Economic Bulletin.

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Holding, holding – Preview of RBNZ Monetary Policy Review, April 2021.

- We expect no change in monetary policy settings at next Wednesday's review, with the OCR on hold at 0.25% for the foreseeable future.
- A softer than expected starting point for the New Zealand economy will be balanced against a rapidly improving global outlook.
- The Government's housing policy announcement last month will have only a moderate impact on the RBNZ's house price forecasts, which were already on the conservative side.
- The RBNZ is already braced for a near-term spike in inflation.
- But it will reiterate that a sustained return to its inflation and employment goals is a considerable time away.

Michael Gordon, Acting Chief Economist
+64 9 336 5670

We expect no significant change in the Reserve Bank's stance at its Monetary Policy Review (MPR) next Wednesday. (Formerly known as the OCR Review – the name change reflects the fact that the Official Cash Rate is no longer the only policy tool in play.) The recent news on the domestic economy has been softer than expected, but this is offset to some degree by a rapidly improving global outlook and growing concerns about cost and price pressures.

In its February *Monetary Policy Statement*, the RBNZ concluded that "meeting [its inflation and employment] requirements will necessitate considerable time and patience". While it didn't publish a forward projection for the OCR (and won't at next week's review either), the implication was that the OCR is unlikely to rise from its current level of 0.25% for a long time. And it could go lower – even negative – if conditions warrant it.

We expect that message to be more or less repeated next week. This would be broadly neutral for financial markets – which wouldn't have been the case prior to the Government's housing policy announcement last month, when the local market had started to join the recent global trend towards pricing in rate hikes.

In terms of recent developments, the news on the New Zealand economy has been on the softer side. GDP fell by 1% in the December quarter last year, against the RBNZ's forecast of a flat result. It's possible that the RBNZ will 'write back' some of this surprise into their forecasts, to the extent that it reflected the greater impact of the loss of overseas tourists during summer – an effect that will work in the other direction through the middle of the year.

While the local picture has been softer lately, forecasts for global growth are being revised up rapidly, driven in part by confidence about the impact of Covid-19 vaccines and new fiscal stimulus measures. That optimism is also manifesting as a strong lift in global commodity prices, including for some of our key exports.

The confirmation of the trans-Tasman travel bubble is a clear 'surprise' for the RBNZ, which had assumed no border reopening of any kind until 2022. That said, it may not end up having much impact on GDP – prior to the border closure, net tourism spending between New Zealand and Australia was closer to balanced. As Kiwis start to head to Australia again, that will come at the expense of those areas that benefited from diverted spending in 2020, such as home furnishings and renovations.

The Government's recent housing policy changes – specifically the removal of interest deductibility for property investors – are a big deal for the housing market, and will have implications for the outlook for consumer spending, activity and inflation. The impact is probably less significant for the RBNZ than for us – its forecast of house prices in the February *MPS* was already on the more conservative side, with house price inflation expected to cool rapidly from the second half of this year.

We'd also note that a dramatic change to the RBNZ's house price forecasts would be inconsistent with its previous statements. Rightly or wrongly, the RBNZ has attributed the recent strength in prices to factors such as demand from returning New Zealanders and constrained housing supply – neither of which would be affected by the tax changes.

Inflation is becoming a hot topic again, both here and overseas. Anecdotes and business surveys reveal growing concern about rising prices, driven by factors such as disruptions to global supply chains and a jump in shipping costs. The RBNZ is already braced for a spike in inflation in the near term, with annual inflation forecast to reach 2.5% by the middle of this year, and not much has happened since February that would warrant revising that forecast even higher. However, we'll be watching for any signs of concern from the RBNZ that this could be more than just a blip.

Overall, the developments since February have been on the negative side for the monetary policy outlook, though not enough to warrant a change in the RBNZ's stance. We expect that next week's statement will repeat the conclusion from February:

"The Committee agreed to maintain its current stimulatory monetary settings until it is confident that consumer price inflation will be sustained at the 2 percent per annum target midpoint, and that employment is at or above its maximum sustainable level."

The RBNZ will also reiterate that it's prepared to provide additional monetary stimulus if necessary. Any further easing would most likely be in the form of a negative OCR, and the RBNZ will again emphasise that it is both willing, and now able, to do so after last year's preparation work. We see no real scope to expand the Large-Scale Asset Purchase (LSAP) programme further, and indeed at the current pace of purchases it's likely to wind up well short of the $100bn cap.

Contact the Westpac economics team.

Michael Gordon, Acting Chief Economist
+64 9 336 5670

Satish Ranchhod, Senior Economist
+64 9 336 5668

Nathan Penny, Senior Agri Economist
+64 9 348 9114

Paul Clark, Industry Economist
+64 9 336 5656

Any questions email:
economics@westpac.co.nz

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