ANZ Research

Preview: RBNZ Monetary Policy Review

5 July 2023

Contact

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Texas Hold'em

Summary

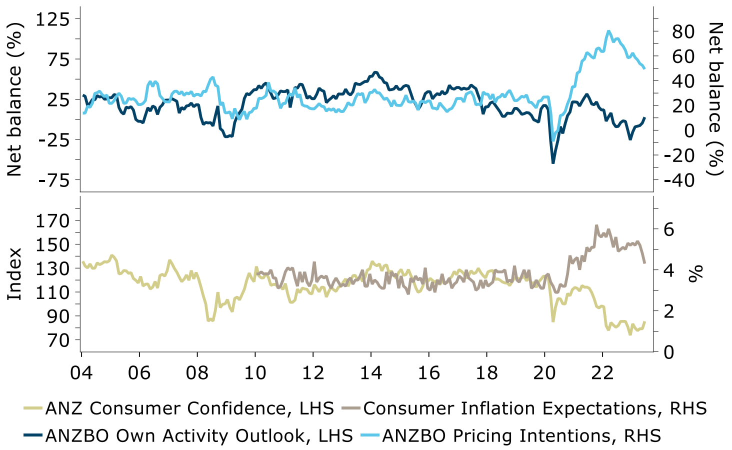
- We expect the RBNZ to keep the OCR unchanged at 5.5% at next week's Monetary Policy Review. Anything else would be a massive surprise.
- Local data since the May MPS has been mixed, but overall supports the RBNZ's wait-and-see stance.
- We continue to see the balance of risks tilted towards the RBNZ eventually having to do more, but it's not today's story.

You gotta know when to hold 'em

The RBNZ made it clear at the May Monetary Policy Statement that they are firmly in "watch, worry and wait" mode, keeping rates on hold as they see if they've done enough to bring inflation sustainably back to target. Domestic data since the Statement has been mixed, not suggesting any urgency to move rates in either direction any time soon.

- **Q1 GDP** fell 0.1%, versus the RBNZ's expectation of a 0.3% lift. The data showed clear evidence of slowing economic momentum, but there was plenty of noise too, including likely cyclone impacts. Demand is definitely cooling, but we expect the 'real' recession (ie one that reflects the aggregation of individuals' more cautious decision-making, and rising unemployment) to occur in the second half of the year.
- **Monthly 'soft' momentum data** (ANZ Business Outlook, Consumer Confidence, PMI, PSI) have all continued to recover. Activity indicators continue to improve, while inflation indicators continue to wane (figure 1). Activity indicators are still subdued and inflation indicators still too high, certainly, but cheers, we'll take those best-of-both-worlds moves.

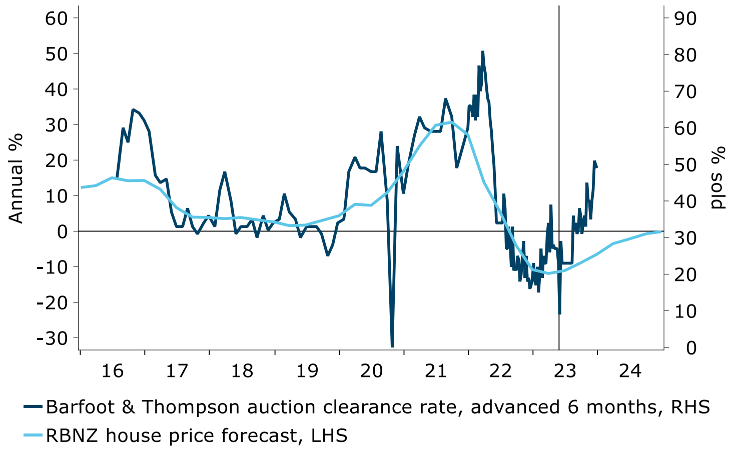
Figure 1. ANZBO /consumer confidence activity and pricing indicators



Source: ANZ, Macrobond, ANZ Research

- Evidence continues to mount that **house prices** have found a floor. The RBNZ's forecast that house prices are going to continue to fall for the rest of the year looks off the mark at this stage (figure 2). Net migration, the RBNZ halt to hikes and the easing of owner-occupier LVR rules seem to be providing support. However, we don't expect the rebound to come to much (just 3% over the rest of the year) given still-high mortgage rates, the possibility of a surge in listings, and our forecast for recession and rising unemployment as the year goes on.

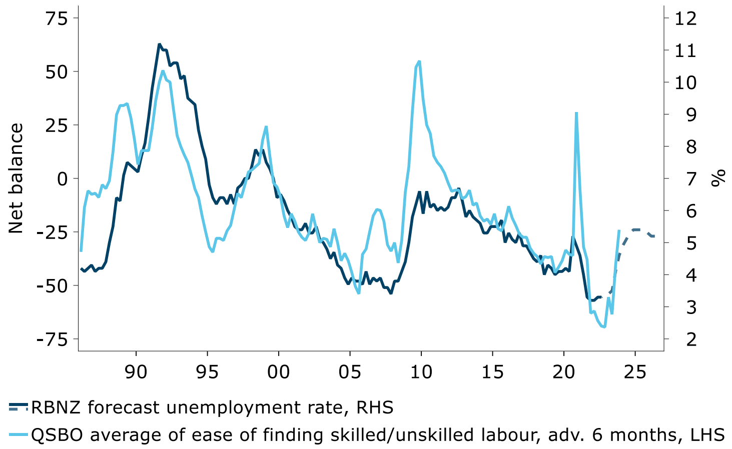
Figure 2. B&T auction clearance rate and RBNZ house price forecast



Source: Corelogic, Barfoot & Thompson, interest.co.nz, Macrobond, ANZ Research

- High-frequency **labour market data** has been relatively robust, with monthly filled jobs rising in both April and May. But with labour supply surging via net migration there are clear signs that labour market tightness is waning (more applicants per job on Seek; lower perceived job availability in the Westpac Employment Confidence Index; indicators in both **ANZBO** and **QSBO** suggesting it's become abruptly much easier to find both skilled and unskilled labour). It's important to interpret the data in the context of the RBNZ's forecast that unemployment is about to rise as rapidly – though not as far – as it did in 2008. That sets a high bar for a dovish surprise (figure 3). Our take is that overall, the QSBO survey and other labour market indicators support the RBNZ's on-hold stance.

Figure 3. QSBO ease of finding labour vs. RBNZ unemployment forecast



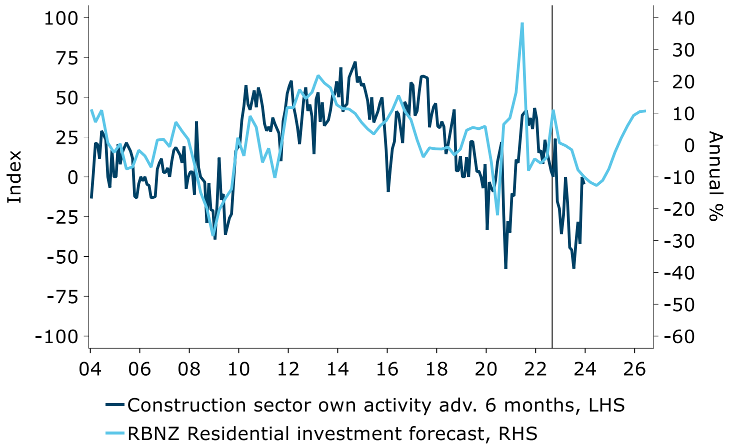
Source: NZIER, RBNZ, Stats NZ, Macrobond, ANZ Research

- April **monthly net migration** was well off recent highs at 5,800. This data is subject to enormous revisions, but that's consistent with our expectation that the recent massive net migration surge will prove relatively short lived, given cooling labour demand and rising outflows.

- ANZ **merchant card spending data** confirms that spending on durables, furniture and vehicles is underperforming, as higher interest rates and the weaker housing market take a toll, but tourism-related spending is holding up, and general retail is a mixed bag. On the whole, services spending is holding up better than spending on goods.

- **Building consents** continue to fall; they were down another 2.2% in May. The ANZ Business Outlook survey suggests downside risk to the RBNZ's forecasts for residential investment (figure 4, over), though the survey's construction activity indicators have lifted sharply off their lows, likely related to a brightening outlook for the housing market.

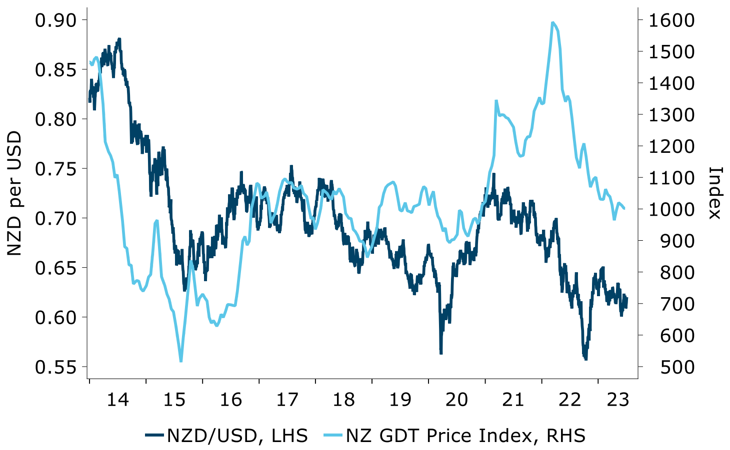
Figure 4. ANZBO construction own activity and RBNZ residential investment forecast



Source: RBNZ, Macrobond, ANZ Research

- **Food prices** rose 0.3% in May, as did the stock measure of **rents**.
- The **current account deficit** remained eyewatering at 8.5% of GDP, highlighting that a slowdown in spending was inevitable one way or another, whatever happens to the Official Cash Rate.
- **Dairy prices** have continued to fall as demand from China remains weak. If prices don't recover later in the season as we are forecasting our milk price forecast of $8.25/kg for the 2023-24 season will come under threat. The **NZD** is also on a weakening trajectory (figure 5).

Figure 5. NZD vs GlobalDairyTrade price index



Source: Global Dairy Trade, Bloomberg, Macrobond, ANZ Research

- **Mortgage rates** have edged higher since the May MPS, with 1 to 3 year fixed mortgage rates up by between 0.1%pts and 0.3%pts (on average across the big-4 banks). In most cases, rates have risen by less than the OCR (which was hiked by 25bps in May), but at this point in the cycle, it's less about carded mortgage rates rising per se, so much as it is about borrowers rolling off lower historic fixed rates onto the current suite of higher rates. RBNZ data shows that average mortgage rate being paid by homeowners is trending higher at a rate of around 0.12%pts per month, and with 90% of borrowers on a fixed rate, the lagged impact of earlier hikes (and consequent rises in wholesale rate) will continue to feed through at a similar pace in the coming months.

Weighing it all up, we don't see the recent data as making a compelling case for the RBNZ to deviate any time soon from the plan that was outlined in May: to stay on hold at 5.5% and see how things unfold. We expect things to remain broadly 'on track' over coming months, as lower oil prices and shipping costs, the easing of cyclone impacts and a significantly less-tight labour market see headline inflation steadily drop away (though not without bumps: the end of the fuel tax subsidy will work in the other direction).

However, we continue to expect a picture of *relative* resilience versus the RBNZ's forecasts. While the economy is certainly slowing markedly as tighter monetary policy bites, overall demand will be supported by the migration surge, the housing market lifting itself off the floor (albeit only to its hands and knees), and fiscal stimulus.

These factors won't outweigh the impact of higher interest rates – we are forecasting a mild recession, with GDP falling 0.3% in the second half of the year (but note that's a much chunkier 0.9% fall in per capita terms), accompanied by rising unemployment. But we don't think overall demand is capitulating to the degree that the RBNZ's forecasts imply. We see the risks tilted towards it becoming evident over time that squeezing the last couple of percentage points out of excess CPI inflation is going to take a bit more work. We continue to forecast that the RBNZ will resume its OCR hikes by the end of the year, with a placeholder 25bp hike pencilled in for November.

It's perhaps worth noting at this juncture that there is a degree of spurious accuracy that tends to be associated with macroeconomic forecasting. An OCR of 5.5% versus 5.75% is neither here nor there in the big picture. The RBNZ's range of estimates for the neutral OCR covers the range 2.7% to 5.4%. That's 270bp of uncertainty on what the 'right' OCR is from that source alone. Add in uncertainty about where the economy is right now (in practice, starting point surprises on output and inflation are by far the biggest driver of forecast revisions), not to mention all the unexpected events that could strike in the next 12 months, and frankly, a more realistic depiction of the uncertainty regarding where history will ultimately judge the OCR should ideally have currently been set 'if only we'd known' would be a range of about 3% to 7%. In that context, the odd thing arguably isn't that there's a range of views out there; it's how narrow the range of views is.

Markets

Financial markets figuratively "got the memo" from the RBNZ in May about them being on hold for the foreseeable future, and as such there is almost nothing priced in, with the 2bps (~8% odds) indicating that no one is seeing any real possibility of anything other than a no-change decision. As such a pause in and of itself will do little to affect market pricing on the day. However, markets will be looking closely at the tone of the press release and summary record of meeting (SRM) for clues about the committee's view on the skew of risks. There was some discussion of different committee members' views on monetary conditions, migration, tourism and the pace at which inflation was moderating in the May SRM, and any shift in views there will be watched closely. But at a high level, it's shaping up as a bit of an "as you were" day for local markets, which are figuratively dancing to a global beat.

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Last updated: 18 April 2023

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