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REINFORCING NEUTRAL

KEY POINTS

- **We have little doubt the RBNZ will leave the OCR at 1.75% next Thursday**, a view shared by the consensus and market. We also suspect it will be used as another opportunity to reinforce a “very neutral” stance.
- **At its February MPS, the RBNZ was at pains to emphasise a balanced tone.** Every positive comment was heavily caveated, both upside and downside scenarios were presented, and numerous uncertainties with the outlook were stressed. The Governor was even more explicit in a subsequent speech, stating that “there is an equal probability that the next OCR adjustment could be up or down”.
- **We (and the market) disagree with the RBNZ’s assessment of the risk profile.** While we certainly can envisage scenarios in which the OCR is cut again (largely involving global shocks), we see a far higher likelihood that the next move in the OCR is up. The economy is growing above trend, the labour market is tightening, and the domestic inflation cycle has turned. So the market wants to trade one way; markets don’t ‘do’ stability. And although pricing for hikes has been trimmed since the start of the year, a hike is still close to fully priced by February – far earlier than the late-2019 hike implied by the RBNZ’s projections.
- **Has anything changed sufficiently since the MPS for the RBNZ to alter its neutral views? The short answer is “probably not”.** The NZD TWI is now around 3% below its February assumptions, but dairy and oil prices are lower too. Because of the latter, you wouldn’t want to bank on recent oil-induced headline inflation lifts being sustained; they should be looked through (and will be). We do see significant upside risk to the RBNZ’s Q1 CPI forecasts on the back of a food price spike (in fact headline inflation back at 2% is not out of the question), but the Q4 GDP figures undershot its expectations. There have been hits and misses, but both upside and downside ones, which will just reinforce in the RBNZ’s mind that considerable uncertainty remains, leaving it happy sitting on its hands.
- **Pro-cyclical parts of the economy are moderating as credit is tightened and RBNZ LVR restrictions bite.** With core inflation still below target, the RBNZ needs growth above trend; sub 3% growth is undesirable. Pre-emptive tightening nuances would risk exacerbating the moderation already being seen into the undesirable zone and potentially reversing the NZD’s recent fall. **There appears little upside for the RBNZ in shifting its stance now, before another read on inflation.**
- **In the meantime, the RBNZ should be chuffed that banks continue to nudge up borrowing rates**, leaving it flexibility to keep the OCR lower for longer than might otherwise be prudent.
- **The global economy remains a key uncertainty.** Other central banks have turned more positive on the global outlook of late. In contrast Governor Wheeler went into reasonable detail a few weeks ago on the risks he sees to the global economy. Despite an improving pulse in key markets, the risks (both political and economic) are not going away.
- **So we expect a neutral, balanced and cautious assessment, not too dissimilar to February.** The market will continue to view that as more ‘signal over substance’ and a tactical game.

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