ANZ Research

Preview: RBNZ Monetary Policy Statement

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Contact

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Confused by acronyms or jargon? See a glossary here.

Not enough runs on the board to declare

- **We expect the RBNZ to leave the OCR at 5.5% next week**, reiterating that they remain in watch-worry-wait mode and that "interest rates need to remain at a restrictive level for a sustained period".
- The data since the February MPS speaks to a clearly slowing economy, but also sticky inflation, with the Q1 forecast miss on non-tradable inflation the fourth in a row and the biggest yet. The RBNZ could take a glass-half-empty or glass-half-full view of things. But overall, we think confirmation that the economy is cooling as the Committee expects and requires will win the day. The data clearly signals a meaningful fall in domestic inflation ahead, with spare capacity steadily opening up.
- That said, we don't expect they'll be in any hurry to signal imminent cuts to an impatient market.

What's new?

Since the February MPS, the data have pointed in different directions.

For the hawks: Q1 non-tradable inflation beat RBNZ expectations by half a percent. At 5.8% y/y, it's a full 1.4% points higher than the RBNZ thought it would be by now when they declared they were done hiking a year ago. Fair to say the Committee would likely have hiked the OCR a bit further had they known that was in store.

For the doves: recent activity and labour market data have tilted to the softer side of expectations, and risks are growing that the economy could have a harder landing than anticipated.

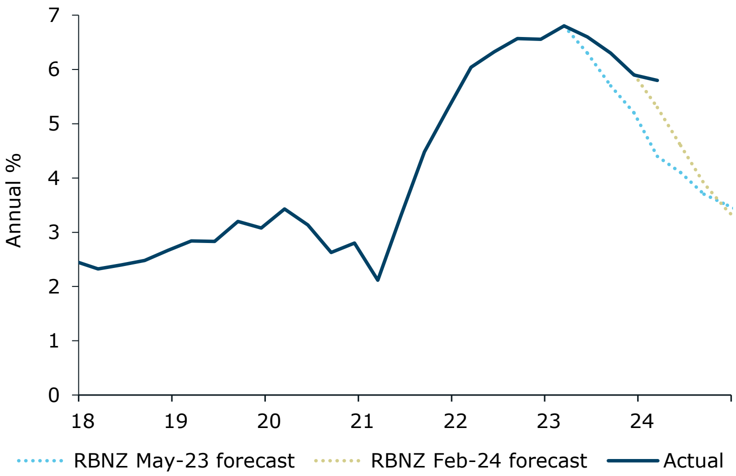
Recent 'dovish' data	Recent 'hawkish' data
• The Q1 unemployment rate rose 0.1%pt (almost 0.2%pt) more than the RBNZ expected, and timelier indicators deteriorated faster. • Q4 GDP was 0.1% lower than the RBNZ expected, and the recession headlines hit both consumer and business sentiment hard. Lead indicators suggest the hitherto resilient services sector is cracking. • QES wage growth fell by more than the RBNZ was anticipating. • Export prices have been a little weaker than the RBNZ expected. • Housing market signals are soft and could see the RBNZ revise its house price forecasts down.	• Non-tradable inflation was 5.8% y/y in Q1, whereas the RBNZ had expected 5.3%. And the surprise was broad-based – core inflation measures also fell less than we were expecting. Tradables inflation also fell a little less than the RBNZ expected, but the overall fall is encouraging and oil prices have retreated lately. • Import prices have held up more than the RBNZ anticipated. • The TWI has been slightly weaker than assumed. • Near-term inflation indicators have held up (pricing intentions, cost expectations, selected monthly price indexes).

The OCR track

The Committee's discussion around what OCR track to publish will be an interesting one.

The last published OCR track in February peaked at 5.59%, ostensibly still a hawkish bias given the OCR is currently at 5.5%, but this was downplayed in the text and press conference. Our ready reckoner, taking into account all the above news, mechanistically suggests an OCR track that's a little higher than previously, due mostly to the higher starting point for non-tradables inflation (figure 1), which the market has largely forgotten about but the RBNZ's model won't have.

Figure 1. Non-tradable inflation versus RBNZ's forecasts



Source: RBNZ, Statistics NZ, ANZ Research

However, with the real economy clearly running softer, and quite possibly running into a wall, we doubt the RBNZ will want to send that message, as the hurdle for further hikes is in practice likely very high now that the activity and labour market data is so clearly softening. To avoid doing so, they have two basic options: fudge it – ie put in some negative judgment that just makes the problem go away (after all, all models are wrong, but some are useful), or else push cuts out further. The latter would likely be met with a collective eye roll by markets that are convinced the RBNZ will be cutting the OCR fairly soon (with around a 50% chance of a cut by August, and a full cut priced by October). But insofar as we don't believe the RBNZ is likely to be looking to have a big impact on market pricing, that's probably neither here nor there.

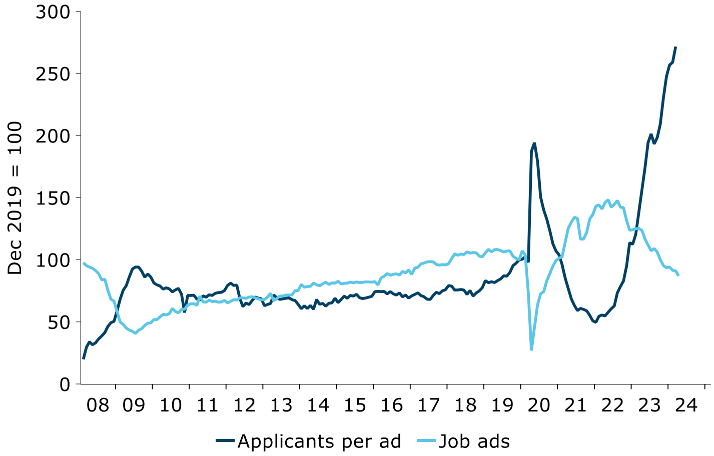
Use your words

The odds of a change in the OCR at this meeting are very low. However, how the Committee weighs up and talks about the upside inflation versus downside growth risks in the Policy Assessment and Summary Record of Meeting will be important for the market.

We expect the RBNZ to maintain its comment that "interest rates need to remain at a restrictive level for a sustained period", essentially describing their OCR track. But there's plenty of nuance that matters too.

If the Policy Assessment downplays the higher non-tradable inflation starting point in light of the wins on the tradable side and the very clear signs of capacity opening up (particularly in the labour market, figure 2, over), then the natural conclusion is that the Committee will be willing to cut the OCR with a greater share of the required disinflation still a forecast rather than a fact. The market would likely see such a tone as corroborating its pricing of 2-3 cuts by year end, regardless of the RBNZ's own OCR forecasts. And certainly we'd be taking a look at our own OCR forecasts in that instance, which are currently broadly aligned with the RBNZ's February MPS track, with no cuts until well into next year.

Figure 2. SEEK job ads and applicant per ad



Source: SEEK, Macrobond, ANZ Research

But if the Committee sounds very worried about their unexpectedly slow progress in bringing non-tradable inflation down, that would suggest that they need to see non-tradable inflation outcomes fall a lot further yet before cuts could be countenanced. And in that context it's important to note that we only get updated CPI inflation data every three months.

In practice, of course, the influence of a fresh set of RBNZ forecasts on market expectations is almost always overtaken quickly by evolving data, as it should be. It's not what the RBNZ says and forecasts next week that will ultimately decide when the first OCR cuts come; it'll be the data that comes out subsequently.

The macro forecasts

While more and more activity and labour market indicators are suggesting sticky inflation risks are indeed dissipating in the medium-term outlook (eg firms in our Business Outlook survey are now expecting wage inflation to be 3% a year from now: tick!), we're yet to see this reflected in the actual price data, where progress has been disappointingly slow to date. The RBNZ Committee will need to make a judgement call on whether this is just a question of timing, or whether something else is going on.

As regards to the RBNZ's updated forecasts, we wouldn't be surprised to see a downgrade to their outlook for GDP growth (due to the signal from the timely recent data, rather than the GDP starting point, which was only marginally weaker than expected, and not in the components the RBNZ focuses on).

However, at the same time, the timely data's signals on costs and pricing suggest broad-based inflation pressures remain way too strong. Given that, we could well see a weaker GDP forecast coupled with a weaker *potential* GDP forecast. That might mean that the CPI inflation outlook isn't significantly lower than before, even if the growth forecast is lower. There are plenty of stories the RBNZ could tell around this kind of change in outlook, including a weaker productivity assumption. It's therefore not necessarily as simple as 'weaker growth means weaker inflation means earlier and/or faster cuts'. Supply-side assumptions have a significant impact on the RBNZ's forecasts too, but unfortunately by their nature are very difficult to predict.

Are we there yet?

Perhaps the hardest part for analysts and the market to get their heads around is the fact that the RBNZ created the current slowdown intentionally. We've all been conditioned over years to think that weak data means rate cuts will be delivered quickly, to get the economy out of an unintended hole. But this hole was dug deliberately. The Governor admitted in November 2022 that he was going to engineer a recession, and here we are. The data at this point doesn't actually suggest the economic slowdown is happening significantly faster than previously thought. And so, on paper at least, why would the RBNZ cut earlier than planned because things are going to plan on activity – and slower than planned in terms of domestic inflation?

All that said, downside risks to the real economy are certainly accumulating as the feedback loops between the labour market and broader confidence and spending start to kick in in earnest. And it is therefore absolutely credible that the RBNZ could indeed end up cutting earlier than they forecast back in February. But so far, those downside scenarios are still risks, not outcomes.

The market either thinks the real economy is going to deteriorate faster than the RBNZ expects, or else that there's an element of strategic bluff in the RBNZ's February OCR track; that if the data were to pan out exactly as they forecast then they would in fact cut earlier. Who's to say that's wrong? But we don't see OCR cuts until the RBNZ has more confidence that the downward path for inflation won't peter out before reaching the desired destination: not only back in the band, but also likelier than not to stay there. The timing and specifics of such a 'confidence' pivot are very difficult to pinpoint, as it will depend not only a bunch of inflation indicators, but also whether the economy is still going south or recovering. A range of combinations of data could meet the requirements. But the general theme is that the weaker the real economy is looking, the fewer inflation runs on the board the RBNZ is likely to require in order to feel confident about cutting the OCR.

Markets

The key focus for markets next Wednesday will be the RBNZ's updated OCR track. As noted, we don't think they'll want to get into the game of reining in markets, especially amid the current high degree of uncertainty. However, if the track shows a more delayed start to the easing cycle compared to February, that might give markets some cause for reflection, given they are currently gunning so hard for cuts. But markets are always going to front-run the RBNZ, and our sense is that any pullback in short-end rates would likely be mild. The bigger shock would be if the Committee decided to lift the track meaningfully, but while we wouldn't rule that out (because a raw model run would likely produce exactly that outcome), we don't think it's likely for strategic reasons unless the Committee really do now think there's a good chance they'll hike again. That seems a long shot given the tone of the recent activity and labour market data.

Markets will also be watching closely for any hints about exactly what they need to see before easing (is CPI in the 1-3% band enough? Or are they more focussed on things like sticky non-tradeable inflation?), and also for reassurance that the hurdle for hikes is very high, which most in markets believe is the case. Insofar as the text will inevitably acknowledge both the higher non-tradable inflation starting point and the steadily accumulating evidence of the impact monetary policy is having on the economy, perhaps everyone will find what they're looking for!

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