Economic Note

Preview of the RBNZ April Monetary Policy Review

9 April 2021

Travel bubbles, housing troubles, outlook muddles

- Developments since the February Monetary Policy Statement have been mixed.
- The global environment continues to look better, while domestically the housing market outlook is cloudier.
- The RBNZ's message will remain that it is in no hurry to start unwinding the current monetary stimulus.

It's been a mixed bag of developments since the RBNZ materially upgraded its economic outlook back in February.

Vaccine roll-outs continue apace in the US and UK, to the point that the global growth outlook is being uprated. Some of NZ's key commodity exports are seeing strong price support. NZ is now bubbling up with Australia, which will enable foreign tourists to enter NZ and inject some cash into those regions that have borne the brunt of the border closure. NZ has started its vaccination programme, although it is too early to say when the population will have been vaccinated sufficiently to achieve herd immunity and enable border controls to be more fully relaxed.

Some events have created potential headwinds. The Government's housing policies aimed at reducing investor housing demand are likely to cool off the housing market – one of the key supports of economic rebound to date – at a much swifter pace. Although we don't expect the wider economic impacts to be large, the changes come with a risk that consumer spending and construction activity will be softer than otherwise this year. Global long-term interest rates have jumped in recent months in response to a brighter global outlook, although so far NZ's key mortgage rates remain unaffected. And, as a reminder that not everything goes quite as forecast, Q4 GDP was weaker than virtually everyone expected, highlighting that even our relatively quick economic rebound has its challenges.

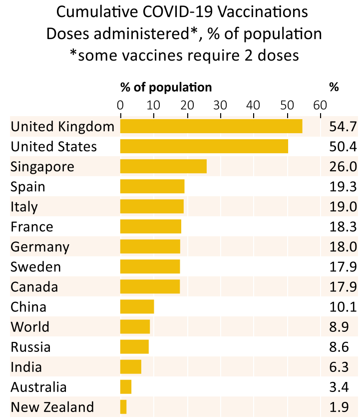
All up, we expect the RBNZ to continue emphasising the economic outlook remains in a muddle, with plenty of chances still for twists and turns. As per usual, the RBNZ will emphasise that highly accommodative monetary policy settings will be needed for some time, and that it stands ready to add support if needed.

A similar outlook, with added twists

The RBNZ's updated (and unpublished) economic forecasts are likely show that the economic outlook and policy-making background are pretty similar to February's Monetary Policy Statement. In short, the global outlook has jab-by-jab got better, while domestically there is more uncertainty around the housing market's outlook and flow-on impact to the economy:

- The IMF recently upgraded its 2021 global outlook by 0.5 percentage points to 6% to reflect added fiscal stimulus and stronger activity permitted by fast vaccination. The US, reflecting strong benefits of both of those developments, saw its outlook boosted by at least a full percentage point for each of 2021 and 2022. Prices for a number of NZ's key exports are being well supported by this global recovery;

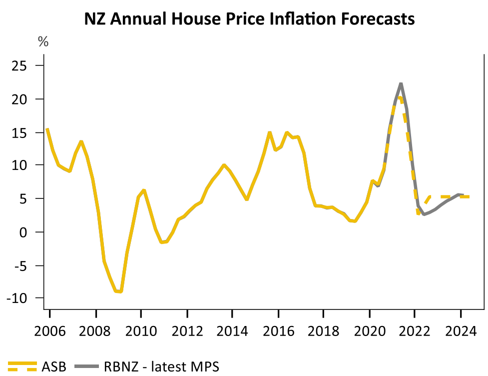
Nick Tuffley – Chief Economist – (649) 301 5659 nick.tuffley@asb.co.nz



Source: Macrobond, ASB

- The Trans-Tasman travel bubble will get underway soon. Historically, Australian visitors accounted for around 40% of visitors to NZ and 25% of visitor spend, though the two-way people flows have been fairly even. Given the different population sizes and limited travel options, it is possible that NZ ends up with a net benefit. Perhaps more important is the extent to which spending in NZ shifts, as the bubble is likely to bring much-needed revenue to beleaguered tourism hotspots. Potentially, NZ's population growth could lift a bit earlier, depending on trans-Tasman flows and the impact of freeing up some MIQ space for arrivals from other countries;
- There have been shifts in NZ monetary conditions. 10-year interest rates have risen nearly a full percentage point since the start of the year, lifting the costs of long-term funding for banks and the Government. This was despite weekly (trimmed down) NZ Government bond purchases under the Large-Scale Asset Purchase (LSAP) programme continuing to be larger than the (reduced) weekly NZ Government bond tender. As some offset, the NZD has edged down to around USD0.70 from the USD0.72-0.74 mark it traded around prior to various housing-related pronouncements from the Government;
- However, the impacts on borrowing costs for households and businesses have been limited. Since early 2021, key 1- and 2-year swap rates have lifted upwards of 15bp but borrowing costs remain near historic lows. The message from the RBNZ will be that borrowing interest rates will need to remain low, and that it will use a combination of measures – policy signalling, the Funding for Lending Programme and its LSAP programme – to achieve this;
- The raft of Government housing policies released last month are intended to make residential property investment less attractive and are likely to abruptly halt the recent surge in house prices. In turn there are likely to be knock-on effects to wider economic activity and probably faster rent inflation;
- Q4 GDP fell 1%, against consensus expectations of a flat result. One surprise was that construction accounted for 60% of the total decline, raising warning flags over whether the sector is capacity-constrained. If so, growth this year might be held back despite the clear pipeline of activity across the residential, commercial and infrastructure sectors. The retail sector also contracted by far more than spending surveys had suggested, implying the lack of foreign visitors has been having a bigger impact than it earlier seemed.

Of these shifts, housing is the one that has brought about the biggest change in uncertainty. There is as yet no official government view on how house prices or rents will be affected. Non-government estimates range from little impact to house prices expected to fall 10%. We discussed how our forecasts changed on Page 2 of our April 6 Weekly: essentially house prices flat for the rest of 2021, housing construction 8% lower over 2021 than otherwise, and rents up around 15% more over the next five or so years than they otherwise would be. So the economic and inflationary impacts of the policy changes could be negligible through to more noticeably cooling the economy at a time when growth was set to be fairly flat anyway. Our current house price forecasts are back down near the RBNZ's February forecasts, suggesting that the RBNZ may not need to adjust its overall view that much at this point in response to the policy announcements.



Source: Macrobond, ASB

RBNZ: just a little patience

With the outlook appearing similar yet with fresh clouds, there is little need for the RBNZ to change its stance. We expect the core messages to be similar: that the RBNZ needs to "maintain the current stimulatory level of monetary settings in order" to meet its objectives, and that "considerable time and patience" will be needed. This will include keeping the LSAP at $100bn and maintaining purchases so to bolster liquidity and exert downward pressure on NZ longer-term yields. The message from the RBNZ will be that borrowing interest rates will need to remain low.

For now, we still expect the RBNZ to remain on hold until August 2022, with the RBNZ to trim the LSAP programme and to halt purchases altogether before that. Factoring in our estimates of the housing policy impacts implies a combination of marginally slower economic growth yet marginally faster inflation. But the housing changes could mean the RBNZ waits longer, particularly if the demand impacts prove to be stronger than we allow for.

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 Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Economist	Nat Keall	nathaniel.keall@asb.co.nz	(649) 301 5720
Data & Publication Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660
www.asb.co.nz/economics			**@ASBMarkets**