



ECONOMIC BULLETIN

RBNZ July 2024 Monetary Policy Review.

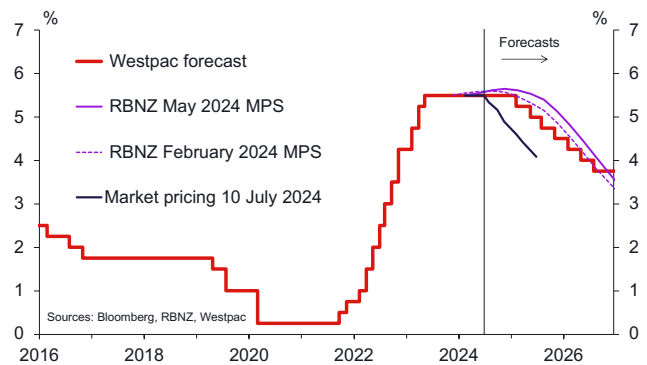


10 Jul 2024 | Kelly Eckhold, Chief Economist | +64 21 786 758 | kelly.eckhold@westpac.co.nz | X: @kellyenz

Keeping it tight... for a while.

- The RBNZ left the OCR at 5.5% as expected.
- The RBNZ took a more dovish view – easing looks to be coming earlier than they previously thought.
- The short-term inflation outlook seems more comfortable for the RBNZ.
- But it's the weaker growth momentum that seems especially top of mind.
- The RBNZ's monetary policy strategy is shifting towards preparing for a reduction in restrictiveness. The RBNZ is "keeping it tight" but looks forward to easing earlier.
- We see this as consistent with our forecast of an initial easing in February 2025 with some chance of a November easing.

Official Cash Rate forecasts



The RBNZ left the OCR unchanged at 5.5% as expected but took a more dovish tone on the outlook.

As we discussed in our *Monetary Policy Review* preview note, a key area of interest was the RBNZ's updated assessment of the forward growth situation given recent weaker economic indicators that have seen markets price in a significant chance of interest rate cuts in 2024.

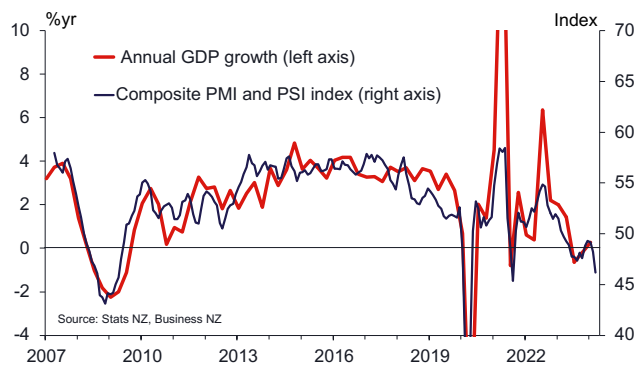
The RBNZ's commentary indeed reflected concerns that the forward growth profile looks weaker than before. In particular, the record of the meeting noted that:

"...recent higher frequency indicators suggest that near-term growth in business activity has weakened. A range of business and consumer surveys, and higher frequency spending and credit data, all point to declining activity."

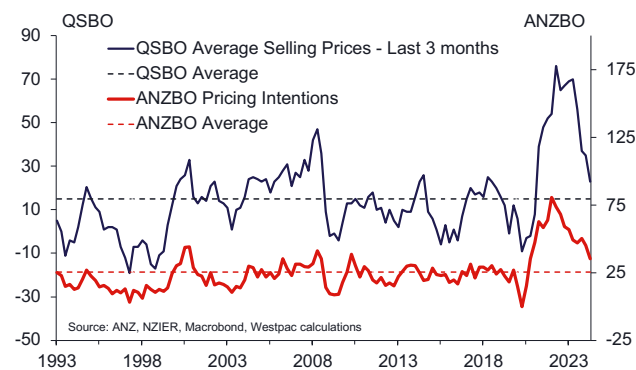
This contrasts with the *May Statement*, in which the RBNZ forecast low but positive GDP growth over each quarter of this year. This suggests that the RBNZ will revise down its GDP growth forecasts in the *August Statement*, and with that project a more negative output gap and so weaker domestic inflation pressures. The record also noted that:

"...recent survey measures of hiring intentions and job vacancies indicate flat employment levels."

Q2 GDP looks weak based on the PMI indicators



Pricing intentions indicators compared to average



Fiscal policy.

Regarding fiscal policy, the record of meeting suggests less concern about Budget 2024 than we had expected, especially considering the comments made in the *May Statement*. The RBNZ noted that lower government spending has already been contributing to weaker demand and it expects that this will continue over the period. It was noted that the positive impact of impending tax cuts on private spending is yet to occur. However, at this stage the RBNZ regards the magnitude of that impact “more uncertain”. We think that part of that uncertainty likely stems from uncertainty regarding the near-term direction of the economy, with current levels of consumer pessimism likely to dampen some consumers’ willingness to spend these cuts.

Inflation.

The RBNZ also sounds more confident about the outlook for inflation, noting that it is expected to return within the target range “...in the second half of the year.” Previously, the RBNZ noted that this was expected to occur “...by the end of 2024.”

The RBNZ’s rhetoric around medium term inflation risks has been dialled back. The RBNZ notes that:

“Domestic inflation measures remain more persistent, but growing excess capacity in the domestic economy provides greater certainty that they will sustainably decline.”

They also seem to have taken some comfort from recent business surveys which have shown an easing in both cost pressures and the number of businesses who have been raising their prices.

Monetary policy strategy.

We didn’t think the RBNZ would have any significant change in message to communicate and wouldn’t be keen to endorse recent dovish market pricing suggesting meaningful chances of OCR cuts by the end of 2024. This was wrong.

While the RBNZ’s commentary was very short, the tone of the commentary suggests a change in strategy is coming. The title of the statement “Inflation approaching target range” and the final sentences:

“The Committee agreed that monetary policy will need to remain restrictive. The extent of this restraint will be tempered over time consistent with the expected decline in inflation pressures.”

are revealing in that the RBNZ is moving towards dialling back restriction as inflation falls closer to target. This tells us that the *May Statement* interest rate track is now stale and that current projections are consistent with an earlier start to easing. To some extent this follows the prevailing trend among developed market central banks to start dialling back restriction once the inflation target range nears. It also reflects the weaker economic data of late and it may also reflect the sense that once inflation is inside the target range the RBNZ can and perhaps will be more relaxed.

This is comforting given the RBNZ’s previous forecast start to the easing cycle was 6 months beyond most domestic forecasters (including our own February 2025 call). The question is the implied extent of the shift in strategy. Our sense is that the “feasible set” for initial RBNZ easing lies in the November 2024 to February 2025 range now.

The extent of the shift in view will come at the *August Statement* and with the benefit of the Q2 CPI and labour market reports due in coming weeks. Should the CPI report in particular print noticeably below the RBNZ’s 0.6% published forecast (we suspect their internal forecast is lower than this now) then this could open up a shift to a November easing forecast – although we still think this is a stretch.

Key will be their confidence on the medium-term inflation outlook as opposed to the proximity of the 1-3% target range “The extent of this restraint will be tempered over time consistent with the *expected* decline in inflation pressures” (our emphasis added).

The RBNZ is setting markets up to price an earlier easing start dependent on the inflation data to come. They are clearly not yet there – or easing would have started – but they no longer are discussing tightening. The RBNZ also are discussing the beginning of a measured rate cut cycle – presumably in line with the evolution of inflation outcomes. We don’t think this is the beginning of the GFC style swift and severe OCR reduction campaign (unless the economy and inflation take a step down commensurate to the much weaker scenario seen in over 2008/09).

Our OCR view.

We retain our call for first cut to the OCR to 5.25% in February 2025. It’s comforting to see the RBNZ move back towards us but it’s not clear they have vaulted us at this point. The RBNZ may have moved back to where they were in February this year where our views were closely aligned. We will be watching the inflation data most carefully to see if it is able to provide the confidence that an earlier move down in the OCR is more likely. The non-tradable inflation components will be top of mind in that regard.

Data to watch.

Key data to watch between now and the August *Statement* include:

- The June quarter CPI (17 July) where the level of core inflation will be especially key (headline CPI forecasts: RBNZ May 0.6% q/q, WBC 0.6% q/q, non-tradables CPI forecasts: RBNZ February 0.8% q/q, WBC 0.8% q/q).
- The June quarter labour market reports (7 August) where further signs of labour market loosening will be sought (unemployment rate forecasts: RBNZ May 4.6%, WBC 4.6%, private sector LCI wages forecasts: RBNZ May 0.9% q/q, WBC 0.8% q/q).

Market reaction.

Markets have reacted significantly to today’s significant change in tone from the RBNZ. At the time of writing, markets are pricing around a 60% chance of a 25bp easing at the August MPS meeting and have more than fully priced a 25bp easing by the time of the October OCR review.

CONTACT

Westpac Economics Team | westpac.co.nz/economics | economics@westpac.co.nz

Kelly Eckhold, Chief Economist | +64 9 348 9382 | +64 21 786 758 | kelly.eckhold@westpac.co.nz

Satish Ranchhod, Senior Economist | +64 9 336 5668 | +64 21 710 852 | satish.ranchhod@westpac.co.nz

Darren Gibbs, Senior Economist | +64 9 367 3368 | +64 21 794 292 | darren.gibbs@westpac.co.nz

Michael Gordon, Senior Economist | +64 9 336 5670 | +64 21 749 506 | michael.gordon@westpac.co.nz

Paul Clark, Industry Economist | +64 9 336 5656 | +64 21 713 704 | paul.clark@westpac.co.nz

Past performance is not a reliable indicator of future performance. The forecasts given in this document are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

DISCLAIMER

Things you should know.

Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141 ('Westpac').

Disclaimer.

This material contains general commentary, and market colour. The material does not constitute investment advice. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Country disclosures.

Australia: Westpac holds an Australian Financial Services Licence (No. 233714). This material is provided to you solely for your own use and in your capacity as a wholesale client of Westpac.

New Zealand: In New Zealand, Westpac Institutional Bank refers to the brand under which products and services are provided by either Westpac or Westpac New Zealand Limited ("WNZL"). Any product or service made available by WNZL does not represent an offer from Westpac or any of its subsidiaries (other than WNZL). Neither Westpac nor its other subsidiaries guarantee or otherwise support the performance of WNZL in respect of any such product. The current disclosure statements for the New Zealand branch of Westpac and WNZL can be obtained at the internet address www.westpac.co.nz.

China, Hong Kong, Singapore and India: This material has been prepared and issued for distribution in Singapore to institutional investors, accredited investors and expert investors (as defined in the applicable Singapore laws and regulations) only. Recipients in Singapore of this material should contact Westpac Singapore Branch in respect of any matters arising from, or in connection with, this material. Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking licence and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activities. This material is intended only to "professional investors" as defined in the Securities and Futures Ordinance and any rules made under that Ordinance. Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking and Insurance Regulatory Commission (CBIRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

UK: The contents of this communication, which have been prepared by and are the sole responsibility of Westpac Banking Corporation London and Westpac Europe Limited. Westpac (a) has its principal place of business in the United Kingdom at Camomile Court, 23 Camomile Street, London EC3A 7LL, and is registered at Cardiff in the UK (as Branch No. BR00106), and (b) authorised and regulated by the Australian Prudential Regulation Authority in Australia. Westpac is authorised in the United Kingdom by the Prudential Regulation Authority. Westpac is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

This communication is being made only to and is directed at (a) persons who have professional experience in matters relating to investments who fall within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (b) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this communication or any of its contents. The investments to which this communication relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this communication or any of its contents. In the same way, the information contained in this communication is intended for "eligible counterparties" and "professional clients" as defined by the rules of the Financial Conduct Authority and is not intended for "retail clients". With this in mind, Westpac expressly prohibits you from passing on the information in this communication to any third party. In particular this communication and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction. This communication is made in compliance with the Market Abuse Regulation (Regulation(EU) 596/2014).

Investment recommendations disclosure.

The material may contain investment recommendations, including information recommending an investment strategy. Reasonable steps have been taken to ensure that the material is presented in a clear, accurate and objective manner. Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts in interests associated with the provision of investment recommendations.

- (i) Chinese Wall/Cell arrangements;
- (ii) physical separation of various Business/Support Units;
- (iii) and well defined wall/cell crossing procedures;
- (iv) a "need to know" policy;
- (v) documented and well defined procedures for dealing with conflicts of interest;
- (vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

U.S: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission ("CFTC") as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC ("WCM"), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 ("the Exchange Act") and member of the Financial Industry Regulatory Authority ("FINRA"). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not be subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.

