Cementing the view

RBNZ OCR Review, September 2018

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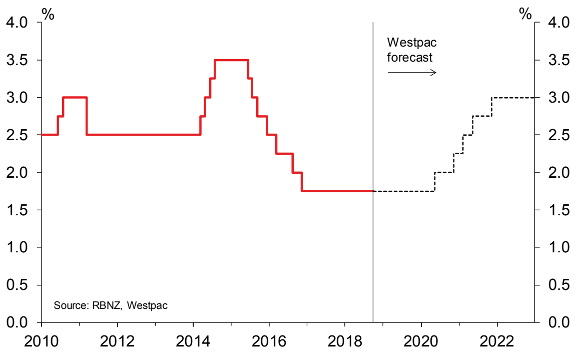
- The RBNZ left the OCR unchanged and repeated the key phrases about the OCR outlook.
- The RBNZ expects to keep the OCR on hold, but the risks are tilted to the downside.
- The detail of today's press release mentioned only downside risks. Although that was more dovish than the August press release, it was in line with other RBNZ communications.
- The RBNZ has not changed its view despite a raft of stronger economic data recently.
- It will take a lot to deter the RBNZ from its soft easing bias, which has more to do with the change of Governor and new mandate than economic conditions.
- This was all very much in line with expectations. We still put the odds of an OCR cut over the coming year at one in three.

Official Cash Rate forecast



At today's OCR Review, the Reserve Bank left the OCR unchanged at 1.75% and repeated all of the key phrases relating to the OCR outlook: "We expect to keep the OCR at this level [1.75%] through 2019 and into 2020"; the next move could be "up or down"; and "We expect to keep the OCR at an expansionary level for a considerable period…".

Today's statement cemented our understanding of the RBNZ's position. The RBNZ expects to keep the OCR on hold, but the balance of risks is to the downside. In particular, if growth disappoints, the RBNZ might cut the OCR. We put the odds of an OCR cut over the coming year at one in three.

That sense of downside risk was missing from the August press release, but was apparent in the detail of the MPS and in comments made to the media in August.

Today's press release rectified that mismatch by being more one-sided about the balance of risks. The RBNZ said its OCR outlook assumes that growth will accelerate, and in the next paragraph said that there are downside risks to growth. The implication is that if GDP growth falls short of expectations, the RBNZ might consider cutting. This was more one-sided than the August press release, which mentioned both upside inflation and downside growth risks.

While that imparted a more dovish feel to the press release compared to August press release, it did not represent a change in the RBNZ's view.

This non-change in the RBNZ's view came despite a raft of stronger economic data recently. Since the August MPS, strong June quarter GDP growth, rising petrol prices, and a weaker exchange rate have all been factors that would normally lean against OCR cuts. But the RBNZ has effectively dismissed all of that. It will take more than a few strong data points to deter the central bank from its soft easing bias.

We think this is because the RBNZ has a new Governor who is operating under a new Policy Targets Agreement (and will soon be under a new Reserve Bank Act). The way the new Governor interprets the new mandate is, unsurprisingly, different to how the previous Governor interpreted the previous mandate. Consequently, the Reserve Bank's stance has changed for reasons other than the trajectory of the economy.

What the Reserve Bank delivered today was very much in line with our expectations, and did not surprise markets either. Consequently, there was very little reaction on either exchange rate or interest rate markets. Markets are pricing about a 30% chance of an OCR cut and are not pricing hikes until the 2020s, which looks about right to us.

Full RBNZ press release

The Official Cash Rate (OCR) remains at 1.75 percent.

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.

Employment is around its sustainable level and consumer price inflation remains below the 2 percent mid-point of our target, necessitating continued supportive monetary policy. Our outlook for the OCR assumes the pace of growth will pick up over the coming year, assisting inflation to return to the target mid-point.

Our projection for the New Zealand economy, as detailed in the August Monetary Policy Statement, is little changed. While GDP growth in the June quarter was stronger than we had anticipated, downside risks to the growth outlook remain.

Robust global economic growth and a lower New Zealand dollar exchange rate is expected to support demand for our exports. Global inflationary pressure is expected to rise, but remain modest. Trade tensions remain in some major economies, increasing the risk that ongoing increases in trade barriers could undermine global growth. Domestically, ongoing spending and investment, by both households and government, is expected to support growth.

There are welcome early signs of core inflation rising towards the mid-point of the target. Higher fuel prices are likely to boost inflation in the near term, but we will look through this volatility as appropriate. Consumer price inflation is expected to gradually rise to our 2 percent annual target as capacity pressures bite.

We will keep the OCR at an expansionary level for a considerable period to contribute to maximising sustainable employment, and maintaining low and stable inflation.

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