Research

Economy Watch

4 October 2023

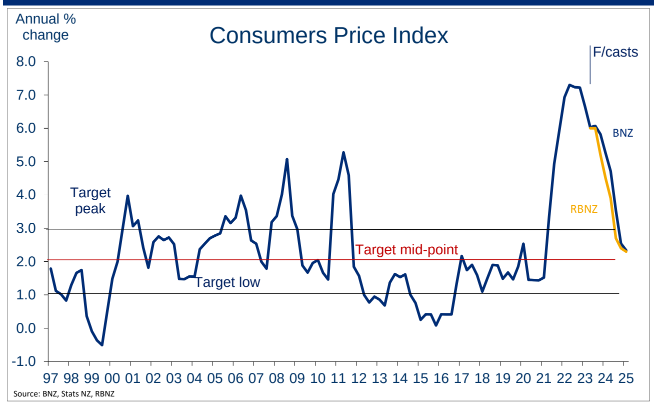
No rate hike this year

- **NZ cash rate unchanged at 5.5%**
- **No indication the RBNZ has a hawkish bias**
- **Monetary conditions tightening anyway**
- **Rise in inflationary risks downplayed**
- **Our rate track unchanged**

There was nothing in today's Monetary Policy Review to suggest the Reserve Bank has meaningfully changed its view since the August Monetary Policy Statement. At the margin there is some suggestion the cash rate may need to stay elevated at 5.5% for longer than previously thought but there is no suggestion that the Bank is contemplating any move in the cash rate this side of Christmas.

Generally speaking we feel the Reserve Bank is downplaying inflation risks. We had expected the Bank to acknowledge specifically that the recent surge in oil prices would push up its near-term inflation projections, which it must surely do, but it didn't. Instead it said "the recent rise in global oil prices could increase domestic costs over coming months, risking headline inflation being higher than expected".

Inflation risks downplayed



Elsewhere, the RBNZ noted that June quarter GDP growth "was stronger than anticipated" but that the "growth outlook remains subdued".

The recent rise in house prices was also downplayed due to the price movement being on low sales volumes.

Given the general tone of downplaying inflationary concerns, we were a little surprised the MPC did not highlight just how rapidly the labour market indicators in yesterday's QSBO softened. We contest that this means a lot for the containment of inflation over the medium term. And it's the medium term that the RBNZ is targeting.

For us, though, the key line in the policy assessment was the repetition of August's "Interest rates are constraining economic activity and reducing inflationary pressure as required". In other words, monetary settings are doing their job. Why would we do anything differently?!

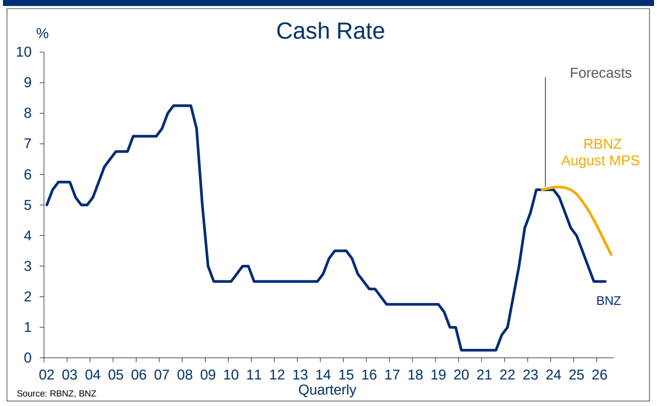
Alongside this, the Monetary Policy Committee did highlight the fact that "financial conditions have continued to tighten with an increase in wholesale and retail lending rates". This is a point that we have been making for some time. The interest rates that borrowers face are rising without any increase in the cash rate. It is highly likely this trend is not yet finished either.

Despite all this, we think the RBNZ is warning the cash rate may have to stay up at 5.5% for longer than it had previously forecast. "The Committee agreed that interest rates may need to remain at a restrictive level for a more sustained period of time".

The last published RBNZ cash rate track implies a first rate cut in Q1, 2025. Perhaps the thought is now later in that year.

Our current forecasts have a first rate cut in the middle of 2024. That's because we believe the economy will be moribund for the next five quarters, the unemployment rate will rise fairly rapidly, wage pressure will dissipate fairly quickly, and the RBNZ will become more quickly pacified that enough has been done.

Rate views unchanged



Following today's statement, we see no reason to change that view. However, we do concede the balance of risk may have shifted slightly towards the first cut being delayed relative to our expectations.

stephen_toplis@bnz.co.nz

Full text from Monetary Policy Review

The Monetary Policy Committee today agreed to hold the Official Cash Rate (OCR) at 5.50%

Interest rates are constraining economic activity and reducing inflationary pressure as required.

Demand growth in the economy continues to ease. While GDP growth in the June quarter was stronger than anticipated, the growth outlook remains subdued. With monetary conditions remaining restrictive, spending growth is expected to decline further.

Globally, economic growth remains below trend and headline inflation has eased for most of our trading partners. Core inflation has also eased, but to a lesser extent. Weakening global demand is putting downward pressure on New Zealand export volumes and prices. Apart from oil, global import prices have eased.

While the imbalance between supply and demand continues to moderate in the New Zealand economy, a prolonged period of subdued activity is required to reduce inflationary pressure.

There is a near-term risk that activity and inflation do not slow as much as needed. Over the medium term, a greater slowdown in global economic demand, particularly in China, could weigh more on commodity prices and New Zealand export revenue.

The Committee agreed that the OCR needs to stay at a restrictive level to ensure that annual consumer price inflation returns to the 1 to 3% target range and to support maximum sustainable employment.

Monetary Policy Committee record of meeting

The Monetary Policy Committee discussed recent developments in the New Zealand economy. The Committee agreed that monetary conditions are restricting spending and reducing inflationary pressure. While supply constraints in the economy continue to ease, inflation remains too high. Spending needs to remain subdued to better match the economy's ability to supply goods and services, so that consumer price inflation returns to its target range.

Global economic activity remains below trend. While global growth has been resilient in recent months this momentum is beginning to fade. Recent data show continued regional variation, with economic strength in the United States but slow momentum in Europe and historically low growth in China. Easing global demand is placing downward pressure on New Zealand exports, in terms of both volumes and prices. Global oil prices have increased, but other import prices have been slightly lower.

Globally, headline inflation continues to fall but declines in core inflation are more gradual and uneven across economies. In discussing recent central bank policy moves, the Committee noted that policy rates are now expected to remain at restrictive levels for a sustained period of time, in order to bring inflation back to respective central bank policy target levels.

The Committee discussed domestic economic developments. The rebound in June quarter GDP data was larger than anticipated, partly reflecting the effects of population growth from high net immigration and momentum in household spending. However, demand growth in the economy continues to ease broadly as expected. The more recent Performance of Manufacturing and Services Indices (PMI and PSI) and NZIER Quarterly Survey of Business Opinion (QSBO) show easing capacity pressures. The Committee noted that with monetary conditions remaining restrictive, they expect to see further declines in per capita spending and for GDP growth to be subdued.

Financial conditions have continued to tighten with an increase in wholesale and retail lending rates. Members noted that the average mortgage rate on outstanding loans continues to rise, and debt servicing costs as a share of income are still increasing. Members also noted that house prices were slightly higher, but that this was on low sales volumes. House prices remain around estimates of sustainable levels.

Members discussed the Pre-election Economic and Fiscal Update 2023 (PREFU) and noted that total government spending as a share of potential GDP is still forecast to decline, but by less than previously expected. Members noted the material increase in government investment over the medium term, due to infrastructure resilience requirements.

The Committee discussed the balance of risks for inflation, output, and employment. Members agreed that the risks to the outlook remained similar to those discussed in the August MPS.

In the near term, members agreed that the risk of greater resilience in domestic demand remained. Upside surprises to, or greater than expected demand-side stimulus from, migration could sustain growth momentum for longer. More resilience in domestic demand could slow the pace of expected disinflation. An easing in wage inflation could take longer, but members noted the lack of recent wage data. The recent rise in global oil prices could increase domestic costs over coming months, risking headline inflation being higher than expected.

Over the medium term, the Committee agreed downside risks around the outlook for global growth remain. A greater slowdown in global growth could see further falls in the price of non-oil imports. Weaker global demand, particularly from China, would likely weigh further on commodity prices and therefore on export revenues.

The Committee discussed the risks around the lagged effect of previous monetary tightening on households and businesses. Recent data show continuing weak demand for credit other than for business working capital requirements. Members agreed the ongoing slowdown in economic activity is not even across sectors of the economy, due to global factors and the varied impact of high domestic interest rates. In particular, the Committee noted that pockets of stress have emerged for some in the household, commercial property, and agricultural sectors.

The Committee agreed that in the current circumstances, there is no material trade-off between meeting the Committee's inflation and employment objectives and maintaining stability of the financial system. Members noted that debt levels are high in some parts of the economy and debt servicing costs have increased. While broad indicators of stress have increased, non-performing loans remain at low levels.

In discussing their Remit objectives, the Committee noted inflation is still expected to decline to within the target band by the second half of 2024. While employment is above its maximum sustainable level, recent indicators show that employment intentions are flat and difficulty in finding labour has reduced.

The Monetary Policy Committee discussed the appropriate stance of monetary policy. The Committee agreed that interest rates may need to remain at a restrictive level for a more sustained period of time, to ensure annual consumer price inflation returns to the 1 to 3% target range and to support maximum sustainable employment.

On Wednesday 4 October, the Committee reached a consensus to maintain the Official Cash Rate at 5.50%.

Attendees:

Reserve Bank members of MPC: Adrian Orr, Karen Silk, Christian Hawkesby, Paul Conway
External MPC members: Bob Buckle, Peter Harris, Caroline Saunders
Treasury Observer: Tim Ng
MPC Secretary: Kate Poskitt

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

Stuart Ritson
Senior Interest Rate Strategist
+64 9 9248601

Mike Jones
BNZ Chief Economist
+64 9-956 0795

Main Offices

Wellington
Level 2, BNZ Place
1 Whitmore St
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