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ECONOMIC ALERT

MONETARY POLICY STATEMENT - FEBRUARY 2018

8 February 2018 | www.bancorptreasury.com

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

Why ...

"Underlying inflation remains low."

And ...

"There has been little sign of domestic inflation picking up."

And ...

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

And ...

"House price inflation has increased somewhat over the past few months but housing credit growth continues to moderate."

And ...

"Commodity prices have increased, although agricultural prices are relatively soft."

And ...

"Fiscal stimulus is expected to be smaller and more delayed than assumed in the November Statement."

Looking ahead ...

"CPI inflation is forecast to trend upwards towards the midpoint of the target range."

And ...

"We assume the trade weighted exchange rate will ease over the projection period."

But ...

"While global inflation remains subdued, there are some signs of emerging pressures."

In conclusion ...

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

And ...

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

And ...

"There are substantial upside and downside risks to the projections, reflecting the large degree of uncertainty in the current economic environment. The Bank judges these risks to be balanced."

Market Implications

Markets were reassured that, against the background of intense volatility over the preceding few days, the Reserve Bank again delivered an MPS that was in line with general expectations, an upbeat growth outlook, a tempered inflation outlook and no change to the forecasted path for the OCR.

Nevertheless, the Reserve Bank said a lot about the low current and projected inflation, and seemed to downplay wage inflation threats despite recent strong growth and jobs growth. That perceived bias and the observation that "*interest rate differentials between New Zealand and our major trading partners have narrowed, reducing the attractiveness of the New Zealand dollar*" caused a slight drop by the New Zealand dollar and increased the New Zealand dollar's vulnerability to further US dollar strength.

Comment

The Reserve Bank was unlikely to deviate from its current script with a new Governor and Policy Targets Agreement due next month.

The biggest focus was on the Reserve Bank's projection for inflation and the OCR given stronger than forecast growth (because of strong upward revisions to the previous three year's growth numbers) and weaker than forecast inflation in the December quarter. Not surprisingly, its projected OCR track was unchanged but the surprise came from the relatively soft inflation outlook and high level of conditionality and *"uncertainties"* in its projections.

Significantly, the Reserve Bank went from describing underlying inflation as *"subdued"* in November to *"low"* today and outlining specific risks to its projections that would justify a lower OCR.

The outgoing top management at the Reserve Bank are leaving the incoming Governor and recently appointed Finance Minister with a 'clean slate' in terms of conditionality and policy choices. A clear conclusion remains — the OCR will remain at 1.75% *"for a considerable period."*