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BANCORP TREASURY SERVICES LIMITED

ECONOMIC ALERT

MONETARY POLICY STATEMENT - MAY 2018

10 May 2018 | www.bancorptreasury.com

"The Official Cash Rate (OCR) will remain at 1.75 percent for some time to come."

And ...

"The direction of our next move is equally balanced, up or down. Only time and events will tell."

Why ...

"Consumer price inflation remains below the 2 percent mid-point of our target due, in part, to recent low food and import price inflation, and subdued wage pressures."

And ...

"Long-term inflation expectations remain well anchored close to 2 percent."

And ...

"A rise in capacity pressure is expected to generate an increase in nontradables inflation over the medium term, leading CPI inflation to settle near the target mid-point."

Looking ahead ...

"Lower population growth, consumption growth and house price inflation are expected to decline."

And ...

"With the outlook for growth above potential, employment is expected to grow faster than the labour force, leading to a decline in the unemployment rate."

And ...

"The risks to the global growth outlook appear balanced over the medium term, while risks to global inflationary pressure remain tilted to the upside."

But ...

"The risks around the OCR projection are broadly balanced."

And ...

"The risks to employment and activity appear to be broadly balanced."

And ...

"The risks to the outlook for inflation are also balanced."

In conclusion ...

"We expect to keep the OCR at this expansionary level for a considerable period of time."

And ...

"Monetary policy needs to be stimulatory to ensure inflation increases towards the midpoint of the target range over the medium term."

Market implications

The recently installed Reserve Bank Governor has not wasted time in putting his mark on Reserve Bank monetary policy even though he delivered a *Monetary Policy Statement* ("MPS") whose message was in line with previous RBNZ messages on the economy, inflation and the OCR.

The Reserve Bank not only put back its timing of the first OCR rise by one quarter and restated its prevailing balanced position but also called the current monetary policy environment *"expansionary"* and *"here for a while."*

The MPS also lacked any reference to the relative value of the New Zealand dollar. Those two factors caused the New Zealand dollar to drop, with the NZD/USD falling 40 points from 0.6980 to 0.6940 in a matter of minutes after the MPS release. Domestic swap rates also fell but to a much lesser extent then the currency.

Comment

The key message in the MPS was contained in the opening sentences that the *"OCR will remain at 1.75 percent for some time to come"* and *"the direction of our next move is equally balanced, up or down."*

Interest rate markets will have to allow more delays to the timing of the first OCR rise and, potentially, its upward track thereafter. The NZD/USD could come under further downward pressure from New Zealand's worsening interest rate differential, with a flow on effect to the New Zealand dollar in general.

Reserve Bank Governor, Adrian Orr, clearly wants us to focus on the key drivers behind the *Policy Targets Agreement* and the risks to those drivers. Significantly, he offered no comment or opinion on the relative value of the New Zealand dollar.