# Economic Note

November OCR and MPS Preview

3 November 2017

## Call back in February

- The RBNZ is widely expected to leave the OCR on hold at 1.75% and continue to emphasise that interest rates are likely to remain low for a prolonged period.
- Economic developments suggest little change in the policy outlook is required.
- It is too soon, and details too light, to incorporate policy changes from the incoming Government.

### Summary

**The Reserve Bank of New Zealand (RBNZ) is facing an outlook of many moving parts,** with uncertainties remaining over the policy outlook which makes November an awkward time to deliver a set of forecasts. **The change in Government will bring a range of new policies that will likely tweak the economic outlook. But it is too soon for the RBNZ to properly assess the economic and inflation impacts.** Furthermore, the incoming Government also has announced a review of the RBNZ Act and Policy Targets Agreement. The RBNZ is about to present a set of forecasts fully aware that the economic forecasts will change and that the RBNZ's own objectives and ways its sets monetary policy could also change. Meanwhile, economic developments have continued in a similar vein this year, with near-term inflation lifting but growth proving a bit softer than expected. Given the messy outlook, the RBNZ is best to keep the policy assessment similar to previous statements; emphasise that interest rates will remain low for a prolonged period and highlight the many uncertainties on the outlook.

### More inflation but less growth momentum

**Recent economic developments have continued with similar themes we have seen emerge over the past year.** The global economic backdrop has continued to gradually improve, but large geopolitical threats continue to loom. The NZ 2017/18 inflation picture is looking slightly stronger following the robust Q3 CPI outcome, some evidence of broadening non-tradable inflation pressures and a lower NZD. However, NZ economic growth has remained at or below trend, core inflation has remained stuck below the target midpoint and business confidence has plunged on political uncertainty. **The RBNZ implied at the September OCR review it has revised its growth outlook lower**, but the composition of revisions matters for inflation. If the weaker growth outlook reflected weaker demand pressures (for example, weaker domestic spending given greater business and consumer caution), the outlook for medium-term inflationary pressures would arguably be weaker. However, if the revision to the Bank's growth outlook was as a result of supply constraints (we have long been of the view that the RBNZ's outlook for residential construction has been too optimistic given capacity constraints) the outlook for inflation would be ambiguous. We suspect, at this stage the RBNZ's weaker growth outlook mainly reflects the latter (i.e. a less favourable output and inflation trade-off), with minimal implications to the OCR path.

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## Vague policy details

**A Government has finally been formed, but at this stage the necessary policy details to update forecasts are lacking.** Many of the incoming polices are mostly proposals and the hard details are yet to be locked down and finalised. For example, the composition of net migration matters in terms of its inflation impact. Until the RBNZ has a clear view of how the incoming Government intends to tighten up entry requirements and who will be affected the most, the RBNZ is limited in its ability to assess the inflation impacts. The full fiscal picture won't be clear until next May's Budget, though the Half Year Update in December may carry a semblance of a mini-Budget and give some clarity. In contrast, there is a reasonable steer on how the minimum wage will increase over the next few years, though as yet legislation has not been passed to 'lock in' the changes.

Given the considerable uncertainties on the economic and policy outlook, we expect the RBNZ will deliver a plain vanilla policy assessment that is short on specifics. This buys the RBNZ more time until more details emerge and a more thorough consideration of the policy outlook can be conducted. To keep the document relevant, however, we expect the **Monetary Policy Statement (MPS) to provide a high-level discussion on potential impacts of various polices to communicate their likely monetary policy implications.** Doing so would give the market a steer on the thought processes the RBNZ would follow. The key areas that will have an impact on the inflation outlook include the degree of fiscal stimulus, immigration policy changes, housing policy changes, a likely Auckland fuel tax, and the proposed lift to the minimum wage. The RBNZ will likely have a clearer picture of the impact of these policies by February MPS, with analysts likely working hard through the summer as more details are available.

## Shifting the goal posts

Grant Spencer is the Acting Governor until a new Governor takes the reins in late March. At some point in his/her term, most likely from the start, the new Governor will have an employment objective added alongside price stability (for more detail see our report here). In addition the Finance Minister wants to legislate a formal committee for policy decision-making. With shifting goal posts, a new captain(s) and a new referee, the RBNZ could possibly be playing a very different game in 2018. It's yet another reason for the RBNZ to remain consistent with its recent policy messages for now.

We see little need for the RBNZ to shift its OCR forecasts, barring some fine-tuning as a result of the weaker NZD. And, if there are any OCR track changes, financial markets would be best served to take them with a bag of salt.

## September 2017 MPS RBNZ media release

*Statement by Reserve Bank Acting Governor Grant Spencer:*

*The Reserve Bank today left the Official Cash Rate (OCR) unchanged at 1.75 percent.*

*Global economic growth has continued to improve in recent quarters. However, inflation and wage outcomes remain subdued across the advanced economies and challenges remain with on-going surplus capacity. Bond yields are low, credit spreads have narrowed and equity prices are near record levels. Monetary policy is expected to remain stimulatory in the advanced economies, but less so going forward.*

*The trade-weighted exchange rate has eased slightly since the August Statement. A lower New Zealand dollar would help to increase tradables inflation and deliver more balanced growth.*

*GDP in the June quarter grew in line with expectations, following relative weakness in the previous two quarters. While exports recovered, construction was weaker than expected. Growth is projected to maintain its current pace going forward, supported by accommodative monetary policy, population growth, elevated terms of trade, and fiscal stimulus.*

*House price inflation continues to moderate due to loan-to-value ratio restrictions, affordability constraints, and a tightening in credit conditions. This moderation is expected to continue, although there remains a risk of resurgence in prices given population growth and resource constraints in the construction sector.*

*Annual CPI inflation eased in the June quarter, but remains within the target range. Headline inflation is likely to decline in coming quarters, reflecting volatility in tradables inflation. Non-tradables inflation remains moderate but is expected to increase gradually as capacity pressure increases, bringing headline inflation to the midpoint of the target range over the medium term. Longer-term inflation expectations remain well anchored at around two percent.*

*Monetary policy will remain accommodative for a considerable period. Numerous uncertainties remain and policy may need to adjust accordingly.*

*Note: Following the departure of Graeme Wheeler, the Reserve Bank's policy making Governing Committee now comprises: Acting Governor Grant Spencer, Deputy Governor Geoff Bascand, and Assistant Governor John McDermott.*


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