NEW ZEALAND ECONOMICS
MARKET FOCUS

15 February 2016

INSIDE

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CREDIT WHERE CREDIT'S DUE

ECONOMIC OVERVIEW

Weakness across credit markets is adding to – and symptomatic of – global market angst. We view price action as more akin to 2011 than 2008. New Zealand remains vulnerable to continued weakness in funding markets and commodity unease, although it is structurally far stronger than in prior periods of dislocation. We expect a bumper retail sales figure, which should cement a strong Q4 GDP result. Our eyes are more on the forward data, with consumer confidence to be perused for any offshore impact. Another weak dairy auction looks likely. We expect inflation expectations to nudge a tad lower but not sufficiently to validate the notion that low headline inflation is materially altering expectations.

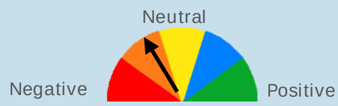
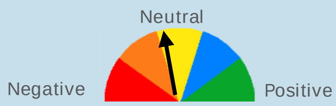
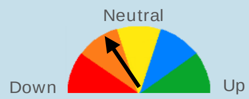
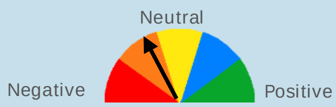
INTEREST RATE STRATEGY

Shifts in sentiment continue to generate considerable market volatility, driving US bond yields towards historic lows. Short-end rates have also drifted lower, but look to have done their dash for now. While the risk profile remains skewed lower, the onus remains on the data to "prove" the case for fresh OCR cuts. We think that is still a way off. The NZGS curve ought to steepen given upcoming supply and the potential for US and global yields to correct higher, but market sentiment is fragile. For investors, the belly of the swap curve is cheap, and enjoys excellent carry. For borrowers, rates are at record lows, but uncertainty is elevated and we prefer to employ optionality.

CURRENCY STRATEGY

We expect the NZD to remain range-bound in the near-term, as market sentiment settles. NZD/USD has displayed resilience to global risk, but the flipside has been a failure to break higher on USD weakness, and to subsequently decline with Friday's improved USD sentiment. NZD/AUD remained equally range-bound. Medium-term risks for the NZD remain skewed lower, with commodity price and global growth unease unlikely to dissipate.

THE ANZ HEATMAP

Variable	View	Comment	Risk profile (change to view)
GDP	2.6% y/y for 2016 Q4	Moderate growth outlook. Downside risks exist (globe) but some local upside risks also evident.	
Unemployment rate	5.4% for 2016 Q4	The demand for labour has recovered, and labour supply is cooling from strong rates. Wage inflation contained.	
OCR	2.50% by Dec 2016	OCR is back at record lows. We have a flat forecast for 2016, with downside risk.	
CPI	1.0% y/y for 2016 Q4	Lower petrol prices and further ACC levy cuts from July expected to keep headline inflation low this year. Core inflation measures likely to remain sub 2%.	

ECONOMIC OVERVIEW

SUMMARY

Weakness across credit markets is adding to – and symptomatic of – global market angst. We view price action as more akin to 2011 than 2008. New Zealand remains vulnerable to continued weakness in funding markets and commodity unease, although it is structurally far stronger than in prior periods of dislocation. We expect a bumper retail sales figure, which should cement a strong Q4 GDP result. Our eyes are more on the forward data, with consumer confidence to be perused for any offshore impact. Another weak dairy auction looks likely. We expect inflation expectations to nudge a tad lower but not sufficiently to validate the notion that low headline inflation is materially altering expectations.

FORTHCOMING EVENTS

Retail Trade Survey – Q4 (10:45am, Tuesday, 16 February). Retail price deflation, strong labour income and a booming tourism sector should support decent volume growth. We have pencilled in a 1.7% q/q lift.

RBNZ Survey of Expectations – Q1 (3:00pm, Tuesday, 16 February). Given petrol price falls, the two-year-ahead measure of inflation expectations may have eased a touch.

GlobalDairyTrade Auction (early am, Wednesday, 17 February). The fundamental backdrop is not conducive to a meaningful recovery in prices.

ANZ Job Ads – Jan (10:00am, Thursday, 18 February).

PPI – Q4 (10:45am, Thursday, 18 February). There is likely to be some impact of the lower NZD and strong wholesale electricity prices. However, the data will otherwise be consistent with sedate price pressures.

ANZ Roy Morgan Consumer Confidence – Feb (1:00pm, Thursday, 18 February).

Government Financial Statements – six months to December (10:00am, Friday, 19 February). Figures should remain relatively close to HYEFU forecasts.

WHAT'S THE VIEW?

Price action across credit markets remains poor. The number of distressed bonds (i.e. those trading at a margin greater than 10%) in the US has lifted sharply this year. Fear has so far been largely confined to junk bond markets, although jitters like those seen in European bank bond markets recently show how nervous markets are, and how easy panic can spread. These concerns are adding additional pressure to markets already reeling from worries over global growth, emerging markets and commodity price falls.

We see price action as more like 2011 than 2008. The former was a timely wake-up call and reminder of complacency risks, as opposed to a precursor to a sustained downturn like 2008. While there are candidates to set off the former (leverage in China being the main one), we are not yet at that juncture.

While mindful of price action, we are viewing events as being part of a necessary structural adjustment. Sugar-pill economics effectively ended when the Fed hiked last year. Yes, the BoJ and ECB are doing more, and others (the Riksbank being the latest) are moving further into negative interest rate territory. But it is the Fed that matters most. **The failure of asset prices to respond to prospects of more liquidity from the ECB and BoJ has been telling.** The sugar pill on offer is no longer so sweet. More disconcertingly, it might just be that markets have less faith in monetary policy-makers full-stop.

Markets are transitioning from being driven primarily by liquidity, to a focus on fundamentals such as growth. And there is not a lot of the latter going round at present (particularly amidst high leverage), so that leads to a wobbly transition. Bad news is now being read as simply bad news. Gone are the days where bad news was seen as good as it foreshadowed more dovish central banks and more cheap money on offer.

Markets will struggle a bit with this transition, but the prior sugar-pill strategy (still the current strategy for some) is akin to rewarding a screaming two-year old with a lolly as a pacifier; hardly sustainable. That doesn't mean more lollies won't be offered; prospects for Fed hikes have all but disappeared and Yellen even fielded questions on the prospect of negative rates in the US last week. The Fed should stand ready to act, but keep the lolly bag away; it's time for the toddler – and the parent – to tough it out a bit.

This transition is not a bad thing. We've been too reliant on monetary policy for too long. In the desire to fix the global economy's problems via liquidity, more challenges have been created by the mispricing of risk and misallocation of capital, which invariably brings attention to the financial sector, with Europe the focal point here. It's not more pump-priming that is required; it's a concerted effort at microeconomic reform to lift growth. This is still the missing ingredient, with politics a major handbrake.

As a debtor nation, New Zealand clearly faces risks from deteriorating funding markets. A dependence on foreign savers has long been the economy's Achilles' heel. **And with funding costs rising, the pressure is on local borrowing and deposit rates to do the same.**

That said, some important context is needed. Directionally, the moves seen in credit markets are

ECONOMIC OVERVIEW

unnerving. But we are still some way away from the extremes recorded in 2008 (or even 2011). The Markit iTraxx index for Australia (comprising 25 equally-weighted investment-grade Australian companies) has risen from around 100bps to over 170bps. In 2009, it peaked at over 400bps!

FIGURE 1. 5-YEAR AUSTRALIAN CORPORATE SPREADS

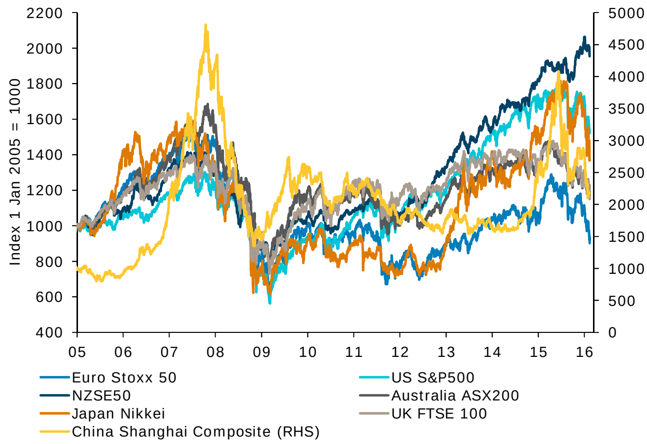
Source: ANZ, Bloomberg

The New Zealand economy is also better placed structurally than it was prior to the GFC.

- **The current account deficit is smaller.** In 2008, the deficit was 8% of GDP. It is now at 3.3%, and actually below its historical average.
- **The national balance sheet is stronger.** Net external debt, at 56% of GDP, is the lowest in 12 years and down from 85% in 2008.
- **We have housing excesses again price-wise but this time around the key driver is a shortage of stock in our largest region. We don't have price and supply excesses concurrently.** We had elements of the both across the nation prior to 2008.
- **Roll-over risk has reduced.** The country's international debt liabilities maturing in less than 90 days has fallen from half of the total in 2008, to less than a quarter now. That buys time.
- **Domestic economic momentum is still strong.** Now that could change quickly, if the signal provided by the tightening seen in financial conditions is anything to go by. But to date, the economy has reasonable momentum, as shown by the latest activity data. Momentum is important; many forget that the economy was already in recession before the GFC actually hit.
- **The microeconomics are better.** Reform has taken place across the welfare, tax and financial system. These changes are hard to measure individually, but together give the economy a better buffer to withstand shocks.

The performance of the NZD amidst current unease is also (frustratingly) telling; it won't go down. Typically it would fall on global credit and equity unease. For sure, USD weakness is adding buoyancy to the NZD. But the resilient NZD is symptomatic of a nation that, while not without its challenges, is wearing one of the cleanest of the dirty shirts. You can see elements of the same thing in the relative performance of the NZX versus global peers. We suspect this reflects not just a macro story but a micro one too (and it is the latter that are deposits in tomorrow's macro story).

FIGURE 2. WORLD EQUITY INDICES



Source: ANZ, Bloomberg

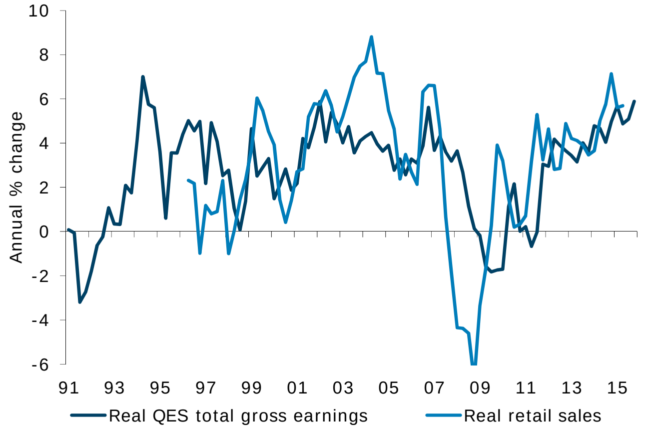
But we must also respect the counter-story. New Zealand's balance sheet metrics are better than pre-2008, but still not strong, and they have shown signs of deterioration recently: household saving is slipping, and leverage is rising. Commodity dependency is still high, and dairy price action is poor amidst high leverage in the sector. Housing is showing bubble-like characteristics in Auckland. We are linked into China both directly and indirectly (via Australia). The balance of power globally is shifting back to the savers; New Zealand is a net borrower. So we can't simply blow off the potential flow through.

We see recent credit market moves as equivalent to perhaps 25-50bps of OCR hikes. Note, however, this represents increases in the marginal cost of funding, as opposed to the average, so we are talking slow-burn pressure if credit price action remains on tenterhooks for a while. The effective mortgage rate is also still easing as fixed rates roll off and looks set to fall a further 10-15bps out to the middle of the year, so we are not set for an immediate rapid tightening. However, this lift in funding costs will maintain pressure on the RBNZ to respond at some stage if price action does not improve. With each passing day, the average cost of funds is rising and the boost from recent mortgage rate cuts is waning; **an inflection point looks to be pending around mid-year.**

ECONOMIC OVERVIEW

Turing to the week ahead, the Retail Trade Survey for Q4 should show solid volume growth. We have pencilled in a decent 1.7% q/q increase. While a softer trend has been evident of late in the likes of ECT data, this does not tell the full story. ECT is based on the nominal value of spending, and with petrol prices falling, food price inflation low, and a backdrop of retail price discounting still generally evident, consumers' retail dollar is going further. On top of this, real gross weekly earnings growth is running at its fastest pace since 1994 (5.9% y/y) and tourist spending is running at a record pace. Together with the cash-flow boost from falling mortgage rates and petrol prices (although the latter is likely to be more evident in figures for 2016), a number of strong pillars continue to support overall consumer spending.

FIGURE 3. RETAIL SALES AND TOTAL GROSS EARNINGS



Source: ANZ, Statistics NZ

Lower petrol prices may see the two-year ahead measure of inflation expectations (from the RBNZ's survey) ease further. In Q4, the two-year measure dipped to 1.85% from 1.94%, although this is still consistent with the inflation target midpoint. Admittedly, we have our misgivings about this survey (and focusing solely on any single particular measure of inflation expectations, for that matter) given its small sample size. Nevertheless, a further dip in expectations at a time when headline inflation is already low reinforces the risk around the OCR profile.

Another fall in prices looks likely at the next GlobalDairyTrade auction. Short-term dairy market dynamics are very challenging. The issue is too much supply, which is partly seasonal, but also linked to structural shifts in the form of increased European supply from efficient producing regions and a lower cost of production (i.e. feed, energy and capital).

NZX futures are pointing to a near 8% fall in the GDT-TWI and 10% for whole milk powder prices. While further price pressure is expected, lower auction volumes at this week's event, higher participation from Chinese buyers at the last auction, and already-low prices suggest the fall may not be as large as implied by the futures market. That said, conducive weather conditions are reportedly seeing strong milk supply growth in Europe; some Chinese buyers could still be on holiday (New Year celebrations); and there has been an increase in the forecast volumes of SMP, AMF, butter and casein at upcoming auctions. The latter indicates the improved seasonal conditions for New Zealand milk supply and the preferred product mix (due to better returns). As we highlighted in our Dairy Update (5th February) further weakness in dairy markets and NZD resilience has seen us revise down our view on the milk price to $3.95/kg MS for 2015/16 and $5.00/kg MS for 2016/17.

Two of our own proprietary indicators (job ads and consumer confidence) are also due this week.

- **Consumer confidence:** In January, sentiment encouragingly held up well (basically unchanged in seasonally adjusted terms). If that has again been the case in February, it will of course provide further evidence that the economy is weathering the global storm well to date.
- **Job ads:** Job advertising rose for the fourth consecutive month in December, clearly pointing to an improvement in labour demand that was later confirmed by the solid Household Labour Force Survey. Not only that, but in each of those four months, the increase was in excess of 1.0% m/m. Together with tentative evidence that the migration cycle is beginning to peak (at record levels of course), we suspect that an improved labour demand backdrop will be enough to absorb new entrants into the labour force and see the unemployment rate continuing to trend lower (outside of some quarterly volatility, that is).

LOCAL DATA

Electronic Card Transactions – Jan. Total retail spending rose 0.3% m/m, while core spending rose 0.6% m/m.

ANZ Monthly Inflation Gauge – Jan. The Gauge posted a 0.6% m/m lift, led by higher tobacco prices. The Underlying Ex-housing Gauge rose 0.1%.

BNZ-Business NZ PMI – Jan. The headline index rose a further 0.9 points to 57.9.

REINZ Housing Market Statistics – Jan. Seasonally adjusted house sales fell 10.3%, while the REINZ House Price Index dipped 0.1% m/m (10.7% y/y).

Food Price Index – Jan. Food prices rose 2.0% m/m, led by a seasonal increase in fruit and vegetable prices.

BNZ-Business NZ PSI – Jan. The index fell 3.1 points to 55.4.

INTEREST RATE STRATEGY

SUMMARY

Shifts in sentiment continue to generate considerable market volatility, driving US bond yields towards historic lows. Short-end rates have also drifted lower, but look to have done their dash for now. While the risk profile remains skewed lower, the onus remains on the data to “prove” the case for fresh OCR cuts. We think that is still a way off. The NZGS curve ought to steepen given upcoming supply and the potential for US and global yields to correct higher, but market sentiment is fragile. For investors, the belly of the swap curve is cheap, and enjoys excellent carry. For borrowers, rates are at record lows, but uncertainty is elevated and we prefer to employ optionality.

THEMES

- Our concern is that markets may have moved too fast too soon, given the solid domestic outlook. Local data is expected to remain resilient, which could see short-term rates unwind part of their recent rally.
- Market volatility and flip-flops continue to characterise price action across markets. The bias is for steepening pressure to assert itself, although this is heavily contingent on the global economy shrugging off recent volatility.
- Nevertheless, the global scene is negatively skewed and we continue to closely monitor the C’s. Credit spreads have widened appreciably since the start of the year. We are closely watching local deposit and borrowing rates for signs of carry-over stresses in funding markets that could pave the way for a lower OCR.
- We continue to see scope for NZ/US yield compression.

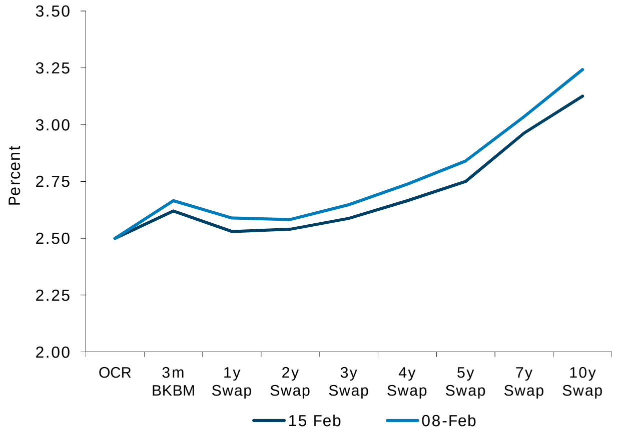
PREFERRED STRATEGIES – INVESTORS

KEY VIEWS – FOR INVESTORS		
GAUGE	DIRECTION	COMMENT
Duration	Neutral	All NZGS yields are at or close to all-time lows, but still high in a global comparison.
2s10s Curve	Neutral/ Steeper	Contingent on global yields correcting higher & local supply.
Geographic 10yr spread	Neutral/ Narrower	Divergent policy argues for gradual narrowing over time.
Swap spreads	Neutral	Long-end spreads at risk of narrowing, given supply.

WATCHING THE DATA

The linkages between commodity, equity, credit, FX, and rates markets are under the spotlight, with thin liquidity amplifying volatility. Despite signs of stabilisation emerging at the end of last week, equity markets have been skittish. Fixed income markets have experienced a significant drop in yields compared to a week ago, with more acute falls for longer durations and a mild “bull-flattening” of the New Zealand swap yield curve (see Figure 1). Lower yields and the flatter curve have contributed to a further scaling back of interest rate expectations with 2y2y and 5y5y rates hovering around record lows.

FIGURE 1. NZ SWAP YIELDS



Source: ANZ, Bloomberg

Our concern is that the short end has moved too fast too soon, given the solid domestic outlook. While there is no doubt where the risk profile resides, it is equally clear that the RBNZ is in no mood to ease, and it will take something more significant to force its hand. Forthcoming data will be key, and this week’s local data is expected to show local resilience, although pockets of weakness (e.g. dairy) should remain apparent. Much of the local economy remains on a solid trajectory and if the market focuses more on the domestic scene, and less on weak offshore market nuances, there is scope for some backing up in short-term yields.

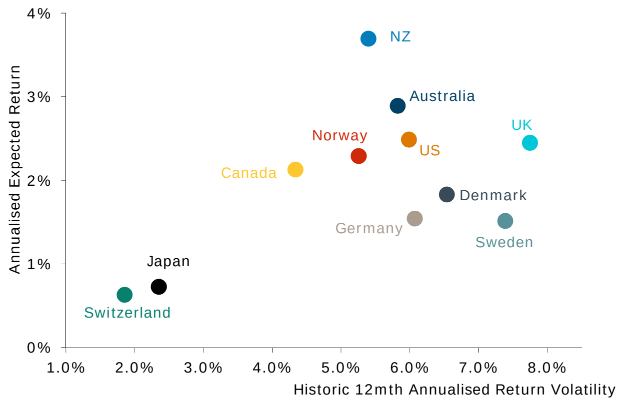
That said, on the local policy front the global scene remains a key focal point, and we are watching our C’s – China, currency, core inflation, commodity markets, credit growth, confidence, and the cost of funds – for signs of stress. We note that the reassessment of risk has contributed to a widening in credit spreads. Various proxies for credit pressures, including CDS spreads, the TED spread, and USD commercial paper rates have pushed higher, suggesting that despite low policy rates, the cost of capital has risen markedly for some. Negative interest rates and flatter yield curves are causing problems for financial institutions and bank debt has seen a significant period of instability, reflected in the noise surrounding the contingent convertible (CoCo) market. **We note that stresses in funding**

INTEREST RATE STRATEGY

markets and the weak commodity price backdrop continue to tighten domestic financial conditions, which flags a potential turn in the hard data in around three months' time.

More generally, the issue for markets is whether the recent spate of volatility is fleeting and merely a blip (the 2011 experience) or the start of a more sustained downturn (like 2008 moves at the time of the GFC). If it's the former, curve steepening is likely to result as long-term rates lift from lows, whereas the latter should see ongoing curve flattening. Our bias is more for curve steepening given local supply pressures (nominal NZGS tenders resume this week) and our forecast of gradually rising US yields. Volatility aside, economics still matters, and the Fed has done its best to play with a straight bat – acknowledging the risk profile and keeping its options open, but also emphasising that the most likely course is for policy rate to go up, albeit gradually.

FIGURE 2. ANNUALISED EXPECTED RISK AND RETURN ON 10-YEAR G10 SOVEREIGN BONDS



Source: ANZ, Bloomberg

Despite the lift in global yields at the end of last week, they remain at historically low levels. Bond yields are in outright negative territory out to at least the five-year tenor for France, Germany and Japan. **Low global rates are likely to maintain investor appetite for yield**, supporting the local market. Crucially, New Zealand's sound fiscal metrics and solid outlook for economic activity should underpin NZD support. NZGS remain an outlier from an expected return perspective (figure 2), and mid-curve swaps continue to earn attractive roll and carry.

PREFERRED STRATEGIES – BORROWERS

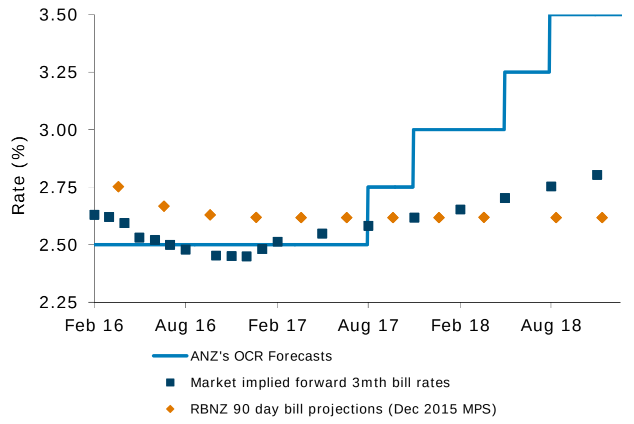
With 10-year swap rates hovering around record lows it is difficult to argue that fixing now does not offer good value, at least from an historical perspective. Given, however, that global rates have yet to find a floor, they may ease further. This – and the volatile trading environment – has us biased towards favouring an **option-based strategy when it comes to new hedging.** We also note that floating rates are also historically cheap, and risks around short-term rates are still biased to the downside. This makes the decision to take on more expensive term cover an even more difficult one (hence our preference for optionality).

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	Low, but the catalyst for an immediate rise is absent.
Uncertainty	Elevated	The key reason for caution.

MARKET EXPECTATIONS

Increased risk aversion has seen a ramping up of local rate-cut expectations. A March OCR cut is about 25% priced, with 28bps of cuts priced in by August and 32bps of cuts priced in by the end of the year.[1] Our core view is for a period of OCR stability, followed by a slow pace of normalisation, but commodity price trends, China developments, funding costs, a spluttering global economy and the benign outlook for inflation keep the risks skewed lower.

FIGURE 3. ANZ OCR FORECAST VERSUS MARKET-IMPLIED FORWARD 3MTH BILL RATES AND RBNZ 90-DAY BILL PROJECTIONS



Source: ANZ, Bloomberg

[1] From July, the new schedule for OCR decisions will be introduced, with four *MPS* and associated OCR announcements each year (in February, May, August and November) and three intervening OCR Reviews (in March, June and September).

CURRENCY STRATEGY

SUMMARY

We expect the NZD to remain range-bound in the near-term, as market sentiment settles. NZD/USD has displayed resilience to global risk, but the flipside has been a failure to break higher on USD weakness, and to subsequently decline with Friday's improved USD sentiment. NZD/AUD remained equally range-bound. Medium-term risks for the NZD remain skewed lower, with commodity price and global growth unease unlikely to dissipate.

TABLE 1: KEY VIEWS			
CROSS	WEEK	MONTH	YEAR
NZD/USD	↔	Mid-range for now	Volatility will remain high
NZD/AUD	↔	Range trading	Above long-run averages
NZD/EUR	↔/↑	Fear to settle	EUR capped by ECB
NZD/GBP	↑	Brexit likely to be in the headlines	GBP resurgence
NZD/JPY	↔/↑	Fear to settle	Yen weakness

THEMES AND RISKS

- China's data wrap this week includes trade, CPI, financing, and FDI. We expect better nuances.
- Global central banks are in calming mode, with the Fed's Dudley calling talk for a return to Fed easing "extraordinarily premature". We expect more of the same from central banks this week.
- We expect a weak GDT auction this week. But so does the market, leaving risks that a less negative number becomes currency positive.
- ANZ consumer confidence is a timely gauge of how volatility is feeding (or not) into local activity.

TABLE 2: KEY UPCOMING EVENT RISK			
EVENT		WHEN (NZDT)	IMPACT RISK
CNY	January Trade	Mon pm	NZD/CNY ↓
NZD	Q4 Retail sales	Tue 10:45	NZD ↓
AUD	RBA minutes	Tue 13:30	NZD/AUD ↔/↑
NZD	Q1 inflation exp.	Tue 15:00	NZD ↓
GBP	CPI, RPI, PPI	Tue 22:30	NZD/GBP ↔/↓
EUR	German ZEW	Tue 23:00	NZD/EUR ↑
NZD	GDT auction	Wed am	NZD ↓
GBP	Employment report	Wed 22:30	NZD/GBP ↔/↓
USD	Housing starts	Thu 02:30	NZD ↔/↑
USD	Fed minutes	Thu 08:00	NZD ↔/↑
NZD	ANZ Job Ads	Thu 10:00	NZD
NZD	Q4 PPI	Thu 10:45	NZD ↓
NZD	ANZ Consumer Conf.	Thu 13:00	NZD
AUD	Employment	Thu 13:30	NZD/AUD ↔/↓
CNY	CPI, PPI	Thu 14:30	NZD/CNY ↔
EUR	ECB AoMP	Fri 01:30	NZD/EUR ↑
USD	Philadelphia Fed	Fri 02:30	NZD/USD ↔/↓
GBP	Retail sales	Fri 22:30	NZD/GBP ↔/↓
USD	January CPI	Sat 02:30	NZD/USD ↓

EXPORTERS' STRATEGY

Exporters should have opportunities to hedge lower, in times when fear dominates market sentiment. While risks do lie lower still, some hedging toward range edges remains prudent.

IMPORTERS' STRATEGY

Importers should look at any rallies as an opportunity to hedge invoices.

DATA PULSE

While overall solid, last week's data highlighted the direction of risk. The ANZ Truckometer declined, but still has a positive trend. QV and REINZ housing data showed Auckland slowing, but the rest of NZ remaining reasonably upbeat. The ANZ Inflation Gauge rose 0.6%, slightly lower than typical for January. Card spending remained solid, yet moderate.

The USD was helped by solid core retail sales at the end of what was a torrid week. Small business optimism and Michigan confidence missed forecasts – but both remain at reasonable levels. Testimony from Fed Chair Yellen acknowledged downside risks, without changing the central tendency.

The AUD was resilient and RBA Governor Stevens was cautiously optimistic. Australian business confidence and conditions continued to ease.

SEK strengthened despite the Riksbank cutting interest rates further into negative territory. Clearly monetary policy alone isn't enough for currencies.

UK data continued to soften, with weak industrial and manufacturing production. The NIESR GDP estimate also softened, and Brexit fears remain.

The EUR followed 'safety' flows higher generally, but European CPI and industrial production were weak.

TABLE 3: NZD VS AUD: MONTHLY GAUGES		
GAUGE	GUIDE	COMMENT
Fair value	↔	FV is above long-run averages.
Yield	↔	Curves look fair.
Commodities	↓	Iron ore stable, milk not so much.
Data	↔/↑	NZ data consistently solid.
Techs	↔	Back to mid-range.
Sentiment	↔	Sentiment improving.
Other	↓	Sentiment suggests was too high.
On balance	↔	**Range trading**

TABLE 4: NZD VS USD: MONTHLY GAUGES		
GAUGE	GUIDE	COMMENT
Fair value	↔	Closer to fair value.
Yield	↔/↑	Yield advantage still present.
Commodities	↓	Commodity markets warning.
Risk aversion	↔	Resilience to risk notable
Data	↔/↓	Peak US pessimism?
Techs	↔/↑	Price action has held well
Other	↓	China remains a key downside.
On balance	↔	**Consolidating, with downside risks.**

CURRENCY STRATEGY

TECHNICAL OUTLOOK

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

NZD/USD continues with the now 7 month pattern of consolidation. The 200dma provides a temporary cap, but we expect this to turn to a pivot as time progresses. Topside resistance in the mid 0.68's and low 0.69's remains formidable and defining of the range, and we expect further consolidation. We also note that support around 0.64 is strengthening.

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

NZD/AUD posted a swift rejection of the top of the range on Friday. This rejection strengthens topside resistance and overall we continue to favour selling toward the top of the recent range. However, support near 0.91 remains pivotal and formidable defining the bottom of the recent range. Should it get to this level, it is worth hedging from a technical perspective.

TABLE 5: KEY TECHNICAL ZONES

CROSS	SUPPORT	RESISTANCE
NZD/USD	0.6480 – 0.6520 0.6330 – 0.6350	0.6780 – 0.6820 0.6940 – 0.6980
NZD/AUD	0.9080 – 0.9120	0.9480 – 0.9520
NZD/EUR	0.5800 – 0.5850 0.5550 – 0.5600	0.6280 – 0.6330
NZD/GBP	0.4400 – 0.4440	0.4650 – 0.4680
NZD/JPY	73.00 – 73.50	79.50 – 80.00 82.40 – 83.00

POSITIONING

EUR shorts were cut by around 30%, contributing to a broad reduction in USD longs. Bucking the trend was leveraged JPY longs which were trimmed. Both AUD and NZD leveraged shorts were reduced.

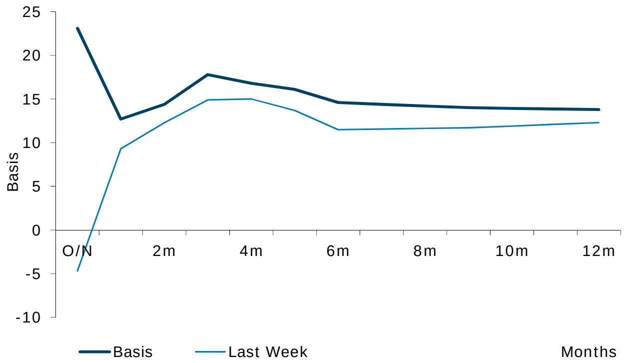
GLOBAL VIEWS

The JPY has benefitted from typical safe haven flows. However, the USD/JPY recording its largest weekly drop since 2009 and the largest two week drop since 1998, has markets asking: has the BoJ lost the ability to weaken the Yen or at least keep it from appreciating?

This question has wider implications than for just JPY. Specifically for NZD is the potential for support from 'carry' in less turbulent times. If markets lose faith in 'funding currencies' remaining weak, such as EUR and JPY, then yield advantage becomes less of a driver. While we believe it is too early to call time on central banks' ability to drive currencies, this question should see markets considering a more diverse set of drivers for currencies, and reduce policy distortion, such as economic prospects for the respective economies (where NZD still performs well), the current account, and terms of trade (both areas of concern for NZD).

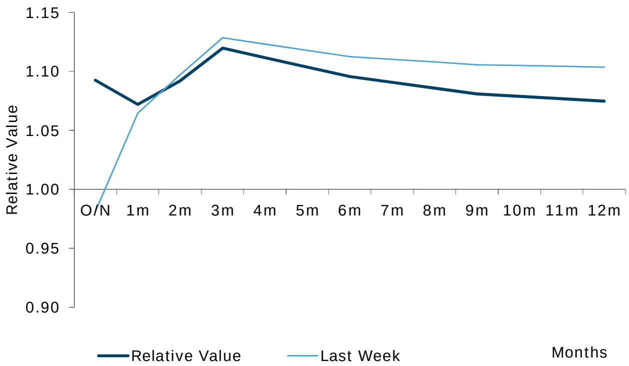
FORWARDS: CARRY AND BASIS

FIGURE 3. NZD/USD SHORT BASIS CURVE



Market fear has seen basis trade wider. The front end has seen demand for cash trading up to OCR+50 over the course of last week. Market demand for NZD cash in uncertain times, reflects global illiquidity and does suggest some short interest in NZD. Despite basis widening, the relative attraction (outright implied yield) of rolls longer than 4m has declined.

FIGURE 4. RELATIVE ATTRACTION OF THE FWD CURVE



Source: ANZ, Bloomberg, Reuters

DATA EVENT CALENDAR

DATE	COUNTRY	DATA / EVENT	MKT.	LAST	NZ TIME
15-Feb	AU	New Motor Vehicle Sales MoM - Jan	--	-0.5%	13:30
	AU	New Motor Vehicle Sales YoY - Jan	--	2.2%	13:30
	NZ	Non Resident Bond Holdings - Jan	--	67.4%	15:00
	EC	Trade Balance SA - Dec	€22.0B	€22.7B	23:00
	EC	Trade Balance NSA - Dec	€27.5B	€23.6B	23:00
	CH	Trade Balance - Jan	$60.60B	$60.09B	UNSPECIFIED
	CH	Exports YoY - Jan	-1.8%	-1.4%	UNSPECIFIED
	CH	Imports YoY - Jan	-3.6%	-7.6%	UNSPECIFIED
	CH	New Yuan Loans CNY - Jan	1900.0B	597.8B	UNSPECIFIED
	CH	Money Supply M2 YoY - Jan	13.5%	13.3%	UNSPECIFIED
16-Feb	NZ	Retail Sales Ex Inflation QoQ - Q4	1.5%	1.6%	10:45
	AU	ANZ-RM Consumer Confidence Index - 14-Feb	--	111.4	11:30
	AU	RBA Feb. Meeting Minutes	--	--	13:30
	NZ	2Yr Inflation Expectation - Q1	--	1.85%	15:00
	UK	CPI MoM - Jan	-0.7%	0.1%	22:30
	UK	CPI YoY - Jan	0.3%	0.2%	22:30
	UK	CPI Core YoY - Jan	1.3%	1.4%	22:30
	UK	Retail Price Index - Jan	259.0	260.6	22:30
	UK	RPI MoM - Jan	-0.6%	0.3%	22:30
	UK	RPI YoY - Jan	1.4%	1.2%	22:30
	UK	RPI Ex Mort Int.Payments (YoY) - Jan	1.4%	1.3%	22:30
	UK	PPI Input NSA MoM - Jan	-1.2%	-0.8%	22:30
	UK	PPI Input NSA YoY - Jan	-8.6%	-10.8%	22:30
	UK	PPI Output NSA MoM - Jan	-0.2%	-0.2%	22:30
	UK	PPI Output NSA YoY - Jan	-0.9%	-1.2%	22:30
	UK	PPI Output Core NSA MoM - Jan	0.1%	0.2%	22:30
	UK	PPI Output Core NSA YoY - Jan	0.0%	0.1%	22:30
	UK	ONS House Price YoY - Dec	--	7.7%	22:30
	GE	ZEW Survey Current Situation - Feb	55.0	59.7	23:00
	GE	ZEW Survey Expectations - Feb	0	10.2	23:00
	EC	ZEW Survey Expectations - Feb	--	22.7	23:00
17-Feb	US	Empire Manufacturing - Feb	-10.5	-19.37	02:30
	US	NAHB Housing Market Index - Feb	60	60	04:00
	US	Total Net TIC Flows - Dec	--	-$3.2B	10:00
	US	Net Long-term TIC Flows - Dec	--	$31.4B	10:00
	AU	Westpac Leading Index MoM - Jan	--	-0.3%	12:30
	UK	Claimant Count Rate - Jan	2.3%	2.3%	22:30
	UK	Jobless Claims Change - Jan	-3.0k	-4.3k	22:30
	UK	Average Weekly Earnings 3M/YoY - Dec	1.9%	2.0%	22:30
	UK	Weekly Earnings ex Bonus 3M/YoY - Dec	1.8%	1.9%	22:30
	UK	ILO Unemployment Rate 3Mths - Dec	5.0%	5.1%	22:30
	UK	Employment Change 3M/3M - Dec	225k	267k	22:30
	EC	Construction Output MoM - Dec	--	0.8%	23:00
18-Feb	US	MBA Mortgage Applications - 12-Feb	--	9.3%	01:00
	US	Housing Starts - Jan	1175k	1149k	02:30
	US	Housing Starts MoM - Jan	2.3%	-2.5%	02:30
	US	Building Permits - Jan	1200k	1204k	02:30
	US	Building Permits MoM - Jan	-0.3%	-6.1%	02:30

Continued on following page

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
18-Feb	US	PPI Final Demand MoM - Jan	-0.2%	-0.2%	02:30
	US	PPI Final Demand YoY - Jan	-0.6%	-1.0%	02:30
	US	PPI Ex Food and Energy MoM - Jan	0.1%	0.2%	02:30
	US	PPI Ex Food and Energy YoY - Jan	0.4%	0.3%	02:30
	US	Industrial Production MoM - Jan	0.4%	-0.4%	03:15
	US	Capacity Utilization - Jan	76.7%	76.5%	03:15
	US	Fed Minutes from Jan 26-27 FOMC Meeting	--	--	08:00
	NZ	ANZ Job Advertisements MoM - Jan	--	1.1%	10:00
	NZ	PPI Input QoQ - Q4	--	1.6%	10:45
	NZ	PPI Output QoQ - Q4	--	1.3%	10:45
	NZ	ANZ Consumer Confidence Index - Feb	--	121.4	13:00
	NZ	ANZ Consumer Confidence MoM - Feb	--	2.3%	13:00
	AU	Employment Change - Jan	13.0k	-1.0k	13:30
	AU	Unemployment Rate - Jan	5.8%	5.8%	13:30
	AU	Participation Rate - Jan	65.2%	65.1%	13:30
	AU	RBA FX Transactions Market - Jan	--	1175M	13:30
	CH	CPI YoY - Jan	1.90%	1.60%	14:30
	CH	PPI YoY - Jan	-5.40%	-5.90%	14:30
	EC	ECB Current Account SA - Dec	--	26.4B	22:00
	EC	Current Account NSA - Dec	--	29.8B	22:00
19-Feb	EC	ECB Account of the Monetary Policy Meeting	--	--	01:30
	US	Philadelphia Fed Business Outlook - Feb	-3	-3.5	02:30
	US	Initial Jobless Claims - 13-Feb	275k	269k	02:30
	US	Continuing Claims - 6-Feb	2250k	2239k	02:30
	US	Leading Index - Jan	-0.2%	-0.2%	04:00
	GE	PPI MoM - Jan	-0.3%	-0.5%	20:00
	GE	PPI YoY - Jan	-2.0%	-2.3%	20:00
	UK	Retail Sales Ex Auto Fuel MoM - Jan	0.7%	-0.9%	22:30
	UK	Retail Sales Ex Auto Fuel YoY - Jan	3.4%	2.1%	22:30
	UK	Retail Sales Inc Auto Fuel MoM - Jan	0.8%	-1.0%	22:30
	UK	Retail Sales Inc Auto Fuel YoY - Jan	3.6%	2.6%	22:30
	UK	Public Finances (PSNCR) - Jan	--	£8.1B	22:30
	UK	Central Government NCR - Jan	--	£20.5B	22:30
	UK	Public Sector Net Borrowing - Jan	-£13.9B	£6.9B	22:30
	UK	PSNB ex Banking Groups - Jan	-£12.3B	£7.5B	22:30
20-Feb	US	CPI MoM - Jan	-0.1%	-0.1%	02:30
	US	CPI YoY - Jan	1.3%	0.7%	02:30
	US	CPI Ex Food and Energy MoM - Jan	0.2%	0.1%	02:30
	US	CPI Ex Food and Energy YoY - Jan	2.1%	2.1%	02:30
	EC	Consumer Confidence - Feb A	-6.6	-6.3	04:00

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 activity has re-accelerated after slowing below trend. Low domestic inflation and global events keep future OCR moves biased to the downside, although our base case remains an extended period of OCR stability.

DATE	DATA / EVENT	ECONOMIC SIGNAL	COMMENT
Tue 16 Feb (10:45am)	Retail Trade Survey – Q4	Robust	Retail price deflation should support volumes, with a solid rate of growth evident.
Tue 16 Feb (3:00pm)	RBNZ Survey of Expectations – Q1	2-year dip	Given petrol price falls, the two-year-ahead measure of inflation expectations may have eased a touch.
Wed 17 Feb (early am)	GlobalDairyTrade Auction	Worrying	The fundamental backdrop is not conducive to a meaningful recovery in prices.
Thu 18 Feb (10:00am)	ANZ Job Ads – Jan	--	--
Thu 18 Feb (10:45am)	PPI – Q4	Down	Some impact of the lower NZD and strong wholesale electricity prices, but otherwise consistent with sedate price pressures.
Thu 18 Feb (1:00pm)	ANZ Roy Morgan Consumer Confidence – Feb	--	--
Fri 19 Feb (10:00am)	Government Financial Statements – Dec	Close to forecast	Figures should remain relatively close to HYEFU forecasts.
Thu 25 Feb (10:45am)	International Travel & Migration – Jan	Still strong	It is hard to think these figures will be anything other than strong for population growth and tourism.
Thu 25 Feb (1:00pm)	ANZ Regional Trends – Q4	--	--
Fri 26 Feb (10:45am)	Overseas Merchandise Trade – Jan	Normal service resumes	The boost in December exports was likely temporary, with a deteriorating trade outlook still expected.
Mon 29 Feb (10:45am)	Building Consents Issued – Jan	Positive trend	Monthly volatility aside, a positive trend in issuance (for both residential and non-residential consents) should persist.
Mon 29 Feb (1:00pm)	ANZ Business Outlook – Feb	--	--
Mon 29 Feb (3:00pm)	RBNZ Credit Aggregates – Jan	Topping out	Credit growth remains strong relative to incomes, but we suspect it is close to a peak.
Tue 1 Mar (10:45am)	Overseas Trade Indexes – Q4		While lower oil prices are providing some offset, weaker export prices should see the terms of trade fall again.
Tue 1 Mar (12:00pm)	QV House Prices – Feb	Peaked	Policy changes and affordability constraints have cooled the Auckland market, and with it the nationwide figures.
Wed 2 Mar (early am)	GlobalDairyTrade Auction	Worrying	The fundamental backdrop is not conducive to a meaningful recovery in prices.
Thu 3 Mar (10:45am)	Building Work Put in Place – Q4	Decent	The construction sector is performing solidly, with quarterly gains expected in both residential and non-residential work.
Thu 3 Mar (1:00pm)	ANZ Commodity Price Index – Feb	--	--
Tue 8 Mar (10:00am)	ANZ Truckometer – Feb	--	--
Tue 8 Mar (10:00am)	Economic Survey of Manufacturing – Q4	Solid	Primary volumes may contract. However, core manufacturing production should record some modest growth.
Wed 9 Mar (10:45am)	Electronic Card Transactions – Feb	Respectable	Lower petrol prices may weigh on the headline figure. However, a number of factors should keep spending growth respectable.
Thu 10 Mar (9:00am)	RBNZ *Monetary Policy Statement*	On hold	Risks to the outlook are clear. However, given the solid domestic growth backdrop, the RBNZ will remain watchful.
Fri 11 Mar (10:30am)	BNZ-Business NZ PMI – Feb	Domestic support	Despite dairy challenges and global turmoil, the sector is benefiting from a strong domestic economy.
Fri 11 Mar (10:45am)	Food Price Index – Feb	Reversal	A partial reversal of January's lift is expected.
On balance		**Data watch**	**Improvement, but with risks. Inflation remains low.**

KEY FORECASTS AND RATES

	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
GDP (% qoq)	0.9	**0.5**	**0.5**	**0.7**	**0.7**	**0.7**	**0.7**	**0.7**	**0.6**	**0.6**
GDP (% yoy)	2.3	**1.9**	**2.2**	**2.6**	**2.5**	**2.6**	**2.8**	**2.8**	**2.7**	**2.7**
CPI (% qoq)	0.3	-0.5	**0.2**	**0.4**	**0.4**	**0.0**	**0.6**	**0.4**	**0.7**	**0.3**
CPI (% yoy)	0.4	0.1	**0.4**	**0.4**	**0.5**	**1.0**	**1.4**	**1.4**	**1.7**	**1.9**
Employment (% qoq)	-0.5	0.9	**0.6**	**0.5**	**0.5**	**0.5**	**0.4**	**0.4**	**0.4**	**0.4**
Employment (% yoy)	1.4	1.3	**1.2**	**1.6**	**2.6**	**2.1**	**1.9**	**1.8**	**1.7**	**1.7**
Unemployment Rate (% sa)	6.0	5.3	**5.8**	**5.7**	**5.6**	**5.4**	**5.3**	**5.3**	**5.2**	**5.1**
Current Account (% GDP)	-3.2	**-3.1**	**-3.4**	**-3.9**	**-4.7**	**-5.7**	**-6.4**	**-6.8**	**-6.6**	**-6.1**
Terms of Trade (% qoq)	-3.7	**-2.0**	**-4.1**	**-6.9**	**-6.0**	**-4.3**	**-0.2**	**2.9**	**4.7**	**3.9**
Terms of Trade (% yoy)	-3.4	**-3.0**	**-8.1**	**-15.7**	**-17.8**	**-19.7**	**-16.5**	**-7.6**	**3.0**	**11.8**

	Apr-15	May-15	Jun-15	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15	Jan-16
Retail ECT (% mom)	-0.6	1.3	0.5	0.4	0.5	0.9	0.1	0.8	0.1	0.3
Retail ECT (% yoy)	3.9	3.2	5.0	5.6	4.2	6.1	5.8	4.6	6.6	5.2
Credit Card Billings (% mom)	0.0	1.9	0.3	1.7	1.3	-1.9	1.7	0.6	-0.8	--
Credit Card Billings (% yoy)	7.2	7.3	6.7	9.7	10.4	7.3	7.8	8.4	7.4	--
Car Registrations (% mom)	-1.4	-0.4	5.2	0.6	-2.3	0.1	-1.4	-2.1	2.8	-3.1
Car Registrations (% yoy)	11.2	6.8	11.2	10.7	7.8	5.0	3.8	1.3	2.4	-1.1
Building Consents (% mom)	-0.5	1.0	-3.6	21.7	-6.9	-5.7	5.1	2.4	2.3	--
Building Consents (% yoy)	2.6	6.6	-3.8	21.9	12.0	17.1	14.4	8.0	17.3	--
REINZ House Price Index (% yoy)	9.3	11.8	14.8	14.9	17.3	20.1	14.1	12.5	12.6	10.7
Household Lending Growth (% mom)	0.5	0.6	0.6	0.7	0.6	0.7	0.7	0.6	0.6	--
Household Lending Growth (% yoy)	5.2	5.5	5.6	6.0	6.3	6.7	7.0	7.2	7.4	--
ANZ Roy Morgan Consumer Conf.	128.8	123.9	119.9	113.9	109.8	110.8	114.9	122.7	118.7	121.4
ANZ Business Confidence	30.2	15.7	-2.3	-15.3	-29.1	-18.9	10.5	14.6	23.0	--
ANZ Own Activity Outlook	41.3	32.6	23.6	19.0	12.2	16.7	23.7	32.0	34.4	--
Trade Balance ($m)	184	367	-182	-730	-1090	-1140	-904	-799	-53	--
Trade Bal ($m ann)	51298	50976	51371	51643	52446	52287	52102	52650	52530	--
ANZ World Commodity Price Index (% mom)	-7.4	-4.8	-3.1	-5.5	-5.3	5.6	7.1	-5.6	-1.8	-2.3
ANZ World Comm. Price Index (% yoy)	-15.3	-18.0	-19.7	-22.1	-23.6	-18.2	-11.6	-15.3	-12.9	-14.7
Net Migration (sa)	4820	5120	4940	5760	5510	5610	6140	6190	5510	--
Net Migration (ann)	56813	57822	58259	59639	60290	61234	62477	63659	64930	--
ANZ Heavy Traffic Index (% mom)	-0.1	-1.1	1.7	-0.1	-0.3	1.8	1.1	0.4	2.6	-4.3
ANZ Light Traffic Index (% mom)	0.3	-0.7	0.9	-0.3	-0.5	-1.2	-0.3	0.3	1.0	-1.4

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	Dec-15	Jan-16	Today	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
NZD/USD	0.685	0.648	0.663	0.63	0.61	0.59	0.59	0.60	0.61	0.63
NZD/AUD	0.937	0.915	0.933	0.94	0.94	0.92	0.92	0.92	0.92	0.93
NZD/EUR	0.628	0.599	0.590	0.60	0.60	0.55	0.54	0.54	0.53	0.53
NZD/JPY	82.52	78.55	75.29	73.7	70.2	67.9	67.9	67.2	67.1	69.3
NZD/GBP	0.463	0.455	0.457	0.45	0.44	0.41	0.39	0.39	0.39	0.39
NZ$ TWI	73.7	70.5	72.2	69.7	68.4	65.3	64.6	64.8	64.9	65.8
INTEREST RATES	Dec-15	Jan-16	Today	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
NZ OCR	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.75
NZ 90 day bill	2.75	2.70	2.60	2.80	2.70	2.70	2.70	2.70	2.80	3.10
NZ 10-yr bond	3.57	3.22	3.02	3.80	3.80	3.80	3.90	3.90	3.90	3.90
US Fed funds	0.50	0.50	0.50	0.50	0.75	1.00	1.25	1.25	1.50	1.75
US 3-mth	0.61	0.61	0.62	0.83	1.08	1.33	1.33	1.33	1.33	1.33
AU Cash Rate	2.00	2.00	2.00	2.00	1.75	1.50	1.50	1.50	1.50	1.50
AU 3-mth	2.38	2.29	2.28	2.10	2.30	2.40	2.40	2.40	2.40	2.40

	12 Jan	8 Feb	9 Feb	10 Feb	11 Feb	12 Feb
Official Cash Rate	2.50	2.50	2.50	2.50	2.50	2.50
90 day bank bill	2.74	2.67	2.64	2.64	2.63	2.62
NZGB 12/17	2.60	2.53	2.47	2.50	2.48	2.45
NZGB 03/19	2.71	2.62	2.54	2.57	2.55	2.53
NZGB 04/23	3.36	3.14	3.01	3.03	3.01	2.99
NZGB 04/27	3.75	3.49	3.36	3.38	3.36	3.33
2 year swap	2.69	2.60	2.56	2.58	2.54	2.53
5 year swap	2.97	2.79	2.71	2.73	2.69	2.67
RBNZ TWI	72.0	72.67	71.83	72.05	72.30	72.40
NZD/USD	0.6530	0.67	0.66	0.66	0.67	0.67
NZD/AUD	0.9386	0.93	0.94	0.94	0.94	0.94
NZD/JPY	76.56	78.18	75.26	75.91	75.24	74.92
NZD/GBP	0.4497	0.46	0.46	0.46	0.46	0.46
NZD/EUR	0.5979	0.60	0.59	0.59	0.59	0.59
AUD/USD	0.6957	0.72	0.70	0.71	0.71	0.71
EUR/USD	1.0921	1.12	1.12	1.13	1.13	1.13
USD/JPY	117.25	116.83	114.32	114.70	112.86	112.37
GBP/USD	1.4520	1.46	1.44	1.45	1.45	1.45
Oil (US$/bbl)	33.20	31.63	29.71	27.96	27.54	26.19
Gold (US$/oz)	1103.51	1156.30	1193.20	1190.65	1206.45	1233.65
Electricity (Haywards)	8.26	5.83	6.61	7.25	8.36	8.20
Baltic Dry Freight Index	402	293	291	290	290	291
Milk futures (USD)	32	32	30	30	29	32

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