ANZ RESEARCH

NEW ZEALAND ECONOMICS
MARKET FOCUS

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INSIDE

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LEADING AND LAGGING

ECONOMIC OVERVIEW

Deteriorating global credit markets (funding costs are on the rise) and the ongoing weakness in export prices (beyond just dairy) is a nasty mix. It highlights tension between where key leading indicators are headed – or could be headed (financial conditions have tightened a lot but confidence is holding up) – and lagging ones (the labour market is performing well). We're not seeing concerted signs of a turn in the former that would necessitate altered views towards the NZD and OCR, but we're watchful. Activity data this week should hold up okay, while our Monthly Inflation Gauge comes at a favourable time to add more to the 'diverging headline versus core' inflation outlook debate.

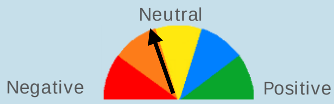
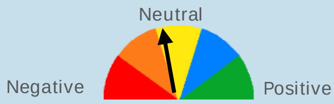
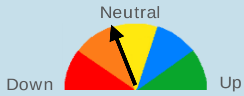
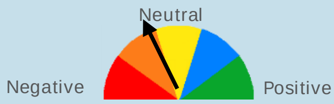
INTEREST RATE STRATEGY

Risk aversion continues to dominate sentiment, with curves flattening as long-term interest rates push lower, going against the grain of consensus forecasts. Pricing across credit markets looks ominous but we continue to view playing from the long side as requiring patience, given the resilience of the New Zealand economy so far. We expect a further period of consolidation in long-end yields as markets digest the tone of global data and events.

CURRENCY STRATEGY

NZD/USD is mid-range (0.64-0.68) with volatility high. We expect NZD/USD to continue to range trade, with sentiment swings presenting opportunities to both exporters and importers. However, the medium-term risks for the NZD still remain skewed lower; China risks abound, commodity and credit price action is poor, questions will surround how long NZ can swim against the global growth tide, and we still expect a firmer USD to dominate. NZD/AUD is overvalued, but doesn't look extended.

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

Deteriorating global credit markets (funding costs are on the rise) and the ongoing weakness in export prices (beyond just dairy) is a nasty mix. It highlights tension between where key leading indicators are headed – or could be headed (financial conditions have tightened a lot but confidence is holding up) – and lagging ones (the labour market is performing well). We're not seeing concerted signs of a turn in the former that would necessitate altered views towards the NZD and OCR, but we're watchful. Activity data this week should hold up okay, while our Monthly Inflation Gauge comes at a favourable time to add more to the 'diverging headline versus core' inflation outlook debate.

FORTHCOMING EVENTS

REINZ Housing Market Statistics – Jan (possibly later this week). Monthly numbers are likely to be volatile, but we expect to see decent volume and price growth in non-Auckland regions. But with Auckland price growth continuing to cool, overall nationwide figures probably will too.

Electronic Card Transactions – Jan (10:45am, Wednesday, 10 February). Sharply lower petrol prices could weigh on overall nominal spending values, but we suspect the underlying story will be respectable. We expect a 0.5% m/m lift in total retail spending.

ANZ Monthly Inflation Gauge – Jan (1:00pm, Wednesday, 10 February).

BNZ-Business NZ PMI – Jan (10:30am, Thursday, 11 February). Manufacturing sentiment has held up well, although it will be interesting to see if global market turmoil has impacted.

Food Price Index – Jan (10:45am, Friday, 12 February). The global commodity price rout is weighing on local food price inflation, although we expect a seasonal lift in January.

BNZ-Business NZ PSI – Jan (10:30am, Monday, 15 February). The services sector is one of the outperformers of this current expansion. This data should be consistent with that.

WHAT'S THE VIEW?

Late last week we lowered our forecast for the Fonterra dairy payout. We have downgraded our expectation for this season to $3.95/kg MS (from $4.25), but significantly, now see next season's payout at just $5/kg MS (from $5.50). **It's the latter that is more noteworthy as it signals a continuation of negative cash-flow** (we consider breakeven to be now in the low $5s).

The economic knock-on from this to the dairy sector and broader economy will be substantial. While the dairy sector is just under 5% of GDP in a direct sense, the indirect channel is closer to 10% of GDP (if not more). Lower dairy prices are at the forefront of a near-20% expected fall in New Zealand's goods terms of trade over 2016. That's a huge hit to the economy's purchasing power and the magnitude of shock is enough to knock up to 3 percentage points off real GDP growth over the subsequent two years. Next season will represent the second successive season of a sub-breakeven payout (in terms of pure farm cash-flow, as opposed to the headline payout, which will be three years sub-par). **A further step lower in dairy prices is also coming at a time global funding costs are on the rise; that's a nasty mix.**

Expectations of continued weakness in the commodity complex (it is not only dairy prices that have been weakening) **highlights tension between what is a leading indicator versus lagging ones such as the labour market.** Volatility in the unemployment rate aside last week, there is no doubt the latter is performing well.

In assessing this tension between leading and lagging indicators, a few key leading numbers will take on pronounced importance over the coming months. The likes of consumer and business confidence will be critical. We've seen today a pull-back in our Truckometer for January, but we're putting it down to monthly noise at this stage. Anecdotes around the country still look reasonably positive to us, particularly many regional housing markets.

The transmission of rising funding costs to the broader economy is set to become a more notable part of the economic story over the coming months. Global credit spreads have widened, and while they are well below levels reached at the height of the GFC, they are elevated compared to where they have been over the past three years. Recently (and more worrying) concern appears to be shifting from highly indebted oil-related companies to European financial institutions. The cost of insuring corporate bonds for European banks and insurers is the highest since 2013. The Fed's Senior Loan Officer Survey is pointing to less appetite to lend. All this may be occurring offshore but it still flags tighter financial conditions via the credit channel of monetary policy locally, which monetary policy may eventually need to offset.

We've seen local financial conditions tighten significantly (figure 2 over). This has us wary, although it's not yet sufficient for us to shift our economic tune. That said, on the face of it, this tightening suggests growth could slow back towards 2-2.5 percent. It has us very alert to signs of a

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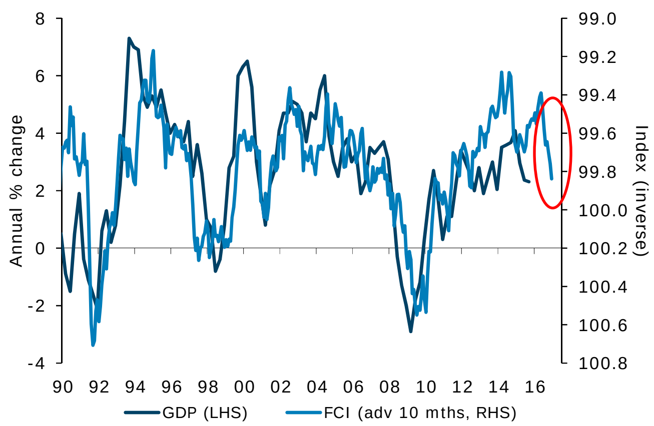
potential turn in the other leading gauges we monitor including business and consumer confidence, our Truckometer (down in January, as previously noted) and the likes of the PMI and PSI surveys.

FIGURE 1. 5-YEAR AUSTRALIAN CORPORATE SPREADS

Source: ANZ, Bloomberg

With low international dairy prices, a lower dairy payout extending pressure on cash-flow until 2017/18, rising funding costs and the NZD back up again, pressure will remain for the OCR to move lower. The December *MPS* included a low export price scenario that required 50bps of further easing.

FIGURE 2. GDP VS FINANCIAL CONDITIONS



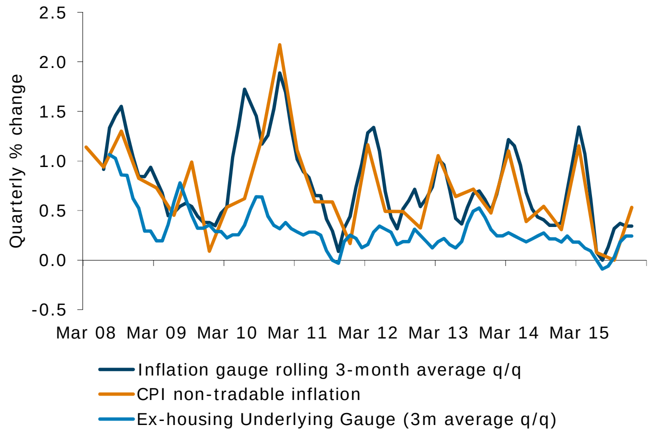
Source: ANZ, Bloomberg, Statistics NZ

However, we are not yet at that juncture. The rest of the economy is generally vibrant and performing well and until we see material signs of a turn on that front, we'll remain in the 'no change' OCR camp. **Key obstacles for us calling the OCR lower at this point include uncertainty over the path of core inflation (looks slightly up), very solid credit growth (leveraging behaviour), and confidence across the economy that is still strong.**

The RBNZ looks to be in a similar mood, given last week's 'take that' swat by the Governor at commentators calling the OCR lower on continued low headline inflation prints. We'll respond to the weak headline inflation environment if we see inflation expectations shift in association. But for now, a holding pattern for the OCR beckons.

Looking at the week ahead, our Monthly Inflation Gauge for January will shed some light on the debate over the path for core inflation. The headline Gauge recorded monthly increases of 0.2% in both November and December last year, with prices up 0.3% on a 3m/3m basis. This is of course low, and we suspect structural factors are playing a role in suppressing price pressures (as they appear to be offshore). That said, the past few months have shown that there is the odd hint of price tension in a few pockets where capacity pressures are evident, namely construction and tourism. Therefore, we will be interested in the January figures (outside of the now-standard lift in tobacco excise tax) to see if that has continued or even intensified.

FIGURE 3. MONTHLY INFLATION GAUGE AND NON-TRADABLE CPI



Source: ANZ, Statistics NZ

Regional divergences will surely again be on show within the January REINZ housing figures, although we suspect we'll see some further moderation in nationwide price growth. Barfoot & Thompson (B&T) data for Auckland last week showed a further recovery in sales volumes after the sharp policy-driven slowing over October/November last year. That said, turnover is still 16% below the July to September average and Auckland price growth has also continued to moderate, with annual growth slowing to 7.2% – the lowest in 10 months. This is consistent with REINZ figures, which in December showed Auckland prices down 2.4% on a quarterly basis – the first quarterly fall since September 2008. A further moderation in Auckland price growth should weigh on the nationwide figures. That said, this should be offset by renewed strength in a number of other regions as

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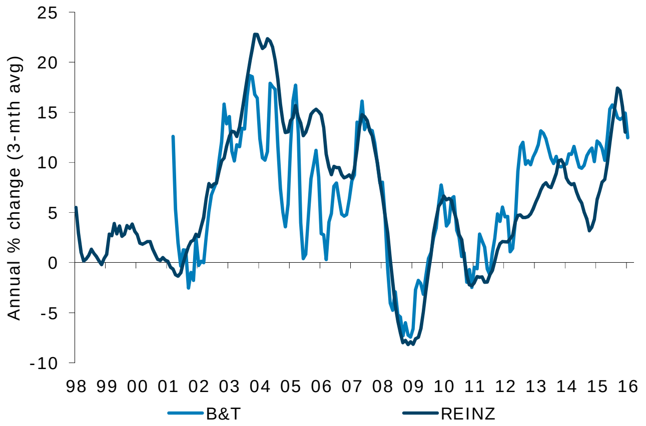
low mortgage rates, strong population growth, regulatory changes (LVR policy loosening) and better affordability support regional market activity.

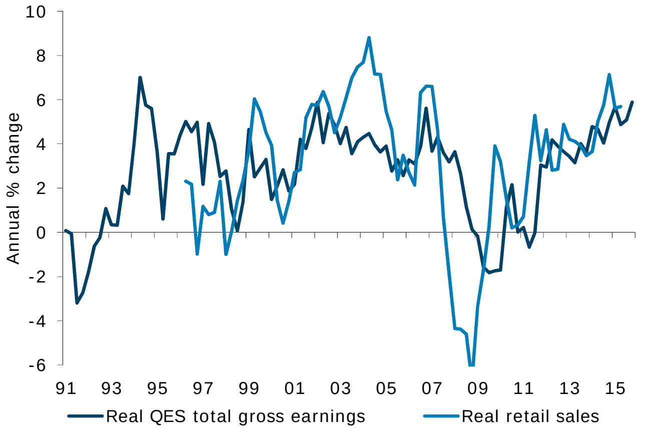
FIGURE 4. BARFOOT & THOMPSON VERSUS REINZ HOUSE PRICES



Source: ANZ, Barfoot & Thompson, REINZ

While lower retail fuel prices may mechanically weigh on the headline value of electronic card spending in January, we are expecting a respectable story under the hood. We estimate that local petrol prices fell around 3% in January, which all else equal will weigh on the nominal value of spending. Together with soft annual food price inflation and retail discounting more generally, we believe falling fuel prices are a key factor behind the value of total retail ECT spending slowing to 0.7% on a 3m/3m basis in December, from rates over 1½% earlier in the year.

FIGURE 5. REAL TOTAL GROSS EARNINGS AND RETAIL SPENDING



Source: ANZ, Statistics NZ

We suspect that the underlying volume story for spending looks even better (the Q4 Retail Trade Survey later this month should confirm that). With the ongoing support provided by low mortgage rates, strong net migration gains, stellar visitor arrival numbers, the discretionary cash-flow benefit that lower petrol prices deliver and the fact that labour income growth is now actually accelerating (despite subdued wage inflation, total gross earnings are running at nearly 6% in real terms), the underlying story for retail spending should be respectable. That will help boost expectations for Q4 GDP. It's another lagging economic signal but we'll take it.

Finally, January Business NZ sentiment gauges for the manufacturing and services sectors are expected to hold up well, although we will be on the lookout for any negative spill-over from global concerns. At 56.7 and 58.9 in December respectively, the PMI and PSI are both sitting at levels well above historical averages and consistent with the solid performance of the domestic economy more generally. Across the globe, outperformance of the services sector is now a reasonably common theme. However, the strength of local manufacturing sector confidence is certainly somewhat of an outlier in a global context and highlights the support the sector is receiving from the strong construction sector pipeline, for example. In general, we expect these themes to have continued, although as this morning's Truckometer hinted, signs of a turn in domestic economic prospects are on our watch-list.

LOCAL DATA

ANZ Commodity Price Index – Jan. The world price index fell 2.3% m/m, with the index down a more modest 0.4% m/m in NZD terms.

GlobalDairyTrade Auction. The GDT-TWI fell a further 7.4%, with whole milk powder prices dropping 10.4%.

Labour Market Statistics – Q4. Employment grew by 0.9% q/q. But courtesy of a 0.3ppt fall in the participation rate, the unemployment rate fell 0.7ppt to 5.3%. Annual growth in LCI private sector wages was 1.6%.

Barfoot and Thompson Auckland Housing Market Statistics – Jan. In seasonally adjusted terms, house sales rose a solid 12.5% m/m, with average sale prices flat (+7.2% y/y).

ANZ Truckometer – Jan. The Heavy Traffic Index fell 4.3% m/m, while the Light Traffic Index fell 1.4%m/m.

QV House Prices – Jan. Nationwide house price growth cooled to 12.6% y/y from 14.2% y/y on a three-month average basis.

INTEREST RATE STRATEGY

SUMMARY

Risk aversion continues to dominate sentiment, with curves flattening as long-term interest rates push lower, going against the grain of consensus forecasts. Pricing across credit markets looks ominous but we continue to view playing from the long side as requiring patience, given the resilience of the New Zealand economy so far. We expect a further period of consolidation in long-end yields as markets digest the tone of global data and events.

THEMES

- Expect risk aversion to dominate market trends, with day-to-day volatility apparent. We expect the yield curve to flatten further, led by the long end.
- Central banks have acknowledged the risks but markets are sceptical over how much they can deliver. Yellen's congressional testimony this week will provide an opportunity to try to right the ship.
- The RBNZ maintains an explicit easing bias, but has signalled rate cuts are not imminent or inevitable. Some unwinding of receive-side trades in our front end has been apparent and resulted in some firming in near-term pricing.
- Our core view is for no OCR cuts over 2016, but the large risk profile towards cuts and the likelihood that local rates will remain low for longer have us biased towards the received side if the sell-off in near-term rates continues.
- Local long-term yields have generally fallen in unison with global peers. We expect long-term yields to trend higher but in the absence of imminent turnaround in US yields the timing is uncertain.

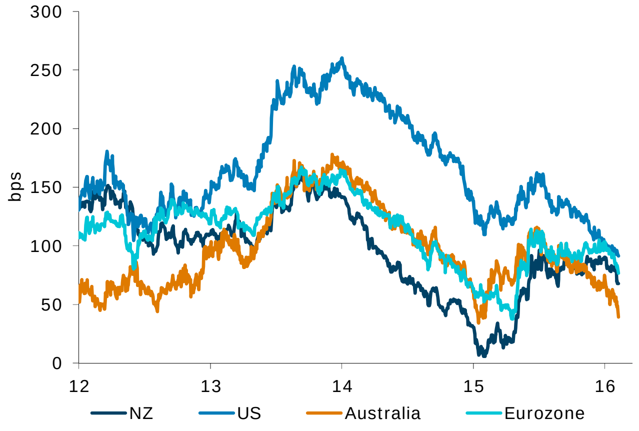
PREFERRED STRATEGIES – INVESTORS

KEY VIEWS – FOR INVESTORS		
GAUGE	**DIRECTION**	**COMMENT**
Duration	Neutral	Close to historic lows across the curve. More about spreads and curves.
2s10s Curve	Steeper	Flattening pressure likely to remain until US long-term rates find a floor.
Geographic 10yr spread	Narrower	Divergent policy argues for further narrowing.
Swap spreads	Neutral	Stabilising, but still low.

FLIP FLOPS

The market has continued to flip-flop from day to day with equities, bond yields and commodity prices tending to move in unison. **While no single clear catalyst behind these moves is evident, increasing risk aversion has characterised moves since the start of the year.** Equities are below start-of-year levels; commodity prices are on the skids (we have revised down our estimates of the Fonterra milk price for both this season and next to NZD3.95 kg/MS and NZD5.00 kg/MS respectively); measures of market volatility remain elevated. Credit market developments look worrying with pressures filtering through to European financials, and we are watching the local scene for signs of spill-over. Global and local yields have rallied and curves have flattened (see figure 1). Local long-term yields have generally fallen in unison with global peers, although shorter-term local yields have not fully participated in the global rally.

FIGURE 1. 2S10S FROM SWAP RATES



Source: ANZ, Bloomberg

It is in this environment that recent comments from central banks have been particularly noteworthy, although the amount of scepticism over what they can do to stabilise the situation has arguably grown following the BoJ's surprise cut and its failure to stabilise markets. Last week's speech by RBNZ Governor Wheeler stuck to the script, signalling that an easing bias was in place, but he was in no immediate hurry to exercise it. This week's local data will shed light on the pace of economic activity (January ECT, PMIs), asset prices (January REINZ housing data) and core inflation (Monthly Inflation Gauge), all of which will be examined for consistency with the 'on hold' OCR message and the bias towards the unwinding or setting of receive-side trades. In a similar vein were comments by BoE Governor Carney in which all nine MPC voters expected the next move in rates to be up. UK market pricing is still biased more towards rate cuts.

While our core view is that the OCR will be left on hold over 2016, the risk profile is skewed to the downside. **Pressures in credit and funding markets remain on our watch list and while domestic retail deposit and lending rates have not moved as yet, the risk is that funding pressures will filter through into higher borrowing costs, particularly if growth in local credit remains well above that of incomes**. Increases in implied funding costs for Australasian corporates have followed those of their

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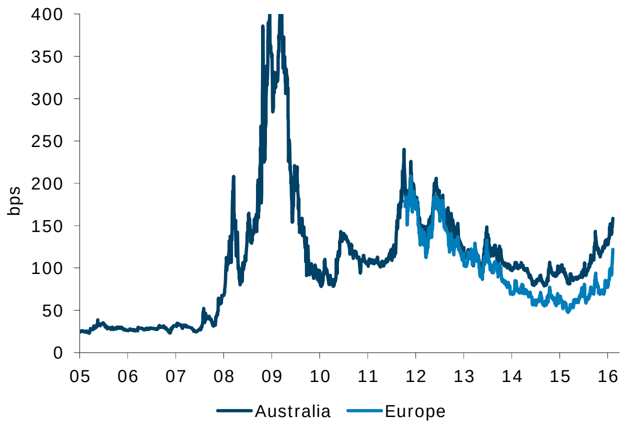
European counterparts upwards. The elevated NZD TWI and the weak terms of trade outlook (a 20% fall in the OTI goods terms of trade expected over 2016) keep the bias firmly towards a lower OCR.

FIGURE 2. 5 YEAR CORPORATE SPREADS



Source: ANZ, Bloomberg

The Fed's Dudley warned against drawing firm conclusions, but conceded if the recent tightening in US financial conditions were sustained it would have a bearing on US rate settings. Certainly, our US FCI points to a pending deceleration in growth, consistent with a 'low for longer' view on US rates. This view appears to have permeated through to global long-term yields. US 10-year Treasury yields sit at 1.75% and have fallen by around 50bps since the start of the year. The BoJ cut has helped push Japanese 10-year bond yields close to record lows (just 0.03%), and with the ECB expected to add to policy stimulus, core Eurozone yields are well below start-of-year levels, with French and German yields negative out to the 5-year maturity. **Local long-term yields have generally fallen in step with global peers.** Given our high outright yields (the only 10-year yields in the G10 north of 3%) there is scope for local yields to outperform global equivalents, which could add to further pressure to flatten the curve. The impact on the NZD TWI – more than 4% higher than assumed in the December *MPS* – is also expected to maintain flattening pressure, via its impact on shorter-term rates.

Abstracting from reasonable signs of solidity in the US labour market and better signs for Q1 US GDP, mixed US data, global concerns and risk aversion have seen the market continue to scale back anticipated Fed tightening, with just 34% odds of a further 25bp hike by the end of the year. **All eyes will now be on Fed President Yellen's semi-annual testimony this week for signs of the extent to which recent events have impacted the Fed's view, and whether a data-dependent and gradual path of Fed tightening remains on track.**

PREFERRED STRATEGIES – BORROWERS

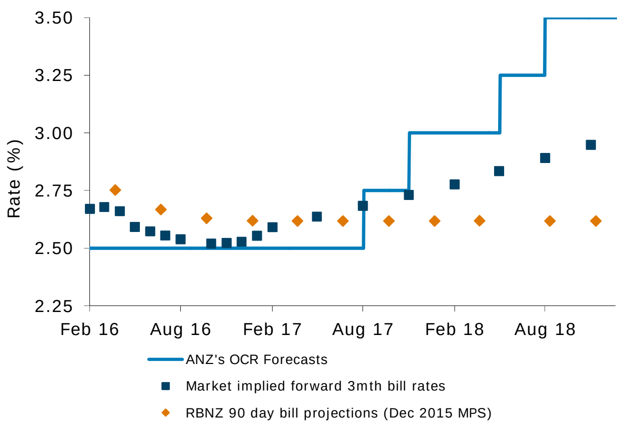
Our forecast for global long-term interest rates to rise gradually is being challenged by markets at the moment. With the 10-year swap rate back at record lows it is difficult to argue that fixing now does not offer good value, at least from a historical perspective. We need to ask, whether there is scope for them to ease further soon. Given this can't be ruled out in the current environment we **favour employing an option-based strategy when it comes to new hedging.** We also note that, floating rates are also historically cheap, and risks to 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

Near-term rate cut expectations have been scaled back considerably, but the market remains biased towards a lower OCR. A March 2016 cut is close to 15% priced, with a 25bp cut not fully priced in until September.[1] While our core view is for a period of OCR stability, followed by a slow pace of normalisation, commodity price trends, China, funding costs, a spluttering global economy and 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 is 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

NZD/USD is mid-range (0.64-0.68) with volatility high. We expect NZD/USD to continue to range trade, with sentiment swings presenting opportunities to both exporters and importers. However, the medium-term risks for the NZD still remain skewed lower; China risks abound, commodity and credit price action is poor, questions will surround how long NZ can swim against the global growth tide, and we still expect a firmer USD to dominate. NZD/AUD is overvalued, but doesn't look extended.

TABLE 1: KEY VIEWS

CROSS	WEEK	MONTH	YEAR
NZD/USD	↔/↓	Downside risks at current levels	Volatility will remain high
NZD/AUD	↔	Range trading	Above long-run averages
NZD/EUR	↔/↓	Following 'fear'	EUR capped by ECB
NZD/GBP	↔	Brexit weighing on GBP	GBP resurgence
NZD/JPY	↔/↓	Following 'fear'	Yen weakness

THEMES AND RISKS

- NZD on a TWI basis back into the zone where it will receive official attention.
- Credit markets are flashing amber; ditto commodities.
- NZ's growth picture is out of sync globally, but for how long can it remain so, given commodity price action and NZ's reliance on them?
- Volatility will remain high. Last week's sell-off (and partial reversal) in USD highlights how quickly markets are changing.
- We expect a positive message from Fed Chair Yellen in her semi-annual testimony to congress. This should help to stabilise USD.

TABLE 2: KEY UPCOMING EVENT RISK

	EVENT	WHEN (NZDT)	IMPACT RISK
AUD	NAB Business Conf.	Tue 13:30	NZD/AUD ↓
GBP	Trade Balance	Tue 22:30	NZD/GBP ↑
USD	NFIB Small B/O	Wed 00:00	NZD/USD ↑
NZD	Card spending	Wed 10:45	NZD ↑
NZD	ANZ inflation gauge	Wed 13:00	NZD
GBP	Industrial production	Wed 22:30	NZD/GBP ↓
USD	**Fed Yellen**	Thu 04:00	NZD/USD ↔/↓
NZD	Business PMI	Thu 10:30	NZD ↔/↑
SEK	Riksbank	Thu 21:30	NZD ↔/↑
USD	Fed Yellen part 2	Fri 04:00	NZD/USD ↔
NZD	Food prices	Fri 10:45	NZD ↔
AUD	RBA Governor Stevens	Fri 11:30	NZD/AUD ↔/↓
EUR	EU Q4 GDP & IP	Fri 23:00	NZD/EUR ↔
USD	Retail sales	Sat 02:30	NZD/USD ↓
CNY	Jan Trade Balance	Mon PM	NZD ↔/↓

EXPORTERS' STRATEGY

Exporters should have opportunities to hedge lower, with fear dominating market sentiment.

IMPORTERS' STRATEGY

Importers should look at any rallies as an opportunity to hedge invoices. With NZD still subject to global fear, and last week's lift driven by fear over US prospects, we would caution against expecting too much.

DATA PULSE

The NZD was supported by domestic releases last week, despite another very weak dairy auction. The strength in the Q4 labour market statistics was complemented by a 'take that' message from the RBNZ. ANZ commodity prices did warn of downside as commodity prices continue to decline on average.

The USD weakened as US data releases were soft (notably both the ISM releases), and markets capitulated on positions. Fed speakers used cautious tones. However, payrolls arrested some of the decline with stronger-than-expected wage growth and a lower unemployment rate.

European PMIs continued to support the EUR, revealing steady if unspectacular growth, while EUR benefited from both a flight to safety and weaker USD.

GBP found support as GBP PMIs rebounded from recent weakness. But the BoE shifted to unanimously on hold, and cut their inflation forecasts, leaving support looking tenuous.

The AUD was little changed despite flat December retail sales and a more dovish outlook from the RBA.

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	↔	Mid range.
Sentiment	↑	AUD has a higher beta to China.
Other	↑	NZ risks less skewed than AUD.
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	↔/↑	Already with a risk 'discount'.
Data	↔/↑	US data is softer.
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 broke higher, continuing with the now 7 month old consolidation pattern. The passage of time has again brought the 200dma back into play, with it now providing a pivot around 0.67. Topside resistance in the mid 0.68's and low 0.69's remains formidable, and we expect further consolidation.

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

As NZD/AUD enters its third year trading broadly above 0.90 we continue to see little prospect for change. The failure to break below the 0.91 pivot reinforces that level, but overall we continue to favour selling toward the top of the recent range.

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	73.80 – 74.20	79.50 – 80.00 82.40 – 83.00

POSITIONING

Leveraged funds reduced net long USD positons by around USD1.5bn to USD22.6bn long last week, with EUR and CAD shorts reducing the most. GBP positioning remains net short, while NZD and AUD positioning remains modestly short.

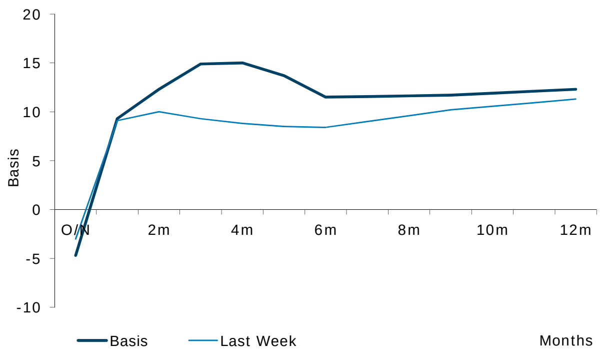
GLOBAL VIEWS

Markets are currently questioning whether the US economy will turn lower. This brings up the question of whether we re-enter the NZD-supportive environment seen from 2010 to mid-2014. This was a world of sub-optimal global growth backstopped by the central bank put. Equities and Asia performed well and commodities held up. NZD soared, with the relative economic outlook, interest rate differentials (carry), and a backstop to 'risk' (central bank put) being contributors to that strength.

While NZ would still have the relative economic outlook and carry differential to support it should the US turn (not our base case), there are clear differences this time. Our major trading partners are struggling to rebalance (Australia away from commodities and China away from investment and external demand), commodity price action is poor, credit spreads are looking ominous, the central bank 'risk' put is looking stale, and the New Zealand economic outlook has downside risks. We do not envisage a change to this external environment, keeping us prepared for further NZD downside.

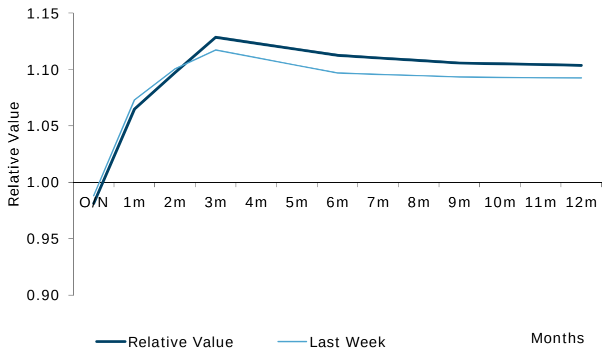
FORWARDS: CARRY AND BASIS

FIGURE 3. NZD/USD SHORT BASIS CURVE



With no constraints to cash we believe spot NZD positioning is normal. The widening in the 3-6m basis space is a response to the pricing out of cuts post Governor Wheeler's speech. Given global risks still point rates lower, S/B 3m out remains attractive.

FIGURE 4. RELATIVE ATTRACTION OF THE FWD CURVE



Source: ANZ, Bloomberg, Reuters

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
9-Feb	AU	NAB Business Conditions - Jan	--	7	13:30
	AU	NAB Business Confidence - Jan	--	3	13:30
	GE	Industrial Production SA MoM - Dec	0.5%	-0.3%	20:00
	GE	Industrial Production WDA YoY - Dec	-0.6%	0.1%	20:00
	GE	Trade Balance - Dec	€20.0B	€20.5B	20:00
	GE	Current Account Balance - Dec	€26.7B	€24.7B	20:00
	GE	Exports SA MoM - Dec	0.5%	0.5%	20:00
	GE	Imports SA MoM - Dec	-0.5%	1.7%	20:00
	UK	Visible Trade Balance GBP/Mn - Dec	-£10400	-£10642	22:30
	UK	Trade Balance Non EU GBP/Mn - Dec	-£2500	-£2450	22:30
	UK	Trade Balance - Dec	-£3000	-£3170	22:30
	CH	Foreign Direct Investment YoY CNY - Jan	-5.9%	-5.8%	9-12 Feb
10-Feb	US	NFIB Small Business Optimism - Jan	94.5	95.2	00:00
	US	JOLTS Job Openings - Dec	5413	5431	04:00
	US	Wholesale Inventories MoM - Dec	-0.2%	-0.3%	04:00
	US	Wholesale Trade Sales MoM - Dec	-0.4%	-1.0%	04:00
	NZ	Card Spending Retail MoM - Jan	0.3%	-0.2%	10:45
	NZ	Card Spending Total MoM - Jan	--	0.1%	10:45
	AU	Westpac Consumer Conf Index - Feb	--	97.3	12:30
	AU	Westpac Consumer Conf SA MoM - Feb	--	-3.5%	12:30
	NZ	ANZ Monthly Inflation Gauge - Jan	--	0.2%	13:00
	AU	HIA New Home Sales MoM - Dec	--	-2.7%	13:00
	UK	Industrial Production MoM - Dec	-0.1%	-0.7%	22:30
	UK	Industrial Production YoY - Dec	1.0%	0.9%	22:30
	UK	Manufacturing Production MoM - Dec	0.1%	-0.4%	22:30
	UK	Manufacturing Production YoY - Dec	-1.4%	-1.2%	22:30
	NZ	REINZ House Sales YoY - Jan	--	3.5%	10-15 Feb
	CH	Aggregate Financing CNY - Jan	2200.0B	1820.0B	10-15 Feb
	CH	Money Supply M0 YoY - Jan	10.6%	4.9%	10-15 Feb
	CH	Money Supply M1 YoY - Jan	14.7%	15.2%	10-15 Feb
	CH	Money Supply M2 YoY - Jan	13.5%	13.3%	10-15 Feb
	CH	New Yuan Loans CNY - Jan	1900.0B	597.8B	10-15 Feb
11-Feb	US	MBA Mortgage Applications - 5-Feb	--	-2.6%	01:00
	UK	NIESR GDP Estimate - Jan	--	0.6%	04:00
	US	Monthly Budget Statement - Jan	$42.5B	-$17.5B	08:00
	NZ	BusinessNZ Manufacturing PMI - Jan	--	56.7	10:30
	AU	Consumer Inflation Expectation - Feb	--	3.6%	13:00
	UK	RICS House Price Balance - Jan	52%	50%	13:01
12-Feb	US	Initial Jobless Claims - 6-Feb	280k	285k	02:30
	US	Continuing Claims - 30-Jan	2248k	2255k	02:30
	NZ	Food Prices MoM - Jan	--	-0.8%	10:45
	AU	Home Loans MoM - Dec	3.0%	1.8%	13:30
	AU	Investment Lending - Dec	--	0.7%	13:30
	AU	Owner-Occupier Loan Value MoM - Dec	--	2.4%	13:30
	AU	Credit Card Balances - Dec	--	A$51.3B	13:30
	AU	Credit Card Purchases - Dec	--	A$25.6B	13:30
	GE	Wholesale Price Index MoM - Jan	--	-0.8%	20:00
	GE	Wholesale Price Index YoY - Jan	--	-1.0%	20:00

Continued on following page

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
12-Feb	GE	CPI MoM - Jan F	-0.8%	-0.8%	20:00
	GE	CPI YoY - Jan F	0.5%	0.5%	20:00
	GE	GDP SA QoQ - 4Q P	0.30%	0.30%	20:00
	GE	GDP WDA YoY - 4Q P	1.4%	1.7%	20:00
	GE	GDP NSA YoY - 4Q P	1.7%	1.8%	20:00
	UK	Construction Output SA MoM - Dec	2.0%	-0.5%	22:30
	UK	Construction Output SA YoY - Dec	0.8%	-1.1%	22:30
	EC	Industrial Production SA MoM - Dec	0.3%	-0.7%	23:00
	EC	Industrial Production WDA YoY - Dec	0.8%	1.1%	23:00
	EC	GDP SA QoQ - Q4 A	0.3%	0.3%	23:00
	EC	GDP SA YoY - Q4 A	1.5%	1.6%	23:00
13-Feb	US	Import Price Index MoM - Jan	-1.5%	-1.2%	02:30
	US	Import Price Index YoY - Jan	-6.8%	-8.2%	02:30
	US	Retail Sales Advance MoM - Jan	0.1%	-0.1%	02:30
	US	Retail Sales Ex Auto MoM - Jan	0.0%	-0.1%	02:30
	US	Retail Sales Ex Auto and Gas - Jan	0.3%	0.0%	02:30
	US	Retail Sales Control Group - Jan	0.3%	-0.3%	02:30
	US	Business Inventories - Dec	0.1%	-0.2%	04:00
	US	U. of Mich. Sentiment - Feb P	92.3	92.0	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 is re-accelerating after slowing below trend. Low domestic inflation will 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
10-15 Feb	REINZ Housing Statistics – Jan	Regional divergence	Monthly numbers are likely to be volatile, but we expect to see decent volume and price growth in non-Auckland regions.
Wed 10 Feb (10:45am)	Electronic Card Transactions – Jan	Bounce back	December was soft. But strong population growth and low mortgage rates should continue to support spending.
Wed 10 Feb (1:00pm)	ANZ Monthly Inflation Gauge – Jan	--	--
Thu 11 Feb (10:30am)	Business NZ PMI – Jan	Watching the globe	Manufacturing sentiment has held up well, although it will be interesting to see if global market turmoil has impacted.
Fri 12 Feb (10:45am)	Food Price Index – Jan	Seasonal lift	The global commodity price rout is weighing on local food price inflation, although we expect a seasonal lift in January.
Mon 15 Feb (10:30am)	Business NZ PSI – Jan	Outperformance	The services sector is one of the outperformers of this current expansion. This data should be consistent with that.
Tue 16 Feb (10:45am)	Retail Trade Survey – Q4	Respectable	Retail price deflation should support volumes, with a respectable 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	--	--
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 what they signal 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	Exports were supported by strong dairy export volumes in December. We believe that was only 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 remain.
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	--	--
On balance		**Data watch**	**Improvement is evident, 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	1.2	0.5	0.4	0.5	0.9	-0.1	0.2	-0.2	--
Retail ECT (% yoy)	3.9	3.2	5.0	5.6	4.2	6.1	5.6	3.7	5.3	--
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	--
Car Registrations (% yoy)	11.2	6.8	11.2	10.7	7.8	5.0	3.8	1.3	2.4	--
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	--
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	0.935	0.94	0.94	0.92	0.92	0.92	0.92	0.93
NZD/EUR	0.628	0.599	0.592	0.60	0.60	0.55	0.54	0.54	0.53	0.53
NZD/JPY	82.52	78.55	76.67	73.7	70.2	67.9	67.9	67.2	67.1	69.3
NZD/GBP	0.463	0.455	0.459	0.45	0.44	0.41	0.39	0.39	0.39	0.39
NZ$ TWI	73.7	70.5	72.4	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	2.64	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

	5 Jan	1 Feb	2 Feb	3 Feb	4 Feb	5 Feb
Official Cash Rate	2.50	2.50	2.50	2.50	2.50	2.50
90 day bank bill	2.75	2.70	2.69	2.65	2.66	2.65
NZGB 12/17	2.77	2.52	2.51	2.52	2.48	2.52
NZGB 03/19	2.89	2.64	2.61	2.62	2.57	2.61
NZGB 04/23	3.58	3.22	3.18	3.18	3.10	3.14
NZGB 04/27	3.97	3.57	3.53	3.53	3.44	3.48
2 year swap	2.77	2.60	2.58	2.59	2.60	2.61
5 year swap	3.13	2.83	2.79	2.82	2.77	2.80
RBNZ TWI	74.4	70.99	71.17	71.77	71.93	72.64
NZD/USD	0.6858	0.65	0.65	0.65	0.65	0.67
NZD/AUD	0.9418	0.91	0.92	0.92	0.93	0.93
NZD/JPY	82.63	77.00	78.48	79.12	78.11	78.72
NZD/GBP	0.4625	0.45	0.45	0.45	0.45	0.46
NZD/EUR	0.6275	0.59	0.60	0.60	0.60	0.60
AUD/USD	0.7282	0.71	0.71	0.71	0.70	0.72
EUR/USD	1.0929	1.09	1.08	1.09	1.09	1.11
USD/JPY	120.48	118.84	121.26	120.87	119.54	117.98
GBP/USD	1.4829	1.44	1.43	1.44	1.44	1.46
Oil (US$/bbl)	37.13	33.21	33.66	31.62	29.90	32.29
Gold (US$/oz)	1063.85	1114.80	1122.05	1125.90	1127.45	1140.20
Electricity (Haywards)	5.92	5.00	6.73	7.60	7.27	6.94
Baltic Dry Freight Index	468	314	310	303	298	297
Milk futures (USD)	37	33	32	34	33	33

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