

NEW ZEALAND ECONOMICS

RBNZ SEPTEMBER OCR REVIEW

22 September 2016

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

SLOW AND STEADY

BOTTOM LINE

As expected, the RBNZ delivered a balanced and measured (and largely unchanged) statement today, maintaining the OCR at 2.0% but retaining a clear easing bias. The factors shaping the monetary policy outlook (strong NZD, low inflation and inflation expectations, housing concerns, solid domestic economy, global fragilities etc) have all been signalled before. We continue to see a further 50bps of OCR cuts in November and February.

KEY POINTS

- **Today's policy assessment was largely unchanged from the one delivered in August.** Importantly, the RBNZ still believes that "our current projections and assumptions indicate that further policy easing will be required to ensure that inflation settles near the middle of the target range." The language seems pretty clear that a November cut is likely.
- **The broad factors shaping the monetary policy outlook are unchanged from what the RBNZ had already signalled.** Global fragilities remain, the NZD is strong and dampening inflation pressures, the domestic economy is performing well, housing remains a financial stability concern (though signs of moderation is noted), and while inflation is expected to lift, low inflation expectations remain a concern and risk.
- **The one change of note was a dropped reference to the NZD making it difficult for the RBNZ to hit its inflation objective.** We are not entirely sure what to make of that. Nothing, because it is implied (obvious) anyway? Or does it mean a greater degree of resignation on the part of the RBNZ that it can do little about NZD strength? At this stage we are leaning towards the former interpretation.
- **Stepping back, it remains a case of the RBNZ operating in an environment full of tension.** "Traditional" policy signals (growth, capacity, labour market, housing etc) are arguing for no further stimulus (or even less!), but are going head to head with the likes of the strong NZD, fragile global economy and low inflation – factors that, while in many ways beyond the RBNZ's direct control, argue for more stimulus.
- **The RBNZ has signalled it will be taking a measured approach to addressing that tension and today's statement is consistent with that.** It is not about to take policy sharply lower, nor will it sit back and do nothing. It is a backdrop where the OCR is biased lower as the RBNZ attempts to respond to the things it can't control by over-stimulating the things it can (the non-tradable side of the economy). That strategy is not without its risks, but is a pragmatic approach right now. We still expect OCR cuts in November and February.
- **Confirmation that "further policy easing will be required" will soothe a market that had become sceptical of the RBNZ's desire to continue easing,** and is the strongest hat-tip to a November cut the market could ask for. We expect the short end and forward rates to resume grinding lower from here, and for geographic bond spreads (which have under-performed badly) to narrow in gradually over coming weeks, assisted by index duration extensions due at the end of the month.

RBNZ SEPTEMBER OCR REVIEW

RBNZ SIDE-BY-SIDE

22 SEPTEMBER 2016 OCR REVIEW	11 AUGUST 2016 MPS
<p>The Reserve Bank today left the Official Cash Rate (OCR) unchanged at 2.0 percent.</p>	<p>The Reserve Bank today reduced the Official Cash Rate (OCR) by 25 points to 2.0 percent.</p>
<p>Global growth is below trend despite being supported by unprecedented levels of monetary stimulus. Significant surplus capacity remains across many economies and, along with low commodity prices, is suppressing global inflation. Volatility in global markets has increased in recent weeks, with government bond yields rising and equities coming off their highs. The prospects for global growth and commodity prices remain uncertain. Political uncertainty remains.</p>	<p>Global growth is below trend despite being supported by unprecedented levels of monetary stimulus. Significant surplus capacity remains across many economies and, along with low commodity prices, is suppressing global inflation. Some central banks have eased policy further since the June <i>Monetary Policy Statement</i>, and long-term interest rates are at record lows. The prospects for global growth and commodity prices remain uncertain. Political risks are also heightened.</p>
<p>Weak global conditions and low interest rates relative to New Zealand are placing upward pressure on the New Zealand dollar exchange rate. The trade-weighted exchange rate is higher than assumed in the August Statement. Although this may partly reflect improved export prices, the high exchange rate continues to place pressure on the export and import-competing sectors and, together with low global inflation, is causing negative inflation in the tradables sector. A decline in the exchange rate is needed.</p>	<p>Weak global conditions and low interest rates relative to New Zealand are placing upward pressure on the New Zealand dollar exchange rate. The trade-weighted exchange rate is significantly higher than assumed in the June Statement. The high exchange rate is adding further pressure to the export and import-competing sectors and, together with low global inflation, is causing negative inflation in the tradables sector. This makes it difficult for the Bank to meet its inflation objective. A decline in the exchange rate is needed.</p>
<p>Second quarter GDP results were consistent with the Bank's growth expectations. Domestic growth is expected to remain supported by strong net immigration, construction activity, tourism, and accommodative monetary policy. While dairy prices have firmed since early August, the outlook for the full season remains very uncertain. High net immigration is supporting strong growth in labour supply and limiting wage pressure.</p>	<p>Domestic growth is expected to remain supported by strong inward migration, construction activity, tourism, and accommodative monetary policy. However, low dairy prices are depressing incomes in the dairy sector and reducing farm spending and investment. High net immigration is supporting strong growth in labour supply and limiting wage pressure.</p>
<p>House price inflation remains excessive, posing concerns for financial stability. There are indications that recent macro-prudential measures and tighter credit conditions in recent weeks are having a moderating influence.</p>	<p>House price inflation remains excessive and has become more broad-based across the regions, adding to concerns about financial stability. The Bank is consulting on stronger macro-prudential measures that should help to mitigate financial system risks arising from the rapid escalation in house prices.</p>
<p>Headline inflation is being held below the target band by continuing negative tradables inflation. Annual CPI inflation is expected to weaken in the September quarter, reflecting lower fuel prices and cuts in ACC levies. Annual inflation is expected to rise from the December quarter, reflecting the policy stimulus to date, the strength of the domestic economy, reduced drag from tradables inflation, and rising non-tradables inflation. Although long-term inflation expectations are well-anchored at 2 percent, the sustained weakness in headline inflation risks further declines in inflation expectations.</p>	<p>Headline inflation is being held below the target band by continuing negative tradables inflation. Annual CPI inflation is expected to weaken in the September quarter, reflecting lower fuel prices and cuts in ACC levies. Annual inflation is expected to rise from the December quarter, reflecting the policy stimulus to date, the strength of the domestic economy, reduced drag from tradables inflation, and rising non-tradables inflation. Although long-term inflation expectations are well-anchored at 2 percent, the sustained weakness in headline inflation risks further declines in inflation expectations.</p>
<p>Monetary policy will continue to be accommodative. Our current projections and assumptions indicate that further policy easing will be required to ensure that future inflation settles near the middle of the target range. We will continue to watch closely the emerging economic data.</p>	<p>Monetary policy will continue to be accommodative. Our current projections and assumptions indicate that further policy easing will be required to ensure that future inflation settles near the middle of the target range. We will continue to watch closely the emerging economic data.</p>

IMPORTANT NOTICE

The distribution of this document or streaming of this video broadcast (as applicable, "publication") may be restricted by law in certain jurisdictions. Persons who receive this publication must inform themselves about and observe all relevant restrictions.

1. Disclaimer for all jurisdictions, where content is authored by ANZ Research:

Except if otherwise specified in section 2 below, this document is issued and distributed in your country/region by Australia and New Zealand Banking Group Limited (ABN11 005 357 522) ("ANZ"), on the basis that it is only for the information of the specified recipient or permitted user of the relevant website (collectively, "recipient"). This document is confidential and may not be reproduced, distributed or published by any recipient for any purpose. It is general information and has been prepared without taking into account the objectives, financial situation or needs of any person. Nothing in this document is intended to be an offer to sell, or a solicitation of an offer to buy, any product, security, instrument or investment, to effect any transaction or to conclude any legal act of any kind. If, despite the foregoing, any services or products referred to in this document are deemed to be offered in the jurisdiction in which this document is received or accessed, no such service or product is intended for nor available to persons resident in that jurisdiction if it would be contradictory to local law or regulation. Such local laws, regulations and other limitations always apply with non-exclusive jurisdiction of local courts. Certain financial products may be subject to mandatory clearing, regulatory reporting and/or other related obligations. These obligations may vary by jurisdiction and be subject to frequent amendment. Before making an investment decision, recipients should seek independent financial, legal, tax and other relevant advice having regard to their particular circumstances.

The views and recommendations expressed in this publication are the author's. They are based on information known by the author and on sources which the author believes to be reliable, but may involve material elements of subjective judgement and analysis. Unless specifically stated otherwise: they are current on the date of this publication and are subject to change without notice; and, all price information is indicative only. Any of the views and recommendations which comprise estimates, forecasts or other projections, are subject to significant uncertainties and contingencies that cannot reasonably be anticipated. On this basis, such views and recommendations may not always be achieved or prove to be correct. Indications of past performance in this publication will not necessarily be repeated in the future. No representation is being made that any investment will or is likely to achieve profits or losses similar to those achieved in the past, or that significant losses will be avoided. Additionally, this publication may contain 'forward looking statements'. Actual events or results or actual performance may differ materially from those reflected or contemplated in such forward looking statements. All investments entail a risk and may result in both profits and losses. Foreign currency rates of exchange may adversely affect the value, price or income of any products or services described in this publication. The products and services described in this publication are not suitable for all investors, and transacting in these products or services may be considered risky. ANZ and its related bodies corporate and affiliates, and the officers, employees, contractors and agents of each of them (including the author) ("Affiliates"), do not make any representation as to the accuracy, completeness or currency of the views or recommendations expressed in this publication. Neither ANZ nor its Affiliates accept any responsibility to inform you of any matter that subsequently comes to their notice, which may affect the accuracy, completeness or currency of the information in this publication. Except as required by law, and only to the extent so required: neither ANZ nor its Affiliates warrant or guarantee the performance of any of the products or services described in this publication or any return on any associated investment; and, ANZ and its Affiliates expressly disclaim any responsibility and shall not be liable for any loss, damage, claim, liability, proceedings, cost or expense ("Liability") arising directly or indirectly and whether in tort (including negligence), contract, equity or otherwise out of or in connection with this publication.

If this publication has been distributed by electronic transmission, such as e-mail, then such transmission cannot be guaranteed to be secure or error-free as information could be intercepted, corrupted, lost, destroyed, arrive late or incomplete, or contain viruses. ANZ and its Affiliates do not accept any Liability as a result of electronic transmission of this publication.

ANZ and its Affiliates may have an interest in the subject matter of this publication as follows:

- They may receive fees from customers for dealing in the products or services described in this publication, and their staff and introducers of business may share in such fees or receive a bonus that may be influenced by total sales.
- They or their customers may have or have had interests or long or short positions in the products or services described in this publication, and may at any time make purchases and/or sales in them as principal or agent.
- They may act or have acted as market-maker in products described in this publication.

ANZ and its Affiliates may rely on information barriers and other arrangements to control the flow of information contained in one or more business areas within ANZ or within its Affiliates into other business areas of ANZ or of its Affiliates. This document is published in accordance with ANZ's policies on Conflicts of Interest and Information Barriers.

Please contact your ANZ point of contact with any questions about this publication including for further information on these disclosures of interest.

2. Country/region specific information:

Australia. This publication is distributed in Australia by ANZ. ANZ holds an Australian Financial Services licence no. 234527. A copy of ANZ's Financial Services Guide is available at <http://www.anz.com/documents/AU/aboutANZ/FinancialServicesGuide.pdf> and is available upon request from your ANZ point of contact. If trading strategies or recommendations are included in this publication, they are solely for the information of 'wholesale clients' (as defined in section 761G of the Corporations Act 2001 *Cth*). Persons who receive this publication must inform themselves about and observe all relevant restrictions.

Brazil. This publication is distributed in Brazil by ANZ on a cross border basis and only following request by the recipient. No securities are being offered or sold in Brazil under this publication, and no securities have been and will not be registered with the Securities Commission – CVM.

Brunei. Japan. Kuwait. Malaysia. Switzerland. Taiwan. This publication is distributed in each of Brunei, Japan, Kuwait, Malaysia, Switzerland and Taiwan by ANZ on a cross-border basis.

Cambodia. APS222 Disclosure. The recipient acknowledges that although ANZ Royal Bank (Cambodia) Ltd. is a subsidiary of ANZ, it is a separate entity to ANZ and the obligations of ANZ Royal Bank (Cambodia) Ltd. do not constitute deposits or other liabilities of ANZ and ANZ is not required to meet the obligations of ANZ Royal Bank (Cambodia) Ltd.

European Economic Area ("EEA"): United Kingdom. ANZ in the United Kingdom is authorised by the Prudential Regulation Authority ("PRA"). Subject to regulation by the Financial Conduct Authority ("FCA") and limited regulation by the PRA. Details about the extent of our regulation by the PRA are available from us on request. This publication is distributed in the United Kingdom by ANZ solely for the information of persons who would come within the FCA definition of "eligible counterparty" or "professional client". It is not intended for and must not be distributed to any person who would come within the FCA definition of "retail client". Nothing here excludes or restricts any duty or liability to a customer which ANZ may have under the UK Financial Services and Markets Act 2000 or under the regulatory system as defined in the Rules of the PRA and the FCA. **Germany.** This publication is distributed in Germany by the Frankfurt Branch of ANZ solely for the information of its clients. **Other EEA countries.** This publication is distributed in the EEA by ANZ Bank (Europe) Limited ("ANZBEL") which is authorised by the PRA and regulated by the FCA and the PRA in the United Kingdom, to persons who would come within the FCA definition of "eligible counterparty" or "professional client" in other countries in the EEA. This publication is distributed in those countries solely for the information of such persons upon their request. It is not intended for, and must not be distributed to, any person in those countries who would come within the FCA definition of "retail client".

Fiji. For Fiji regulatory purposes, this publication and any views and recommendations are not to be deemed as investment advice. Fiji investors must seek licensed professional advice should they wish to make any investment in relation to this publication.

Hong Kong. This publication is issued or distributed in Hong Kong by the Hong Kong branch of ANZ, which is registered at the Hong Kong Monetary Authority to conduct Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) regulated activities. The contents of this publication have not been reviewed by any regulatory authority in Hong Kong. If in doubt about the contents of this publication, you should obtain independent professional advice.

IMPORTANT NOTICE

India. This publication is distributed in India by ANZ on a cross-border basis. If this publication is received in India, only you (the specified recipient) may print it provided that before doing so, you specify on it your name and place of printing. Further copying or duplication of this publication is strictly prohibited.

Myanmar. This publication is intended to be of a general nature as part of customer service and marketing activities provided by ANZ in the course of implementing its functions as a licensed bank. This publication does not take into account your financial situation or goals and is not Securities Investment Advice (as that term is defined in the Myanmar Securities Transaction Law 2013). The contents of this publication have not been reviewed by any regulatory authority in Myanmar. If in doubt about the contents of this publication, you should obtain independent professional advice.

New Zealand. This publication is intended to be of a general nature, does not take into account your financial situation or goals, and is not a personalised adviser service under the Financial Advisers Act 2008.

Oman. This publication has been prepared by ANZ. ANZ neither has a registered business presence nor a representative office in Oman and does not undertake banking business or provide financial services in Oman. Consequently ANZ is not regulated by either the Central Bank of Oman or Oman's Capital Market Authority. The information contained in this publication is for discussion purposes only and neither constitutes an offer of securities in Oman as contemplated by the Commercial Companies Law of Oman (Royal Decree 4/74) or the Capital Market Law of Oman (Royal Decree 80/98), nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market Law (issued vide CMA Decision 1/2009). ANZ does not solicit business in Oman and the only circumstances in which ANZ sends information or material describing financial products or financial services to recipients in Oman, is where such information or material has been requested from ANZ and by receiving this publication, the person or entity to whom it has been dispatched by ANZ understands, acknowledges and agrees that this publication has not been approved by the CBO, the CMA or any other regulatory body or authority in Oman. ANZ does not market, offer, sell or distribute any financial or investment products or services in Oman and no subscription to any securities, products or financial services may or will be consummated within Oman. Nothing contained in this publication is intended to constitute Omani investment, legal, tax, accounting or other professional advice.

People's Republic of China ("PRC"). Recipients must comply with all applicable laws and regulations of PRC, including any prohibitions on speculative transactions and CNY/CNH arbitrage trading. If and when the material accompanying this document is distributed by Australia and New Zealand Banking Group Limited (ABN 11 005 357 522) ("ANZ") or an affiliate (other than Australia and New Zealand Bank (China) Company Limited ("ANZ C")), the following statement and the text below is applicable: No action has been taken by ANZ or any affiliate which would permit a public offering of any products or services of such an entity or distribution or re-distribution of this document in the PRC. Accordingly, the products and services of such entities are not being offered or sold within the PRC by means of this document or any other document. This document may not be distributed, re-distributed or published in the PRC, except under circumstances that will result in compliance with any applicable laws and regulations. If and when the material accompanying this document relates to the products and/or services of ANZ C, the following statement and the text below is applicable: This document is distributed by ANZ C in the Mainland of the PRC.

Qatar. This publication has not been, and will not be lodged or registered with, or reviewed or approved by, the Qatar Central Bank ("QCB"), the Qatar Financial Centre ("QFC") Authority, QFC Regulatory Authority or any other authority in the State of Qatar ("Qatar"); or authorised or licensed for distribution in Qatar; and the information contained in this publication does not, and is not intended to, constitute a public offer or other invitation in respect of securities in Qatar or the QFC. The financial products or services described in this publication have not been, and will not be registered with the QCB, QFC Authority, QFC Regulatory Authority or any other governmental authority in Qatar; or authorised or licensed for offering, marketing, issue or sale, directly or indirectly, in Qatar. Accordingly, the financial products or services described in this publication are not being, and will not be, offered, issued or sold in Qatar, and this publication is not being, and will not be, distributed in Qatar. The offering, marketing, issue and sale of the financial products or services described in this publication and distribution of this publication is being made in, and is subject to the laws, regulations and rules of, jurisdictions outside of Qatar and the QFC. Recipients of this publication must abide by this restriction and not distribute this publication in breach of this restriction. This publication is being sent/issued to a limited number of institutional and/or sophisticated investors (i) upon their request and confirmation that they understand the statements above; and (ii) on the condition that it will not be provided to any person other than the original recipient, and is not for general circulation and may not be reproduced or used for any other purpose.

Singapore. This publication is distributed in Singapore by the Singapore branch of ANZ solely for the information of "accredited investors", "expert investors" or (as the case may be) "institutional investors" (each term as defined in the Securities and Futures Act Cap. 289 of Singapore). ANZ is licensed in Singapore under the Banking Act Cap. 19 of Singapore and is exempted from holding a financial adviser's licence under Section 23(1)(a) of the Financial Advisers Act Cap. 100 of Singapore. In respect of any matters arising from, or in connection with the distribution of this publication in Singapore, contact your ANZ point of contact.

United Arab Emirates. This publication is distributed in the United Arab Emirates ("UAE") or the Dubai International Financial Centre (as applicable) by ANZ. This publication: does not, and is not intended to constitute an offer of securities anywhere in the UAE; does not constitute, and is not intended to constitute the carrying on or engagement in banking, financial and/or investment consultation business in the UAE under the rules and regulations made by the Central Bank of the United Arab Emirates, the Emirates Securities and Commodities Authority or the United Arab Emirates Ministry of Economy; does not, and is not intended to constitute an offer of securities within the meaning of the Dubai International Financial Centre Markets Law No. 12 of 2004; and, does not constitute, and is not intended to constitute, a financial promotion, as defined under the Dubai International Financial Centre Regulatory Law No. 1 of 200. ANZ DIFC Branch is regulated by the Dubai Financial Services Authority ("DFSA"). The financial products or services described in this publication are only available to persons who qualify as "Professional Clients" or "Market Counterparty" in accordance with the provisions of the DFSA rules. In addition, ANZ has a representative office ("ANZ Representative Office") in Abu Dhabi regulated by the Central Bank of the United Arab Emirates. ANZ Representative Office is not permitted by the Central Bank of the United Arab Emirates to provide any banking services to clients in the UAE.

United States. ANZ Securities, Inc. ("ANZSI") is a member of the Financial Industry Regulatory Authority ("FINRA") (www.finra.org) and registered with the SEC. ANZSI's address is 277 Park Avenue, 31st Floor, New York, NY 10172, USA (Tel: +1 212 801 9160 Fax: +1 212 801 9163). Except where this is an FX-related publication, this publication is distributed in the United States by ANZSI (a wholly owned subsidiary of ANZ), which accepts responsibility for its content. Information on any securities referred to in this publication may be obtained from ANZSI upon request. This publication or material is intended for institutional use only – not retail. If you are an institutional customer wishing to effect transactions in any securities referred to in this publication you must contact ANZSI, not its affiliates. ANZSI is authorised as a broker-dealer only for institutional customers, not for US Persons (as "US person" is defined in Regulation S under the US Securities Act of 1933, as amended) who are individuals. If you have registered to use this website or have otherwise received this publication and are a US Person who is an individual: to avoid loss, you should cease to use this website by unsubscribing or should notify the sender and you should not act on the contents of this publication in any way. Non-U.S. Analysts: Non-U.S. analysts may not be associated persons of ANZSI and therefore may not be subject to FINRA Rule 2242 restrictions on communications with subject company, public appearances and trading securities held by the analysts. Where this is an FX-related publication, it is distributed in the United States by ANZ's New York Branch, which is also located at 277 Park Avenue, 31st Floor, New York, NY 10172, USA (Tel: +1 212 801 9160 Fax: +1 212 801 9163). Commodity-related products are not insured by any U.S. governmental agency, and are not guaranteed by ANZ or any of its affiliates. Transacting in these products may involve substantial risks and could result in a significant loss. You should carefully consider whether transacting in commodity-related products is suitable for you in light of your financial condition and investment objectives.

Vietnam. This publication is distributed in Vietnam by ANZ or ANZ Bank (Vietnam) Limited, a subsidiary of ANZ. Please note that the contents of this publication have not been reviewed by any regulatory authority in Vietnam. If you are in any doubt about any of the contents of this publication, you should obtain independent professional advice.

This document has been prepared by ANZ Bank New Zealand Limited, Level 10, 171 Featherston Street, Wellington 6011, New Zealand, Ph 64 9 357 4065, e-mail nzeconomics@anz.co.nz, <http://www.anz.co.nz>

