28 June 2018

RBNZ Will Move Rates Sooner

- RBNZ provides no clear directional bias
- But looks more edgy
- A shock would cause a rate cut
- But broader momentum in inflation still argues for a tightening bias
- Our view of a hike mid-2019 is unchanged

The RBNZ is closer to moving interest rates. That is the key message from today's OCR review. What is less clear is in what direction. Be that as it may, we stick with our view that the cash rate is more likely to rise than fall and that the Reserve Bank will be bringing forward that rate hike, from its previously published early - 2020, in due course.

First up, we note that there are several subtle, but specific, changes in today's statement that highlight the fact that the RBNZ is now more jumpy. In May the Bank said the OCR will remain at 1.75% "for some time". Now it says it will remain there "for now". Back in May it said that it expected to keep the OCR at "this" expansionary level for a considerable period of time. Now it expects to keep the OCR at "an" expansionary level.

For both hawks and doves there was something to grab from the statement. For either hawk or dove the fact that the Reserve Bank seems closer to moving is fuel for the fire. For the doves, specifically, though:

- The global outlook is tempered by trade tensions
- The weaker than anticipated GDP means more spare capacity than expected
- Fiscal stimulus is less than anticipated

For the hawks:

- The Bank says that its outlook for the New Zealand economy, as detailed in the MPS, remains intact
- Inflation is likely to increase in the near term due to higher fuel prices
- Capacity constraints will push inflation back to the mid-point of the Bank's target band

In pointing out the above the Bank has done a very good job at acknowledging all the changes that have become evident since the MPS was released. Indeed, overall we think it was a very well-crafted statement. If we were to criticize anything, and we acknowledge we are being pedantic, it is that there is the odd sloppiness in the text. For example, the Bank refers to there being "marginally more spare capacity" but the May MPS says that the output gap is positive so the Bank should have said something like "marginally less capacity constraint". And it refers to the "2 percent mid-point of our target" and the "2 percent annual target". But we are splitting hairs.

Whatever the case, we remind all and sundry that the Reserve Bank's decisions ultimately revolve around its inflation projections and, now, its labour market considerations. So, in this vein, the RBNZ still expects inflation to gradually rise to its 2.0% target and that employment is around its sustainable level. This is why we think an implicit tightening bias must still be in place.

Putting all this together, we think the best way of interpreting all the above is to say:

- The RBNZ really doesn't want to move interest rates
- But if there is a rate move in the next few months it will be because of a negative shock so rates would fall
- However, the likelihood of this is very small and the anchor to the forecast track is that rising inflation will ultimately necessitate a less stimulative cash rate.

Financial markets didn't move on today's announcement. This is an appropriate reaction in our view. The balance of risk remains that weak short term activity data nudge markets towards a more dovish view which is then eventually stymied by upward momentum in inflation.

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Full text of RBNZ statement on the following page.

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

The Official Cash Rate (OCR) will remain at 1.75 percent for now. However, we are well positioned to manage change in either direction – up or down – as necessary.

Our outlook for the New Zealand economy, as detailed in the May Monetary Policy Statement, remains intact. Employment is around its sustainable level and consumer price inflation remains below the 2 percent mid-point of our target, necessitating continued supportive monetary policy for some time to come.

Global economic growth is expected to support demand for our products and services. Global inflationary pressure is also expected to be higher but remain modest. This outlook has been tempered slightly by trade tensions in some major economies. Ongoing volatility in some emerging market economies continues.

Domestically, ongoing spending and investment, by both households and government, is expected to support growth. However, the recent weaker GDP outturn implies marginally more spare capacity in the economy than we anticipated. The Government's projected spending impulse is also slightly lower and later than anticipated.

CPI inflation is likely to increase in the near term due to higher fuel prices. Beyond that, inflation is expected to gradually rise to our 2 percent annual target, resulting from capacity pressures.

The best contribution we can make to maximising sustainable employment, and maintaining low and stable inflation, is to ensure the OCR is at an expansionary level for a considerable period.

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