

NEW ZEALAND ECONOMICS RBNZ MPS PREVIEW

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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

TEA BREAK

KEY POINTS

- **We don't believe the economy needs additional stimulus right here and expect the RBNZ will keep the OCR unchanged at 2.25%.** While the economist community is a little more convinced of action (10 of 16 are calling a cut according to Bloomberg), the market is 24% priced for one.
- **When we assess the data tea-leaves, it certainly doesn't feel like an economic backdrop crying out for a cut right now:**
 - **The domestic economy is still solid.** The construction, tourism and non-dairy agriculture sectors are all performing well. Migration remains strong. Confidence is still decent and activity indicators are holding up. GDP growth appears to be tracking a tad above trend.
 - **The inflation backdrop is showing signs of shifting.** Inflation expectations have stabilised, oil prices are up (offsetting the impact of the higher NZD). Core inflation is rising and there is tentative evidence that wages are too. Capacity pressures are becoming more evident.
 - **Housing is booming and credit growth is strong.** For the RBNZ to be noting financial stability concerns from housing at the same time as cutting would be contradictory to say the least. The 'what is the bigger risk' pendulum has swung away from dairy and back towards housing.
 - **The global scene has improved.** Concerns will no doubt remain – we share these concerns. But the global economy doesn't appear at the precipice like it did earlier in the year. A Fed that is finally making noise about further hikes is also taking pressure off the NZD/USD.
- **An easing bias will no doubt be retained.** Inflation expectations are low (albeit stabilising of late), the NZD remains higher than "desirable", dairy strains continue and cautiousness towards global prospects will linger. The combination of downside scenarios, explicit commentary ("further easing may be required") and a downwardly sloping bank bill projection will make it clear about the likely direction of any future moves. We expect the bill profile will imply one further cut (i.e. have a similar end point as in March), although leave the exact timing open to plenty of conjecture.
- **However, we would not be surprised if some elements of the statement/projections hinted at the possibility of no further easing at all.** Certainly, there is now a credible 'no change' scenario that has reasonable odds. The data almost demands a little more balance to return to the discussion, at least relative to the RBNZ's tone earlier in the year. The market is already shifting to this view. But fear of turbo-charging the NZD further means this is probably a step too far for the RBNZ for now.
- **Further easing is still within our forecasts.** We suspect the combination of global unease, high NZD and prospects for increased competition for deposits (which will force up borrowing rates if the OCR does not fall) will bring the RBNZ back to the table. We have pencilled in cuts in August and early 2017. However, it is far from a strong conviction view (we put the probability of an August cut at just 60%). The trade-offs of further easing will need to be weighed carefully.

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