BNZ Forecasts Rate Cuts: November and February

- RBNZ leaves cash rate unchanged at 1.00%
- It maintains a clear easing bias
- We think growth won’t meet RBNZ expectations
- So increase our expected easing
- But note that RBNZ suggests an extended pause at some stage

Unlike the August Monetary Policy Statement, today’s OCR delivered no surprises. In short, the RBNZ left its cash rate unchanged at 1.00%, it confirmed it has an easing bias, and noted that interest rates will be staying low for some time.

Obviously, there were some in financial markets who were looking for a more dovish statement as the NZD jumped after its release and there was a small sell off in rates. We suspect this was more about positioning than the market, as a whole, being caught off guard.

The committee noted that “new information since the August Monetary Policy Statement did not warrant a significant change to the monetary policy outlook.” We would concur with that sentiment, on balance. In summary:
- Q2 GDP growth came in on expectations;
- weakening leading indicators suggest that future GDP growth will be lower than the RBNZ expect; but
- a lower exchange rate, higher petrol prices and higher food prices mean inflation (at least in the short term) should be higher than forecast.

It was nice to see the RBNZ acknowledge that weakness in business confidence partly reflects “policy uncertainty and low profitability in some sectors”. We have been pushing this barrow for some time. We have also noted that these factors will moderate the impact of lowering interest rates. We are not yet convinced that the RBNZ sees things this way.

The Bank remains of the view that “low interest rates and increased government spending are expected to support a pick-up in domestic demand over the coming year”. We again concur. However, we are less optimistic that the pace of growth will match the RBNZ’s expectations. For example, we are looking for GDP growth of just 0.3% through the September quarter of this year compared to the RBNZ’s pick of 0.6%. Of course, these data are not released until December 19 so will have limited bearing on the RBNZ’s November MPS decision.

Will growth bounce?

What is likely to have more of a bearing on the November decision is the likelihood that the RBA will have lowered its cash rate a further 25 basis points by then. Our NAB colleagues believe the rate reduction will come as early as next week. They also believe the RBA will follow this up with another cut (to 0.5%) in December.

Ultimately, however, softer than expected growth is likely to dominate the RBNZ’s thinking so we are today including a February rate cut into our forecast cash rate track in addition to the reduction we expect in November. We are quick to note that this shift in stance has been well foreshadowed and we are doing it today because we have recently lowered our growth forecasts not because of anything in the OCR statement.

Moreover, if growth slows as low as many of our leading indicators are currently foreshadowing then even more rate cuts are a distinct possibility. That said, there are the first signs of evidence in the committee’s summary record of meeting that the RBNZ would be open to a pause, at some stage in the not too distant future,
by acknowledging “the long and variable lags between monetary policy decisions and outcomes”. We would thus not be surprised if the RBNZ looked to an extended period of no rate movement after the February cut. While we are not forecasting it, we would actually be comfortable with an extended pause now.

Interestingly, the RBNZ gave the government a gentle reminder that there is room for more fiscal stimulus. There is. And we don’t have any difficulty with the central bank giving the government a gentle nudge either. We continue to believe interest rates will be less effective as we converge on zero. Furthermore, we don’t think that the current level of interest rates (or the NZD for that matter) is impeding economic growth so other “tools” may be needed to influence the economy. In the current environment it is necessary that both the fiscal and monetary authorities work in tandem and refrain from playing demarcation games.

Nonetheless, we caution that fiscal easing is not that simple. Extra spending on infrastructure might be problematic given the capacity constraints that exist, tax cuts don’t appear to be on the government’s agenda, and the government must be very cautious in ensuring that any increase in expenditure is more about quality than quantity. We should also add that regulatory changes could be looked at to play a major role in stimulating the economy, and at relatively low cost. Anything that the government can do to assist in removing the bottlenecks that seem to be afflicting so many businesses at the moment would be welcomed.

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The full text of today’s RBNZ OCR Review –

The Official Cash Rate (OCR) remains at 1.0 percent. The Monetary Policy Committee agreed that new information since the August Monetary Policy Statement did not warrant a significant change to the monetary policy outlook.

Employment is around its maximum sustainable level, and inflation remains within our target range but below the 2 percent mid-point.

Global trade and other political tensions remain elevated and continue to subdue the global growth outlook, dampening demand for New Zealand’s goods and services. Business confidence remains low in New Zealand, partly reflecting policy uncertainty and low profitability in some sectors, and is impacting investment decisions.

Global long-term interest rates remain near historically low levels, consistent with low expected inflation and growth rates into the future. Consequently, New Zealand interest rates can be expected to be low for longer.

The reduction in the OCR this year has reduced retail lending rates for households and businesses, and eased the New Zealand dollar exchange rate.

Low interest rates and increased government spending are expected to support a pick-up in domestic demand over the coming year. Household spending and construction activity are supported by low interest rates, while the incentive for businesses to invest will grow in response to demand pressures.

Keeping the OCR at low levels is needed to ensure inflation increases to the mid-point of the target range, and employment remains around its maximum sustainable level. There remains scope for more fiscal and monetary stimulus, if necessary, to support the economy and maintain our inflation and employment objectives.

Meitaki, thanks.

Summary record of meeting

The Monetary Policy Committee agreed the new information since the August Monetary Policy Statement did not warrant a significant change to the monetary policy outlook.

The Committee noted that employment remains close to its maximum sustainable level but consumer price inflation remains below the 2 percent target mid-point.

Continued...
The Committee members discussed the initial impacts of reducing the OCR to 1.0 percent in August. They were pleased to see retail lending interest rates decline, along with a depreciation of the exchange rate.

The members anticipated a positive impulse to economic activity over the coming year from monetary and fiscal stimulus. The members noted that there remains scope for more fiscal and monetary stimulus if necessary, to support the economy and our inflation and employment objectives.

The Committee noted that, while GDP growth had slowed over the first half of 2019, impetus to domestic demand is expected to increase. Household spending and construction activity are supported by low interest rates, while business investment should lift in response to demand pressures.

The Committee expected increasing demand to keep employment near its maximum sustainable level. Rising capacity pressures and increasing import costs, higher wages, and pressure on margins are expected to lift inflation gradually to 2 percent.

The Committee discussed the long and variable lags between monetary policy decisions and outcomes. 

The members noted several key uncertainties affecting the outlook for monetary policy, where there was a range of possible outcomes.

Global trade and other geopolitical tensions remain elevated and continue to subdue the global growth outlook, dampening demand for New Zealand’s goods and services.

Business confidence remains low in New Zealand, partly reflecting policy uncertainty and low profitability in some sectors, and is affecting investment decisions.

Fiscal policy is expected to lift domestic demand over the coming year. However, any increase in government spending could be delayed or it could have a smaller impact on domestic demand than assumed.

Some members noted that ongoing low inflation could cause inflation expectations to fall. Others noted that this risk was balanced by the potential for rising labour and import costs to pass through to inflation more substantially over the medium term.

The Committee discussed the secondary objectives from the remit and remained comfortable with the monetary policy stance.

The Committee agreed that developments since the August Statement had not significantly changed the outlook for monetary policy. They reached a consensus to keep the OCR at 1.0 percent and that, if necessary, there remains scope for more fiscal and monetary stimulus.

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