ANZ Research

RBNZ MPR Preview

8 April 2021

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Let the dust settle

Key points

The Reserve Bank has its next opportunity to comment on the state of the world on Wednesday next week, at its OCR Review. There will be no supporting forecasts nor press conference.

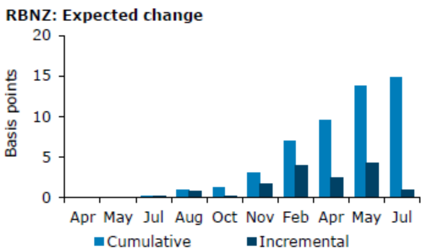
- We expect the RBNZ to leave the OCR at 0.25% and do not expect any changes to the overall size, duration and general terms of the FLP and LSAP programmes.
- The RBNZ is likely to play with a straight bat, reiterating its "wait and see" and "least regrets" approaches to policy.
- The data-flow is starting to soften, but this is consistent with the RBNZ's (and our) forecasts that harder yards lie ahead for the economy.
- Housing tax policy changes represent a new downside risk, but there are upside risks for both activity and inflation as well, including the trans-Tasman travel bubble.

Straight bat

We expect the RBNZ will want to play this one with a pretty straight bat, keeping the OCR at 0.25% and leaving the general terms of the FLP and LSAP programmes unchanged. There's no reason for the RBNZ to deviate from its "wait and see" nor its "least regrets" strategies, or to set out to influence market pricing for OCR hikes, which is pretty mild (figure 1).

Figure 1. What's priced in

New Zealand	Rate	*Change from current*
Current Rate¶	*0.25*	
Wed 14 Apr 21	0.25	*0.00*
Wed 26 May 21	0.25	*0.00*
Wed 14 Jul 21	0.25	*0.00*
Wed 18 Aug 21	0.26	*0.01*
Wed 6 Oct 21	0.26	*0.01*
Wed 24 Nov 21	0.28	*0.03*
Wed 23 Feb 22	0.32	*0.07*
Wed 13 Apr 22	0.35	*0.10*
Wed 25 May 22	0.39	*0.14*
Wed 13 Jul 22	0.40	*0.15*



¶ *OCR announced after RBNZ meeting at 2pm Wednesday, takes effect from Thursday*

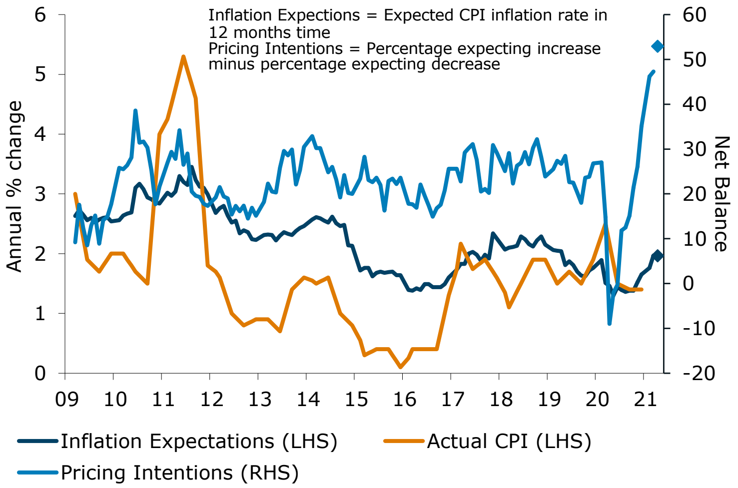
Source: Bloomberg, ANZ Research

The data-flow is softening (unsurprisingly)

Economic data has started to soften in recent weeks, such as the gentle rolling over in business sentiment, consumer confidence, retail sales, and a drop in February building consents. The biggest disappointment was GDP falling 1.0% q/q in Q4, versus RBNZ expectations of 0.0%. But coming off such a huge Q3 bounce, this miss is of less import than normal, and the 'news' value of the general data-flow for the RBNZ is limited, given that its forecasts, like ours, have already built in a softening as unsustainable spending overshoots fade, fiscal stimulus wanes, and the pain from the closed border mounts.

On the other hand, though, pricing pressures have continued to build both here and overseas. And, inflation expectations in the ANZ Business Outlook have rebounded to 2.0%, from a low of 1.3% in May 2020 (figure 2). Pricing intentions are at a record high, in data that goes back to 1992.

Figure 2. Inflation indicators out of the ANZ Business Outlook survey



Source: ANZ Research

We expect the RBNZ to look through these pricing pressures, chalking them up to temporary supply disruptions, the closed border clogging up the labour market, and rebounding global activity boosting import prices. Their focus will rather be on the emerging weakness in activity indicators – on the basis of which we expect a bit of copy-paste from February in the Review Policy Assessment in that "the economic outlook ahead remains highly uncertain"; and that it remains "prepared to provide additional monetary stimulus if necessary."

Upside and downside risks remain

Risks from recent policy announcements point in both directions:

- The removal of interest deductibility for property investors will certainly take some heat out of the housing market, but the impact could be greater or lesser than whatever guesstimate the RBNZ has landed on. The housing market is an important driver of economic momentum currently, so housing developments have a significant bearing on the OCR outlook.
- The confirmed date for the trans-Tasman travel bubble will immensely improve the outlook for the tourism sector, though its effect on measured GDP is more nuanced, as we intend to discuss in an upcoming Insight.

For both of these policy announcements, it's too early to know with any certainty how their effects will flow through the economy. But the RBNZ is in the fortunate position of not having to make any bold calls immediately.

As well as the start of the comeback for international tourism there are other upside risks to growth – the US economy is picking up steam rapidly, supporting global demand and commodities, including, via its impact on China, prices for New Zealand's key exports. Higher export incomes are a boon for local businesses, but increased shipping costs will also be clipping the ticket (if you can even find a ship), so some caution is warranted.

Other downside risks remain. Until the New Zealand population reaches herd immunity, the risk of heading back into lockdown still looms over 2021. And the construction sector is facing enormous strains, as discussed in our Data Wrap last week. The RBNZ will be hoping that a revitalised tourism sector will be able to step up and take some of the growth load, but they will take nothing for granted under their "least regrets" approach.

And as mentioned earlier, upside inflation risks have also been building, with cost and pricing indicators in the ANZ Business Outlook survey extremely strong. The RBNZ will be keen to look through these cost-driven price increases, as they aren't growth-friendly and should prove temporary. But insofar as they put a floor under inflation expectations, they do shore up the medium-term inflation outlook and raise the possibility that the RBNZ may not in fact have all the time in the world before needing to start reducing its stimulus. On the other hand, if the housing policy changes do succeed in taking heat out of the housing market, it would be politically much easier to cut the OCR should downside risks (in housing or elsewhere) come to fruition.

It's far from clear which of these many risks will materialise. But for now, the RBNZ is under no pressure to make any early judgements about how all these moving parts will fall into place. The economy is in much better shape than anyone thought it would be a year ago; the exchange rate is well off its highs; and though long-term yields are higher, this reflects better global growth prospects, rather than an unwarranted tightening in financial conditions.

Where to from here for the LSAP?

The pace (and duration) of LSAP purchases continues to fall as the pace of issuance has slowed, and this trend is likely to continue. With global yields rising and the worst of the crisis behind us, there is less work for the LSAP to do from a macroeconomic perspective, and we expect it to have less of an influence on bond yields and the slope of the yield curve going forward. That speaks to a further gradual reduction in the pace of purchases, especially if the pace of issuance slows further, which is the risk.

However, exiting QE elegantly isn't easy. Reducing the pace of LSAP purchases too quickly could slow the pace of growth in settlement cash (or possibly even drive it lower), which may in turn tighten bank funding conditions and drive up short-term interest rates, both of which would be unwelcome at this time. This is a complicated issue, and we intend to address it in an upcoming Insight.

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We welcome your questions and feedback. Click here for more information about our team.

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