NEW ZEALAND ECONOMICS
MARKET FOCUS

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INSIDE

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MUDDLE THROUGH

ECONOMIC OVERVIEW

The strong domestic economy is clearly a driving force behind NZD strength, particularly against a 'muddle through' global backdrop. Valuation-wise, the NZD is stretched. But for it to fall meaningfully, either the domestic scene must deteriorate sharply (we can't really see that) or something major needs to occur offshore. And with regards to the latter, it is the scenarios at the extremes of the global growth 'bell curve' that we suspect will be what drives a meaningful shift in currency markets, although we are far more mindful of the negative end of the spectrum at present. In the meantime, this muddle-through global scene should ensure the NZD remains a 'buy on dips'.

DATA PREVIEW – Q2 GDP & BALANCE OF PAYMENTS

There shouldn't be too much to dislike within the Q2 GDP and Balance of Payments figures. Activity growth in excess of 1% q/q and a current account deficit narrowing to around 2½% of GDP clearly paints a favourable picture for the New Zealand economy from both a cyclical and structural sense.

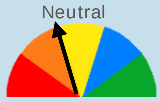
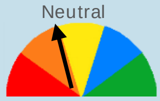
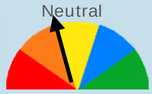
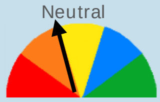
INTEREST RATE STRATEGY

Short-end rates look set to drift higher over the next fortnight as the market gets 'gun-shy' on RBNZ rate cut expectations on what will likely be solid GDP data, and a pause at next week's *OCR Review*. TWI strength remains a key issue for monetary policy, and we still expect two more OCR cuts from here. All else equal, that will both limit how high rates can go near term, and suggest we'll ultimately see them go lower yet. But for now a pause beckons. NZ/US spreads are expected to continue gradually narrowing, but like the short end, are in for a pause near-term.

CURRENCY STRATEGY

Technically, the NZD looks to have overshot and is prone to a pullback. However, amidst solid domestic data – expected to be reinforced this week – and a 'muddle-through' world, 'buy on dips' still dominates 'sell the rally'. The canary in the coalmine remains the global scene (and the Fed in particular), with signs of tension within the Fed over the path for policy. Excess liquidity is underpinning elevated asset prices but creating systemic instability, and there is growing unease over the latter. We doubt market volatility can remain so sanguine in this environment.

THE ANZ HEATMAP

Variable	View	Comment	Risk profile (change to view)
GDP	3.1% y/y for 2017 Q2	The economy is recording decent momentum, and we expect that to generally continue. Downside risk mainly stems from offshore.	Negative  Positive
Unemployment rate	5.0% for 2017 Q2	The unemployment rate should continue to trend lower. Wage inflation is contained, in part due to strong labour supply growth.	Negative  Positive
OCR	1.50% by Jun 2017	A further 50bps of cuts out to early 2017, despite housing, with the global scene and NZD strength key drivers.	Down  Up
CPI	0.7% y/y for 2017 Q2	Low petrol prices and further ACC levy cuts from July expected to keep headline inflation low this year. Core inflation measures to remain historically low.	Negative  Positive

ECONOMIC OVERVIEW

SUMMARY

The strong domestic economy is clearly a driving force behind NZD strength, particularly against a 'muddle through' global backdrop. Valuation-wise, the NZD is stretched. But for it to fall meaningfully, either the domestic scene must deteriorate sharply (we can't really see that) or something major needs to occur offshore. And with regards to the latter, it is the scenarios at the extremes of the global growth 'bell curve' that we suspect will be what drives a meaningful shift in currency markets. We are far more mindful of the negative end of the spectrum at present especially with central banks needing to draw a line in the sand in favour of medium-term stability and against distortions driven by excessive liquidity. In the meantime, this muddle-through global scene should ensure the NZD remains a 'buy on dips'. Beyond what should be positive Q2 GDP and current account data this week, data (including some of our own proprietary releases) will provide a signal on whether strong Q2 momentum has continued into Q3.

FORTHCOMING EVENTS

Food Price Index – August (10:45am, Tuesday, 13 September). Although fruit and vegetable prices typically rise in August, low commodity prices and NZD strength should cap overall gains.

REINZ Housing Market Statistics – August (9:30am, Wednesday, 14 September). Anecdotes have emerged that the latest LVR restrictions are taking a bite out of market activity and we'd expect to see some signs of this, at least through volumes, but not prices yet.

Balance of Payments – Q2 (10:45am, Wednesday, 14 September). Courtesy of a larger goods and service surplus, the seasonally adjusted current account deficit should narrow further. We see the annual balance narrowing to 2.6% of GDP.

BNZ-BusinessNZ PMI – Aug (10:30, Thursday, 15 September). Activity is holding up at respectable levels despite the strong NZD, with the well-performing domestic economy lending support.

GDP – Q2 (10:45am, Thursday, 15 September). We expect growth of 1.1% q/q (3.6% y/y), with broad-based gains, but particularly from goods-producing industries. We see upside risk.

ANZ Job Ads – August (10:00am, Friday, 16 September).

ANZ Roy Morgan Consumer Confidence – September (1:00pm, Friday, 16 September).

BNZ-BusinessNZ PSI – Aug (10:30am, Monday, 19 September). We wouldn't be surprised to see a little softness (but not a weak signal) as LVR restrictions impact housing market activity.

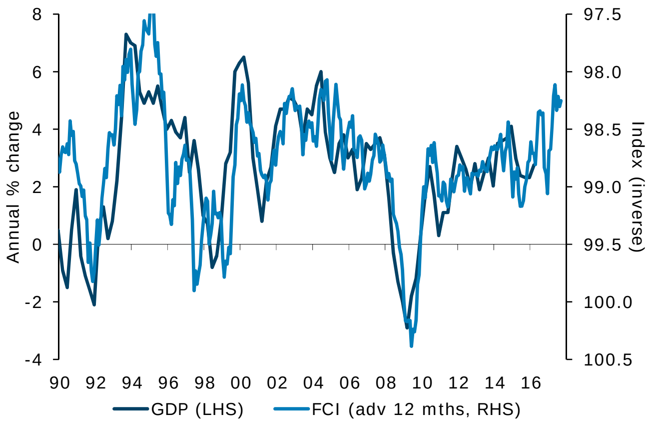
WHAT'S THE VIEW?

The New Zealand economy continues to just roll on, with this week's Q2 GDP figures set to confirm acceleration from early in the year. But that is hardly *new* news. New Zealand's solid growth picture – and its drivers – are now well appreciated.

It is a story that has plenty of legs left yet, particularly when it is accompanied with a narrowing current account deficit (also expected to be confirmed by data this week), giving that growth a more sustainable feel to it (or at least a less worrying borrow-and-spend style feel, despite credit growth ripping along at a fair clip at present). Throw in rebounding dairy prices (with forward prices continuing to lift), and there is distinct lack of bad news out there. Rather, the so-called problems (credit growth, housing affordability, too much migration, skill shortages etc) are partly symptomatic (albeit not entirely) of good news. Any economy has aches and pains as it expands and New Zealand is no different.

Leading gauges (financial conditions and our confidence composite), point to more of the same. And that is important! This week's GDP figures are for Q2 after all and it is now mid-September!

FIGURE 1: NZ GDP VS FINANCIAL CONDITIONS INDEX



Source: ANZ, Statistics NZ, Bloomberg

It is certainly not a domestic growth picture that spells a dramatic shift in the NZD's prospects any time soon. A number of relativities remain skewed in the NZD's favour: growth, yield, fiscal position, the political scene and more recently, stronger commodity export prices. At a time of abundant global liquidity and low market volatility, these factors get pushed up the list of importance as key currency drivers. And this is coming at a time when the global economy is 'muddling through'. It's easy to look good against something that is muddled.

So while the NZD looks to have had an eye-watering move (it's back over 78 on a TWI basis and knocking louder on the AUD parity door), **we are not**

ECONOMIC OVERVIEW

really too surprised. Some fundamental valuation metrics say the NZD is stretched, but arguably the most important fundamental – relative growth – says it is not.

FIGURE 2: GLOBAL MACRO AND FINANCIAL 'SCORECARD' – SELECTED PEER MARKETS

CATEGORY	NZD	AUD	USD	CAD	GBP	EUR
Economic Growth	3.6%^	3.3%	1.2%	1.1%	2.2%	1.6%
Annual Inflation	0.4%	1.0%	0.8%	1.3%	0.6%	0.2%
Policy Rate	2.0%	1.5%	0.5%	0.5%	0.3%	0.0%
10yr Bond Yield*	2.4%	2.0%	1.7%	1.1%	0.9%	0.0%
Unemployment	5.1%	5.7%	4.9%	7.0%	4.9%	10.1%
C/A Balance % GDP	-2.6%^	-3.8%	-2.6%	-3.4%	-5.7%	3.3%
Budget Balance % GDP~	-0.1%	-2.4%	-3.8%	-2.4%	-3.2%	-2.1%
Govt Net Debt % GDP~	7%	20%	82%	27%	81%	91%

Source: ANZ, Bloomberg, IMF

* EUR 10yr Bond Yield is the German Bund ^ ANZ estimate for Q2 2016

~ Budget Balances and Net Debt are 2016 data from the April 2016 IMF WEO (except Europe, where we use Eurostat data)

1st place in each category shaded **dark blue**, 2nd place **light blue**, second last place **orange**, and last place shaded **red**.

Source: ANZ, Bloomberg, IMF

To be fair, we wouldn't be surprised to see the NZD ease back over the coming weeks given the strength of the recent run; currencies don't tend to run in straight lines. But the spirit looks set to remain one of elevation.

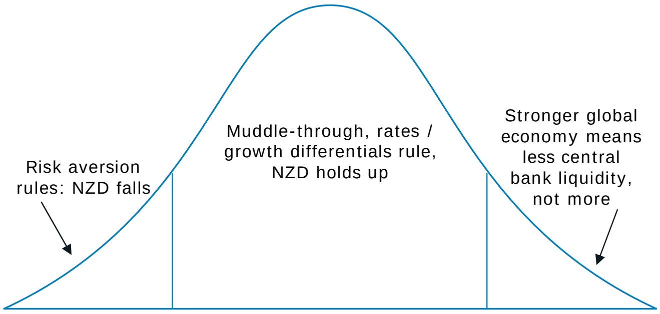
Indeed, when it comes to a material change in the NZD's direction from here, either the domestic economy needs to collapse (we can't see that) or we see something major offshore. There look to be two opposing scenarios.

1. **The US economy picks up from its current growth funk.** At a time when it is already close to full employment, this sees inflation pressures lift, providing the Fed with greater confidence to remove ultra-stimulatory monetary conditions. Markets take a hike in their stride; good economic news is good despite rates moving up. A stronger US economy supports stronger global prospects, particularly in EM Asia, and other central banks are able to move to a more neutral stance. Core currencies rise, while peripheral ones weaken. The market starts to transition away from central bank liquidity-driven thinking without too much of a ripple.

2. **Global growth conditions deteriorate sharply**, which would call into question extended asset valuations in many markets. Financial stability risks become a systemic (bad) reality. There are plenty of candidates for the cause: distorted price signals for too long, too much debt across emerging markets, something geopolitical in the Middle East, Europe and political fracas globally. It only takes a small fuse to light a big bomb. Heightened risk aversion would also sharply reduce the attractiveness of carry trade-type strategies and the appeal of high-yielding assets like the NZD. A repatriation of global capital, increased market volatility and decreased risk appetite see all clambering for a small NZD exit door. Supposed 'safe haven' NZD status works in a low volatility (and muddle through) world. This scenario is apt right now given our sense that central banks are becoming more alert to the negative side of ultra loose policy.

These two scenarios are clearly very different and paint the currency outlook as quite binary at present. Admittedly, we can't really see much chance of the dream scenario #1 unfolding. While we have more sympathy for the second, it is still just a scenario and not our central view.

FIGURE 3: GLOBAL GROWTH OUTCOMES AND THE NZD



Source: ANZ

In the meantime, 'muddle through' for the global economy looks like the name of the game. And in that environment, where global growth is neither great nor terrible, markets continue to rely on central bank liquidity to support asset valuations, and volatility remains contained, we believe the main prognosis for the NZD is a 'buy on dips'. Yes, it is elevated valuation-wise against a number of crosses, but we just can't see the catalysts to really shift it from this theme. **Some signs of a mini tantrum late last week across markets do have us on alert though, as we are starting to detect more unease over the side effects of extraordinary loose policy** (refer currency section on page 8).

Turning to the week ahead, as mentioned above, June quarter GDP and Balance of Payments figures should paint a healthy picture of the economy's recent cyclical and structural performance. In fact, the GDP figures have the potential to be an outright boomer, and we see some upside risk to our already relatively hefty 1.1% q/q estimate. Our full preview of the data is on page 6, but it's fair to say that we don't think there will be much to dislike. The current account deficit should narrow further and activity growth should certainly be strong enough to see per capita growth accelerate from its current sluggish annual pace of 0.7% to something more respectable in excess of 1%.

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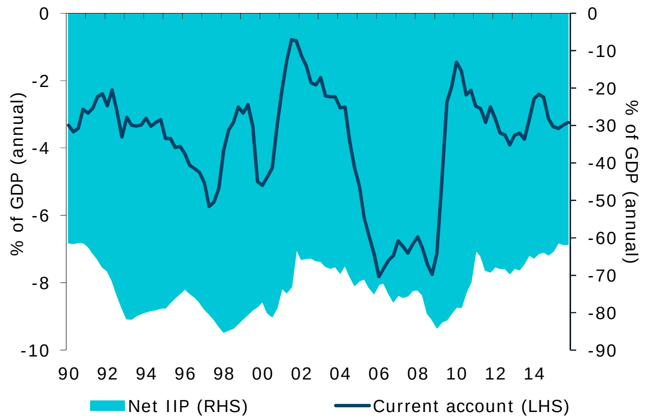
But stepping back from the spot estimates of the figures themselves, what is arguably more important is what they are highlighting in combination. Strong activity growth in a quarter is of course not uncommon. Neither is a narrowing current account deficit. What is far more uncommon – at least in the New Zealand context – is for these two things to occur at the same time. **Historically, strong domestic activity growth, particularly when it is accompanied with housing market largesse as it is now, has seen the current account deficit widen** as households ride net wealth gains by boosting spending (and increasing dissaving) and 'sin' indicators such as the current account deficit widen. While household credit growth has certainly accelerated sharply over recent years and housing valuations leave us mindful, the fact it hasn't been accompanied by a broad-based credit upswing or sharp lift in consumption growth, at least in per capita terms, gives the current growth backdrop a more sustainable feel to it despite housing-related risks.

FIGURE 4: CURRENT ACCOUNT AND NET INTERNATIONAL INVESTMENT POSITION

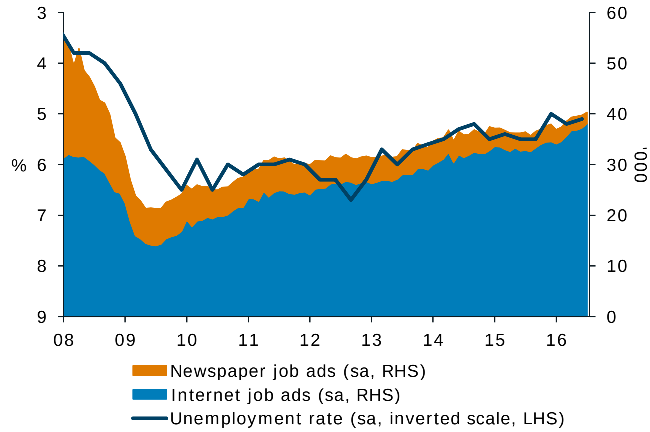


Source: ANZ, Statistics NZ

Elsewhere this week, **other data (including some of our proprietary gauges) will provide a signal on whether strong growth momentum has continued into Q3**.

Even with plenty of doubt sounding the employment growth figures from the latest HLFS, the fact they point to strong labour demand is not inconsistent with our Job Ads measure, for which the August figures will be released this week. In fact, recent job advertising data suggests labour demand continues to strengthen, with total advertising rising for the sixth consecutive month in July, lifting 1.4% m/m, to be 9.8% higher than a year ago (on a three-month average basis). Importantly, this growth is also reasonably broad-based across the country, with Canterbury being the main exception. Now, of course labour supply growth remains strong as well, which means that there is still some capacity for firms to meet this demand. But we expect the downward trend in the unemployment rate to continue, eventually resulting in a modest lift in wage growth.

FIGURE 5: JOB ADS AND THE UNEMPLOYMENT RATE



Source: ANZ, Statistics NZ, Seek, Trade Me, Dominion Post, Hawke's Bay Today, Manawatu Standard, NZ Herald, ODT, The Press, Waikato Times

Among other things, this solid labour market backdrop is no doubt a key factor supporting consumer confidence at present. Our ANZ-Roy Morgan measure for September is released this week and it has continued to oscillate around its historical average for the better part of nine months now. In fact, in seasonally adjusted terms, it has risen modestly for the past four months in a row, to be sitting at its highest level since November 2015 in August. Together with its business sentiment equivalent, it is consistent with a decent underlying trend in growth momentum continuing.

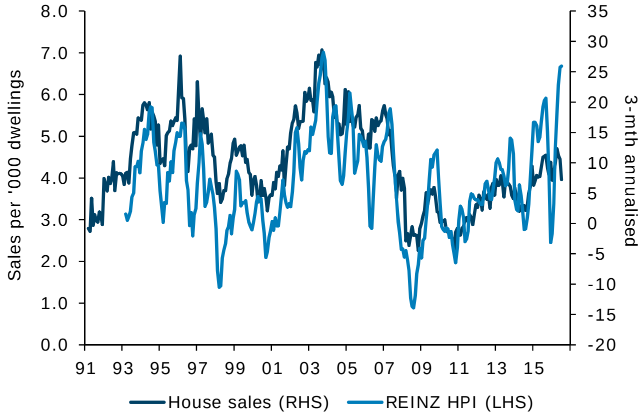
That said, the BusinessNZ monthly indicators (PMI and PSI) may hint at a slightly softer pace of GDP growth in Q3 than seen in Q2. We noted a few weeks ago that while the overall growth picture for New Zealand looked strong, and arguably stronger than even a few months ago, there would still be inter-quarterly volatility to contend with. And one thing we are mindful of (beyond the natural statistical payback after a strong Q2) is for the latest RBNZ LVR restrictions to weigh on housing market and services sector activity. We are hearing anecdotes along those lines and perhaps the PSI gauge, which did soften from 56.4 to 54.2 in July, will reflect that again.

We also expect the latest REINZ housing market figures for August on Wednesday morning. The focus with this data will be whether there are any signs of cooling activity. While the RBNZ's latest round of LVR restrictions are not officially implemented until October, given the need to manage pipelines the finance sector has largely implemented

ECONOMIC OVERVIEW

the policy change already, and we are hearing anecdotes that this has affected market activity. If that is the case, we'd expect to see early signs of that in these figures. Up until now, outside of weaker sales volumes – which we put largely down to a lack of new market listings – there have certainly been few signs of cooler house price growth. In fact, in July, nationwide stratified house prices rose by 2.4% m/m, which was the strongest monthly price growth in close to a year. What is more meaningful though is that monthly growth was already strong. In fact, on a 3-month annualised basis, nationwide price growth is running at 26%.

FIGURE 6: REINZ HOUSE PRICES AND SALES



Source: ANZ, REINZ

LOCAL DATA

ANZ Truckometer – August. The Heavy Traffic Index rose 6.7% m/m, while the Light Traffic Index rose 1.0% m/m.

GlobalDairyTrade Auction. The GDT TWI lifted 7.7%, with whole milk powder prices up 3.7%.

Economic Survey of Manufacturing – Q2. Total sales volumes rose 2.8% q/q, with 'core' sales up 1.4% q/q.

ANZ Monthly Inflation Gauge – August. The headline gauge rose 1.1% q/q, with annual growth slipping to 2.0% from 2.1%.

Electronic Card Transactions – Q2. Total retail spending fell 0.4% m/m, with core spending down 0.6% m/m.

DATA PREVIEW

SUMMARY

There shouldn't be too much to dislike within the Q2 GDP and Balance of Payments figures. Activity growth in excess of 1% q/q (lifting per capita growth) and a current account deficit narrowing to around 2½% of GDP clearly paints a favourable picture for the New Zealand economy from both a cyclical and structural sense. It is little wonder the NZD remains resilient!

CURRENT ACCOUNT – 2016Q2

(Wednesday 14 September, 10.45am)

Current Account	ANZ	Market
Quarter (nsa)	**-$100m**	-$295m
Quarter (sa)	**-$989m**	--
Annual	**-$6.4B**	--
% of GDP	**-2.6%**	-2.6%

The unadjusted current account looks set to be close to 'balanced' in Q2. We expect a small deficit of just $100m, which would be the smallest Q2 deficit since 2009. It would be enough to see the annual deficit narrow to $6.4bn or 2.6% of GDP, remaining well below its historical average (of 3.7%).

A decent narrowing in seasonally adjusted terms is on the cards too. Largely on account of an improvement in the goods balance (back into surplus for the first time since 2013), we see the seasonally adjusted current account deficit narrowing to ~$1.0bn (from $1.5bn). This comes despite a modest drop in the terms of trade over the quarter, as a surge in export volumes offsets this price effect. The services balance is forecast to remain well in surplus (although slightly less than in Q1, with tourist spending dipping a touch off elevated levels), while the primary and secondary income deficit is expected to be largely unchanged.

It speaks to a stronger cyclical and structural economic picture. The fact the economy is growing strongly (set to be confirmed by the subsequent GDP figures) and yet the current account deficit is still narrowing from already below-average levels highlights a far less vulnerable economic picture than has been evident in the past. Despite housing and debt exuberance in some parts, this hasn't broadened into an economy-wide free-for-all, which has often been the tendency. This better structural picture should also be reinforced by a further drop in key balance sheet ratios like external debt to GDP.

And we now expect this improvement to by-and-large persist. Whereas previously we felt the current account deficit was at risk of widening sharply as habits of old returned, we now see it holding in a reasonably sustainable 2½% to 3½% of GDP range.

GROSS DOMESTIC PRODUCT – 2016Q2

(Thursday 15 September, 10.45am)

GDP	ANZ	RBNZ	Market
Quarterly %	**1.1%**	0.8%	1.1%
Annual %	**3.6%**	3.3%	3.6%
Ann. Ave. %	**2.8%**	2.7%	2.8%

We expect production-based GDP growth of 1.1% q/q, which would lift annual growth to 3.6%. It is above the RBNZ's August *MPS* pick, although this was finalised prior to the release of strong building work figures. For the first time in 12 months we expect primary, goods, and services sector activity to all contribute positively to quarterly GDP growth.

Led by construction, goods production is expected to have risen by 2.4% q/q. Partial data showed solid gains in residential and non-residential building work, and we also expect a solid lift in 'other' construction. Additionally, total manufacturing production is expected to make a 0.2%pt contribution to overall GDP growth, with broad-based gains across primary and 'core' elements.

Services sector activity is expected to expand 0.8% q/q, a similar pace to that recorded over the prior three quarters. While professional, administrative and support services activity is likely to be flat, we expect decent growth in the retail and accommodation sectors, wholesale trade, rental, hiring and real estate services and arts and recreation services. Services sector activity continues to be supported by strong population growth, housing market activity, low interest rates and a booming tourism sector.

In fact, our expenditure GDP models are pointing to upside risk. Like with the (preferred) production-based figures, broad-based growth is expected at the expenditure GDP level, with solid contributions likely from household consumption, residential and other fixed asset investment and net exports. Some of this strength should be offset by a drag from inventories, although there is (as always) plenty of uncertainty surrounding the extent of this.

MARKET IMPLICATIONS

We expect the data to confirm why the NZD has been outperforming – namely a cyclical and structural picture that looks better than many. Until that picture changes, we can't see the NZD falling meaningfully. And for monetary policy, near-term market pricing is far more likely to be thrown around by inflation and inflation expectation nuances than further validation of a decent growth performance.

INTEREST RATE STRATEGY

SUMMARY

Short-end rates look set to drift higher over the next fortnight as the market gets 'gun-shy' on RBNZ rate cut expectations on what will likely be solid GDP data, and a pause at next week's *OCR Review*. TWI strength remains a key issue for monetary policy, and we still expect two more OCR cuts from here. All else equal, that will both limit how high rates can go near term, and suggest we'll ultimately see them go lower yet. But for now a pause beckons. NZ/US spreads are expected to continue gradually narrowing, but like the short end, are in for a pause near-term. Long-end rates are at the top of trading ranges on the back of ECB disappointment. But absent any real change in the tempo of G3 data, we don't expect to see a break-out of trading ranges.

THEMES

- Profit-taking and 'sell the rumour, buy the fact' style price action is putting upward pressure on the short end. We expect this nervousness to continue through till the September *OCR Review*, at which point we expect yields to top out.
- Robust data notwithstanding, NZD TWI strength and low inflation expectations remain key issues for monetary policy, and will keep the RBNZ at the easing table. This needs to be respected.
- A long-end range break-out cannot be discounted near term. What is less clear is how sustainable such a move will be. Fiscal policy will ultimately have to bear more of the burden across the G10 economies, but easy monetary policy and excess liquidity remain key features and will cap yields.

MONETARY POLICY AND SHORT END

The short end has succumbed to more selling pressure over the past week, lifting the bellwether 2 year swap by around 10bps off its ~1.94% low. While we see limited scope for any respite this coming fortnight (given the data/event calendar), we also believe it would be 'dangerous' to ignore TWI strength, weakening inflation expectations and high odds of a negative Q3 CPI print. All these factors will keep the RBNZ at the table. **Somewhat stale long positioning does have the potential to drive further near-term selling, but with the medium-term policy backdrop still supportive, we favour lightening up now, with a view to reinstating long positions later on**.

GLOBAL MARKETS AND LONG END

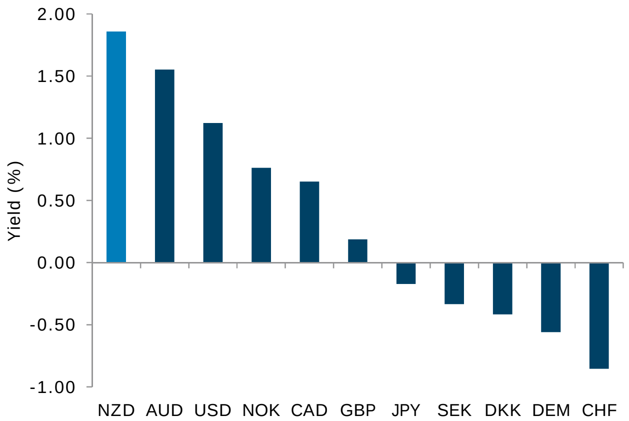
Global long-term bond yields have risen on the back of a number of market-disappointing monetary policy developments (no further ECB easing, upbeat comments from the BoE's Carney, and talk of a September Fed hike being 'live' still). This has resulted in **a notable shift in the 'vibe' in markets away from an expectation of imminent mass easings in Europe, the UK and Japan towards policy being more stable and fiscal policy doing more.** While at face value that's negative for bonds, ultimately the data will dictate what happens. With European and US inflation soft, and fiscal flexibility limited in the major economies, we don't expect the current rout in markets to be sustained.

STRATEGY

Investors: We favour lightening up on received short-end positons and NZ/US spread trades (but to maintain OIS exposure to November) and to await a period of 'cleaner air' before reinstating positions.

Borrowers: No change. Watching and waiting is still our favoured strategy. We are not confident that the lows are yet in for term yields, despite dramatic falls. With BKBM also biased lower, we favour options.

FIGURE 1: G10 5YEAR SOVEREIGN BOND YIELDS: SPOT THE OUTLIER!



Source: ANZ, Bloomberg

KEY VIEWS		
SECTOR	**DIRECTION**	**COMMENT**
Short end	Neutral	Has scope to continue drifting higher in coming days, but don't lose sight of the high TWI.
Long end	Neutral/bullish	Stressed near term, but will come back. Yield convergence and homogenisation the main theme still.
Yield Curve	Biased flatter	Ironically, near-term flattening boosted by short-end complacency. More eventual easing = flatter curve.
Geographic spreads	Neutral/ Narrower	New Zealand is still the standout G10 bond market, especially in the belly of the curve (Figure 1). Spread compression trades have benefitted from higher US yields, allowing for some profit-taking.
Swap spreads	Neutral	NZGS demand still OK, but corporate payers have been savvy; unlikely to hedge any time soon.
NZD/TWI	Holding up	We expect the TWI to hold up; unlikely to roll over until growth slows and until the OCR goes much lower.

CURRENCY STRATEGY

SUMMARY

Technically, the NZD looks to have overshot and is prone to a pullback lower. However, amidst solid domestic data – expected to be reinforced this week – and a 'muddle-through' world, 'buy on dips' still dominates 'sell the rally'. The canary in the coalmine remains the global scene (and the Fed in particular), with signs of tension within the Fed over the path for policy. Excess liquidity is underpinning elevated asset prices but creating systemic instability, and there is growing unease over the latter. We doubt market volatility can remain so sanguine in this environment.

TABLE 1: KEY VIEWS			
CROSS	**GUIDE**	**MONTH**	**YEAR**
NZD/USD	↔/↓	Solid data a key plank of support but shifting Fed stance	Firmer USD to be an eventual 'saviour'
NZD/AUD	↔	Parity now or never!	0.93-0.98 range
NZD/EUR	↔	NZ yield attractive	NZ better
NZD/GBP	↔	BoE tone neutral	Fully priced. Toppy.
NZD/JPY	↔/↑	BoJ wants yen lower	USD/JPY ~100 untenable for BoJ

THEMES AND RISKS

- Mixed messages from Fed speakers of late, but the overall lesson seems clear; September is 'live', with labour data trusted more than GDP. September looks too early, but we sense an inclination to get another run (hike) on the board given the risks associated with keeping rates low for too long.
- Attention is firmly on FOMC voter Brainard tonight; she is typically dovish, but markets don't look well placed for anything other than that.
- ECB and BoJ not doing more (for now) but not doing less either.
- Little change in the domestic data pulse. Still a good news story but the market is expecting that.
- Bad news (ISM service sector data) is seen as good for markets as the low-for-longer drug and blind faith in the Fed and central banks continues, but markets are looking a little more wary.
- The NZD/AUD continues to prod higher and while extended valuation-wise, the top is not yet in.

ASSESSMENT

When one talks about fundamental drivers of currencies, growth doesn't get enough attention. It is nonsense to say a currency is unjustified by the fundamentals if GDP growth is around 3½%. A caveat is still required though. If that growth is associated with widening external imbalances, care must be taken. However, **New Zealand finds itself set to report this week both strong GDP and a narrower current account deficit.**

So the same old story of strong domestic support in combination with yield remains in place.

From a technical perspective we are mindful of the recent surge; the NZD has risen ~7% on a TWI basis since the end of May. A pullback seems likely. Price action on Friday saw early signs. However, as attention turns to the week ahead, **we struggle to see any catalysts for any movement to be much more than noise** with 'buy on the dip' still in vogue.

GLOBAL VIEWS

The concept of 'muddle through' global growth still dominates our assessment. **This supports shallow cycles and ranges for currencies. Effectively the status quo becomes default.**

But stepping back, we believe a battle is brewing. Excess liquidity is underpinning asset prices but also creating systemic instability. For central banks, it's about choosing the lesser of two evils, particularly for the Fed over the year ahead. Stand pat and let systemic risks intensify, or move too early and risk undermining a world beset by fragilities. What we do know is that **the pendulum needs to shift towards not exacerbating market distortions – and that will come at the expense of growth.** This will bring attention back towards fundamentals. So while it's a case of status quo and muddle through for now, we doubt it will last.

TABLE 2: NZD VS AUD: MONTHLY GAUGES		
GAUGE	**GUIDE**	**COMMENT**
Fair value	↔	Higher fair value range
Yield	↔/↑	OCR gap to persist into early 2017
Commodities	↔/↑	Dairy up, iron ore down
Data	↑	This week's NZ data will be robust
Techs	↔/↑	Break of 0.97 ⇨assault on parity
Sentiment	↔	Sellers lining up ~0.965
Other	↔/↓	Market wary of valuations here
On balance	↔/↑	**Parity not sustainable, but could spike there this month**

TABLE 3: NZD VS USD: MONTHLY GAUGES		
GAUGE	**GUIDE**	**COMMENT**
Fair value	↔/↓	High but USD the main problem
Yield	↔	NZ yield and other factors support
Commodities	↔/↑	NZ comdty prices up 3.2% in Aug
Risk aversion	↔/↓	The NZD's main Achilles Heel and the Fed looks to be shifting
Data	↔/↑	NZ data pulse still very strong
Techs	↔/↑	Good support in low 0.72s
Other	↓	Positioning could squeeze on Fed
On balance	↔	**More than just a yield story but Fed holds the key.**

POSITIONING

NZD longs have lifted sharply, adding potential for a squeeze lower should Fed rhetoric be less dovish, which we see as a risk. EUR and GBP positions remain very short, and could result in short squeezes.

DATA EVENT CALENDAR

DATE	COUNTRY	DATA / EVENT	MKT.	LAST	NZ TIME
12-Sep	CH	Money Supply M0 YoY - Aug	7.4%	7.2%	12-15 Sep
	CH	Money Supply M1 YoY - Aug	24.0%	25.4%	12-15 Sep
	CH	New Yuan Loans CNY - Aug	725.0B	463.6B	12-15 Sep
	CH	Money Supply M2 YoY - Aug	10.5%	10.2%	12-15 Sep
13-Sep	NZ	Food Prices MoM - Aug	--	-0.2%	10:45
	AU	ANZ-RM Consumer Confidence Index - 11-Sep	--	114.3	11:30
	AU	NAB Business Conditions - Aug	--	8.0	13:30
	AU	NAB Business Confidence - Aug	--	4.0	13:30
	CH	Industrial Production YoY - Aug	6.2%	6.0%	14:00
	CH	Retail Sales YoY - Aug	10.2%	10.2%	14:00
	CH	Fixed Assets Ex Rural YTD YoY - Aug	7.9%	8.1%	14:00
	GE	CPI MoM - Aug F	0.0%	0.0%	18:00
	GE	CPI YoY - Aug F	0.4%	0.4%	18:00
	GE	CPI EU Harmonized MoM - Aug F	-0.1%	-0.1%	18:00
	GE	CPI EU Harmonized YoY - Aug F	0.3%	0.3%	18:00
	UK	CPI MoM - Aug	0.4%	-0.1%	20:30
	UK	CPI YoY - Aug	0.7%	0.6%	20:30
	UK	CPI Core YoY - Aug	1.4%	1.3%	20:30
	UK	RPI MoM - Aug	0.4%	0.1%	20:30
	UK	RPI YoY - Aug	1.8%	1.9%	20:30
	UK	PPI Input NSA MoM - Aug	0.6%	3.3%	20:30
	UK	PPI Input NSA YoY - Aug	8.1%	4.3%	20:30
	UK	PPI Output NSA MoM - Aug	0.3%	0.3%	20:30
	UK	PPI Output NSA YoY - Aug	1.0%	0.3%	20:30
	UK	PPI Output Core NSA MoM - Aug	0.2%	0.4%	20:30
	UK	PPI Output Core NSA YoY - Aug	1.3%	1.0%	20:30
	EC	Employment QoQ - Q2	--	0.3%	21:00
	EC	Employment YoY - Q2	--	1.4%	21:00
	GE	ZEW Survey Current Situation - Sep	56.0	57.6	21:00
	GE	ZEW Survey Expectations - Sep	2.5	0.5	21:00
	EC	ZEW Survey Expectations - Sep	--	4.6	21:00
	US	NFIB Small Business Optimism - Aug	94.8	94.6	22:00
14-Sep	US	Monthly Budget Statement - Aug	-$105.5B	-$64.4B	06:00
	NZ	REINZ House Sales YoY - Aug	--	-10.1%	09:30
	NZ	BoP Current Account Balance - Q2	-0.295B	1.306B	10:45
	NZ	Current Account GDP Ratio YTD - Q2	-2.6%	-3.0%	10:45
	AU	Westpac Consumer Conf Index - Sep	--	101.0	12:30
	AU	Westpac Consumer Conf SA MoM - Sep	--	2.0%	12:30
	UK	Claimant Count Rate - Aug	2.2%	2.2%	20:30
	UK	Jobless Claims Change - Aug	1.8k	-8.6k	20:30
	UK	ILO Unemployment Rate 3Mths - Jul	4.9%	4.9%	20:30
	UK	Employment Change 3M/3M - Jul	172k	172k	20:30
	EC	Industrial Production SA MoM - Jul	-1.0%	0.6%	21:00
	EC	Industrial Production WDA YoY - Jul	-0.8%	0.4%	21:00
	US	MBA Mortgage Applications - 9-Sep	--	0.9%	23:00
15-Sep	US	Import Price Index MoM - Aug	-0.1%	0.1%	00:30
	US	Import Price Index YoY - Aug	-2.2%	-3.7%	00:30
	NZ	BusinessNZ Manufacturing PMI - Aug	--	55.8	10:30

Continued on following page

DATA EVENT CALENDAR

DATE	COUNTRY	DATA / EVENT	MKT.	LAST	NZ TIME
15-Sep	NZ	GDP SA QoQ - Q2	1.1%	0.7%	10:45
	NZ	GDP YoY - Q2	3.6%	2.8%	10:45
	AU	Employment Change - Aug	15.0k	25.3k	13:30
	AU	Unemployment Rate - Aug	5.7%	5.7%	13:30
	AU	Participation Rate - Aug	64.9%	64.9%	13:30
	AU	New Motor Vehicle Sales MoM - Aug	--	-1.3%	13:30
	AU	New Motor Vehicle Sales YoY - Aug	--	1.6%	13:30
	AU	RBA FX Transactions Market - Aug	--	444M	13:30
	UK	Retail Sales Ex Auto Fuel MoM - Aug	-0.7%	1.5%	20:30
	UK	Retail Sales Ex Auto Fuel YoY - Aug	4.8%	5.4%	20:30
	UK	Retail Sales Inc Auto Fuel MoM - Aug	-0.4%	1.4%	20:30
	UK	Retail Sales Inc Auto Fuel YoY - Aug	5.4%	5.9%	20:30
	EC	Trade Balance SA - Jul	€22.0B	€23.4B	21:00
	EC	Trade Balance NSA - Jul	€29.6B	€29.2B	21:00
	EC	CPI MoM - Aug	0.1%	-0.6%	21:00
	EC	CPI YoY - Aug F	0.2%	0.2%	21:00
	EC	CPI Core YoY - Aug F	0.8%	0.8%	21:00
	UK	Bank of England Bank Rate - Sep	0.25%	0.25%	23:00
	UK	BoE Asset Purchase Target - Sep	£435B	£435B	23:00
16-Sep	US	Current Account Balance - Q2	-$120.8B	-$124.7B	00:30
	US	Retail Sales Advance MoM - Aug	-0.1%	0.0%	00:30
	US	Retail Sales Ex Auto MoM - Aug	0.2%	-0.3%	00:30
	US	Retail Sales Ex Auto and Gas - Aug	0.3%	-0.1%	00:30
	US	Retail Sales Control Group - Aug	0.4%	0.0%	00:30
	US	Initial Jobless Claims - 10-Sep	265k	259k	00:30
	US	Continuing Claims - 3-Sep	2150k	2144k	00:30
	US	Philadelphia Fed Business Outlook - Sep	1.0	2.0	00:30
	US	PPI Final Demand MoM - Aug	0.1%	-0.4%	00:30
	US	PPI Final Demand YoY - Aug	0.1%	-0.2%	00:30
	US	PPI Ex Food and Energy MoM - Aug	0.1%	-0.3%	00:30
	US	PPI Ex Food and Energy YoY - Aug	1.0%	0.7%	00:30
	US	Empire Manufacturing - Sep	-1.00	-4.21	00:30
	US	Industrial Production MoM - Aug	-0.2%	0.7%	01:15
	US	Capacity Utilization - Aug	75.7%	75.9%	01:15
	US	Business Inventories - Jul	0.1%	0.2%	02:00
	NZ	ANZ Job Advertisements MoM - Aug	--	1.4%	10:00
	NZ	ANZ Consumer Confidence Index - Sep	--	117.7	13:00
	NZ	ANZ Consumer Confidence MoM - Sep	--	-0.4%	13:00
	NZ	Non Resident Bond Holdings - Aug	--	67.2%	15:00
	EC	Labour Costs YoY - Q2	--	1.7%	21:00
17-Sep	US	CPI MoM - Aug	0.1%	0.0%	00:30
	US	CPI YoY - Aug	1.0%	0.8%	00:30
	US	CPI Ex Food and Energy MoM - Aug	0.2%	0.1%	00:30
	US	CPI Ex Food and Energy YoY - Aug	2.2%	2.2%	00:30
	US	U. of Mich. Sentiment - Sep P	90.6	89.8	02:00
	US	Total Net TIC Flows - Jul	--	-$202.8B	08:00
	US	Net Long-term TIC Flows - Jul	--	-$3.6B	08:00

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, with downside risks mainly stemming from offshore. But with inflation low and the NZD high, our base case is for OCR cuts in November and early 2017, taking the OCR to 1.5%.

DATE	DATA/EVENT	ECONOMIC SIGNAL	COMMENT
Tue 13 Sep (10:45am)	Food Price Index – Aug	Flat	Although fruit and vegetable prices typically rise in August, low commodity prices and NZD strength should cap overall gains.
Wed 14 Sep (9:30am)	REINZ Housing Markets Statistics – Aug	Turning?	Anecdotes have started to emerge that the latest round of LVR restrictions are taking a bite out of market activity and we'd expect to see some signs of this in volumes.
Wed 14 Sep (10:45am)	Balance of Payments – Q2	Narrower	Courtesy of a larger goods and service surplus, the seasonally adjusted current account deficit should narrow further.
Thu 15 Sep (10:30am)	BNZ-BusinessNZ PMI – Aug	Balance	Activity is holding at respectable levels despite the strong NZD, with the well-performing domestic economy lending support.
Thu 15 Sep (10:45am)	GDP – Q2	Strong	We expect growth of 1.1% q/q (3.6% y/y), with broad-based gains, but particularly from goods-producing industries.
Fri 16 Sep (10:00am)	ANZ Job Ads – Aug	--	--
Fri 16 Sep (1:00pm)	ANZ Roy Morgan Consumer Confidence – Sep	--	--
Mon 19 Sep (10:30am)	BNZ-BusinessNZ PSI – Aug	Stable	The index has softened a little of late, but we are not expecting that to persist for long.
Wed 21 Sep (early am)	GlobalDairyTrade auction	Can they be maintained?	Key is whether recent price gains can be maintained beyond the preferential free-trade window with China closing around Oct.
Wed 21 Sep (10:45am)	International Travel & Migration – Aug	Still strong	Net inflows may be past their highs, but we see little chance of a fall to historical average (~15K) any time soon.
Thu 22 Sep (9:00am)	RBNZ OCR Review	No change	Future OCR cut(s) will be signalled, but the RBNZ is taking it gradually and has shown a preference to move on MPS dates.
Mon 26 Sep (10:45am)	Overseas Merchandise Trade – Aug	A wider deficit	Due to softer agricultural exports, the unadjusted trade balance typically widens in August and we expect no different this year.
Mon 26 Sep (3:00pm)	RBNZ New Residential Mortgage Lending – Aug	Cooling off highs	Tighter bank lending criteria are likely to see the rate of new lending growth ease off its current strong pace.
Fri 30 Sep (10:45am)	Building Consents Issued – Aug	Positive trend	Issuance has swung about somewhat of late, but we expect a modestly positive trend to remain.
Fri 30 Sep (1:00pm)	ANZ Business Outlook – Sep	--	--
Fri 30 Sep (3:00pm)	RBNZ Credit Aggregates – Aug	Strong	New lending growth is set to slow, which will eventually flow through into the rate of growth in the overall stock of credit.
Wed 5 Oct (early am)	GlobalDairyTrade Auction	Can they be maintained?	Key is whether recent price gains can be maintained beyond the preferential free-trade window with China closing around Oct.
Wed 5 Oct (1:00pm)	ANZ Commodity Price Index – Sep	--	--
Thu 6 Oct (10:00am)	ANZ Truckometer – Sep	--	--
On balance		**Data watch**	**Momentum is increasing at present, albeit with risks. Inflation remains low.**

KEY FORECASTS AND RATES

	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
GDP (% qoq)	0.7	**1.1**	**0.6**	**1.0**	**0.8**	**0.7**	**0.7**	**0.6**	**0.6**	**0.6**
GDP (% yoy)	2.8	**3.6**	**3.4**	**3.5**	**3.5**	**3.1**	**3.2**	**2.8**	**2.6**	**2.6**
CPI (% qoq)	0.2	0.4	**-0.2**	**0.0**	**0.6**	**0.3**	**0.6**	**0.1**	**0.7**	**0.7**
CPI (% yoy)	0.4	0.4	**-0.1**	**0.4**	**0.8**	**0.7**	**1.6**	**1.7**	**1.8**	**1.8**
Employment (% qoq)	1.4	2.4	**-0.4**	**0.6**	**0.5**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**
Employment (% yoy)	2.0	4.5	**4.3**	**4.0**	**3.1**	**1.1**	**1.9**	**1.7**	**1.6**	**1.6**
Unemployment Rate (% sa)	5.2	5.1	**5.1**	**5.0**	**5.0**	**5.0**	**4.9**	**4.9**	**4.8**	**4.8**
Current Account (% GDP)	-3.0	**-2.6**	**-2.6**	**-2.5**	**-2.7**	**-2.9**	**-2.8**	**-2.7**	**-2.5**	**-2.5**
Terms of Trade (% qoq)	4.2	-2.1	**-0.9**	**0.5**	**0.9**	**1.3**	**1.9**	**1.8**	**0.9**	**0.9**
Terms of Trade (% yoy)	-0.4	-3.9	**-1.0**	**1.6**	**-1.6**	**1.8**	**4.7**	**6.0**	**6.0**	**6.0**

	Nov-15	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16
Retail ECT (% mom)	0.9	0.1	0.3	0.8	0.1	0.8	-0.2	1.1	0.2	-0.4
Retail ECT (% yoy)	4.6	6.6	5.2	9.2	6.2	7.8	3.3	6.8	5.8	3.7
Credit Card Billings (% mom)	0.7	-0.7	2.1	-0.7	-1.0	2.6	-0.2	-1.3	2.7	--
Credit Card Billings (% yoy)	8.5	7.5	7.5	6.3	4.3	8.7	5.5	3.3	5.2	--
Car Registrations (% mom)	-2.0	3.0	-2.8	5.7	-3.8	6.4	-3.7	-0.9	-0.3	2.1
Car Registrations (% yoy)	1.3	2.4	-1.1	7.4	-0.2	8.7	4.2	-1.2	-1.9	2.6
Building Consents (% mom)	1.8	2.7	-8.3	10.7	-9.4	6.9	-0.2	21.9	-10.5	--
Building Consents (% yoy)	7.4	17.8	4.9	26.9	0.7	12.8	10.1	41.0	7.3	--
REINZ House Price Index (% yoy)	12.5	12.6	10.7	11.9	13.3	14.5	14.7	14.2	16.3	--
Household Lending Growth (% mom)	0.6	0.6	0.6	0.6	0.6	0.8	0.8	0.8	0.9	--
Household Lending Growth (% yoy)	7.2	7.4	7.5	7.6	7.7	7.9	8.1	8.3	8.6	--
ANZ Roy Morgan Consumer Conf.	122.7	118.7	121.4	119.7	118.0	120.0	116.2	118.9	118.2	117.7
ANZ Business Confidence	14.6	23.0	..	7.1	3.2	6.2	11.3	20.2	16.0	15.5
ANZ Own Activity Outlook	32.0	34.4	..	25.5	29.4	32.1	30.4	35.1	31.4	33.7
Trade Balance ($m)	-795	-42	12	367	189	350	344	110	-433	--
Trade Bal ($m ann)	52648	52510	52764	52831	52599	52626	52854	52661	52158	--
ANZ World Commodity Price Index (% mom)	-5.6	-1.8	-2.3	0.5	-1.3	-0.8	1.0	3.5	2.1	3.2
ANZ World Comm. Price Index (% yoy)	-15.3	-12.9	-14.7	-17.8	-22.4	-16.8	-11.7	-5.6	1.9	11.1
Net Migration (sa)	6230	5510	6090	6000	5340	5490	5550	5700	5600	--
Net Migration (ann)	63659	64930	65911	67391	67619	68110	68432	69090	69015	--
ANZ Heavy Traffic Index (% mom)	0.2	2.8	-4.3	1.7	3.3	-2.5	-2.5	4.1	-5.3	6.7
ANZ Light Traffic Index (% mom)	0.3	0.9	-1.4	2.4	0.8	-1.6	-1.3	2.5	-0.5	1.0

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	Jul-16	Aug-16	Today	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
NZD/USD	0.720	0.725	0.734	0.73	0.71	0.69	0.67	0.65	0.64	0.64
NZD/AUD	0.948	0.964	0.973	0.95	0.93	0.93	0.93	0.93	0.94	0.89
NZD/EUR	0.644	0.650	0.653	0.68	0.68	0.66	0.63	0.59	0.58	0.57
NZD/JPY	73.47	74.82	75.28	76.7	74.6	69.0	67.0	65.0	64.0	67.2
NZD/GBP	0.544	0.552	0.553	0.57	0.57	0.56	0.54	0.49	0.47	0.46
NZ$ TWI	75.0	75.9	78.3	77.0	75.8	73.7	71.5	69.0	68.3	67.5
INTEREST RATES	Jul-16	Aug-16	Today	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
NZ OCR	2.25	2.00	2.00	2.00	1.75	1.50	1.50	1.50	1.50	1.50
NZ 90 day bill	2.28	2.28	2.26	2.30	2.00	1.80	1.80	1.80	1.80	1.80
NZ 10-yr bond	2.21	2.24	2.42	1.90	1.90	2.10	2.20	2.40	2.40	2.70
US Fed funds	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25
US 3-mth	0.76	0.84	0.85	0.68	0.93	0.93	1.30	1.30	1.55	1.55
AU Cash Rate	1.75	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
AU 3-mth	1.86	1.74	1.73	1.80	1.80	1.80	1.80	1.80	1.80	1.80

	9 Aug	5 Sep	6 Sep	7 Sep	8 Sep	9 Sep
Official Cash Rate	2.25	2.00	2.00	2.00	2.00	2.00
90 day bank bill	2.23	2.23	2.22	2.23	2.23	2.23
NZGB 03/19	1.75	1.85	1.84	1.82	1.82	1.86
NZGB 05/21	1.79	1.86	1.88	1.86	1.86	1.91
NZGB 04/23	1.90	1.99	2.01	1.97	1.97	2.02
NZGB 04/27	2.20	2.29	2.30	2.24	2.25	2.33
2 year swap	1.96	2.01	2.01	1.99	2.00	2.01
5 year swap	2.09	2.12	2.13	2.10	2.11	2.15
RBNZ TWI	75.85	77.90	78.10	79.02	78.80	78.32
NZD/USD	0.7135	0.7318	0.7342	0.7469	0.7466	0.7324
NZD/AUD	0.9349	0.9644	0.9616	0.9727	0.9666	0.9712
NZD/JPY	73.03	75.60	75.85	75.89	75.88	75.21
NZD/GBP	0.5490	0.5489	0.5507	0.5582	0.5583	0.5520
NZD/EUR	0.6438	0.6555	0.6575	0.6640	0.6612	0.6520
AUD/USD	0.7632	0.7588	0.7635	0.7679	0.7724	0.7541
EUR/USD	1.1083	1.1164	1.1167	1.1248	1.1292	1.1233
USD/JPY	102.36	103.31	103.31	101.60	101.63	102.69
GBP/USD	1.2996	1.3331	1.3331	1.3381	1.3372	1.3267
Oil (US$/bbl)	43.06	44.39	44.39	44.85	45.47	47.63
Gold (US$/oz)	1333.62	1324.80	1326.45	1351.68	1345.75	1338.90
Electricity (Haywards)	4.62	4.90	5.29	5.03	7.12	8.38
Baltic Dry Freight Index	631	724	745	773	792	804
Milk futures (USD)	44	--	45	46	48	46

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