Risks to the OCR outlook are 'equally weighted'

- The RBNZ Governor delivered a speech discussing the key risks to the economic outlook.
- Overall risks to the OCR outlook are balanced, with downside risks from the global outlook.
- The RBNZ notes the uncertainty around the US outlook and the risks to global growth from protectionist policies.

Summary and Implications
The RBNZ Governor delivered a speech on the "balance of risks around the Reserve Bank's monetary policy setting". The Governor concluded that "the **risks around the OCR are equally weighted".**

The various messages from the RBNZ Governor's speech are **exactly the same as in the February Monetary Policy Statement (MPS),** with the **RBNZ's stance firmly neutral**. The RBNZ explicitly spelled out that there is an equal chance of the next OCR move being a hike or a cut. **Global risks – with a big focus on Trump – are weighted to the downside, while domestic risks are skewed to the upside.** The Governor noted that the risks to the inflation outlook remain balanced. If the economy develops in line with the RBNZ's current forecasts, the current OCR should be sufficient to return inflation to 2%. The implications for the OCR outlook remain the same: the RBNZ expects to be on hold for the next 2-plus years. **We continue to expect a gradual tightening cycle to start from late 2018**.

Risks to NZ's economic outlook
As previously noted ,the RBNZ Governor highlighted the **key risks to NZ economic expansion** include a weaker global growth backdrop, a major domestic policy 'correction' (i.e. fiscal or monetary policy) or a rise in interest rates (in particular triggered by an increase in offshore funding costs).

Domestic risks
The Governor reiterated the Bank sees **upside risks to the migration outlook and the commodity price outlook.**

Meanwhile, the Bank sees **downside risks** stemming from the vulnerabilities of **highly leveraged households and the imbalanced property market.** On this, the Governor noted with some relief that house price inflation has moderated substantially in recent months. Although, he adds, it's still too early to know if this moderation will continue.

Finally, the Governor noted that the **NZD may be higher than projected in February**. However, how monetary policy responds depends on the drivers of that lift, with consideration on the implications for domestic capacity constraints. For example, when the lift reflects stronger NZ fundamentals (such as higher export commodity prices), the RBNZ is less inclined to lower the OCR. Again, this view is detailed in the recent MPS.

External risks
Governor Wheeler notes "the **greatest source of uncertainty** that could have important impacts on our economy relate to fiscal expansion (on the upside) and an increase in trade protectionism (on the downside) in the United States."

Looking at **protectionism** first, the RBNZ picks out the potential **labelling of China as a currency manipulator** and the possibility of **a border-adjusted tax as the key risks**. Increased protectionist measures could mean higher US tariffs, pushing US prices higher, in turn requiring "a more accelerated tightening in monetary policy by the Federal Reserve, and could be expected to put upward pressure on the US dollar exchange rate". Increased protectionism could also limit GDP growth in major economies such as the US, China and Europe by 2-3% (assuming a 10% lift in trading costs), while imports and exports would also contract. Governor Wheeler warns "New Zealand would not fare well in such circumstances", with both the direct impact of exports to the US being hit, as well as a downturn in the global economy. This would mean NZ sees lower demand and weaker commodity prices, while global uncertainty would push external funding costs higher.

On the flip side, **US fiscal expansion would directly boost US demand for NZ exports**. In addition, commodity prices would rise, while other US trade partners would also benefit, flowing through to NZ. The RBNZ's working shows a 1% lift in US GDP from fiscal stimulus would take 18 months to lift NZ GDP, by 0.3%. The US Federal Reserve would again need to lift the Fed Funds rate, which would lift the USD and weaken the NZD, offsetting some of the impact of higher borrowing costs.

The uncertainties around **China** relate to how fast it will grow over the medium term. There has been a rapid build-up in corporate debts (mainly amongst State-Owned Enterprises) and the pace of planned economic reform is still unclear.

The RBNZ clearly sees **downside risk to the UK's and EU's growth outlook** in the wake of **Brexit**, with potential for political considerations to drive a path to more restrictive trade arrangements.

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