RBNZ AUGUST MONETARY POLICY STATEMENT

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GOING NOWHERE FAST

BOTTOM LINE

- The RBNZ held the OCR at 1.75% as expected and reaffirmed that "the direction of our next move could be up or down".
- But in an unambiguously dovish signal, the timing for the first projected OCR hike was pushed out a year versus the May Statement, now implying hikes from around late 2020.
- We continue to expect the OCR to remain on hold for a considerable time.

KEY POINTS

- **The RBNZ held the OCR at 1.75% as universally expected. "We expect to keep the OCR at this level through 2019 and into 2020, longer than we projected in our May Statement."**
- The RBNZ acknowledged the policy trade-off that it faces. Softening activity and rising inflation makes the outlook for policy more complicated at present. But as we foreshadowed, **the RBNZ will "look through" volatility in CPI inflation** and will only respond to "persistent movements in inflation". Stronger core inflation is a "welcome" development.
- The OCR projection implies hikes from around Q3 2019, with the cash rate lifting to 2% by late 2020. In practice, late 2019 or late 2020 are both beyond "the foreseeable future", but **it is a deliberate dovish signal to the market.** However, the RBNZ didn't paint itself into any corners: "The direction of our next OCR move could be up or down."
- The short-term outlook for inflation is marginally lower, driven largely by softer tradables inflation, courtesy of the TWI and petrol. Non-tradables inflation is projected to be marginally stronger in the near term, but weaker from mid-2019. This is related to the fact that **the estimated output gap starting point has been revised lower to around zero**, and in fact is estimated to have turned negative in Q2 and projected to remain so for a year. Headline inflation is now expected to reach 2% in Q1 2021, rather than Q4 2020. But **while the CPI track may be similar, as a result of the lower output gap there's now a decent dent in the lift in the all-important non-tradables measure.** A "welcome" lift in core inflation in Q2 was noted and inflation expectations "remain anchored".
- **The near-term outlook for GDP growth has been revised down** on the back of the Q1 downward surprise, softer business sentiment and weak house price inflation. **However, growth is assumed to "recover to some extent" in the second half of the year**, led by consumption. Over the medium term, growth is expected to be supported by monetary policy, fiscal policy, business investment and net exports. The outlook for business investment is a key part of the story, with firms expected to respond to capacity pressures and higher real labour costs. The RBNZ acknowledges that the fall in business confidence is a key risk to this outlook.
- The RBNZ judges that employment is "roughly around its maximum sustainable level".

RBNZ MPS REVIEW

- **Discussion of the global economy remains positive on balance**, but the Bank acknowledged that downside risks have increased, with further escalation in trade tensions. That said, they also acknowledged that "inflation has increased in many trading partners and wage pressures are emerging". The TWI is assumed to fall over the projection period, contributing to tradables inflation.
- As we expected, the RBNZ's risk scenarios centred on the policy trade-off that it faces. **Downbeat business sentiment and softening in the housing market present a risk to activity** should they flow through into investment and hiring, with the OCR track 100bps lower in this scenario. **On the other hand, if higher prices were to pass through into medium-term inflation expectations, then inflation would be stronger than expected** and the OCR would need to be about 50bps higher. In the press conference the Governor said the risks around the forecasts are "balanced" but it is nonetheless notable that the OCR implications are not.
- **Our take:** As the near-term growth outlook has deteriorated, our own views on the outlook for monetary policy have become a bit more circumspect. The RBNZ has signalled that the OCR will remain unchanged until into 2020, which is later than our current pick of a move in November next year. Given the world is always changing, there is little practical difference between projecting late-2019, late-2020, or a completely flat track; they are all effectively "wait and see" placeholders. But the key information is in the signalling: **the RBNZ has very consciously sent a message that they have become more dovish in the past six weeks.**
- **We are comfortable keeping our call unchanged until we get a clearer picture of the growth outlook. We see downside risk to the RBNZ's expectation of a growth bounce-back this year.** We expect the RBNZ will remain cautious, even as CPI inflation lifts. The reiteration that the next move could be up or down indicates that the Bank is still comfortable with its wait-and-see approach, an approach we concur with at this juncture. But **it's fair to say that downside risks have increased – and if the outlook were to deteriorate significantly, we expect a cut would be firmly on the table. It's all about the growth outlook – CPI lumps and bumps along the way are just a distraction.**
- **Market reaction:** Although the market had geared up for a more dovish statement today, which was duly delivered, **we still saw the NZD weaken and swap yields fall modestly on the decision, with the market no doubt reacting to the lower-for-longer OCR track.** There is potential for those moves to continue in the very near term. However, with bills-OIS unlikely to narrow much more, a further drop in near-term yields from here would require the market to embrace the idea of an OCR cut, and we are not there yet. The NZD is likely to continue to grind lower, although again, at current levels it is far more reliant on the data continuing to undershoot expectations; and those expectations have obviously been lowered recently.

RBNZ MPS REVIEW

RBNZ NEWS RELEASE KEY QUOTES

	NEW: 9 AUGUST MPS	PREVIOUS: 28 JUNE OCR
OCR decision and outlook	The Official Cash Rate (OCR) remains at 1.75 percent. **We expect to keep the OCR at this level through 2019 and into 2020, longer than we projected in our May *Statement*.** The direction of our next OCR move **could be up or down.** We will keep the OCR at an expansionary level for a considerable period to contribute to maximising sustainable employment, and maintaining low and stable inflation.	The Official Cash Rate (OCR) will remain at 1.75 percent for now. However, we are well positioned to manage change in **either direction – up or down** – as necessary. Consumer price inflation remains below the 2 percent mid-point of our target, necessitating continued supportive monetary policy for some time to come. The best contribution we can make to maximising sustainable employment, and maintaining low and stable inflation, is to ensure the OCR is at an expansionary level for a considerable period.
Growth outlook	**While recent economic growth has moderated, we expect it to pick up pace over the rest of this year and be maintained through 2019.** ... capacity and labour constraints promote business investment, supported by low interest rates. Government spending and investment is also set to rise, while residential construction and household spending remain solid.	Our outlook for the New Zealand economy, as detailed in the May Monetary Policy Statement, remains intact. Domestically, ongoing spending and investment, by both households and government, is expected to support growth. However, the recent weaker GDP outturn implies marginally more spare capacity in the economy than we anticipated. The Government's projected spending impulse is also slightly lower and later than anticipated.
Inflation	**There are welcome early signs of core inflation rising.** Inflation will increase towards 2 percent over the projection period as capacity pressures bite. This path may be bumpy however, with one-off price changes from global oil prices, a lower exchange rate, and announced petrol excise tax rises expected. **We will look through this volatility as appropriate, and only respond to any persistent movements in inflation.**	CPI inflation is likely to increase in the near term due to higher fuel prices. Beyond that, inflation is expected to **gradually** rise to our 2 percent annual target, resulting from capacity pressures.
Employment	The labour market has tightened over the past year and employment is roughly around its maximum sustainable level. We expect the unemployment rate to decline modestly from its current level	Employment is around its sustainable level.
Global	Robust global growth and a lower New Zealand dollar exchange rate will support export earnings.	Global economic growth is expected to support demand for our products and services. Global inflationary pressure is also expected to be higher but remain modest. This outlook has been tempered slightly by trade tensions in some major economies. Ongoing volatility in some emerging market economies continues.
Risks	Risks remain to our central forecast. **The recent moderation in growth could last longer.** Low business confidence can affect employment and investment decisions. **Conversely, there is a chance that inflation could increase faster** if cost pressures can pass through into higher prices and impact inflation expectations.	

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