ANZ Research

RBNZ MPS Preview

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Watch, wait – and worry

- We expect the RBNZ will leave the OCR unchanged at 1% next Wednesday, indicating that they expect to sit on the side-lines for the time being, but that they are watching emerging global risks closely.
- They will acknowledge the human impact of the tragic new coronavirus, with cautious language about possible risks to the economic outlook. Domestic conditions give the RBNZ scope to wait and see how developments unfold.
- We expect the OCR track will be broadly unchanged, despite a stronger domestic backdrop. The economic impacts associated with the outbreak are highly uncertain and are likely to sit largely in the 'risks' basket for now. But a short-term negative impact on GDP growth, commodity prices and global wholesale interest rates may feature in the central forecast. Exactly how they incorporate it won't matter too much – any forecast will be out of date in a week.

Key points

It is universally expected that the RBNZ will leave the OCR on hold at 1% at its Monetary Policy Statement next Wednesday at 2pm.

There are clear signs that the housing market is responding vigorously to previous cuts, fiscal policy is set to underpin the medium-term outlook, and core inflation pressures are rising. Inflation and the labour market are both in a good position. So the Reserve Bank will be comfortable going back to its familiar "wait and see" mode.

But risks associated with the new coronavirus will be weighing on the RBNZ's thinking and feature heavily in their discussion, if not the central forecasts. It is far too early to assess the impacts of the outbreak and associated disruption. So for the most part, we expect developments to sit predominantly in the "risk" basket, with strong emphasis on the enormous uncertainty at present. Only modest impacts are likely to feature in the central projections; a near-term dent to GDP (largely via goods and services exports) and the recent decline in dairy prices may feature as specific changes, along with lower global wholesale interest rates.

We expect some rather cautious wording in the MPS about emerging risks, potentially with a discussion of possible channels, notwithstanding considerable uncertainty. Overall, we expect the OCR track will be broadly unchanged, but with some signalling that the OCR could go lower if required. The market isn't likely to put too much weight on the exact forecasts, and rightly so. With things moving fast, any economic forecast is likely to be out of date fast.

Looking in the rear-view mirror, since the November MPS:

- GDP came in at 0.7% q/q, much stronger than the RBNZ's forecast of 0.3%, but offsetting this, **we now know the loss of growth momentum over 2019 was much sharper**. What this means for the RBNZ's assessment of capacity pressures – and how much growth needs to be achieved to deliver its targets – is difficult to predict. In its November forecasts the RBNZ significantly reduced its estimate of the economy's speed limit. Consistent with this, this month Statistics NZ significantly revised down its estimate of net migration over 2019 (as we and the RBNZ had expected they would).
- Based on the slowing in growth last year and the range of data we look at, **capacity pressures have eased a little**. We estimate that the output gap is slightly negative. But the labour market is strong; **the economy is close to maximum sustainable employment**, with the unemployment rate at 4.0% in Q4, better than expected by both us and the RBNZ (4.2%).

- Looking forward, **near-term activity indicators have lifted.** These are based on business and consumer surveys along with traffic data, and suggest that GDP has found a tentative floor. Headwinds are still relevant, including credit constraints, uncertainty, and high household debt. But tailwinds of low interest rates and broadly lower NZD have gained the upper hand – for now.
- **House price inflation has been stronger than expected.** We expect house price inflation will peak at 8% y/y versus an RBNZ forecast peak of 5.7%. This will support both consumption and residential investment.
- **Fiscal spending is also expected to provide further support.** The Government announced an additional $12bn in infrastructure spending in December. This isn't expected to have a meaningful impact on GDP any time soon, but will shore up the pipeline of work and provide more certainty. The Government also declared 'mission accomplished' on its 20% of GDP point target for net debt. The new 15-25% target leaves the door open for additional spending announcements as we head towards the election.
- **Inflation is in a comfortable spot.** Q4 CPI inflation was 1.9% y/y, close to target and stronger than the RBNZ's forecast of 1.6%. To be fair, much of the headline surprise was due to the volatile tradable component, but core inflation measures suggest that broader pressures are emerging, even outside of housing, at the strongest rate in many years.
- **The global data-flow has been mixed.** Up until recently, the global outlook, while still being revised down, had been showing signs of bottoming out. **But risks associated with the new coronavirus in China are increasing.** The human toll is tragically rising, and the economic impact of the outbreak and associated disruption is looking more significant by the day – particularly for China, but also for many other countries. The impacts are highly uncertain, however.
- **For New Zealand, a near-term impact on GDP is likely**, given disruption to our goods exports and reduced demand for tourism and education, especially in light of travel restrictions. But beyond that, it is far too early to know what the impact may be. The channels are numerous and complex (see our ANZ Weekly Focus). If the virus is contained rapidly, a bounce back might be expected. But **the risk of a larger and more prolonged impact cannot be ruled out.**
- Up until recently, New Zealand's commodity prices have been resilient, due to constrained supply rather than unusually strong demand. However, **commodity prices have started to fall, reflecting disruption from the coronavirus**. Dairy prices fell 4.7% in the latest GDT auction overnight. Anecdotally, other commodity prices are under pressure for the same reason.
- The NZD TWI rose late last year, but has been falling on coronavirus concerns and at 71.8 is sitting just above the RBNZ's November MPS forecast (71.4). Should developments associated with coronavirus worsen, **the NZD could be an important shock absorber to emerging global risks.**

All up, **domestic developments would point to an upgrade to the RBNZ's growth forecasts**. But this is likely to be tempered somewhat by a near-term dent in exports and a more conservative outlook for commodity prices. It is far too soon to gauge the impact, however, and it is unknown how much the RBNZ will build into their central forecasts. We expect that the OCR track will be broadly unchanged, but that the RBNZ will signal a willingness to provide more stimulus if required.

The domestic outlook is more positive, and this is supportive of a gradual improvement in growth and inflation remaining near target. But we have long said that in a small open economy, global developments have the potential to change the landscape significantly. The new coronavirus will hopefully be contained promptly, but the disruption effects on China's consumers, as well as its ports and other places of business, could have a significant impact on the New Zealand economy over coming months. The longevity and economic impact of SARS, while serious, turned out to be less than feared. Here's hoping that will prove to be the case this time.

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