Economic Bulletin.

20 September 2019

A laggard no longer – Preview of the September 2019 RBNZ decision.

- **We expect the RBNZ will stay its hand at the September OCR Review, after the jumbo-sized cut in August.**
- **The RBNZ will probably leave the door open to further OCR cuts without making any strong signal.**
- **The global outlook is still shaky, but it is not obviously worse than the RBNZ's previous forecasts.**
- **The domestic economy is weaker than the RBNZ expected, but offsetting that, the exchange rate is significantly lower.**
- **We continue to expect that the RBNZ will cut 25bps in November, although it is not a done deal.**
- **Inflation expectations data, released the day before the November MPS, will be influential in that decision.**

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Following the RBNZ's steep 50 basis point cut in August, we think it will be happy to stay its hand at the September OCR Review.

The RBNZ will probably say that it is now watching and waiting to see how its action to date plays out. Its commentary will probably leave the door open to the possibility of further OCR cuts, without committing to any specific action. The sort of phrases that we think could crop up are:

"Further OCR cuts remain a possibility"

and/or

"The Committee decided to wait for further evidence on how the OCR cuts to date have affected the economy before deciding whether further easing is required."

This would not be as strong as the June easing signal, which said that further easing was "likely". However, it would probably be enough to keep markets pricing roughly a 75% chance of an OCR cut in November.

Much of this year has been a story of ongoing deterioration in the global and New Zealand economic outlook, and the RBNZ has been left playing catch-up. At each review the RBNZ has concluded that the economic outlook was worse than expected at the previous review. Consequently, the RBNZ has downgraded the OCR outlook at every review since February.

We think September will be different. The RBNZ did more to get ahead of the game in August. Although the economic outlook remains poor, it is probably no worse than the RBNZ previously forecast. The RBNZ's thinking is probably still in line with its August projections, which implied a 50/50 chance of another OCR cut at some point (the low point in the OCR projection was 0.9%).

Recent economic developments have been mixed:

- The global economic outlook remains shaky and economists' forecasts of global growth have dropped further. But the RBNZ was prepared for the worst in August, and the situation hasn't obviously deteriorated beyond that. Prices for key New Zealand export products such as milk and logs have actually risen a little in recent weeks, compared to the sharp declines we were experiencing earlier in the year.
- The RBNZ will probably downgrade its assessment of the New Zealand economy. GDP growth in the June quarter proved equal to the RBNZ's forecast. However, the PMI manufacturing survey, consumer confidence and business confidence have all dropped, and we are increasingly hearing reports from businesses that activity has slackened "in the past few months." This renders untenable the RBNZ's forecast that GDP growth is set to accelerate over the second half of 2019.
- The offsetting "positive" from an inflation forecasting point of view is the exchange rate, which is now more than 3% lower than the RBNZ's previous forecast on a trade weighted basis.
- The June quarter labour market report showed that unemployment was far lower than the RBNZ anticipated, and wage growth is picking up more rapidly. This data came out the day before the RBNZ's August MPS, and was not included in its forecasts. That said, more forward-looking indicators such as job ads have deteriorated, so the RBNZ may not alter its unemployment forecasts by much.

Looking ahead to November, we remain of the view that the RBNZ will cut the OCR by 25 basis points, although it is not a done deal. The RBNZ is already 50/50 on whether a further OCR cut will be needed. Any number of global risks could materialise to push them over the line, not to mention the deteriorating domestic economy.

Perhaps the most influential of all the data between now and November will be the RBNZ's own inflation expectations survey. This will be published the day before the MPS, but the RBNZ will have the results around a week earlier. A drop in inflation expectations figured very prominently in the RBNZ's decision to cut the OCR in August. Whether the next survey rises or falls could well be influential for the RBNZ's November decision.

Financial markets are currently pricing around a 20% chance of an OCR cut next week, so an on hold decision will create a natural tendency for interest rates and the exchange rate to rise a little. Markets are pricing roughly a 75% chance of an OCR cut by November, and the type of statement we anticipate would not really change that. Overall then, it seems there is some risk of interest rates and the exchange rate rising on the day, but only a little.

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