAUGE	GUIDE	COMMENT
Fair value	↔	FV is above long-run averages.
Yield	↔	In line with shift in yields.
Commodities	↔	We note iron ore strength.
Data	↔/↑	NZD data is resilient.
Techs	↔/↓	Towards the top of the range.
Sentiment	↔	Equal reactions to sentiment.
Other	↔/↓	RBA sentiment the driver.
On balance	↔	**Close to top of range.**

TABLE 4: NZD VS USD: MONTHLY GAUGES

GAUGE	GUIDE	COMMENT
Fair value	↔	Closer to fair value.
Yield	↔/↓	RBA cut applies pressure.
Commodities	↔	Risks reasonably well priced.
Risk aversion	↔/↑	Resilience to risk notable.
Data	↔/↓	US data has improved, but NZD data remains strong.
Techs	↔	Testing pivotal support.
Other	↔/↓	USD sentiment on the improve.
On balance	↔/↓	**Factors still point lower, but near-term catalysts missing.**

CURRENCY STRATEGY

TECHNICAL OUTLOOK

FIGURE 1. NZD/USD DAILY CANDLES WITH RSI & MA

NZD/USD is at key levels. The 0.6680-0.6720 area has been a pivot since we based in September 2015. Also in the zone are the 100dma at 0.6721 and the 200dma at 0.6653. Finally there are two uptrends that converge near 0.66. This implies that buyers should consider from here on down as prime territory for long NZD/USD positions.

FIGURE 2. NZD/AUD DAILY CANDLES WITH RSI & MA

This cross looks to be heading higher to test resistance near 0.9450-0.95. However, it is over-bought, and momentum will likely begin to wane once the 0.94 level is achieved. Support is now entrenched near the 200dma at 0.9158. There is no suggestion that this cross will break its recent range, and importers could use strength from here to hedge.

TABLE 5: KEY TECHNICAL ZONES		
CROSS	**SUPPORT**	**RESISTANCE**
NZD/USD	0.6710 – 0.6750 0.6600 – 0.6650	0.7050 – 0.7080 0.7160 – 0.7200
NZD/AUD	0.9010 – 0.9060 0.8780 – 0.8820	0.9400 – 0.9430 0.9480 – 0.9520
NZD/EUR	0.5800 – 0.5850	0.6200 – 0.6230
NZD/GBP	0.4530 – 0.4560	0.4930 – 0.4980
NZD/JPY	69.80 – 70.20	77.70 – 78.50

POSITIONING

Position reduction remains the dominant theme, with NZD, CAD and AUD longs cut, along with EUR shorts. The exception was JPY longs, which were added to, as well as GBP shorts, which grew again.

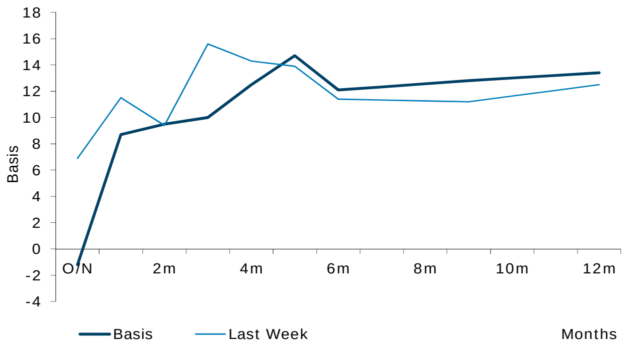
GLOBAL VIEWS

The Fed minutes showed that "most" FOMC members saw June as "likely appropriate" – albeit with data caveats (we note that it hasn't been the data that's been the problem so far). However, the key point for currencies is to remember the **adverse feedback loop** that faces the Fed and currency markets. The Fed minutes noted "real GDP was expected to increase … largely reflecting … the **higher projected trajectory for equity prices and lower assumed paths for both longer-term interest rates and the foreign exchange value of the dollar**."

The problem with that statement is of course that Fed 'normalisation' poses risks for equity prices, would strengthen USD, and also lift longer-term interest rate expectations. A stronger USD tightens financial conditions, meaning less need to hike. It is something of a circular argument, but it is what happens when currencies become vehicles through which monetary policy gets expressed, in a world that is "coupled" as opposed to "decoupled". The Fed needs to hike but can't become too decoupled from others.

FORWARDS: CARRY AND BASIS

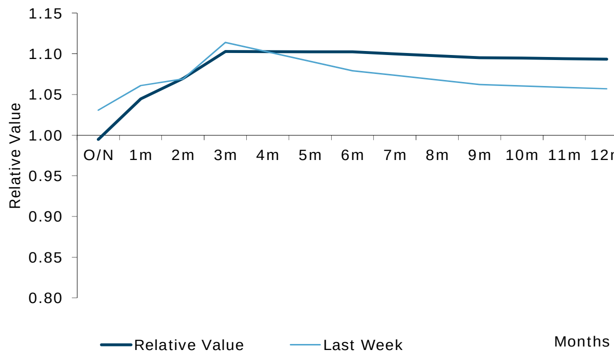
FIGURE 3. NZD/USD SHORT BASIS CURVE



Source: ANZ, Bloomberg, Reuters

Short-end basis has contracted, whereas it has risen further out, making it attractive to roll further than the 3m point for once. Cash looks relatively well balanced, indicating balanced spot markets, and suggesting spot markets are long – consistent with CFTC data.

FIGURE 4. RELATIVE ATTRACTION OF THE FWD CURVE



Source: ANZ, Bloomberg, Reuters

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
23-May	GE	Markit/BME Manufacturing PMI - May P	52.0	51.8	19:30
	GE	Markit Services PMI - May P	54.6	54.5	19:30
	GE	Markit/BME Composite PMI - May P	53.9	53.6	19:30
	EC	Markit Manufacturing PMI - May P	51.9	51.7	20:00
	EC	Markit Services PMI - May P	53.2	53.1	20:00
	EC	Markit Composite PMI - May P	53.2	53.0	20:00
24-May	US	Markit Manufacturing PMI - May P	51.0	50.8	01:45
	EC	Consumer Confidence - May A	-9.0	-9.3	02:00
	AU	ANZ-RM Consumer Confidence Index - 22-May	--	115.1	11:30
	GE	Private Consumption QoQ - Q1	0.6%	0.3%	18:00
	GE	Government Spending QoQ - Q1	0.8%	1.0%	18:00
	GE	Capital Investment QoQ - Q1	1.4%	1.5%	18:00
	GE	Construction Investment QoQ - Q1	1.5%	2.2%	18:00
	GE	Domestic Demand QoQ - Q1	0.9%	0.8%	18:00
	GE	Exports QoQ - Q1	0.5%	-0.6%	18:00
	GE	Imports QoQ - Q1	1.0%	0.5%	18:00
	GE	GDP SA QoQ - Q1 F	0.7%	0.7%	18:00
	GE	GDP WDA YoY - Q1 F	1.6%	1.6%	18:00
	GE	GDP NSA YoY - Q1 F	1.3%	1.3%	18:00
	UK	Public Finances (PSNCR) - Apr	--	£16.6B	20:30
	UK	Central Government NCR - Apr	--	£18.8B	20:30
	UK	Public Sector Net Borrowing - Apr	£5.8B	£4.2B	20:30
	UK	PSNB ex Banking Groups - Apr	£6.4B	£4.8B	20:30
	GE	ZEW Survey Current Situation - May	49.0	47.7	21:00
	GE	ZEW Survey Expectations - May	12.0	11.2	21:00
	EC	ZEW Survey Expectations - May	--	21.5	21:00
	UK	CBI Retailing Reported Sales - May	8	-13	22:00
	UK	CBI Total Dist. Reported Sales - May	13	13	22:00
25-May	US	Richmond Fed Manufact. Index - May	8	14	02:00
	US	New Home Sales - Apr	521k	511k	02:00
	US	New Home Sales MoM - Apr	2.0%	-1.5%	02:00
	NZ	Trade Balance - Apr	25M	117M	10:45
	NZ	Exports - Apr	4.08B	4.20B	10:45
	NZ	Imports - Apr	3.98B	4.09B	10:45
	NZ	Trade Balance 12 Mth YTD - Apr	-3972M	-3838M	10:45
	AU	Skilled Vacancies MoM - Apr	--	-1.2%	13:00
	AU	Construction Work Done - Q1	-1.5%	-3.6%	13:30
	CH	Westpac-MNI Consumer Sentiment - May	--	117.8	13:45
	GE	GfK Consumer Confidence - Jun	9.7	9.7	18:00
	GE	IFO Business Climate - May	106.8	106.6	20:00
	GE	IFO Current Assessment - May	113.3	113.2	20:00
	GE	IFO Expectations - May	100.8	100.4	20:00
	US	MBA Mortgage Applications - 20-May	--	-1.6%	23:00
26-May	US	Advance Goods Trade Balance - Apr	-$60.0B	-$56.9B	00:30
	US	House Price Purchase Index QoQ - Q1	--	1.4%	01:00
	US	FHFA House Price Index MoM - Mar	0.5%	0.4%	01:00
	US	Markit Services PMI - May P	53.0	52.8	01:45
	US	Markit Composite PMI - May P	--	52.4	01:45

Continued on following page

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
26-May	JN	PPI Services YoY - Apr	0.2%	0.2%	11:50
	AU	Private Capital Expenditure - Q1	-3.5%	0.8%	13:30
	NZ	Budget 2016	--	--	14:00
	UK	BBA Loans for House Purchase - Apr	44700	45096	20:30
	UK	GDP QoQ - Q1 P	0.4%	0.4%	20:30
	UK	GDP YoY - Q1 P	2.1%	2.1%	20:30
	UK	Private Consumption QoQ - Q1 P	0.5%	0.6%	20:30
	UK	Government Spending QoQ - Q1 P	0.4%	0.3%	20:30
	UK	Gross Fixed Capital Formation QoQ - Q1 P	0.9%	-1.1%	20:30
	UK	Exports QoQ - Q1 P	0.1%	0.1%	20:30
	UK	Imports QoQ - Q1 P	1.0%	0.9%	20:30
	UK	Index of Services MoM - Mar	0.2%	0.1%	20:30
	UK	Index of Services 3M/3M - Mar	0.6%	0.7%	20:30
	UK	Total Business Investment QoQ - Q1 P	--	-2.0%	20:30
	UK	Total Business Investment YoY - Q1 P	--	3.0%	20:30
27-May	US	Initial Jobless Claims - 21-May	275k	278k	00:30
	US	Continuing Claims - 14-May	2142k	2152k	00:30
	US	Durable Goods Orders - Apr P	0.4%	1.3%	00:30
	US	Durables Ex Transportation - Apr P	0.3%	-0.2%	00:30
	US	Cap Goods Orders Nondef Ex Air - Apr P	0.3%	-0.8%	00:30
	US	Cap Goods Ship Nondef Ex Air - Apr P	0.1%	0.0%	00:30
	US	Pending Home Sales MoM - Apr	0.7%	1.4%	02:00
	US	Pending Home Sales NSA YoY - Apr	0.2%	2.9%	02:00
	US	Kansas City Fed Manf. Activity - May	-3	-4	03:00
	UK	GfK Consumer Confidence - May	-4	-3	11:05
	JN	Natl CPI YoY - Apr	-0.4%	-0.1%	11:30
	JN	Natl CPI Ex Fresh Food YoY - Apr	-0.4%	-0.3%	11:30
	JN	Natl CPI Ex Food, Energy YoY - Apr	0.6%	0.7%	11:30
	JN	Tokyo CPI YoY - May	-0.5%	-0.4%	11:30
	JN	Tokyo CPI Ex-Fresh Food YoY - May	-0.4%	-0.3%	11:30
	JN	Tokyo CPI Ex Food, Energy YoY - May	0.6%	0.6%	11:30
	CH	Industrial Profits YoY - Apr	--	11.1%	13:30
28-May	US	GDP Annualized QoQ - Q1 S	0.9%	0.5%	00:30
	US	Personal Consumption - Q1 S	2.1%	1.9%	00:30
	US	GDP Price Index - Q1 S	0.7%	0.7%	00:30
	US	Core PCE QoQ - Q1 S	2.1%	2.1%	00:30
	US	U. of Mich. Sentiment - May F	95.5	95.8	02:00
	CH	Leading Index - Apr	--	99.1	28-31 May
	UK	Nationwide House PX MoM - May	--	0.2%	28 May - 4 Jun
	UK	Nationwide House Px NSA YoY - May	--	4.9%	28 May - 4 Jun

Key: AU: Australia, EC: Eurozone, GE: Germany, JN: Japan, NZ: New Zealand, UK: United Kingdom, US: United States, CH: China.
Source: Dow Jones, Reuters, Bloomberg, ANZ Bank New Zealand Limited. All $ values in local currency.
Note: All surveys are preliminary and subject to change

LOCAL DATA WATCH

Domestic economic momentum is reasonable at present, albeit moderating. However, downside risks exist (mainly from offshore) and with inflation already low, we believe the RBNZ will cut the OCR twice more, with the next cut pencilled in for August.

DATE	DATA/EVENT	ECONOMIC SIGNAL	COMMENT
Wed 25 May (10:45am)	Overseas Merchandise Trade – Apr	Export recovery	Seasonally adjusted export values fell sharply in both February and March. We expect some recovery.
Thu 26 May (2:00pm)	Budget	Slowly on the mend	An ongoing gradual pace of fiscal improvement. The figures overall are looking good relative to many international peers.
Tue 31 May (10:45am)	Building Consent Issuance – Apr	Trending higher	Issuance has been volatility recently. We have some concerns regarding capacity constraints, but issuance should still trend higher.
Tue 31 May (1:00pm)	ANZ Business Outlook – May	--	--
Tue 31 May (3:00pm)	RBNZ Credit Aggregates – Apr	Re-leveraging	Credit growth may not accelerate from current elevated rates, but it remains well above income growth.
Wed 1 Jun (10:45am)	Overseas Trade Indexes – Q1	Terms of trade fall	Previous commodity price falls are still impacting. We expect a further fall in the terms of trade.
Wed 1 Jun (1:00pm)	ANZ Regional Trends – Q1	--	--
Thu 2 Jun (early am)	GlobalDairyTrade Auction	Still low	We still believe the fundamental backdrop is not yet conducive to a meaningful recovery in prices.
Fri 3 Jun (10:45am)	Building Work Put in Place – Q1	Modest lift	Modest increases (circa 2% q/q) in both residential and non-residential volumes are likely.
Fri 3 Jun (1:00pm)	ANZ Commodity Price Index – May	--	--
Tue 7 Jun (10:00am)	ANZ Truckometer – May	--	--
Wed 8 Jun (10:45am)	Economic Survey of Manufacturing – Q1	Mixed	Primary volumes may bounce back a touch, while core production should be reasonable, as signalled by the PMI.
Thu 9 Jun (9:00am)	RBNZ Monetary Policy Statement	On hold	We don't think the economy needs further interest rate support right now. However, a clear easing bias will be retained.
Fri 10 Jun (10:45am)	Electronic Card Transactions – May	Respectable	A number of support factors for consumer spending remain, which should keep the underlying pace respectable overall.
13-17 Jun	REINZ Housing Market statistics – May	Booming	Strength in the regions is being joined by a sharp recovery in Auckland activity. National house price growth is rising again.
Tue 14 Jun (10:45am)	Food Price Index – May	Small lift	A small lift is possible, led by a seasonal gain in fruit and vegetable prices.
Wed 15 Jun (10:45am)	Balance of Payments – Q1	Slightly wider	Courtesy of a deterioration in the goods balance, we expect the annual current account deficit to widen slightly.
Thu 15 Jun (early am)	GlobalDairyTrade Auction	Up off lows, but still low	Prices have lifted off lows, but we still do not believe the fundamental backdrop is conducive to a meaningful recovery.
Thu 17 Jun (10:45am)	GDP – Q1	Not bad	We have pencilled in a 0.7% q/q lift. While this is modestly below the pace of growth over H2 2015, it is still decent.
Fri 17 Jun (10:30am)	BNZ-Business NZ PMI – May	Holding up	Despite the pressures on manufacturing globally, the domestic sector continues to perform well.
Fri 17 Jun (1:00pm)	ANZ-Roy Morgan Consumer Confidence – Jun	--	--
On balance		**Data watch**	**Reasonable momentum at present, but with risks. Inflation remains low.**

KEY FORECASTS AND RATES

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
GDP (% qoq)	0.9	**0.7**	**0.7**	**0.6**	**0.6**	**0.6**	**0.7**	**0.7**	**0.7**	**0.7**
GDP (% yoy)	2.3	**2.8**	**3.1**	**2.8**	**2.5**	**2.4**	**2.4**	**2.5**	**2.6**	**2.7**
CPI (% qoq)	-0.5	0.2	**0.4**	**0.4**	**0.0**	**0.6**	**0.4**	**0.7**	**0.3**	**0.6**
CPI (% yoy)	0.1	0.4	**0.4**	**0.5**	**1.0**	**1.4**	**1.4**	**1.7**	**1.9**	**1.9**
Employment (% qoq)	1.0	1.2	**0.6**	**0.5**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**
Employment (% yoy)	1.4	2.0	**2.3**	**3.3**	**2.7**	**1.9**	**1.7**	**1.6**	**1.6**	**1.6**
Unemployment Rate (% sa)	5.4	5.7	**5.5**	**5.4**	**5.4**	**5.3**	**5.2**	**5.2**	**5.1**	**5.0**
Current Account (% GDP)	-3.0	**-3.3**	**-3.5**	**-4.0**	**-4.6**	**-5.0**	**-5.1**	**-5.0**	**-4.8**	**-4.6**
Terms of Trade (% qoq)	-2.0	**-1.9**	**-3.0**	**-2.7**	**-0.4**	**0.8**	**1.8**	**2.7**	**1.8**	**0.8**
Terms of Trade (% yoy)	-3.2	**-6.1**	**-10.3**	**-9.3**	**-7.8**	**-5.3**	**-0.6**	**5.0**	**7.3**	**7.2**

	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16	May-16
Retail ECT (% mom)	0.5	0.9	0.1	0.7	0.2	0.3	0.7	0.1	0.9	--
Retail ECT (% yoy)	4.2	6.1	5.8	4.6	6.6	5.2	9.2	6.2	7.8	--
Credit Card Billings (% mom)	1.5	-2.0	1.7	0.7	-0.7	1.8	-0.5	-1.4	2.5	--
Credit Card Billings (% yoy)	10.4	7.3	7.8	8.5	7.4	8.2	7.3	4.8	9.1	--
Car Registrations (% mom)	-2.3	0.0	-1.3	-2.0	3.1	-2.8	5.8	-3.6	6.3	--
Car Registrations (% yoy)	7.8	5.0	3.8	1.3	2.4	-1.1	7.4	-0.2	8.7	--
Building Consents (% mom)	-7.1	-4.8	5.0	1.7	2.7	-8.4	10.3	-9.8	--	--
Building Consents (% yoy)	11.1	17.5	14.6	7.2	17.7	4.9	26.7	0.6	--	--
REINZ House Price Index (% yoy)	17.3	20.1	14.1	12.5	12.6	10.7	11.9	13.3	14.5	--
Household Lending Growth (% mom)	0.6	0.7	0.7	0.6	0.6	0.6	0.6	0.6	--	--
Household Lending Growth (% yoy)	6.3	6.7	6.9	7.2	7.4	7.5	7.6	7.7	--	--
ANZ Roy Morgan Consumer Conf.	109.8	110.8	114.9	122.7	118.7	121.4	119.7	118.0	120.0	116.2
ANZ Business Confidence	-29.1	-18.9	10.5	14.6	23.0	..	7.1	3.2	6.2	--
ANZ Own Activity Outlook	12.2	16.7	23.7	32.0	34.4	..	25.5	29.4	32.1	--
Trade Balance ($m)	-1090	-1140	-905	-795	-42	12	367	117	--	--
Trade Bal ($m ann)	52446	52287	52101	52648	52510	52764	52834	52677	--	--
ANZ World Commodity Price Index (% mom)	-5.3	5.6	7.1	-5.6	-1.8	-2.3	0.5	-1.3	-0.8	--
ANZ World Comm. Price Index (% yoy)	-23.6	-18.2	-11.6	-15.3	-12.9	-14.7	-17.8	-22.4	-16.8	--
Net Migration (sa)	5490	5570	6130	6200	5540	6090	6010	5330	5520	--
Net Migration (ann)	60290	61234	62477	63659	64930	65911	67391	67619	68110	--
ANZ Heavy Traffic Index (% mom)	-0.3	1.8	1.0	0.2	3.0	-4.4	1.7	3.3	-2.4	
ANZ Light Traffic Index (% mom)	-0.5	2.6	-0.4	0.3	-1.1	-1.4	2.6	0.5	0.0	

Figures in bold are forecasts. mom: Month-on-Month qoq: Quarter-on-Quarter yoy: Year-on-Year

KEY FORECASTS AND RATES

	ACTUAL			FORECAST (END MONTH)						
FX RATES	Mar-16	Apr-16	Today	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
NZD/USD	0.693	0.698	0.677	0.65	0.63	0.59	0.58	0.58	0.60	0.62
NZD/AUD	0.902	0.918	0.936	0.88	0.88	0.88	0.88	0.88	0.88	0.89
NZD/EUR	0.609	0.609	0.603	0.59	0.59	0.55	0.52	0.50	0.50	0.51
NZD/JPY	77.81	74.31	74.53	68.3	66.2	62.0	58.0	58.0	60.0	62.0
NZD/GBP	0.481	0.477	0.467	0.48	0.43	0.39	0.37	0.37	0.38	0.38
NZ$ TWI	72.2	72.2	73.0	68.6	67.1	63.4	61.4	60.9	61.8	63.1
INTEREST RATES	Mar-16	Apr-16	Today	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
NZ OCR	2.25	2.25	2.25	2.25	2.00	2.00	1.75	1.75	1.75	1.75
NZ 90 day bill	2.34	2.40	2.39	2.40	2.20	2.10	2.00	2.00	2.00	2.00
NZ 10-yr bond	2.93	2.85	2.69	3.00	2.90	2.90	3.10	3.20	3.40	3.50
US Fed funds	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50
US 3-mth	0.63	0.64	0.66	0.83	0.83	1.08	1.08	1.33	1.33	1.58
AU Cash Rate	2.00	2.00	1.75	1.75	1.50	1.50	1.50	1.50	1.50	1.50
AU 3-mth	2.29	2.15	1.99	2.30	2.30	2.40	2.40	2.40	2.40	2.40

	20 Apr	16 May	17 May	18 May	19 May	20 May
Official Cash Rate	2.25	2.25	2.25	2.25	2.25	2.25
90 day bank bill	2.33	2.34	2.35	2.35	2.37	2.38
NZGB 12/17	2.11	2.07	2.10	2.13	2.18	2.17
NZGB 03/19	2.19	2.09	2.12	2.15	2.21	2.20
NZGB 04/23	2.69	2.45	2.49	2.49	2.56	2.55
NZGB 04/27	2.84	2.60	2.63	2.63	2.71	2.70
2 year swap	2.23	2.22	2.23	2.26	2.30	2.31
5 year swap	2.39	2.33	2.36	2.37	2.43	2.42
RBNZ TWI	73.5	72.56	72.67	72.84	72.53	72.88
NZD/USD	0.70	0.68	0.68	0.68	0.67	0.68
NZD/AUD	0.90	0.93	0.93	0.93	0.93	0.94
NZD/JPY	76.45	73.81	74.19	74.11	74.05	74.57
NZD/GBP	0.49	0.47	0.47	0.47	0.46	0.46
NZD/EUR	0.62	0.60	0.60	0.60	0.60	0.60
AUD/USD	0.78	0.73	0.74	0.73	0.72	0.72
EUR/USD	1.14	1.13	1.13	1.13	1.12	1.12
USD/JPY	109.03	108.96	108.97	109.08	110.02	110.15
GBP/USD	1.44	1.44	1.45	1.44	1.46	1.46
Oil (US$/bbl)	40.88	46.22	47.72	48.29	48.12	48.16
Gold (US$/oz)	1251.05	1277.10	1279.40	1275.95	1256.87	1254.55
Electricity (Haywards)	6.77	6.02	6.14	5.59	5.22	5.20
Baltic Dry Freight Index	669	613	643	642	634	625
Milk futures (USD)	44	48	49	49	49	48

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