TREADING CAREFULLY

- Today the RBNZ left the OCR at 1.75%, as universally expected, and retained its cautiously upbeat stance.
- The OCR is expected to remain low for a considerable period.

KEY POINTS

- At today’s OCR announcement the RBNZ left the OCR at 1.75%, and retained a cautiously upbeat stance. In Grant Spencer’s last OCR announcement as Acting Governor, the RBNZ kept the message clear and consistent.

- The RBNZ remains positive on the growth outlook. Growth is “expected to strengthen, supported by accommodative monetary policy, a high terms of trade, government spending and population growth”. House price inflation is “moderate” and the labour market is expected to tighten.

- Downside risks were broadly downplayed: “the outlook for global growth continues to gradually improve” and “equity markets have been strong” albeit more volatile. The downside Q4 GDP surprise was “mainly due to weather effects”. Looking at financial conditions, the NZD remains high and some modest tightening has been seen in funding markets. But the RBNZ did not comment on either of these factors.

- With inflation “forecast to trend upwards” over the medium term (looking through an expected near-term weakening) the RBNZ is treading water with regards to monetary policy. The February MPS forecasts showed the RBNZ is not expecting to tighten monetary policy until the second half of 2019 and we agree with that assessment.

- But as always, the RBNZ retained a data-dependent stance, as “numerous uncertainties remain and policy may need to adjust accordingly”. The RBNZ’s next move is expected to be a hike, but the RBNZ is being careful to not give that signal prematurely, given the market’s tendency to pre-empt. The February MPS made it clear that the Bank sees risks on both sides. We expect this broad spirit of cautiousness (particularly with regard to the inflation outlook) to continue for some time yet.

- With interest rates on hold this year, OCR decisions have taken a bit of a backseat insofar as the market is concerned. Global financial and political developments, fiscal policy and potential changes to the Policy Targets Agreement and RBNZ governance are instead at the fore. We anticipate the new PTA will be announced sometime over the next few days. If it is as we expect (with the addition of a “full employment” target in some form, and only minor tweaks as regards more flexible use of the inflation target band), the implications for the monetary policy outlook will be limited.

- There will be considerably more interest in the May MPS – the first under the reins of new Governor, Adrian Orr. Barring any significant changes to the dataflow we don’t expect any major changes in the RBNZ’s views, at least until he gets his feet well under his desk.

- There was no discernible market reaction to the release.
The Reserve Bank today left the Official Cash Rate (OCR) unchanged at 1.75 percent.

The outlook for global growth continues to **gradually** improve. While global inflation remains subdued, there are some signs of emerging pressures. Commodity prices have continued to increase and agricultural prices are picking up. Equity markets have been strong, although volatility has increased. Monetary policy remains easy in the advanced economies but is gradually becoming less stimulatory.

Global economic growth continues to improve. While global inflation remains subdued, there are some signs of emerging pressures. Commodity prices have increased, although agricultural prices are relatively soft. **International bond yields have increased since November but remain relatively low.** Equity markets have been strong, although volatility has increased recently. Monetary policy remains easy in the advanced economies but is gradually becoming less stimulatory.

The exchange rate has firmed since the November Statement, due in large part to a weak US dollar. We assume the trade weighted exchange rate will ease over the projection period.

GDP growth eased over the second half of 2017 but is expected to strengthen, driven by accommodative monetary policy, a high terms of trade, government spending and population growth. Labour market conditions continue to tighten. Compared to the November Statement, the growth profile is weaker in the near term but stronger in the medium term.

The Bank has revised its November estimates of the impact of government policies on economic activity based on Treasury’s HYEFU. The net impact of these policies has been revised down in the near term. The Kiwibuild programme contributes to residential investment growth from 2019.

House price inflation has increased somewhat over the past few months but housing credit growth continues to moderate.

Annual CPI inflation in December was lower than expected at 1.6 percent, due to weakness in manufactured goods prices. While oil and food prices have recently increased, traded goods inflation is projected to remain subdued through the forecast period. Non-tradable inflation is moderate but expected to increase in line with increasing capacity pressures. Overall, CPI inflation is forecast to trend upwards towards the midpoint of the target range. Longer-term inflation expectations are well anchored at 2 percent.

Monetary policy will remain accommodative for a considerable period. Numerous uncertainties remain and policy may need to adjust accordingly.
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