ANZ Research

RBNZ Monetary Policy Statement Preview

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To be sure

- Next Wednesday the RBNZ will leave the OCR at 1.75%. However, we expect a dovish tone, in line with the March OCR Review, and a downward-sloping OCR forecast track implying around 35bp of OCR cuts by the end of the year.
- Domestic data has confirmed the economy is cooling but hardly freezing up. Near-term risks around China's growth – and hence commodity prices – are diminishing. There is no urgency for RBNZ action.
- Nonetheless we are forecasting an OCR cut in August, with two more to follow, as it becomes incontrovertible that capacity pressures are waning meaningfully before core inflation is where it needs to be.

Key points

It's a toughie, but weighing it all up 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 that it remains data dependent, but the baseline is now an expectation that the next move in the OCR will be downward, and we expect this to be reflected in the published OCR forecast.

Since the March OCR Review,

- The exchange rate has eased around 3.5% on a trade-weighted basis. This will be a very welcome development for the RBNZ, but it will be aware that maintaining this will be contingent on delivering OCR cuts in reasonably short order.
- Q1 inflation came out a little weaker than expected, but the surprise was entirely in the less-important tradable component, and petrol prices are now on the way up.
- Q1 labour market data remained consistent with employment around its maximum sustainable level, but momentum has clearly stalled. Employment growth was weak and wage inflation soft, but the unemployment rate (a better measure of capacity) fell to 4.2%.
- Indicators for Q1 GDP growth such as QSBO experienced trading activity suggest growth may disappoint RBNZ expectations yet again. More importantly, the Bank's capacity suite will suggest that pressures are waning rather abruptly.
- Forward-looking indicators such as the Truckometer suggest weakness will persist near term, but there is tentative evidence of finding a floor.
- Global data has improved – most importantly for New Zealand, there is increasing evidence that stimulus efforts in China are gaining traction.

As well as the data flow, there are a number of strategic issues of which the RBNZ decision-making committee will be cognisant during their deliberations:

- The March OCR Review included a comment that being out of synch with global central bank peers could place upward pressure on the NZD. A weak Q1 core inflation print in Australia has now seen the market price in the chance of a cut by the RBA next week at 40%, down from just over 60% at its peak. The timing of the two meetings is very close, but at the margin, an RBA cut would raise the odds of the RBNZ following suit.

- The Committee will discuss the likely market reaction to a cut or the lack of one. The market is undecided on the matter; analysts, however, are tilted firmly in favour of a cut. The Governor has made it clear that meeting market or analyst expectations is not something he feels obliged to do; however, the RBNZ is likely to prefer the NZD not to leap higher on the day. The words of the Policy Assessment and the nuances of the projections will need to be carefully chosen.

The MPS is a great deal more than just the Policy Assessment and the OCR track. In terms of the details of the forecasts:

- The RBNZ is likely to show a downward-sloping OCR track implying between one and two cuts this year. We expect three cuts eventually but there is no need to "commit" to so much stimulus at this early stage.
- We expect a decent downward revision to the RBNZ's growth forecasts for this year, likely offset by higher growth next year as the forecast OCR cuts kick in.
- The NZD has fallen further than the RBNZ forecast in February. This, plus higher oil prices, will push up the forecast for tradable inflation.
- The track for non-tradable inflation is likely to be weaker in the near term as a result of the weaker growth outlook, but to strengthen further out following a forecast growth rebound.

The RBNZ also typically describes a key upside and downside risk around the published forecasts. We expect the broad tenor of these to remain the same: global downside risks to growth, but upside inflation risks from cost pressures, including the minimum wage increase. The portrayed impact on the OCR forecast track gives an indication of how the RBNZ views the balance of risks. Given the opportunity to essentially reset the forecasts this month, it would seem likely that the risks will be described as roughly balanced. The risk of an upward break-out in inflation now appears smaller, given the narrowing gap between experienced costs and pricing intentions, but the downside risks to global growth also appear to be in retreat at present, compared to even six weeks ago.

The state of the labour market warrants a deeper discussion, given "supporting maximum sustainable employment" is in the remit of the monetary policy committee. A 'dovish' take would focus on the fall in employment and soft wage growth. A 'hawkish' read would centre on the low unemployment rate and business surveys that continue to indicate shortages in skilled and unskilled labour (ie pipeline wage inflation). There was something for everyone, in short, but looking through the noise, the claim that employment remains around maximum sustainable levels continues to be valid, for now.

In our view, the Monetary Policy Committee will be convinced by August that an OCR cut is necessary to be able to credibly forecast inflation sustainably returning to the midpoint of the target band over the medium term. So why not just get on with it now? With things muddling along well enough, global risks diminishing, and the next print of CPI inflation likely to lift to sit tantalisingly close to target, the cost of waiting for a bit more certainty appears small. It would be entirely defensible to wait for a bit more evidence that the waning in capacity pressures is outweighing cost-push factors. We believe this evidence will be incontrovertible by August. For now, a clear signal that the RBNZ meant what it said in March about the next move in the OCR more likely being downward should be enough to hold onto the bulk of the easing in monetary conditions the dovish tilt in March delivered. The Governor did not promise to cut the OCR at the first available opportunity. He just called it like he saw it. He'll continue to do so.

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