ANZ Research

RBNZ MPS Preview

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Take two

- Next Wednesday we expect the RBNZ to cut the OCR 25bps to 1.25% and leave the door open to more.
- The RBNZ said in June that a lower OCR "was likely to be necessary" and that risks were "tilted to the downside". Data since then has confirmed this.
- We are forecasting a further OCR cut in November, with the risks rapidly tilting towards another next year should the economy fail to recover its mojo.

Key points

We expect the RBNZ will cut the Official Cash Rate 25bps to 1.25% at its Official Cash Rate Review next Wednesday at 2pm. We expect the projections will leave the door open to another cut, which we anticipate will be delivered in November.

Since the June OCR Review:

- Signals for Q2 GDP growth are weak – we have pencilled in just 0.4% quarterly growth, versus the RBNZ's May forecast of 0.7%. We suspect the RBNZ will also trim their optimistic forecasts of a sharp bounce-back in the second half of the year, given the state of business sentiment.
- House prices are now falling at the national level on a quarterly basis – we expect a lower forecast for house price inflation and hence consumption.
- Log prices have crashed; dairy prices have dipped; oil prices are a little lower.
- The TWI has been up and down but has remained supported despite the weaker domestic growth outlook and softer commodity prices. Although the exchange rate is a contrary beast that can turn on a dime, that matters, particularly since it reflects lower interest rates abroad rather than good dataflow for the New Zealand economy.
- At some point the RBNZ is likely to assume the neutral OCR has fallen, but it is difficult to know when this may affect the forecasts.
- The small positives (a bit more fiscal spending, possibly a slightly more positive output gap starting point) were largely discounted at the OCR Review, so we assume this will remain the case.
- Although the labour market remains tight, forward indicators for employment (eg employment intentions, job ads) have dropped markedly.

Still to come:

- The Federal Reserve is expected to cut the fed funds rate on 31 July but the exchange rate impact will depend on the words around it.
- The labour market data suite is due on 6 August – likely too late to affect the published forecasts, but not the decision. The RBNZ expect a tick up in the unemployment rate to 4.3%, but we think it could go further – we're pencilling in a rise to 4.4% in Q2.
- Inflation expectations data is due on 6 August as well. This data isn't closely watched, but as we noted in a recent Weekly Focus, the RBNZ will have very little tolerance for a slip in these measures.

We expect the RBNZ to revise down its interest rate forecasts, implying at least even odds of another cut to come, in line with our forecasts. Rather than fully 'committing' to another cut, given the very real uncertainties about the path of the economy from here, choosing rather to "use their words" and talk about downside risks.

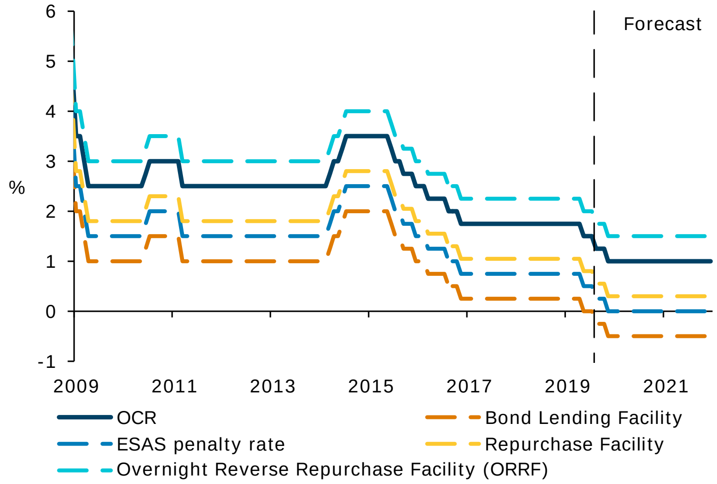
We are forecasting that the economy will find a floor shortly before starting a gradual recovery, partly because of the extra monetary stimulus we expect the Reserve Bank to delivering. However, evidence for this bottoming (eg in the Truckometer Light Traffic Index) remains highly tentative, and measures of business sentiment and intentions suggest significant downside risk. In particular, the tight labour market that has been supporting household spending is coming under threat, with employment intentions in our most recent ANZ Business Outlook survey falling from 0 to a net 6% of firms expecting to cut jobs, and plummeting for the construction sector (-33%), which matters because this sector is supposedly going to be a key growth driver over the year ahead. And broader economy-wide growth signals continue to weaken, with several at their lowest levels in a decade.

The struts under the New Zealand economic expansion are being kicked out one by one. Monetary policy can do its (small remaining) bit, but not without incurring financial stability risks that macroprudential policy would need to counter, dampening its impact, given already record-high household debt levels and elevated prices for houses and other assets.

Fiscal policy is going to have to step up to do the heavy lifting, preferably with a well-directed infrastructure spend. The Government has huge amounts of untapped borrowing capacity at record-low interest rates and there is certainly no shortage of worthwhile projects to undertake, given the enormous population growth experienced in recent years. And the way things are headed, it appears there will soon be some spare capacity to deliver it. Given the long lags involved with infrastructure spending, it's time to get cracking.

Finally, on a technical note, the fall in the OCR to 1.25% will see the first of the RBNZ's standing facilities, the bond lending facility, drop into negative rate territory (figure 1). This facility is little used, so an adjustment is not urgent, but we may see some words around this. For details on the implications of an ever-lower OCR on monetary policy implementation and prospects for unconventional monetary policy in New Zealand, see our recent paper.

Figure 1. Official Cash Rate and RBNZ standing facility rates



Source: RBNZ, ANZ Research

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