ANZ Research

RBNZ February Monetary Policy Statement

13 February 2019

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Biding its time

Bottom line

- The RBNZ held the OCR at 1.75% as expected and employed a marginally more dovish tone than in the November MPS. It restored the comment that the next OCR move "could be up or down" and emphasised both upside and downside risks.
- Downside developments since November have been incorporated in a slightly flatter projected OCR track, a weaker inflation track, and a weaker GDP growth track.
- We continue to expect an OCR cut by year end as growth disappoints (starting in Q4); we are forecasting November, with two cuts to follow next year.

Key points

The RBNZ today held the OCR at 1.75% as universally expected. The OCR projection was slightly flatter, with OCR hikes still projected to kick off in Q2 2020 but now reaching 2% by Q2 2021 (rather than late 2020).

The RBNZ struck only a slightly more dovish tone than in the November MPS. It returned to signalling that OCR cuts are a distinct possibility, saying that the next move could be "up or down". It also noted the softer outlook for growth and building global risks, saying "the risk of a sharper downturn in trading-partner growth has… heightened over recent months". However, they also continue to highlight the possibility that "inflation could rise faster if firms pass on cost increases to prices to a greater extent".

In all, the RBNZ remained careful to keep its options open. The two upside/downside alternative scenarios were much as we expected. However, the calibration of these indicates the Bank considers the risks around their updated projections to be balanced, whereas we continue to see them as skewed to the downside, despite the downward tweaks.

Details of the projections

The RBNZ expect to see a bounce-back in growth in coming quarters (0.8% q/q for Q4 and Q1), after the soft print in Q3 (0.3% q/q). But the outlook for both GDP growth and the output gap were revised down over the projection. The RBNZ now expects GDP growth to accelerate to around 3% y/y by the end of the year – a more modest acceleration than in November, when growth was expected to reach 3.4%. The revisions largely reflect weaker potential growth, though the output gap now peaks at 0.5% of potential output (versus 0.7%).

The outlook for non-tradable inflation is a bit stronger in the near term, reflecting the stronger-than-expected starting point. However, the medium-term outlook is a touch lower, reflecting a weaker output gap in the latter forecast years. The outlook for headline inflation in the near term is weaker on account of a softer forecast for tradable inflation. This reflects a weaker-than-expected starting point and recent weakness in petrol prices. Although the RBNZ will continue to look through temporary movements in tradable inflation, the outlook is weaker overall, with headline inflation now expected to decelerate to 1.2% y/y in Q3 2019 before picking up to 2% by the end of 2020, with no overshoot of the midpoint as previously.

Risk scenarios

The two scenarios reflect where the RBNZ believes the most salient risks lie, and how they balance out. Based on the calibration of the scenarios in today's Statement, risks continue to be considered balanced, albeit around a weaker central track than previously.

The downside scenario highlighted the risk of a sharp global slowdown flowing through to weaker export demand and consumer and business confidence, assuming the exchange rate does not depreciate. This scenario was associated with a 50bp lower OCR by mid-2020.

On the upside, the RBNZ continues to highlight the possibility that rising costs could pass through to inflation more strongly than expected. A scenario in which non-tradable inflation is 0.5%pts higher in early 2020 is associated with a 50bp higher OCR by late-2020.

Our take

Today's Statement moves the RBNZ into only slightly more dovish territory versus November. We thought they may have moved slightly further in this direction today, and perhaps flattened the OCR track completely. However, the RBNZ certainly has the luxury of time to see how developments unfold, with the economy looking a little soft at the edges, not overtly weak, and inflation inching ever closer to the midpoint of the target band.

We continue to expect that the next move in the OCR will be down. In our view, growth this year will fail to accelerate to the degree that the RBNZ forecasts, with it gradually becoming clear that more monetary stimulus will be needed to generate a sustained lift in inflation.

The timing of the first cut is uncertain. Global risks could see it eventuate more quickly, particularly if New Zealand's commodity prices start to feel the heat. On the other hand, firms' costs are elevated, and we could see an inflation surprise on the upside, buying the RBNZ more time. But on balance, we think the need for OCR cuts will become apparent by year end, with our forecasts incorporating the first move in November, with two to follow next year.

Market reaction

The market was looking for a more dovish tilt to the Statement this afternoon. The OCR rate track was only marginally flatter, with the track gradually rising from Sep 2020. The NZD reacted strongly, gaining 1.5% against the USD at the outset before partially retracing. The NZ OIS market unwound its gains but is still pricing a 60% chance of a cut by Nov 2019. We expect the NZD to continue this run while the market digests the Statement and adjusts expectations accordingly.

RBNZ news release key quotes

	Previous: 8 November MPS	**New**: 13 February 2019
OCR decision and outlook	The Official Cash Rate (OCR) remains at 1.75 percent. We expect to keep the OCR at this level **through 2019 and into 2020**. We will keep the OCR at an expansionary level for a considerable period to contribute to maximising sustainable employment, and maintaining low and stable inflation. As always, the timing and direction of any future OCR move remains data dependent.	The Official Cash Rate (OCR) remains at 1.75 percent. We expect to keep the OCR at this level **through 2019 and 2020. The direction of our next OCR move could be up or down.** We will keep the OCR at an expansionary level for a considerable period to contribute to maximising sustainable employment, and maintaining low and stable inflation.
Growth outlook	The pick-up in GDP growth in the June quarter was partly due to temporary factors, and business surveys continue to suggest growth will be soft in the near term. GDP growth is expected to pick up over 2019. Monetary stimulus and population growth underpin household spending and business investment. Government spending on infrastructure and housing also supports domestic demand. **The level of the New Zealand dollar exchange rate will support export earnings.**	Despite the weaker global impetus, we expect low interest rates and government spending to support a pick-up in New Zealand's GDP growth over 2019. Low interest rates, and continued employment growth, should support household spending and business investment. Government spending on infrastructure and housing also supports domestic demand.
Inflation	However, core consumer price inflation remains below our 2 percent target mid-point, necessitating continued supportive monetary policy. As capacity pressures build, core consumer price inflation is expected to rise to around the mid-point of our target range at 2 percent.	However, core consumer price inflation remains below our 2 percent target mid-point, necessitating continued supportive monetary policy. As capacity pressures build, consumer price inflation is expected to rise to around the mid-point of our target range at 2 percent.
Employment	Employment is around its maximum sustainable level.	Employment is near its maximum sustainable level.
Risks	There are both upside and downside risks to our growth and inflation projections. Downside risks to the growth outlook remain. Weak business sentiment could weigh on growth for longer. Upside risks to the inflation outlook also exist. Higher fuel prices are boosting near-term headline inflation. We will look through this volatility as appropriate. Our projection assumes firms have limited pass through of higher costs into generalised consumer prices, and that longer-term inflation expectations remain anchored at our target.	There are upside and downside risks to this outlook. A more pronounced global downturn could weigh on domestic demand, but inflation could rise faster if firms pass on cost increases to prices to a greater extent.
Global	Trade tensions remain in some major economies, raising the risk that trade barriers increase and undermine global growth.	Trading-partner growth is expected to further moderate in 2019 and global commodity prices have already softened, reducing the tailwind that New Zealand economic activity has benefited from. **The risk of a sharper downturn in trading-partner growth has also heightened over recent months.**

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