Put on your happy face

- As universally expected, the RBNZ left the OCR on hold. The door was left open to further cuts but not opened further, with the RBNZ stating that "new information since the August Monetary Policy Statement did not warrant a significant change to the monetary policy outlook".

- The RBNZ continue to expect a pick-up in domestic demand over the coming year due to easier monetary conditions and fiscal spending. We are sceptical.

- We continue to forecast three more 25bp cuts (in November, February and May) taking the OCR to just 0.25%.

Key points

As universally expected, the RBNZ left the OCR unchanged at 1.00% at its Official Cash Rate Review today, but the tone was a bit more upbeat than the market was expecting. The RBNZ noted that "there remains scope for more fiscal and monetary stimulus, if necessary", but concluded that "new information since the August Monetary Policy Statement did not warrant a significant change to the monetary policy outlook". We anticipate that they will be convinced by November, however, when we expect the next 25bp cut to be delivered.

The RBNZ acknowledged that subdued global growth and low business confidence here at home were dampening the outlook. However, outside of business sentiment, the recent weaker data flow (PMI, Truckometer, job ads) that we're reading as pretty meaningful was not acknowledged. The Reserve Bank's unanticipated 50bp cut in August seems to have caused some alarm amongst firms and consumers, so perhaps today's statement was carefully worded so as to reassure. The RBNZ argues that "low interest rates and increased government spending are expected to support a pick-up in domestic demand over the coming year.”

In the Summary of Meeting the Committee noted risks to the outlook, but this time refrained from using the word "downside".

- Elevated global trade and geopolitical tensions remain in focus – and their implications for the global outlook, and ultimately demand for New Zealand's goods and services.

- Domestically, low business confidence remains on the RBNZ’s radar, noting policy uncertainty and low profitability in some sectors are key factors.

- Fiscal policy remains a key growth driver in the Committee’s eyes, but they note the risk that this could run into delays – we think that’s quite likely.

- Slipping inflation expectations were discussed, but so too was the “potential for rising labour and import costs to pass through to inflation more substantially over the medium term.”

We agree that it isn’t one-way traffic out there: monetary conditions are looser, near-term inflation indicators are actually looking a bit stronger, and cost pressures are real. But the strong downward trend in a reliable suite of forward indicators suggest that GDP growth is set to disappoint the RBNZ’s expectations over the rest of this year at least, and we anticipate that by November the RBNZ will have run out of patience again.
The tensions between monetary policy and financial stability objectives are real at the moment, with the most effective channel for monetary policy in New Zealand being giving the housing market a gee-up, while the LVR restrictions that are still in place are designed to reduce riskier housing lending. In the Summary of Meeting it was noted that “the Committee discussed the secondary objectives from the remit and remained comfortable with the monetary policy stance.” The secondary objectives include efficiency and soundness of the financial system. If the housing market were to respond vigorously to the lower mortgage rates on offer then the RBNZ will face a tricky choice, but for now, financial stability risks don’t appear to be being exacerbated.

The bottom line

In our view, a “watch, worry (in private), and wait” stance at this point is very defensible. There has been a substantial easing in financial conditions in the past year, and as was noted in the Summary of Meeting, there are “long and variable lags between monetary policy decisions and outcomes”. Interest rates have fallen substantially and the NZD is lower, and there is time to see what effect this has on confidence and economic activity.

But nonetheless, forward indicators such as the ANZ Truckometer indexes suggest that growth is going to continue to slide over the remainder of the year at least, weakening the medium-term inflation outlook. And with inflation expectations already low and falling, we suspect the RBNZ will again feel the need to shoot first and ask questions later – unleashing what little conventional firepower it has left by mid-next year. We continue to expect 25bp cuts in November, February, and May to take the OCR to 0.25% – around its useful limit.

Market reaction

The market was caught a little off-guard by the upbeat tone of the RBNZ’s September OCR Review, which saw the NZD rally 0.6% on the release. While no change was expected by markets, participants were anticipating a statement dovish enough to support market pricing for the November MPS (and beyond). This saw the odds of a November 25bp cut fall to 76%, down from an almost-certain 92% chance priced in earlier today. The yield on the 10-year NZ Government bond reacted more modestly, rising 1bp. We expect the NZD to remain buoyed by the Statement in the near term, while yields are likely to rise further as the market continues to digest this afternoon’s decision.
RBNZ news release key quotes (re-ordered by theme)

<table>
<thead>
<tr>
<th><strong>OCR decision</strong></th>
<th><strong>New:</strong> 25 September 2019</th>
<th><strong>Previous:</strong> 7 August 2019</th>
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<tr>
<td><strong>The Official Cash Rate (OCR) remains at 1.0 percent.</strong> The Monetary Policy Committee agreed that new information since the August Monetary Policy Statement did not warrant a significant change to the monetary policy outlook.</td>
<td><strong>The Official Cash Rate (OCR) is reduced to 1.0 percent.</strong> The Monetary Policy Committee agreed that a lower OCR is necessary to continue to meet its employment and inflation objectives.</td>
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<th><strong>Growth outlook</strong></th>
<th><strong>New:</strong> 25 September 2019</th>
<th><strong>Previous:</strong> 7 August 2019</th>
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<tbody>
<tr>
<td>Business confidence remains low in New Zealand, partly reflecting policy uncertainty and low profitability in some sectors, and is impacting investment decisions.</td>
<td>GDP growth has slowed over the past year and growth headwinds are rising. In the absence of additional monetary stimulus, employment and inflation would likely ease relative to our targets.</td>
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<th><strong>Global</strong></th>
<th><strong>New:</strong> 25 September 2019</th>
<th><strong>Previous:</strong> 7 August 2019</th>
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<tr>
<td>Global trade and other political tensions remain elevated and continue to subdue the global growth outlook, dampening demand for New Zealand’s goods and services.</td>
<td>Global economic activity continues to weaken, easing demand for New Zealand’s goods and services. Heightened uncertainty and declining international trade have contributed to lower trading-partner growth. Central banks are easing monetary policy to support their economies. Global long-term interest rates have declined to historically low levels, consistent with low expected inflation and growth rates into the future.</td>
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<tr>
<td>Global long-term interest rates remain near historically low levels, consistent with low expected inflation and growth rates into the future. Consequently, New Zealand interest rates can be expected to be low for longer.</td>
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<th><strong>Employment &amp; Inflation</strong></th>
<th><strong>New:</strong> 25 September 2019</th>
<th><strong>Previous:</strong> 7 August 2019</th>
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<tr>
<td>Employment is around its maximum sustainable level, and inflation remains within our target range but below the 2 percent mid-point. Keeping the OCR at low levels is needed to ensure inflation increases to the mid-point of the target range, and employment remains around its maximum sustainable level. There remains scope for more fiscal and monetary stimulus, if necessary, to support the economy and maintain our inflation and employment objectives.</td>
<td>Employment is around its maximum sustainable level, while inflation remains within our target range but below the 2 percent mid-point. Recent data recording improved employment and wage growth is welcome. Our actions today demonstrate our ongoing commitment to ensure inflation increases to the mid-point of the target range, and employment remains around its maximum sustainable level.</td>
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<th><strong>OCR outlook</strong></th>
<th><strong>New:</strong> 25 September 2019</th>
<th><strong>Previous:</strong> 7 August 2019</th>
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<tr>
<td>Low interest rates and increased government spending are expected to support a pick-up in domestic demand over the coming year. Household spending and construction activity are supported by low interest rates, while the incentive for businesses to invest will grow in response to demand pressures.</td>
<td>In New Zealand, low interest rates and increased government spending will support a pick-up in demand over the coming year. Business investment is expected to rise given low interest rates and some ongoing capacity constraints. Increased construction activity also contributes to the pick-up in demand.</td>
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