

# RBNZ Monetary Policy Statement Review

27 November 2024



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## 50bp cut, as expected

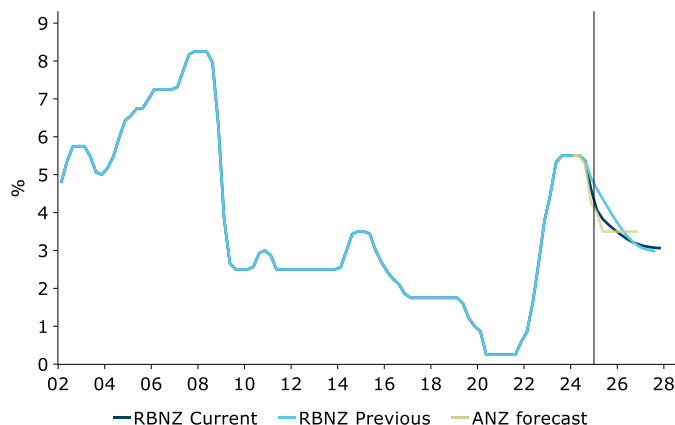
### Summary

- The RBNZ cut the Official Cash Rate (OCR) 50bp to 4.25% today in what the Record of Meeting notes was a consensus decision. The RBNZ's updated forecast OCR track has about -40bp implied for the February MPS, with a slower pace thereafter down to around 3.0%, as before. A comment from the Governor at the press conference suggested that a 50bp cut in February is the baseline expectation.
- The RBNZ revised down their GDP forecast from the latter part of 2025 onwards. But at the same time, they were more pessimistic about the supply side, meaning their output gap forecast is slightly less negative and their non-tradable inflation forecast slightly higher.
- Our OCR forecast is unchanged: we continue to pencil in 25bp cuts in February, April and May, taking the OCR to 3.5%. As always, the speed and extent of easing will be highly data dependent, but that's particularly true given there is such a long gap to the next meeting. The odds of a 50bp cut in February have lifted, given the Governor's comments, but the data between now and then will carry the day, and there are clear signs of a broad-based lift in activity (from a very weak starting point).

### In brief

Traders and economists were in agreement about what the RBNZ would do today, and the Committee duly delivered a 50bp cut in the Official Cash Rate (OCR) to 4.25%. Beyond the OCR decision itself, the main interest for the market was the forecast OCR track. This was front-loaded versus the August MPS (figure 1), reflecting the faster pace of cuts now already delivered. It is technically on the fence regarding whether February will bring a 25bp or 50bp cut, but the Governor made a comment at the press conference that made it clear that another 50bp is the default at this point. There's a slower pace of easing thereafter, with the RBNZ forecasting the OCR to reach approximately 3%, as before. Short-end interest rates and the NZD/USD both spiked higher initially before retracing on dovish comments from the Governor at the press conference.

**Figure 1. OCR forecast**



Source: RBNZ, Macrobond, ANZ Research

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## Key quotes:

- **OCR decision:** “The Committee reached a consensus to lower the Official Cash Rate by 50 basis points to 4.25 percent. ... The Committee agreed that a 50-basis point cut is consistent with their mandate of maintaining low and stable inflation, while seeking to avoid unnecessary instability in output, employment, interest rates and the exchange rate.”
- **OCR outlook:** “If economic conditions continue to evolve as projected, the Committee expects to be able to lower the OCR further early next year.” Adrian Orr at the press conference described the OCR projection as consistent with a 50bp cut in February.
- **Domestic activity:** “Economic growth is expected to recover from the December quarter, in part due to lower interest rates, but there is uncertainty around the exact timing and speed of the recovery.”
- **Inflation outlook:** “With significant spare productive capacity expected in the economy over the next 12 months, the Committee is confident that remaining inflation pressures will abate. Feedback from recent surveys and business visits suggest domestic price and wage setting behaviours are becoming consistent with inflation remaining sustainably at target.
- **Inflation risks:** “Geopolitical risks and climate-related energy and food risks pose uncertainty over the medium term. There may be higher relative price volatility and more unpredictability in aggregate inflation. ... Members discussed uncertainty about the persistence of some components of inflation.”

As we head into the three-month break from OCR decisions, the RBNZ remains firmly in data-watch mode, as do we. Over that time, we’ll get just about all data going, including a half-year fiscal update. How vigorous the economic recovery will prove is uncertain; we’ll know quite a bit more about how the economy is responding to lower interest rates by late-February. Early signs are positive.

## RBNZ forecasts in brief

After baking in a slightly stronger starting point, the RBNZ revised down their GDP forecast from the latter part of 2025 onwards. But at the same time, their output gap forecast is slightly less negative over the forecast, meaning the main driver of the downgrade has come via the supply side. Indeed, the RBNZ note that they have made some assumption changes to their model for potential output, putting more weight on changes in the population than previously, and that a downward revision to the net migration outlook since the August MPS has lowered their expectation for potential GDP. Chief Economist Paul Conway also noted in the press conference that the RBNZ has revised down its assumption for productivity growth over the forecast period.

That implies that the weaker GDP outlook doesn’t mean less inflation pressure down the track. In fact, the RBNZ’s CPI inflation outlook is slightly higher than previously forecast, driven largely by an upgrade to the non-tradables inflation outlook. That said, headline CPI inflation is forecast to remain within 2.0% and 2.4% over the forecast horizon. The RBNZ is now expecting a more gradual slowing in non-tradable inflation than we are forecasting.

See [page 7](#) for charts comparing the RBNZ’s latest forecasts against the August MPS and our own forecasts.

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## Risks

As always, the RBNZ were at pains to outline risks to the outlook on both sides, noting uncertainties around:

- the pace of economic recovery as monetary restriction is withdrawn,
- domestic price setting behaviour,
- the persistence of some components of inflation, and
- geopolitical and climate-related risks, as potential catalysts for higher-than-expected volatility.

## Our take

One wouldn't guess it from the volatility seen in financial markets in the past 90 minutes, but there were few surprises in the Monetary Policy Statement. The RBNZ has taken the OCR a big step closer to neutral, and left its options open from here.

While headline inflation is close to ideal at 2.2%, the mix isn't yet quite where it needs to be, with non-tradable inflation still nearly 5%. Given the softness in the economy, the RBNZ can have confidence in its forecast that domestic inflation pressures will continue to recede. But the risks are not one-sided around their forecasts (as highlighted by the reduction in their estimates of how fast the economy is capable of growing sustainably). Barring negative shocks, we continue to see the RBNZ reverting to a more standard pace of cutting, 25bp per meeting, from February, as they attempt to steer a path that balances the risks of inflation being too high or too low down the track.

If the data comes in soft, then the RBNZ will clearly not hesitate to deliver another 50bp cut in February, but there's a lot of water to flow under the bridge before then. Pricing for February will continue to wax and wane with the data flow between now and then, but the current data vibe shows a fairly enthusiastic response to the rate cuts seen so far, albeit from a low base. Certainly, today's cut makes for a merrier Christmas for borrowers.

## Financial markets

Short-end interest rates and the NZD/USD both spiked higher after the RBNZ announcement, with the bellwether 2-year swap rate up 12bp to 3.73% and the Kiwi up nearly half a cent to around 0.5880. We suspect that that initial reaction was largely because the RBNZ's OCR track (which is a quarter-average) implied a 40bp cut in February, essentially suggesting that the Committee was still undecided about a 25bp or 50bp cut at the next meeting. The RBNZ also explicitly noted the conditionality of further rate cuts, which could have spooked some punters. However, in the press conference that followed, Governor Orr said that the track implied another 50bp cut in February, at which point both swap rates and the Kiwi turned lower again, and volatility was the proverbial winner on the day.

Where short-end rates and the Kiwi go next will ultimately depend on the data, but we are wary that the OCR is now below both the US fed funds rate and Australia's cash rate, and that could start to weigh on the Kiwi in weeks to come if USD exceptionalism rises to the fore again.

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## OCR 4.25% - OCR lowered further as inflation returns to target

The Monetary Policy Committee today agreed to reduce the Official Cash Rate by 50 basis points to 4.25 percent.

Annual consumer price inflation has declined and is now close to the midpoint of the Monetary Policy Committee's 1 to 3 percent target band. Inflation expectations are also close to target and core inflation is converging to the midpoint. If economic conditions continue to evolve as projected, the Committee expects to be able to lower the OCR further early next year.

Economic activity in New Zealand remains subdued and output continues to be below its potential. With excess productive capacity in the economy, inflation pressures have eased. Domestic price and wage setting behaviours are becoming consistent with inflation remaining near the target midpoint. The price of imports has fallen, also contributing to lower headline inflation.

Economic growth is expected to recover during 2025, as lower interest rates encourage investment and other spending. Employment growth is expected to remain weak until mid-2025 and, for some, financial stress will take time to ease.

Global economic growth is expected to remain subdued in the near term. Geopolitical conditions and policy uncertainty could contribute to increased economic and inflation volatility over the medium term.

The Monetary Policy Committee agreed that having consumer price inflation close to the middle of its target band puts it in the best position to respond to any shocks to inflation.

## Summary Record of Meeting – November 2024

Consumer price inflation is sustainably within the Monetary Policy Committee's 1 to 3 percent target range, and measures of core inflation are converging on the midpoint. Restrictive monetary policy and subdued economic activity overseas have slowed domestic demand. Lower import prices have also contributed to lower inflation. Expectations of future inflation, the pricing intentions of firms, and spare productive capacity are consistent with the inflation target being sustainably achieved. This provides the context and the confidence for the Committee to further ease monetary policy restraint.

### **Global economic activity expected to remain subdued**

Economic growth rates in the US and China are expected to slow over the year ahead, while the growth outlook for Europe remains sluggish. Headline inflation is close to target in most advanced countries, but some persistence in services inflation remains. Central banks are reducing interest rates, although the pace of monetary policy easing varies across countries due to differences in economic conditions. Global sovereign debt levels have increased markedly since 2020 and continue to expand. This creates risks of higher global bond yields and risk premia.

### **Significant spare productive capacity expected over the next year**

Domestic economic activity remains below trend, as a result of weakness in demand for durable goods consumption and investment. This has been reflected in falling activity in interest rate sensitive sectors such as construction, manufacturing, and retail trade. In contrast, some services sectors have continued to grow.

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Considerable spare productive capacity remains in the economy, although this is expected to steadily reduce over the projection period. Consistent with feedback from business visits, high frequency indicators suggest that the economy has stabilised in recent months. Economic growth is expected to recover from the December quarter, in part due to lower interest rates, but there is uncertainty around the exact timing and speed of the recovery.

The Committee noted that the projections incorporate the fiscal assumptions from the 2024 Budget Economic and Fiscal Update.

### **Labour market conditions easing**

Wage growth is slowing, consistent with inflation returning to the target midpoint. Employment levels and job vacancies have declined, reflecting subdued economic activity. Unemployment is expected to continue rising in the near term since the labour market typically takes longer to recover than output. Net immigration to New Zealand has reduced significantly from high rates over recent history. The rate of migrant arrivals has slowed, and departures of New Zealanders have increased, partly in response to subdued labour market conditions relative to Australia.

### **Lower OCR passing through to mortgage rates**

Market interest rates have declined in response to actual and expected OCR reductions. The decline in mortgage rates has been less than for wholesale rates, in part reflecting changes in the composition and cost of bank funding. The average rate on outstanding mortgages has now peaked at 6.4 percent and is expected to decline to 5.8 percent over the next 12 months as borrowers refix their mortgage interest rates at lower levels in line with a falling OCR.

### **No trade-off between meeting inflation objectives and financial stability**

The Committee noted the findings of the Bank's November 2024 Financial Stability Report. Some households and businesses are experiencing financial stress. While non-performing loans remain low compared to past recessions, further financial stress is likely to emerge even as the economy recovers. The banking system remains well capitalised and in a strong financial position to support customers experiencing distress. The Committee agreed that there is currently no material trade-off between meeting inflation objectives and maintaining financial stability.

### **Inflation is expected to remain near the midpoint**

Headline consumer price inflation has declined to close to the target midpoint, measures of core inflation are converging on the target midpoint, and inflation expectations at all horizons are close to the target midpoint. With significant spare productive capacity expected in the economy over the next 12 months, the Committee is confident that remaining inflation pressures will abate. Feedback from recent surveys and business visits suggest domestic price and wage setting behaviours are becoming consistent with inflation remaining sustainably at target.

### **There are near-term risks to the economic outlook**

The Committee discussed two key uncertainties to the near-term outlook. While domestic price setting behaviour is now more in line with the Committee's inflation objective, members discussed uncertainty about the persistence of some components of inflation. The Committee also noted that, while lower interest rates are expected to underpin a recovery in the domestic economy, the exact speed and timing of the recovery is subject to uncertainty.

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### **There is a risk of greater inflation volatility over the medium term**

Geopolitical risks and climate-related energy and food risks pose uncertainty over the medium term. There may be higher relative price volatility and more unpredictability in aggregate inflation. The Committee agreed that having consumer price inflation close to the middle of its target band puts it in the best position to respond to any shocks to inflation.

### **The Committee agreed to lower the OCR**

With headline inflation close to the midpoint and measures of core inflation converging on the midpoint, the Committee has more confidence to continue removing monetary policy restraint. The Committee agreed that a 50 basis point cut is consistent with their mandate of maintaining low and stable inflation, while seeking to avoid unnecessary instability in output, employment, interest rates and the exchange rate.

If economic conditions continue to evolve as projected, the Committee expects to be able to lower the OCR further early next year.

On Wednesday 27 November the Committee reached a consensus to lower the Official Cash Rate by 50 basis points to 4.25 percent.

### **Attendees**

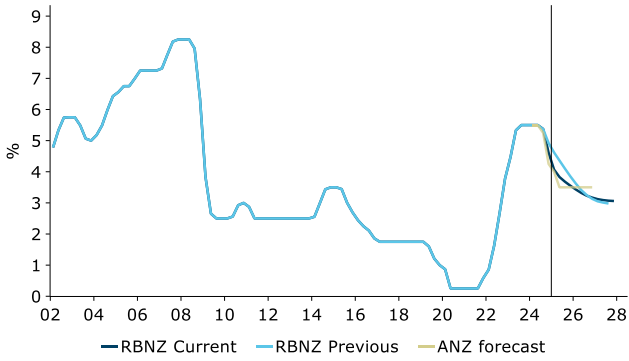
MPC members: Adrian Orr (Chair), Bob Buckle, Carl Hansen, Christian Hawkesby, Karen Silk, Paul Conway, Prasanna Gai

Treasury Observer: Tim Ng

MPC Secretary: Chris Bloor

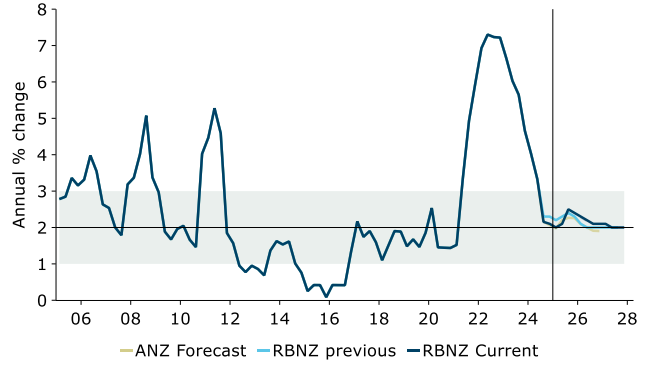
# Key forecasts: Activity outlook weaker, inflation outlook stronger

## The RBNZ has lowered their OCR track



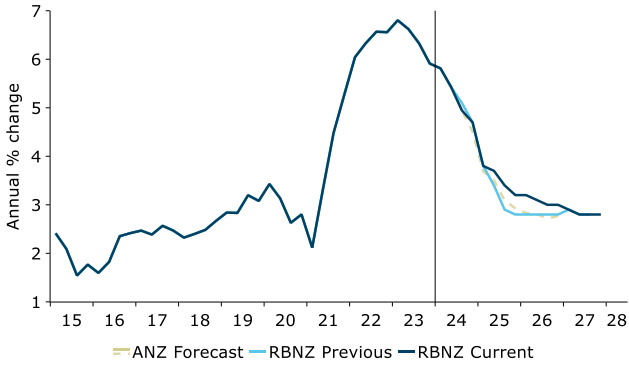
Source: RBNZ, Macrobond, ANZ Research

## CPI inflation is a little higher over the medium term...



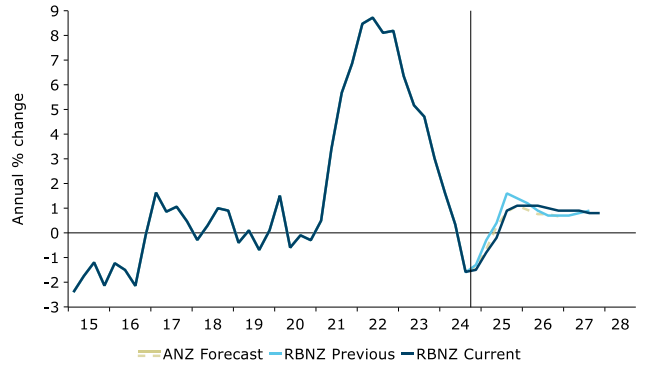
Source: RBNZ, Stats NZ, Macrobond, ANZ Research

## ...driven by more persistence in non-tradables...



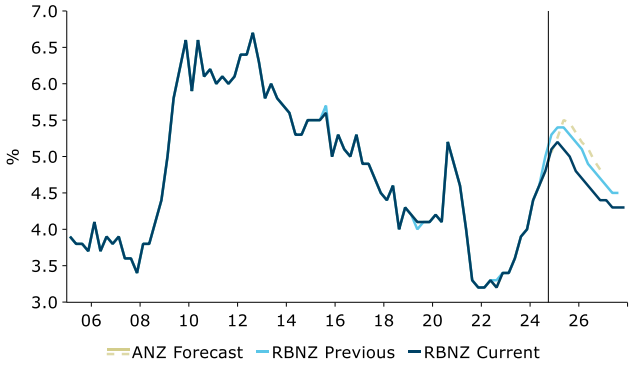
Source: Stats NZ, RBNZ, Macrobond, ANZ Research

## ...and a similar profile for tradables



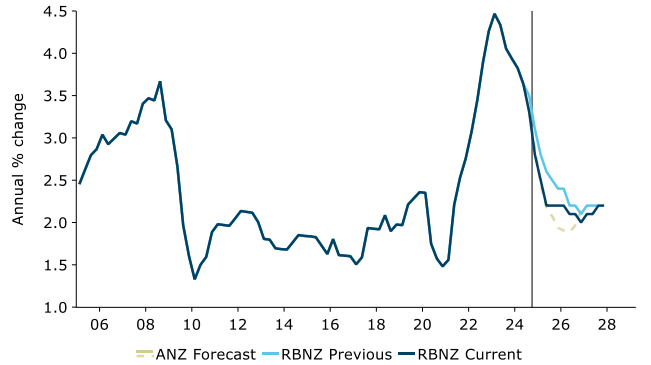
Source: RBNZ, Stats NZ, Macrobond, ANZ Research

## The unemployment rate peaks a little lower



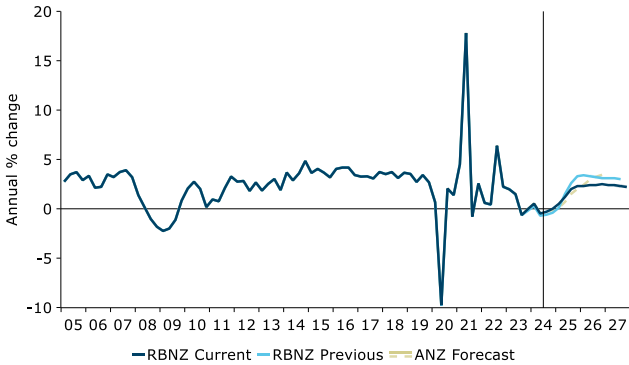
Source: RBNZ, Stats NZ, Macrobond, ANZ Research

## LCI wage growth is expected to be weaker



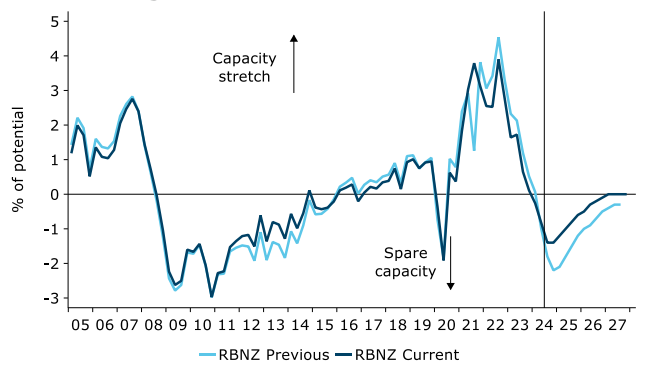
Source: RBNZ, Stats NZ, Macrobond, ANZ Research

## GDP forecasts have been revised down in the medium term...



Source: Stats NZ, Macrobond, ANZ Research

## ...driven by the supply side, leaving their output gap a little less negative than before



Source: RBNZ, Macrobond, ANZ Research





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