ANZ Research

RBNZ OCR Review

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Ready to roll

Bottom line

- The RBNZ held the OCR at 1.50% as universally expected but employed a considerably more dovish tone around the outlook in its Policy Assessment and Summary of Meeting. Risks around their most recent projections have moved from "balanced" to "tilted to the downside".
- The Committee "agreed that more support from monetary policy was likely to be necessary."
- We are bringing forward our forecast OCR cuts to August and November.

Key points

The RBNZ today held the OCR at 1.5% as universally expected. The Committee highlighted increasing downside global risks, while acknowledging that the local data had been mixed. The RBNZ concluded that "a lower OCR may be needed over time". We expect two further OCR cuts in August and November.

There was no urgency for the Reserve Bank to cut the OCR again immediately. The economy has indeed slowed considerably, but the most forward-looking indicators – and looser financial conditions – suggest a recovery in the second half of the year. The global slowdown is real, but the pass-through into the New Zealand economy has been muted so far – and there are reasons to think commodity prices may continue to be resilient. The labour market is still tight (though employment fell in Q1), and inflation is still trending up, albeit too slowly for the Reserve Bank's liking.

All that said, the downside risks are clear. The RBNZ identified several, and we agree with them:

- The global economic outlook has weakened, trade tensions persist, and both oil and dairy prices have fallen;
- Imported inflation could remain soft;
- Some of the factors supporting Q1 GDP look temporary;
- House price inflation continues to weaken;
- Fiscal policy looks stronger but spending could be delayed.

To these we would add that indicators and anecdote out of the construction sector suggest that this will flip from a support to a drag on growth later this year.

Upside risks to inflation and employment are becoming few and far between. Cost pressures are real (the risk that wage growth could abruptly emerge warranted a mention) but capacity pressures have eased substantially, which is not an environment conducive to a flurry of sustained inflation.

The Summary Record of Meeting confirmed that it was a consensus decision to leave the OCR unchanged. Since the Committee has been instructed to seek consensus, this fact is not particularly newsworthy.

The last two paragraphs warrant quoting in full:

> The Committee discussed whether additional monetary stimulus was necessary given continued falls in global growth and subdued domestic demand. The members agreed that more support from monetary policy was likely to be necessary.
>
> The Committee discussed the merits of lowering the OCR at this meeting. However, the Committee reached a consensus to hold the OCR at 1.5 percent. They noted a lower OCR may be needed over time.

The Reserve Bank sets policy for New Zealand. Nonetheless what global central banks are up to is important, above and beyond how it reflects global economic developments. That's because interest rate relativities have implications for currencies. Reserve Bank of Australia Governor Lowe said this week that it is a "dangerous game" to use policy rate cuts for competitive devaluations, and he's not wrong, but there are costs to staying out of the fray as well.

Oddly enough, in the current global context, an OCR of just 1.5% is high enough to pull in foreign money and put upward pressure on the NZD. ANZ is now expecting the Reserve Bank of Australia to deliver two further cuts very promptly, in July and August (and we are forecasting two cuts this year by the US Federal Reserve as well). However, it's not necessary for the RBNZ to match the RBA's speed. The RBA has considerably more work to do to achieve their medium-term targets.

In that context, it was notable that the Committee declined the opportunity to slap the NZD down this afternoon. They noted that "a number of central banks are easing their monetary policy settings to support demand" but chose not to re-insert the comment that this was putting upward pressure on the NZD.

The Reserve Bank has made it clear that they are likely to cut again sooner rather than later. We have been talking about this risk for some time, but now the RBNZ has confirmed their take on recent developments we are now officially bringing forward our forecast cuts to August and November.

Market reaction

The market took a mixed view of the RBNZ's stance this afternoon. While the Statement clearly opens the door to further cuts, it stopped short of promises to keep pace with global central bank peers.

The Statement was sufficiently dovish to keep future OCR expectations largely unchanged, with market OIS pricing for a cut in August backing up only 1-2bp. The NZD dropped 0.6% against the USD at the outset before retracing as markets digested the Statement. An 80% chance of a cut is still priced in for the August MPS, with a 54% chance of a follow-up cut by November. The NZ 10-year government bond yield rose 12ps to 1.539%. The fact the long end has moved more than OIS pricing is perhaps reflective of just how far and how fast long-end yields have fallen in the past week. It's more nuanced than a simple race to the bottom.

RBNZ news release

New: 26 June 2019	**Previous**: 8 May 2019
	Tena koutou katoa, welcome all.
The Official Cash Rate (OCR) remains at 1.5 percent. Given the weaker global economic outlook and the risk of ongoing subdued domestic growth, a lower OCR may be needed over time to continue to meet our objectives.	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 global economic outlook has weakened, and downside risks related to trade activity have intensified. A number of central banks are easing their monetary policy settings to support demand. The weaker global economy is affecting New Zealand through a range of trade, financial, and confidence channels.	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.
Domestic growth has slowed over the past year. While construction activity strengthened in the March 2019 quarter, growth in the services sector continued to slow. Softer house prices and subdued business sentiment continue to dampen domestic spending.	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.
We expect low interest rates and increased government spending to support a lift in economic growth and employment. Inflation is expected to rise to the 2 percent mid-point of our target range, and employment to remain near its maximum sustainable level.	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.
Given the downside risks around the employment and inflation outlook, a lower OCR may be needed	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.
Meitaki, thanks.	Meitaki, thanks.

Summary record of meeting

The Monetary Policy Committee agreed that the outlook for the economy has softened relative to the projections in the May 2019 Statement.

The Committee noted that inflation remains slightly below the mid-point of the inflation target and employment is broadly at its maximum sustainable level. The Committee agreed that a lower OCR may be needed to meet its objectives, given further deterioration in the outlook for trading-partner growth and subdued domestic growth.

Relative to the May Statement, the Committee agreed that the risks to achieving its consumer price inflation and maximum sustainable employment objectives are tilted to the downside.

The members noted that global economic growth had continued to slow. They discussed the recent falls in oil and dairy prices, and that several central banks are now expected to ease monetary policy to support demand.

The Committee discussed the ongoing weakening in global trade activity. A drawn out period of tension could continue to suppress global business confidence and reduce growth. Resolution of these tensions could see uncertainty ease.

The Committee discussed the trade, financial, and confidence channels through which slowing global growth and trade tensions affect New Zealand. The members noted in particular the dampening effect of uncertainty on business investment. Some members noted that lower commodity prices and upward pressure on the New Zealand dollar could see imported inflation remain soft.

While global economic conditions had deteriorated, the Committee noted that domestic GDP growth had held up more than projected in the March 2019 quarter. The members discussed disparities in growth across sectors of the economy, with construction strong and services weak. The members also discussed whether some of the factors supporting growth in the quarter would continue.

The members noted two largely offsetting developments affecting the outlook for domestic growth: softer house price inflation and additional fiscal stimulus.

The Committee noted that recent softer house prices, if sustained, are likely to dampen household spending. The Committee also noted the recent falls in mortgage rates and the Government's decision not to introduce a capital gains tax.

The Committee noted that Budget 2019 incorporated a stronger outlook for government spending than assumed in the May Statement. The members discussed the impact on growth of any increase in government spending being delayed, for example due to timing of the implementation of new initiatives and current capacity constraints in the construction sector.

The members discussed the subdued nominal wage growth in the private sector and the apparent disconnect from indicators of capacity pressure in the labour market. The Committee discussed the possibility of this relationship re-establishing. Conversely, the continuing absence of wage pressure could indicate that there is still spare capacity in the labour market. Some members also noted that reduced migrant inflows could see wage pressure increase in some sectors.

The Committee discussed whether additional monetary stimulus was necessary given continued falls in global growth and subdued domestic demand. The members agreed that more support from monetary policy was likely to be necessary.

The Committee discussed the merits of lowering the OCR at this meeting. However, the Committee reached a consensus to hold the OCR at 1.5 percent. They noted a lower OCR may be needed over time.

Attendees

Reserve Bank staff: Adrian Orr, Geoff Bascand, Christian Hawkesby, Yuong Ha

External: Bob Buckle, Peter Harris, Caroline Saunders

Observer: Gabriel Makhlouf

Secretary: Chris McDonald

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