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ECONOMIC ALERT

MPS — NOVEMBER 2018

8 November 2018 | www.bancorptreasury.com

"The Official Cash Rate (OCR) remains at 1.75 percent."

And ...

"We expect to keep the OCR at this level through 2019 and into 2020."

But ...

"The timing and direction of any future OCR move remains data dependent."

Why ...

"Core consumer price inflation remains below our 2 percent target mid-point, necessitating continued supportive monetary policy."

But ...

"Indicators of labour market tightness suggest that employment is near its maximum sustainable level."

Looking ahead ...

"We expect to keep the OCR at this level through 2019 and into 2020."

And ...

"Two key assumptions are that firms continue to adjust prices only gradually as costs increase and that weak business sentiment does not signal a lasting downturn in demand."

Why ...

"We assume that … underlying inflation will increase only gradually. However, if firms start passing through cost increases more quickly, headline inflation could increase more rapidly than projected."

In conclusion ...

"We will keep the OCR at an expansionary level for a considerable period."

Market implications

The Reserve Bank of New Zealand ("RBNZ") addressed the markets' main questions and assumptions, left its forecasted path for the OCR unchanged but raised as many questions as it answered.

The tone in this *Monetary Policy Statement* ("MPS") was probably a little more hawkish than in the August MPS. Markets inferred an even more hawkish tome when recent jobs data was added to the mix.

The RBNZ added to the recent market shift to remove the chance of an OCR cut although the divergence between market pricing and RBNZ timing for the first OCR rise remains. That added to underlying confidence in recent rises in local swap rates and the New Zealand dollar.

All is well in the New Zealand economy and a higher OCR is likely a matter of when, not if. However, *"the world outlook poses downside risks to domestic growth"* and, by implication, those external risks apply to domestic growth employment inflation, and monetary policy.

A positive outcome for the RBNZ, and the New Zealand dollar, was that markets no longer price in an OCR cut and forecast an OCR path more closely aligned to the RBNZ's.

Comment

The RBNZ removed the warning that *"the direction of our next OCR move could be up or down."* Rather, it noted that *"there are both upside and downside risks to our growth and inflation projections"* and that *"any future OCR move remains data dependent."* These subtle tweaks are encouraging a shift of market focus from the OCR to drivers for future OCR decisions.

The RBNZ will look through the first round effects of higher petrol prices but will be on alert for any second or third round effects. It noted labour market tightness but was unable to address an even tighter labour market as evidenced in yesterday's stellar data.

The message from the RBNZ is that New Zealand economy is doing well and higher interest rates are expected but external risks still dominate, leaving the RBNZ like every other central bank *"data dependent"* for its next action(s).