Economic Bulletin.

25 September 2019

Making it interesting – RBNZ OCR Review, September 2019.

- The OCR Review was in line with our expectations, but less dovish than markets expected.
- Markets and economists expect an OCR cut in November, but the RBNZ is not signalling such a move.
- We are sticking to our forecast of a November OCR cut, but we now regard it as a close call.
- We expect weak data between now and November will push the RBNZ over the line.
- But one potential impediment is a repeat of August's strong housing market data.

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Nobody was surprised that the RBNZ today left the OCR unchanged at 1.0%.

But today's RBNZ OCR Review certainly added interest to the game of forecasting the November *Monetary Policy Statement*. Financial markets are pricing a high chance of an OCR cut in November, and in a recent survey 12 out of 13 economists predicted a cut. But today the RBNZ did not sound like a central bank that is planning to cut at its next meeting. We are sticking to our forecast that the RBNZ will cut again in November, but we now consider it a close call.

The tone of the RBNZ press release was very much in line with what we expected, but disappointed financial markets who were expecting a clearer signal of a cut in November.

The RBNZ's overall message was that although the economy is currently slow, the interest rate reductions to date should shore things up. Many paragraphs were devoted to the effect of the monetary stimulus already delivered, including comments such as:

"The reduction in the OCR this year has reduced retail interest rates… and eased the New Zealand dollar exchange rate."

"Low interest rates…are expected to support a pick-up in domestic spending."

"The [MPC] members anticipated a positive impulse to economic activity over the coming year from monetary and fiscal stimulus."

and

"The Committee noted that, while GDP growth had slowed… domestic demand is expected to increase. Household spending and construction activity are supported by low interest rates, while business investment should lift in response to demand pressures."

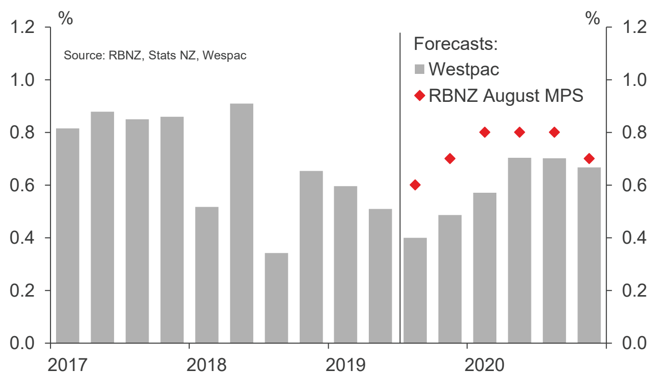
The RBNZ certainly referred to weakness in the economic situation, but its bottom-line assessment was that the outlook for monetary policy *"has not changed significantly"* since the August MPS. The August MPS included an OCR forecast that reached a low of 0.9%, which implies roughly a 50/50 chance of one more OCR cut. Presumably the RBNZ still thinks those are roughly the odds. The forward guidance sentence, repeated in the press release and the summary record of meeting, suggested that the central bank is open to the possibility of cutting the OCR, but is not committed:

"There remains scope for more fiscal and monetary stimulus, if necessary."

What all of this means is that it would take some form of negative data surprise to prompt the RBNZ to cut in November. We are sticking to our forecast of a November cut, because we think the required negative data surprises could well be forthcoming:

- Recent data and anecdotes from business suggest that September quarter GDP growth will be significantly weaker than the RBNZ's forecast of 0.6%.
- We are forecasting cuts from both the Federal Reserve and the Reserve Bank of Australia between now and November. This could raise the threat of the exchange rate rising in the RBNZ's mind.
- We expect unemployment to rise in the September quarter (the data will print a week before the November MPS).
- The employment fallout from the recent forestry downturn is only just becoming apparent now, and will probably get worse over the coming few months.
- Weak inflation expectations data was very influential in the RBNZ's decision to cut 50bps in August. The next batch of inflation expectations data will be published the day before the November MPS, but the RNBZ will have the data a week early. The survey could do anything. If it is weak, the RBNZ would probably cut the OCR again.

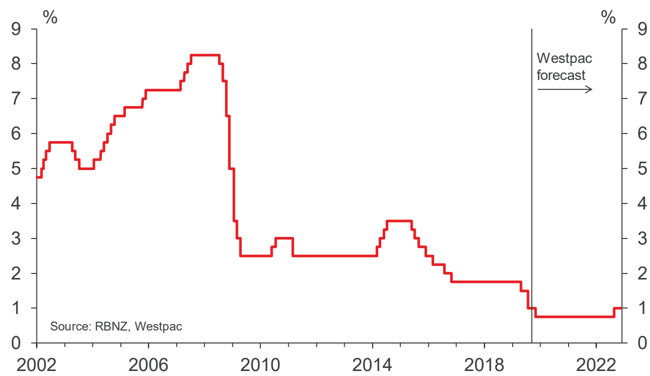
GDP growth forecasts



The one fishhook in all of this is the housing market. Our strong view has long been that the housing market will pick up in response to lower mortgage rates. We expected this to become apparent only around the turn of the year, which is why we were forecasting no OCR cuts beyond November. But the August Real Estate Institute price data was very strong indeed – the 1.4% increase in seasonally adjusted nationwide prices was the strongest in a single month since mid-2016. That might have been an aberration. But if the September housing market data is also strong, some members of the MPC might argue against an OCR cut in November.

At this stage the balance of risks still favours a cut in November, but the RBNZ has confirmed that it is a "live" meeting, not a done deal.

Official Cash Rate



Quirks and oddities.

There were a few quirks and oddities in the RBNZ's commentary today that are worth highlighting.

First, the RBNZ's twice-repeated comment that *"there remains scope for more **fiscal and** monetary stimulus"* (our emphasis). The RBNZ seems to be exhorting the Government to spend more as a countercyclical measure, which is a fairly unusual move for the RBNZ.

The second oddity was a single-sentence paragraph in the summary record of meeting:

"The Committee discussed the long and variable lags between monetary policy decisions and outcomes."

It is not at all clear what the relevance of this sentence is, or whether the discussion had any bearing on the OCR decision. Our guess is that the Committee wanted to wait and see what the impact of the cuts to date would be, and there was a discussion about how long that might take. But that is pure supposition on our part.

And most opaque of all was another single-sentence paragraph:

"The Committee discussed the secondary objectives from the remit and remained comfortable with the monetary policy stance."

Our guess on this one is even more speculative. The Committee might have done a bit of soul searching on whether the decision to cut 50bps at the last Statement was consistent with the RBNZ's secondary objective that it should "seek to avoid unnecessary instability," given the nervousness in the business community that followed the double-sized cut.

Full text of RBNZ statement:

The Official Cash Rate (OCR) remains at 1.0 percent. The Monetary Policy Committee agreed that new information since the August Monetary Policy Statement did not warrant a significant change to the monetary policy outlook.

Employment is around its maximum sustainable level, and inflation remains within our target range but below the 2 percent mid-point.

Global trade and other political tensions remain elevated and continue to subdue the global growth outlook, dampening demand for New Zealand's goods and services. Business confidence remains low in New Zealand, partly reflecting policy uncertainty and low profitability in some sectors, and is impacting investment decisions.

Global long-term interest rates remain near historically low levels, consistent with low expected inflation and growth rates into the future. Consequently, New Zealand interest rates can be expected to be low for longer.

The reduction in the OCR this year has reduced retail lending rates for households and businesses, and eased the New Zealand dollar exchange rate.

Low interest rates and increased government spending are expected to support a pick-up in domestic demand over the coming year. Household spending and construction activity are supported by low interest rates, while the incentive for businesses to invest will grow in response to demand pressures.

Keeping the OCR at low levels is needed to ensure inflation increases to the mid-point of the target range, and employment remains around its maximum sustainable level. There remains scope for more fiscal and monetary stimulus, if necessary, to support the economy and maintain our inflation and employment objectives.

Meitaki, thanks.

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