VITAL SIGNS

- The RBNZ will again leave the OCR at 1.75%, and retain a message of caution until inflation shows consistent signs of life.
- In light of the recent lacklustre data pulse, the RBNZ’s prognosis of economic momentum and inflation pressure will be watched with interest.
- Our expectation is that the RBNZ will eventually tighten monetary policy in the second half of 2019, once it is assured that inflation is alive and well.

KEY POINTS

- The RBNZ will leave the OCR at 1.75%, as universally expected, at the June OCR announcement next Thursday. A clear, consistent message will be retained: the RBNZ will remain cautious until inflation shows consistent signs of life.

- Developments since the May MPS have been negative on balance.
  - Businesses are downbeat and this is being reflected in investment and employment intentions. Today’s GDP data confirm that economic momentum is gradually moderating.
  - The housing market is stable, but household sentiment and spending growth have been waning.
  - Inflation pressures are subdued. Our ANZ Monthly Inflation Gauge shows that core domestic inflation is anaemic.
  - While the global picture remains positive, risks have increased (particularly around escalating trade tensions).

- There are reasons to believe some degree of pick-up in inflation is around the corner. Wage inflation is set to increase, partly as a result of policy changes, which will contribute to rising cost pressures faced by firms. At the same time, disinflationary forces that have been holding down inflation (perhaps related to technology and globalisation) are expected to dissipate gradually, global inflation is expected to increase and depreciation in the exchange rate is expected to provide a further boost.

- But economic momentum is gradually softening. Downside risks have increased, and we expect it will be difficult to achieve above-trend rates of growth from here. The economy is arguably close to full employment and we expect it will stay around there, but this has been insufficient so far to generate sustained core inflation pressure. In this environment, we see inflation increasing only very gradually.

- The RBNZ will remain cautious until inflation shows more consistent signs of life. In recent communications the RBNZ has sent a very clear message that it is determined to meet its inflation target, with a move up or down in interest rates equally likely. We expect that cautious message will be retained next Thursday. The RBNZ will maintain its wait-and-see approach, even as inflation rises little by little over the coming year. After two false starts this cycle, it will want to be sure that inflation is broad based and likely to be sustained (with headline inflation close to target) before an interest rate increase will be on the table.

- We expect that the RBNZ will eventually tighten monetary policy in the second half of 2019, once it is confident that inflation is alive and well. This timeline is consistent with the RBNZ’s own projections.
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