ANZ Research

# Review of the RBNZ Monetary Policy Review

12 July 2023

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Contact

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## Nothing to see here

- The RBNZ left the OCR unchanged at 5.5%, as universally expected.
- Also as expected, there was a good deal of copy-paste from the July Monetary Policy Statement. One new factor was an implicit acknowledgement that the RBNZ's house price forecasts are too pessimistic. The RBNZ also suggested house prices may have reached "sustainable" levels.
- We continue to expect a 25bp hike at the November Monetary Policy Statement, but this is not today's story. For now, inflation indicators continue to fall obediently, and the RBNZ's pause is highly credible.

### In brief

As universally anticipated, the RBNZ today left the Official Cash Rate (OCR) unchanged at 5.5%, and confirmed it remains comfortably on hold while it waits to see the impacts of the rapid tightening thus far.

**Key quotes:**

- **OCR outlook:** "The Committee agreed that the OCR will need to remain at a restrictive level for the foreseeable future."
- **Labour market:** "While employment is above its maximum sustainable level, there are signs of labour market pressures dissipating and vacancies declining."
- **Domestic activity:** "businesses are reporting slower demand for their goods and services, and weak investment intentions."
- **Capacity:** "The return of net inward migration continues broadly as anticipated, and is assisting to ease labour shortages. The net impact of immigration on overall capacity pressures remains uncertain."
- **Inflation pressures:** "inflation is expected to continue to decline from its peak, and with it measures of inflation expectations. Core inflation is expected to decline as capacity constraints ease."
- **Fiscal policy:** "Broader government spending is anticipated to decline in inflation-adjusted terms and in proportion to GDP."
- **Housing market:** "house prices have returned to more sustainable levels." "The Committee judged that after recent falls, house prices are now around sustainable levels." "The outlook for the housing market has become more balanced."
- **Global outlook:** "Global economic growth remains weak and inflation pressures are easing."

In a hat tip to the firmer tone of housing data in recent months, the Committee noted "that the outlook for the housing market has become more balanced", in acknowledgement that the RBNZ's forecast for house prices to continue to decline across the rest of the year now looks too pessimistic. The Committee also noted that "after recent falls, house prices are now around sustainable levels." With real house prices adjusted for income growth back around 2019 levels, that statement seems a little inconsistent with the debate that was raging back then. But what 'sustainable' means is a bit vague, providing some wriggle room.

## Our take

Today's decision to leave the OCR unchanged at 5.5% was an easy one, as rate decisions go. As we noted in our Preview, the data since the May MPS has had its unders and overs but overall clearly supports the RBNZ's on-hold stance – and in any case, it would take a lot to move the dial when the pause is only six weeks old!

Our OCR forecast remains unchanged: we've been clear we don't expect the RBNZ or the market to come around to our view that more is needed until much later in the year. Indeed, we are likely to see a lower CPI print next week than the RBNZ forecast in its May MPS. We are forecasting a mild recession, but don't think the economy (and the labour market in particular) is rolling over quite as rapidly as the RBNZ expects; hence our placeholder 25bp hike in November. We'd characterise 5.5% as the RBNZ's first pass at what's needed, not necessarily the final word. This forecasting business is too uncertain for anyone to be sure of that.

There's certainly a lot of water to flow under the bridge before the end of the year. While on balance we see the risks as tilted to the OCR still needing to go a little higher, there are risks that could see the RBNZ cutting rates by year end, absolutely. After all, New Zealand's economic cycles tend in practice to be brought to an abrupt end by global developments, not gently brought into land by domestic monetary policy. Will China manage to stabilise the consumption outlook? Will US inflation allow the Fed to stop hiking before something breaks? Fingers crossed.

And domestically, fiscal stimulus and migration could well prove either more or less inflationary than anticipated. COVID or energy prices could upset the apple cart. The housing market and/or labour market could throw curveballs. For now, sitting pat, confident the OCR is at a contractionary level and bringing inflation pressures down, is a sensible strategy. Back to data-watching, everyone.

## Market reaction

The RBNZ remains in "watch, worry and wait" mode, and are a lot more credible and comfortable in that stance than some global peers. The RBNZ's goal today would have been to avoid unnecessary volatility, as there was no pressing need for them to say anything at all. And on that front, it was pretty much "mission accomplished": swap rates are down just 4-8bps across the curve on the day at the time of writing. The NZD is slightly higher after a small dip. Next stop, Q2 CPI next week! We'll finalise our pick after the food and rent data tomorrow, but at this stage it's looking likely to print below the RBNZ's May MPS pick of 6.1% y/y.

## Official Cash Rate remains on hold

The Monetary Policy Committee today agreed to leave the Official Cash Rate (OCR) at 5.50%.

The level of interest rates are constraining spending and inflation pressure as anticipated and required. The Committee agreed that the OCR will need to remain at a restrictive level for the foreseeable future, to ensure that consumer price inflation returns to the 1 to 3% annual target range, while supporting maximum sustainable employment.

Global economic growth remains weak and inflation pressures are easing. This follows a period of significant monetary policy tightening by central banks internationally. Global inflation rates continue to decline, assisted by the normalisation of international supply chains, and the decline in shipping costs and energy prices. The weaker global growth has led to lower export prices for New Zealand's goods.

In New Zealand, inflation is expected to continue to decline from its peak, and with it measures of inflation expectations. Core inflation is expected to decline as capacity constraints ease. While employment is above its maximum sustainable level, there are signs of labour market pressures dissipating and vacancies declining.

Consumer spending growth has eased and residential construction activity has declined, while house prices have returned to more sustainable levels. More generally, businesses are reporting slower demand for their goods and services, and weak investment intentions.

The return of net inward migration continues broadly as anticipated, and is assisting to ease labour shortages. The net impact of immigration on overall capacity pressures remains uncertain. The ongoing recovery in tourism spending is supporting demand.

The repair and rebuild underway in regions of the North Island due to severe weather events will support economic activity in the near term. Broader government spending is anticipated to decline in inflation-adjusted terms and in proportion to GDP.

The Committee is confident that with interest rates remaining at a restrictive level for some time, consumer price inflation will return to within its target range of 1 to 3% per annum, while supporting maximum sustainable employment.

## Record of meeting July 2023

The Monetary Policy Committee discussed recent developments in the New Zealand economy. The Committee agreed that monetary conditions are restricting spending and reducing inflationary pressure as anticipated. However, inflation remains too high. Spending needs to remain subdued to better match the economy’s ability to supply goods and services, so that consumer price inflation returns to its target range of 1 to 3%. Supply capacity constraints in the economy continue to ease.

Global economic growth remains below trend for most of our trading partners, partly as a result of significant monetary policy tightening by central banks internationally. Global growth is expected to weaken further. Economic growth is moderating more rapidly in China, with recent data suggesting a slowing in economic momentum.

Headline inflation has continued to fall in most countries, assisted by lower energy prices and a normalisation of international supply chains and shipping costs. However globally, core inflation remains high. This has prompted some central banks to further increase interest rates recently. In discussing recent central bank policy moves, the Committee noted that monetary policy in New Zealand reached a more restrictive level earlier than in many other economies.

The Committee discussed domestic economic developments. Recent data suggest that tight monetary conditions are constraining domestic spending as expected. Residential building activity has started to ease and falling consent numbers suggest it will continue to slow. Economic activity contracted slightly in the March 2023 quarter. Recent indicators suggest that growth is likely to remain weak in the near term, despite some support from repair and rebuild work underway in regions of the North Island due to severe weather events. Broader government spending is anticipated to decline in inflation-adjusted terms and in proportion to GDP.

Labour shortages have started to ease, partly in response to the recent arrival of more migrants. Firms report that it is becoming easier to find labour and economy-wide vacancy rates have fallen.

The Committee judged that after recent falls, house prices are now around sustainable levels. House prices have stabilised in recent months and the Committee noted that the outlook for the housing market has become more balanced. Higher net migration is supporting demand for housing but higher interest rates continue to exert downward pressure on housing demand.

The Committee agreed that there is no trade-off between meeting the Committee's inflation and employment objectives and maintaining the stability of the financial system. Debt levels are high in some parts of the economy, and pockets of stress are emerging. However, early indicators point to only a moderate increase in stressed lending over the coming months and non-performing loans remain at very low levels.

In discussing their Remit objectives, the Committee noted inflation is still expected to decline within the target band by the second half of 2024. The Committee discussed risks to the persistence of domestic inflation pressures and imported inflation and judged that the risks around the inflation projection were broadly balanced. Employment remains above its maximum sustainable level, however recent indicators suggest that labour market conditions are easing.

The Committee noted that monetary conditions have continued to tighten with mortgage rates increasing further in recent months in response to higher wholesale rates. The Committee noted that bank term deposit rates had increased recently, broadening the transmission of tighter monetary policy. The lagged effects of previous monetary tightening is still passing through to households as more households move off lower fixed rates. Average mortgage rates on outstanding loans have increased from about 3% in early 2022 to about 5% currently. Based on current commercial bank pricing, average mortgage rates are expected to reach around 6% in early 2024.

The Monetary Policy Committee discussed the appropriate stance of monetary policy. The Committee agreed that interest rates will need to remain at a restrictive level for the foreseeable future, to ensure consumer price inflation returns to the 1 to 3% target range while supporting maximum sustainable employment.

On Wednesday 12 July the Committee reached consensus to leave the Official Cash Rate unchanged at 5.5%.

**Attendees:**

Reserve Bank members of MPC: Adrian Orr, Christian Hawkesby, Karen Silk, and Paul Conway

External members of MPC: Bob Buckle, Peter Harris and Caroline Saunders.

Treasury Observer: Tim Ng

MPC Secretary: Chris Bloor

# Contact us

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