

Fed Hyperactive as RBNZ Hibernates

- NZ OCR kept at 1.75%
- RBNZ downplays short-term growth and inflation weakness
- But shows no signs of waking from its slumber
- Meanwhile, the Fed gets more aggressive
- Ultimately putting upward pressure on the RBNZ's future rate track

We had expected today's RBNZ OCR review to be singularly unexciting. We were right! There is nothing in today's very short missive from the Bank to suggest that it has changed from its February MPS view of the world in any meaningful way. And that view, remember, does not have a rate increase fully priced until Q1, 2020.

At the margin, we felt the Bank was giving a subtle signal that any talk of rate cuts should be smothered. Whenever the Bank noted issues of weakness it was quick to dispel their significance. For example:

- The RBNZ states that Q4 growth was weaker than expected but attributes this to "weather-effects on agricultural production" and then goes on to note that "growth is expected to strengthen";
- It reinforces this with "Labour market conditions are projected to tighten further";
- It acknowledges that "CPI is expected to weaken further" but reiterates its expectation that it will still then "trend upwards towards the midpoint of the target range".

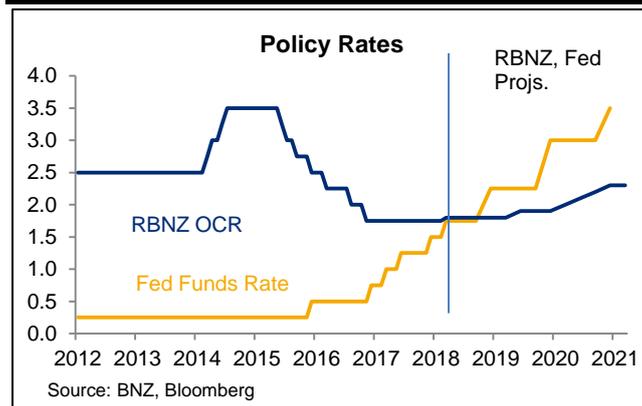
Not surprisingly, markets have not reacted to today's statement as there was nothing to react to.

The stance of the RBNZ stands out in stark comparison with the positioning of the United States' Federal Reserve, as evidenced in this morning's FOMC statement. While the RBNZ is happy to sit on its hands the Fed is all-go.

Today the Fed delivered a rate track that was even more aggressive than before. There's still another two rate hikes penned in for this year but now there are three hikes in 2019 (previously two) and two extra hikes in 2020 (previously one).

There are good reasons why the Fed is more aggressive than the RBNZ. Core inflation is closing in on the Fed's

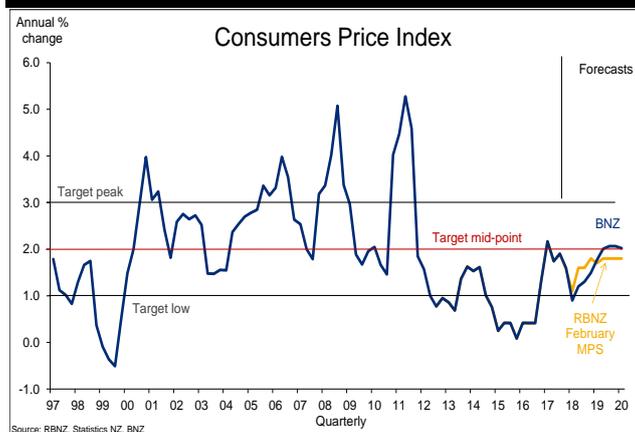
Fed Relatively Aggressive



target much more rapidly than core inflation in New Zealand is; the US economy is perceived to be closer to full capacity; and, importantly, its unemployment rate is threatening to fall well below that economy's NAIRU.

Be that as it may, we continue to struggle with the RBNZ's belief that rates here can stay as low, for as long, as it currently projects. If the Fed is right about the state of the US economy then this means that New Zealand will be facing into a more inflationary world. Moreover, we are reaching our own capacity constraints, particularly in the labour and housing markets. Additionally, one has to question how well the NZD would perform, and how NZ would fund itself in the event that the projected rates of the respective central banks come to fruition.

Inflation To Dip



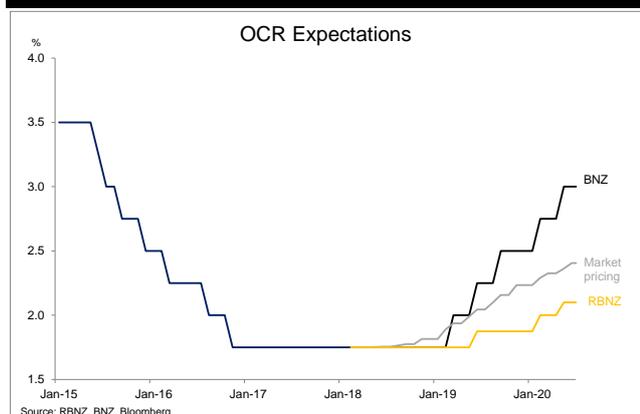
This is one of the reasons we have taken a more aggressive stance on rates than the RBNZ has. We acknowledge, however, that the next set of inflation outcomes is likely to come in below the RBNZ's February MPS statement and that this will reinforce its view that the cash rate can stay here for longer than we have assumed. Accordingly, there is significant risk that we will need to postpone our forecast first rate increase from February 2019 to later in the year but we won't be rushing to do this as there is plenty of water to go under the bridge yet. Perhaps more importantly, we still believe that it would take a negative economic shock to generate the OCR track that the RBNZ currently projects.

While our rate forecasts are at the hawkish end of the spectrum, we equally note that market pricing also remains more aggressive than the RBNZ's expectations.

So now it's just wait and watch until the May MPS - an MPS that will be overseen by a new Governor, Adrian Orr, and a new Policy Targets Agreement, which will include some sort of employment maximization mandate alongside the current inflation objective. We don't expect these changes will have a material impact on the Bank's near-term stance but a changing of the guard will always bring with it new nuances that will need to be pondered.

stephen_toplis@bnz.co.nz

RBNZ More Dovish Than Market



The full text of today's RBNZ OCR Review – Official Cash Rate unchanged at 1.75 percent

Statement by Reserve Bank Governor Grant Spencer:

The Reserve Bank today left the Official Cash Rate (OCR) unchanged at 1.75 percent.

The outlook for global growth continues to gradually improve. While global inflation remains subdued, there are some signs of emerging pressures. Commodity prices have continued to increase and agricultural prices are picking up. Equity markets have been strong, although volatility has increased. Monetary policy remains easy in the advanced economies but is gradually becoming less stimulatory.

GDP was weaker than expected in the fourth quarter, mainly due to weather effects on agricultural production. Growth is expected to strengthen, supported by accommodative monetary policy, a high terms of trade, government spending and population growth. Labour market conditions are projected to tighten further.

Residential construction continues to be hindered by capacity constraints. The Kiwibuild programme is expected to contribute to residential investment growth from 2019. House price inflation remains moderate with restrained credit growth and weak house sales.

CPI inflation is expected to weaken further in the near term due to softness in food and energy prices and adjustments to government charges. Tradables inflation is projected to remain subdued through the forecast period. Non-tradables inflation is moderate but is expected to increase in line with a rise in capacity pressure. Over the medium term, CPI inflation is forecast to trend upwards towards the midpoint of the target range. Longer-term inflation expectations are well anchored at 2 percent.

Monetary policy will remain accommodative for a considerable period. Numerous uncertainties remain and policy may need to adjust accordingly.

Contact Details

BNZ Research

Stephen Toplis

Head of Research
+64 4 474 6905

Craig Ebert

Senior Economist
+64 4 474 6799

Doug Steel

Senior Economist
+64 4 474 6923

Jason Wong

Senior Markets Strategist
+64 4 924 7652

Nick Smyth

Interest Rates
Strategist
+64 4 924 7653

Main Offices

Wellington

Level 4, Spark Central
42-52 Willis Street
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Toll Free: 0800 283 269

Auckland

80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Toll Free: 0800 283 269

Christchurch

111 Cashel Street
Christchurch 8011
New Zealand
Toll Free: 0800 854 854

National Australia Bank

Peter Jolly

Global Head of Research
+61 2 9237 1406

Alan Oster

Group Chief Economist
+61 3 8634 2927

Ray Attrill

Head of FX Strategy
+61 2 9237 1848

Skye Masters

Head of Fixed Income Research
+61 2 9295 1196

Wellington

Foreign Exchange +800 642 222
Fixed Income/Derivatives +800 283 269

Sydney

Foreign Exchange +61 2 9295 1100
Fixed Income/Derivatives +61 2 9295 1166

London

Foreign Exchange +44 20 7796 3091
Fixed Income/Derivatives +44 20 7796 4761

New York

Foreign Exchange +1 212 916 9631
Fixed Income/Derivatives +1 212 916 9677

Hong Kong

Foreign Exchange +85 2 2526 5891
Fixed Income/Derivatives +85 2 2526 5891

ANALYST DISCLAIMER: The person or persons named as the author(s) of this report hereby certify that the views expressed in the research report accurately reflect their personal views about the subject securities and issuers and other subject matters discussed. No part of their compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in the research report. Research analysts responsible for this report receive compensation based upon, among other factors, the overall profitability of the Markets Division of National Australia Bank Limited, a member of the National Australia Bank Group ("NAB"). The views of the author(s) do not necessarily reflect the views of NAB and are subject to change without notice. NAB may receive fees for banking services provided to an issuer of securities mentioned in this report. NAB, its affiliates and their respective officers, and employees, including persons involved in the preparation or issuance of this report (subject to the policies of NAB), may also from time to time maintain a long or short position in, or purchase or sell a position in, hold or act as advisors, brokers or commercial bankers in relation to the securities (or related securities and financial instruments), of companies mentioned in this report. NAB or its affiliates may engage in these transactions in a manner that is inconsistent with or contrary to any recommendations made in this report.

NEW ZEALAND DISCLAIMER: This publication has been provided for general information only. Although every effort has been made to ensure this publication is accurate the contents should not be relied upon or used as a basis for entering into any products described in this publication. Bank of New Zealand strongly recommends readers seek independent legal/financial advice prior to acting in relation to any of the matters discussed in this publication. Neither Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication.

US DISCLAIMER: If this document is distributed in the United States, such distribution is by nabSecurities, LLC. This document is not intended as an offer or solicitation for the purchase or sale of any securities, financial instrument or product or to provide financial services. It is not the intention of nabSecurities to create legal relations on the basis of information provided herein.

National Australia Bank Limited is not a registered bank in New Zealand.