ANZ RESEARCH

# NEW ZEALAND ECONOMICS
## RBNZ NOVEMBER *MONETARY POLICY STATEMENT*

10 November 2016


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## STRAIGHT BAT

- RBNZ cuts OCR 25bps to 1.75%, as expected; mild easing bias remains.
- But outlook more balanced and strength of the economy hard to ignore. Risks no longer solely to the downside, though skewed slightly that way.
- NZD will continue to frustrate but policy looks on hold for some time.

### KEY POINTS

- **As widely expected, the OCR was cut 25bps to 1.75%.** The OCR forecast track suggests they are done, with around a 20% chance of another cut built in. The last sentence of the assessment ("numerous uncertainties remain, particularly in respect of the international outlook, and policy may need to adjust accordingly") acknowledges that risk so we have a mild easing bias but nothing more. **We think that is entirely appropriate.**
- **In response the NZD lifted half a cent and the 2 year swap is up 10 points (though a lot of the latter move will be offshore-driven).** OIS markets are locked on 1.75%. Although we do not believe the New Zealand economy is in need of as much monetary policy stimulus as it is getting at present, today's *Statement* and forecasts were a reasonable compromise given the Bank had painted itself into a corner with strong signalling.
- **Since the *OCR Review* in September, economic activity data has generally surprised on the upside.** This was acknowledged in forecasts that showed annual average GDP growth of 3.7% in the year to March 2017, versus 3.4% in the August *MPS*. That broadly concurs with our own assessment.
- **Recent inflation data has been more mixed, with only the vaguest hints of a turn upwards. On this front the RBNZ rhetoric and forecasts were little changed** (annual CPI 1.3% in March 2017, vs 1.1%). More notable was that the comment expressing concern that inflation expectations may decline further was dropped from the policy assessment.
- **The strong NZD will continue to frustrate** (the TWI is trading over 79 vs. 77 in the RBNZ's track and has naturally popped higher following today's statement). **The RBNZ says the NZD is "higher than is sustainable for balanced economic growth" and "a decline in the exchange rate is needed."** Short a global event we doubt they'll get it, given the domestic growth backdrop. This keeps the bias for rates lower for longer to ensure a lift in non-tradables inflation and inflation expectations.
- **We note an array of scenarios is presented, both up and down; this in itself conveys the risk profile around policy settings. Risks are no longer strictly to the downside and this needs to be recognised.**
- **We agree with the spirit of the RBNZ's economic assessment.** Strong, above-trend growth is eating into capacity, the NZD is likely to remain high, and housing is a financial stability concern. Although macro-prudential measures do appear to be working, the RBNZ is wary of assuming victory prematurely: "Although house price inflation has moderated in Auckland, it is uncertain whether this will be sustained given the continuing imbalance between supply and demand."

# RBNZ NOVEMBER *MPS*

- **Attention will turn to how much of the 25bp cut is passed on. We doubt it will be the full amount.** Banks need more deposits and if that means deposit rates can't fall, borrowing rates can't either. The RBNZ likely won't be too displeased with this mix. It means the OCR can be used to tackle the high NZD and offset tradable deflationary forces without needing to be overly concerned about boosting housing.
- **Short-end rates are higher but we doubt that they will sustain such lofty levels through to Christmas. Carry will prevent this**, even if there is potential for near-term capitulation. Confirmation of a cut and the maintenance of a mild easing bias (20% odds) has been met with relief at the very short end, which still had lingering doubts over whether we'd actually see a cut today (OIS was pricing in ~80% odd of a cut). **Reiteration that a lower NZD is required and the fact that the 2 year swap is already 55bps above the OCR will cap upside potential**, but the real fear is what happens if we see a wave of mortgage fixing and corporate hedging. This has the potential to push the market further, despite the high cost of carry implied by such levels.

## RBNZ SIDE-BY-SIDE

| 10 NOVEMBER 2016 MPS | 22 SEPTEMBER 2016 OCR |
|---|---|
| The Reserve Bank **today reduced the Official Cash Rate (OCR) by 25 basis points to 1.75 percent.** | The Reserve Bank today **left the Official Cash Rate (OCR) unchanged at 2.0 percent.** |
| **Significant surplus capacity exists across the global economy despite improved economic indicators in some countries. Global inflation remains weak even though commodity prices have come off their lows. Political uncertainty remains heightened and market volatility is elevated.** | **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.** |
| Weak global conditions and low interest rates relative to New Zealand are keeping upward pressure on the New Zealand dollar exchange rate. **The exchange rate remains higher than is sustainable for balanced economic growth** and, together with low global inflation, continues to generate negative inflation in the tradables sector. A decline in the exchange rate is needed. | 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. |
| Domestic growth is being supported by strong population growth, construction activity, tourism, and accommodative monetary policy. **Recent dairy auctions have been positive, but uncertainty remains around future outcomes.** High net immigration is supporting growth in labour supply and limiting wage pressure. | 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. |
| House price inflation remains excessive and is posing concerns for financial stability. **Although house price inflation has moderated in Auckland, it is uncertain whether this will be sustained given the continuing imbalance between supply and demand.** | 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.** |

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| Headline inflation continues to be held below the target range by ongoing negative tradables inflation. Annual CPI inflation was weak in the September quarter, in part due to 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, and reduced drag from tradables inflation. | 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.** |
| Monetary policy will continue to be accommodative. **Our current projections and assumptions indicate that policy settings, including today's easing, will see growth strong enough to have inflation settle near the middle of the target range. Numerous uncertainties remain, particularly in respect of the international outlook, and policy may need to adjust accordingly.** | 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.** |

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