4 May 2018

RBNZ MPS Preview: Out with the old, in with the old

- **New Governor, new PTA**
- **But the world is no different**
- **So policy shift highly unlikely**
- **Minimal change to rate track**
- **But tight labour market removes any lingering thoughts of a cut**

Those looking for a radical shift in the stance of the RBNZ thanks to the installation of a new governor and a new Policy Targets Agreement will be disappointed. Yes, there will be subtle nuances and, it goes without saying that Adrian Orr's presentation style in the post MPS news conference will be more dynamic than his predecessor. But a change in direction? No!

Orr is open, articulate and sometimes very humorous but he's still, at his core, a relatively mainstream economist who has already committed himself to price stability with a focus on the mid-point of the RBNZ's target band. Moreover, he has also openly stated that he has the use of existing expertise within the RBNZ whom he will defer to. Accordingly, the broader framework for the Bank's analysis will be unchanged from that of the February Monetary Policy Statement and March OCR review.

In those respective reviews the RBNZ stuck to its premise that interest rates will "remain accommodative for a considerable period". Indeed, they are currently forecast to remain static until mid-2019. We would be surprised if the Bank's OCR track moved in any meaningful way compared with that published in February.

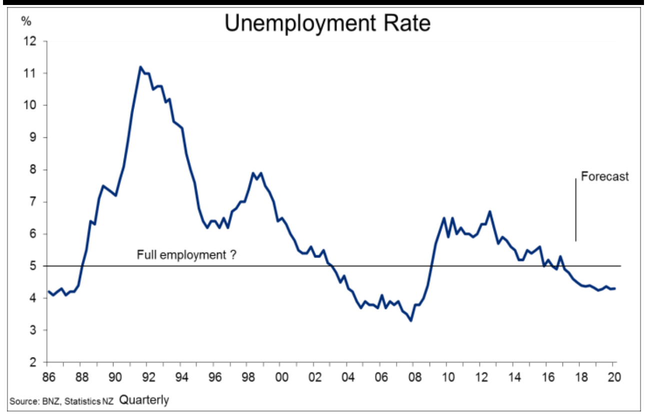
There may, nonetheless, be some subtle changes in the content of the MPS in order to meet the requirements of the new PTA. In particular, the RBNZ is now tasked with explaining "how current monetary policy decisions contribute to supporting maximum levels of sustainable employment within the economy". This doesn't necessarily mean that the Bank will change what it does but it might feel the need to more thoroughly explain what it's doing and why with deference to the labour market.

When the employment dual mandate was initially being discussed many thought that this would result in a more dovish central bank. At the time we dissented with this view and we maintain our belief that, at the very margin, it is likely to bend the RBNZ more towards the hawkish end of the spectrum. By almost any measure available one can conclude that the economy is already very close to its maximum level of sustainable employment. Indeed if the RBNZ's 4.7% estimate of the NAIRU (Non-Accelerating Inflation Rate of Unemployment) is apt then the 4.4% recently reported is already below target. We definitely have more confidence that the labour market is at target, and likely to stay that way for some time, than we are convinced inflation is, or will be, near target any time soon.

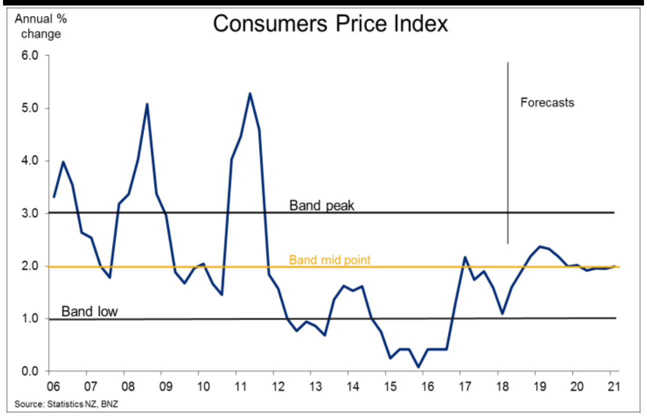
At the very least one would have to conclude that the RBNZ could not contemplate cutting interest rates while the labour market is so tight. Whether the Bank is willing to say this publicly or not is moot.

As for CPI inflation, we think the risks to the RBNZ's medium term views are to the upside.

Unemployment At Target



Inflation Not Yet There



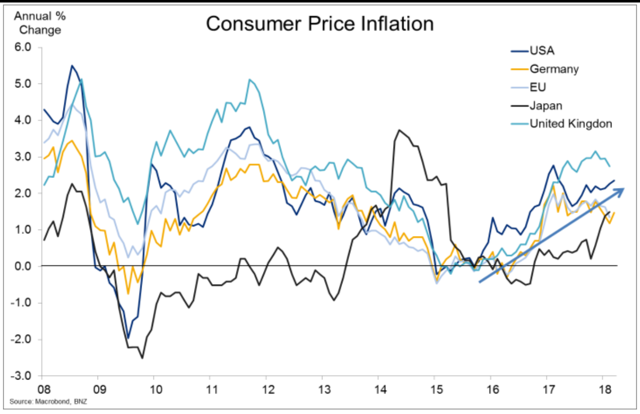
National Australia Bank

- The NZ TWI is below the level that the RBNZ had assumed when it put its last full set of forecasts together. It's only around 2% shy at this stage but we think it will decline further.
- Commodity prices, particularly oil, are elevated relative to expectations.
- We have seen higher global inflation and raised inflation forecasts. And,
- domestic capacity constraints seem to be getting more aggressive.

It's debatable whether the RBNZ will see heightened inflation, as we do, but it would seem highly unlikely to us that it would produce an inflation track any lower than previously published. This again suggests that any shift, was there to be one, should only be to the hawkish side.

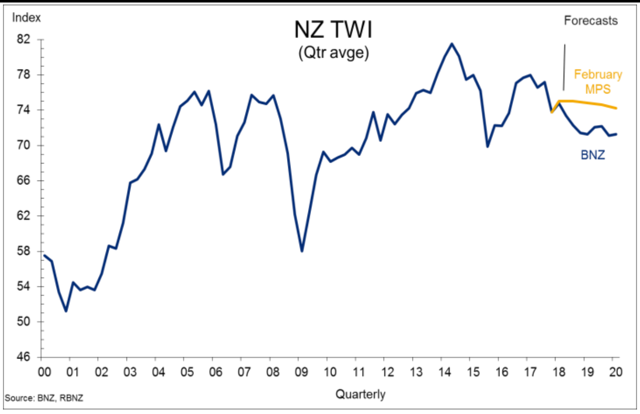
Sure, Q4 GDP came in weaker than the RBNZ had anticipated but the Bank was quick to dismiss this in its March OCR review when it said that it was "mainly due to weather effects on agriculture production" and that, despite this, "growth is expected to strengthen". We still think the RBNZ is too optimistic about future growth but we don't see anything in recent data that would cause it to change its view at this juncture.

Global Inflation Rising

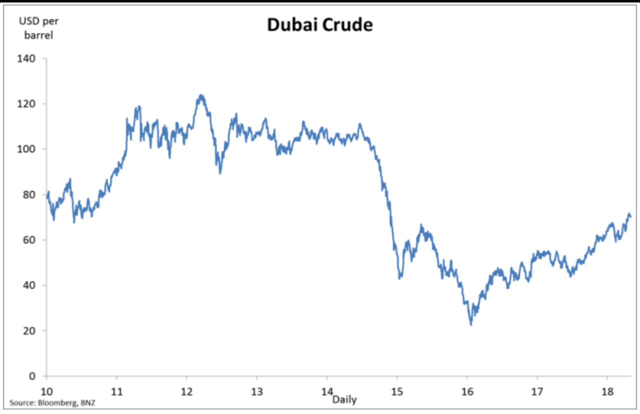


Currently the market has New Zealand's first rate hike fully priced in for the June 2019 OCR review. We've formally got February in our forecast track but, realistically, we are equivocating between February and May. On this basis, and, given what we think the RBNZ will say next Thursday, we believe minimal market reaction will be the order of the day. The risk is that market players read too much into any small changes in substance, or style, resulting in an unwarranted reaction.

NZD Weakening



Oil Prices Up



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