RBNZ MONETARY POLICY STATEMENT PREVIEW

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CONTRIBUTORS

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KEEPING WITH THE SPIRIT

- The RBNZ will again leave the OCR at 1.75%, and retain a cautiously upbeat stance.
- Developments since the November Statement have been mixed to say the least, but we are not expecting the broad spirit of its assessment to change a great deal.
- A similar interest rate profile is likely (although at the margin the risks are perhaps that it is a touch lower). The RBNZ is not expecting to have to tighten until the second half of 2019. This is a view we now share.

KEY POINTS

- **We expect the RBNZ to again leave the OCR at 1.75% at its Monetary Policy Statement next Thursday (9am).** The Bank has maintained a watchful stance for some months now. And while it sounded a slightly more upbeat tone in November, a broad spirit of cautiousness has underpinned its assessment for some time. We don’t see that changing next week.
- **It has been close to three months since the November Monetary Policy Statement, and developments have certainly been mixed since then:**
  - **There is a little more clarity on the fiscal policy front.** In November, the RBNZ made some very preliminary assumptions about selected elements of the Government’s policy mix. Following the Half-year Update and ‘mini budget’, there is now more information available, although there is still plenty of uncertainty about the economic impact of new policy initiatives. The free year of tertiary education will knock a little bit off CPI inflation, but we don’t have enough information to assess the net impact on the RBNZ’s forecasts of other fiscal initiatives.
  - **GDP growth has been revised meaningfully higher.** The economy performed far stronger over 2015 and 2016 than previously thought. Is there less capacity now because of this, or was potential growth higher too? Either way, it doesn’t alter the fact that inflation has been absent. It wouldn’t surprise us to see the RBNZ dedicate a box to describing how the changes affect its overall views.
  - **Business confidence has tumbled.** To be fair, the underlying details of our own Business Outlook or the NZIER QSBO are not quite as bad, and consumers are still reasonably upbeat, but more caution with regards to hiring and investing is creeping in as margin pressure squeezes profitability. At face value, it suggests downside risks to the RBNZ’s near-term GDP forecasts.
  - **Housing market activity has bounced modestly.** Sales volumes are off lows and house prices have risen in each of the past five months. We suspect this will have come as a modest surprise to the Bank.
  - **The NZD is around 2½% above its November projections.** Oil prices are higher too, so there are some offsets from an inflation perspective, but it doesn’t appear as though New Zealand’s export commodity prices are keeping pace. That is growth negative.
- **Headline inflation is easing again.** The soft Q4 CPI result, base effects, the higher NZD and the impact of the Government’s tertiary education policies are likely to see headline inflation retreat towards the lower end of the target band once again. The RBNZ will be mindful of the potential implications of this for the formation of inflation expectations.

- **Signs of broad-based price pressures are absent, despite clear evidence of a tight labour market and broader capacity pressures.** The RBNZ’s Sectoral Factor Model of core inflation was again unchanged at 1.4% and if anything, alternative core and underlying measures of inflation ticked a little lower in Q4. This observation alone is likely to see the RBNZ heavily discount the implications from the upward GDP revisions.

- **The global growth backdrop remains positive.** Global growth is solid and broad-based and markets are more confident in reflationary themes, with measures of inflation compensation lifting off historic lows. While central banks remain cautious, recent rhetoric remains consistent with a gradual pace of policy normalisation.

  - **Trying to make heads or tails of all that is far from easy, and we suspect there have been interesting internal discussions going on.** But it does not feel like a backdrop where the RBNZ will feel comfortable going out on a limb and taking a strong view – or at least a view that significantly departs from its previous thinking. There are too many moving parts for that. For us, all recent developments have done is reiterate that “numerous uncertainties remain”.

  - **When uncertainty is high, you fall back on what you know and can observe.** The lack of broad-based inflation pressure, despite an economy that has been performing reasonably well, will be right at the top of the list. It will leave the RBNZ believing that there is no need to rush and that “Monetary policy will remain accommodative for a considerable period.”

  - **The RBNZ’s inflation projections will be downgraded again and it is possible that it lowers its near-term GDP forecasts a touch as well given recent signals from business surveys.** One could therefore make an argument that developments on balance justify the RBNZ tweaking its interest rate projection lower too (and that is the direction we do see the risks pointed), but chances are it is left largely unchanged. With the first hike so far into the future, there is no urgency to take a stand.
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