Research
Economy Watch
10 April 2024

RBNZ Sticks To The Script

- **RBNZ holds OCR at 5.50%, as expected**
- **Notes some near-term price pressures remain**
- **But maintains guidance as we thought**
- **Our rate track unchanged**

The RBNZ held its cash rate at 5.50% this afternoon. This was as we expected and expected by all and sundry. It was fully priced by the market. So, no surprise there. In fact, in the big picture there was no surprise whatsoever to us in the very short statement issued today.

The Bank retained its previous guidance. Noting that 'the Committee is confident that maintaining the OCR at a restrictive level for a sustained period will return consumer price inflation to within the 1 to 3 percent target range this calendar year.'

In our preview, we thought the RBNZ could easily cut and paste the policy assessment from February. To us, the balance of data did not seem sufficiently different to cause any material change. That is how the Bank seems to have seen things too. As the RBNZ put it, 'The New Zealand economy continues to evolve as anticipated by the Monetary Policy Committee.'

The Bank did note some 'near-term price pressures remain'. We see this as a nod to next week's Q1 CPI shaping up to be a bit stronger than the RBNZ's previous forecast, as we also noted in our preview. Indeed, in the Summary Record of Meeting, the Bank explicitly said 'The Committee noted that recent monthly Selected Price Indices (SPI) imply some upside risk to the March 2024 quarter Consumer Price Index (CPI). But, more broadly and importantly, the Bank saw that the balance of risks was little changed since the February Statement. As you were.

The RBNZ's comments on fiscal policy tallies with our thinking. Not surprisingly the fiscal outlook is based on the most recent published forecasts in the HYEFU and commitments outlined in the BPS. 'The Committee noted that government expenditure is indicated to decline as a share of the economy in coming years.' But no mention of tax cuts. As discussed in our preview, on the fiscal side of things, the Bank can't include any detail until such time as the detail is public and is formal government policy. This remains a key area to watch. The RBNZ will have the full Budget (due on 30 May) details in time for its July Monetary Policy Review.

The Bank also noted the significant upward revision to net immigration, although, like in February, noted both supply and demand implications with respect to migration's influence on inflationary pressures.

In the Summary, the Bank said 'Members agreed that there remains limited tolerance to increase the time to achieve the inflation target while inflation remains outside the target band and while inflation expectations and pricing intentions remain elevated.' This suggests that the Bank may become less aggressive once inflation gets inside the target band and inflation expectations and pricing intentions ease. It would all add to the Bank's comfort level, but exactly when that happens remains to be seen.

Overall, there was nothing in today's missive from the central bank to change our broad view of the world. We maintain our forecast that the RBNZ is on hold for the time being and we continue to expect the first rate cut later this year.

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Full text of today's RBNZ OCR Review:

The Monetary Policy Committee today agreed to leave the Official Cash Rate (OCR) at 5.50 percent.

The New Zealand economy continues to evolve as anticipated by the Monetary Policy Committee. Current consumer price inflation remains above the Committee's 1 to 3 percent target range. A restrictive monetary policy stance remains necessary to further reduce capacity pressures and inflation.

Globally, while there are differences across regions, economic growth remains below trend and is expected to remain subdued. However, most major central banks are cautious about easing monetary policy given the ongoing risk of persistent inflation.

Economic growth in New Zealand remains weak. While some near-term price pressures remain, the Committee is confident that maintaining the OCR at a restrictive level for a sustained period will return consumer price inflation to within the 1 to 3 percent target range this calendar year.

Summary Record of Meeting – April 2024

The Monetary Policy Committee discussed recent developments in the New Zealand and global economies. The Committee agreed that the New Zealand economy has evolved largely as expected since the February *Statement*. Restrictive monetary policy is contributing to an easing in capacity pressures to ensure inflation returns to target.

Economic growth in most of New Zealand's major trading partners has been below trend. However, this has varied across regions, with stronger activity in the United States compared with the Euro Area and Australia. Economic growth in most major economies is forecast to slow further over 2024. In China, policymakers have announced a similar growth target for this calendar year, which may be difficult to achieve amid ongoing structural challenges.

The Committee noted that in most major economies the better balance between the demand for, and supply of, labour has been reflected in a decline in job vacancies. However, growth in unit labour costs remains elevated. Inflation will continue to be persistent in regions where higher labour costs have not been accompanied by improved productivity or reduced profit margins.

Most major central banks remain cautious about easing monetary policy given the risks of inflation persistence and elevated inflation expectations. Financial market pricing for most central bank policy rates continues to imply some easing later this year, although this has lessened over recent weeks. Participants in global financial markets continue to exhibit strong confidence in the corporate earnings outlook, as reflected in equity prices and credit spreads.

Aggregate commodity price indices have remained relatively stable despite ongoing geopolitical uncertainties. Oil prices have increased while agricultural commodity prices have generally been weaker. The recent spike in global shipping costs, which has partially receded, has yet to be observed in New Zealand merchandise trade data. This timing is consistent with information from discussions with businesses that suggest shipping contracts in New Zealand are typically renegotiated every three to six months.

The Committee discussed domestic economic data released since the February *Statement*. Gross Domestic Product for the December 2023 quarter was close to expectations and implies a continued easing in capacity pressure in the economy. Some higher frequency indicators suggest a modest recovery in activity in the first quarter of 2024. However, measures of business confidence have declined and firms' own expectations for activity and investment have weakened. Near-term business pricing intentions have declined but remain elevated, in part reflecting an uptick in both realised and expected costs.

The Committee noted that recent monthly Selected Price Indices (SPI) imply some upside risk to the March 2024 quarter Consumers Price Index (CPI). The Committee agreed that there was large monthly variability in the SPI series and noted that recent relative price changes are due mostly to volatile components including fuel, domestic airfares, and overseas accommodation.

The Committee noted the continued strength in net migration, which is supporting aggregate consumer spending and rising dwelling costs. While the rate of net migration has declined from its recent peak, there have been significant upward revisions to recent historical data. Net migration also adds to labour supply in the economy and has helped to alleviate capacity pressures. Members noted the large decline over recent quarters in the share of firms reporting difficulty in finding labour.

The Committee discussed the outlook for fiscal policy and its implications for monetary policy. Based on the most recent published forecasts in the *Half-Year Economic and Fiscal Update*, and the commitments outlined in the *Budget Policy Statement*, the Committee noted that government expenditure is indicated to decline as a share of the economy in coming years.

Domestic financial conditions have eased marginally since the February *Statement* with declines in wholesale interest rates and the New Zealand dollar. There have been modest reductions in retail interest rates. However, these remain consistent with the Committee's restrictive monetary policy stance, with credit growth remaining subdued. The Committee noted that despite a reduction in wholesale funding costs, term deposit rates were little changed reflecting increasing competition for retail deposits.

The Committee discussed whether recent developments in the New Zealand and global economies had implications for when inflation returns to target. Members agreed that there had not been a material change since the February *Statement* and that monetary policy settings continue to constrain demand broadly as expected. Members agreed that there remains limited tolerance to increase the time to achieve the inflation target while inflation remains outside the target band and while inflation expectations and pricing intentions remain elevated.

The Committee discussed upside risks to the inflation outlook. Members agreed that persistence of services inflation remains a risk and goods price inflation remains elevated. Anticipated near-term increases to local government rates, insurance, and utility costs, could also further slow the decline in headline inflation.

The Committee discussed downside risks to the inflation outlook. Members noted that ongoing restrictive monetary policy in an environment of weak global growth could lead to a more rapid decline in inflation than expected. Business and consumer confidence remain particularly weak which could lead to more unemployment and financial stress than expected. Structural challenges facing the economy in China remain a concern given its importance for the global economy and for New Zealand's trade.

Overall, members agreed that the balance of risks was little changed since the February *Statement*. Ongoing restrictive monetary policy settings are necessary to reduce inflation, while avoiding unnecessary instability in output, employment, interest rates and the exchange rate.

In discussing the appropriate stance of monetary policy, members agreed they remain confident that monetary policy is restricting demand. A further decline in capacity pressure is expected, supporting an ongoing decline in inflation. The Committee agreed that interest rates need to remain at a restrictive level for a sustained period to ensure annual consumer price inflation returns to the 1 to 3 percent target range. On Wednesday 10 April, the Committee reached a consensus to keep the Official Cash Rate at 5.50 percent.

Attendees

MPC members: Adrian Orr (Chair), Bob Buckle, Carl Hansen, Caroline Saunders, Christian Hawkesby, Karen Silk, Paul Conway
Treasury Observer: Tim Ng
MPC Secretary: David Craigie

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