

NEW ZEALAND ECONOMICS RBNZ MPS PREVIEW

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CONTRIBUTORS

Cameron Bagrie
Chief Economist

Telephone: +64 4 802 2212
E-mail: cameron.bagrie@anz.com

Philip Borkin
Senior Economist

Telephone: +64 9 357 4065
E-mail: philip.borkin@anz.com

WALKING THE TALK

KEY POINTS

- **The RBNZ made it clear last month that it will be returning to the easing table, and like the consensus, we expect a 25bp OCR cut to 2.0% this week** – an all-time low. This is fully priced by the market.
- **In fact, the market looks to be placing some odds on a 50bps cut. We struggle to see the rationale for a larger move when the economy is performing well.** Historically, the RBNZ has delivered larger cuts only in “emergency” situations – hardly the case at present. But we expect an explicit easing bias to be retained, with the bill projection implying at least one more cut, and alternative scenarios reinforcing more if required.
- **Last month’s economic update will likely form the base of the policy assessment.** In fact, it wouldn’t surprise us if the wording was very similar (particularly as only three weeks have passed). While the RBNZ will retain a positive view towards domestic growth prospects and still see financial stability risks from housing (mitigated to a degree by recent macro-prudential policy measures), the reality remains that the strong NZD is making it “difficult for the Bank to meet its inflation objective”.
- **The strong NZD will lower the Bank’s near-term annual inflation forecasts** by perhaps around 0.5%pts, mechanically forcing a lower 90 day bank bill profile. We expect it to signal at least one further OCR cut.
- **With the NZD increasingly battling a portfolio shock (and being supported by strong domestic activity growth) the OCR needs to go a lot lower to take the NZD down with it.** But with the domestic growth picture strong, capacity pressures emerging, and housing and credit largesse clear to see, we are not convinced that aggressively lowering interest rates is in the economy’s best medium-term interests. Inflation is low for reasons beyond the RBNZ’s control and we see little problem with sustained low inflation for a period, as opposed to the RBNZ ‘needing’ to hit the 2% target. A deflationary rut is not around the corner. Some pragmatism over the Policy Targets Agreement is required.
- **To be fair, this is a view we take of global monetary policy more generally, so it is not something about which we can be overly critical of the RBNZ.** Domestic monetary policy operates in a coupled world and the RBNZ cannot swim against the tide of global forces indefinitely. But we do worry about the endgame. **Inflation targeting, in its current form, looks to be on borrowed time.**
- **In the meantime, one thing that looks set to help the RBNZ with some of the tensions it faces (NZD vs housing) is a rising wedge between wholesale and retail borrowing rates.** We are not expecting the full OCR cut to be passed on to borrowers. In fact, in Australia following the latest RBA cut we saw some deposit rates actually rise! Similar funding pressures are evident here. That should give the RBNZ some comfort that a lower OCR can be directed more towards the NZD and inflation with less consequential flow-on into sectors such as housing that don’t need more of a boost (and arguably need less).

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