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ECONOMIC ALERT

MONETARY POLICY STATEMENT - AUGUST 2017

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

Why...

"Domestic headline inflation has returned to the target range."

And…

"Longer-term inflation expectations remain well anchored at around 2 percent."

But…

"CPI inflation is expected to be variable over the next year, due in large part to movements in tradables inflation."

And…

"Spare capacity remains in our main trading partners, despite highly stimulatory monetary policy in those economies."

And…

"Core inflation and measures of wage inflation remain persistently low across many trading partners."

Looking ahead...

"Monetary policy will remain accommodative for a considerable period."

And...

"A lower New Zealand dollar is needed to increase tradeables inflation and help deliver more balanced growth."

And...

"GDP growth is forecast to strengthen, with annual growth averaging 3.4 percent over the next two years."

And...

"Tradeables inflation is expected to remain below its historical average for some time."

And…

"House price inflation is projected to remain lower than in recent years."

But…

"Numerous uncertainties remain and policy may need to adjust accordingly."

In conclusion…

"The current stance of monetary policy is expected to support above-trend GDP growth, such that non-tradeables inflation gradually increases and headline inflation settles around the midpoint of the Bank's target range over the medium term."

But…

"Although measures of uncertainty have reduced, risks remain skewed to the downside."

Market Implications

The main market expectations for today's Reserve Bank statement related to how assertive would be the Reserve Bank's neutral stance and any changes to the projected track for the OCR.

The Reserve Bank not only unequivocally restated its neutral monetary policy stance, but also warned *"risks remain skewed to the downside."* The projected track for the OCR is unchanged for the third straight statement.

The unchanged Reserve Bank language and OCR track disappointed those expecting the Reserve Bank to be more dovish, which gave the New Zealand dollar and swap rates a slight nudge higher. However, the Reserve Bank's more assertive comment about a lower New Zealand dollar (*"needed"* as opposed to *"would help"* in the June *OCR Review*), considerably dampened the New Zealand dollar's rise.

Comment

The Reserve Bank restated 3.50% as neutral for the OCR, which means that an OCR of 1.75% is stimulatory. However, weak price and wage inflation, *"longer-term inflation expectations … well anchored at around 2 percent"*, a stronger than desired New Zealand dollar and *"risks … skewed to the downside"* demand that *"monetary policy will remain accommodative [i.e. the OCR will remain at 1.75%] for a considerable period."*

The Reserve Bank's admission of its own forecast 'failures', many caveats about its forecasts and future risks, despite its forecasting resources, are reminders about not relying entirely on forecasts and the importance of regularly reviewing forecasts and adjusting expectations and strategies accordingly.