

RBNZ May Monetary Policy Statement

8 May 2019



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The first cut is the deepest

Bottom line

- The RBNZ cut the OCR 25bp to 1.50% today, citing slower global and domestic growth.
- **It wasn't all guns blazing, however:** the forecast OCR track implied only a half chance of a further cut, sometime next year.
- The RBNZ has downgraded its near-term outlook substantially, meaning the hurdle for a further cut is high for now. As before, we expect a further OCR cut in November, with one more cut to follow early next year.

Key points

The RBNZ today cut the OCR 25bp to 1.50%. Both the market and analysts were divided on what action the RBNZ would take today, meaning a market reaction was guaranteed either way.

The RBNZ struck a dovish tone, noting that global economic growth has slowed but also that some indicators had improved lately, while on the domestic front, **"the outlook for employment growth is more subdued and capacity pressure is expected to ease slightly"**. In sum, "The Monetary Policy Committee decided a lower OCR is necessary to support the outlook for employment and inflation consistent with its policy remit." We agree, as it happens, but had believed on balance that they would require a little more evidence before leaping into action.

The Committee did not give strong guidance that further cuts could be expected, **describing the outlook for interest rates as now "more balanced"**. The OCR is forecast to be at 1.48% by the end of the year, implying they do not expect to be cutting again anytime soon. The track implies a 50% chance of a further cut sometime next year, but then increases over the projection. In practice, the market is likely to continually try to front-run cuts, as a single cut followed by a prolonged hold would be unprecedented. But given the uncertainties it makes sense for the RBNZ to tread carefully for now.

Details of the projections

The RBNZ now expects only 0.4% q/q growth in Q1 (previously 0.8%), but have kept Q2 unchanged at 0.7% and bumped up growth from the second half of the year. GDP growth is now seen as accelerating from a trough of 2.0% y/y in Q2 2019 to a peak of 3.3% y/y by Q2 2020 (previous peak of 3.1% in Q3 2019). Additional monetary stimulus has introduced a strong cyclical uplift into annual GDP growth, which still looks a little on the optimistic side compared to our own outlook. The output gap now peaks at 0.6% of potential output (versus +0.5% in the February projections), but slips into negative territory in the near term.

The outlook for non-tradable inflation is a bit weaker in the near term, reflecting the weaker-than-expected growth recently experienced. Over the medium term the outlook is little changed, as the forecast for easier financial conditions works its magic. The outlook for tradable inflation is a little stronger owing to higher petrol prices and a weaker NZD-TWI. Headline inflation is expected to gradually lift to 2.0% by Q2 2021 (previously by the end of 2020).

Risks

Unusually, the RBNZ chose not to present risk scenarios as such (likely because they were tiring of repeating themselves), but they did provide a discussion.

On the growth outlook, the risk discussion focused on global conditions. The central projections assume that supportive monetary policy globally will stabilise the global growth cycle, but global growth could deteriorate further, affecting New Zealand through trade, financial market, and confidence channels. Alternatively, the easing in global financial conditions since the beginning of the year, or quick resolution to trade negotiations, could lead to a pick-up in global growth.

On inflation, the Statement noted that weaker GDP could flow through to weaker capacity pressure, and imported inflation could slow more than expected if global growth slows or commodity prices decline. On the upside, capacity pressure could be greater than assumed or cost pressures could flow through to prices by more than expected.

Now the RBNZ has moved to a committee decision-making structure, the **Monetary Policy Statement now also includes a "Summary record of meeting"**, describing the discussion that took place this morning. The summary noted that the Committee reached a consensus about cutting the OCR today and lowering the OCR forecast track. We suspect that consensus will be the usual state of play going forward, but time will tell. There was also a discussion of risks: a more marked global slowdown (or a faster recovery, though this was seen as less likely), the investment outlook, government spending, a possible pick-up in the housing market, and elevated cost pressures. The Committee **agreed that the "overall risks to the inflation projection were balanced."**

Our take

The RBNZ cut the OCR but stopped short of promising further aggressive action. We have long argued that the RBNZ would cut the OCR, but in the end they have taken the plunge a little earlier than we anticipated.

"One and done" would be a very unusual cutting cycle. It could happen, since the RBNZ has acted more proactively than has historically been the case, but we continue to forecast that this is just the start of a sequence of three cuts. Given the magnitude of the downward **revision to the RBNZ's Q1 growth outlook**, the hurdle for near-term further disappointment is high, but the **RBNZ's growth forecasts further out are considerably higher than our own**. Lower interest rates will support growth, but too-high interest rates are not this **economy's problem at present**. We therefore forecast that by November the ducks will have lined up for another cut, followed by one in February. In our view deterioration in global conditions is the primary risk that could bring this forward.

Figure 1: GDP forecasts



Source: Statistics NZ, ANZ, RBNZ

Market reaction

The market was always going to lurch today, with market pricing pretty much exactly 50:50 in the weeks leading into the Statement before expectations fading somewhat over the last day. The NZD reacted strongly, falling 1.0% against the USD as the decision was announced before retracing. A lower OCR track saw the NZ OIS market rally as expectations for future easing were built into the curve, with another cut priced in by the May 2020 meeting.

We expect the NZD to continue to lag its peers now that the RBNZ has entered into an easing cycle, while pricing should ebb and flow as markets regather after this Statement. The NZ 10-year bond yield rallied 5% as the decision hit the wires **but has failed to reach its lows seen after the RBNZ's March Statement**. We expect this move lower to find support in time.

RBNZ news release key quotes

New: 8 May 2019

Previous: 27 March 2019 (re-ordered by theme)

OCR decision

The Official Cash Rate (OCR) has been reduced to 1.5 percent.

The Monetary Policy Committee decided a lower OCR is necessary to support the outlook for employment and inflation consistent with its policy remit.

The Official Cash Rate (OCR) remains at 1.75 percent. Given the weaker global economic outlook and reduced momentum in domestic spending, the more likely direction of our next OCR move is down.

Global

Global economic growth has slowed since mid-2018, easing demand for New Zealand's goods and services. This lower global growth has prompted foreign central banks to ease their monetary policy stances, supporting growth prospects.

However, there is uncertainty about the global economic outlook. Trade concerns remain, while some other indicators suggest trading-partner growth is stabilising.

The global economic outlook has continued to weaken, in particular amongst some of our key trading partners including Australia, Europe, and China. This weaker outlook has prompted central banks to ease their expected monetary policy stances, placing upward pressure on the New Zealand dollar.

Growth outlook

Domestic growth slowed from the second half of 2018. Reduced population growth through lower net immigration, and continuing house price softness in some areas, has tempered the growth in household spending. Ongoing low business sentiment, tighter profit margins, and competition for resources has restrained investment.

Domestic growth slowed in 2018, with softness in the housing market and weak business investment contributing.

We expect ongoing low interest rates, and increased government spending and investment, to support economic growth over 2019. Low interest rates, and continued employment growth, should support household spending and business investment. Government spending on infrastructure, housing, and transfer payments also supports domestic demand.

Employment & Inflation

Employment is near its maximum sustainable level. However, the outlook for employment growth is more subdued and capacity pressure is expected to ease slightly in 2019. Consequently, inflationary pressure is projected to rise only slowly.

Employment is near its maximum sustainable level. 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.

Risks

The balance of risks to this outlook has shifted to the downside. The risk of a more pronounced global downturn has increased and low business sentiment continues to weigh on domestic spending. On the upside, inflation could rise faster if firms pass on cost increases to prices to a greater extent.

OCR outlook

Given this employment and inflation outlook, a lower OCR now is most consistent with achieving our objectives and provides a more balanced outlook for interest rates.

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.



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