OPENING THE DOOR?

- Today the RBNZ left the OCR at 1.75%, as universally expected, and retained a neutral communication strategy.
- However, the statement was more dovish at the margin. There were also hints that the Bank is showing a greater preparedness to act if conditions sway from its expected path.
- Ultimately, the OCR will remain low for a considerable period.

KEY POINTS

- The RBNZ left the OCR at 1.75%, and reaffirmed its cautious stance. The RBNZ retained its neutral communication strategy, stating that they are "well positioned to manage change in either direction – up or down – as necessary."
- The accompanying statement was more dovish at the margin, with the OCR to remain at 1.75% “for now”, rather than “for some time to come”. The RBNZ has also subtly changed its wording within its forward guidance phrase from "we expect to keep the OCR at this expansionary level for a considerable period of time" to "an expansionary level for a considerable period". We need to be careful not to overplay this, but it does suggest a greater willingness to move the OCR lower if necessary. But the key message is this: interest rates will remain low for some time yet.
- Based on recent developments, we expect to see a flatter path for the OCR at the August MPS. The RBNZ noted that the outlook from the May MPS “remains intact”, but that there was “marginally more spare capacity in the economy” than anticipated given the recent softer GDP outcome, and that the Government’s spending impulse is “slightly lower and later than anticipated”, which will dampen the medium-term outlook. They also noted that the global outlook has been “tempered slightly by trade tensions”.
- They noted that inflation remains low, but that “inflation is expected to gradually rise to our 2 percent annual target, resulting from capacity pressures”. The recent depreciation of the exchange rate will no doubt help bolster the outlook for inflation, but given that this depreciation has coincided with weaker domestic data, we don’t think it will be providing the RBNZ with much comfort. The outlook for inflation is uncertain and we think there are risks on both sides of the ledger.
- Balancing these risks and all else equal, we expect inflation will increase in light of rising cost pressures, but this is likely to occur only very gradually and we expect it will take some time for the RBNZ to be assured that inflation is rising in a consistent and sustained way.
- In this low inflation environment, the RBNZ will “ensure that the OCR is at an expansionary level for a considerable period”. We think the RBNZ will maintain a cautious monetary policy strategy until they see inflation rise in a consistent and sustained way.
- We are picking that the OCR will eventually rise, with a hike for November 2019, but a lot can happen between now and then. We see risks to domestic inflation as skewed to the downside, and we
could equally argue for a flat track. And if conditions deteriorated significantly, a cut could eventuate quite rapidly. It goes without saying of course, but the flow of data over the next few months will be incredibly important. Further deterioration in any forward-looking indicators would no doubt be a worry for the RBNZ.

- Despite today’s dovish statement, the market reaction was modest. The OIS curve has flattened a touch and the swap market rallied slightly. The NZD/USD has popped a touch higher, but we think that reflects short market positioning rather than suggesting the market has interpreted the statement hawkishly.
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