Amplifying Global FX Capital

Real Time Briefing

4 September 2017

Previewing RBA and BoC - Canada my again surprise hawkishly

RBA may upgrade investment outlook

The RBA policy statement later today probably cannot introduce any new dovish elements; as such it should not have much of a weakening influence on the AUD.

The RBA could sound more upbeat on investment, and this may provide the AUD some support. The tone of the surrounding data this week, especially GDP, may be more influential on the AUD.

The RBA already has a pretty detailed message that appreciation of the exchange rate would not be helpful. This part of the statement should be the same. With the recent appreciation of a number of currencies against the USD, including noticeably the CNY, the AUD TWI is lower than at the time of the August meeting.

The RBA may comment on what it expects in broad terms for the GDP report to be released on the next day. Market expectations are for a rise of 0.8%q/q and 1.8%y/y. The last piece of the puzzle for this data is released later today (Net exports).

The year ended GDP figure will look soft and under-estimate the underlying strength in the economy; taking in two somewhat disrupted weaker quarters; Q3 last year (-0.4%q/q) and Q1 this year (+0.3%q/q).

There is scope for the RBA to sound more upbeat about the business outlook. In the August statement, they said, "Some pick-up in non-mining business investment is expected". They could and probably should sound more optimistic on investment in light of recent capex and construction work done data.

In August they said, "One source of uncertainty for the domestic economy is the outlook for consumption." They may continue to express caution related to "slow growth in real wages and high levels of household debt."

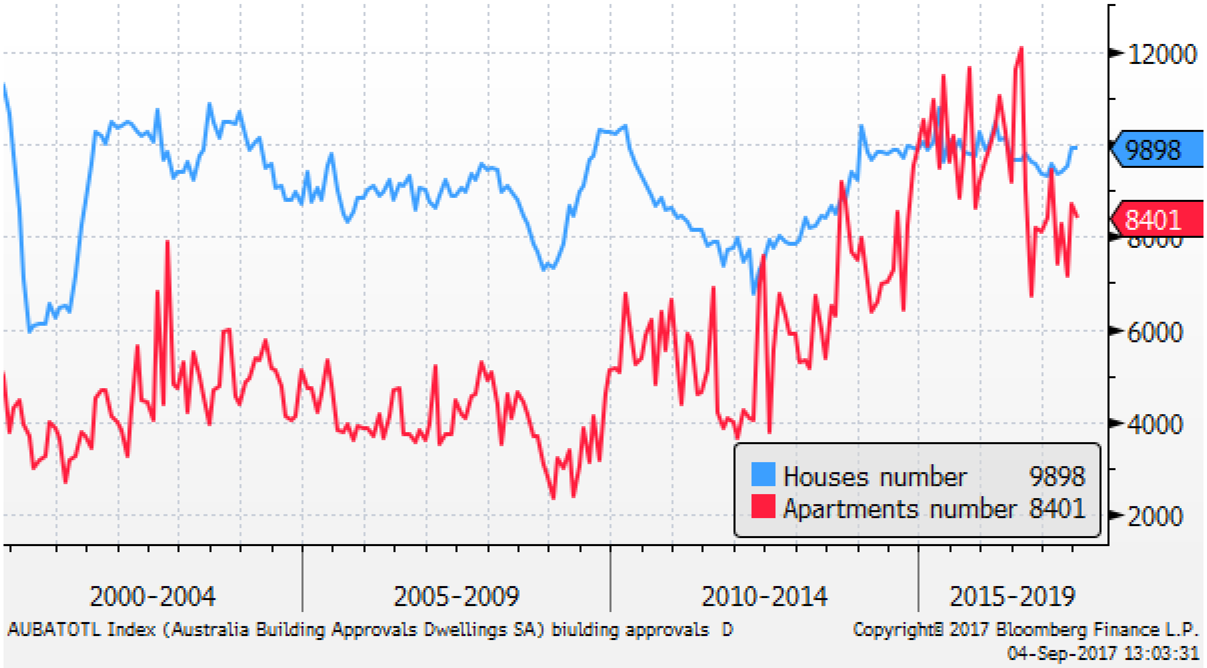
In general, much of the rest of the statement covering employment, inflation, housing and the global outlook doesn't need tweaking.

Mixed but solid recent Australian data indicators

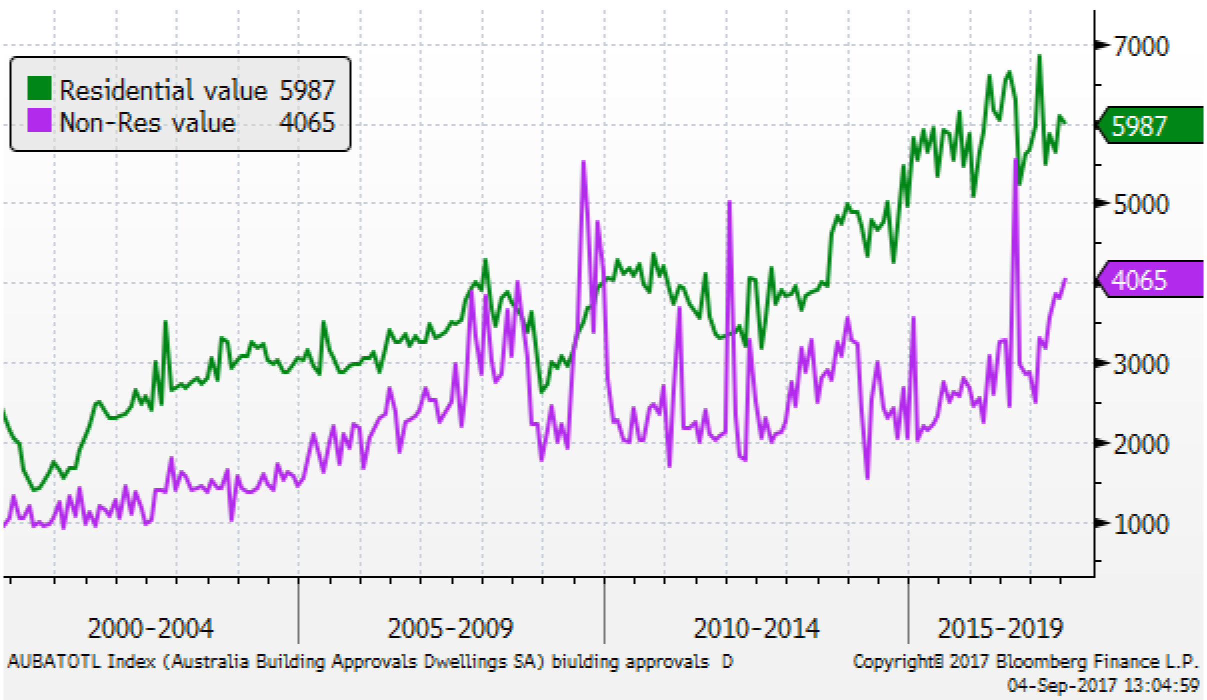
In other recent Australian data, residential building approvals were stronger than expected; falling only 1.7% m/m in July after an 11.7% rise in June, above -5.0% expected.

Non-residential approvals by value also continued to rise to the highest three month average since the post-GFC emergency fiscal boost in 2009.

Australian residential building approvals number

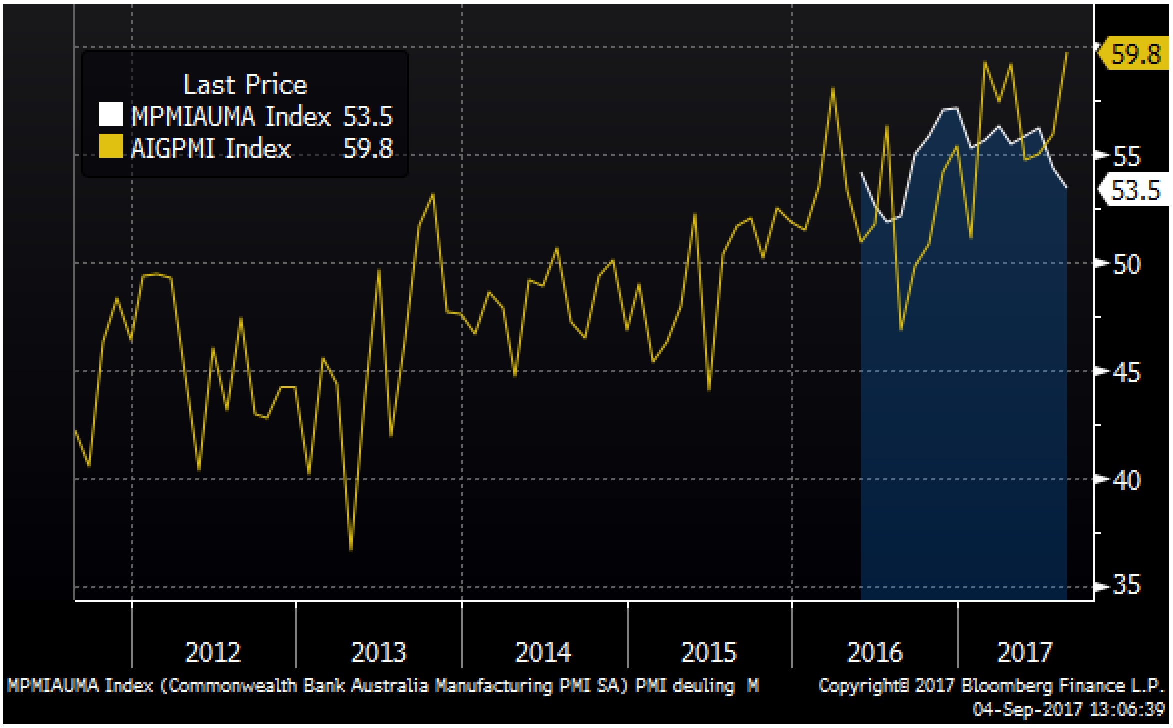


Building approvals by value - non-residential highest three months since 2009



Australian PMI data sent mixed signals; the AiG version rose to a 15 year high of 59.8 in August. The newer version from Markit, sponsored by CBA, fell from 54.4 to 53.5

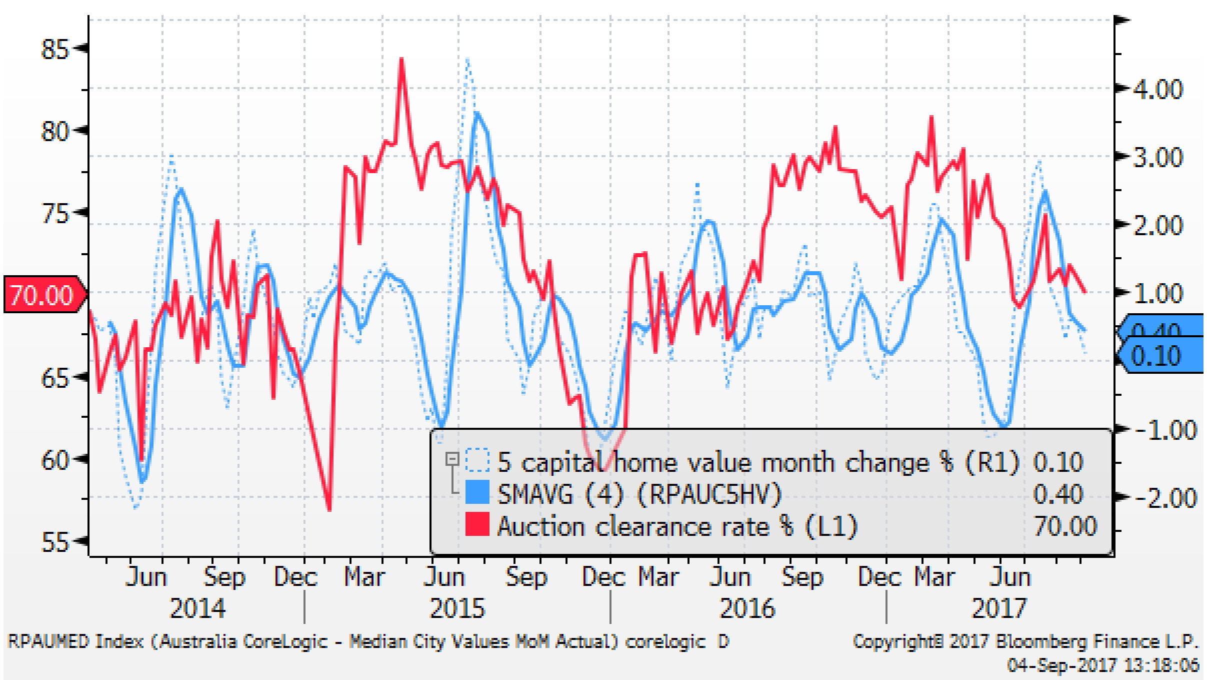
Deulling PMIs



CoreLogic house price data was soft, up only 0.1%m/m in August, near the low end of the range for this time of year.

Weekly auction clearance rates have softened to a low for the year, now at their seasonal average for the last five years.

CoreLogic house price and auction clearance rates



As such, there does appear to be moderation in the strength in the housing market, consistent with the assessment by the RBA, and some tightening in lending conditions, increased supply of apartments, and some moderation in foreign demand.

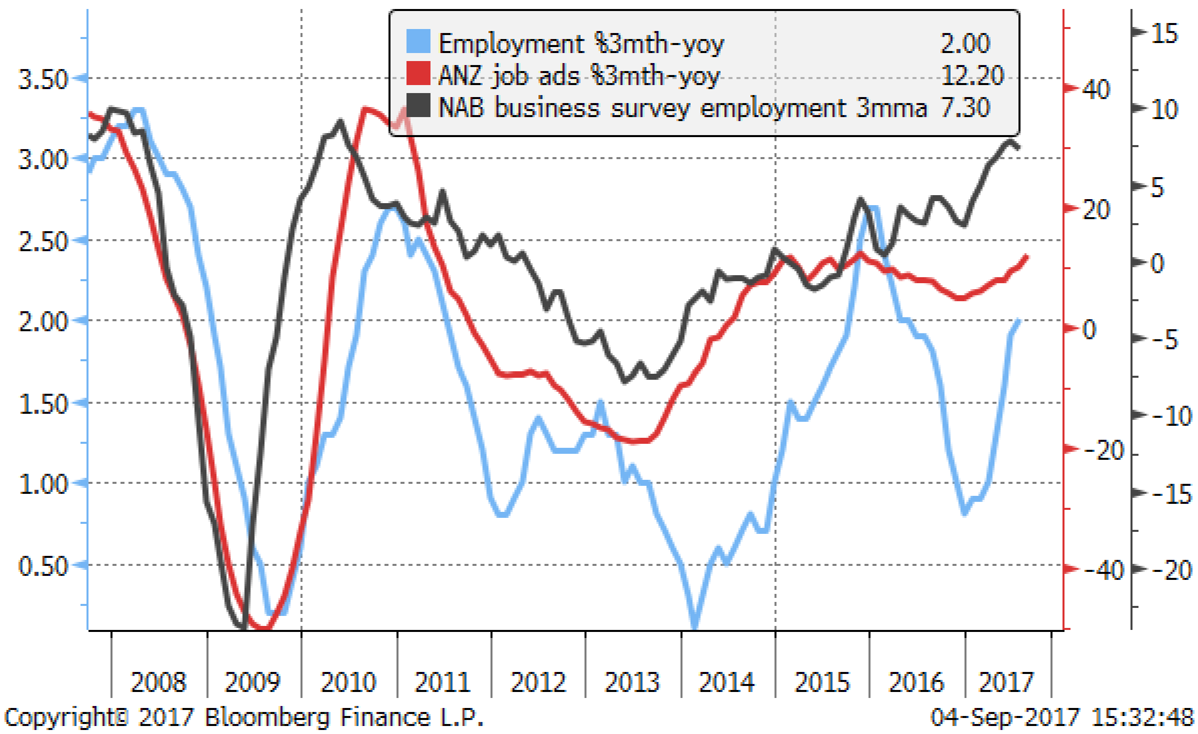
The Melbourne Institute monthly inflation index rose a modest 0.1%m/m in Aug, for the third month in a row; suggesting inflation pressures have softened from earlier in the year. The annual rise was 2.6%y/y.

The MI trimmed mean inflation rate also rose only 0.1%m/m, after 0.1%m/m in July and 0.2%m/m in June. The annual rise was 2.5%y/y.

The 12mth gauges are still more chunky, running above the official inflation data, after stronger increases from Q3 last year to around April this year.

Some of the building block data for GDP were weaker than expected, including Inventories -0.4%q/q, below +0.3% expected. The decline may be the flipside of the record rise in engineering work down report last week. Company operating profits were also a bit softer than expected. The data help keep in check GDP forecasts for Wednesday.

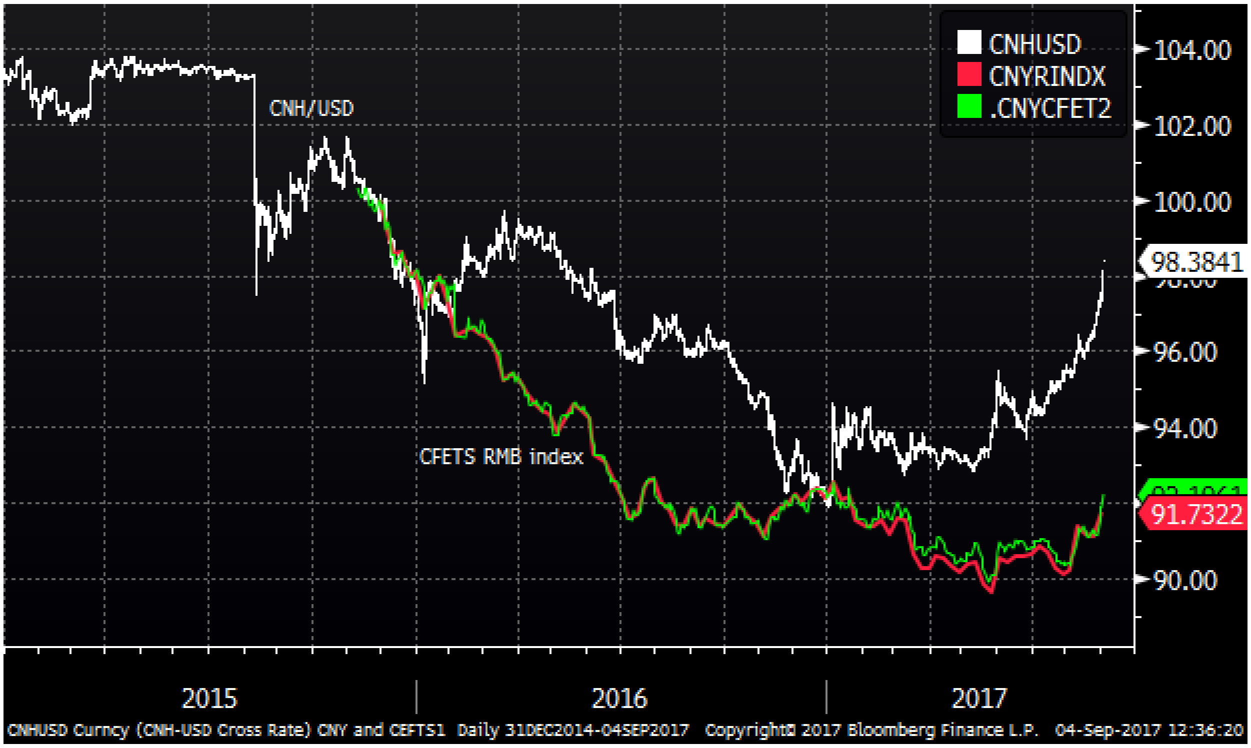
ANZ job ads rose strongly, up 12.2% 3mth-yoy in August, a high rate since 2015.



Chinese market developments

Chinese market developments are interesting. The CNY appreciation has accelerated, and the official CNY basket is at a high since January. Since 28-Aug, CNH is up 1.7%.

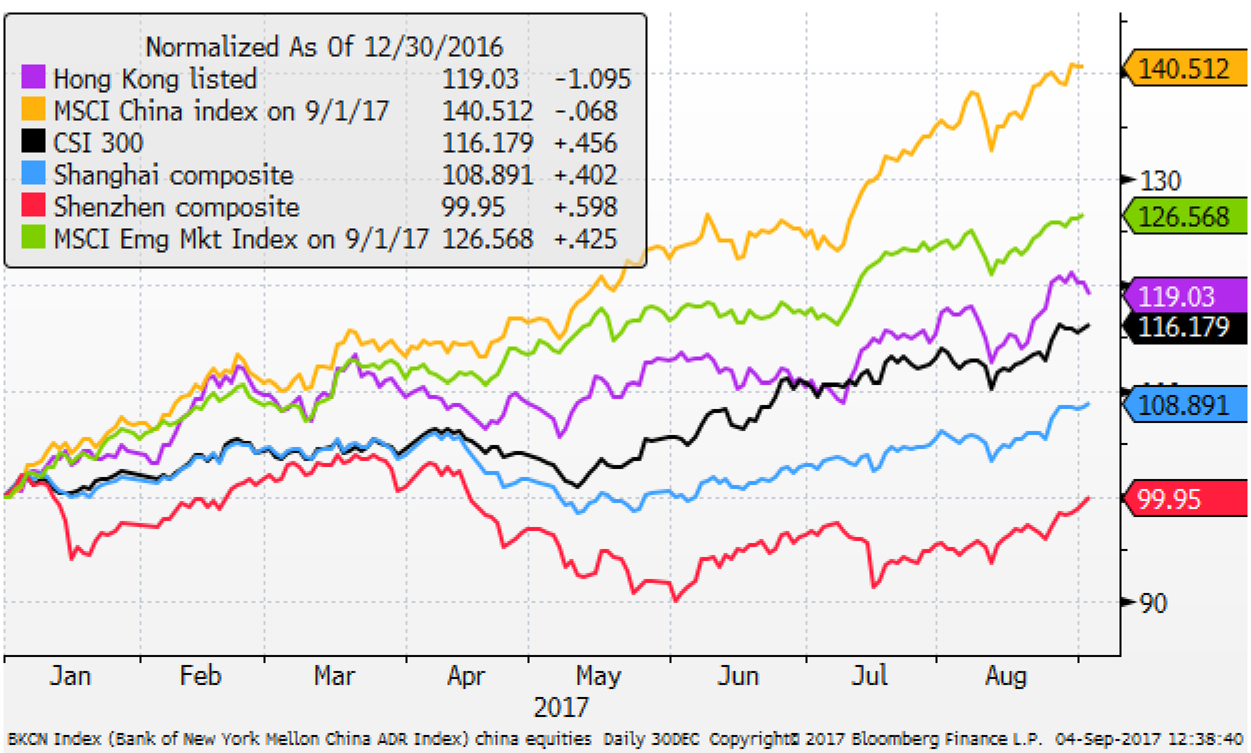
CNY and official basket



Market commentary suggest this strength reflects support by the government ahead of the 19th National Congress scheduled to begin on 18 October, and a wider 10-year government yield advantage over US Treasuries.

Chinese 10-year government and corporate yields

Mainland Chinese equities are also relatively strong, rising even as others in the region were hit by the latest North Korean nuclear weapons tests.



Iron ore and coking coal futures are weaker on Monday, this in part may reflect the strength in the CNY, reducing demand for commodities futures priced in CNY. Some see speculative demand for commodity futures as related to capital outflow strategies, and the strength in CNY may be lessening capital outflow.

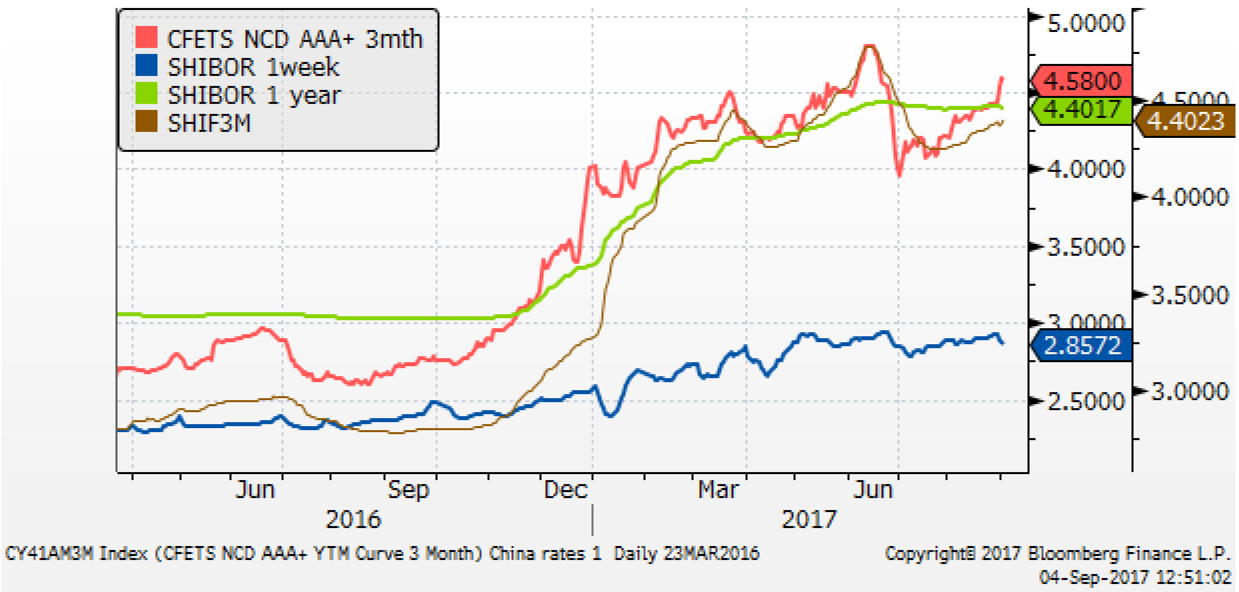
However, steel prices remain more robust near recent highs.

In money market rates, 3mth NCDs lifted on Thursday/Friday last week somewhat abruptly and are approaching highs for the year, set in June. These are used by small and medium sized banks to fund shadow-bank investments and may represent some tightening in credit conditions.

Corporate and government bond yields are gently rising against the falling trend in major bond markets. It is hard to say if this relates to stronger growth expectations in China or somewhat tightening in credit conditions.

Overall, Chinese markets are sending mixed messages at the moment.

Chinese money market rates – NCD rates higher



Bank of Canada may again surprise hawkishly

The more interesting central policy decision this week is likely to be the Bank of Canada. According to Bloomberg, 21 out of 26 analysts surveyed think rates will remain on hold, 5 predict a hike.

The rates markets are rating the odds of a hike at 56%, so better than even.

The BoC hiked rates for the first time this cycle at its previous meeting on 12 July, by 25bp to 0.75%. This began the process of removing essentially two emergency rate cuts in 2015 to deal with an oil price shock.

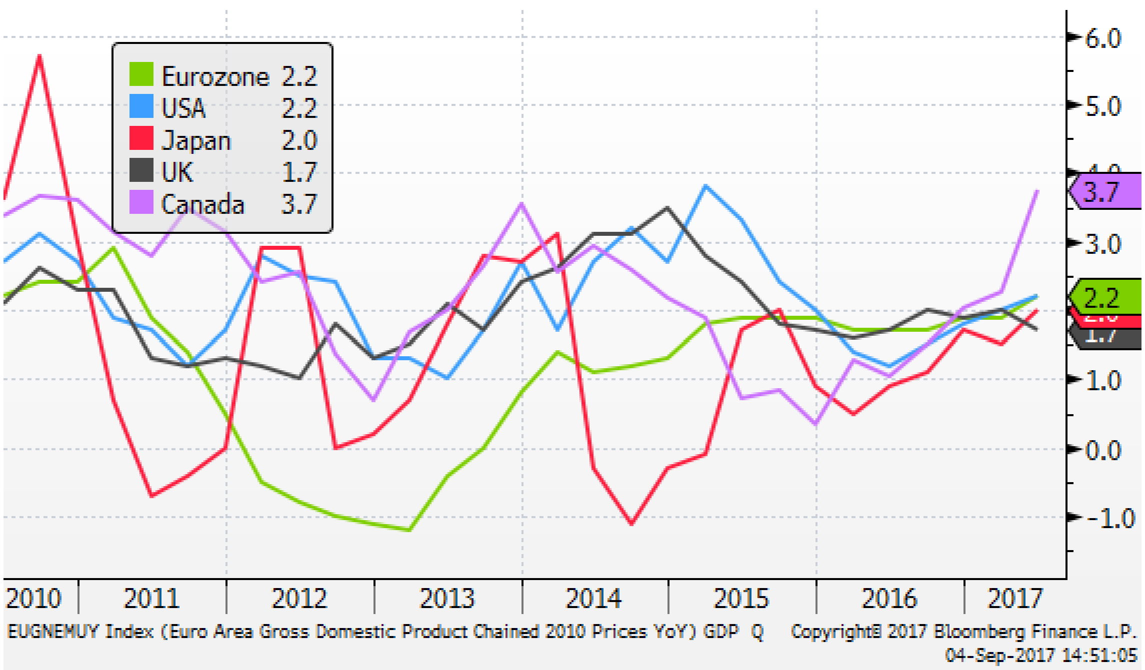
The BoC is essentially fully priced by the market to deliver a second hike by its next meeting on 25-October. This would seem sensible timing as it would coincide with the quarterly monetary policy review.

A third hike this cycle is priced to be delivered by the 7 March policy meeting next year.

The odds of a hike on Wednesday got a lift after the stronger than expected Q2 GDP report released on Thursday last week.

GDP rose 4.5%q/q saar in Q2; above 3.7% expected, up 3.7%y/y using the quarterly data, or 4.1% 3mth/yoy using monthly data. The fastest annual pace since 2000.

GDP %y/y – Canada surges ahead of other major economies



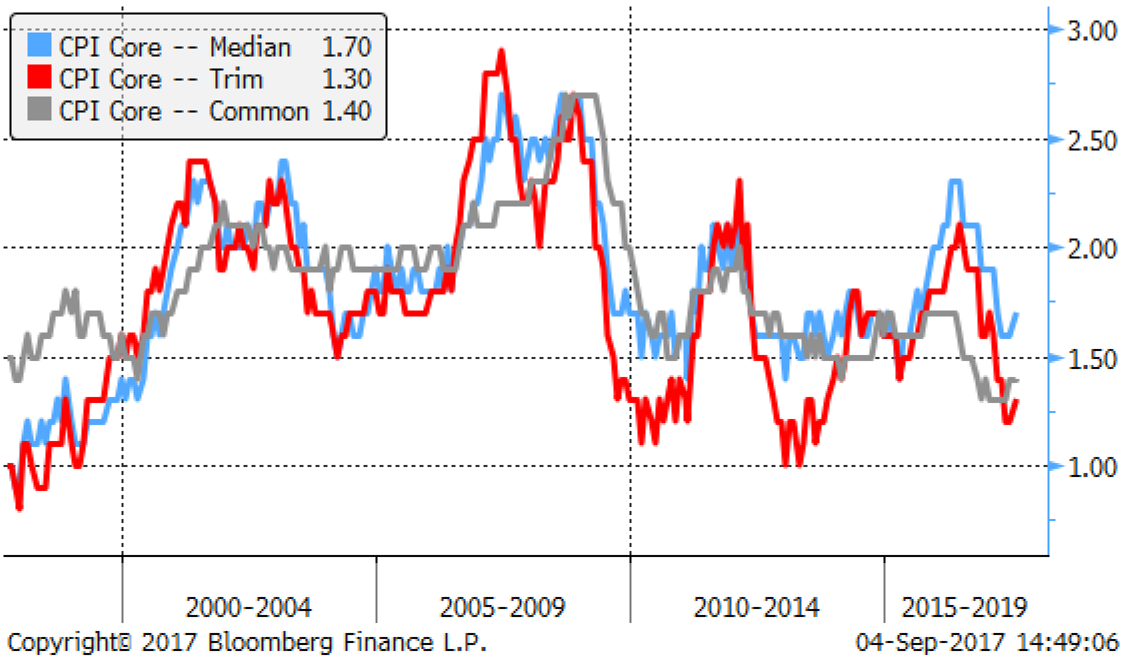
So the presumption is that the data puts pressure on the Bank of Canada that is more focused than many central banks on an output gap model of inflation to speed up the pace of policy tightening.

The Bank of Canada sees its neutral rates at 3.0%, so rates are still very accommodative. In July, it forecast that its output gap would be closed by around the end of this year.

It forecast GDP growth this year of 2.8%. Growth in the first half has annualized at 4.1%, so the output gap may well be closed already.

Inflation is well below target, but the most recent readings suggest it is rising again, and consistent with the BoC forecast for it to return to the target of 2% in mid-2018.

Core Canada inflation %y/y



So you could argue that with the output gap now likely to be near closed moving into a positive gap through the rest of the BoC forecast horizon, and inflation forecast to be on target by mid-2018, the BoC should should think rates need to rise close to neutral in the next 12 months. It has a lot of work to get rates from 0.75% to 3%, and it might seem more urgent to hike again this week.

If the BoC do hike again this week, the market is likely to build in more hikes in the year ahead and boost the CAD. A decision to hold steady might help soften the CAD a bit, but then the market will still feel confident that the BoC will hike again on 25 October.

The broader mix of data suggest that the pace of growth may be moderating, but from a high level in the first half of the year, and the unemployment rate has fallen sharply from 6.9% at the end of last year to 6.3% in August. This is low by Canadian standards; it has only been lower in the pre-GFC period from 2006 to 2008.

The RBA and RBNZ have told us they are not compelled to follow policy developments abroad, but if the CAD rises further on a hike this week, the chances are this does spill over to AUD and NZD.

The BoC is not adverse to surprising the market, and they are hard to call. It seems to me another hike this week is indeed more likely than not.

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