

RBNZ Monetary Policy Statement Preview

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Hold off, hold on

- Next Wednesday the RBNZ will leave the OCR at 1.75%. However, we expect a more dovish tone, acknowledging the changing balance of risks and endorsing current market pricing, which favours cuts.
- Domestic data since the November MPS has been mixed but the economy is clearly coming off the boil. Trading partner growth is slowing markedly.
- We are forecasting an OCR cut by year-end, whether the RBNZ changes their growth and OCR forecasts meaningfully next week or not. We expect the economy to continue to fail to accelerate as the year progresses, making the case for easier policy clear in time.

Key points

We expect the RBNZ will leave the OCR unchanged at 1.75% at its Monetary Policy Statement (MPS) next Wednesday at 2pm. The RBNZ will reaffirm a data-dependent 'watch and wait' stance, though the 'worry' element is growing.

Since the November MPS, Q3 GDP surprised on the downside at just 0.3% q/q and a weaker HLFS unwound much of the Q3 upward labour market surprise that inconveniently landed a day before the November MPS. Meanwhile global data has weakened markedly, particularly in China, Europe and Australia, though this is yet to have any evident impact on demand for New Zealand's commodities.

On the other hand, non-tradable inflation in Q4 was a bit stronger than the RBNZ had expected, and we may well see some further uplift in the short term on account of previous strength in the economy.

On balance, while 'watch and wait' remains a highly defensible stance, given the local data is softening rather than tanking, the RBNZ will acknowledge that the world is changing – and the tone of other central banks such as the US Fed and the Reserve Bank of Australia has changed along with it.

Since the November MPS, the market has moved from pricing a small chance of a hike this year to now be fully consistent with our view of a cut by year-end. This is an appropriate reflection of the emerging risks, and in our view the RBNZ is unlikely to feel any pressure to send strong signals to the market (in either direction) to 'correct' it.

Downside growth risks are accumulating. The question is whether these risks will make it into the central forecast or remain in the alternative scenarios. On balance, we believe the published OCR track will be tweaked flatter, if not flat, on the back of a weaker growth outlook. But it isn't a necessary component of our November cut call that the RBNZ jumps on the dovish bandwagon so soon.

The potential growth impacts of a more marked global slowdown are now a more pertinent risk than any delayed impact from last year's slump in business confidence; this is likely to comprise the downside scenario. A broadening of inflation pressure remains the most relevant upside risk: firms are reporting sharply higher costs, yet very modest pricing intentions. We are forecasting that resource pressures will dissipate before inflation breaks out meaningfully (and the weaker-than-expected labour market data supports our take), but clearly it could go either way. Regardless, something has to give – pricing intentions and costs don't tend to move in opposite directions for long.

A key uncertainty is the likely revisions to the estimated output gap (current spare capacity in the economy) and equivalently, potential output (the speed limit of the economy). These ruminations will determine whether the RBNZ will still conclude that a marked acceleration in GDP growth is required to ensure medium-term inflation heads sustainably back to target, as they have in recent forecasts.

There are a few moving parts in the equation.

- First, Q3 2018 GDP came in at 0.3% q/q versus the RBNZ forecast of 0.7%. All else equal, this will lower the estimate of the end-point output gap (and hence expected inflation pressure down the track).
- Second, the unemployment rate was reported to be sharply lower in Q3 (3.9%). But today, at 4.3%, it is **close to the RBNZ's November MPS** forecast of 4.4% in Q4.
- Third, complicating matters, there were significant upward revisions to GDP growth over 2017. This would ostensibly seem to be a positive, in that stronger growth means stronger inflation. However, viewed through another lens, **it's problematic that** stronger growth than previously thought has *still* only been dragging core inflation by its ankles. Perhaps the **economy's speed limit is higher than thought, meaning a given** GDP growth forecast would generate *less* inflation pressure. And taking a really glass-half-empty view of things, the higher past growth does make the deceleration more marked.

Weighing it up, **we don't think the RBNZ will conclude that capacity pressures** are still **increasing, though it's** certainly too soon to assume they are set to wane quickly.

In the big picture, there is little pressure for the RBNZ to say much, let alone do much, at this meeting. The economy is softening at the edges but still doing fine, and market pricing is appropriately adjusting to the risk profile. However, the ground is shifting. Global growth risks are to the fore, and the US Federal Reserve, and now the RBA, have abruptly taken overtly more dovish stances. A case could certainly be made for the RBNZ to be similarly proactive and endorse market pricing, such as by re-introducing a phrase along the lines of **"the next move in the OCR could be up or down"**. **When** global growth slows, the New Zealand economy inevitably feels the chill, and the dataflow out of both China and Australia, who together take 40% of our goods exports, has turned rapidly south.

A Statement in line with our expectations would endorse current market pricing, but whether the market runs further will likely hinge on whether the OCR track is lowered. There is in practice no urgency to do so, but we believe the RBNZ will want to clearly signal that it is cognisant of the emerging risks to the growth and inflation outlook, while noting that upside inflation risks have certainly not evaporated.



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