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ECONOMIC ALERT

OCR REVIEW - SEPTEMBER 2017

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

Why ...

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

And ...

"House price inflation continues to moderate due to loan-to-value ratio restrictions, affordability constraints, and a tightening in credit conditions."

And ...

"The trade-weighted exchange rate has eased slightly since the August Statement."

Looking ahead ...

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

And ...

"Headline inflation is likely to decline in coming quarters, reflecting volatility in tradables inflation."

And ...

"Growth is projected to maintain its current pace going forward, supported by accommodative monetary policy, population growth, elevated terms of trade, and fiscal stimulus."

In conclusion ...

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

And ...

"There remains a risk of resurgence in [house] prices given population growth and resource constraints in the construction sector."

And ...

"A lower New Zealand dollar would help to increase tradables inflation and deliver more balanced growth."

Market Implications

The Reserve Bank's statement today announcing the OCR Review not only delivered an entirely predictable and expected outcome (i.e. an unchanged OCR and a neutral monetary policy bias) but was almost a complete repeat of the *Monetary Policy Statemen*t ("MPS") announcement last month.

Faced with the statement's predictability and sameness, local currency and interest rate markets were little moved. The NZD eased modestly as markets absorbed a continuation of the Reserve Bank's neutral, 'lower for longer' stance on the OCR.

Comment

Judged by the central bank mantra that 'boring is beautiful,' today's Reserve Bank statement was a timeless masterpiece. The significant aspects of today's statement were the changes from last month's MPS announcement.

"Global economic growth ***has continued to improve*** *in recent quarters"* rather than *"has become more broad-based."*

"A lower New Zealand dollar ***would help*** *to increase tradables inflation and deliver more balanced growth"* rather than *"is needed."*

"Growth is projected to ***maintain its current pace"*** rather than *"improve."*

"This moderation [in house price inflation] is expected to ***continue"*** rather than *"persist."*

"The outlook for tradables inflation remains weak" has been removed.

Of these changes, the most significant are that a lower New Zealand dollar is no longer *"needed"* although it *"would help"* and the outlook for tradables inflation is no longer *"weak"* although there is *"volatility in tradables inflation."*

The Reserve Bank, like the Federal Reserve ("Fed"), needs solid evidence to deviate from its well-signalled monetary policy path. The difference is that the Reserve Bank's path is an unchanged OCR, whereas the Fed's path is a higher federal funds rate. Interestingly, markets have a more optimistic outlook versus the stable track signalled by the Reserve Bank. In the case of the Fed path, markets are less optimistic.

The implications are huge for the New Zealand dollar if either central bank is proved correct, let alone if both are proved correct.