

RBNZ OCR Call Change: First cut in November

17 July 2024



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Contact

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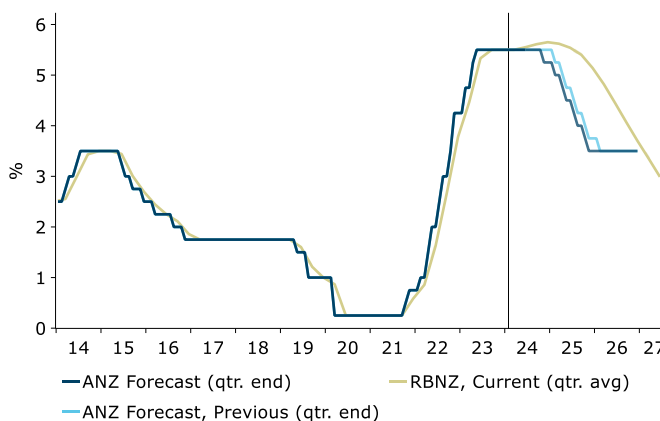
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OCR call change – 25bp cut in November

Summary

- We have brought forward our forecast timing of the first 25bp cut in the Official Cash Rate (OCR) to **November, rather than in February**. We see the balance of risks around that as tilted towards earlier (October) rather than later. Beyond that, we are forecasting a steady run of 25bp cuts at each meeting to a terminal rate of 3.5% as before (figure 1).
- On top of the RBNZ's acknowledgement last week of emerging downside risks for activity, today's [Q2 CPI data](#) should alleviate the RBNZ's concerns expressed in May about upside domestic inflation risks. While non-tradables did technically deliver a fifth consecutive upward surprise for the RBNZ (and us), it was small (0.1%pt), and as it happens, there was a one-off methodological change to the measurement of road user charges. Without this, non-tradable inflation would likely have printed in line with our forecast. There were plenty of details across the release showing inflation pressures are reducing.
- There is an enormously wide gulf between the RBNZ's May MPS forecast of no cuts until August 2025, and both market economists' evolving forecasts and particularly (spectacularly) current market pricing. But the RBNZ is not afraid to change its mind when the facts change.

Figure 1. OCR forecast



Source: RBNZ, Macrobond, ANZ Research

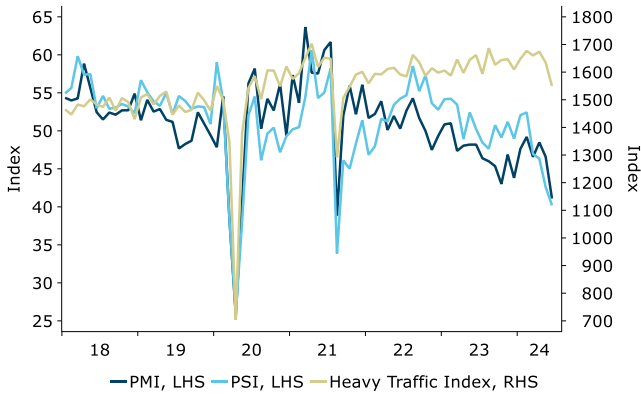
The Reserve Bank surprised markets and economists alike with the extent of their tonal shift at last week's [Monetary Policy Review](#). We can only guess whether or not the RBNZ actually expected or intended such an enormous reaction, but there were two key comments that excited markets:

- "The extent of [monetary policy] restraint will be tempered over time consistent with the expected decline in inflation pressures". Strictly speaking this is nothing new – there's no mention of timing. But in the complicated dance between the RBNZ and markets the vibe matters enormously, and that statement had a decidedly dovish tone.
- That the Committee "discussed the risk that... tight monetary policy is feeding through to domestic demand more strongly than expected." The risks of sticky inflation were discussed too, to be fair, but the market has its dove-tinted glasses on.

And today brought the biggie, [CPI inflation](#). We'd characterise today's data as reassuring relative to the fears the RBNZ expressed in May that they might not be getting the traction they expected. While non-tradables inflation was 0.1%pt higher than the RBNZ had expected, there was a one-off methodological change to the measurement of road user charges. Without this, non-tradable inflation would likely have printed in line with our forecast. There was plenty of evidence across the release of easing domestic inflation pressures. See our [Review](#) for more detail.

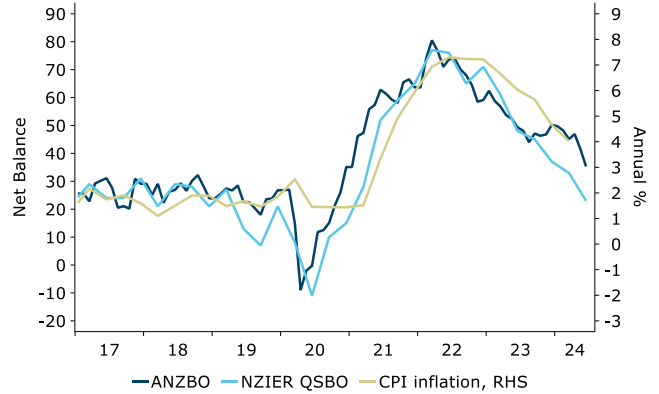
The reason the market is gunning for imminent cuts is the fact that recent activity, labour market, and to some extent inflation indicators have rolled over. Much of it is 'second tier' but the list is long: QSBO, ANZBO, Truckometer, card spending, PMI, PSI, job ads, and house sales. Figure 2 shows the vibe, while figure 3 shows falling pricing intentions in the NZIER Quarterly Survey of Business Opinion and the ANZ Business Outlook survey.

Figure 2. PMI, PSI and heavy traffic index



Source: Business NZ, BNZ, Macrobond, ANZ Research

Figure 3. QSBO and ANZBO pricing intentions vs CPI



Source: NZIER, Stats NZ, Macrobond, ANZ Research

Cuts are clearly just a matter of time. The big question is, how much time? Here's the calendar of selected upcoming data:

July 2024

Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	31				

August 2024

Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday
29	30	31	1	2	3	4
5	6	7	8	9	10	11
12	13	14	15	16	17	18
19	20	21	22	23	24	25
26	27	28	29	30	31	

September 2024

Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday
2	3	4	5	6	7	8
9	10	11	12	13	14	15
16	17	18	19	20	21	22
23	24	25	26	27	28	29
30	1	2	3	4	5	6

October 2024

Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday
30	31	1	2	3	4	5
6	7	8	9	10	11	12
13	14	15	16	17	18	19
20	21	22	23	24	25	26
27	28	29	30	31		

November 2024

Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday
28	29	30	1	2	3	4
5	6	7	8	9	10	11
12	13	14	15	16	17	18
19	20	21	22	23	24	25
26	27	28	29	30	1	2

- ANZBO ANZ Business Outlook survey
- CC Consumer confidence
- CPI Consumers Price Index
- GDP Gross Domestic Product
- LM Labour market data
- MPR Monetary Policy Review
- MPS Monetary Policy Statement
- PMI Performance of Manufacturing Index
- PSI Performance of Services Index
- QSBO Qtrly Survey of Business Opinion
- RT Retail trade

A couple of key points to note:

- labour market data is a week before the August MPS.
- CPI data is a week after the October MPS, but they'll have Q2 GDP data.

Unlike the market, we still see a cut in **August** as unlikely at this stage, given non-tradable inflation is still so high (5.4%), and the RBNZ is not yet likely to be revising down their growth forecasts dramatically beyond perhaps the very near term. We certainly wouldn't rule out that the Committee could be ready to jump, but for now it seems likelier that if the RBNZ is confident things are well in hand, it would use the August MPS to set up a cut in October or November. That would lock in most of the observed easing in monetary conditions, while providing optionality as the Committee awaits the assurance of one more read of GDP and QSBO, as well as certainty that the drop seen in the monthly indicators isn't a temporary reaction to the RBNZ's hawkishness in May (analogous to what we saw in November 2022 in response to the RBNZ's talk of a deliberate recession).

October is a possibility we certainly wouldn't discount. The RBNZ prefers to deliver turning points at Monetary Policy Statements, where a full set of forecasts can provide the justification and set out the path ahead. But setting up a cut in the August MPS could tick that box. The remaining tricky issue with October is that CPI inflation is out just a week later (again). That doesn't rule out a move, but perhaps raises the hurdle a little.

All up, we see **November** as the likeliest timing at this stage. By then the RBNZ will know more about:

- Whether the rolling over in the soft data will stick, or whether there's a temporary element of noise and possibly even residual seasonality, given how seasonal adjustment models have struggled with the immense volatility caused by COVID.
- The impact of tax cuts and other income-supplementing fiscal measures.
- Inflation – it should be back in the band by then. But tradable inflation could spring some unpleasant surprises (eg shipping costs).

The desire for certainty needs to be weighed against causing unnecessary damage to the economy – an accusation that one suspects would be levelled by most business owners at this point. It is the RBNZ's job to be a bit paranoid about inflation, but it is also required to avoid unnecessary volatility in output. In terms of the risk around our November call, we now view an October cut as likelier than the RBNZ waiting until February.

How far, how fast?

A key question for the market is not only when the first cut will come, but also how quickly and how far the OCR will ease.

It's difficult to take a strong view on this at present. We have left in a simple 25bp cut at each meeting to a terminal rate of 3.5% for now, and will reassess the medium-term outlook when we undertake our quarterly forecast round in mid-August. If the data continues to head south, the odds will increase that the RBNZ will have to cut below their estimate of neutral (long-run currently 2.75%) in order to minimise an inflation undershoot, all else equal (which it never is).

The market is pricing a solid chance of 50bp cuts in the months ahead, but large cuts are typically seen in response to sudden large negative economic shocks, rather than just weaker-than-expected starting point data. It could happen, of course, but it would likely require significant downward revisions to the RBNZ's growth forecasts, which are currently very similar to our own. An extra consideration for the November meeting is that there is then a three-month gap before another scheduled opportunity to move the OCR, whereas for the earlier meetings, it's just a six-week gap.



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