Economic Note

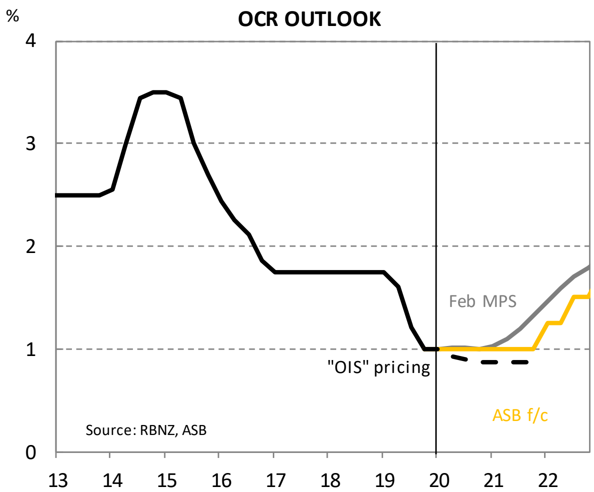
RBNZ February 2020 Monetary Policy Statement Review

12 February 2020

High threshold for OCR inoculation

- The RBNZ kept the OCR at 1% as expected. The RBNZ's economic outlook (even with a minor coronavirus impact baked in) now shows very little need for OCR cuts at this point.
- Of surprise to us was the extent to which the RBNZ's OCR forecast track has been lifted, to imply a full 25bp OCR hike by the end of 2021.
- We have pulled our forecast OCR cut after previously flagging its reducing probability, but a prolonged coronavirus impact could still spur a cut.

Summary and key take outs



To cut to the chase, **we no longer think that the RBNZ will cut the OCR – unless the impacts of the coronavirus prove to be much larger and more prolonged** than the short, sharp impact viral outbreaks tend to have. Barring coronavirus, an OCR cut would be unlikely. Rather than base a forecast of an OCR cut entirely on an uncertain event, we have decided to pull the May 2020 OCR cut we had forecast.

There are two key points to take out of the February Monetary Policy Statement (MPS). First is **the RBNZ's increased conviction since November that – barring the coronavirus outbreak – it has done enough to stimulate the economy**. Inflation is close to the target mid-point. The RBNZ even now notes that it is exceeding its employment objective – for the first time since this objective formally came into being last April. The underlying tone of the statement was more upbeat than in November. And the RBNZ still sees the impact of its new bank capital requirements as having only modest economic impacts (though remains watchful).

The second point is that **the RBNZ has factored in a modest economic hit from coronavirus** and assumes that the impact will be short-lived and wash through before any monetary policy stimulus would start taking effect.

If coronavirus wasn't clouding the skies, it is clear that the RBNZ wouldn't be contemplating an OCR cut at all. The RBNZ's OCR forecast track sits at 1% in the near term, arguably a 'neutral' stance, with a full 25bp OCR hike built in by the end of 2021. And that track incorporates some economic impact from coronavirus.

Although we have formally pulled our forecast OCR cut, a cut remains a distinct possibility. We expect a larger coronavirus impact that the RBNZ does. The virus risks are skewed to a prolonged period before NZ sees a noticeable rebound in its key export earnings. Dry weather conditions are also a risk. Trend growth is really only in the early stages of lifting from its anaemic 2019 pace and is vulnerable to shocks.

Nick Tuffley – Chief Economist (649) 301 5659 nick.tuffley@asb.co.nz
Mark Smith – Senior Economist (649) 301 5657 mark.smith@asb.co.nz

RBNZ base case is upbeat

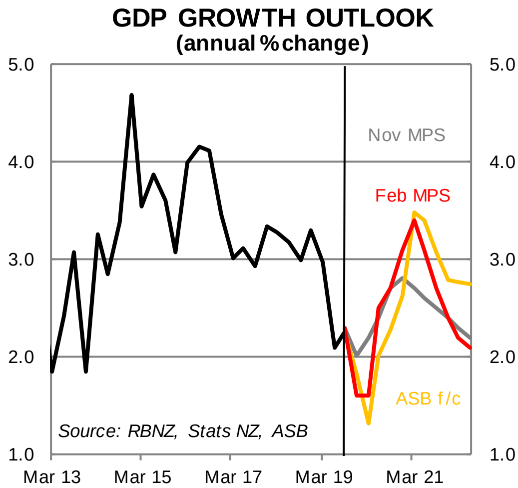
The RBNZ has become more optimistic since November about the economy's prospects, when it was already confident that it had stimulated the economy enough to meet its inflation and employment objectives. The fact that it sees itself as exceeding its maximum sustainable employment target underscores that the RBNZ sees its job as done for the time being.

The RBNZ notes a number of factors that will help lift growth over time. Interest rates are clearly loosening the mortgage belt, fuelling added housing and consumer indulgence. The RBNZ now sees 2020 consumer spending as being stronger than previously forecast. The Government's infrastructure spending plans are now set to do metaphorical burnouts on a highway coming nearer to you. The RBNZ has also built in added 2020 Government operating expenditure signalled in December's Fiscal Update. The RBNZ is also factoring in stronger Terms of Trade than in November, even with some near-term impact from coronavirus on export prices.

Meanwhile, the RBNZ has not adjusted its view of the 'goldilocks' neutral interest rate in the wake of its new bank capital requirements. It doesn't see the magnitude of the impact as being great, and that the impact will be spread over time anyway. Although we disagree with the RBNZ's sanguine view, it would clearly take some clearly visible impacts to alter its assumptions. And, increasingly the impacts will get lost in the wash of events with more pronounced impacts.

All up, this more bullish base case for the economic outlook raises the hurdle for any further OCR cuts.

Coronavirus risks highlighted



The coronavirus received considerable attention in the MPS and featured as a special topic in Chapter Three. While the coronavirus featured heavily in the RBNZ's policy assessment and discussion of the risks, we were surprised that the RBNZ chose to incorporate the (still highly uncertain) economic impacts of the coronavirus outbreak into its published projections. The projections incorporated a scenario in which the coronavirus outbreak has a temporary economic impact on New Zealand, mostly during the first half of 2020.

In its projections, the RBNZ assumed a scenario where there is no substantial coronavirus outbreak in New Zealand and the outbreak overseas is beginning to be contained by the end of February 2020. This would result in a short period of disruption to NZ economic activity, with travel disruptions likely to be significant through February, before gradually easing over March. We note that at just under 45,000 persons, the growth in new reported overseas cases of the coronavirus looks to be slowing, with none yet to be reported in NZ.

The RBNZ has assumed that, as a result of the coronavirus outbreak, Q1 NZ GDP will be 0.3% lower than otherwise, mostly on account of lower goods and services exports, with some offset from lower import volumes and higher inventories. The policy assessment made mention that some sectors are being significantly affected, with the risks skewed towards the impacts being larger and more persistent. Our estimates of the impact on Q1 GDP are about twice the RBNZ's, but we note that the impacts of the outbreak are highly uncertain. Moreover, the RBNZ has not taken into account wider economic impacts (including indirect effects on economic activity via increasing caution on local firms and households) that could translate into a larger economic impact.

Of more importance to the policy outlook is the duration of disruptions caused by the virus. The RBNZ notes that the monetary policy implications of the outbreak are "small at this stage", given the impacts of the coronavirus are assumed to be short-lived (mostly during 2020H1) and because monetary policy takes time to have its full effect on the economy. We note that the NZ economy is well positioned and the RBBZ has the luxury of waiting for developments to unfold. Chapter Three noted that the RBNZ, along with Government agencies, are closely monitoring the coronavirus outbreak and its impacts on New Zealand's economy. However, the RBNZ acknowledges that the monetary policy implications would be larger (i.e. the OCR would most certainly be cut) if the outbreak and economic impacts prove to be more significant or persist for longer than it has assumed.

Side-by-side comparison

February 2020 MPS	**November 2019 MPS**
OCR Decision, balance of risks and outlook	*OCR Decision, balance of risks and outlook*
The Monetary Policy Committee has decided to keep the Official Cash Rate (OCR) at 1.0 percent. We assume the overall economic impact of the coronavirus outbreak in New Zealand will be of a short duration, with most of the impacts in the first half of 2020. Nevertheless, some sectors are being significantly affected. There is a risk that the impact will be larger and more persistent. Monetary policy has time to adjust if needed as more information becomes available. Low interest rates remain necessary to keep employment and inflation around target.	The Monetary Policy Committee has decided to keep the Official Cash Rate (OCR) at 1.0 percent. Economic developments since the August *Statement* do not warrant a change to the already stimulatory monetary setting at this time. Interest rates will need to remain at low levels for a prolonged period to ensure inflation reaches the mid-point of our target range and employment remains around its maximum sustainable level. We are committed to achieving our inflation and employment objectives. We will add further monetary stimulus if needed.
Global Outlook/exports	*Global Outlook/exports*
Slower global growth over 2019 acted as a headwind to domestic growth. In addition, competitive pressures and recent subdued business confidence have suppressed business investment. The global economic environment has shown signs of stabilising and trade tensions have receded somewhat. However, the COVID-19 (coronavirus) outbreak is an emerging downside risk.	Trading-partner growth has also slowed. Growth in global trade and manufacturing is weak and uncertainty remains high, dampening global business investment. New Zealand's export commodity prices have been robust, underpinning a positive terms of trade.
Exchange rate	*Exchange rate*
No comment.	The lower New Zealand dollar exchange rate this year is also providing a useful additional offset to the weaker global economic environment.
Economic Activity	*Economic Activity*
However, soft momentum in economic growth has continued into early 2020. Economic growth is expected to accelerate over the second half of 2020 driven by monetary and fiscal stimulus, and the high terms of trade. The outlook for government investment is stronger following the Government's announcements in December. There are also indications household spending growth will increase.	Economic growth continued to slow in mid-2019 reflecting weak business investment and soft household spending. We expect economic growth to remain subdued over the remainder of the calendar year. We will continue to monitor economic developments and remain prepared to act as required. Domestic economic activity is expected to increase during 2020 supported by low interest rates, higher wage growth, and increased government spending and investment. The low level of the OCR has flowed through to lower lending rates more generally, which support spending and investment. Rising capacity pressures are projected to promote a pick-up in business investment.
Labour market	Labour market
Employment is at or slightly above its maximum sustainable level.	Employment remains around its maximum sustainable level.
Inflation	*Inflation*
Inflation is close to the 2 percent target mid-point and within our target range	Inflation remains below the 2 percent target mid-point but within our target range.

Source: RBNZ, ASB

ASB Economics & Research			Phone
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5957
Senior Economist	Jane Turner	jane.turner@asb.co.nz	(649) 301 5853
Senior Economist	Mike Jones	Mike.jones@asb.co.nz	(649) 301 5660
Senior Rural Economist	Nathan Penny	nathan.penny@asb.co.nz	(649) 448 8778
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Data & Publication Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

www.asb.co.nz/economics

@ASBMarkets