Baby steps

Preview of RBNZ Monetary Policy Statement, Nov 2018

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- Recent data on the New Zealand economy and inflation has been clearly stronger than the RBNZ expected.
- Consequently the November MPS has to be at least a little more hawkish than the August missive.
- But any change will be minor and confined to the details. We expect the RBNZ to stick to the same broad outlook for monetary policy.
- The RBNZ's OCR forecast may be slightly higher than the August forecast.
- But the all-important comment that the next move in the OCR could be "up or down" will probably be retained.
- For markets, the balance of risks is skewed towards swap rates and the NZD rising a little.
- Labour market data will print one day before the MPS, and could influence the tone of the press release, Chapter 1, and the Governor's comments at the press conference.

Over the past few months New Zealand's economic and inflation data has headed north, and has been clearly stronger than the Reserve Bank's forecasts. June quarter GDP came in well ahead of the RBNZ's expectation, September inflation was 0.9% compared to the RBNZ's forecast of 0.4%, and the exchange rate is lower than the RBNZ expected. Most second-tier data, such as electronic card transactions and building consents, have been strong. And fixed mortgage rates have fallen sharply, which will be a source of stimulus for house prices.

Next week's *Monetary Policy Statement* will no doubt acknowledge these facts, and consequently may be a touch more hawkish than the August *MPS*. However, any change will be minor, and will be confined to the details of the document. We expect the RBNZ to stick to the same broad monetary policy outlook, including restating the all-important phrase that the next move in the OCR could be "up or down". We expect the key features of the *MPS* to be:

- In the September OCR review, the key policy paragraph was "*We expect to keep the OCR at this level through 2019 and into 2020. The direction of our next OCR move could be up or down.*" We expect the RBNZ will say more or less the same thing next week.
- The RBNZ has concluded all recent missives by saying that it "*intends to keep the OCR at an expansionary level for a considerable period.*" That will be repeated.
- The RBNZ's August OCR forecast was flat at 1.8%, before starting to rise in September 2020. That putative date for OCR rises could be brought forward by one or two quarters.
- The RBNZ will probably state that it has upgraded its inflation forecast. That is partly due to rising petrol prices, which the RBNZ will look through. However, the RBNZ may also acknowledge that core inflation has been a little stronger than anticipated. The RBNZ will make it clear that these signs of rising inflation are welcome.
- In the September OCR Review the RBNZ acknowledged that GDP growth had exceeded forecast, but tempered that by saying downside risks to growth remain. We expect similar words next week.
- The August *MPS* featured uneven alternative scenarios. In the downside scenario, the OCR fell by 100 basis points, while in the upside scenario the OCR was only

50 basis points higher. We would expect balanced scenarios next week.

The RBNZ tends to alter its stance only in fits and starts. It tends to stick to one point of view for an extended period, and then to lurch to a new view only every once in a while. In the periods between those large changes of stance, the Reserve Bank tends to make only minor adjustments to the monetary policy outlook.

The RBNZ's most recent major change of stance occurred in August. At that time the RBNZ admitted that the economy was simply not accelerating in the fashion it has previously forecast (belatedly, in our view). Consequently, the RBNZ said that the OCR was going to have to remain low for longer than previously expected – and could even be cut. The other reason for this change of stance was probably the new Governor and the new set of targets under which the RBNZ is operating.

With the last major "reset" having occurred so recently, it seems unlikely that the RBNZ would make major changes to the monetary policy outlook now, even though the recent run of strong data has been quite marked.

The RBNZ will also be cautious in its assessment of the recent run of strong data, and may want to see the strong data continue for longer before reacting. The RBNZ may cite a range of risks to the economic outlook. Recent economic data may have been strong, but business confidence is desperately low, and now consumer confidence has also fallen. There is a risk that that could portend a weakening of the domestic economy. Global risks include declines in US share prices over the past week or two, emerging market volatility, and the escalating trade war between the US and China. And the RBNZ will be cautious about recent signs that core inflation is rising, given that inflation was so low for so long.

Known unknowns

Next week's *MPS* will be unusual, since it comes the day after the September quarter labour market figures. The RBNZ's forecasting and drafting process will be all but complete by that time, and will have to be prepared without knowledge of the unemployment rate. But there will still be time for the RBNZ to change the press release, Chapter 1 of the *MPS*, and the Governor's comments at the press conference.

The RBNZ will be very keen to take account of the labour market figures because it is operating under a dual mandate now. It needs to get any commentary right, because there is a three month gap until the next monetary policy missive in February. And the RBNZ will be keen to be seen as taking account of the labour market, to please the Government that recently altered the mandate.

All of this means that the last-minute labour market data *could* have an influence on the overall tone that the RBNZ sets on the day.

Our forecast is for the unemployment rate to rise from 4.5% to 4.6%. That would count as an important downside development for the RBNZ, tempering the otherwise strong flow of data we have seen recently. But there is a great deal of uncertainty about unemployment numbers from quarter to quarter, and markets should be sensitive to any large move.

The other "known unknown" is the RBNZ's December quarter survey of inflation expectations. The RBNZ will know the results by the time it prepares its forecasts, whereas we do not. Businesses are complaining ever more loudly about rising costs, so we would not be surprised if elements of this survey have increased. If so, the case for a small hawkish shift from the RBNZ would strengthen.

Market reaction and scenarios

A statement along the lines we are expecting would generate only a small market reaction – perhaps two basis points higher in swap rates. We see little risk of the RBNZ surprising markets on the dovish side, given what has happened to the data. The risk scenario is one in which the RBNZ reacts strongly to recent data, and adjusts one of the key policy guidance phrases to become less dovish. There is only a small chance of that happening, but it would generate a large market reaction. Consequently, we think the balance of risks is slanted toward swap rates and the exchange rate rising on the day, rather than falling.

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