BANCORP

BANCORP TREASURY SERVICES LIMITED

ECONOMIC ALERT

MONETARY POLICY STATEMENT - NOVEMBER 2017

9 November 2017 | www.bancorptreasury.com

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

Why ...

"Underlying inflation remains subdued."

And ...

"Global economic growth continues to improve, although inflation and wage outcomes remain subdued."

And ...

"Commodity prices are relatively stable."

And ...

"CPI inflation is projected to remain near the midpoint of the target range and longer-term inflation expectations are well anchored at 2 percent."

And ...

"A weaker outlook for housing and construction [will be] offset by accommodative monetary policy, the continued high terms of trade, and increased fiscal stimulus."

Looking ahead ...

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

And ...

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

And ...

"Low house price inflation is expected to continue, reinforced by new government policies on housing."

But ...

"It remains uncertain how persistent the slowing in the housing market will be."

In conclusion ...

"In the current environment, additional stimulus would risk generating unnecessary volatility in the economy, while a premature tightening would risk undermining growth and could cause headline inflation to settle below the midpoint of the target range."

Market Implications

The Reserve Bank delivered an economic, inflation and fiscal policy assessment that was more upbeat than markets expected, although its policy outlook is still very balanced despite higher near term projected growth and inflation tracks and a lower New Zealand dollar.

The Reserve Bank accepted the Trade Weighted Index's ("TWI") recent fall and adopted a practical assumption that it will remain at current levels throughout its forecast period. It dropped its previous observation that a lower TWI *"would help to increase tradables inflation"* and now consider that the TWI's recent fall *"if sustained, will increase tradables inflation and promote more balanced growth."*

Significantly, the Reserve Bank's forecast OCR track is almost unchanged from that in the August *Monetary Policy Statement* and still implies the first OCR rise will not be until very late in 2019. Where they vary, the new forecasts are higher but the first divergence from August's forecast is not until June 2019 and any variances are only 0.10%.

The Reserve Bank's acceptance of the TWI's recent fall and its upbeat economic and fiscal policy assessments, gave the New Zealand dollar an immediate lift. Local interest rate markets were unmoved in the face of virtually unchanged OCR forecasts.

Comment

The Reserve Bank explicitly restated its expectation for the next OCR move to be a rise. However, that rise is at least two years away and subject to *"numerous uncertainties."* Furthermore, any deviations from assumptions and forecasts will result in the Reserve Bank adjusting policy accordingly.

Today's Reserve Bank statement repeated some clear messages — the OCR is not going anywhere soon and the Reserve Bank will be closely monitoring global inflation, domestic inflation expectations, house price inflation, the exchange rate, the new government's fiscal policies and domestic capacity pressures. Furthermore, the Reserve Bank is content not to join the Federal Reserve, Bank of England and Bank of Canada in raising their respective cash rate, rather it will stand beside its ANZAC brother in maintaining floating and short swap rates 'lower for longer'.