Expect the unexpected

- Next Thursday the RBNZ will leave the OCR at 1.75% and reaffirm that the next move in the OCR could be up or down.

- Despite the stronger GDP and CPI starting point, we expect to see a slightly flatter projection for the OCR due primarily to weaker commodity prices and a softening global growth outlook.

- We see the OCR on hold for the foreseeable future with risks tilted towards the next move being a cut.

Key points

- We expect the RBNZ will leave the OCR unchanged at 1.75% at its Monetary Policy Statement next Thursday at 9am. The RBNZ will reaffirm that the next move in the OCR could be up or down.

- Since the August Monetary Policy Statement, Q2 GDP and Q3 CPI both surprised on the upside. This certainly gives the RBNZ a little more breathing room, but policy deliberations will remain focused on the balance of medium-term risks. The RBNZ has made it clear that it is concerned about the outlook for activity; that it will look through temporary boosts to inflation; and that core inflation needs to increase sustainably to the 2% midpoint.

- In this context, the increase in Q3 headline inflation is something of a red herring. Broad-based price pressures are still lacking and core inflation appears to have stabilised below the target midpoint. In the same vein, while the stronger starting point for activity is helpful, the RBNZ is likely to still conclude that a marked acceleration in GDP growth is required from here to ensure medium-term inflation heads sustainably back to target.

- And on this front, the signs aren’t promising. Since the last Statement, commodity prices have fallen, businesses remain downbeat and the global outlook has softened around the edges, with rising market volatility and the uncertain outlook for China of particular concern. While the TWI has fallen, it has not been sufficient to offset recent developments. We see the economy holding up fine, but the RBNZ wants it to do more than that.

- On balance, we therefore expect to see a flatter OCR track than in the August Statement, with eventual OCR increases pushed out a little further. It is also possible that the RBNZ simply go to a flat track, underscoring their rhetoric that the next OCR move could be up or down.

- A Statement in line with our expectations could come as a surprise to markets. Following the August Statement, the market-implied probability of a cut by the middle of next year reached almost 50%, but that probability has been pared back considerably, reflecting the stronger GDP and CPI starting point and the fact that hard data has generally held up. However, while the RBNZ will acknowledge the stronger data, we expect that they will reaffirm a cautious approach, choosing to emphasise – as they did in September – that downside growth risks have not gone away.

- We currently see the OCR on hold for the foreseeable future. It will be difficult for the economy to accelerate and to sustain stronger inflation over the medium term. We see risks being tilted towards the next OCR move being a cut, but we are mindful of risks on both sides of the ledger.
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