ANZ Research

Review of the RBNZ July Monetary Policy Review

10 July 2024

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Watch this space

- As universally expected, the RBNZ today left the OCR unchanged at 5.50%.
- The accompanying commentary had similarities to May, but it clearly acknowledged the weaker tone of recent indicator data, with the Record of Meeting revealing the Committee "discussed the risk that this may indicate that tight monetary policy is feeding through to domestic demand more strongly than expected."
- We highlighted last week that risks are tilting towards the first cut coming in November rather than February as we are forecasting; today's Review tilts things a little further that way. But the data will decide: next week's CPI data was always going to be more important for the OCR outlook than whatever the RBNZ had to say today. A cooperative vibe would certainly smooth the path to a cut this year.

In brief

As anticipated, the RBNZ today left the Official Cash Rate (OCR) unchanged at 5.50%. The tone of the Policy Assessment and Summary Record of Meeting was balanced. Sticky inflation got a mention, but the recent weaker tilt to growth and inflation indicators was clearly acknowledged.

Key quotes:

- **OCR outlook:** "The Committee agreed that monetary policy will need to remain restrictive. The extent of this restraint will be tempered over time consistent with the expected decline in inflation pressures."
- **Inflation:** "Domestic inflation measures remain more persistent, but growing excess capacity in the domestic economy provides greater certainty that they will sustainably decline." "The Committee is confident that inflation will return to within its 1-3 percent target range over the second half of 2024."
- **Domestic activity:** "The Committee noted that recent higher frequency indicators suggest that near-term growth in business activity has weakened. A range of business and consumer surveys, and higher frequency spending and credit data, all point to declining activity. Members discussed the risk that this may indicate that tight monetary policy is feeding through to domestic demand more strongly than expected."
- **Labour market:** "The Committee discussed signs of easing in the labour market. Recent survey measures of hiring intentions and job vacancies indicate flat employment levels."
- **Fiscal:** "Members noted timing differences between the impact of lower government spending and tax policy changes. Lower government spending has already been contributing to weaker demand and will continue to do so. However, the positive impact of tax cuts on private spending is yet to occur and is more uncertain."

Our take

The risks around the growth outlook and therefore the medium-term inflation outlook have tilted south in the six weeks since the May Monetary Policy Statement, but so far it's survey and sentiment data rather than the "tier 1" data of GDP, CPI and the Household Labour Force Survey. GDP data for Q1 was close to RBNZ expectations, and although we saw the details as dovish, other interpretations are possible.

With the crucial CPI inflation out next week, there tactically wasn't much to be gained for the RBNZ by taking a strong view of recent developments and risking egg on their face. As regards CPI, we're forecasting the same as the RBNZ for non-tradable inflation (0.8% q/q), with two months of SPI data pointing to a helpful downside surprise on tradable inflation, but the unwelcome Q1 CPI data certainly highlighted that surprises happen.

In that context, today's Review was always likely to be a placeholder. Neither economists nor the market are buying into the RBNZ's May MPS forecast that the first OCR cut will come only in August next year, but tactically it makes sense for the RBNZ to wait for firmer evidence before pivoting. In the meantime, the market is already doing the work for the RBNZ, now pricing more than two cuts by the end of this year.

The RBNZ's acknowledgement of the recent softer data confirm they are willing to reassess their medium-term inflation outlook. However, it was always a high bar to signal very much more than that today given next week's CPI could move their assessment in either direction. The clear acknowledgement of emerging downside momentum means the risks around our call for cuts from February skew a little bit more towards November, but at the end of the day the data will decide; the RBNZ always reserves the right to change its mind. We will wait for Q2 CPI data next week to firm up our view on rate-cut timing. If the overall vibe of the data is cooperative, the path to a first cut in November will be considerably smoother.

Market reaction

Financial markets reacted swiftly, with the bellwether 2yr swap rate around 18bp lower, and the NZD around half a cent lower, within an hour of the MPR. We think that reaction was understandable given the number of dovish judgements in the press release and summary record of meeting, which read like a mini-pivot. Although we think it's a stretch to call this a full-blown pivot given the Committee's assessment of balanced risks around inflation and their caution around the impact of tax cuts, markets are behaving as though it was just that. And that assessment isn't likely to change given how downbeat markets are on the economy. Ignoring hawkish messaging and latching onto dovish messaging is where the market mood is, and the trend lower in rates is likely to continue, barring any major upside surprises, which have been absent of late.

OCR 5.50% – Inflation Approaching Target Range

The Monetary Policy Committee today agreed to maintain the Official Cash Rate at 5.50 percent.

Restrictive monetary policy has significantly reduced consumer price inflation, with the Committee expecting headline inflation to return to within the 1 to 3 percent target range in the second half of this year.

The decline in inflation reflects receding domestic pricing pressures, as well as lower inflation for goods and services imported into New Zealand. Labour market pressures have eased, reflecting cautious hiring decisions by firms and an increased supply of labour. The level of economic activity, including business and consumer investment spending and investment intentions, is consistent with the restrictive monetary stance.

Current and expected government spending will restrain overall spending in the economy. However, the positive impact of the pending tax cuts on private spending is less certain.

Some domestically generated price pressures remain strong. But there are signs inflation persistence will ease in line with the fall in capacity pressures and business pricing intentions.

The Committee agreed that monetary policy will need to remain restrictive. The extent of this restraint will be tempered over time consistent with the expected decline in inflation pressures.

Summary Record of Meeting

The Monetary Policy Committee discussed recent developments in the domestic and global economies and the implications for monetary policy in New Zealand.

Global economic growth remains below trend and is expected to pick up only gradually over the next year. The economic outlook varies among New Zealand's trading partners, with economic growth in the United States remaining stronger than in many other advanced economies. Meanwhile, economic growth in China is forecast to be subdued relative to recent norms.

Global consumer price inflation has been trending down. This has given some central banks the confidence to either start, or to signal, a gradual reduction in policy interest rates. Nevertheless, monetary policy remains at restrictive levels in most advanced economies, and the recent stalling in global disinflation has tempered market expectations of the speed of official rate reductions.

The Committee noted that global equity prices continue to reflect expectations of a smooth disinflation process. Members discussed risks to this 'smooth landing' scenario, noting market pricing of risk could increase materially if these expectations are not met.

The Committee agreed that New Zealand's restrictive monetary policy is reducing domestic demand and consumer price inflation. The Committee is confident that inflation will return to within its 1-3 percent target range over the second half of 2024.

Members agreed that there is now more evidence of excess productive capacity emerging, with measures of capacity utilisation and difficulty finding labour easing materially. The Committee noted that recent higher frequency indicators suggest that near-term growth in business activity has weakened. A range of business and consumer surveys, and higher frequency spending and credit data, all point to declining activity. Members discussed the risk that this may indicate that tight monetary policy is feeding through to domestic demand more strongly than expected.

The Committee discussed signs of easing in the labour market. Recent survey measures of hiring intentions and job vacancies indicate flat employment levels. Net migration has also fallen in recent months to levels consistent with the pre-COVID period.

Members discussed recent changes to financial conditions in New Zealand. Non-performing bank loans and corporate insolvencies have increased from low levels in line with declining economic activity. These metrics are slow moving, and hence measures of financial stress are expected to keep rising.

Bank credit growth also remains very subdued, in line with weakness in the domestic economy and low business and consumer confidence. Bank funding costs are expected to remain elevated as funding sources revert to higher cost wholesale and deposit funding. Elevated funding costs in turn are expected to underpin lending rates over the medium term.

The Committee discussed the impact of fiscal policy as announced in the Government's Budget 2024. Government expenditure is forecast to decline as a share of the economy in coming years. Members noted timing differences between the impact of lower government spending and tax policy changes. Lower government spending has already been contributing to weaker demand and will continue to do so. However, the positive impact of tax cuts on private spending is yet to occur and is more uncertain.

Members discussed progress towards achieving their inflation objective. Recent monthly Selected Price Indexes suggest weakening in some of the more volatile inflation components, while survey measures of cost pressures and pricing intentions have continued to decline. Headline inflation is expected to return to within the 1 to 3 percent target range in the second half of this year. Domestic inflation measures remain more persistent, but growing excess capacity in the domestic economy provides greater certainty that they will sustainably decline.

The Committee discussed the balance of risks to the inflation outlook. Members noted a risk that domestically driven inflation could be more persistent in the near term. However, there is also a risk that price setting behaviour and inflation expectations could normalise more rapidly as headline inflation declines.

Members discussed risks to the economic outlook stemming from Government policy. They discussed the challenge of delivering fiscal consolidation. In addition, some members noted that Government regulatory reforms may affect pricing behaviour in several sectors and the productive capacity of the economy. The net impact of these policies remains uncertain.

The appropriate stance of monetary policy was discussed. The Committee agreed that monetary policy will need to remain restrictive. The extent of this restraint will be tempered over time consistent with the expected decline in inflation pressures.

On Wednesday 10 July, the Committee reached a consensus to maintain the Official Cash Rate at 5.50 percent.

Attendees:

MPC members: Adrian Orr (Chair), Bob Buckle, Carl Hansen, Christian Hawkesby, Karen Silk, Prasanna Gai.

Treasury Observer: Tim Ng.

MPC Secretary: Chris Bloor.

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