ANZ RESEARCH

NEW ZEALAND MARKET FOCUS

13 March 2017

INSIDE

NZ ECONOMICS TEAM

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

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

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

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

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

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

BATTLE-LINES

ECONOMIC OVERVIEW

A notable shift in tone from key global central banks raises some key questions with regards to the global liquidity cycle, asset valuations, the trajectory for the NZD and by association, the stance of the RBNZ. The USD is in the box seat and yields have risen. But what does the shift in central bank stance and tightening in US financial conditions mean for future growth prospects? Do higher real yields mean asset valuations are at risk of realignment? Additionally, political risks still abound with markets less data-sensitive and more reactive to non-data developments. Plenty of risks and uncertainties remain, but at this stage we are taking a watchful stance when it comes to assessing our own forecasts.

DATA PREVIEW – Q4 GDP & BALANCE OF PAYMENTS

The rate of quarterly GDP growth is expected to soften a touch in Q4, partly related to temporary weather influences. We believe that tight supply (rather than meaningfully softer demand) conditions are dominating. The current account deficit should remain at a historically comfortable level.

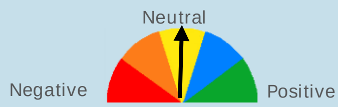
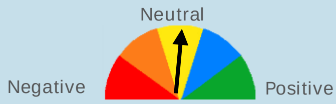
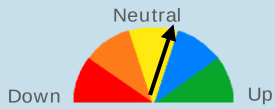
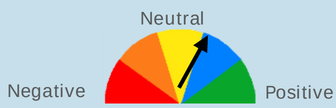
INTEREST RATE STRATEGY

Short-end rates continue to range-trade, navigating a "tug of war": the RBNZ's very neutral stance versus higher global interest rates and the NZD's recent re-rating lower. Technically, there is scope for short-end rates to adjust lower, but with spreads like the NZ/AU 1yr1yr at narrow extremes, few are prepared to chase it. Globally, the focus is on the Fed, with a hike expected at this week's FOMC meeting. A hike in itself won't cause a stir; it's fully priced in. But the potential for upward revisions to the dot plots (already above market expectations) and 'getting on with it' nuances are a risk for the long end, and any weakness will be felt here.

CURRENCY STRATEGY

With the Fed now firmly hiking and debate over the pace of upcoming hikes intensifying, the drivers of the liquidity cycle are shifting. That should keep the USD in the box seat and the NZD in sell-any-rally mode. However, we do need to acknowledge that the recent USD rally has petered out, which we suspect means we will need to see the commodity complex give way and four-hike sentiment towards the Fed to firm for movements to accelerate again. Neither are our central scenarios, though we believe a turn in the commodity complex is a key risk. A reasonable domestic pulse is expected to keep the NZD supported against non-USD crosses.

THE ANZ HEATMAP

Variable	View	Comment	Risk profile (change to view)
GDP	3.2% y/y for 2017 Q3	The economy is recording decent momentum, and we expect that to generally continue at least over the first part of 2017. Downside risk mainly stems from offshore.	
Unemployment rate	4.7% for 2017 Q3	We are looking through the Q4 lift in the unemployment rate. Job ads firmly signal it lower. Finding staff is a huge challenge for firms.	
OCR	1.75% by Sep 2017	With strong growth, capacity pressures emerging and inflation past its lows, further OCR cuts would now be hard to justify. Next move is up.	
CPI	1.9% y/y for 2017 Q3	Headline inflation is past its lows, with base effects seeing it return to the target mid-point early next year. Risks are that this occurs earlier.	

ECONOMIC OVERVIEW

SUMMARY

A notable shift in tone from key global central banks raises some key questions with regards to the global liquidity cycle, asset valuations, the trajectory for the NZD and by association, the stance of the RBNZ. The USD is in the box seat and yields have risen. But what does the shift in central bank stance and tightening in US financial conditions mean for future growth prospects? Do higher real yields mean asset valuations are at risk of realignment? Additionally, political risks still abound with markets less data-sensitive and more reactive to non-data developments. Plenty of risks and uncertainties remain, but at this stage we are taking a watchful stance when it comes to assessing our own forecasts, and we still believe the New Zealand economy has enough momentum to navigate such periods of uncertainty. In data this week, Q4 GDP figures are expected to show the economy expanded 0.7% q/q (perhaps with some downside risk), while consumer confidence figures and the BusinessNZ indicators will provide updates on early 2017 momentum.

FORTHCOMING EVENTS

Balance of Payments – Q4 (10:45am, Wednesday, 15 March). We expect a small improvement in the seasonally adjusted current account deficit, which should see the annual deficit narrow to 2.8% of GDP.

GDP – Q4 (10:45am, Thursday, 16 March). We believe production GDP will expand by 0.7% q/q, with annual growth at 3.2% y/y, although risks are arguably skewed to the downside.

BNZ-BusinessNZ PMI – February (10:30am, Friday, 17 March). After softening in January, a bounce is possible. However, with construction sector activity facing some headwinds, that is likely to flow through into domestic manufacturing.

ANZ-Roy Morgan Consumer Confidence – March (1:00pm, Friday, 17 March).

BNZ-BusinessNZ PSI – February (10:30am, Monday, 20 March). Services activity is holding up solidly even with housing market activity cooling.

WHAT'S THE VIEW?

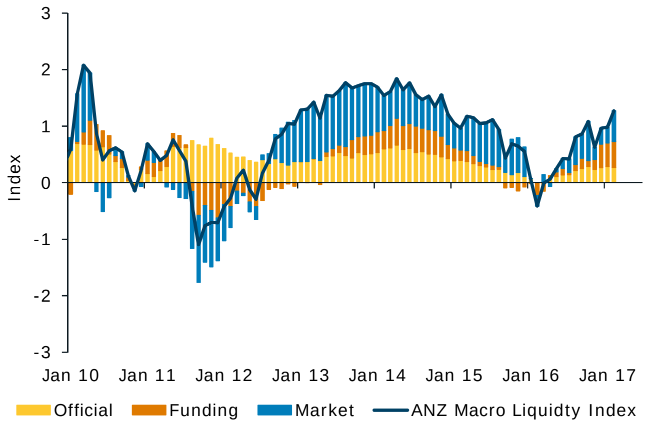
The global battle-lines are being drawn. The Fed in set to hike this week, which is earlier than the market initially anticipated. Not only that, but further tightening beyond that is likely, with the debate shifting from perhaps two to three hikes in 2017, to now three to four. While the ECB maintained its dovish rhetoric last week, there was still a tactical tilt towards neutral, with an acknowledgement that the severe downside risks are less pronounced, and its expectation is that it will not to have to ease again. The RBA has recently been more upbeat towards the global economy too.

We believe progress towards meeting inflation targets / mandates is only part of the reason for this shift. Yes the data has been better and inflation has popped up. However, our sense is that central banks are becoming increasingly attuned to the negative side-effects of extraordinary policy stimulus; this has been a shift that has been evolving for a year or so. The likes of the Fed have a job to do and are increasingly prepared to get on with it.

For markets (and New Zealand) we are entering evolving territory.

- **The movement flags a turn in the global liquidity cycle, or at least its key drivers**. Global liquidity (perceived or actual) plays a key role in swings in financial markets. Our Australian colleagues have developed a liquidity index and noted a shift in the structure of global liquidity in December, with official or monetary liquidity being replaced by a lift in private or funding liquidity. The key question is how far the latter can support market sentiment in an environment where the former is tightening.

FIGURE 1: ANZ LIQUIDITY INDEX



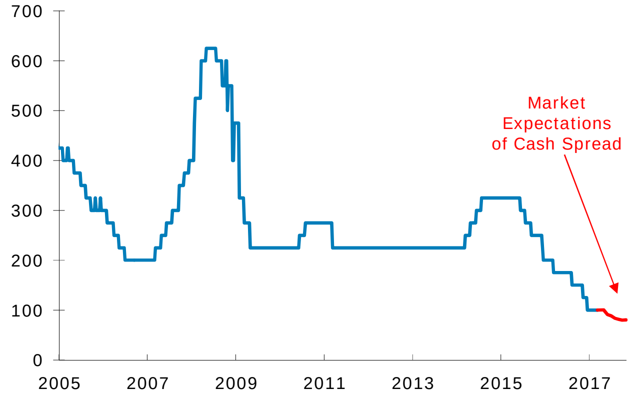
Source: ANZ, Bloomberg

- **The NZD has naturally taken a hit.** It still has shiny credentials but they are a little less glossy. 'Sell the rally' replaces 'buy the dip'.
- **A weaker currency will have carry-over implications for the RBNZ**; all else being equal it brings prospects for an OCR hike into play earlier, with the NZD less deflationary than assumed. Everything else is seldom equal of course; dairy prices are turning south (although the NZD movement still exceeds that). We're still picking a May 2018 start to OCR hikes, with banks doing the work for the RBNZ over the coming 12 months, lifting borrowing rates as competition for deposits intensifies. However,

ECONOMIC OVERVIEW

something still doesn't add up. If the Fed hikes four times this year, the fed funds rate will be on a par with the OCR and an astounding 175bps above the ECB's Main Refinancing Rate. Everyone will be chasing the USD if that pans out, which would result in a material tightening in US financial conditions. Questions will surround whether the US growth story can hold up if fiscal policy does not join the fray, and the lags here are long.

FIGURE 2: NZ/US CASH RATE DIFFERENTIAL



Source: ANZ, RBNZ, Federal Reserve, Bloomberg

- **Global and local interest rates will continue to prod higher.** It won't be as strong as a trend but the directional bias is up.
- **With real yields now on the move, asset valuations are set for a test. Some realignment with economic fundamentals needs to occur**. This is where price action will test the mettle of central banks that have long been too slavishly dictated to by the toy-throwing antics of the equity market.
- **Attention will centre on commodity prices as both a bellwether for global growth but also an inflation driver.** The impetus to headline inflation from the earlier lift in oil prices will fade beyond April. The latest softness in oil prices actually suggests it could become a drag. For core inflation to pick up further, wage growth needs to start accelerating around the globe.

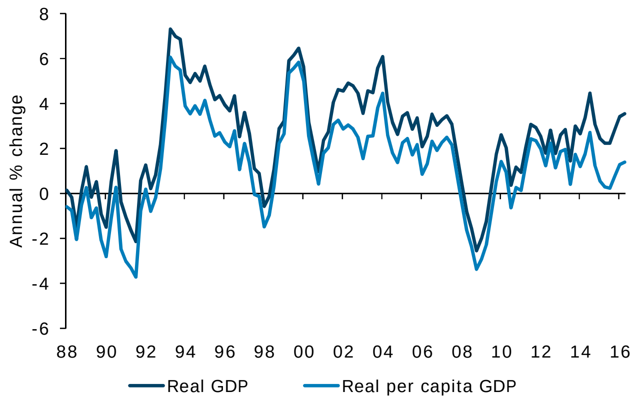
The combination doesn't warrant any shift in our forecasts (though our NZD forecasts will be under review) but do add an additional layer of risk, volatility and uncertainty. And that's before we include the anti-globalisation resentment vote shaping economic direction in many pockets of the world at present. Markets are increasingly reacting to non-data developments as opposed to data signals. The New Zealand economy still has enough positives and momentum to navigate through such periods of tension, but we'd be remiss not to acknowledge and recognise the shifting sands and the role liquidity conditions have played over recent years.

With regards to the domestic data calendar this week, the main focus will be on GDP and Balance of Payments figures for Q4. We have previews for both on page 6.

We believe the economy expanded 0.7% q/q over the final three months of 2016, which would round out full calendar year growth at a respectable 3.2%. That rate of quarterly growth would represent a step-down from Q3's 1.1% pace, and we actually see the risks skewed towards a modestly weaker outcome. However, that needs to be seen in the context of 1) poor spring weather negatively impacting agricultural production, with milkfat and livestock slaughtering both contracting; and 2) increased signs that capacity constraints are biting on growth. On the latter in particular, we remain of the view that demand conditions haven't really softened, but supply has become more of a constraining issue. Notwithstanding these forces, the construction sector and services industries more broadly should have again recorded decent growth, with the latter related to the boost to demand that strong population growth is providing (although it is not just about that).

But this same strong population growth will mean that per capita figures look a little mediocre. In fact, we estimate that the economy barely treaded water in per capita terms in the quarter, at just +0.1% q/q. Again, the temporary influences around weather impacts and capacity pressures need to be considered, but that would still see annual per capita growth ease to just 1.0% y/y, which is around half the average annual growth in this measure achieved since 1993. It could well invigorate the debate about the wider merits of current record net migrant inflows. We have little doubt that this will be a point of conjecture heading into this year's election.

FIGURE 3: GDP AND PER CAPITA GDP GROWTH



Source: ANZ, Statistics NZ

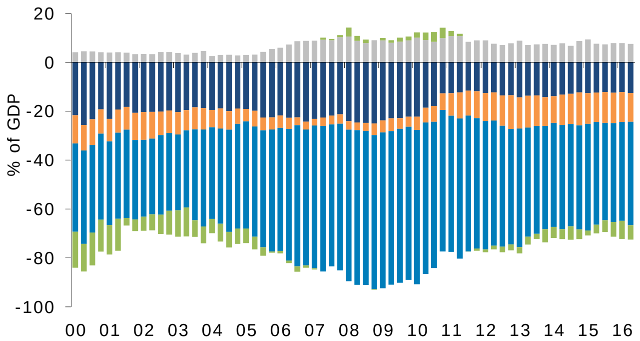
ECONOMIC OVERVIEW

The Balance of Payments figures are expected to show another narrowing in the annual current account deficit. We estimate the deficit fell to 2.8% of GDP, which would be the smallest level since Q3 2014. It also remains well below its historical average of 3.7% of GDP.

At this stage of the economic cycle, typically we would be talking about much larger current account deficits, or at least widening ones. The fact that we aren't doing that is testament to the fact that while we have had a housing boom, we haven't really had a consumption equivalent – at least not to the same degree we typically have had in the past. It does speak to less vulnerability to global financial market shocks than we have been used to in the past, which is good news given the global risks just described.

However, the risk going forward does look to be skewed towards modestly larger deficits. With global interest rates lifting, the costs associated with servicing the economy's stock of external debt will rise. However, it also comes down to the fact that a gap between bank deposit and credit growth remains, which has forced banks into increased offshore borrowing. Now to be fair, banks are attempting to close that gap, but that is only occurring slowly to date, which leaves risks to growth in overseas borrowing to the upside. You can actually see the impact of this theme already, with the economy's net international liability position beginning to grow again after a period of improvement. In Q3, it sat at 64.9% of GDP, which is up from a low of 62.1% and the largest net liability position in close to two years. If the funding gap is not closed, that figure will rise further and rating agencies will take note.

FIGURE 4: NET INTERNATIONAL INVESTMENT POSITION COMPOSITION

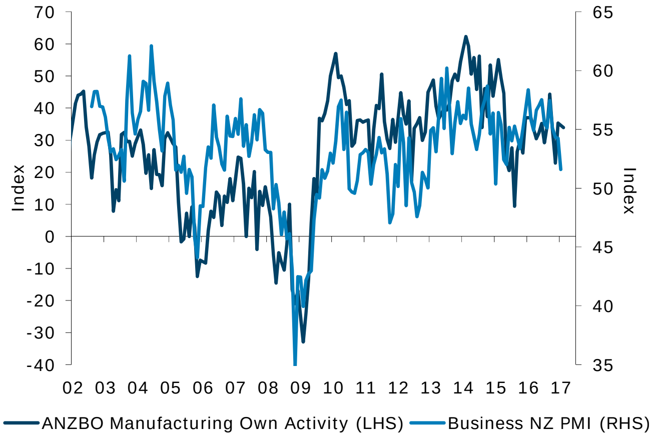


Source: ANZ, Statistics NZ

In other data, our consumer confidence figures for March will help shed more light on early-2017 economic momentum. Some data on cyclical elements of the economy have softened of late, particularly those related to the housing market and construction sector. But at this stage we do not view this as anything alarming in terms of signalling prospects for sharply weaker conditions. One of the reasons for that interpretation is the fact that confidence levels in the economy remain elevated. Confidence doesn't necessarily drive the economic cycle so much as reflect it, but it is true that it can certainly exacerbate it. So we'll be on the look-out regarding the March figures whether there is any change on that front.

The softening in some cyclical pockets could be reinforced by the BNZ-BusinessNZ PMI for February. The index fell to a four-year low of 51.6 in January (sharply down from 54.2 in December), with the production component the main driver of the fall. Now it must be borne in mind that this series is volatile, so it would be unwise to draw strong conclusions at this stage. Indeed, we wouldn't rule out a bounce, as manufacturing sentiment within our Business Outlook survey is still holding up at reasonable levels. But with the manufacturing sector having earlier ridden on the coat-tails of booming construction activity, and with the latter now facing a few more near-term challenges with regards to capacity and capital constraints (indeed, consent issuance has fallen), perhaps the latest PMI softness can be explained.

FIGURE 5: MANUFACTURING SECTOR SENTIMENT



Source: ANZ, BNZ, BusinessNZ

But again, the equivalent services sector data, which we expect to hold at a decent level, means it is hard to get overly bearish. In stark contrast to the manufacturing measure, the BNZ-BusinessNZ PSI rose to 59.5 in January, which is the highest level since September 2015. This comes despite weaker housing market activity and no doubt reflects support from ongoing strong population growth.

ECONOMIC OVERVIEW

LOCAL DATA

GlobalDairyTrade Auction. The GDT-TWI fell 6.3%, with whole milk powder prices 12.4% lower.

ANZ Truckometer – February. The Heavy Traffic Index rose 2.3% m/m, while the Light Traffic Index lifted 0.7% m/m.

Economic Survey of Manufacturing – Q4. Total manufacturing sales volumes fell 1.8% q/q.

ANZ Monthly Inflation Gauge – February. Prices rose 0.2% m/m (2.2% y/y).

Electronic Card Transactions – February. After rising 2.7% m/m in January, spending retraced 0.6% m/m.

REINZ Housing Market Statistics – February. In seasonally adjusted terms, sales turnover bounced 1.1% m/m, with the REINZ House Price Index up 0.4% m/m.

Food Price Index – February. Food prices rose 0.2% m/m (2.2% y/y).

DATA PREVIEW

SUMMARY

The rate of quarterly GDP growth is expected to soften a touch in Q4, partly related to temporary weather influences. We believe that tight supply (rather than meaningfully softer demand) conditions are dominating. The current account deficit should remain at a historically comfortable level.

CURRENT ACCOUNT – 2016Q4

(Wednesday 15 March, 10.45am)

Current Account	ANZ	Market
Quarter (non-sa)	**-$2,565m**	-$2,425m
Quarter (sa)	**-$1,835m**	--
Annual	**-$7.2bn**	--
% of GDP	**-2.8%**	-2.7%

The unadjusted current account deficit should narrow in Q4, in line with the typical seasonal pattern. We expect a $2.6bn deficit, around half as large as that recorded in Q3. This would be enough to see the annual deficit fall to 2.8% of GDP, the smallest since Q3 2014.

The seasonally adjusted deficit is also expected to narrow, albeit modestly, with offsetting movements at the compositional level. Although the terms of trade bounced strongly in Q4, the goods deficit looks set to widen a touch, given export volume weakness. A lift in international tourist spending (after some softer quarters) should boost the services balance, which we estimate will rise to the highest level on record. Overall, we see the seasonally adjusted goods and services balance printing around +$480m. The income deficit has been remarkably stable of late and we have little reason to think that stability won't have continued in Q4, with the deficit to remain around $2.3bn.

At this point in the cycle, New Zealand's external imbalances would typically be much more of an issue. However, the current account deficit remains below historical averages and external debt is well down on where it peaked in 2008. In part this reflects the fact that a housing boom has not been followed by a consumption boom equivalent as has often occurred in the past.

However, the risks are skewed towards the deficit widening (albeit modestly) from here. In particular, the gap between domestic credit and deposit growth remains large. While we do see that gap closing in time, this is occurring only slowly. That's creating offsetting tensions. It means pressure for credit to slow further, which risks turning a moderation in growth into a more aggressive slowdown. However, not slowing credit growth further would mean a wider current account deficit.

GROSS DOMESTIC PRODUCT – 2016Q4

(Thursday 16 March, 10.45am)

GDP	ANZ	RBNZ	Market
Quarterly %	**0.7%**	1.0%	0.7%
Annual %	**3.2%**	3.5%	3.2%
Ann. Ave. %	**3.2%**	3.3%	3.2%

We expect production-based GDP growth of 0.7% q/q in Q4. While that would be a step down from Q3's 1.1% q/q pace (and risks are perhaps downwardly skewed), annual growth would hold at a respectable 3.2% y/y. However, strong population growth will mean per capita figures look mediocre, with quarterly growth of just 0.1% (1.0% y/y).

Primary industries looks set to drag on growth. Poor spring weather conditions hampered milk production and other elements of agricultural activity. This, together with a partial retracement of last quarter's surge in forestry and logging activity, is expected to see the sector contract 1.6% q/q overall.

This should be offset by reasonable services sector growth. We have pencilled in a 0.7% q/q lift, boosted by further solid growth in professional and administrative services, arts, recreation and other services, and health care and social services. Some of this is clearly related to strong population growth. Rental and real estate services activity is expected to expand, but at its softest quarterly pace in three years, which is consistent with cooler housing market activity.

Goods production is expected to have risen 0.3% q/q. Stronger construction activity (around 1.5% q/q) looks set to be partially offset by a dip in manufacturing activity, with primary food production also expected to contract on poor spring weather.

We wouldn't be surprised if expenditure GDP undershot its production equivalent, having surpassed it by a reasonable amount over the past three quarters. At the components level, the figures are likely to be mixed. After some strong growth, private consumption growth is likely to be more modest, while residential and other fixed asset investment should both record respectable growth. Inventories are likely to contribute positively, with net exports dragging on activity.

MARKET IMPLICATIONS

While growth in line with our view could be perceived as soft, especially with some cyclical indicators continuing to roll over, it is important to look at the drivers behind it. We still believe it primarily reflects tighter supply conditions (capacity) rather than softer demand, and that presents quite a different backdrop for the outlook for inflation and the RBNZ.

INTEREST RATE STRATEGY

SUMMARY

Short-end rates continue to range-trade, navigating a "tug of war": the RBNZ's very neutral stance versus higher interest rates in the US and Australia and the NZD's recent re-rating lower. Technically, there is scope for short-end rates to adjust lower, but with spreads like the NZ/AU 1yr1yr at narrow extremes, few are prepared to chase it. Globally, the focus is on the Fed, with a hike expected at this week's FOMC meeting. A hike in itself won't cause a stir; it's fully priced in. But the potential for upward revisions to the dot plots (already above market expectations) and 'getting on with it' nuances are a risk for the long end, and any weakness will be felt here. US bond yields have adjusted higher in recent weeks, but they remain low compared to the dot plots, and are extremely low in real terms. Ahead of what looks to be a shift in the tempo of Fed policy, a showdown is looming.

THEMES

- Short-end rates have technical potential to adjust lower, given the gap between implied forward rates and the RBNZ/our forecasts, and attractive carry. But they are tight on a spread to Australia and the TWI is now below the RBNZ's projections.
- Strong US non-farm payroll data (that has come after a wave of solid data and upbeat "Fedspeak") has cemented expectations for a Fed hike this week. But it's the long-term path of policy that has the most potential to drive US yields higher.
- We find it odd that the US bond curve has flattened into the most recent ramping-up of fed funds expectations. The Fed is behind the curve, not ahead of it, and the curve should be steeper. It suggests markets are coy about the inflation impulse beyond the oil boost. Wages are key.

MONETARY POLICY AND SHORT END

Dynamics at the short end of the curve remain as they have for some weeks – with technical potential for realignment (lower) towards the RBNZ's February projections going head to head with rising global bond yields and policy rates, and now a lower NZD.

At the moment the focus is squarely on the US and Fed policy, with markets now fully pricing three hikes this year. However, in recent weeks we have also seen an upward revision to policy expectations in Australia (with ~30% odds of a hike by December now priced in), and a tactical shift towards neutral by the ECB. That's a far cry from where we were at the end of January, when markets were convinced that the Fed may hike twice if they were lucky, and the RBA might ease again. And it's **this shift in the global tempo that has left the local market unwilling to chase short-end yields lower, despite attractive carry and a decent rate-hike premium already built in**.

GLOBAL MARKETS AND LONG END

Global interest rates continue to rise, and are putting upward pressure on local long-end rates. While we have yet to see US 10-year Treasury bonds break out of familiar ranges, we now think it's a matter of time before they do. However, that's subject to commodity prices not taking a turn for the worse, and we are somewhat wary they may, courtesy of a turn in the liquidity cycle. Positioning remains an issue, and short-covering has prevented yields from rising too far so far. **Market positioning remains short,** suggesting progress higher will be slow. But with the Fed stepping up the pace of tightening and US yields well below the Fed's assumed terminal fed funds rate, **there is strong pressure on yields to rise**.

But even as the Fed steps up the pace of tightening, it has a long way to go before the real fed funds rate reaches zero (around 18 months at its current pace). With US core CPI inflation already above 2% and unemployment below 5%, the Fed has work to do. Given this, we find it difficult to buy into the idea of a flatter US yield curve. While it is understandable, given positioning, and the speed of the recent re-rating of policy expectations, looking ahead, **we expect the curve to steepen as the long end adjusts to the realities of where US policy and inflation are headed, with spill-over for the local market.**

STRATEGY

Investors: We prefer to remain short duration, and positioned for a steeper curve. We see scope for the NZ/US spread to continue to narrow, and for linkers to outperform ahead of CPI data next month.

Borrowers: No change. **BKBM is at a record low, but term interest rates are biased higher.** We believe it makes sense to add to hedges on dips. Rates remain low in the context of the past quarter century of controlled inflation.

KEY VIEWS

SECTOR	DIRECTION	COMMENT
Short end	Neutral	Still daylight between RBNZ projections and market; R+C is attractive, but global rates are moving higher and if we see no further cuts; next move is a hike. Mortgage paying potential exists but is well behaved.
Long end	Bearish	US market at key levels; poised to break higher. Market hasn't adjusted to number of Fed hikes coming.
Yield Curve	Steeper	Strategically favour a steepener, based largely on bearish global view. US curve should be steeper too.
Geographic spreads	Neutral/ narrower	Spreads at tight end of range. Should narrow further over the year as USTs grind higher (especially given neutral RBNZ tone). Generally well correlated with the outlook for policy rate spreads (narrower!).
Swap spreads	Neutral	NZGS demand fair. Some risk of corporate paying, but global uncertainties likely to keep payers at bay.
NZD/TWI	Off highs	RBNZ February inflation projections now outdated given lower TWI. TWI is still high though.

CURRENCY STRATEGY

SUMMARY

With the Fed now firmly hiking and debate over the pace of upcoming hikes intensifying, and the ECB more neutral, the drivers of the liquidity cycle are shifting. That should keep the USD in the box seat and the NZD in sell-any-rally mode. However, we do need to acknowledge that the recent USD rally has petered out, which we suspect means we will need to see the commodity complex give way and four-hike sentiment towards the Fed to firm for movements to accelerate again. Neither are our central scenarios, though we believe a turn in the commodity complex is a key risk. A reasonable domestic pulse is expected to keep the NZD supported against non-USD crosses. The extent of NZD/AUD's retracement has caught us by surprise but with the inflation cycles in the NZD's favour we expect this cross to recover lost ground.

TABLE 1: KEY VIEWS			
CROSS	**GUIDE**	**MONTH**	**YEAR**
NZD/USD	↔	Correction lower now looks complete	Firmer USD bias ultimately wins
NZD/AUD	↔/↑	Consolation mode	Push higher
NZD/EUR	↔/↑	Politics not euro-supportive	Huge growth/politics divide
NZD/GBP	↔/↑	Consumer slowing as BoE feared	Brexit execution woes weighing
NZD/JPY	↔	JPY the new safe-haven	Japan a defensive play; US strong too

THEMES AND RISKS

- The Fed is hiking and it's now a question of whether it is three or four times in 2017 and not two or three. The ECB also appears more neutral.
- The USD is in charge.
- We still like NZD's domestic story but that's now being usurped by the liquidity cycle and pending yield convergence with the US.
- Rates of change (more tightening) favour the USD; levels (interest rates, growth) are still in NZD's favour.
- Milk prices are lower; is the hard commodity complex next?

ASSESSMENT

A shift in the drivers of the liquidity cycle is upon us. The Fed is hiking. 'Sooner' means 'as soon as possible'. Inflation is on target and unemployment keeps falling. Debate is turning to how regularly it will hike after March, with "once a quarter" getting more airtime. That looks a tad aggressive to us given various political and economic uncertainties, but we've pencilled in three hikes over the year. **With the ECB striking a more neutral tone as well, market attention is turning to the long journey to get monetary policy back to less extraordinary policy settings.** And that's enough to change perceptions towards liquidity conditions.

The USD remains firmly in the box seat and perception towards the NZD now shifts from 'buy the dip' to 'sell the rally'.

That said, the initial retracement into a new zone (0.68-0.71) now looks complete. The failure of bonds or the USD to kick on in response to the firm payrolls figures signifies how much good news is already factored into the USD; and also that data thematics are not solely in the driver's seat.

Further pushes lower for the NZD/USD now look contingent on two dynamics. First, sentiment needs to firm towards the Fed hiking four times in 2017. We're coy about pencilling in such a track; there are simply too many global vulnerabilities on offer, and in a coupled (as opposed to decoupled) world we struggle to see the US-ROW differential extending too far. Second, the commodity complex needs to start to give way. We view the latter as now a key risk with oil prices starting to fade, though that also lessens the inflation impulse and dampens pressure on global long-end yields to rise.

The extent of NZD/AUD retracement has caught us by surprise, fading back towards notions of fairer value courtesy of flow and relative commodity movements in the AUD's favour.

We continue to favour the NZD over the AUD. New Zealand's business and inflation cycle is further advanced, which is at odds with central bank rhetoric (RBNZ more dovish than the RBA).

TABLE 2: NZD VS AUD: MONTHLY GAUGES		
GAUGE	**GUIDE**	**COMMENT**
Fair value	↔/↑	Fair value is 0.93; we're below that.
Yield	↔/↓	NZ/AU spreads now pretty tight.
Commodities	↔/↓	Hards outperforming softs of late.
Data	↔/↓	AU data surprises have been positive.
Techs	↔	In consolidation mode just below 0.92.
Sentiment	↔/↓	Has swung into AUD's favour.
Other	↔/↑	NZ growth pulse stronger than AU, although perhaps less so than before.
On balance	↔	**More neutral now.**

TABLE 3: NZD VS USD: MONTHLY GAUGES		
GAUGE	**GUIDE**	**COMMENT**
Fair value	↔/↑	Below fair-value estimate of ~0.75.
Yield	↔	Yields heading higher in both markets.
Commodities	↔/↓	Softer dairy prices need acknowledging.
Risk aversion	↔/↓	Has potential to add to volatility.
Data	↔	Data-flow solid in both countries.
Techs	↔/↑	Bounce off ~0.69 lows encouraging.
Sentiment	↔/↓	USD strength the main theme.
Other	↔/↑	Speculators now short.
On balance	↔	**From buy dips to sell rallies.**

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
13-Mar	AU	Credit Card Balances - Jan	--	A$52.8B	13:30
	AU	Credit Card Purchases - Jan	--	A$27.7B	13:30
14-Mar	AU	ANZ-RM Consumer Confidence Index - 12-Mar	--	113.9	11:30
	AU	NAB Business Conditions - Feb	--	16	13:30
	AU	NAB Business Confidence - Feb	--	10	13:30
	CH	Retail Sales YTD YoY - Feb	10.6%	10.4%	15:00
	CH	Fixed Assets Ex Rural YTD YoY - Feb	8.2%	8.1%	15:00
	CH	Industrial Production YTD YoY - Feb	6.2%	6.0%	15:00
	GE	CPI MoM - Feb F	0.6%	0.6%	20:00
	GE	CPI YoY - Feb F	2.2%	2.2%	20:00
	GE	CPI EU Harmonized MoM - Feb F	0.7%	0.7%	20:00
	GE	CPI EU Harmonized YoY - Feb F	2.2%	2.2%	20:00
	EC	Industrial Production SA MoM - Jan	1.4%	-1.6%	23:00
	EC	Industrial Production WDA YoY - Jan	0.9%	2.0%	23:00
	GE	ZEW Survey Current Situation - Mar	77.8	76.4	23:00
	EC	ZEW Survey Expectations - Mar	--	17.1	23:00
	GE	ZEW Survey Expectations - Mar	13.0	10.4	23:00
	US	NFIB Small Business Optimism - Feb	105.6	105.9	23:00
15-Mar	US	PPI Final Demand MoM - Feb	0.1%	0.6%	01:30
	US	PPI Final Demand YoY - Feb	1.9%	1.6%	01:30
	US	PPI Ex Food and Energy MoM - Feb	0.2%	0.4%	01:30
	US	PPI Ex Food and Energy YoY - Feb	1.5%	1.2%	01:30
	NZ	BoP Current Account Balance NZD - Q4	-2.425B	-4.891B	10:45
	NZ	Current Account GDP Ratio YTD - Q4	-2.7%	-2.9%	10:45
	AU	Westpac Consumer Conf Index - Mar	--	99.6	12:30
	AU	Westpac Consumer Conf SA MoM - Mar	--	2.3%	12:30
	AU	New Motor Vehicle Sales MoM - Feb	--	0.6%	13:30
	AU	New Motor Vehicle Sales YoY - Feb	--	-0.9%	13:30
	UK	Claimant Count Rate - Feb	--	2.1%	22:30
	UK	Jobless Claims Change - Feb	--	-42.4k	22:30
	UK	Average Weekly Earnings 3M/YoY - Jan	2.4%	2.6%	22:30
	UK	Weekly Earnings ex Bonus 3M/YoY - Jan	2.5%	2.6%	22:30
	UK	ILO Unemployment Rate 3Mths - Jan	4.8%	4.8%	22:30
	UK	Employment Change 3M/3M - Jan	80k	37k	22:30
	EC	Employment QoQ - Q4	--	0.2%	23:00
	EC	Employment YoY - Q4	--	1.2%	23:00
16-Mar	US	MBA Mortgage Applications - 10-Mar	--	3.3%	00:00
	US	Empire Manufacturing - Mar	15.0	18.7	01:30
	US	CPI MoM - Feb	0.0%	0.6%	01:30
	US	CPI YoY - Feb	2.7%	2.5%	01:30
	US	CPI Ex Food and Energy MoM - Feb	0.2%	0.3%	01:30
	US	CPI Ex Food and Energy YoY - Feb	2.2%	2.3%	01:30
	US	Retail Sales Advance MoM - Feb	0.1%	0.4%	01:30
	US	Retail Sales Ex Auto MoM - Feb	0.1%	0.8%	01:30
	US	Retail Sales Ex Auto and Gas - Feb	0.2%	0.7%	01:30
	US	Retail Sales Control Group - Feb	0.2%	0.4%	01:30
	US	NAHB Housing Market Index - Mar	65	65	03:00
	US	Business Inventories - Jan	0.3%	0.4%	03:00

Continued on following page

DATA EVENT CALENDAR

DATE	COUNTRY	DATA / EVENT	MKT.	LAST	NZ TIME
16-Mar	US	FOMC Rate Decision - Mar	1.00%	0.75%	07:00
	US	Total Net TIC Flows - Jan	--	-$42.8B	09:00
	US	Net Long-term TIC Flows - Jan	--	-$12.9B	09:00
	NZ	GDP SA QoQ - Q4	0.7%	1.1%	10:45
	NZ	GDP YoY - Q4	3.2%	3.5%	10:45
	AU	Consumer Inflation Expectation - Mar	--	4.1%	13:00
	AU	Employment Change - Feb	16.5k	13.7k	13:30
	AU	Unemployment Rate - Feb	5.7%	5.7%	13:30
	AU	Full Time Employment Change - Feb	--	-44.5k	13:30
	AU	Part Time Employment Change - Feb	--	58.2k	13:30
	AU	Participation Rate - Feb	64.6%	64.6%	13:30
	AU	RBA FX Transactions Market - Feb	--	A$557M	13:30
	NZ	Non Resident Bond Holdings - Feb	--	62.50%	15:00
	EC	CPI MoM - Feb	0.4%	--	23:00
	EC	CPI YoY - Feb F	2.0%	2.0%	23:00
	EC	CPI Core YoY - Feb F	0.9%	0.9%	23:00
	JN	BOJ Policy Balance Rate - Mar	--	-0.1%	UNSPECIFIED
	JN	BOJ 10-Yr Yield Target - Mar	--	0.0%	UNSPECIFIED
17-Mar	UK	Bank of England Bank Rate - Mar	0.25%	0.25%	01:00
	UK	BoE Asset Purchase Target - Mar	£435B	£435B	01:00
	UK	BoE Corporate Bond Target - Mar	£10B	£10B	01:00
	US	Housing Starts - Feb	1260k	1246k	01:30
	US	Housing Starts MoM - Feb	1.1%	-2.6%	01:30
	US	Building Permits - Feb	1260k	1293k	01:30
	US	Building Permits MoM - Feb	-2.6%	5.3%	01:30
	US	Initial Jobless Claims - 11-Mar	240k	243k	01:30
	US	Continuing Claims - 4-Mar	2053k	2058k	01:30
	US	Philadelphia Fed Business Outlook - Mar	28.0	43.3	01:30
	US	JOLTS Job Openings - Jan	5562	5501	03:00
	NZ	BusinessNZ Manufacturing PMI - Feb	--	51.6	10:30
	NZ	ANZ Consumer Confidence Index - Mar	--	127.4	13:00
	NZ	ANZ Consumer Confidence MoM - Mar	--	-1.0%	13:00
	EC	Trade Balance SA - Jan	€22.0B	€24.5B	23:00
	EC	Trade Balance NSA - Jan	--	€28.1B	23:00
	EC	Construction Output MoM - Jan	--	-0.2%	23:00
	EC	Construction Output YoY - Jan	--	3.2%	23:00
18-Mar	US	Industrial Production MoM - Feb	0.2%	-0.3%	02:15
	US	Capacity Utilization - Feb	75.5%	75.3%	02:15
	US	Manufacturing (SIC) Production - Feb	0.4%	0.2%	02:15
	US	U. of Mich. Sentiment - Mar P	97.0	96.3	03:00
	US	Leading Index - Feb	0.4%	0.6%	03:00

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 economic momentum is solid although there are some hints of softening. Inflation has lifted off lows, which is consistent with the next move in the OCR being upwards, but probably not until 2018.

DATE	DATA/EVENT	ECONOMIC SIGNAL	COMMENT
Wed 15 Mar (10:45am)	Balance of Payments – Q4	Contained	The current account deficit has been remarkably stable around 3% of GDP. We expect a further narrowing towards 2.8%.
Thu 16 Mar (10:45am)	GDP – Q4	0.7% q/q	Our current bottom-up estimate points to growth of 0.7% q/q, which, although a little softer than Q3, is still decent.
Fri 17 Mar (10:30am)	BNZ-BusinessNZ PMI – Feb	Bounce?	The index fell in January. We believe it will bounce, but are keeping an eye on the signal.
Fri 17 Mar (1:00pm)	ANZ-Roy Morgan Consumer Confidence – Mar	--	--
Mon 20 Mar (10:30am)	BNZ-BusinessNZ PSI – Feb	Strong	Despite a weaker housing market, services sector activity is being supported by population growth and low interest rates.
Tue 21 Mar (10:45am)	International Travel & Migration – Feb	Holding up	Net migrant inflows are holding near all-time highs and we doubt that picture is going to change much any time soon. Visitor arrivals should still grow, but perhaps at a slower pace.
Wed 22 Mar (early am)	GlobalDairyTrade Auction	Easing	Improved global supply has shifted sentiment. The key to whether we see ongoing price weakness is Chinese demand.
Thu 23 Mar (9:00am)	RBNZ OCR Review	On hold	The RBNZ made it pretty clear in February that it doesn't intend to move the OCR any time soon. That message will be repeated.
Fri 24 Mar (10:45am)	Overseas Merchandise Trade – Feb	Improving	Stronger export commodity prices should begin to correspond with an improving underlying trend.
Fri 24 Mar (3:00pm)	RBNZ New Residential Mortgage Lending – Feb	Still slowing	Ongoing bank funding pressures and RBNZ prudential restrictions will see the pace of new lending continue to slow.
Fri 31 Mar (10:45am)	Building Consent Issuance – Feb	More headwinds	While the demand backdrop for housing remains strong, supply is facing increased headwinds from both capacity and capital.
Fri 31 Mar (1:00pm)	ANZ Business Outlook – Mar	--	--
Fri 31 Mar (3:00pm)	RBNZ Credit Aggregates – Feb	Off highs	Overall household credit growth has passed its peak. We expect it to continue moderating over the course of 2017.
Tue 4 Apr (10:00am)	NZIER QSBO – Q1	Still decent	Confidence may ease off highs, but will still be decent. We'd expect to see more signs of capacity and price tensions.
Wed 5 Apr (early am)	GlobalDairyTrade Auction	Easing	Improved global supply has shifted sentiment. The key to whether we see ongoing price weakness is Chinese demand.
Wed 5 Apr (10:00am)	ANZ Job Ads – Mar	--	--
Wed 5 Apr (1:00pm)	ANZ Commodity Price Index – Mar	--	--
Thu 6 Apr (10:00am)	Government Financial Statements – Feb	Running ahead	While the fiscal costs of the Kaikoura earthquakes are yet to be incorporated, tax revenue continues to run ahead of projections.
On balance		**Data watch**	**Momentum is decent at present, albeit with risks. Inflation is showing tentative signs of lifting.**

KEY FORECASTS AND RATES

	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
GDP (% qoq)	1.1	**0.7**	**0.9**	**0.8**	**0.8**	**0.6**	**0.6**	**0.5**	**0.5**	**0.5**
GDP (% yoy)	3.5	**3.2**	**3.4**	**3.5**	**3.2**	**3.1**	**2.8**	**2.5**	**2.2**	**2.1**
CPI (% qoq)	0.3	0.4	**0.5**	**0.4**	**0.6**	**0.2**	**0.9**	**0.5**	**0.6**	**0.1**
CPI (% yoy)	0.4	1.3	**1.7**	**1.7**	**1.9**	**1.7**	**2.1**	**2.2**	**2.2**	**2.0**
Employment (% qoq)	1.3	0.8	**0.7**	**0.6**	**0.4**	**0.4**	**0.4**	**0.4**	**0.3**	**0.3**
Employment (% yoy)	6.1	5.8	**5.2**	**3.4**	**2.5**	**2.1**	**1.8**	**1.6**	**1.5**	**1.4**
Unemployment Rate (% sa)	4.9	5.2	**5.0**	**4.8**	**4.7**	**4.7**	**4.6**	**4.5**	**4.5**	**4.4**
Current Account (% GDP)	-2.9	**-2.8**	**-2.7**	**-2.7**	**-2.7**	**-2.9**	**-3.0**	**-3.1**	**-3.2**	**-3.2**
Terms of Trade (% qoq)	-1.1	5.7	**0.3**	**-0.1**	**-0.4**	**-0.6**	**0.4**	**0.2**	**0.1**	**0.1**
Terms of Trade (% yoy)	-1.1	6.7	**2.7**	**4.7**	**5.4**	**-0.9**	**-0.8**	**-0.4**	**0.1**	**0.8**

	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17
Retail ECT (% mom)	-0.4	1.3	0.2	-1.2	2.0	0.5	0.0	0.1	2.7	-0.6
Retail ECT (% yoy)	3.3	6.8	5.8	3.2	6.1	4.2	5.1	5.8	5.6	2.6
Credit Card Billings (% mom)	-0.5	-0.9	2.5	-0.9	2.9	3.0	-4.2	3.2	0.2	--
Credit Card Billings (% yoy)	6.1	4.1	5.7	2.3	8.3	10.1	4.2	8.6	7.1	--
Car Registrations (% mom)	-4.5	-0.7	0.1	2.6	-4.0	12.2	3.6	-6.1	1.4	0.2
Car Registrations (% yoy)	4.2	-1.2	-1.9	2.6	-0.8	13.1	18.4	7.8	12.2	7.3
Building Consents (% mom)	-0.9	16.5	-4.4	-3.2	1.1	0.0	-8.9	-7.9	0.8	--
Building Consents (% yoy)	10.1	39.4	8.0	11.8	17.1	14.0	2.4	-10.6	-1.7	--
REINZ House Price Index (% yoy)	14.7	14.2	16.3	11.7	9.7	14.4	14.9	13.5	11.7	10.5
Household Lending Growth (% mom)	0.7	0.8	0.8	0.8	0.8	0.6	0.6	0.7	0.5	--
Household Lending Growth (% yoy)	8.1	8.3	8.6	8.7	8.8	8.7	8.6	8.7	8.7	--
ANZ Roy Morgan Consumer Conf.	116.2	118.9	118.2	117.7	121.0	122.9	127.2	124.5	128.7	127.4
ANZ Business Confidence	11.3	20.2	16.0	15.5	27.9	24.5	20.5	21.7	..	16.6
ANZ Own Activity Outlook	30.4	35.1	31.4	33.7	42.4	38.4	37.6	39.6	..	37.2
Trade Balance ($m)	343	107	-351	-1240	-1388	-798	-725	-36	-285	--
Trade Bal ($m ann)	52854	52660	52078	51900	51938	51943	51667	51620	51931	--
ANZ World Commodity Price Index (% mom)	1.0	3.5	2.1	3.2	5.1	0.7	3.2	0.7	-0.1	2.0
ANZ World Comm. Price Index (% yoy)	-11.7	-5.6	1.9	11.1	10.6	4.0	13.6	16.5	19.1	20.9
Net Migration (sa)	5610	5770	5700	5690	6340	6220	6210	6050	6460	--
Net Migration (ann)	68432	69090	69015	69119	69954	70282	70354	70588	71305	--
ANZ Heavy Traffic Index (% mom)	-2.5	5.4	-6.4	7.1	-2.1	-0.5	3.7	-0.3	-1.0	2.3
ANZ Light Traffic Index (% mom)	-1.4	2.7	-0.6	1.0	0.1	-1.6	1.5	0.2	-0.3	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	Jan-17	Feb-17	Today	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18
NZD/USD	0.728	0.719	0.693	0.72	0.70	0.69	0.68	0.68	0.68	0.67
NZD/AUD	0.964	0.938	0.919	0.92	0.92	0.93	0.94	0.94	0.93	0.91
NZD/EUR	0.680	0.679	0.649	0.70	0.69	0.68	0.68	0.68	0.65	0.64
NZD/JPY	82.80	80.79	79.55	82.8	80.5	79.4	78.2	78.2	78.2	77.1
NZD/GBP	0.585	0.578	0.569	0.59	0.58	0.58	0.58	0.55	0.54	0.54
NZ$ TWI	78.3	77.2	76.2	78.0	76.5	76.1	75.7	75.5	74.2	72.9
INTEREST RATES	Jan-17	Feb-17	Today	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18
NZ OCR	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	2.00	2.25
NZ 90 day bill	1.99	2.00	1.96	2.00	2.00	2.00	2.00	2.10	2.30	2.50
NZ 10-yr bond	3.37	3.23	3.38	3.60	3.70	3.80	3.90	4.00	4.10	4.30
US Fed funds	0.75	0.75	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.75
US 3-mth	1.03	1.05	1.12	1.13	1.20	1.33	1.45	1.60	1.75	2.00
AU Cash Rate	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
AU 3-mth	1.77	1.78	1.79	1.70	1.70	1.70	1.70	1.70	1.70	1.70

	10 Feb	6 Mar	7 Mar	8 Mar	9 Mar	10 Mar
Official Cash Rate	1.75	1.75	1.75	1.75	1.75	1.75
90 day bank bill	2.02	1.99	1.99	1.98	1.97	1.96
NZGB 03/19	2.17	2.18	2.18	2.18	2.20	2.21
NZGB 05/21	2.54	2.59	2.59	2.60	2.63	2.64
NZGB 04/23	2.81	2.87	2.87	2.89	2.93	2.95
NZGB 04/27	3.20	3.31	3.31	3.33	3.38	3.40
2 year swap	2.35	2.35	2.34	2.33	2.36	2.36
5 year swap	2.96	3.02	3.02	3.02	3.06	3.09
RBNZ TWI	78.50	77.04	76.64	76.38	76.04	75.98
NZD/USD	0.7190	0.7020	0.6991	0.6944	0.6900	0.6923
NZD/AUD	0.9369	0.9247	0.9202	0.9188	0.9202	0.9179
NZD/JPY	81.41	79.86	79.63	79.22	79.15	79.47
NZD/GBP	0.5756	0.5725	0.5729	0.5715	0.5678	0.5690
NZD/EUR	0.6756	0.6628	0.6610	0.6578	0.6535	0.6486
AUD/USD	0.7674	0.7592	0.7597	0.7558	0.7498	0.7542
EUR/USD	1.0643	1.0591	1.0576	1.0557	1.0558	1.0673
USD/JPY	113.22	113.76	113.90	114.08	114.71	114.79
GBP/USD	1.2491	1.2261	1.2202	1.2151	1.2153	1.2167
Oil (US$/bbl)	52.99	53.33	53.19	52.68	49.83	48.75
Gold (US$/oz)	1224.89	1234.15	1226.25	1218.10	1205.80	1198.63
Electricity (Haywards)	5.49	4.32	4.92	4.46	5.08	4.85
Baltic Dry Freight Index	702	979	1033	1045	1064	1086
NZX WMP Futures (US$/t)	3330	2915	2910	2625	2625	2625

IMPORTANT NOTICE

IMPORTANT NOTICE

This document has been prepared by ANZ Bank New Zealand Limited, Level 10, 171 Featherston Street, Wellington 6011, New Zealand,
Ph 64-4-802 2212, e-mail nzeconomics@anz.com, http://www.anz.co.nz