

NEW ZEALAND ECONOMICS OCR VIEW CHANGE

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KEY POINTS

- **We now expect the RBNZ to hold fire** and leave the OCR unchanged in August.
- **Obviously this is tempting fate** ahead of a) Q2 CPI figures; b) a strong NZD; and c) global uncertainty. We could get usurped by any of these. **However, equally, we view it as folly to sit on the sidelines** and wait for the data to move and then for us to change our view.
- **We view the forecast change as warranted on a number of levels:**
 1. **The economy clearly does not need more stimuli;** it's growing at an above-trend rate and capacity is being eaten into. Skill shortages are appearing. Outside of dairying, the economy is doing very well. The tenor of data in the lead-up to the August decision (including Q2 labour market figures) is expected to be strong.
 2. **Housing is booming** so much that it is becoming a financial stability threat; **you can't divorce that from monetary policy and throw more fuel on the fire by cutting the OCR.** Macroprudential policy tweaks have been flagged, but not until much later on (the end of the year).
 3. **The housing boom is spilling over into the general economy.** Our Monthly Inflation Gauge is flagging rising pressure from construction costs and key interest rate-sensitive parts of the economy.
 4. **The RBNZ has opposing problems;** the NZD and housing. It has more influence over the latter right now. **It's far from obvious that an OCR cut will lower the NZD in the current environment.**
 5. **Significant inflation flexibility is required** in the current instance. Inflation expectations are low, but have stopped falling. Obviously, a higher NZD will dampen near-term inflation, but **the signs are positive for medium-term inflation trends given economic strength.**
- **Against this backdrop, we have some clear challenges. The global scene is worrisome.** It could turn quickly and we suspect it will. **The NZD will likely remain problematic. Funding costs are likely to put pressure on domestic deposit and mortgage rates** at some stage (arguably the RBNZ would want to see that anyway as a mechanism to slow the housing market a bit).
- **However, these are tomorrow's unknowns. We take a view of course, and the above combination is still expected to see the OCR fall further eventually.** We still expect a further 50bps of OCR cuts, but have simply pushed that down the track into 2017. Interest rate convergence given currency divergence (from fundamentals) remains a key thematic shaping our medium-term views.
- **Monetary policy now sits a long way from neutral.** Each incremental push lower from current levels needs to be weighed carefully. There are only so many bullets in the chamber. **We see little point firing a bullet into the unknown. If unknowns become more known by August then so be it.** But the known at present is that the economy is performing well and there are encouraging signs that this is flowing into inflation. As such, **further easing is not needed right now.**

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