NEW ZEALAND ECONOMICS
MARKET FOCUS

6 July 2015

INSIDE

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TIME TO SHIFT THE FISCAL STANCE

ECONOMIC OVERVIEW

As economic headwinds increase, so too does the likelihood that the NZD continues to adjust lower and last year’s 100bps of RBNZ rate hikes get completely removed – which is now our central scenario. But while monetary policy is generally expected to do the heavy lifting when growth slows, fiscal policy and local authorities have stabilising roles to play too; they have sizeable balance sheets and the ability to absorb economic weakness better than SMEs. They should be moving to a more expansionary stance with the economy slipping below trend. This week, the data is expected to be consistent with a decelerating pace of domestic growth.

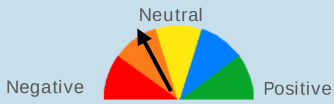
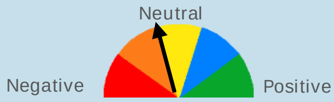
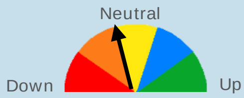
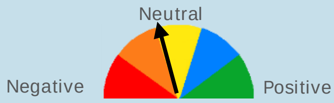
INTEREST RATE STRATEGY

Last week’s change of OCR forecast (we now expect the RBNZ to completely unwind last year’s hikes) was local and not global driven – the latter just reinforces the risk profile. Market pricing is adjusting, but remains far too optimistic, with the OCR priced to rise from mid-2016 onwards. The “no” vote in Greece has created an atmosphere of significant volatility, and is likely to result in flatter yield curves as markets contemplate a global slump in confidence, position un-winding, and a later and more gradual start to the Fed tightening cycle. For New Zealand, this means lower rates across the curve, with a bias to flatten as global bond markets respond to events in Europe (and China for that matter!).

CURRENCY STRATEGY

The increase in global risk premia driven by Greek concerns and Chinese equity market declines should keep pressure on NZD/USD and NZD/JPY. However, with Europe more exposed directly to Greece and Australia more exposed to China, there is a risk of AUD, EUR, and GBP pricing in a larger risk premia than the NZD, supporting those NZD crosses. A lot of bad news towards the New Zealand economy seems to be priced in at current levels of the NZD.

THE ANZ HEATMAP

Variable	View	Comment	Risk profile (change to view)
GDP	2.6% y/y for 2016 Q2	Economic momentum is running at a sub-trend pace as previous supports begin to wane.	
Unemployment rate	5.7% for 2016 Q2	The demand for labour is slowing, while labour supply remains strong. Wage inflation contained.	
OCR	2.50% by Jun 2016	The RBNZ is now responding to a weaker macro backdrop. We expect the full reversal of 2014 rate hikes.	
CPI	1.6% y/y for 2016 Q2	Sub-1% annual inflation over 2015. Benign global backdrop; domestic pricing pressures contained so far.	

ECONOMIC OVERVIEW

SUMMARY

As economic headwinds increase, so too does the likelihood that the NZD continues to adjust lower and last year's 100bps of RBNZ rate hikes get completely removed – which is now our central scenario. But while monetary policy is generally expected to do the heavy lifting when growth slows, fiscal policy and local authorities have stabilising roles to play too; they have sizeable balance sheets and the ability to absorb economic weakness better than SMEs. They should be moving to a more expansionary stance with the economy slipping below trend. This week, the data is expected to be consistent with a decelerating pace of domestic growth.

FORTHCOMING EVENTS

NZIER Quarterly Survey of Business Opinion – Q2 (10:00am, Tuesday, 7 July). Business confidence and activity expectations should ease, although perhaps not as sharply as our monthly *Business Outlook* survey given that the QSBO does not directly survey the agricultural sector. Pricing gauges should remain benign.

Government Financial Statements – May (10:00am, Wednesday, 8 July). The fiscal accounts have been running well ahead of Treasury forecasts. We expect that to continue, highlighting the possibility of a return to full-year OBEGAL surpluses by 2014/15.

ANZ Truckometer – June (10:00am, Thursday, 9 July).

Electronic Card Transactions – June (10:45am, Thursday, 9 July). We expect a 0.6% m/m increase. The underlying pace of retail spending growth is expected to continue slowing as previous supports begin to fade.

ANZ Monthly Inflation Gauge – June (1:00pm, Friday, 10 July).

Food Price Index – June (10:45am, Monday, 13 July). Food prices typically lift in June due to seasonally higher fruit and vegetable prices.

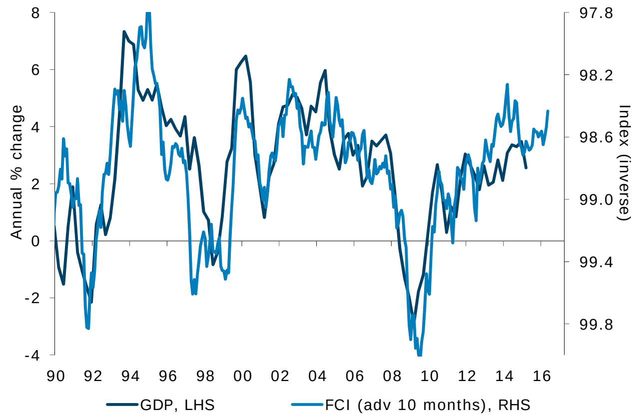
WHAT'S THE VIEW?

We're seeing the economy's natural shock absorbers come into play as economic headwinds mount. These headwinds are not hard to find. It now looks like the terms of trade will fall around 20% from their peak, representing close to a 3% hit to real activity growth over the next two years. Additionally, there is receding momentum from the Christchurch rebuild, with business sentiment in the region having falling sharply of late. And global ructions are obvious. The NZD has adjusted lower (with more to come) and the full reversal of last year's RBNZ OCR hikes is now our central view (although we do not necessarily feel that will occur in a straight line). A lower NZD is a welcome development for the export sector. But brace for some pain in retailing, with margins set to come under further pressure.

Economic challenges for New Zealand clearly exist. But there is an inherent danger that we talk ourselves into a hole. Confidence can be fickle and small open economies can be prone to moving in a stop-start fashion. One of the challenges can be to keep 'Chicken Little' style analysis at bay.

We're still constructive on the outlook overall and are coy about throwing around the "R" (recession) word and writing the economy off just yet. Financial conditions have eased, migration flows are strong and some sectors are performing very well (such as tourism). The economy is simply moving into a weaker period of the business cycle. While growth has decelerated, it is certainly not one we'd class as a full-blown downturn.

FIGURE 1. GDP VS. FINANCIAL CONDITIONS INDEX



Source: ANZ, Statistics NZ

Historically, it has been the combination of internal excesses and global events that have tipped the economy into a more enduring period of weakness. Undeniably, there are some global candidates at present. And internally, one could point to excesses in the likes of the overvalued Auckland property market and the concentration of debt in the dairy sector for signs of largesse. We are not claiming the economy is bullet proof.

However, structural metrics are far healthier than in the not-too-distant past. Net external debt is just 58% of GDP (it was close to 85% in 2008), households now have a positive savings rate, the current account deficit is manageable at 3.6% of GDP, credit growth is running at a low single digit pace, household deposit growth has been outstripping credit growth for the better part of seven years, banks have more term funding in place, inflation is low, potential

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growth higher, and the fiscal position is robust. Sadly there is little acknowledgement of these statistics when the economic fraternity assess the outlook and risks. Such forces do not negate business cycle dynamics coming into play. However, they do strengthen the economy's ability to navigate through the cycle with less volatility.

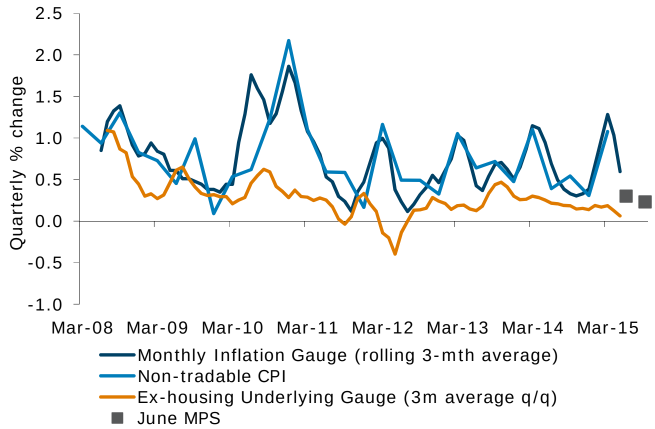
Monetary policy is generally expected to do the heavy lifting when growth slows. However, fiscal policy and local authorities have stabilising roles to play too. Both the government and local authorities have large balance sheets, which allow them to absorb swings in the business cycle more easily than SME's. It goes against human nature for fiscal policy to be run in a counter-cyclical sense (i.e. crank things up in bad times and wind things back in the good times), but it is sound economics. Of course there are relatively long lags involved, which can make the pursuit of such an approach difficult. But that shouldn't stifle the concept altogether.

Fiscal policy could move to a more neutral stance – or even an expansionary one – next year if thinking-caps were put on now. The sacrificial lamb would be nascent operating surpluses. But with net debt sitting around 27% of GDP, delaying or deferring the achievement of surpluses for a year or two is trivial – and as discussed below, the accounts are still running ahead of expectation anyway. Local authorities in rural (dairy) aligned regions could also be pulling forward investment projects. And there is room for rates relief, or at least limiting the magnitude of increase. There shouldn't be a fear from officials to use the balance sheets at their disposal. **The Government sector has a role to play just as monetary policy does, particularly when growth is below trend.**

This week, we will take a lot of interest in a couple of our own proprietary gauges.

The first – released at the end of the week – is our Monthly Inflation Gauge for June. This gauge has proven itself to be an accurate and timely indicator of domestic inflationary trends and it will provide a clear steer on directional risks to Q2 CPI. The headline gauge fell in both April and May, the first time consecutive falls have been seen. In many ways, the subsequently released weak Q1 GDP result and the softening in some leading indicators put this benign inflation backdrop in better context. It is certainly consistent with the economy running at a below trend pace. With regard to the June result, we note that in order for it to be broadly consistent with a Q2 lift in non-tradable inflation projected in the RBNZ's June *MPS* (+0.3% q/q), the gauge would need to increase by 0.6% m/m. That is not out of the question, although the average June increase over the past four years has been just 0.1% m/m.

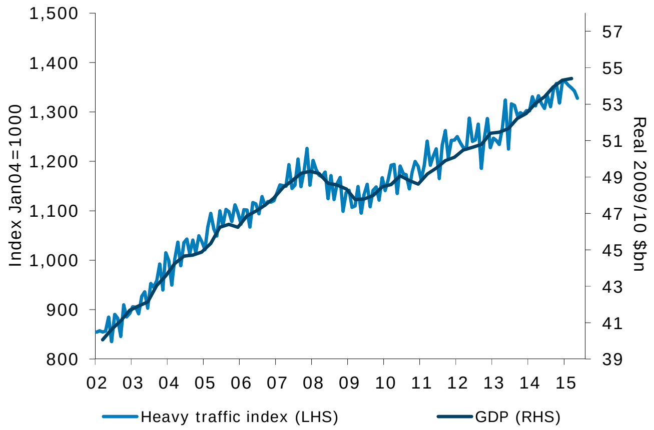
FIGURE 2. MONTHLY INFLATION GAUGE AND NON-TRADABLE CPI



Source: ANZ, RBNZ, Statistics NZ

After falling for five consecutive months, the Heavy Traffic Index component of our Truckometer is the second of our key proprietary indicators due this week. Clearly the focus will be on whether it has fallen further in June, or if any signs of stabilisation are evident. A further fall would be a concerning sign for near-term economic momentum. In fact, even if a bounce is seen, it is pointing to the possibility of another soft – if not negative – Q2 GDP result. It would take a 3% jump in June for it not to signal a negative quarterly GDP outturn in Q2. A 3% jump is not particularly uncommon, but it usually follows a sharp fall, rather than the gentle rolling over of the index experienced of late.

FIGURE 3. GDP and ANZ HEAVY TRAFFIC INDEX



Source: ANZ, NZ Transport Agency, Statistics NZ

The June quarter QSBO is expected to broadly convey the themes contained within recent ANZ *Business Outlook* surveys; that is moderating growth as opposed to a rout. Confidence should retreat further and activity indicators should be consistent with softening economic momentum. The

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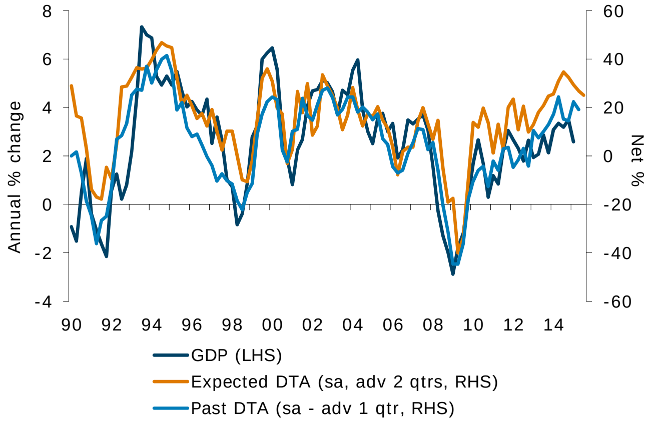
survey should also show relatively contained pricing pressures, despite some evidence of capacity strains (historically high CUBO and modest difficulty in finding skilled staff). However, we would not be surprised if the falls in sentiment in the QSBO do not quite match the signals from our monthly ANZ survey. This is largely because the QSBO does not directly survey the agricultural sector (where sentiment is obviously weak). But we'd certainly expect the survey to pick up the shifting (weakening) sentiment across the construction sector and Christchurch.

FIGURE 4. GDP VS QSBO DOMESTIC TRADING ACTIVITY

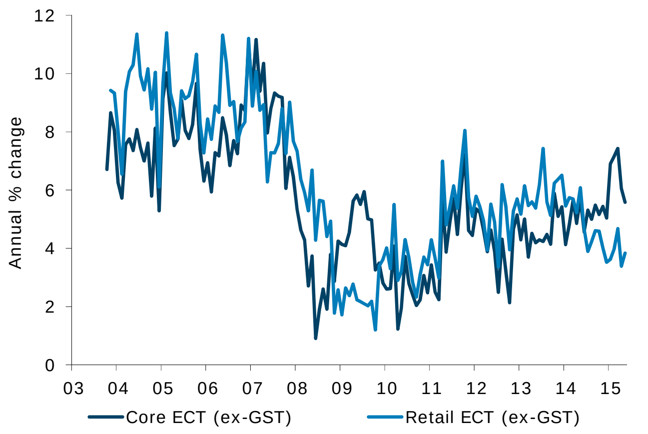


Source: ANZ, NZIER, Statistics NZ

It is likely that the Government's financial accounts continue to show the underlying fiscal numbers running ahead of forecast. In the 10 months to April, the OBEGAL was in surplus to the tune of $448m, which was over $1bn ahead of the Budget forecasts. Both stronger revenue and lower expenditure was contributing to this trend. While the fiscal numbers are extremely volatile on a monthly basis, with seasonality, the timing of provisional tax payments and other one-off expenditures throwing the figures around, with only two months of the fiscal year left, there is clearly a decent chance that 2014/15 will be marked as the year that a return to full-year underlying fiscal surpluses was achieved.

Finally this week, Electronic Card Transactions for June are expected to show modest retail spending growth. In May, total retail spending rose a solid 1.2% m/m. However, this was led by a 4.8% m/m increase in fuel retailing, on account of higher retail petrol prices. Core retail spending was more modest, with growth of just 0.4% m/m. In June, we estimate that petrol prices rose by a further circa 2% and so this should again underpin an increase in overall nominal spending (we expect a 0.6% m/m increase). But again we expect the cash flow impact of this to weigh on core retail spending growth.

FIGURE 5. RETAIL ELECTRONIC CARD SPENDING



Source: ANZ, Statistics NZ

Looking further forward, we certainly believe more headwinds for retail spending are emerging. While there remains support from low interest rates, strong population growth, net wealth gains and the well-performing tourism sector, the weakness in rural cash flow and a moderating performance of the labour market should see household income growth, and as a result spending growth, slow. Clearly, the cash flow boost from lower petrol prices, which is likely to have played a big part in the strength of retail spending to begin the year, have also now passed.

LOCAL DATA

Building Consents – May. Dwelling consent issuance was flat, with housing consents rising 2.4% m/m and multi-dwelling consents falling 5.3% m/m. Non-residential consents were valued at $424m sa.

ANZ Business Outlook – June. Headline business confidence fell to a net -2% - the first time in negative territory since February 2011. Firms' own activity expectations eased to a three-year low of +24.

RBNZ Credit Aggregates – May. Total private sector credit growth rose 0.8% sa m/m (+5.9% y/y), with 3-month annualised growth accelerating to 7.0%.

GlobalDairyTrade auction. The GDT TWI fell a further 5.9% to US$2,276/tonne, with wholemilk powder prices falling by 10.8% to $2,054/tonne.

QVNZ House Prices – June. Nationwide prices rose 3.6% over the previous three months, with annual growth at 9.3%. Prices in Auckland are up 17% y/y.

ANZ Commodity Price Index – June. The world price index fell by 3.1%, led again by weaker dairy prices. In NZD terms, the index rose 2.9%.

Barfoot & Thompson Auckland Housing – June. House sales rose 3.7% sa m/m (+13% y/y). However, new listings surged 11% m/m, following a 16% m/m increase in May.

INTEREST RATE STRATEGY

SUMMARY

Last week's change of OCR forecast (we now expect the RBNZ to completely unwind last year's hikes) was local and not global driven – the latter just reinforces the risk profile. Market pricing is adjusting, but remains far too optimistic, with the OCR priced to rise from mid-2016 onwards. The "no" vote in Greece has created an atmosphere of significant volatility, and is likely to result in flatter yield curves as markets contemplate a global slump in confidence, position un-winding, and a later and more gradual start to the Fed tightening cycle. For New Zealand, this means lower rates across the curve, with a bias to flatten as global bond markets respond to events in Europe (and China for that matter!).

THEMES

- We now expect the OCR to get back to 2.5%. We already have one 25bp cut in hand, and we expect a second cut later this month, a third cut in September, then a pause, followed by a fourth cut in March 2016.
- A July cut is fully priced in, but it is the profile of expectations beyond July that is the main focus. Beyond July, expectations for cuts are too timid and too gradual. The tick shaped curve will remain, but the low point needs to be pushed out.
- Our forecasts (which were made prior to the Greek vote) have the Fed hikes starting in September, but that is clearly now at risk. Given that lift-off has been the big "bogey-man" for the bond market this year, any pushing out of Fed normalisation will see bond yields fall, possibly dramatically.
- Throw all of these factors into the pot and they argue unequivocally for lower interest rates, even before accounting for what could be a marked shift in risk appetite and investor confidence. The short-end has a mile-marker, the OCR. But the long-end has no such anchor, and we expect a flatter curve.

PREFERRED STRATEGIES – INVESTORS

KEY VIEWS – FOR INVESTORS		
GAUGE	**DIRECTION**	**COMMENT**
Duration	Strategically bullish	FOMC gradualism, China caution + high NZ bond yields = bullish.
2s10s Curve	Flatter	Whole curve moving lower, but the short-end is more about timing than direction.
Geographic 10yr spread	Neutral	OCR outlook argues for narrower, but spreads tend to widen on a rally.
Swap spreads	Neutral	Bond demand still decent, but hot money likely to be receiving.

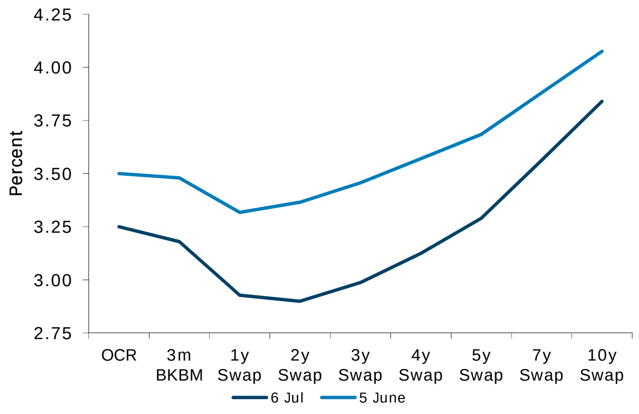
GREECE VOTE TO DRIVE GLOBAL YIELDS LOWER

Things are moving fast offshore and **the situation in Greece remains very fluid** despite the resounding "no" vote. Chief among the concerns is that nobody knows what a "no" vote actually means, and how the wider Euro area will respond. It is not a guarantee that Greece will leave the euro, but markets need to price in the risk with more vigour. We won't dwell much further on Greece here other than to say that it will undermine global confidence, has seen interest rates fall, has sapped risk appetite, and is unlikely to be fleeting. **For interest rate markets, this means more cautious policy here and abroad, allocation back into bonds and others safer assets, and flatter yield curves.**

THE RBNZ HAS MORE WORK TO DO

Greece may be front and centre, but even before this morning's referendum results we felt that the RBNZ had more work do to. Indeed, following last week's double-whammy of softer business confidence and softer dairy prices, **we moved to lower our OCR forecasts another notch, calling for 25bp cuts at the next two meetings, then a pause, then a final cut in March 2016**. After this morning's news, the risk is we see this schedule accelerated and/or revised lower. But stepping away from the global scene and focussing purely on dairy prices – the reason softer prices are such a concern is because they portend of a more pronounced fall in the terms of trade, which will necessitate more policy support. Make no doubt, the NZD has depreciated, and every little bit helps. But it has not fallen by enough, and our fear is that it won't be able to unless the OCR goes lower too. **The market has responded, taking the bellwether 2-year swap rate back below 3% for the first time since 2013. We expect it to go lower in coming days** – markets tend to overshoot, and Australia saw its 2-year swap rate go below its terminal cash rate. It's probably a stretch to expect that here, but the bias remains lower.

FIGURE 1: NZ SWAP CURVE



Source: ANZ, Bloomberg

INTEREST RATE STRATEGY

Greece may be in the headlines, but **ultimately it's the local that data matters in terms of gauging how much work the RBNZ might have to do**. Had the data been improving, the analysis would certainly be tougher. But when the data and the global scene are moving the same way (south), it becomes a question of when to cut and by how much, rather than whether to cut. This week we expect the NZIER QSBO to show similar signs as last week's ANZ *Business Outlook*. We are also awaiting our Monthly Inflation Gauge (due Friday) to assess the degree of core inflation pressure. Soft readings from the latter suggest little is standing in the way of the OCR moving lower. **July is for all intents and purposes a done deal, but confirmation of soft core inflation backdrop will likely cement in a September cut** for the market if Greece doesn't do so beforehand.

IT'S ALL ABOUT TIMING

While the question of "how much" easing may be on its way is somewhat fluid, we view that as more of a global "delta". As such, we're more focussed on how the market stands vis-à-vis our forecasts. In our view this is a safer source of mispricing to "exploit", and does not rest on making wild assumptions about what may or may not happen to Greece, Fed policy or Chinese stock prices. As we have noted in past editions of this column, **one thing that is here to stay is the tick-shaped curve**, as this is the only feasible shape one can use to "join the dots" between an OCR that's headed lower, and long term interest rates that are higher. Even if we set aside for now the issue of the market still not pricing in enough easing relative to our forecasts, **the issue we have is more of when that rate bottoms out, not where it bottoms out**. By around 10am Monday, the market was pricing in a low point at 2.62% by March 2016 (see chart bottom right). We think the RBNZ will still be easing by then, and that it will be at least a year before hikes can be envisaged. As such, **we see tremendous value in receiving trades that exploit this overly optimistic view of where rates may be during the second half of 2016**.

MIND THE GAP

Amid all the talk of easier policy, one could be forgiven for believing that we may also see a tightening of the spread (or "gap") to other key markets, like the US. We sympathise with that view, and ordinarily our call for deeper OCR cuts would have us calling a narrowing in the NZ/US 10 year bond spread (and all else equal, the NZ/AU spread). The trouble is; history shows that these spreads tend to widen as outright yields fall, principally because the New Zealand bond market tends to be less whippy (i.e. is generally a lower flow, lower beta market). **Given the likelihood of much lower US bond yields in the coming week, spreads are likely to widen in the interim**. We are also mindful that the Australian market is still pricing in a chance of cuts, and if that intensifies, we're likely to see Australian bond yields fall sharply too, and New Zealand has typically been a laggard when that has occurred.

FLATTENING BIAS

We are also mindful that the New Zealand yield curve generally changes shape in response to domestic factors at the short-end and global factors at the long-end. The rally at the short-end was already well in train before things soured in Greece and China. And while we see scope for more, all we are really talking about is a few basis points and the ironing out of timing issues, as noted earlier. At the end of the day, **the short-end can't stray too far from the OCR. But the long-end can go a lot further, and with global yields on a downward march, we expect much of the recent steepening of the curve to be unwound**.

PREFERRED STRATEGIES – BORROWERS

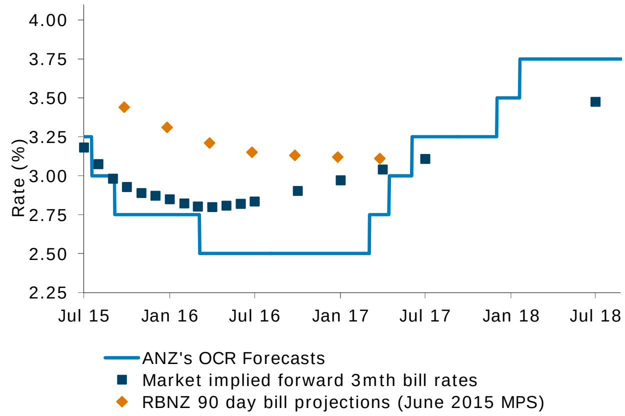
Our preference is to watch and wait. Things are fluid, and, and it's not just markets that are cautious, so are businesses.

KEY VIEWS – FOR BORROWERS		
GAUGE	**VIEW**	**COMMENT**
Hedge ratio	Majority hedged	Historic hedges adequate. No immediate reason to add cover.
Value	Cheap	Cheap but getting cheaper.
Uncertainty	Elevated	The key course of caution.

MARKET EXPECTATIONS

25bps is now fully priced for July, but there are only 63bps of cuts priced in total. The profile is too light and too delayed, but will only change gradually.

FIGURE 2. ANZ OCR FORECAST AGAINST MARKET-IMPLIED FORWARD 3MTH BILL RATES AND RBNZ 90 DAY BILL PROJECTIONS



Source: ANZ, Bloomberg

CURRENCY STRATEGY

SUMMARY

The increase in global risk premia driven by Greek concerns and Chinese equity market declines should keep pressure on NZD/USD and NZD/JPY. However, with Europe more exposed directly to Greece and Australia more exposed to China, there is a risk of AUD, EUR, and GBP pricing in a larger risk premia than the NZD, supporting those NZD crosses. A lot of bad news towards the New Zealand economy seems to be priced in at current levels of the NZD.

TABLE 1: KEY VIEWS			
CROSS	WEEK	MONTH	YEAR
NZD/USD	↔/↓	NZD shorts are extended	USD to strengthen
NZD/AUD	↔/↑	Getting closer to fair value	Topside capped
NZD/EUR	↔/↑	EUR remains weak	EUR remains weak
NZD/GBP	↔/↑	GBP in demand	GBP resurgence
NZD/JPY	↓	Official support for JPY	Yen weakness

THEMES AND RISKS

- The Chinese equity bear market is weighing on the NZD via the sentiment channel.
- The Greek referendum has resulted in an increase in uncertainty, which will also weigh on NZD.
- While US data supports Fed "lift-off", global developments argue against it. Given Fed based USD positioning, the question is whether markets are happy keeping long USD positions on safe-haven status, perhaps explaining NZD/USD stasis.
- The QSBO is expected to reinforce the message from last week's ANZ Business Confidence, keeping NZD capped.
- We do not expect the four central bank announcements this week to have too much of an impact, but all are capable of surprising markets.

TABLE 2: KEY UPCOMING EVENT RISK			
EVENT		WHEN (NZDT)	LIKELY IMPACT
USD	ISM non-manuf.	Tue 02:00	NZD/USD ↓
NZD	QSBO	Tue 10:00	NZD ↓
AUD	RBA	Tue 16:30	NZD/AUD ↑
EUR	German Ind. Prod.	Tue 18:00	NZD/EUR ↑
GBP	Industrial production	Tue 20:30	NZD/GBP ↑
JPY	C/A, T/B	Wed 11:50	NZD/JPY ↓
GBP	UK Budget	Wed 23:30	NZD/GBP ↓
USD	Fed minutes	Thu 06:00	NZD/USD ↓
NZD	Truckometer	Thu 10:00	NZD ↔
NZD	Card spending	Thu 10:45	NZD ↔
AUD	Employment	Thu 13:30	NZD/AUD ↓
KRW	BoK	Thu PM	NZD/KRW ↑
GBP	BoE	Thu 23:00	NZD/GBP ↓
GBP	Trade Balance	Fri 20:30	NZD/GBP ↑
CAD	Employment	Sat 00:30	NZD/CAD ↓
USD	Fed Yellen	Sat 04:30	NZD/USD ↓

EXPORTERS' STRATEGY

NZD/USD exporters should buy calls instead of spot. Exporters to AUD and EUR should consider hedging.

IMPORTERS' STRATEGY

With NZD in freefall across a variety of crosses, importers should use any bounces to extend hedging.

DATA PULSE

NZ data continues to underperform. ANZ business confidence declined into negative territory for the first time since 2011. The GlobalDairyTrade auction was weak again, prompting us to downgrade our forecast for the milk price and the OCR, which has weighed on the currency. ANZ commodity prices were a little more positive, with ex-dairy commodities proving resilient, and the NZD index increasing 2.9%. We acknowledge the softness across NZ data, but we're coming to the view that too much bad news is now being priced in.

Australian retail sales underperformed market expectations, and the trade deficit was larger than expected, but AUD has been trading off Chinese equity markets – the Shanghai composite has declined 28% - officially a bear market. In aggregate the Chinese PMIs disappointed, and **China remains a key concern for both AUD and NZD.** South Korea and Taiwan both revealed sharp declines in activity, adding to concern.

US data has maintained a relatively solid pace. The ISM and Markit PMI both exceeded expectations. US non-farm payrolls were marginally below expectations, but still showed a reasonable pace.

The Japanese Q2 Tankan survey was strong, at face value suggesting "Abenomics" is yielding some results.

The UK manufacturing PMI disappointed, as June data continues to miss expectations. **GBP is looking a little vulnerable** from the data aspect.

TABLE 3: NZD VS AUD: MONTHLY GAUGES		
GAUGE	GUIDE	COMMENT
Fair value	↔	Still above fair value.
Yield	↔/↓	Yield outlook reversing.
Commodities	↔	Iron ore declining again.
Data	↓	AU data somewhat stabilised.
Techs	↑	A buy zone.
Sentiment	↔	Peak NZD negative sentiment?
Other	↓	Strong momentum lower.
On balance	↔	**Downside risks are easing.**

TABLE 4: NZD VS USD: MONTHLY GAUGES		
GAUGE	GUIDE	COMMENT
Fair value	↔	Closer to fair value.
Yield	↔	Yield advantage being cut.
Commodities	↓	Dairy still concerning.
Risk aversion	↓	China, EU and global fears.
Data	↓	NZ data rolling over.
Techs	↑	NZD overstretched.
Other	↑	FOMC signals slow normalisation.
On balance	↔/↓	**NZD still has downside.**

CURRENCY STRATEGY

TECHNICAL OUTLOOK

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

NZD technical indications remain weak, as the kiwi quickly reaches its 0.66 targets. Topside resistance seems a long way above, starting at 0.6940, and is thick until 0.7020, then 0.7080, before peaking at 0.7180-0.7230. Support around the 0.65-0.66 level looks fairly strong. However, today's chart takes a step wider looking at the post-float average at 0.63 as a defining support level in the NZD.

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

This cross broke support last week trading below 0.88. However, it swiftly rejected this break. The rebound increases the chances of consolidation in NZD/AUD with a test back to resistance near 0.9050-0.91 becoming increasingly plausible.

TABLE 5: KEY TECHNICAL ZONES		
CROSS	SUPPORT	RESISTANCE
NZD/USD	0.6580 – 0.6620 0.64	0.6940 – 0.6960 0.7000 – 0.7020
NZD/AUD	0.8600 – 0.8650	0.9040 – 0.9100
NZD/EUR	0.5900 – 0.5950	0.6350 – 0.6400
NZD/GBP	0.4250 – 0.4300	0.4680 – 0.4720
NZD/JPY	80.00 – 80.50	83.50 – 87.50

POSITIONING

NZD short positioning continues to grow. CFTC IMM positioning remains at record short levels. EUR shorts were increased last week, while JPY benefited from safe haven flows along with GBP.

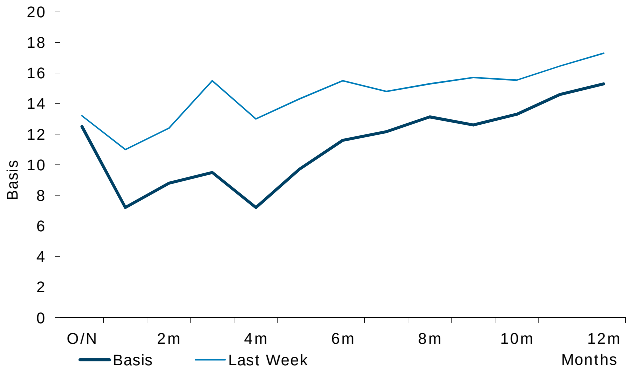
GLOBAL VIEWS

Greece remains firmly in the headlines, but the price action around the recent break-down in negotiations has been puzzlingly benign. Price action is telling us that markets remain confident that the ECB has the tools to handle an unexpected scenario in the Greek market. Last week the ECB made additional state-backed corporate eligible for QE and still has the, as yet unused, OMT program. For now, Greece is only marginally adding to weight on the NZD, as risks of global contagion look contained. But we remain concerned about larger EUR declines.

Chinese demand is a vital input for NZD valuation and markets are becoming increasingly worried over the impact of the bear market in the Chinese stock market. The Shanghai Composite ended last week 28% off its June peak, while the more tech-heavy Shenzhen ended off 34% from its June peak. A stock market correction of that magnitude typically generates large declines in consumer demand, and China is our second largest trade partner and second largest source of tourists.

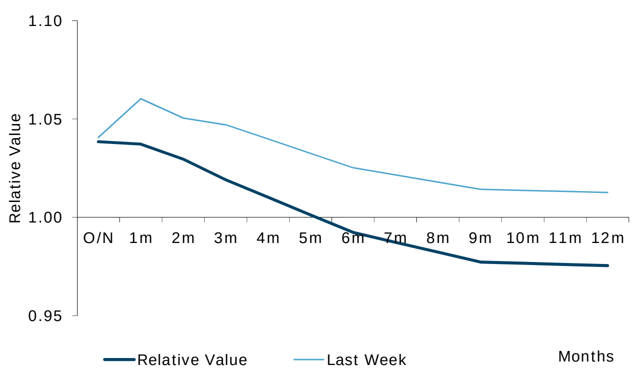
FORWARDS: CARRY AND BASIS

FIGURE 4. NZD/USD SHORT BASIS CURVE



Basis contracted over the week as rates cuts are continuing to be priced in along the curve. Short basis out to two weeks will stay elevated as people try to fund short spot positions into the RBNZ meeting date.

FIGURE 5. RELATIVE ATTRACTION OF THE FWD CURVE



Source: ANZ, Bloomberg, Reuters

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
6-Jul	AU	TD Securities Inflation MoM - Jun	--	0.3%	12:30
	AU	TD Securities Inflation YoY - Jun	--	1.4%	12:30
	AU	ANZ Job Advertisements MoM - Jun	--	0.0%	13:30
	GE	Factory Orders MoM - May	-0.4%	1.4%	18:00
	GE	Factory Orders WDA YoY - May	3.8%	0.4%	18:00
	GE	Markit Construction PMI - Jun	--	50.8	19:30
	GE	Markit Retail PMI - Jun	--	55.8	20:10
	EC	Markit Retail PMI - Jun	--	51.4	20:10
	EC	Sentix Investor Confidence - Jul	15.0	17.1	20:30
	UK	Halifax House Prices MoM - Jun	0.3%	-0.1%	6-11 Jul
	UK	Halifax House Price 3Mths/Year - Jun	8.3%	8.6%	6-11 Jul
7-Jul	US	Markit Composite PMI - Jun F	--	54.6	01:45
	US	Markit Services PMI - Jun F	54.9	54.8	01:45
	US	ISM Non-Manf. Composite - Jun	56.4	55.7	02:00
	NZ	NZIER Business Opinion Survey - Q2	--	23	10:00
	AU	ANZ-RM Consumer Confidence Index - 5-Jul	--	116.3	11:30
	AU	AiG Perf of Construction Index - Jun	--	47.8	11:30
	AU	RBA Cash Rate Target - Jul	2.00%	2.00%	16:30
	GE	Industrial Production SA MoM - May	0.1%	0.9%	18:00
	GE	Industrial Production WDA YoY - May	2.6%	1.4%	18:00
	AU	Foreign Reserves - Jun	--	A$73.2B	18:30
	UK	Industrial Production MoM - May	-0.2%	0.4%	20:30
	UK	Industrial Production YoY - May	1.6%	1.2%	20:30
	UK	Manufacturing Production MoM - May	0.1%	-0.4%	20:30
	UK	Manufacturing Production YoY - May	1.8%	0.2%	20:30
8-Jul	US	Trade Balance - May	-$42.75B	-$40.90B	00:30
	UK	NIESR GDP Estimate - Jun	--	0.6%	02:00
	US	JOLTS Job Openings - May	5300	5376	02:00
	US	IBD/TIPP Economic Optimism - Jul	48.8	48.1	02:00
	JN	BoP Current Account Balance - May	¥1563.6B	¥1326.4B	11:50
	JN	Trade Balance BoP Basis - May	-¥287.5B	-¥146.2B	11:50
	US	MBA Mortgage Applications - 3-Jul	--	-4.7%	23:00
9-Jul	US	US Fed Minutes from June 16-17 FOMC Meeting	--	--	06:00
	US	Consumer Credit - May	$18.50B	$20.54B	07:00
	NZ	ANZ Truckometer Heavy MoM - Jun	--	-1.1%	10:00
	NZ	Card Spending Retail MoM - Jun	0.5%	1.2%	10:45
	NZ	Card Spending Total MoM - Jun	--	1.4%	10:45
	UK	RICS House Price Balance - Jun	36%	34%	11:01
	CH	CPI YoY - Jun	1.3%	1.2%	13:30
	CH	PPI YoY - Jun	-4.6%	-4.6%	13:30
	AU	Employment Change - Jun	0.0K	42.0K	13:30
	AU	Unemployment Rate - Jun	6.1%	6.0%	13:30
	AU	Full Time Employment Change - Jun	--	14.7K	13:30
	AU	Part Time Employment Change - Jun	--	27.3K	13:30
	AU	Participation Rate - Jun	64.7%	64.7%	13:30
	GE	Trade Balance - May	€20.5B	€21.8B	18:00
	GE	Current Account Balance - May	€16.0B	€19.6B	18:00
	GE	Exports SA MoM - May	-0.8%	2.0%	18:00

Continued on following page

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
9-Jul	GE	Imports SA MoM - May	0.1%	-0.8%	18:00
	UK	BOE Asset Purchase Target - Jul	£375B	£375B	23:00
	UK	Bank of England Bank Rate - Jul	0.50%	0.50%	23:00
10-Jul	US	Initial Jobless Claims - 4-Jul	277K	281K	00:30
	US	Continuing Claims - 27-Jun	--	2264K	00:30
	NZ	ANZ Monthly Inflation Gauge MoM - Jun	--	-0.1%	13:00
	AU	Home Loans MoM - May	-3.0%	1.0%	13:30
	AU	Investment Lending - May	--	2.6%	13:30
	AU	Owner-Occupier Loan Value MoM - May	--	3.1%	13:30
	UK	Construction Output SA MoM - May	0.8%	-0.8%	20:30
	UK	Construction Output SA YoY - May	3.1%	1.5%	20:30
	UK	Visible Trade Balance GBP/Mn - May	-£9700	-£8561	20:30
	UK	Trade Balance Non EU GBP/Mn - May	-£2800	-£2094	20:30
	UK	Trade Balance - May	-£2150	-£1202	20:30
	NZ	REINZ House Sales YoY - Jun	--	21.6%	10-15 Jul
	CH	New Yuan Loans CNY - Jun	1050.0B	900.8B	10-15 Jul
	CH	Money Supply M2 YoY - Jun	11.0%	10.8%	10-15 Jul
	CH	Aggregate Financing CNY - Jun	1400.0B	1219.6B	10-15 Jul
	CH	Money Supply M1 YoY - Jun	4.4%	4.7%	10-15 Jul
	CH	Money Supply M0 YoY - Jun	3.1%	1.8%	10-15 Jul
	CH	Foreign Reserves - Jun	$3725.0B	$3730.0B	10-15 Jul
11-Jul	US	Wholesale Inventories MoM - May	0.3%	0.4%	02:00
	US	Wholesale Trade Sales MoM - May	0.9%	1.6%	02:00

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

Economic momentum is slowing and downside risks are apparent. At a time of subdued core inflation, the RBNZ is taking action by cutting the OCR. We expect the RBNZ to ultimately return the OCR to 2.5%, with cuts in July, September and March.

DATE	DATA/EVENT	ECONOMIC SIGNAL	COMMENT
Tue 7 Jul (10:00am)	NZIER Quarterly Survey of Business Opinion – Q3	Turning	As seen in the timelier *Business Outlook* survey, confidence and activity measures should fall from highs. Pricing gauges should remain benign.
Wed 8 Jul (10:00am)	Government Financial Statements – May	Surpluses beckon	The fiscal accounts have been running well ahead of Treasury forecasts. We expect that to continue, highlighting the possibility of a return to full-year OBEGAL surpluses by FY15.
Thu 9 Jul (10:00am)	ANZ Truckometer – Jun	--	--
Thu 9 Jul (10:45am)	Electronic Card Transactions – Jun	Moderating	The underlying pace of retail spending growth is expected to continue slowing as previous supports begin to fade.
Fri 10 Jul (1.00pm)	ANZ Monthly Inflation Gauge – Jun	--	--
10-17 Jul	REINZ Housing Market Statistics – Jun	Watching	It is probably still too soon to assess the impact of recent RBNZ and Government policy announcements, but we'll be watching the data closely.
Mon 13 Jul (10:45am)	Food Price Index – Jun	Seasonal increase	Food prices typically lift in June due to seasonally higher fruit and vegetable prices.
Thu 16 Jul (early am)	GlobalDairyTrade auction	Flat?	We believe we are closer to the trough in prices, although uncertainty over the outlook is high and sentiment is weak.
Thu 16 Jul (10:30am)	Business NZ Manufacturing PMI – Jun	A further fall?	Momentum in the manufacturing sector is beginning to soften.
Thu 16 Jul (10:45am)	CPI – Q2	Benign	Headline inflation is forecast at +0.3% q/q (+0.2% y/y), with a bounce in petrol prices contributing. But outside of this, inflation should remain benign.
Thu 16 Jul (1:00pm)	ANZ Roy Morgan Consumer Confidence – Jul	--	--
Fri 17 Jul (10:00am)	ANZ Job Ads – Jun	--	--
Mon 20 Jul (10:30am)	Business NZ Services PSI – Jun	Still holding up	The services sector has been outperforming other parts of the economy. While some moderation is expected, outperformance is likely to remain a theme.
Tue 21 Jul (10:45am)	International Travel & Migration – May	Beginning to top out	A 5K net PLT inflow is expected, with annual net inflows to hit a record high. Visitor arrivals primed for further falls.
Thu 23 Jul (9:00am)	RBNZ OCR Review	25bp cut	The economy is running at a below-trend pace. At a time of already-low inflation, a lower OCR is needed to get inflation back to the target mid-point.
Fri 24 Jul (10:45am)	Overseas Merchandise Trade – Jun	Commodity price headwinds	Some recoil from the May spike in exports is expected. Commodity export price falls should result in the deteriorating trend in the trade balance reasserting itself.
Thu 30 Jul (10:45am)	Building Consents – Jun	Capped	Nationwide dwelling consent issuance is flat-lining. However, the composition is shifting. Auckland is trending higher, Canterbury is falling.
Fri 31 Jul (1:00pm)	ANZ Business Outlook – Jul	--	--
Fri 31 Jul (3:00pm)	RBNZ Credit Aggregates – Jun	Firming	Overall credit growth is accelerating. While this in part reflects stronger housing credit growth, it is also most likely due to cash flow pressures in the agricultural space.
On balance		**Data watch**	**The economy is running at a sub-trend pace, and risks are skewed to the downside. Inflation is subdued.**

KEY FORECASTS AND RATES

	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
GDP (% qoq)	0.2	**0.5**	**0.6**	**0.6**	**0.7**	**0.7**	**0.6**	**0.6**	**0.6**	**0.6**
GDP (% yoy)	2.6	**2.4**	**2.0**	**2.0**	**2.5**	**2.6**	**2.6**	**2.6**	**2.6**	**2.6**
CPI (% qoq)	-0.3	**0.3**	**0.5**	**0.2**	**0.5**	**0.4**	**0.6**	**0.1**	**0.1**	**0.1**
CPI (% yoy)	0.1	**0.2**	**0.3**	**0.7**	**1.5**	**1.6**	**1.7**	**1.6**	**1.6**	**1.6**
Employment (% qoq)	0.7	**0.5**	**0.4**	**0.4**	**0.3**	**0.3**	**0.3**	**0.3**	**0.3**	**0.3**
Employment (% yoy)	3.2	**3.4**	**2.9**	**2.0**	**1.7**	**1.5**	**1.3**	**1.3**	**1.3**	**1.3**
Unemployment Rate (% sa)	5.8	**5.8**	**5.8**	**5.8**	**5.7**	**5.7**	**5.6**	**5.6**	**5.6**	**5.6**
Current Account (% GDP)	-3.7	**-3.9**	**-4.1**	**-4.5**	**-5.3**	**-5.7**	**-5.9**	**-5.8**	**-5.8**	**-5.8**
Terms of Trade (% qoq)	1.5	**-4.8**	**-5.1**	**-4.5**	**-0.2**	**0.0**	**0.7**	**0.3**	**0.3**	**0.3**
Terms of Trade (% yoy)	-5.3	**-10.0**	**-10.5**	**-12.4**	**-13.8**	**-9.5**	**-4.0**	**0.9**	**0.9**	**0.9**

	Sep-14	Oct-14	Nov-14	Dec-14	Jan-15	Feb-15	Mar-15	Apr-15	May-15	Jun-15
Retail ECT (% mom)	0.1	1.0	0.1	0.0	0.0	1.1	0.7	-0.7	1.2	--
Retail ECT (% yoy)	4.7	5.2	3.2	3.7	4.5	4.0	3.7	3.9	3.2	--
Credit Card Billings (% mom)	0.2	1.4	0.4	-0.5	1.9	0.0	0.6	-0.4	1.9	--
Credit Card Billings (% yoy)	4.5	6.8	5.2	4.6	6.3	5.8	5.2	7.2	7.1	--
Car Registrations (% mom)	2.9	-1.4	0.1	2.1	-0.7	-0.3	2.4	-1.6	-0.4	--
Car Registrations (% yoy)	31.1	21.3	16.5	21.0	17.1	12.1	11.8	11.2	6.8	--
Building Consents (% mom)	-14.9	12.6	12.1	-6.5	-2.5	-5.6	9.9	-0.9	0.0	--
Building Consents (% yoy)	-0.1	13.0	16.1	2.6	7.8	-0.2	7.3	3.1	6.5	--
REINZ House Price Index (% yoy)	3.3	2.6	4.7	5.7	8.5	7.1	8.5	9.3	11.8	--
Household Lending Growth (% mom)	0.3	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.7	--
Household Lending Growth (% yoy)	4.9	4.8	4.7	4.7	4.8	4.9	5.0	5.2	5.5	--
ANZ Roy Morgan Consumer Conf.	127.7	123.4	121.8	126.5	128.9	124.0	124.6	128.8	123.9	119.9
ANZ Business Confidence	13.4	26.5	31.5	30.4	..	34.4	35.8	30.2	15.7	-2.3
ANZ Own Activity Outlook	37.0	37.8	41.7	37.3	..	40.9	42.2	41.3	32.6	23.6
Trade Balance ($m)	-1359	-892	-283	-200	52	84	661	183	350	--
Trade Bal ($m ann)	667	-56	-492	-1183	-1416	-2129	-2372	-2656	-2570	--
ANZ World Commodity Price Index (% mom)	-1.3	-0.9	-1.4	-4.4	-0.3	4.2	4.6	-7.4	-4.9	-3.1
ANZ World Comm. Price Index (% yoy)	-9.5	-11.5	-12.5	-17.2	-18.4	-15.8	-11.9	-15.3	-18.0	-19.7
Net Migration (sa)	4700	5200	4990	4090	5460	4810	5010	4770	5140	--
Net Migration (ann)	45414	47684	49836	50922	53797	55121	56275	56813	57822	--
ANZ Heavy Traffic Index (% mom)	2.6	0.9	-2.9	3.3	0.0	-0.5	-0.4	-0.5	-1.0	--
ANZ Light Traffic Index (% mom)	0.9	0.3	-1.6	2.1	0.7	-0.9	-0.2	0.1	-0.7	--

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	Apr-15	May-15	Today	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
NZD/USD	0.711	0.675	0.669	0.68	0.66	0.65	0.65	0.64	0.64	0.64
NZD/AUD	0.930	0.880	0.893	0.92	0.90	0.90	0.92	0.91	0.91	0.91
NZD/EUR	0.647	0.604	0.607	0.65	0.67	0.64	0.61	0.57	0.57	0.57
NZD/JPY	88.23	82.68	81.86	82.3	80.5	80.0	80.6	80.0	80.0	80.0
NZD/GBP	0.465	0.430	0.430	0.45	0.44	0.43	0.42	0.41	0.41	0.41
NZ$ TWI	75.7	71.2	70.5	73.6	73.0	71.6	70.8	69.1	69.1	69.1
INTEREST RATES	Apr-15	May-15	Today	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
NZ OCR	3.50	3.25	3.25	2.75	2.75	2.50	2.50	2.50	2.50	2.50
NZ 90 day bill	3.47	3.26	3.18	2.90	2.90	2.60	2.60	2.70	2.70	2.70
NZ 10-yr bond	3.63	3.63	3.54	3.80	3.80	3.80	3.90	3.90	3.90	3.90
US Fed funds	0.25	0.25	0.25	0.50	0.75	1.00	1.25	1.50	1.75	1.75
US 3-mth	0.28	0.28	0.28	0.60	0.85	1.10	1.35	1.60	1.85	1.85
AU Cash Rate	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
AU 3-mth	2.15	2.15	2.15	2.20	2.20	2.20	2.20	2.20	2.20	2.20

	3 Jun	29 Jun	30 Jun	1 Jul	2 Jul	3 Jul
Official Cash Rate	3.50	3.25	3.25	3.25	3.25	3.25
90 day bank bill	3.46	3.28	3.26	3.24	3.22	3.22
NZGB 12/17	3.12	2.81	2.84	2.84	2.75	2.73
NZGB 03/19	3.20	2.90	2.92	2.93	2.85	2.83
NZGB 04/23	3.57	3.28	3.27	3.29	3.25	3.23
NZGB 04/27	3.84	3.62	3.62	3.65	3.63	3.62
2 year swap	3.32	3.08	3.09	3.09	3.01	2.98
5 year swap	3.57	3.27	3.29	3.30	3.24	3.20
RBNZ TWI	74.5	71.75	71.19	71.08	70.33	70.56
NZD/USD	0.7136	0.68	0.68	0.68	0.67	0.67
NZD/AUD	0.9228	0.89	0.89	0.88	0.88	0.89
NZD/JPY	88.84	84.07	83.30	83.40	82.70	82.69
NZD/GBP	0.4655	0.44	0.43	0.43	0.43	0.43
NZD/EUR	0.6331	0.62	0.61	0.61	0.61	0.61
AUD/USD	0.7733	0.77	0.77	0.77	0.77	0.76
EUR/USD	1.1272	1.10	1.12	1.11	1.11	1.11
USD/JPY	124.49	122.91	122.37	122.54	123.34	123.07
GBP/USD	1.5330	1.57	1.57	1.57	1.56	1.56
Oil (US$/bbl)	59.67	59.41	58.34	59.48	56.94	56.93
Gold (US$/oz)	1184.45	1183.35	1176.90	1174.35	1168.25	1166.95
Electricity (Haywards)	4.44	2.63	3.47	3.35	3.87	3.75
Baltic Dry Freight Index	598	813	800	794	794	805
Milk futures (USD)	97	93	93	92	91	91

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