RBNZ MPS Preview

5 November 2019

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- We expect the RBNZ will cut the OCR to 0.75% next Wednesday, and leave the door ajar to further cuts while stopping short of overtly signalling them.
- A downgrade to the RBNZ's near-term growth forecasts will be the catalyst, despite offsetting developments.
- We continue to forecast two more 25bp cuts to follow (in February and May), with the final cut being a placeholder for acknowledging the tightening of monetary conditions associated with requiring banks to hold more capital.

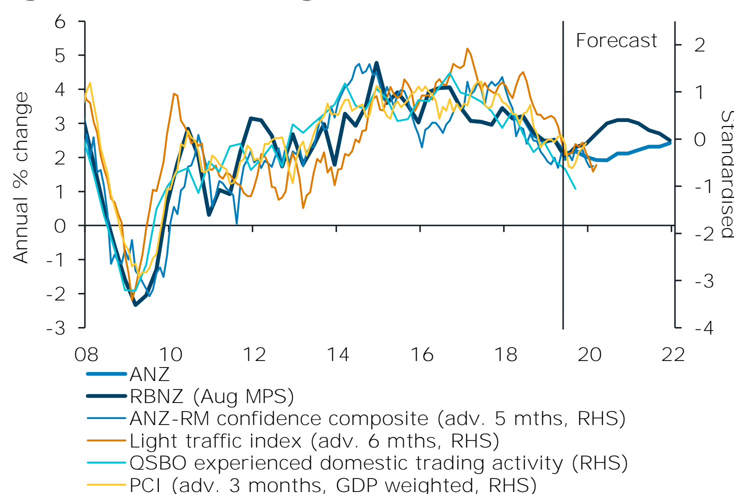
Key points

We expect the RBNZ will, after weighing it up, cut the OCR 25bp to 0.75% at its Monetary Policy Statement next Wednesday at 2pm. With the currency in mind the RBNZ will not close the door on further cuts, but it is likely to stress that it will assess how earlier stimulus is transmitting though the broader economy before moving again.

Since the 25 September OCR Review:

- **Activity indicators** (figure 1) suggest that the RBNZ's August growth forecast is going to be downgraded. We suspect the RBNZ will maintain an optimistic outlook for business investment further out, but the near-term outlook clearly needs a prune. It's worth bearing in mind that the RBNZ still requires the economy to run relatively hot to get inflation up sustainably to the midpoint of the inflation target. That's a much higher bar than, say, just dodging recession.

Figure 1. Near-term GDP growth indicators



Source: Statistics NZ, NZTA, NZIER, BNZ-BusinessNZ, Roy-Morgan, RBNZ, ANZ Research

- The **global data-flow** has generally deteriorated further, with only the US fighting the tide. While market sentiment has recently lifted significantly on reduced geopolitical uncertainty, the global growth outlook has worsened. The IMF recently took a knife to their forecasts and now anticipates that global growth in 2019 will be the weakest since the Global Financial Crisis. A global growth downgrade would, all else equal, see the RBNZ revise down their outlook for commodity prices, export volumes, and/or tradable inflation.

- **Inflation expectations** remain under the 2% CPI target midpoint, though we will not receive the RBNZ's preferred measure until the day before the MPS. The RBNZ will have it around a week earlier. Based on the ANZ Business Outlook inflation expectations measure we anticipate a mild fall.
- We expect only 0.1% **employment growth** in Q3, with the unemployment rate rising to 4.2%. That's still a 'tight' labour market, but it shouldn't be forgotten that the RBNZ now has an employment mandate as well. That said, the RBNZ were forecasting an unemployment rate of 4.4% in Q3 in the August MPS, so a lift from Q3's 3.9% won't be new news.
- In the **RBNZ credit conditions survey** last week banks reported that they are tightening credit availability for the corporate, agricultural and commercial property sector due to regulation, balance sheet constraints and risk perceptions and tolerance (figures 2 and 3). This data may not enter the RBNZ's models, but it certainly deserves a place in their deliberations.

Figure 2. RBNZ credit conditions survey: observed change in credit availability last 6 months

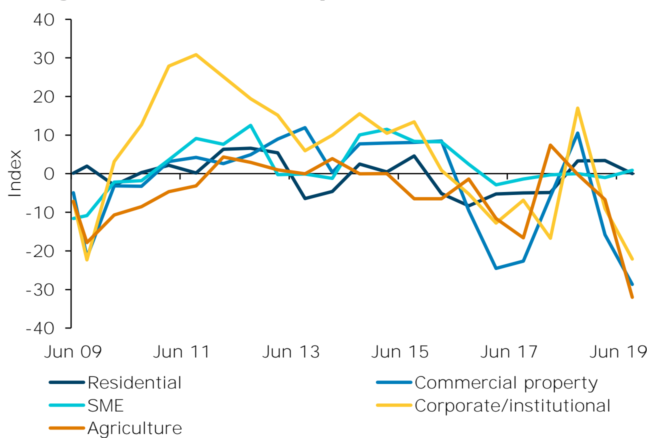
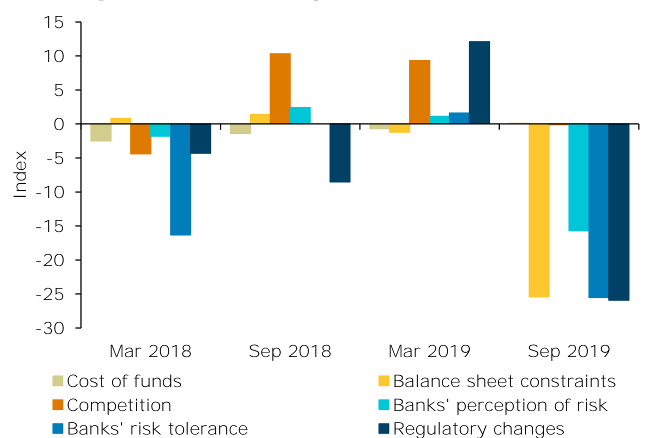


Figure 3. RBNZ credit conditions survey: factors affecting credit availability



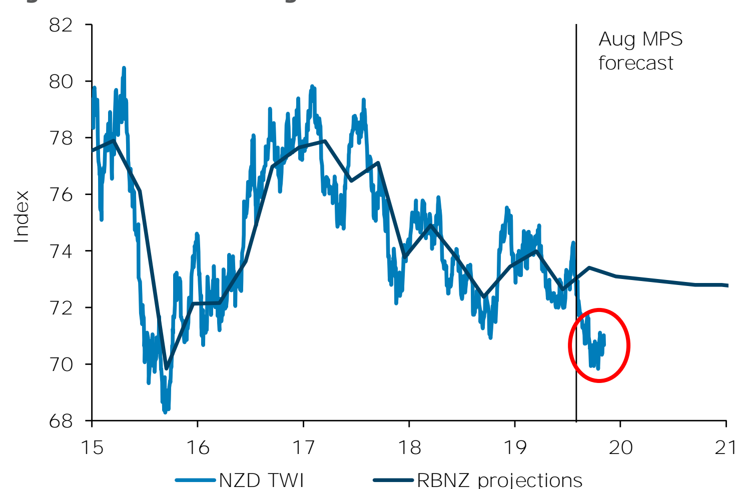
Source: RBNZ, ANZ Research

It hasn't been one-way traffic though, and there are good reasons why the market in the last month has backed off considering a cut to be a slam-dunk.

- The **NZD TWI** is tracking 3.5% lower than the RBNZ expected at the August MPS (figure 4). However, the NZD is lower partly due to the RBNZ's actual and expected proactive rate cutting, so the RBNZ should discount this a little to avoid double-counting.
- **Q3 CPI inflation** was a bit stronger than the RBNZ expected, but the non-tradable surprises were all in regulated prices. Still, it helps, as higher headline inflation reduces downside risk for inflation expectations.
- The **housing market is showing signs of life** as lower mortgage rates and aggressive competition work their magic. A wide range of outcomes for the housing market is plausible from here as lower interest rates go head to head with tax and other policy changes – and uncertain net migration to boot. It's hard to know what the RBNZ will predict. It has the opportunity to coordinate the OCR and LVR decisions this month, with a bit of give and take.

Other factors have been tracking largely as the RBNZ expected since the September OCR Review. Commodity prices have continued to hold up as supply constraints outweigh slowing growth in China.

Figure 4. NZD trade weighted index



Source: Bloomberg, RBNZ, ANZ Research

The New Zealand economy is experiencing slipping growth, not a sudden tilt into recession. Nonetheless GDP growth has halved, from 4.1% in 2016 to 2.1% at the last read (Q2). It is difficult to know what to make of such a slow slide – is it weakening demand, business pessimism about the global outlook or policy changes, constrained resources (particularly labour), or something else? The causes really matter, in terms of the appropriate monetary and fiscal policy response.

But while the outlook is uncertain, looking ahead, we predict that the OCR has not seen its lows. The global outlook remains shaky, businesses are wary, and changing bank capital requirements will tighten financial conditions, requiring a lower OCR to offset. We won't know the details of the latter until early December, but it will presumably enter the RBNZ forecasts at the February MPS. We have put in a 25bp cut in May as a placeholder for now. This would take the OCR to 0.25% – around where we consider its useful limit to be. Any further downside surprises will therefore up the ante on both fiscal policy and unconventional monetary policy options.

We expect that the RBNZ will leave the door ajar to an OCR below 0.75%, with the forecast rate track bottoming out slightly below that. The RBNZ will likely prefer to avoid a clear "one and done" rate-cut scenario, as this would risk prompting an unhelpfully hawkish market reaction and a tightening in financial conditions. That said, with market pricing having come back considerably recently, the RBNZ may now be less concerned about this possibility.

The likely market response in both rates and FX will be a part of the RBNZ's 'regrets' analysis, which has featured prominently in the rate cut decisions and discussions of late. 'If you don't have much ammo, come out firing' has been the approach thus far, and we are assuming they'll stick to the general principle of it being better to risk overdoing it than miss the boat. It's a long time until the next rate-cut opportunity in February.

The current positive vibe in global markets is yet to prove its sustainability. If it persists and transmits to a better mood here in New Zealand, the OCR's march to the bottom may take a little longer than we are currently forecasting, as this would grant the RBNZ time to pause and assess the impact of their actions so far. But with the data out of our biggest export partners China and Australia continuing to disappoint significantly, and credit conditions for much of the economy tightening and set to continue to do so, a rock-bottom OCR is surely just a matter of time.

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