ANZ Research

Review of the RBNZ October Monetary Policy Review

9 October 2024

Contact

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Doubling down

- As almost universally expected, the RBNZ today cut the Official Cash Rate 50bp to 4.75%. The Record of Meeting noted that "The Committee discussed the respective benefits of a 25-basis point versus a 50-basis point cut in the OCR. They agreed that a 50-basis point cut at this time is most consistent with the Committee's mandate," describing a 4.75% OCR as "still restrictive."
- The accompanying commentary discussed risks to both the upside and the downside, but dedicated more words to the latter. That said, the commentary gave very little away as regards next steps. That is only reasonable with CPI data due next week, and key labour market data also out before the next Monetary Policy Statement.
- Our OCR forecast is unchanged, with a follow-up 50bp cut pencilled in for November, and 25bp cuts after that as the OCR nears estimates of neutral. But there's lots more data to come between now and the November meeting, starting with Q3 CPI inflation next week.

In brief

As widely anticipated, the RBNZ today cut the Official Cash Rate (OCR) 50bp to 4.75%. In a hint that, as we anticipated, the universality of expectations of such a move may have played into the decision, the Committee "noted that current short-term market pricing is consistent with this decision."

While promising nothing, the tone of the Policy Assessment and Summary Record of Meeting leaned towards the dovish side, insofar as confidence about the inflation outlook has clearly grown. That leaves the market free to continue to price a follow-up 50bp cut in November. That is also our forecast, though one has to characterise any forecast as highly conditional on the data between now and then, including CPI next week and the Household Labour Force Survey in early November.

Key quotes:

- **OCR decision:** "The Committee discussed the respective benefits of a 25-basis point versus a 50-basis point cut in the OCR. They agreed that a 50-basis point cut at this time is most consistent with the Committee's mandate of maintaining low and stable inflation, while seeking to avoid unnecessary instability in output, employment, interest rates, and the exchange rate." "The Committee noted that current short-term market pricing is consistent with this decision."
- **OCR outlook:** "The Committee confirmed that future changes to the OCR would depend on its evolving assessment of the economy."
- **Capacity:** "The New Zealand economy is now in a position of excess capacity, encouraging price- and wage-setting to adjust to a low-inflation economy."
- **Labour market:** "Labour market conditions are expected to ease further, with filled jobs and advertised vacancy rates continuing to decline."

- **Domestic activity:** "the New Zealand economy has evolved largely as expected." "High-frequency indicators point to continued subdued growth in the near term."
- **Inflation outlook:** "The Committee assesses headline consumer price inflation to be within its 1 to 3 percent target band in the September 2024 quarter and to remain around the midpoint in the medium-term." "while domestic price-setting behaviour is now more in line with its mandate, there are still risks that further adjustments might be faster or slower than currently expected."
- **Global risks:** Members discussed risks around the Middle East, China's growth outlook, and US elections.

Our take

As we noted in our Preview, a 50bp cut abruptly became the default expectation last week, with almost all economists predicting it, and the market similarly aligned. That was despite the August Monetary Policy Statement setting up a 25bp cut, and the data on net since then not providing much in the way of reasons to revise down activity or inflation forecasts. Indeed, the RBNZ noted that "the New Zealand economy has evolved largely as expected" and "the outlook is broadly consistent with the August Monetary Policy Statement." However, the data (and the NZIER Quarterly Survey of Business Opinion in particular) has provided the RBNZ with more *certainty* around their forecasts of near-term disinflation, and that, very reasonably, counts for quite a bit. Cutting a little or a lot essentially comes down to a question of confidence that enough has been done.

The tone of the Policy Assessment tilted to the dovish side. The Committee "noted that while domestic price-setting behaviour is now more in line with its mandate, there are still risks that further adjustments might be faster or slower than currently expected," but there was very little mention of upside risks beyond that. Early signs of the impact of rate cuts (eg a surge in business confidence and expectations, the Barfoot and Thompson auction clearance rate) were not discussed. Rather, the Committee noted that "high-frequency indicators point to continued subdued growth in the near term." The Committee noted labour market conditions are expected to ease further, and "weak house price growth, lower levels of net immigration, and ongoing fiscal consolidation are expected to constrain aggregate demand growth."

The next move remains conditional on the data – as always – but there was nothing in today's commentary to dissuade the market from continuing to price a follow-up 50bp cut in November as the likeliest outcome. That seems entirely fair, and is our forecast, but the further above neutral the OCR is, the easier it is to justify outsized moves. With the divergence between backward-looking and forward-looking data likely to persist for some time the Committee's decision-making isn't likely to get any easier any time soon – and nor will forecasting those decisions. The data between now and the November Monetary Policy Statement will influence everyone's views to a greater or lesser extent, and it could end up being another tricky one, but for now we are comfortable with our forecast of a follow-up 50bp cut in November. It's notable that that meeting has to do the work of two, due to the missing January meeting in the schedule.

Market reaction

Short-end interest rates and the NZD fell in the immediate aftermath of the decision, with the bellwether 2yr swap rate down around 6bps, and the NZD down around 25bps. We think that was entirely logical given that markets weren't fully pricing in the 50bp cut we saw (markets had 45bp priced in, or roughly 80/20 odds in favour of 50bp rather than 25bp).

The Committee's characterisation of policy as "still restrictive" clearly suggests more cuts are coming, with the pace dependent on the evolution of data. The Committee's explicit mention that "current short-term market pricing is consistent with this decision" and that it was "seeking to avoid unnecessary instability in output, employment, interest rates, and the exchange rate" suggests a willingness to take what's on the proverbial table if it's logical to do so (which was the assumption underlying our change of call to a 50bp cut today).

We still expect a 50bp cut in November at this stage, as does the market. Whether the market starts to contemplate a lesser 25bp cut or a larger 75bp cut will depend on incoming data, with the focus very much on Q3 CPI data next week. Front-loading cuts has bought the Committee optionality, and we wholeheartedly agree that they are "well-placed to deal with any near-term surprises". With this larger cut now behind us, it won't be long before the OCR is below the fed funds rate and the RBA cash rate, and we see that as a vulnerability for the Kiwi as we head into 2025, especially with the US nicely on track for a soft landing.

OCR 4.75% – Monetary restraint reduced as inflation converges to target

The Monetary Policy Committee today agreed to cut the Official Cash Rate (OCR) to 4.75 percent. The Committee assesses that annual consumer price inflation is within its 1 to 3 percent inflation target range and converging on the 2 percent midpoint.

Economic activity in New Zealand is subdued, in part due to restrictive monetary policy. Business investment and consumer spending have been weak, and employment conditions continue to soften. Low productivity growth is also constraining activity.

Some exporters have benefited from improved export prices. However, global economic growth remains below trend. The outlook for the United States and China is for growth to slow, while geopolitical tensions remain a significant headwind for world economic activity.

The New Zealand economy is now in a position of excess capacity, encouraging price- and wage-setting to adjust to a low-inflation economy. Lower import prices have assisted the disinflation.

The Committee agreed that it is appropriate to cut the OCR by 50 basis points to achieve and maintain low and stable inflation, while seeking to avoid unnecessary instability in output, employment, interest rates, and the exchange rate.

Summary Record of Meeting – October 2024

Members of the Monetary Policy Committee agreed that the stance of monetary policy has been consistent with ensuring low and stable inflation. Since the August Monetary Policy Statement, the New Zealand economy has evolved largely as expected. The Committee agreed that excess capacity has dampened inflation expectations, and price and wage changes are now more consistent with a low-inflation environment. New Zealand's annual consumer price inflation is assessed to currently be within the Committee's 1 to 3 percent target band and is expected to converge to the target midpoint.

Members observed that global economic activity remains below trend

Global economic growth remains below its long-run trend and is expected to remain so for the year ahead. Economic growth in the United States and China is expected to slow. The disinflationary process in advanced economies has led to further reductions in official policy interest rates.

The Committee agreed that domestic activity is weak

Members agreed that increasing excess capacity is leading to lower inflationary pressure in the New Zealand economy. Economic growth is weak, in part because of low productivity growth, but mostly due to weak consumer spending and business investment. High-frequency indicators point to continued subdued growth in the near term. Some exporting businesses have been supported by higher export prices, particularly in the dairy industry.

Labour market conditions are expected to ease further, with filled jobs and advertised vacancy rates continuing to decline. More generally, weak house price growth, lower levels of net immigration, and ongoing fiscal consolidation from spending restraint, are expected to constrain aggregate demand growth.

The Committee noted that while wholesale and bank interest rates have declined, financial conditions remain restrictive, and credit demand remains subdued. The current preference for shorter-term mortgage rates by borrowers will increase the speed with which changes in the OCR influence household cashflows over coming months.

Members are confident that inflation is converging to target

The Committee agreed that monthly price indices signal a continued decline in consumer price inflation in New Zealand. Recent business visits suggest that weak demand is restricting the pass-through of increased input costs to prices faced by consumers. This is consistent with business surveys, which show a declining share of businesses intending to increase prices. Business price-setting behaviour is now more consistent with the Committee's inflation remit.

The Committee assesses headline consumer price inflation to be within its 1 to 3 percent target band in the September 2024 quarter and to remain around the midpoint in the medium-term.

The Committee considered global and domestic risks

Members discussed how recent events in the Middle East could pose significant risks to both global economic activity and energy prices. Should conflict escalate, oil prices and shipping costs could rise, and adverse investor sentiment could trigger asset price corrections and tighter financial conditions. Members noted that the current market pricing of risk was especially sensitive to downside economic surprises.

Uncertainty about the effectiveness of recent policy actions in China also posed downside risks to New Zealand's export growth, as well as export and import prices. Heightened uncertainty around the US elections, and the implications for US trade and fiscal policies, could also be significant for international financial markets and global economic activity.

Members noted that while domestic price-setting behaviour is now more in line with its mandate, there are still risks that further adjustments might be faster or slower than currently expected.

Members agreed to ease monetary restraint

The Committee agreed that the economic environment provided scope to further ease the level of monetary policy restrictiveness, consistent with its mandate of low and stable inflation.

The Committee discussed the respective benefits of a 25-basis point versus a 50-basis point cut in the OCR. They agreed that a 50-basis point cut at this time is most consistent with the Committee's mandate of maintaining low and stable inflation, while seeking to avoid unnecessary instability in output, employment, interest rates, and the exchange rate. The Committee noted that current short-term market pricing is consistent with this decision.

The Committee acknowledged that the outlook is broadly consistent with the August Monetary Policy Statement. Members agreed that an OCR of 4.75 percent is still restrictive and leaves monetary policy well-placed to deal with any near-term surprises. The Committee confirmed that future changes to the OCR would depend on its evolving assessment of the economy.

On Wednesday 9 October 2024, the Committee reached a consensus to reduce the Official Cash Rate by 50 basis points, from 5.25 percent to 4.75 percent.

Attendees

MPC members: Adrian Orr (Chair), Bob Buckle, Carl Hansen, Christian Hawkesby, Karen Silk, Paul Conway, Prasanna Gai
Treasury Observer: James Beard
MPC Secretary: Marea Sing

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