ANZ RESEARCH

NEW ZEALAND ECONOMICS
MARKET FOCUS

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INSIDE

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SUBTLE SHIFTS

ECONOMIC OVERVIEW

A June OCR cut from the RBNZ is far from a done deal, with domestic housing and economic anecdotes making it more tenuous with each passing day. That said, we still believe further easing is more likely than not, considering global vulnerabilities and NZD strength amidst currency games from other central banks. The Fed continues to drag its heels over further tightening and more RBA easing can't be ruled out this week following the soft CPI, although recent BoJ and ECB reluctance means it is admittedly not a unanimous signal, and we are on the lookout for any subtle shifts. Domestic labour market data this week is expected to send a decent signal (notwithstanding quarterly volatility), while dairy prices are likely to lift modestly off low levels.

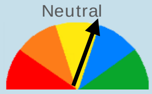
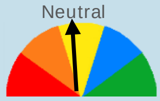
INTEREST RATE STRATEGY

We see the odds of a June OCR cut at about 60%, consistent with current market pricing, although there is also a possibility we may already be at the trough of the OCR cycle. Low inflation has moved market odds of a RBA rate cut this week to more than 50%, putting rates convergence on the backburner for now. Mixed global data and a cautious Fed have contributed to a small retracement in global yields, although pending Fed hikes, along with the improving data pulse in China and Europe, keep yields biased higher. Despite increased local issuance, our high local yields and RBNZ easing bias are expected to see spreads with global yields eventually narrow.

CURRENCY STRATEGY

The NZD has been boosted by a USD that now looks oversold, and by a solid run of domestic data, which has seen RBNZ rate-cutting expectations ease. Our expectation is that NZD will remain stronger than ideal for the export community until the cautious global (particularly US) environment resolves itself. We expect the RBA to hold policy steady this week capping NZD/AUD strength, which is something for importers to consider when making hedging decisions. However, NZD/AUD exporters should note that support has been reaffirmed lower.

THE ANZ HEATMAP

Variable	View	Comment	Risk profile (change to view)
GDP	2.5% y/y for 2016 Q4	While growth momentum looks reasonable now, tighter financial conditions suggest a more moderate backdrop over 2H 2016.	
Unemployment rate	5.3% for 2016 Q4	The unemployment should continue to trend lower. Wage inflation is contained, but a turn maybe in sight.	
OCR	1.75% by Dec 2016	A further 50bps of cuts this year. Growth is set to moderate, inflation is low, and global risks abound.	
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 to remain historically low.	

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SUMMARY

A June OCR cut from the RBNZ is far from a done deal, with domestic housing and economic anecdotes making it more tenuous with each passing day. That said, we still believe further easing is more likely than not, considering global vulnerabilities and NZD strength amidst currency games from other central banks. The Fed continues to drag its heels over further tightening and more RBA easing can't be ruled out this week following the soft CPI, although recent BoJ and ECB reluctance means it is admittedly not a unanimous signal, and we are on the lookout for any subtle shifts. Domestic labour market data this week is expected to send a decent signal (notwithstanding quarterly volatility), while dairy prices are likely to lift modestly off low levels.

FORTHCOMING EVENTS

GlobalDairyTrade Auction (early am, Wednesday, 4 May). Prices should continue to lift modestly off low levels, although the fundamental backdrop is not yet conducive to a meaningful recovery.

Labour Market Statistics – Q1 (10:45am, Wednesday, 4 May). There will no doubt be ongoing vagaries to contend with, but we expect the tone to be solid overall, with decent employment growth (+1.0% q/q) and an unemployment rate that is trending lower (5.5%).

QV House Prices – Apr (12:00pm, Wednesday, 4 May). The Auckland market is coming back to the boil, while regional markets are booming. This measure of nationwide annual price growth should start to stabilise after previously moderating.

ANZ Commodity Price Index – Apr (1:00pm, Wednesday, 4 May).

WHAT'S THE VIEW?

We arguably did not learn a great deal from the RBNZ last week as it kept its cards pretty close to its chest. Yes it kept policy unchanged, when it could have cut again, and the tone of the statement was modestly less dovish than in March (although it was hard for it not to be, to be fair, given the dataflow). But it maintained an easing bias and its base-case looks as though it is still consistent with its March *MPS* where one further 25bp cut was signalled.

It remains our central forecast for now, but we continue to feel that a June OCR cut is far from a done deal. Justifications for cutting certainly exist – dairy woes, NZD strength, low inflation expectations, funding cost pressures, and lingering global vulnerabilities. But when weighed against a domestic economy that is still operating near trend, evidence that core inflation is stabilising, capacity pressures intensifying, re-leveraging behaviour evident by households and housing markets booming nationwide, a June cut is becoming more tenuous with each passing day.

Now just to be clear, we continue to believe that further easing is more likely than not. Our overarching framework behind that is built on our view of current global themes: when we consider the still-vulnerable global backdrop and the actions of other central banks that are no doubt keeping the NZD stronger than desirable, we suspect the RBNZ will get dragged back to the rate-cutting table at some stage. However, it is becoming at the least an interesting question of timing, with the robust domestic economic performance currently usurping the strong NZD theme.

But it is precisely because of this view that we are keeping a very close eye on the actions of other central banks at present, and this backdrop looks to be becoming a little more interesting than the race to the bottom – and below – that has previously dominated. In the past few weeks we have seen both the ECB and BoJ – two central banks that have been embarking on aggressive policy easing – show a reluctance to deliver any more. The ECB shied away from commenting on the euro despite it strengthening over recent months, and it is now facing plenty of internal criticism about the policies it has already implemented. And despite low inflation, a stronger yen, a stagnating economy and a broad expectation that it would ease, the BoJ surprised markets and commentators alike last week by keeping policy unchanged.

We of course need to be careful about making sweeping assessments. An apparent reluctance to act now doesn't mean that will always be the case. Both the ECB and BoJ reiterated that they would ease further if needed, and given low inflation, the risk profile is certainly still skewed in that direction. Moreover, the Fed continues to show a hesitancy to lift rates again and the latest soft CPI figures have meant that further easing from the RBA can't be ruled out (in fact the market now has the odds at over 50% for a cut tomorrow!). The ultra-stimulatory policy settings evident the world over certainly don't look to be disappearing any time soon.

But we still wonder whether the ECB and BoJ's reluctance signals that we are inching closer to the end-game for the significant and unprecedented monetary policy moves seen since the GFC. We'd say it is more of a subtle shift than a game-changer at this stage, but it could still be a meaningful shift nonetheless. RBA Governor Stevens has recently talked about the "diminishing returns"

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from monetary policy easing and the BIS has warned for some time that an overreliance on monetary policy is creating financial stability risks. We agree with the BIS and believe that global economy – and markets – has been too reliant on extraordinarily loose monetary policy for too long. The misallocation of resources across both sectors (excessive consumption) and across time (excessive debt accumulation) is getting too large to ignore. If we are indeed nearing an end game, perhaps this would even put the pressure back on governments around the world to push for better microeconomic outcomes and structural reform, although it is hard to have much confidence in this given the political backdrop and short-termism evident to date.

Admittedly, maybe this is 'pie in the sky' thinking. Even if it is the case that further policy easing is less likely going forward, it is not as if stimulus is about to be removed in any aggressive fashion any time soon – particularly with the Fed continuing to drag its heels over further normalisation. Our house view is that the BoJ will deliver further easing, and further ECB action is also quite likely. Because of that, it is still a world where the NZD will remain supported and higher than "desirable".

Nevertheless, we still believe it is important to keep an eye out for any marginal shifts in the global monetary policy backdrop. Smaller central banks like the RBNZ have been forced into additional policy action in part due to the action of others, and so if that backdrop is changing, even if only subtly, that is something that needs to be taken into consideration.

Turning to the week ahead, March quarter labour market figures are in focus. We expect them to paint a reasonably solid picture overall. Of course, with any labour market data, there is potential for surprises and head-scratchers. The key question ahead of these figures is how the unemployment rate behaves following the surprise plunge in Q4 to a close to a seven-year low of 5.3%.

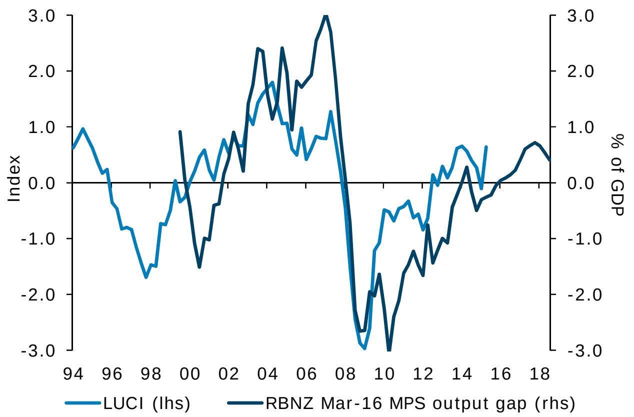
Employment growth is expected to be decent. We have pencilled in a 1.0% q/q increase, which would broadly consistent with the signal provided by firms' hiring intentions as well as our own job ads series. That would be enough to see annual growth lift from its current lows of 1.2% to 1.6%.

But it is the supply side where there is most uncertainty. While we already know that working age population growth increased strongly over the quarter (in fact, annual growth at 2.5% is at an all-time high), it is hard to have a great deal of confidence regarding how the participation rate will behave. History suggests it should increase in line with strong labour demand (to be consistent with the encouraged/discouraged worker effect), but that was not the case in Q4, where it dipped 0.3%pts to 68.4% – the lowest since mid-2013. For what it is worth, we do feel the participation rate will increase in Q1, with our expectation being for it to lift to 68.8%, which would see the unemployment rate tick up to 5.5%. For the record, next quarter will be an even bigger lottery, with Statistics NZ to update its definition of "actively seeking" work such that browsing internet job sites is no longer considered sufficient (consistent with the fact that browsing newspaper job ads has never been sufficient). This could see both the unemployment and participation rates drop sharply – and it is not yet clear how revisions will be handled.

While some may view the higher unemployment rate we anticipate in Q1 as a softer signal, we wouldn't. In fact, if it came in line with our expectation, it would confirm a downward trend in the unemployment rate and be consistent with a labour market backdrop where spare capacity is slowly reducing. That would certainly be consistent with some of the anecdotes we are picking up on the ground.

To be fair, this modestly tighter labour market situation is unlikely to be result in stronger wage growth yet. In fact, wage inflation is expected to remain benign (with the private sector LCI printing at 0.3% q/q, 1.7% y/y), although this is also a reflection of the subdued consumer price inflation backdrop more generally. However, we do believe a turn in the wage cycle is closer at hand. The RBNZ's new Labour Utilisation Composite Index (a useful measure to assess the overall "signal" coming from a number of labour market inputs) is starting to imply that, and we expect it to tighten modestly further in Q1.

FIGURE 1. LABOUR UTILISATION COMPOSITE INDEX VS OUTPUT GAP



Source: ANZ, Statistics NZ

Some further improvement in dairy prices is expected at this week's GDT auction. NZX dairy futures are indicating a 4% lift for the GDT-TWI and

ECONOMIC OVERVIEW

3% for whole milk powder. The main drivers are lower seasonal volumes and the continued price improvements being seen for most other commodities (such as oil reaching US$46-48/bbl).

Only 13,000Mt of WMP is expected to be offered through the May GDT events, the lowest volume ever offered in May. This is expected to increase buyer competition and support prices. That said, Europe has increased its production of WMP recently and it is currently priced more competitively than GDT. This suggests buyers have options, which is likely to cap price improvements coming from lower seasonal supply from New Zealand and little overhang of product heading into next season.

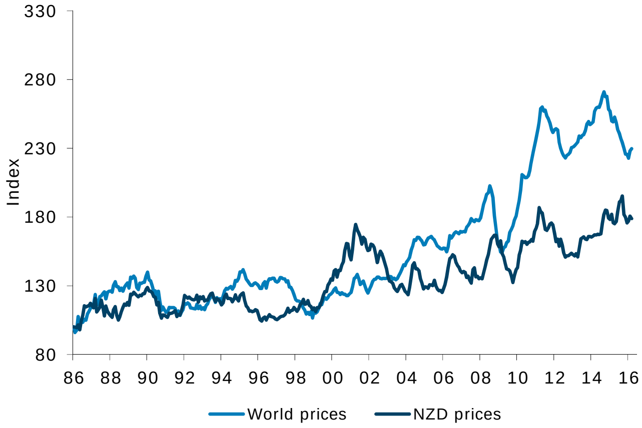
In contrast, New Zealand-sourced SMP has been trading at a discount to European intervention prices. The average price at the last GDT auction was just US$1,727/t, whereas the European intervention price is around US$1,850-$1,900/t. Dairy futures are anticipating prices will lift to these levels at this week's auction.

However, Europe continues to push out more SMP and butter. Europe's domestic market for butter continues to support this product mix – with no butter yet to enter intervention, but some heading into private storage. In stark contrast, SMP inventory levels continue to build rapidly, which will hang over the market for some time. There has also been a substantial build-up of key US dairy products in recent months, with the likes of cheese inventories hitting a 10-year high. It seems at some point the US could start exporting more, with their own domestic market now struggling to absorb increased milk supply.

These global dynamics suggest the sustained improvement in prices that is required to restore profitability (ie to US$3,000/t) remains some way off yet. The light at the end of the tunnel is more aggressive cuts to farm-gate prices in Europe and elsewhere. In recent weeks there has been another wave of cuts across key markets (especially Europe and Australia), which at some point is going to place more pressure on the milk supply brake.

Finally, we will again focus on the non-dairy component of the ANZ Commodity Price Index. Encouragingly, non-dairy prices rose 0.7% m/m in March, which was the second consecutive monthly increase. It followed nine months of falls, and was led by increases in beef, skins, wool and lamb prices. Compared with a year ago, prices are down 7.9%, and 15% below the September 2014 peak. However, NZD prices are only 1.0% below last year's levels. This highlights that while the NZD is still presenting some challenges to the likes of the dairy sector, for many other sectors, its strength is still being offset by respectable global prices overall.

FIGURE 2. NON-DAIRY ANZ COMMODITY PRICES



Source: ANZ

LOCAL DATA

Overseas Merchandise Trade – Mar. An unadjusted trade surplus of $117m was recorded, although a deficit of $588m in seasonally adjusted terms was seen.

RBNZ OCR Review. The cash rate was left at 2.25%, although an easing bias was retained ("further policy easing may be required").

Building Consents Issued – Mar. Total dwelling consents fell 9.8% m/m, fully reversing a 10% m/m gain in February.

ANZ Business Outlook – Apr. Headline confidence lifted from +3 to +6, still a low level. However, firms' own activity expectations rose to a decent +32.

RBNZ Credit Aggregates – Mar. Total private sector credit grew at 0.5% m/m (+7.0% y/y).

INTEREST RATE STRATEGY

SUMMARY

We see the odds of a June OCR cut at about 60%, consistent with current market pricing, although there is also a possibility we may already be at the trough of the OCR cycle. Low inflation has moved market odds of a RBA rate cut this week to more than 50%, putting rates convergence on the backburner for now. Mixed global data and a cautious Fed have contributed to a small retracement in global yields, although pending Fed hikes, along with the improving data pulse in China and Europe, keep yields biased higher. Despite increased local issuance, our high local yields and RBNZ easing bias are expected to see spreads with global yields eventually narrow.

THEMES

- Small back-up in local short-term yields and curve flattening as no OCR cut delivered. Global curves have mildly steepened, with larger falls in short-term rates.
- The door to a June OCR cut remains open, and that remains our forecast for now, but we see this as very much a line-ball call (we put the odds of a cut at about 60%).
- Rates convergence for short to mid-term rates likely to be put on the backburner given the renewed possibility of an RBA cut this week.
- Curves are biased to steepen, but this is expected to be modest, given the gradualist and data-dependent nature of Fed hikes. Spreads have widened of late, but we continue to expect eventual convergence in local and global yields despite increased local supply.

PREFERRED STRATEGIES – INVESTORS

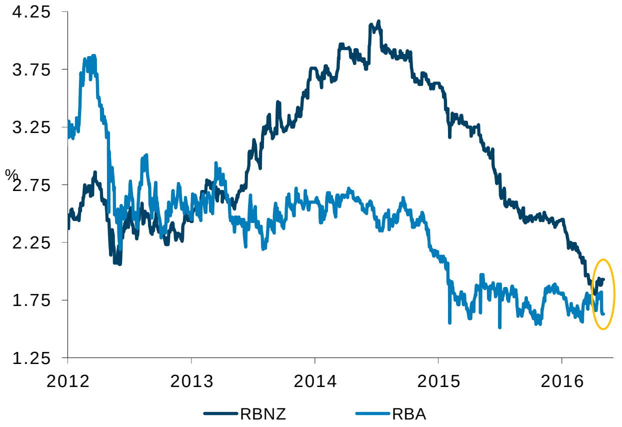
KEY VIEWS – FOR INVESTORS		
GAUGE	**DIRECTION**	**COMMENT**
Duration	Neutral	Near-term reasonable; long-end rates still high in global context.
2s10s Curve	Steeper	OCR biased lower, but long end still biased mildly higher.
Geographic 10yr spread	Narrower	Divergent policy biases argue for gradual narrowing.
Swap spreads	Neutral	Risk of narrowing, given increased bond supply.

AMBIGUITY ABOUNDS

Post the RBNZ OCR decision, local yields have nudged higher, with larger moves for near and short-term rates. In fact, local rates have done something of a round-trip since the March *MPS*, with yields beyond the 1-year tenor back to where they were preceding the *MPS*. Short-end swap yields have drifted higher but on thin volumes, although receiving interest has acted to temper increases. For longer tenors, spreads with global yields have widened as local yields have not taken part in the global rally.

With the RBNZ retaining an easing bias, market pricing has gravitated towards a June OCR cut, which is just under 60% priced. **This is consistent with the 60% odds we put on a June cut, although we note that if the global scene stabilises the current OCR rate could well be the trough this cycle. Indeed, the risk is that short-term yields back up further as the 31bps of cuts priced in by the end of the year is wound back.** This week's local data is expected to confirm a low-wage backdrop and a marginally higher unemployment rate, whilst still showing that labour market and economic activity in general is doing okay. A small climb is expected for prices at this week's GlobalDairyTrade auction.

FIGURE 1: 12 MONTH AHEAD CASH RATE EXPECTATIONS



Source: ANZ, Bloomberg

A theme we had been emphasising of late has been interest rate convergence, driven by respective policy outlooks (RBNZ cuts, RBA on hold). Following the weak Q1 CPI report, the market is increasingly trying to second-guess the RBA, particularly as the April RBA assessment flagged that continued low inflation "would provide scope for easier policy". Market odds of an RBA cut have risen significantly, with a cut now more than 50% priced. Short-end spreads between NZ and Australian rates also widened significantly towards the end of last week. Kiwi swaps look to be a strategic short-term receive if the RBA stands pat, and the RBNZ cuts over the next few months.

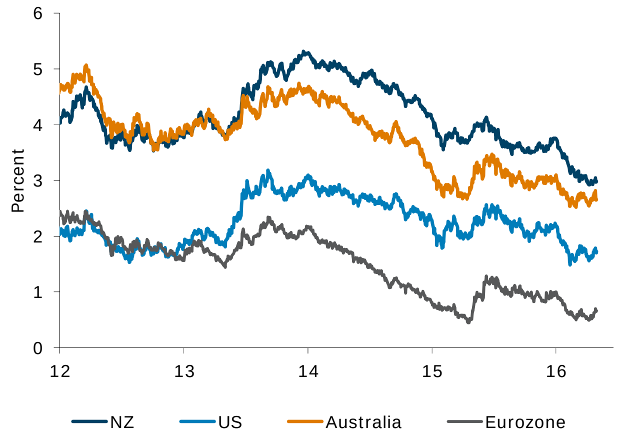
Global curves have mildly steepened, driven by a slightly larger rally in short-term yields. Whilst the Fed signalled that rates are set to move up, the tone of its latest policy assessment was cautious. Markets have remained sceptical, with odds of a 25bp hike only about two-thirds priced by the end of the year**.** The US dataflow has been mixed, with Q1 GDP

INTEREST RATE STRATEGY

and consumer spending subdued, although rising employment and wage growth boosting labour incomes. **The bond curve is perhaps under pressure to flatten further if US data disappoints.** Our forecasts have a June Fed hike pencilled in, but this is conditional on the dataflow improving. Coming off a barrage of weak US corporate earnings reports – including Apple's first revenue drop in 13 years – markets will looks to April jobs data and ISM reports this week for signs.

Chinese data has remained resilient and Euro area data has been on an improving trajectory, as evidenced by stronger-than-expected Q1 GDP. However, Euro-area inflation readings have surprised to the downside, helping to cap yields.

FIGURE 2: 10 YEAR SWAP RATES



Source: ANZ, Bloomberg

The easing bias from the RBNZ and our relatively high outright local yields are supporting local long-term yields, which are hovering around historical lows. Despite increasing bond issuance set to come on stream, demand for NZD assets shows few signs of letting up. There was strong demand for the $150m tender of the 2033 bond, with $612m of bids and a coverage ratio of 4.08. This week's $100m tender of the 2035 bond will also provide a further test for the market. Next week's figures will be examined for signs of increased demand by non-residents for New Zealand government bonds, from the 67.4% in March.

The collapse in global break-even inflation rates looks to have coincided with the decline in oil prices, and whilst the recovery in crude oil prices has seen global break-evens bounce, lifts in Kiwi yields have lagged. While our local yields are less sensitive to movements in oil prices compared to US yields, this theme also applies to local yields. **Add to this the increased emphasis the RBNZ seems to be placing on pushing up headline inflation to the inflation target midpoint and linkers look to provide good value.**

PREFERRED STRATEGIES – BORROWERS

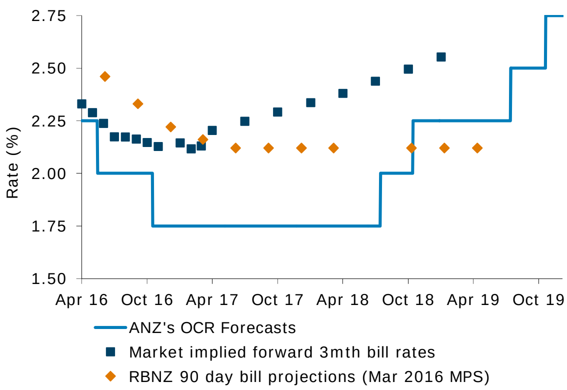
Local rates are historically very low and it is cheap to fix. Our bias is for rates to gradually drift higher, but with few catalysts on the horizon to signal an impending 'snap' higher in longer-term yields, and with the risk that this improved environment proves fleeting, borrowers can likely afford to wait on the side lines. Credit spreads are likely to remain volatile and subject to swings in global sentiment. Swap hedges are ineffectual in protecting against movements in credit spreads and could prove counter-productive if swap rates fall. This, and the volatile trading environment, **has us biased towards favouring an option-based strategy when it comes to new hedging.** This makes the decision to take on more expensive term hedging a difficult one.

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

Odds are skewed towards a June OCR cut, with 14bps of cuts priced in, 23bps by August and 31bps by the end of the year. This is consistent with our view of the risk profile relative to the 50bps of cuts we forecast for the remainder of the year. Current market pricing, in which hikes from mid-2017 are signalled, looks premature considering the lack of inflationary pressure and we expect some of the recent selloff in the belly of the curve to be unwound.

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



Source: ANZ, Bloomberg

CURRENCY STRATEGY

SUMMARY

The NZD has been boosted by a USD that now looks oversold, and by a solid run of domestic data, which has seen RBNZ rate-cutting expectations reduced. Our expectation is that NZD will remain stronger than "desirable" for the economy until the cautious global (particularly US) environment resolves itself. We expect the RBA to hold policy steady this week, capping NZD/AUD strength, which is something for importers to consider when making hedging decisions. However, NZD/AUD exporters should note that support has been reaffirmed lower.

TABLE 1: KEY VIEWS

CROSS	WEEK	MONTH	YEAR
NZD/USD	↔/↑	Awaiting catalysts	Profile still lower
NZD/AUD	↔	Supported	Remain above long-run averages
NZD/EUR	↔	Still in range	Political risks for EUR
NZD/GBP	↔/↓	Brexit driving higher	GBP resurgence
NZD/JPY	↓	Risks are lower	JPY returning to averages

THEMES AND RISKS

- The domestic labour market data is expected to remain positive, continuing the run of local data supporting NZD.
- After last week's soft Q1 CPI, markets will be closely watching the RBA for a dovish tilt (or even a cut). Failure to meet these expectations could cap NZD/AUD.
- US manufacturing activity and payrolls data need to be strong to lift USD, given Fed caution.

TABLE 2: KEY UPCOMING EVENT RISK

EVENT		WHEN (NZST)	IMPACT RISK
AUD	NAB B/C	Mon 13:30	NZD/AUD ↑
EUR	Markit PMIs	Mon 20:00	NZD/EUR ↓
USD	ISM	Tue 02:00	NZD/USD ↓
CNY	Caixin (mfg) PMI	Tue 13:45	NZD/CNY ↑
AUD	RBA	Tue 16:30	NZD/AUD ↑
AUD	Federal Budget	Tue pm	NZD/AUD ↔/↓
GBP	Markit (mfg) PMI	Tue 20:30	NZD/AUD ↓
NZD	GDT auction	Wed am	NZD ↑
NZD	Employment	Wed 10:45	NZD ↑
NZD	QV house prices	Wed 12:00	NZD ↔
NZD	ANZ Commodities	Wed 13:00	NZD
EUR	Markit (svcs) PMI	Wed 20:00	NZD/EUR ↓
USD	ISM (n-mfg)	Thu 02:00	NZD/USD ↓
AUD	T/B, retail sales	Thu 13:30	NZD/AUD ↓
CNY	Caixin (svcs) PMI	Thu 13:45	NZD
GBP	Markit (svcs) PMI	Thu 20:30	NZD/GBP ↓
AUD	RBA SOMP	Fri 13:30	NZD/AUD ↓
USD	Payrolls	Sat 00:30	NZD/USD ↑
CNY	Trade balance	Sat pm	NZD/CNY ↑

EXPORTERS' STRATEGY

Exporters may wish to hold out given the potential for USD to again find demand.

IMPORTERS' STRATEGY

Importers could take advantage of NZD strength as long-term factors suggest strength will be transient. NZD/AUD importers should consider strength as an opportunity for hedging, given we were recently lower.

DATA PULSE

The US Federal Reserve maintained a cautious tone, leaving USD under pressure. US data was soft, with the Markit PMI, Philadelphia Fed, Chicago PMI, spending, and Q1 GDP all softer than expectations.

The RBNZ was perceived as less dovish, allowing NZD to lift. ANZ business confidence remained resilient, although trade data revealed that seasonally adjusted March export values were their lowest since 2009. **JPY was unequivocally strong** as the BoJ missed market expectations and kept policy steady. Japanese inflation continued to ease and we continue to believe the BoJ will act again.

AUD fell as headline Q1 CPI was unexpectedly negative. With the report generally soft, markets sent AUD yields and the AUD lower.

Chinese PMIs eased, but remained expansionary.

GBP continued to rise as Brexit fears eased. Q1 GDP and net consumer credit remained solid.

EUR strengthened, following a stronger Q1 GDP, rather than the weak April CPI.

TABLE 3: NZD VS AUD: MONTHLY GAUGES

GAUGE	GUIDE	COMMENT
Fair value	↔	FV is above long-run averages.
Yield	↑	Yields have gone in NZ's favour.
Commodities	↔	Iron ore strength priced.
Data	↔/↓	CPI aside, Australian data solid.
Techs	↔	Back to mid-range.
Sentiment	↔	Equal reactions to sentiment.
Other	↔/↓	NZD has higher beta to global.
On balance	↔	**Mid-range.**

TABLE 4: NZD VS USD: MONTHLY GAUGES

GAUGE	GUIDE	COMMENT
Fair value	↔	Closer to fair value.
Yield	↔/↑	Markets pricing out RBNZ.
Commodities	↔	Risks reasonably well priced.
Risk aversion	↔/↑	Resilience to risk notable.
Data	↔/↓	US data has been soft and NZD strong, leaving risks one way.
Techs	↔/↑	The break higher has not yet been negated.
Other	↔/↓	Global sentiment improving, which releases the Fed.
On balance	↔/↓	**Factors point lower, but near-term catalysts missing.**

CURRENCY STRATEGY

TECHNICAL OUTLOOK

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

The uptrend in NZD/USD remained in place and pivotal support near the 55 and 100dma's (0.6786 & 0.6720 respectively) will need to be broken to negate it. The next major resistance is the 0.72 resistance. The overall profile still suggests selling NZD/USD should it test higher.

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

NZD/AUD has pivoted away from the head and shoulders, and now looks like it will remain in the range. With the 0.91 pivot now broken again we are clear for a test toward 0.94. However, the key lesson from last week is that support in the 0.88's has been reaffirmed, and should remain strong.

TABLE 5: KEY TECHNICAL ZONES		
CROSS	**SUPPORT**	**RESISTANCE**
NZD/USD	0.6710 – 0.6750 0.6600 – 0.6650	0.7050 – 0.7080 0.7160 – 0.7200
NZD/AUD	0.8780 – 0.8820 0.8700 – 0.8740	0.9400 – 0.9430 0.9480 – 0.9520
NZD/EUR	0.5800 – 0.5850	0.6280 – 0.6330
NZD/GBP	0.4630 – 0.4660	0.4930 – 0.4980
NZD/JPY	69.80 – 70.20	78.70 – 79.50

POSITIONING

USD longs continue to be reduced as markets increased their AUD long positions by about a third, before the Q1 CPI. NZD longs were also increased, along with JPY longs before the BoJ. EUR and GBP shorts were both cut.

GLOBAL VIEWS

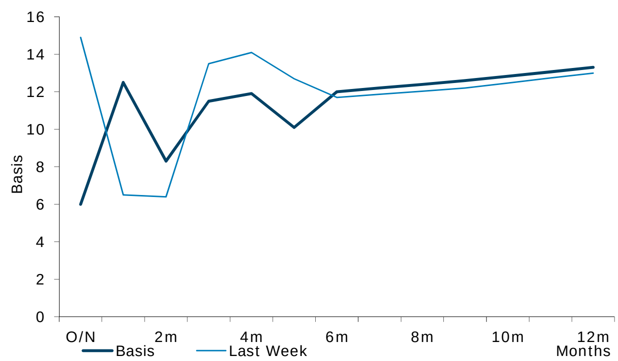
Last week the BoJ held policy steady – despite economic data that suggests it will need to act, and despite downgrading its inflation and growth forecasts. This elicited a 4.7% drop in USD/JPY. The JPY reaction is notable, as it reflects a theme running through currency markets at present, which is to question the limits of monetary policy's ability to impact currencies.

NZD reflects this dynamic, with the NZD trading higher on both a trade-weighted and USD basis than prior to the surprise March OCR cut. In RBA week, it is also a relevant dynamic given RBA Governor Stevens talked about this topic in New York recently.

This has implications for central banks such as the RBNZ that have had issues with currency strength, and argues that the reaction of currencies to monetary policy easing may be changing. All else equal, this could keep NZD elevated. However, as noted on page 2, it appears central banks are also questioning the limits of their powers and may pull back on the easing throttle, which could reduce upward pressure on NZD.

FORWARDS: CARRY AND BASIS

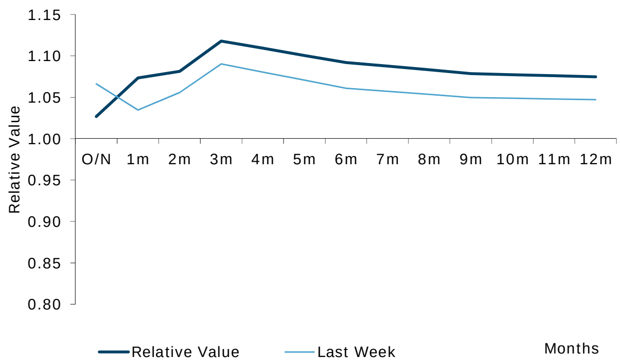
FIGURE 3. NZD/USD SHORT BASIS CURVE



Source: ANZ, Bloomberg, Reuters

Earlier last week, basis contracted as the forward market anticipated RBNZ action. However, when no action was forthcoming, basis pushed wider with interest to unwind S/B positions. Cash levels suggest spot markets are relatively comfortably positioned.

FIGURE 4. RELATIVE ATTRACTION OF THE FWD CURVE



Source: ANZ, Bloomberg, Reuters

DATA EVENT CALENDAR

DATE	COUNTRY	DATA / EVENT	MKT.	LAST	NZ TIME
2-May	AU	Melbourne Institute Inflation MoM - Apr	--	0.0%	13:00
	AU	Melbourne Institute Inflation YoY - Apr	--	1.7%	13:00
	AU	NAB Business Conditions - Apr	--	12	13:30
	AU	NAB Business Confidence - Apr	--	6	13:30
	AU	Commodity Index AUD - Apr	--	86.6	18:30
	AU	Commodity Index YoY - Apr	--	-15.4%	18:30
	GE	Markit/BME Manufacturing PMI - Apr F	51.9	51.9	19:55
	EC	Markit Manufacturing PMI - Apr F	51.5	51.5	20:00
	CH	Leading Index - Mar	--	99	2-3 May
3-May	US	Markit Manufacturing PMI - Apr F	50.8	50.8	01:45
	US	ISM Manufacturing - Apr	51.4	51.8	02:00
	US	ISM Prices Paid - Apr	52.0	51.5	02:00
	US	ISM New Orders - Apr	--	58.3	02:00
	US	Construction Spending MoM - Mar	0.5%	-0.5%	02:00
	AU	ANZ-RM Consumer Confidence Index - 1-May	--	111.7	11:30
	AU	Building Approvals MoM - Mar	-2.0%	3.1%	13:30
	AU	Building Approvals YoY - Mar	-14.0%	-9.0%	13:30
	CH	Caixin PMI Mfg - Apr	49.8	49.7	13:45
	AU	RBA Cash Rate Target - May	2.00%	2.00%	16:30
	UK	Markit PMI Manufacturing SA - Apr	51.2	51.0	20:30
	EC	PPI MoM - Mar	0.0%	-0.7%	21:00
	EC	PPI YoY - Mar	-4.3%	-4.2%	21:00
4-May	US	ISM New York - Apr	--	50.4	01:45
	US	IBD/TIPP Economic Optimism - May	46.5	46.3	02:00
	NZ	Unemployment Rate - Q1	5.5%	5.3%	10:45
	NZ	Employment Change QoQ - Q1	0.6%	0.9%	10:45
	NZ	Employment Change YoY - Q1	1.3%	1.3%	10:45
	NZ	Participation Rate - Q1	68.6%	68.4%	10:45
	NZ	Pvt Wages Ex Overtime QoQ - Q1	0.3%	0.4%	10:45
	NZ	Pvt Wages Inc Overtime QoQ - Q1	0.3%	0.4%	10:45
	NZ	Average Hourly Earnings QoQ - Q1	0.5%	0.2%	10:45
	AU	AiG Perf of Services Index - Apr	--	49.5	11:30
	NZ	QV House Prices YoY - Apr	--	11.4%	12:00
	NZ	ANZ Commodity Price - Apr	--	-1.3%	13:00
	GE	Markit Services PMI - Apr F	54.6	54.6	19:55
	GE	Markit/BME Composite PMI - Apr F	53.8	53.8	19:55
	EC	Markit Services PMI - Apr F	53.2	53.2	20:00
	EC	Markit Composite PMI - Apr F	53.0	53.0	20:00
	UK	Markit/CIPS Construction PMI - Apr	54.0	54.2	20:30
	EC	Retail Sales MoM - Mar	-0.1%	0.2%	21:00
	EC	Retail Sales YoY - Mar	2.6%	2.4%	21:00
	US	MBA Mortgage Applications - 29-Apr	--	-4.1%	23:00
5-May	US	ADP Employment Change - Apr	195k	200k	00:15
	US	Trade Balance - Mar	-$41.1B	-$47.1B	00:30
	US	Nonfarm Productivity - Q1 P	-1.3%	-2.2%	00:30
	US	Unit Labor Costs - Q1 P	3.0%	3.3%	00:30
	US	Markit Services PMI - Apr F	52.1	52.1	01:45
	US	Markit Composite PMI - Apr F	--	51.7	01:45

Continued on following page

DATA EVENT CALENDAR

DATE	COUNTRY	DATA / EVENT	MKT.	LAST	NZ TIME
5-May	US	ISM Non-Manf. Composite - Apr	54.7	54.5	02:00
	US	Factory Orders - Mar	0.6%	-1.7%	02:00
	US	Factory Orders Ex Trans - Mar	--	-0.8%	02:00
	US	Durable Goods Orders - Mar F	0.8%	0.8%	02:00
	US	Durables Ex Transportation - Mar F	-0.1%	-0.2%	02:00
	US	Cap Goods Orders Nondef Ex Air - Mar F	--	0.0%	02:00
	US	Cap Goods Ship Nondef Ex Air - Mar F	--	0.3%	02:00
	AU	HIA New Home Sales MoM - Mar	--	-5.3%	13:00
	AU	Trade Balance - Mar	-2900M	-3410M	13:30
	AU	Retail Sales MoM - Mar	0.3%	0.0%	13:30
	AU	Retail Sales Ex Inflation QoQ - Q1	0.7%	0.6%	13:30
	CH	Caixin PMI Services - Apr	--	52.2	13:45
	CH	Caixin PMI Composite - Apr	--	51.3	13:45
	UK	Halifax House Prices MoM - Apr	-0.3%	2.6%	19:30
	UK	Halifax House Price 3Mths/Year - Apr	9.6%	10.1%	19:30
	EC	Markit Retail PMI - Apr	--	49.2	20:10
	UK	Official Reserves Changes - Apr	--	$756M	20:30
	UK	Markit/CIPS Services PMI - Apr	53.5	53.7	20:30
	UK	Markit/CIPS Composite PMI - Apr	53.2	53.6	20:30
	US	Challenger Job Cuts YoY - Apr	--	31.7%	23:30
6-May	US	Initial Jobless Claims - 30-Apr	260k	257k	00:30
	US	Continuing Claims - 23-Apr	2124k	2130k	00:30
	AU	AiG Perf of Construction Index - Apr	--	45.2	11:30
	AU	Foreign Reserves - Apr	--	A$64.3B	18:30
	GE	Markit Construction PMI - Apr	--	55.8	19:30
	GE	Markit Retail PMI - Apr	--	54.1	20:10
	CH	BoP Current Account Balance - Q1 P	--	$91.9B	UNSPECIFIED
7-May	US	Change in Nonfarm Payrolls - Apr	200k	215k	00:30
	US	Change in Private Payrolls - Apr	190k	195k	00:30
	US	Change in Manufact. Payrolls - Apr	-5k	-29k	00:30
	US	Unemployment Rate - Apr	5.0%	5.0%	00:30
	US	Average Hourly Earnings MoM - Apr	0.3%	0.3%	00:30
	US	Average Hourly Earnings YoY - Apr	2.4%	2.3%	00:30
	US	Consumer Credit - Mar	$16.00B	$17.22B	07:00
	CH	Foreign Reserves - Apr	$3200.0B	$3212.6B	UNSPECIFIED

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

LOCAL DATA WATCH

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

DATE	DATA/EVENT	ECONOMIC SIGNAL	COMMENT
Wed 4 May (early am)	GlobalDairyTrade Auction	Lift off lows	Prices should continue to lift modestly off low levels, although the fundamental backdrop not yet conducive of a meaningful recovery.
Wed 4 May (10:45am)	Labour Market Statistics – Q1	Solid, but unemployment recoil	The tone of the data should be reasonable overall, although the unemployment rate should bounce after Q4's sharp fall.
Wed 4 May (12:00pm)	QV House Prices – Apr	Regional mix	The Auckland market is coming back to the boil, while regional markets are booming.
Wed 4 May (1:00pm)	ANZ Commodity Price Index – Apr	--	--
10-13 May	REINZ Housing Market Statistics – Apr	Boom times	Last month's figures showed that almost every region is strengthening markedly. Another month of that would confirm the trend.
Tue 10 May (10:00am)	ANZ Truckometer – Apr	--	--
Tue 10 May (10:00am)	Government Financial Statements – Mar	Decent	Tax revenue is running ahead of forecast as stronger real activity offsets the impact of low inflation.
Tue 10 May (10:45am)	Electronic Card Transactions – Apr	Holding up	Strong population growth, lower interest rates, an improving labour market and low petrol prices are supporting spending.
Wed 11 May (9:00am)	RBNZ Financial Stability Report	Increased concern	More concern will be highlighted, both domestically (dairy, housing) and also re offshore. We wouldn't rule out additional macro-prudential measures being signalled.
Thu 12 May (10:30am)	BNZ-Business NZ Manufacturing PMI – Apr	Moderating	Activity is holding at a reasonable level, but does look to be moderating from the strong pace seen earlier in the year.
Thu 12 May (10:45am)	Food Price Index – Apr	Benign	A flat to slightly positive increase is expected for the month.
Fri 13 May (10:45am)	Retail Trade Survey – Q1	Solid	Another decent lift in sales volumes is likely, with support from population growth, low interest rates and discounting.
Mon 16 May (10:30am)	BNZ-Business NZ Services PSI – Apr	Holding	Services sector activity has moderated off strong levels. We expect it to continue to hold at a decent level overall.
Tue 17 May (3:00pm)	RBNZ Survey of Expectations – Q2	Stable	Inflation expectations are likely to stabilise at a low level, although recent petrol price increases imply some upside.
Wed 18 May (early am)	GlobalDairyTrade Auction	Still low	We still believe the fundamental backdrop is not yet conductive of a meaningful recovery in prices.
Wed 18 May (10:45am)	PPI – Q1	Lower	Commodity price movements will continue to dominate, with both input and output price indices likely to be lower.
Thu 19 May (10:00am)	ANZ Job Ads – Apr	--	--
Thu 19 May) (1:00pm	ANZ-Roy Morgan Consumer Confidence – May	--	--
Fri 20 May (10:45am)	International Travel & Migration – Apr	Strong	Last month showed a softer net inflow, although we are not yet ready to call the turn in the migration cycle.
Wed 25 May (10:45am)	Overseas Merchandise Trade – Apr	Export recovery	Seasonally adjusted export values fell sharply in March (and February). We expect some recovery.
Thu 26 May (2:00pm)	Budget	Slowly on the mend	The projections will show an ongoing gradual pace of fiscal improvement, with the figures overall looking good relative to many international peers.
On balance		**Data watch**	**Reasonable momentum at present, but with risks. Inflation remains low.**

KEY FORECASTS AND RATES

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
GDP (% qoq)	0.9	**0.7**	**0.7**	**0.6**	**0.6**	**0.6**	**0.7**	**0.7**	**0.7**	**0.7**
GDP (% yoy)	2.3	**2.8**	**3.1**	**2.8**	**2.5**	**2.4**	**2.4**	**2.5**	**2.6**	**2.7**
CPI (% qoq)	-0.5	0.2	**0.4**	**0.4**	**0.0**	**0.6**	**0.4**	**0.7**	**0.3**	**0.6**
CPI (% yoy)	0.1	0.4	**0.4**	**0.5**	**1.0**	**1.4**	**1.4**	**1.7**	**1.9**	**1.9**
Employment (% qoq)	0.9	**1.0**	**0.5**	**0.5**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**
Employment (% yoy)	1.4	**1.3**	**2.0**	**3.0**	**2.4**	**1.8**	**1.7**	**1.7**	**1.6**	**1.6**
Unemployment Rate (% sa)	5.3	**5.5**	**5.5**	**5.4**	**5.3**	**5.2**	**5.2**	**5.1**	**5.1**	**5.0**
Current Account (% GDP)	-3.0	**-3.3**	**-3.5**	**-4.0**	**-4.6**	**-5.0**	**-5.1**	**-5.0**	**-4.8**	**-4.6**
Terms of Trade (% qoq)	-2.0	**-1.9**	**-3.0**	**-2.7**	**-0.4**	**0.8**	**1.8**	**2.7**	**1.8**	**0.8**
Terms of Trade (% yoy)	-3.2	**-6.1**	**-10.3**	**-9.3**	**-7.8**	**-5.3**	**-0.6**	**5.0**	**7.3**	**7.2**

	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16
Retail ECT (% mom)	0.4	0.4	0.9	0.1	0.8	0.2	0.3	0.6	0.1	--
Retail ECT (% yoy)	5.6	4.2	6.1	5.8	4.6	6.6	5.2	9.2	6.2	--
Credit Card Billings (% mom)	1.7	1.5	-2.0	1.7	0.7	-0.7	1.8	-0.5	-1.1	--
Credit Card Billings (% yoy)	9.7	10.4	7.3	7.8	8.5	7.4	8.2	7.3	4.8	--
Car Registrations (% mom)	0.5	-2.3	0.0	-1.3	-1.9	3.1	-2.9	5.7	-3.9	--
Car Registrations (% yoy)	10.7	7.8	5.0	3.8	1.3	2.4	-1.1	7.4	-0.2	--
Building Consents (% mom)	22.2	-7.1	-4.8	5.0	1.7	2.7	-8.4	10.3	-9.8	--
Building Consents (% yoy)	21.8	11.1	17.5	14.6	7.2	17.7	4.9	26.7	0.6	--
REINZ House Price Index (% yoy)	14.9	17.3	20.1	14.1	12.5	12.6	10.7	11.9	13.3	--
Household Lending Growth (% mom)	0.7	0.6	0.7	0.7	0.6	0.6	0.6	0.6	0.6	--
Household Lending Growth (% yoy)	6.0	6.3	6.7	6.9	7.2	7.4	7.5	7.6	7.7	--
ANZ Roy Morgan Consumer Conf.	113.9	109.8	110.8	114.9	122.7	118.7	121.4	119.7	118.0	120.0
ANZ Business Confidence	-15.3	-29.1	-18.9	10.5	14.6	23.0	..	7.1	3.2	6.2
ANZ Own Activity Outlook	19.0	12.2	16.7	23.7	32.0	34.4	..	25.5	29.4	32.1
Trade Balance ($m)	-730	-1090	-1140	-905	-795	-42	12	367	117	--
Trade Bal ($m ann)	51643	52446	52287	52101	52648	52510	52764	52834	52677	--
ANZ World Commodity Price Index (% mom)	-5.5	-5.3	5.6	7.1	-5.6	-1.8	-2.3	0.5	-1.3	--
ANZ World Comm. Price Index (% yoy)	-22.1	-23.6	-18.2	-11.6	-15.3	-12.9	-14.7	-17.8	-22.4	--
Net Migration (sa)	5740	5500	5610	6150	6240	5540	6090	5990	5330	--
Net Migration (ann)	59639	60290	61234	62477	63659	64930	65911	67391	67619	--
ANZ Heavy Traffic Index (% mom)	-0.1	-0.3	1.8	0.9	0.2	3.0	-4.4	1.7	2.5	--
ANZ Light Traffic Index (% mom)	-0.3	-0.5	2.6	-0.4	-1.1	1.0	-1.4	2.3	0.8	--

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	Feb-16	Mar-16	Today	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
NZD/USD	0.661	0.693	0.699	0.65	0.63	0.59	0.58	0.58	0.60	0.62
NZD/AUD	0.925	0.902	0.919	0.88	0.88	0.88	0.88	0.88	0.88	0.89
NZD/EUR	0.606	0.609	0.610	0.59	0.59	0.55	0.52	0.50	0.50	0.51
NZD/JPY	74.62	77.81	74.37	68.3	66.2	62.0	58.0	58.0	60.0	62.0
NZD/GBP	0.477	0.481	0.479	0.48	0.43	0.39	0.37	0.37	0.38	0.38
NZ$ TWI	71.0	72.2	73.7	68.6	67.1	63.4	61.4	60.9	61.8	63.1
INTEREST RATES	Feb-16	Mar-16	Today	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
NZ OCR	2.50	2.25	2.25	2.00	2.00	1.75	1.75	1.75	1.75	1.75
NZ 90 day bill	2.56	2.34	2.38	2.20	2.10	2.00	2.00	2.00	2.00	2.00
NZ 10-yr bond	2.97	2.93	2.85	3.00	2.90	2.90	3.10	3.20	3.40	3.50
US Fed funds	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50
US 3-mth	0.63	0.63	0.64	0.83	0.83	1.08	1.08	1.33	1.33	1.58
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	2.29	2.29	2.15	2.30	2.30	2.40	2.40	2.40	2.40	2.40

	29 Mar	25 Apr	26 Apr	27 Apr	28 Apr	29 Apr
Official Cash Rate	2.25	2.25	2.25	2.25	2.25	2.25
90 day bank bill	2.35	2.32	2.33	2.32	2.39	2.40
NZGB 12/17	2.14	2.12	2.15	2.11	2.13	2.11
NZGB 03/19	2.28	2.20	2.25	2.22	2.22	2.20
NZGB 04/23	3.05	2.72	2.77	2.75	2.71	2.70
NZGB 04/27	3.38	2.86	2.91	2.90	2.85	2.84
2 year swap	2.24	2.20	2.23	2.20	2.26	2.26
5 year swap	2.47	2.38	2.40	2.39	2.40	2.41
RBNZ TWI	71.9	72.76	72.56	72.71	73.09	73.29
NZD/USD	0.6749	0.69	0.69	0.69	0.69	0.70
NZD/AUD	0.89	0.89	0.89	0.90	0.91	0.91
NZD/JPY	76.62	75.68	76.35	76.44	75.72	74.81
NZD/GBP	0.47	0.48	0.47	0.47	0.48	0.48
NZD/EUR	0.60	0.61	0.61	0.61	0.61	0.61
AUD/USD	0.76	0.77	0.77	0.76	0.76	0.77
EUR/USD	1.12	1.13	1.13	1.13	1.13	1.14
USD/JPY	113.53	109.41	111.02	111.09	109.34	107.28
GBP/USD	1.42	1.43	1.45	1.46	1.45	1.46
Oil (US$/bbl)	37.99	42.76	41.67	42.52	45.29	46.03
Gold (US$/oz)	1218.55	1234.95	1236.85	1244.01	1249.75	1275.95
Electricity (Haywards)	5.17	7.07	6.24	7.81	7.28	6.59
Baltic Dry Freight Index	409	690	704	715	710	703
Milk futures (USD)	40	44	45	46	47	47

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