ANZ Research

RBNZ OCR Review

27 March 2019

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Bottom line

- The RBNZ held the OCR at 1.75% as expected but employed a considerably more dovish tone in the Review commentary.
- "Given the weaker global economic outlook and reduced momentum in domestic spending, the more likely direction of our next OCR move is down."
- We continue to forecast that the next move is an OCR cut in November, but risks have now shifted in the direction of an earlier move, depending on the domestic and global data flow.

Key points

The RBNZ today held the OCR at 1.75% as expected. However, it now believes that "the more likely direction of our next OCR move is down." Upside inflation risks still warranted a passing mention, but were soundly trumped by domestic and global downside risks to growth. We concur.

The Reserve Bank is not under pressure to cut the OCR right away. Growth has dipped but is still respectable. Commodity prices are holding up well, so the pass-through from global woes is muted so far. The labour market is clearly tight, supporting household spending. And inflation is gradually tracking towards where it needs to be as previous strong capacity stretch feeds through. The RBNZ has time to see how developments unfold.

However, the economy has been undershooting the RBNZ's forecasts, and acceleration this year now seems very unlikely, as was implicitly acknowledged in today's Review. Population growth is slowing, the housing market continues to cool, our suite of indicators for capacity pressures suggests they are now waning – with cost pressure and non-tradable inflation likely to follow, and downside global growth risks continue to worsen. The RBNZ sets policy for NZ conditions, but if they had remained a neutral outlier versus other central banks, the NZD would have gone to the moon. The Statement today explicitly mentioned that more dovish global central bank stances were "placing upward pressure on the New Zealand dollar".

We continue to forecast that the next OCR move is down, but the risk is now that it comes earlier than our forecast of November, given the RBNZ's tone has shifted to be overtly dovish a little earlier than we thought it might. Like the RBNZ, we'll be watching both the domestic and global dataflow closely.

Market reaction

The market was surprised by the extent of the dovish stance taken by the RBNZ this afternoon. The NZD sold off against major peers, falling 1.5% against the USD before retracing slightly. The NZ OIS market rallied, with marked adjustments to future OCR expectations. The market is now pricing in a 45% chance of a cut by June (up from next to nothing prior to this meeting) with a full cut priced in by November. The NZ 10-year government bond rallied 11bps, and now sits at (fresh) record lows. We expect the Review to weigh on the NZD for some time, and yields are also likely to continue to remain under downward pressure on the back of today's RBNZ commentary and ongoing global sentiment.

RBNZ news release

Previous: 13 February 2019	**New**: 27 March 2019
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.	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.**
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.	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.
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.	**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.**
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.	**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.
As capacity pressures build, consumer price inflation is expected to rise to around the mid-point of our target range at 2 percent.	As capacity pressures build, consumer price inflation is expected to rise to around the mid-point of our target range at 2 percent.
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.	**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.
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.	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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