ASB

Economic Note

RBNZ March OCR Review

22 March 2018

Spencer glides over the finish line

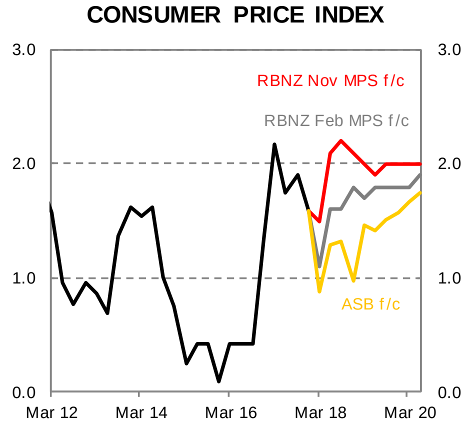
- The OCR remained on hold at 1.75%. As expected, the neutral stance remained in place: "Numerous uncertainties remain and policy may need to adjust accordingly."
- The main changes to the assessment were acknowledgement of weak near-term inflation and of construction capacity constraints.
- Attention turns to the imminent release of the new Policy Targets Agreement and its implications for policy.

The RBNZ's statement changed very little and was very much in line with what was expected. We continue to expect that the RBNZ will keep the OCR on hold until August 2019. The RBNZ's statement suggests little change in the RBNZ's underlying outlook.

The next point of interest for monetary policy matters will be the new Policy Targets Agreement, which may not be publicly released until Monday. We expect the PTA to contain a non-numerical employment objective, though don't expect it to materially alter monetary policy decisions.

Low near-term inflation expected

The RBNZ reserved a good chunk of the policy assessment for the inflation outlook. The RBNZ acknowledged that, largely due to government charges (likely to be cuts to tertiary tuition fees) and lower food and energy prices, CPI inflation is expected to weaken in the near term. If this is the case it would represent a further downward revision to the Bank's inflation forecasts, which largely appear to be due to a reassessment of the degree of inflationary pressure coming from the tradable sector. As such, the February MPS expectation of annual CPI inflation lifting to 1.8% by the end of the year now looks highly questionable: we expect annual CPI inflation to trough at around 0.9% in the March quarter before ending 2018 at 1.0%. Risks of a continued undershoot of actual CPI inflation relative to the Bank's forecasts have us comfortable in assuming that the OCR is unlikely to move higher until well into 2019.



Acknowledging construction constraints

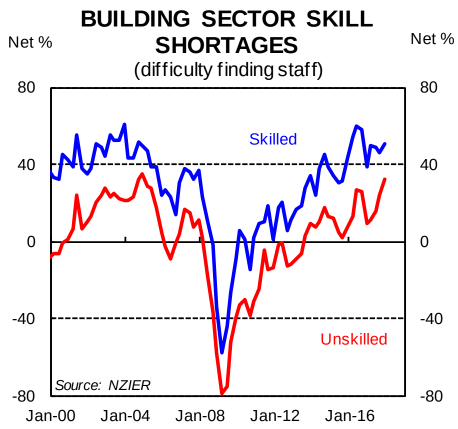
The RBNZ acknowledged that capacity constraints may be impacting on residential construction, which was a new inclusion for the one-page media release. We have long said that construction sector capacity constraints were a downside risk to the RBNZ's residential construction forecasts, and at the February MPS there were some early

Nick Tuffley – Chief Economist (649) 301 5659 nick.tuffley@asb.co.nz
Mark Smith – Senior Economist (649) 301 5657 mark.smith@asb.co.nz
Jane Turner – Senior Economist (649) 301 5853 jane.turner@asb.co.nz

Please refer to the important disclosures at the end of this document.

indications of the RBNZ acknowledging this risk. At the May MPS we may see the RBNZ revise its residential investment forecast lower (which may also marginally lower GDP growth forecasts), but also maintain (if not increase) inflation coming directly from the construction sector.

Beyond residential construction, it appears the RBNZ's medium-term growth outlook is largely unchanged. We have similar growth forecasts to the RBNZ, and in today's review the RBNZ reiterated it expects growth to remain supported by low interest rates, the high Terms of Trade, government spending and population growth.



The NZD non-comments

The NZD was not mentioned in the statement. We don't think financial markets should read too much into this. Recent NZD comments from the RBNZ on the NZD have largely reduced to noting any movements in the NZD relative to its past forecasts and expressing an expectation about where it is expected to head over the longer term. The comments have become descriptive, rather than carrying any loaded intent to talk the NZD lower. Given the NZD has been tracking in line with the RBNZ's February MPS expectations, that meant little need to expressly comment on the NZD as it made little difference to the RBNZ's forecast assessment for this meeting.

Will Adrian Orr row to a new cadence?

The next point of interest for monetary policy matters will be the release of the new Policy Targets Agreement. We expect the PTA to contain a non-numerical employment objective, and the focus will be on to what extent (if any) the new target is likely to alter monetary policy decisions. Our long-standing view has been that an added objective might alter the timing of OCR moves at the margin, but shouldn't materially change the overall interest rate cycle. But the impact will depend on how much flexibility is retained.

The new PTA needs to be signed before incoming Governor Adrian Orr takes up his position on Tuesday 27th March. Public release of the new PTA is imminent, though recent media comments suggest it may not be released until next Monday.

Please see side-by-side comparisons of the March and February OCR media releases overleaf.

March 2018 OCR	February 2018 MPS
OCR Decision	*OCR Decision*
The Reserve Bank today left the Official Cash Rate (OCR) unchanged at 1.75 percent.	The Reserve Bank today left the Official Cash Rate (OCR) unchanged at 1.75 percent.
Global Outlook	Global Outlook
The outlook for global growth continues to gradually improve. While global inflation remains subdued, there are some signs of emerging pressures. Commodity prices have continued to increase and agricultural prices are picking up. Equity markets have been strong, although volatility has increased. Monetary policy remains easy in the advanced economies but is gradually becoming less stimulatory.	Global economic growth continues to improve. While global inflation remains subdued, there are some signs of emerging pressures. Commodity prices have increased, although agricultural prices are relatively soft. International bond yields have increased since November but remain relatively low. Equity markets have been strong, although volatility has increased recently. Monetary policy remains easy in the advanced economies but is gradually becoming less stimulatory.
Exchange rate	*Exchange rate*
No comment.	The exchange rate has firmed since the November Statement, due in large part to a weak US dollar. We assume the trade weighted exchange rate will ease over the projection period.
Economic Activity	*Economic Activity*
GDP was weaker than expected in the fourth quarter, mainly due to weather effects on agricultural production. Growth is expected to strengthen, supported by accommodative monetary policy, a high terms of trade, government spending and population growth. Labour market conditions are projected to tighten further. Residential construction continues to be hindered by capacity constraints. The Kiwibuild programme is expected to contribute to residential investment growth from 2019.	GDP growth eased over the second half of 2017 but is expected to strengthen, driven by accommodative monetary policy, a high terms of trade, government spending and population growth. Labour market conditions continue to tighten. Compared to the November Statement, the growth profile is weaker in the near term but stronger in the medium term. The Bank has revised its November estimates of the impact of government policies on economic activity based on Treasury's HYEFU. The net impact of these policies has been revised down in the near term. The Kiwibuild programme contributes to residential investment growth from 2019.
Housing market	*Housing market*
House price inflation remains moderate with restrained credit growth and weak house sales.	House price inflation has increased somewhat over the past few months but housing credit growth continues to moderate.
Inflation	*Inflation*
CPI inflation is expected to weaken further in the near term due to softness in food and energy prices and adjustments to government charges. Tradables inflation is projected to remain subdued through the forecast period. Non-tradables inflation is moderate but is expected to increase in line with a rise in capacity pressure. Over the medium term, CPI inflation is forecast to trend upwards towards the midpoint of the target range. Longer-term inflation expectations are well anchored at 2 percent.	Annual CPI inflation in December was lower than expected at 1.6 percent, due to weakness in manufactured goods prices. While oil and food prices have recently increased, traded goods inflation is projected to remain subdued through the forecast period. Non-tradable inflation is moderate but expected to increase in line with increasing capacity pressures. Overall, CPI inflation is forecast to trend upwards towards the midpoint of the target range. Longer-term inflation expectations are well anchored at 2 percent.
Policy Outlook	*Policy Outlook*
Monetary policy will remain accommodative for a considerable period. Numerous uncertainties remain and policy may need to adjust accordingly.	Monetary policy will remain accommodative for a considerable period. Numerous uncertainties remain and policy may need to adjust accordingly.

For the full March 2018 RBNZ media release, please click here.

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 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
Economist	Kim Mundy	kim.mundy@asb.co.nz	(649) 301 5661
Data & Publication Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

www.asb.co.nz/economics

@ASBMarkets

Disclaimer

This document is published solely for informational purposes. It has been prepared without taking account of your objectives, financial situation, or needs. Before acting on the information in this document, you should consider the appropriateness and suitability of the information, having regard to your objectives, financial situation and needs, and, if necessary seek appropriate professional or financial advice.

We believe that the information in this document is correct and any opinions, conclusions or recommendations are reasonably held or made, based on the information available at the time of its compilation, but no representation or warranty, either expressed or implied, is made or provided as to accuracy, reliability or completeness of any statement made in this document. Any opinions, conclusions or recommendations set forth in this document are subject to change without notice and may differ or be contrary to the opinions, conclusions or recommendations expressed elsewhere by ASB Bank Limited. We are under no obligation to, and do not, update or keep current the information contained in this document. Neither ASB nor any person involved in the preparation of this document accepts any liability for any loss or damage arising out of the use of all or any part of this document.

Any valuations, projections and forecasts contained in this document are based on a number of assumptions and estimates and are subject to contingencies and uncertainties. Different assumptions and estimates could result in materially different results. ASB does not represent or warrant that any of these valuations, projections or forecasts, or any of the underlying assumptions or estimates, will be met.