

NEW ZEALAND ECONOMICS RBNZ MPS PREVIEW

3 February 2017

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REINING IT IN

KEY POINTS

- **We expect the RBNZ to maintain the OCR at 1.75% next Thursday**, which is a view shared by the consensus and market, **and strike a balanced tone.**
- **In many ways, it seems like a great deal has changed since the RBNZ's November Statement.** Headline inflation has returned to the RBNZ's target band for the first time in two years, and some measures of core inflation are back at (or close) to 2%; inflation expectations have stabilised / risen; evidence of capacity pressures have intensified (with the exception of Q4 labour market figures); the global economy is looking firmer; the Fed is talking about three rate hikes this year and other central banks are hinting at less inclination to ease; and fiscal expansion has gained greater prominence globally. This is occurring at a time when the domestic economy continues to march along at a pace well above trend.
- **Given the above, it is not surprising that the market is pondering the prospects of rate hikes.** A full hike is now priced in by November, and certainly an OCR at record lows (and projected by the RBNZ to remain that way for the foreseeable future in November) has become harder to justify.
- **But we doubt the RBNZ is ready to fully embrace that view yet.** The odds of additional easing have clearly reduced. But that does not mean the discussion automatically shifts to hikes. With the NZD sitting 4% above its November projections, wage growth remaining sticky at low levels, the unemployment rate rising in Q4, retail banks lifting mortgage and deposit rates, housing market activity far cooler than six months ago, and a number of global uncertainties and risks remaining, caution should remain a central theme. The fact the RBNZ has had to reverse two attempts at tightening cycles since 2009 is also a factor.
- **We expect the Statement to strike somewhat of a cautious, neutral tone.** Forward guidance is likely to be relatively nonchalant, reiterating "numerous uncertainties". The need for the NZD to fall will be reinforced. And while the Bank's interest rate projection will be lifted a touch, that will be about removing the small implied chance of an additional cut presented in November, with it expected to remain flat overall. We suspect various upside and downside scenarios will be used to emphasise the neutral tone (and the skew of risks around it).
- **In terms of the Bank's forecasts, we are also not expecting a major change in message.** The growth outlook will remain strong, and while some upside tweaks to the near-term inflation profile will be necessary, any judgements around capacity, growth and inflation expectations driving stronger domestic inflation will need to be offset, at least partially, by the impact that the stronger NZD will have on tradable inflation.
- **The market (pricing wise) looks to be expecting a hat-tip to a tightening bias; we think a shift from an easing bias to something more neutral is more likely for now.** On the face of it that should help cap the NZD and drive a modest short-end rally on the day, although the reality is that the market is unlikely to change its expectation that a hike is coming, and the risk is admittedly skewed towards that occurring this year.

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