

The 2017 election race is heating up

- Two weeks is a long time in politics, with two leadership changes marking a tight race.
- This week's PREFU will give parties a realistic base for assessing the financial viability of their policies.
- Donald Trump continues to cause waves offshore.

The lead-up to the 2017 general election has kicked up a gear in the last couple of weeks. The resignation of Andrew Little and quick promotion of Jacinda Arden as leader of the Labour Party, combined with the resignation of Metiria Turei as co-leader of the Green Party, reinforces that two weeks is a long time in NZ politics. Now, with **Labour rapidly rising in the polls** (the most recent One News Colmar Brunton poll saw Labour jump 13 points to 37% compared to National's 44%), **the 2017 election on the 23rd of September is developing into what looks like a tight race.**

This week, the NZ Treasury will release the Pre-Election Economic and Fiscal Update (PREFU); essentially an update of the Budget forecasts that takes into account the current economic outlook. The PREFU is **designed to give all the political parties transparency over the state of the Crown financial positions.** That gives parties a realistic basis **for assessing the financial feasibility of their policies.**

Since the Budget 2017 release in May, the fiscal position has been favourable. Tax revenue has come in around \$1.1bn higher than forecast for the year to May. If this trend continues, **we expect that the unfettered Treasury estimates are likely to show an operating surplus for the 2016/17 year in the vicinity of \$2.8bn or 1.1% of GDP.** Over subsequent years, we expect the forecast surplus could be as much as \$2bn/year higher than those forecast in the May Budget.

If our forecasts are broadly correct, then the post-election government will have the luxury of choice, in contrast to the restraint needed after the Global Financial Crisis and Canterbury earthquakes triggered large deficits. Whether that choice comes in the form of tax cuts, boosts to welfare, more infrastructure spending or some combination of the above remains to be seen. **So watch for the size of the forecast surpluses; the bigger they are the more choices you are going to be presented with as the final month of the election campaign roars into life.**

Aside from poll-jumping in NZ, **Donald Trump also garnered a lot of attention last week,** starting with his comments surrounding the Charlottesville protests. What followed were a **number of high-profile CEOs stepping down from Trump's advisory councils.** Trump's decision to then disband two of these councils, followed by his **decision to fire his Chief Strategist, Steve Bannon,** **reignited concerns that Trump will struggle to carry out his economic agenda.** Combined with the sad events in Barcelona late last week, the risk-on sentiment that had seen equity markets hitting fresh highs recently unwound. **Last week, the Dow Jones fell 0.8% and the S&P 500 lost 0.7%.**

Foreign Exchange

- Risk aversion dominates market sentiment over the past week, quiet week ahead.

Interest Rates

- Interest rates lower on weak market sentiment, with falls greatest in longer-end rates.

Week Ahead

- The Pre-Election Economic and Fiscal Update is due out, and we expect a trade deficit of \$450m in July.

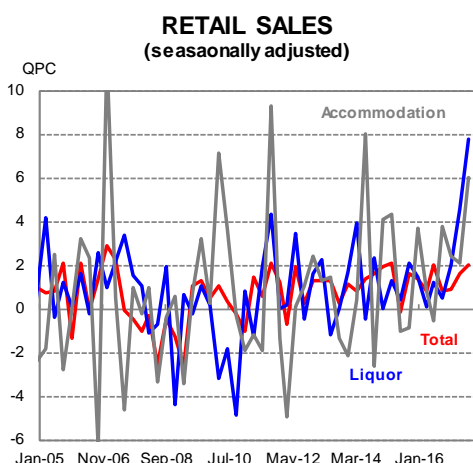
Week in Review

- Dairy prices slipped, consumer confidence for August stayed firm, and net migration remains high.

Global Calendars

- UK GDP and Eurozone PMIs are due.

Chart of the Week: Lion's roar into NZ spending data



Turns out the **real winner from the Lions series was actually the retail sector,** despite the impact missing in action in the monthly electronic card spending data series. However, the Q2 retail sales data release showed **retail spending surged over the quarter and particularly in those categories where you'd expect Lions fans (but also World Masters athletes) to have an effect.** Namely, accommodation, liquor retailing and food and beverages services categories all saw spending growth leap higher over the June quarter.

While red-jacketed Lions fans were more visible during their visit, the more understated World Masters Games athletes and their partners may have had a similarly large impact on spending earlier in the quarter. After all, **more international athletes descended on Auckland in late April than descended on Rio for the 2016 Olympic Games.** While retail sales growth is unlikely to maintain Q2 levels, improving dairy incomes, population growth and high levels of consumer confidence will continue to support retail spending over the remainder of 2017.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7314	0.7306	0.7422	0.7174	0.7269	FLAT	0.7200	0.7450
NZD/AUD	0.9222	0.9257	0.9401	0.9351	0.9508	FLAT	0.9120	0.9380
NZD/JPY	79.98	80.02	83.05	81.13	72.92	FLAT	78.70	81.00
NZD/EUR	0.6220	0.6182	0.6381	0.6758	0.6411	FLAT	0.6130	0.6310
NZD/GBP	0.5684	0.5616	0.5721	0.5778	0.5530	FLAT	0.5590	0.5770
TWI	77.3	76.9	78.6	78.1	76.9	FLAT	76.00	79.00

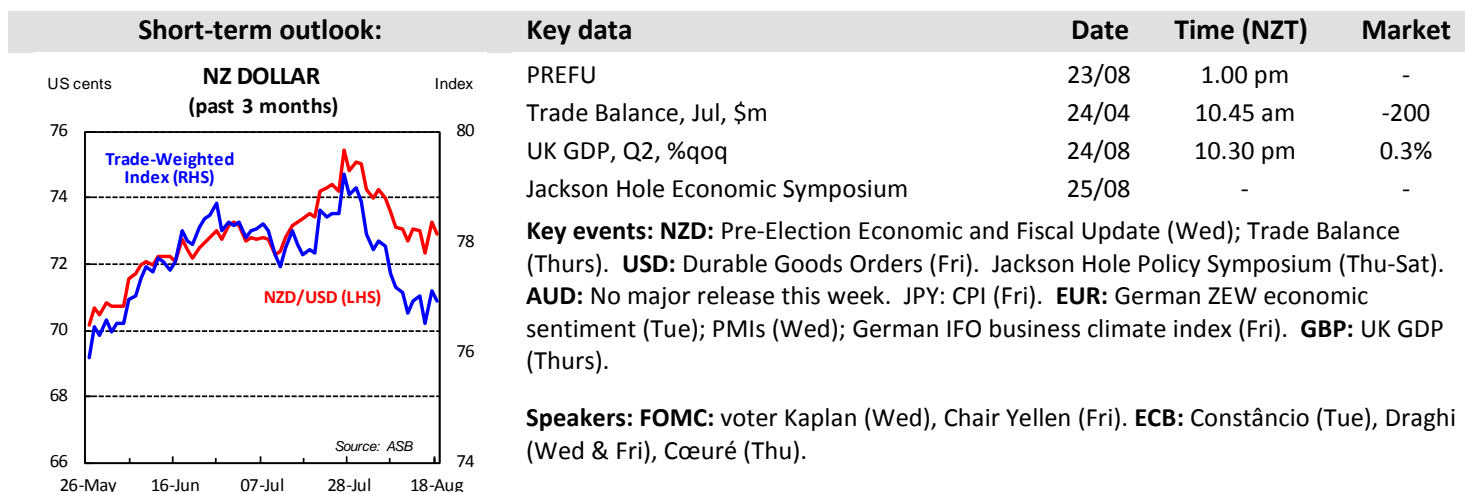
^Weekly support and resistance levels * Current is as at 9.30 am Monday; week ago as at Monday 5pm.

Risk aversion was the main theme in financial markets last week, with the week starting off with concerns about increased US-North Korean tensions and finishing with a terror attack in Barcelona. Reports that President Trump had fired his Chief Strategist Steve Bannon also added growing uncertainty around the ability of the President to carry out his economic agenda.

Over this volatile week, the **NZD finished broadly unchanged against the USD**. We expect the USD to continue to consolidate this week, with the annual Jackson Hole Economic Symposium (Thursday - Saturday) likely to be the main source of volatility.

The **NZD fell against the AUD last week**, with the AUD supported by firm iron ore prices and evidence of an improving labour market. There are no major Australian releases this week. The Pre-Election Update and Trade Balance are event risks but unlikely to be major currency movers.

The **NZD outperformed the EUR last week**, with the EUR falling following the release of the ECB meeting minutes, which contained some comments expressing concerns about an overshooting of the EUR.



Medium-term outlook:

Last Quarterly Economic Forecasts

Our FX forecasts were fine-tuned in mid-July following a period of low volatility in currency markets. Despite the fine-tuning, we have left our USD forecasts unchanged. Uncertainties around the timing of US fiscal stimulus remain, especially given the ongoing difficulties in getting other reforms through Congress, and will continue to weigh on the USD. **As a result, we continue to expect the NZD/USD to average 0.7200 over the second half of 2017. Over 2018, we expect the NZD to outperform the USD.** NZ's persistently high Terms of Trade (ToT) will continue to provide the NZD with significant support. The high ToT will lift real GDP and will keep the RBNZ on track to raise interest rates by early 2019. **We expect the USD to stabilise once the fiscal policies are signed into effect, however, this may now not occur until 2019.**

On top of the persistently high ToT, the NZD remains supported by relatively high interest rates, increased offshore investor demand and a structural improvement in the current account deficit. As a result, we expect the NZD/AUD to remain firm. Further, the **risk that the RBNZ raises interest rates before the Reserve Bank of Australia will further support the NZD/AUD.** Over 2017, we expect the NZD/AUD to average 0.9500 then lifting above 0.9600 towards the end of 2018.

We have revised our GBP forecast higher again, following our upward revision in May. High UK CPI is likely to see the BoE raise interest rates in November. Further, the fact that the European Court of Justice will now have a role in UK law making post-Brexit means the UK economy is likely to hold up better than expected over the forecast horizon. We expect the NZD/GBP to largely remain within a range of 0.54-0.57 until the end of 2019.

In the near term we expect to see NZD/JPY hold above 80. The recent narrowing of the Japanese current account surplus is adding less support to the JPY. Further out, the prospect for more BOJ easing and RBNZ tightening should further strengthen the NZD against the JPY, holding the NZD/JPY above 84 over 2018.

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	1.75	1.75	1.75	1.75	2.00	FLAT
90-day bank bill	1.95	1.96	1.94	2.03	2.22	FLAT
2-year swap	2.18	2.16	2.22	2.33	1.97	FLAT
5-year swap	2.64	2.62	2.76	3.01	2.10	FLAT
5-year benchmark gov't stock	2.43	2.45	2.57	2.60	1.77	FLAT
NZSX 50	7874	7763	7671	7097	7392	FLAT

^Weekly support and resistance levels * Current is as at 9.30am Monday; week ago as at Monday 5pm.

Interest rates fell over the week, with the flattening of the curve driven by larger falls for longer-end rates. The rally in global rates look to be a by-product of mixed economic data, increased risk aversion, geopolitical tension and increasing expectations of a potential watering down of pending US tax cuts. US rate hike expectations have been slightly watered down relative to a week prior, with the market currently assigning just a 36% chance of a Fed hike by the end of the year (versus more than 40% odds a week ago). Across the Tasman, the RBA Board Minutes confirmed that policy is on hold over the near term, with odds of a RBA hike only around 70% in 12 months' time (we have the RBA on hold until late 2018). **Local rates outperformed global counterparts as the process of rates convergence continued and the low for longer RBNZ message continued to sink in.**

Short-term outlook:

Key data

Date

Time (NZT)

Market

NZ PREFU

23/08

midday

-

EZ Composite PMI, Aug

23/08

8:00pm

55.5

US Markit Manufacturing PMI, Aug

24/08

01:45am

53.4

NZ Trade Balance, \$m

24/08

10:45 am

-200

JP CPI, Jul, %yoy

25/08

11:30 am

0.4%

Comment: With a dearth of key global data this week, the focus will be on the Fed's annual Jackson Hole symposium (Aug 25-27). With both the ECB's Draghi (also due to give a speech in Germany on Wednesday) and the Fed's Yellen scheduled to speak, markets will be on the lookout. The Eurozone composite PMI for August is forecast to post a strong result. We anticipate the ECB will taper its QE programme in early 2018, and begin to lift deposit and refi rates in June 2018. The Japanese July CPI is likely to be soft given low wage growth and inflation expectations.

Global events should dictate local market direction. **The Pre-election Economic & Fiscal update will provide a useful yardstick for assessing the degree of fiscal headroom that could be earmarked for future fiscal initiatives.** Thursday's NZD150m tender of the 2033 bond follows mixed performances at previous events. With less than 5 weeks to go until the local General Election and **with recent polls tightening considerably, local markets are likely to be somewhat on edge** over the next few weeks (or months) until a new government is announced.

Medium-term outlook:

Last Quarterly Economic Forecasts

The RBNZ continued to hold the OCR at its record-low of 1.75% at its August Monetary Policy Statement (MPS) and Official Cash Rate (OCR) Review. The RBNZ retained its neutral bias and continued to note the numerous uncertainties. However, **the key surprise was the RBNZ left the OCR outlook unchanged** (with two hikes by mid-2020) in **contrast to widely-held expectations of a flatter OCR forecast.**

The RBNZ's frustration with the elevated NZD increased in August. The RBNZ made an effort to undermine support for the NZD by emphasising the external currency drivers (i.e. weaker USD) while downplaying the domestic drivers (i.e. higher NZ export prices) and stated that a lower NZD was "needed". **The RBNZ dismissed the recent weaker GDP growth outcomes** and focussed on the robust economic outlook. Going forward, growth will be supported by low interest rates, strong population growth, high Terms of Trade and fiscal stimulus. Furthermore, we see **upside risk to the RBNZ conservative medium-term milk-price assumption**, which will provide further support to NZ growth.

The RBNZ remains confident in the medium-term inflation outlook, despite anticipated volatility in headline inflation this year. The RBNZ expects inflation will dip below 1% (due to volatility in fuel and food) before swiftly recovering to reach 2% by 2018. **The RBNZ appears to be relying on a very swift pick-up in non-tradable inflation.** This is a fairly **bold assumption** given the RBNZ is wary that **price-setting behaviours have become more backward looking.** Nonetheless, **we expect the RBNZ will start lifting the OCR in Q1 2019** which is slightly earlier than the RBNZ's expectations for a hike in Q3 2019.

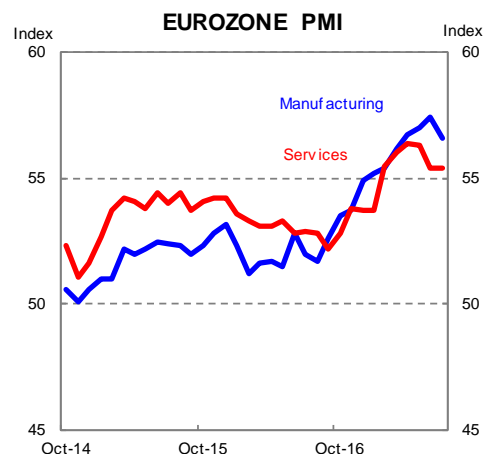
Key international data for the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
Japan CPI, July, %yoy	25/08	11:30 am	0.4	0.4	0.3
Eurozone Composite PMI, July, index	23/08	8:00 pm	55.7	55.5	56
UK GDP, Q2, %qoq	24/08	8:30 pm	0.3	0.3	0.3

Japan's inflation pressures remain very weak despite more than four years of extreme policy easing by the Bank of Japan. We see little chance of Japan's inflation rising amid weak wage growth and low inflation expectations.

We forecast a slight increase towards 56 for the **August Eurozone composite PMI**. Strong activity data in Germany and Italy point towards an improvement over July's 55.7 print.

We anticipate the **Q2 UK GDP** growth reading will be unchanged from the preliminary estimate of 1.7% yoy and 0.3% qoq.



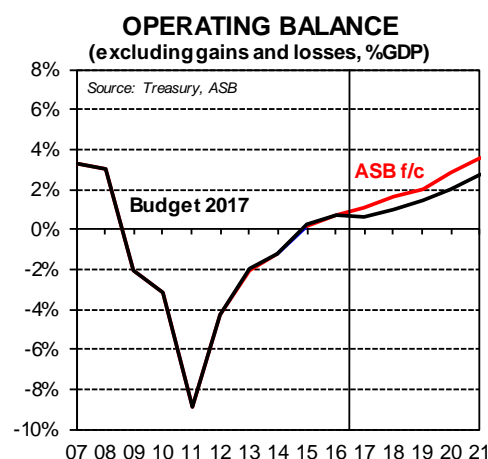
NZ Data Preview: a look at the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
Pre-Election Economic and Fiscal Update, OBEGAL 2016/17, %GDP	23/08	12:00 pm	0.7	-	1.1
Trade balance, July, \$m	24/08	10:45 am	+242	-	-450

The **Pre-Election Economic and Fiscal Update (PREFU)** presents an update to the Treasury's economic and fiscal forecasts prior to the upcoming election (scheduled for 23 Sep). Unlike other Treasury updates, for the PREFU the Government does not have the ability to make revenue or expenditure changes and or policy changes.

Since Budget 2017 release in May, economic activity has been firm and tax revenue has come in around \$1.1bn higher than forecast for the year to May. If this continues, **we expect that the unfettered Treasury estimates are likely to show an operating surplus for the 2016/17 year in the vicinity of \$2.8bn (1.1% of GDP)**. In other words, the Government's books are in good shape, with room for fiscal expansion either via additional tax cuts or increased spending.

We expect a **trade deficit of \$450m in July**, reflecting seasonal weakness in agricultural exports and as imports pick up seasonally through to the end of the year. Looking over the month, we expect dairy export volumes to dip after temporary volume strength last month. At the same time, import values remain firm in line with healthy domestic demand. Looking at the annual balance, **we expect the annual trade deficit to widen a touch to \$3.76 billion**.



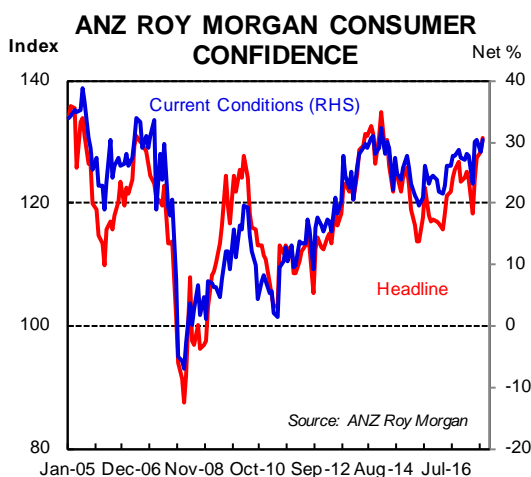
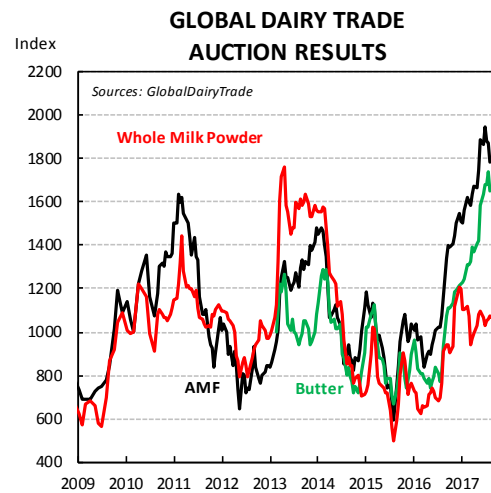
Data Recap: weekly recap

Data	Date	Actual	Market forecast	ASB Forecast
GlobalDairyTrade auction, whole milk powder, % change	15/08	-0.6	-	+3 to +5
Consumer confidence, Aug, index	17/08	126.2	-	-
International Travel & Migration, Jul, Net Migration, 000s	21/08	5,810	-	6,200

Dairy auction prices dipped ever so slightly at last week's auction. Milk fat prices again led the fall, with butter and anhydrous milk fat (AMF) falling 1.3% and 1.2%, respectively. Whole milk powder (WMP) also fell 0.6%. **Notably, on the eve of the auction, futures prices suggested a WMP price lift in the 3% to 5% range. Taking a step back, it's not altogether surprising that milk fat prices took another breather last week, given the price explosion over recent months.** Butter prices, for example, have surged over 34% this year, while AMF prices have lifted a more modest, but still robust, 17%. **However, we suspect that the slowdown in milk fat prices may be temporary.** Demand continues to surge and inventories are now very tight. Indeed as supply struggles to keep up, we expect that any lift in milk fat prices will lift dairy prices more generally.

The August ANZ-Morgan Consumer Confidence Survey shows household sentiment remains firm, with overall confidence up 0.8 points to 126.2, well above historical averages (119). Headline confidence rose in both unadjusted and seasonally-adjusted terms, with the latter at its highest level since July 2014. Solid household income growth in relation to low consumer price inflation, low unemployment, higher rural incomes and the prospect of an electoral bidding war (tax cuts versus higher social spending) are likely key supports underpinning the consumer mood. The upshot is that **still-elevated levels of sentiment are pointing to a reasonable second half of the year** for consumer spending.

Net migration recorded another strong month in July, with annual arrivals posting yet another new record high (now 72,402). Net migration was down slightly on the previous month, but recent trends remain intact. Permanent and long-term (PLT) departures remain low while PLT arrivals continue to rise. The **annual number of student inflows remains steady at 24,000 per annum** and 18% of all PLT arrivals, down from a peak of 28,000 and 23% of PLT arrivals in February 2016. Meanwhile the **proportion of arrivals on work visas remained steady at record highs of 34%.** New Zealand's strong economy and relatively strong labour market continues to attract migrants from all around the world. **Over the near term, we expect net migration to remain elevated.** However, an improving labour market in Australia, if sustained, could potentially slow net migration as it reduces arrivals from Australia and possibly increases departures from NZ. Future migration policies remain up in the air as we head into a close election.



Global Data Calendars

Calendar - Australasia, Japan and China

Date	Time (NZT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 21 Aug	15:00	NZ	Credit card spending	Jul	m%ch	0.2	~	~
	16:30	JN	All industry activity index	Jun	m%ch	-0.9	~	~
	17:30	JN	Nationwide department sales	Jul	y%ch	1.4	~	~
Tue 22 Aug	11:30	AU	ANZ Roy Morgan Weekly Confidence Index	Aug	Index	111.7	~	~
	17:00	JN	Supermarket sales	Jul	y%ch	-1.2	~	~
Wed 23 Aug	01:00	CH	Conference Board China July Leading Economic Index					
	13:00	AU	Skilled vacancies	Jul	m%ch	0.9	~	~
	18:00	JN	Machine tool orders	Jul F	y%ch	26.3	~	~
Thu 24 Aug	10:45	NZ	Trade balance	Jul	NZD mn	242	-200	-450
	12:30	JN	Nikkei Japan PMI manufacturing	Aug P	Index	52.1	~	~
	17:00	JN	Leading index CI	Jun F	Index	106.3	~	~
Fri 25 Aug	11:30	JN	National CPI	Jul	y%ch	0.4	~	~
	11:50	JN	PPI services	Jul	y%ch	0.8	~	~
	13:30	CH	Industrial profits	Jul	y%ch	19.1	~	~

Calendar - North America & Europe

Date	Time (UKT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 21 Aug	00:01	UK	Rightmove house prices	Aug	m%ch	0.1	~	~
	09:30	UK	Public finances (PSNCR)	Jul	£bn	18.3	~	~
	13:30	US	Chicago Fed National Activity Index	Jul	Index	0.1	~	~
Tue 22 Aug	08:25	US	MBA mortgage foreclosures	Q2	%	1.4	~	~
	08:25	US	Mortgage delinquencies	Q2	%	4.7	~	~
	10:00	EC	ZEW survey expectations	Aug	~	35.6	~	~
	14:00	US	FHFA house price index	Jun	m%ch	0.4	~	~
	14:00	US	House price purchase index	Q2	q%ch	1.4	~	~
	15:00	US	Richmond Fed manufacturing index	Aug	Index	14.0	10.0	~
Wed 23 Aug	08:00	EC	ECB's Draghi speaks in Lindau, Germany					
	09:00	EC	Markit Eurozone manufacturing PMI	Aug P	Index	56.6	~	~
	09:00	EC	Markit Eurozone services PMI	Aug P	Index	55.4	~	~
	12:00	US	MBA Mortgage applications	Aug	%	0.1	~	~
	14:05	US	Fed's Kaplan speaks to Oil Group in Midland, Texas					
	14:45	US	Markit US manufacturing PMI	Aug P	Index	53.3	~	~
	15:00	US	New home sales	Jul	000	610.0	613.0	~
Thu 24 Aug	15:00	EC	Consumer confidence	Aug A	~	-1.7	~	~
	09:30	UK	UK finance loans for housing	Jul	~	40,200	~	~
	09:30	UK	GDP	Q2 P	q%ch	0.3	~	~
	13:30	US	Initial jobless and continuing claims	Aug	~	~	~	~
	15:00	US	Existing home sales	Jul	\$mn	5.5	5.6	~
	16:00	US	Kansas City Fed manufacturing activity	Aug	~	10.0	~	~
Fri 25 Aug	08:26	US	Kansas City Fed hosts annual Jackson Hole Policy Symposium					
	13:30	US	Durable goods orders	Jul P	%	6.4	-5.7	~

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