

NEW ZEALAND ECONOMICS OCR FORECAST CHANGE

13 May 2016

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A HIGHER HURDLE

KEY POINTS

- **We now expect the RBNZ to maintain the OCR at 2.25% in June.**
- **We have felt for some time that a June cut was a line-ball call. Recent developments have, in our view, tipped the balance:**
 - The economy is showing very **few signs of rolling over** despite dairy strains and the tightening in financial conditions. Activity indicators remain solid. Business and consumer sentiment are at decent levels.
 - There has been a **clear improvement in the global scene** (in financial markets at least, if not growth). We doubt it will last, to be honest, but central banks need to go with what they know when rates are at extremes. Rising oil prices are a key influence on the profile of near-term inflation and negate the deflationary impact of a higher NZD.
 - The **housing market is accelerating**, and strength is broad-based (outside of Christchurch). Auckland prices have quickly retraced earlier falls. This is occurring at a time of elevated – and rising – debt levels. The RBNZ has an inflation target and not a house price one. But the two overlap, and **it would seem self-defeating to pour more interest rate fuel on the fire** at the same time as noting increased housing concerns and warning of macro-prudential measures to come.
 - **Core inflation appears to be rising**, and capacity constraints are intensifying, particularly in the construction sector. The latest labour market figures showed tentative signs of a lift in wage growth.
 - **Inflation expectations have stabilised.** Market break-evens have increased and recent petrol price increases should see some surveyed measures lift off lows. The upcoming RBNZ 2-year ahead measure is likely to be key; we expect a small lift.
 - The Government has signalled **a more expansionary fiscal stance in the near term**, supporting activity. That said, a greater focus on debt repayment in the medium term argues for rates low for longer.
 - There are tactical reasons for pausing in June with CPI and GDP data around the corner. “Baiting” the market by holding but with an easing bias is not without (currency) risk. But **cutting but signalling no more to come can be worse**, as the December 2015 experience shows.
- **Further RBNZ easing is still more likely than not, however.** The global situation remains vulnerable and the actions of other central banks are keeping the NZD stronger than “desirable”. In a world where currencies are diverging from fundamentals, interest rates must converge, and this is a force we suspect will drag the RBNZ back to the easing table at some stage. We expect more aggressive competition for deposits over 2H 2016, which will place upward pressure on retail deposit rates.
- **Our forecast change is therefore one of timing.** It is again a close call, but we have pushed our June cut into August (with odds at around 60%). Given global risks we still see the OCR getting to a low of 1.75%, but now not until 2017.

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