RBNZ Monetary Policy Statement Preview

9 August 2023

Contact
Sharon Zollner or David Croy for more details.

A placeholder MPS

Summary

- We expect the RBNZ will leave the Official Cash Rate (OCR) unchanged at 5.50% at its Monetary Policy Statement (MPS) next Wednesday, with the RBNZ to reiterate their "watch, worry and wait" stance.
- Data since the July nothing-to-see-here Monetary Policy Review has been mixed, with relatively resilient demand but inflation indicators falling according to the script – an attractive mix, but one of questionable sustainability.
- As always, there's a huge amount of wiggle room in terms of how the Committee interprets the implications of the recent data flow. We don't expect a hat-tip to the chance of more hikes in this Statement, but the OCR forecast may show rates remaining at their peak for a little longer.

It's all about the data

To recap, the main data releases between the RBNZ's last published forecasts in May and the 12 July Monetary Policy Review (MPR) showed:

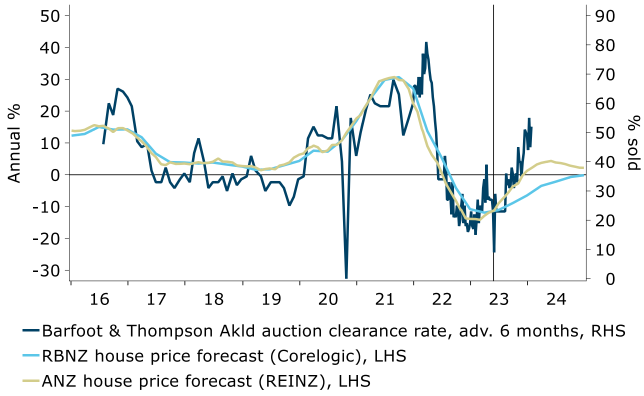
- weaker-than-expected Q1 GDP (-0.1% q/q versus RBNZ forecast of +0.3%), but with cyclone disruption evident;
- rebounding soft momentum data but softening inflation indicators;
- evidence of house prices finding a floor;
- filled jobs rising;
- migration off its highs;
- weakening discretionary and durables spending;
- lower building consents;
- lower dairy prices (but a lower TWI too);
- mortgage rates continuing to edge higher.

So, what's the "new news" since then? To a large extent it's been more of the same, a mixed bag: a degree of resilience in domestic activity but falling export prices, and more positively, inflation indicators obediently falling. We expect the RBNZ will see enough easing in inflation pressures to remain on hold and reiterate similar messages to July. But we see enough resilience to remain comfortable in our view that the next OCR move will be up.

Let's take a closer look at how the data has landed since the MPR on 12 July.

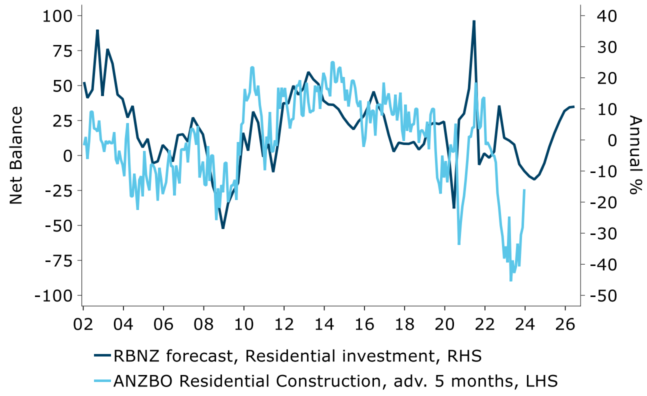
The **housing market** has continued to rebound, with house prices now clearly rising, though we don't expect it to come to much. But the RBNZ is going to have to revise up its forecasts (figure 1, over), and the Committee will have to decide whether to lift its residential investment and consumption forecasts on the back of it. The recovery in construction sector activity expectations in the ANZ Business Outlook survey suggests that residential investment may not decline for as long as the RBNZ is expecting (figure 2, over). Higher consumption and residential investment forecasts could be worth as much as +20bp on the OCR track, but the RBNZ is likely to use judgement to dampen it, given the enormous uncertainty.

Figure 1. House price forecasts and the Barfoot & Thompson auction clearance rate



Source: Corelogic, REINZ, B&T, interest.co.nz, Macrobond, ANZ Research

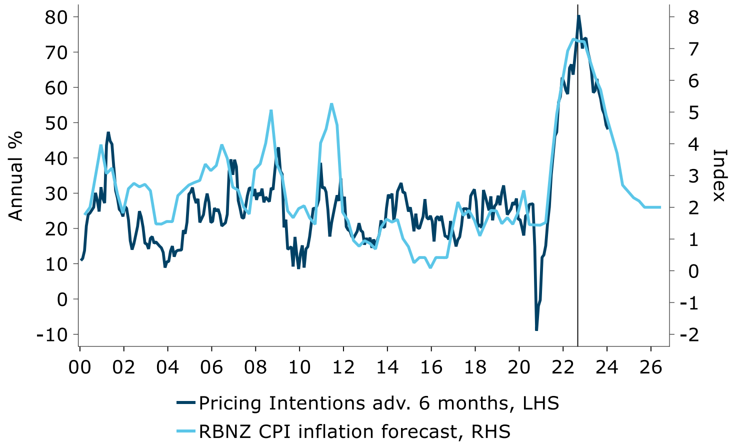
Figure 2. ANZBO residential construction intentions and RBNZ forecast residential investment



Source: RBNZ, Macrobond, ANZ Research

There's been mixed news on **inflation.** While headline Q2 CPI data was in line with RBNZ expectations, non-tradable inflation (6.6%) came in 0.3ppts higher than the RBNZ was anticipating, which all else equal is worth perhaps +15bp on the OCR track. There's no downward trend evident in non-tradable inflation at all as yet, and some measures of core inflation actually rose. More encouragingly, inflation indicators in the ANZ Business Outlook survey have continued to drop away and at this stage are perfectly in line with the RBNZ's May MPS inflation forecast (figure 3).

Figure 3. ANZBO pricing intentions vs. RBNZ May CPI forecast

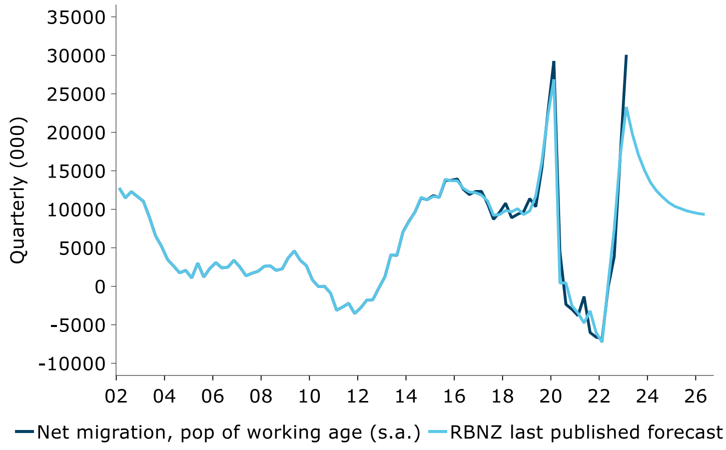


Source: RBNZ, Macrobond, ANZ Research

Labour market. The labour market remained tight in Q2, despite strong labour force growth from both net migration and a pick-up in the labour force participation rate to a fresh record high, but it is loosening, with a lift in both underemployment and unemployment. Supply-side growth has done much of the work for the RBNZ so far in easing labour constraints, but the demand side will need to pick up the baton from here. Wage growth was close to the RBNZ's expectation. Overall, we don't see any strong implications for the OCR track from the labour market data.

Net migration. There's been another small upward starting surprise for the RBNZ on the migration front, but with departures now lifting markedly it's probably neither here nor there. The RBNZ is agnostic on the inflation impacts of net migration in any case.

Figure 4. Net migration of working age vs. RBNZ assumption



Source: Stats NZ, Macrobond, RBNZ, ANZ Research

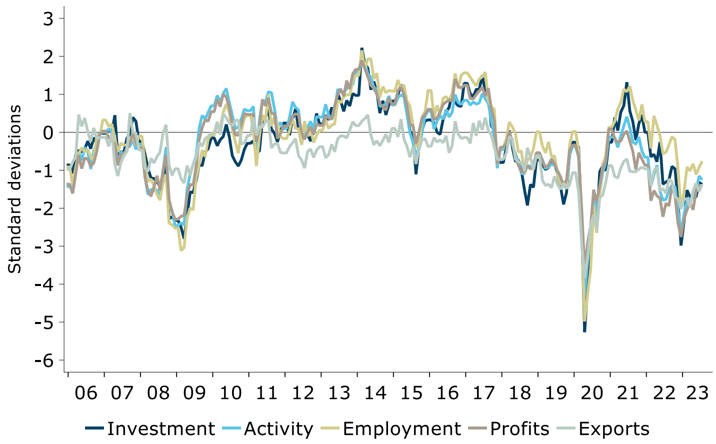
Fiscal policy. The RBNZ will again use the Budget update in its forecasts, so election promises won't contribute to forecast revisions. But we continue to see expansionary fiscal policy as an upside risk to the ultimate OCR peak.

Dairy prices have continued to drop, prompting Fonterra to make a substantial downgrade to their payout guidance for next season. We don't know what the RBNZ was assuming in May, but the resulting weaker terms of trade could be worth as much as 20bp off the OCR track, in and of itself.

In other news since the July MPR:

- Business activity indicators in the ANZ Business Outlook survey continue to lift. They remain under par but are back in pre-COVID ranges (figure 5). Employment intentions are the most robust.

  Figure 5. Standardised ANZBO activity indicators

  Source: Macrobond, ANZ Research

- Consumer spending is weakening, but not falling off a cliff. ECT card spending continues to suggest weakening retail sales volumes per capita. The RBNZ is already forecasting weaker consumption than we are, so the "news" element for them here is limited.
- The NZD trade-weighted index is a little lower than the RBNZ's May assumption of 71.5 – it's perhaps worth +5bp on the OCR track.

- Fixed mortgage rates have risen. RBNZ data shows that average 1yr and 2yr special rate rose 36bps and 24bps respectively between May and July, and they have risen a touch further in recent weeks. This tightening in monetary conditions reduces the amount of work the OCR needs to do by as much as 25bps, all else equal, but we don't know what the RBNZ was expecting fixed mortgage rates to do, and therefore how much of this is 'news'.
- Global inflation pressures are a mixed bag. Shipping and supply chain issues continue to improve, and China's producer price deflation is another tailwind for bringing global goods inflation down. But oil prices are rising once more (up 15.5% since the May MPS forecasts were finalised and 9.5% since the July MPR) and supply disruptions in the global food industry continue (both weather and war). The RBNZ revised down its estimates of imported inflation in May; another such helpful revision looks unlikely. Meanwhile the removal of the subsidies on fuel and public transport will add 0.6% to headline CPI in Q3 (that's not new news).

Likely changes to forecasts

We expect the RBNZ to:

- revise up its forecasts for house prices and non-tradable inflation on the back of the starting point surprises to both, but not make any large changes to the forecast profiles for either;
- revise down export price forecasts, with associated lower incomes also a dampener for consumption, offsetting potential housing impacts;
- potentially re-examine its Labour Cost Index forecasts. They looked oddly high in May and might get a downgrade to be more consistent with the non-tradable inflation outlook, particularly given a small downward starting point surprise;
- upgrade Q2 GDP growth, but that's just payback for the unexpected weakness in Q1. It's timing rather than a momentum story.

In terms of evolving risks, global energy prices, downside risks to China's outlook and New Zealand's terms of trade, potentially stickiness of non-tradable inflation and the impact of migration on housing are all worth a mention.

What about the **OCR track**? As outlined above, if the RBNZ is looking for reasons to publish a higher OCR track than in May, it's not hard to find them. But it's not hard to find reasons to discount them at this stage either, and there are clear offsets. Overall, we doubt the RBNZ will want to send a very different message to that in the July MPR, given the uncertainties and offsets. The May MPS forecasts indicated cuts in the second half of 2024. It's possible these are pushed out slightly further, but we certainly don't expect the RBNZ's forecasts to imply any more hikes from here just yet.

In terms of tone, we expect the RBNZ to balance "resolute" and "confident", leaving all doors open regarding their next move.

Markets

This Statement is unlikely to create too much of a stir. Markets know that the RBNZ is “dug in” for the time being, and a pause is universally expected. We do think it’s possible that the RBNZ tweak its projections and pushes the 5½% peak in their OCR track out a little longer, but if so, that shouldn’t cause too much of a stir either, especially with markets still pricing in the risk of hikes and the OCR expected to remain at or above 5½% till mid-2024.

We do see scope for markets to continue to price out some of the easing that’s priced in over late 2024, especially if US markets move in that direction, but that’s likely to be gradual and next week’s MPS is unlikely to accelerate or decelerate that trend. Unless the RBNZ is hawkish, which seems unlikely this early in the “watch, worry and wait” phase, we don’t envisage an abrupt shift in market pricing – hard data is needed for that.

Contact us

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Sharon Zollner
Chief Economist

Follow Sharon on Twitter
@sharon_zollner

Telephone: +64 9 357 4094
Email: sharon.zollner@anz.com

General enquiries:
research@anz.com

Follow ANZ Research
@ANZ_Research (global)

David Croy
Senior Strategist

Market developments, interest rates, FX, unconventional monetary policy, liaison with market participants.

Telephone: +64 4 576 1022
Email: david.croy@anz.com

Susan Kilsby
Agricultural Economist

Primary industry developments and outlook, structural change and regulation, liaison with industry.

Telephone: +64 21 633 469
Email: susan.kilsby@anz.com

Miles Workman
Senior Economist

Macroeconomic forecast co-ordinator, fiscal policy, economic risk assessment and credit developments.

Telephone: +64 21 661 792
Email: miles.workman@anz.com

Henry Russell
Economist

Macroeconomic forecasting, economic developments, labour market dynamics, inflation and monetary policy.

Telephone: +64 21 629 553
Email: henry.russell@anz.com

Kyle Uerata
Economic Statistician

Economic statistics, ANZ proprietary data (including ANZ Business Outlook), data capability and infrastructure.

Telephone: +64 21 633 894
Email: kyle.uerata@anz.com

Natalie Denne
PA / Desktop Publisher

Business management, general enquiries, mailing lists, publications, chief economist's diary.

Telephone: +64 21 253 6808
Email: natalie.denne@anz.com

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