ANZ Research

Review of the RBNZ Monetary Policy Review

4 October 2023

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A more sustained period of time

- As universally expected, the RBNZ today left the OCR unchanged at 5.5%, with the accompanying commentary a touch less hawkish than we expected and markets feared.
- That said, relative to the August MPS, the signal was on the hawkish side, with the Committee agreeing that interest rates may need to remain at a restrictive level for a more sustained period of time.
- We continue to pencil in a 25bp hike in November, but after today's guidance (high for longer, as opposed to teeing up a November hike) the Q3 CPI release (out 17 October) will be key.

In brief

As anticipated, the RBNZ today left the Official Cash Rate (OCR) unchanged at 5.5%. However, the Committee acknowledged that, on balance, risks are skewed towards rates needing to remain at restrictive levels for longer than previously thought, with the Summary Record of Meeting noting "The Committee agreed that interest rates may need to remain at a restrictive level for a more sustained period of time, to ensure annual consumer price inflation returns to the 1 to 3% target range and to support maximum sustainable employment."

On face value, the above statement acknowledges that while upside domestic CPI inflation pressures may be materialising, the RBNZ's first port of call is to signal 'high for longer', opposed to 'higher for longer'.

Overall, we'd tee up the October Review as having a little more 'wait' than 'worry' to it vs our expectation, but with a reasonable acknowledgement of upside risks to the inflation outlook. And while the door is still open for a hike in November (which was signalled as a possibility in the August MPS projection), the hurdle feels a little more data dependent than previously.

Key quotes:

- **OCR outlook:** "The Committee agreed that interest rates may need to remain at a restrictive level for a more sustained period of time."
- **Labour market:** "While employment is above its maximum sustainable level, recent indicators show that employment intentions are flat and difficulty in finding labour has reduced."
- **Domestic activity:** "There is a near-term risk that activity and inflation do not slow as much as needed. Members agreed that the risks to the outlook remained similar to those discussed in the August MPS."
- **Inflation pressures:** "The recent rise in global oil prices could increase domestic costs over coming months, risking headline inflation being higher than expected."
- **Fiscal:** Members discussed the Pre-election Economic and Fiscal Update 2023 (PREFU) and noted that total government spending as a share of potential GDP is still forecast to decline, but by less than previously expected."

- **Housing market:** "Members also noted that house prices were slightly higher, but that this was on low sales volumes. House prices remain around estimates of sustainable levels."
- **Global outlook:** "Over the medium term, the Committee agreed downside risks around the outlook for global growth remain."

Our take

Today's decision to leave the OCR unchanged at 5.5% may not have been as clear cut as the RBNZ Committee was expecting back in August, thanks to the recent run of better domestic data. As we noted in our Preview, indicators for domestic momentum have had a little more shine to them than is consistent with the August MPS outlook. That said, in their words, yesterday's Quarterly Survey of Business Opinion showed "easing capacity pressures". But unfortunately, the turnaround in oil prices adds a new degree of urgency to the need to get core inflation pressures lower, although the RBNZ also acknowledged recent declines in non-oil import prices. The Committee downplayed the impacts of recent strong GDP and consumption data, attributing it in-part to high net immigration and noting that "demand growth continues to ease broadly as expected". However, they will have less scope to look through the possibility of stronger domestic momentum should upside risks to their CPI inflation outlook materialise.

While tighter monetary policy is clearly cooling demand (ask any retailer), offsets from net migration and fiscal policy have been potent. All up, the data is evolving in a manner consistent with our view that 5.5% as a 'first bid' for the peak OCR is a little optimistic in the context of such persistently high core inflation.

Economic resilience is usually a good thing, but in this context it's problematic in that it could force the RBNZ to keep hiking until something breaks; that is, an eventual harder landing for the economy. The fact is, the risk of causing a hard landing should never trump the risk of failing to deliver on the inflation target, as that could result in worse economic outcomes on average over the longer run. Global central banks face the same constraints. We absolutely have sympathy with those who think "surely this can't end well?" It could well be that a hard landing globally ends up solving the inflation problem, as we are only at the beginning of seeing the repercussions of widespread erroneous assumptions that interest rates would stay super-low indefinitely. But not addressing inflation wouldn't ameliorate those risks; it would worsen them.

Our OCR forecast remains unchanged: we expect a 25bp hike in November. The Q3 reads on both the CPI and labour market will be important. Fiscal policy settings after the election may alter the outlook slightly, but we'll just have to wait and see. Come November, the RBNZ won't yet have a full set of updated forecasts from the Treasury, but the Treasury Observer on the Monetary Policy Committee will at least provide a high-level vibe.

All told, today's Review does little to change where we see the balance of risks around monetary policy settings. And it's important to note that if the wheels don't fall off the global economy and the domestic data does warrant a top-up hike in November as we expect, chances are the RBNZ will follow that up with another hike. But for now, we'll just have to wait and see how the data evolve. Next stop: Q3 CPI, out 17 October.

Market reaction

Short term interest rates and NZD reacted negatively, perceiving the statement as dovish on account of the lack of pointed hawkish comments, and in the absence of any comment in the summary record of meeting about the Committee considering a 25bp hike (which we thought was a possibility given recent data). The statement was short and concise and not significantly different from August. Hawkish comments were reasonably guarded, and that was enough to see the 2yr swap rate fall about 4bp, and the Kiwi fall around 40bp. With a hike expected in November, we don’t see significant downside risks for interest rates, especially with global bond yields still rising.

Official Cash Rate remains at 5.50%

The Monetary Policy Committee today agreed to hold the Official Cash Rate (OCR) at 5.50%

Interest rates are constraining economic activity and reducing inflationary pressure as required.

Demand growth in the economy continues to ease. While GDP growth in the June quarter was stronger than anticipated, the growth outlook remains subdued. With monetary conditions remaining restrictive, spending growth is expected to decline further.

Globally, economic growth remains below trend and headline inflation has eased for most of our trading partners. Core inflation has also eased, but to a lesser extent. Weakening global demand is putting downward pressure on New Zealand export volumes and prices. Apart from oil, global import prices have eased.

While the imbalance between supply and demand continues to moderate in the New Zealand economy, a prolonged period of subdued activity is required to reduce inflationary pressure.

There is a near-term risk that activity and inflation do not slow as much as needed. Over the medium term, a greater slowdown in global economic demand, particularly in China, could weigh more on commodity prices and New Zealand export revenue.

The Committee agreed that the OCR needs to stay at a restrictive level to ensure that annual consumer price inflation returns to the 1 to 3% target range and to support maximum sustainable employment.

Monetary Policy Committee record of meeting

The Monetary Policy Committee discussed recent developments in the New Zealand economy. The Committee agreed that monetary conditions are restricting spending and reducing inflationary pressure. While supply constraints in the economy continue to ease, inflation remains too high. Spending needs to remain subdued to better match the economy’s ability to supply goods and services, so that consumer price inflation returns to its target range.

Global economic activity remains below trend. While global growth has been resilient in recent months this momentum is beginning to fade. Recent data show continued regional variation, with economic strength in the United States but slow momentum in Europe and historically low growth in China. Easing global demand is placing downward pressure on New Zealand exports, in terms of both volumes and prices. Global oil prices have increased, but other import prices have been slightly lower.

Globally, headline inflation continues to fall but declines in core inflation are more gradual and uneven across economies. In discussing recent central bank policy moves, the Committee noted that policy rates are now expected to remain at restrictive levels for a sustained period of time, in order to bring inflation back to respective central bank policy target levels.

The Committee discussed domestic economic developments. The rebound in June quarter GDP data was larger than anticipated, partly reflecting the effects of population growth from high net immigration and momentum in household spending. However, demand growth in the economy continues to ease broadly as expected. The more recent Performance of Manufacturing and Services Indices (PMI and PSI) and NZIER Quarterly Survey of Business Opinion (QSBO) show easing capacity pressures. The Committee noted that with monetary conditions remaining restrictive, they expect to see further declines in per capita spending and for GDP growth to be subdued.

Financial conditions have continued to tighten with an increase in wholesale and retail lending rates. Members noted that the average mortgage rate on outstanding loans continues to rise, and debt servicing costs as a share of income are still increasing. Members also noted that house prices were slightly higher, but that this was on low sales volumes. House prices remain around estimates of sustainable levels.

Members discussed the Pre-election Economic and Fiscal Update 2023 (PREFU) and noted that total government spending as a share of potential GDP is still forecast to decline, but by less than previously expected. Members noted the material increase in government investment over the medium term, due to infrastructure resilience requirements.

The Committee discussed the balance of risks for inflation, output, and employment. Members agreed that the risks to the outlook remained similar to those discussed in the August MPS.

In the near term, members agreed that the risk of greater resilience in domestic demand remained. Upside surprises to, or greater than expected demand-side stimulus from, migration could sustain growth momentum for longer. More resilience in domestic demand could slow the pace of expected disinflation. An easing in wage inflation could take longer, but members noted the lack of recent wage data. The recent rise in global oil prices could increase domestic costs over coming months, risking headline inflation being higher than expected.

Over the medium term, the Committee agreed downside risks around the outlook for global growth remain. A greater slowdown in global growth could see further falls in the price of non-oil imports. Weaker global demand, particularly from China, would likely weigh further on commodity prices and therefore on export revenues.

The Committee discussed the risks around the lagged effect of previous monetary tightening on households and businesses. Recent data show continuing weak demand for credit other than for business working capital requirements. Members agreed the ongoing slowdown in economic activity is not even across sectors of the economy, due to global factors and the varied impact of high domestic interest rates. In particular, the Committee noted that pockets of stress have emerged for some in the household, commercial property, and agricultural sectors.

The Committee agreed that in the current circumstances, there is no material trade-off between meeting the Committee’s inflation and employment objectives and maintaining stability of the financial system. Members noted that debt levels are high in some parts of the economy and debt servicing costs have increased. While broad indicators of stress have increased, non-performing loans remain at low levels.

In discussing their Remit objectives, the Committee noted inflation is still expected to decline to within the target band by the second half of 2024. While employment is above its maximum sustainable level, recent indicators show that employment intentions are flat and difficulty in finding labour has reduced.

The Monetary Policy Committee discussed the appropriate stance of monetary policy. The Committee agreed that interest rates may need to remain at a restrictive level for a more sustained period of time, to ensure annual consumer price inflation returns to the 1 to 3% target range and to support maximum sustainable employment.

On Wednesday 4 October, the Committee reached a consensus to maintain the Official Cash Rate at 5.50%.

Attendees:

Reserve Bank members of MPC: Adrian Orr, Karen Silk, Christian Hawkesby, Paul Conway

External MPC members: Bob Buckle, Peter Harris, Caroline Saunders

Treasury Observer: Tim Ng

MPC Secretary: Kate Poskitt

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Last updated: 18 April 2023

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