

NZ Insight: Navigating the watch-worry-wait summer

5 December 2023



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Contact

Sharon Zollner or
Miles Workman for more
details.

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Long time between drinks

- We've been warning since the RBNZ's pause back in May that a pause is not necessarily a peak, though we recently transferred another hike from our central forecast to the top of the risk basket. There are good reasons for the RBNZ to be worried and impatient, but also solid signs of progress in the inflation battle. Weighing it up, the RBNZ's November MPS signalled a low bar to further hikes, with the Committee's OCR track implying a hike in February is pretty much a coin toss.
- The RBNZ explicitly warned that any more delays to getting inflation down would likely result in a rate hike. With that warning ringing in our ears, in this note we discuss the data flow in the long break between now and the February Monetary Policy Statement, highlighting the possible hurdles and nuances around the coming data with respect to a possible hike in February, or at least keeping the prospect of hikes alive.
- As we've noted before, the RBNZ seems unlikely to kickstart the hiking machine again for the sake of just 25bp, as if that's all that's perceived to be needed, then just holding a little longer is a perfectly good substitute. Unless the facts change (always a live possibility!), if the RBNZ does hike in February (or after that), chances are they'll go again.
- What are the odds that hiking again would be a 'mistake'? in the narrow sense of CPI inflation undershooting 2% due to a bit more hiking – one would have to say "remote". But insofar as it might result in the RBNZ cutting earlier due to a harder landing than anticipated (or strictly necessary): could well be. But the RBNZ may well consider that an acceptable risk to take, given the known real costs of not getting on top of inflation in a timely manner.

Introduction

"If inflation pressures were to be stronger than anticipated, the OCR would likely need to increase further" (RBNZ November MPS).

The RBNZ delivered an unambiguously hawkish [Monetary Policy Statement](#) (MPS) in November, signalling that they see a hefty chance they'll need to hike the OCR again due to disappointingly slow progress in bringing inflation down.

Part of November's hawkish signalling may be strategy: jaw-boning the market to prevent cuts being priced in earlier than desired by the RBNZ (easing monetary conditions in the process). But there also appears to be genuine concern that the bulk of the transmission of monetary policy has already washed over the economy, and that it hasn't diluted core inflation pressures and inflation expectations as much as hoped.

Regardless of their reasons, the RBNZ has drawn a line in the sand, and now it's up to the data flow to decide if the OCR is going higher as early as February next year. Indeed, at face value, the peak in the forecast OCR track of 5.69% suggests the onus is now on the data to provide reasons *not* to hike. We don't actually think the burden of proof lies there, but the hurdle to hike again is clearly lower than was generally appreciated.

And it's important to note that an upward surprise doesn't necessarily mean a reacceleration in activity and inflation; the data could provide a green light to hikes by simply not moving fast enough along its deflationary trajectory. The RBNZ appears to be getting impatient, and very reasonably concerned about the risk that progress could stall.

In this note we discuss the RBNZ's near-term forecasts and the nuance around them that could determine if the RBNZ's signal for Q1 (February MPS) lands on heads or tails. With three months between now and then, whatever your favourite indicator is, chance is, it's coming out.

Key economic releases between now and 28 February

14 December: Q3 GDP

The November MPS forecast is +0.3% q/q. We are also at +0.3%, but will firm our estimate up after all the partials are in, the last of which are out this Friday, 8 December.

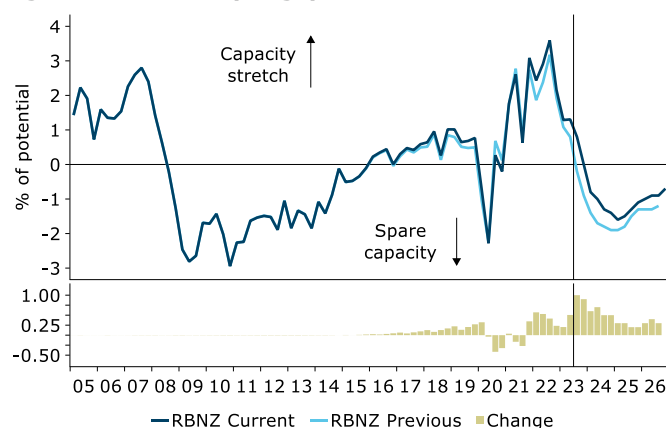
The RBNZ certainly appeared to take an inflationary view of Q2's surprisingly strong GDP read of 0.9% q/q for production GDP and 1.3% for expenditure – the latter including some stronger-than-anticipated consumer spending, particularly durables consumption, which lifted 3.3% q/q. We attributed a decent share of that to the rebound from Cyclone Gabrielle, but it's not clear that's how the RBNZ saw it. Whatever they think drove it, the RBNZ has pencilled in a 0.9% q/q contraction in private consumption for Q3, so it's a relatively low bar for a positive surprise.

So now we wait for the Q3 GDP release to provide a clearer signal of whether the Q2 consumer spending was temporary cyclone impacts or indeed stronger momentum. But it'll be messy due to lingering uncertainty around seasonal patterns and the annual benchmarking revisions party.

At the end of the day, GDP only matters for inflationary pressures insofar as how it's traveling relative to the economy's speed limit (aka potential GDP). On that front, it was interesting to see that the RBNZ's put a lot less of Q2's strong growth into potential than we would have thought, given the strong growth in the labour supply. This saw them revise up their estimate of the output gap (and thus medium-term inflation pressure) substantially (figure 1). Indeed, the nuance around splitting demand and supply-side drivers means it would be far too simplistic to conclude that "Q3 GDP stronger than X implies they'll definitely be hiking". The details will matter. But a decent positive surprise on private consumption might well mean game on.

Upshot: watch capacity indicators and the mix of growth, not just headline growth indicators.

Figure 1. RBNZ output gap estimate revision



Source: RBNZ, Macrobond, ANZ Research

20 December: The Half-Year Economic and Fiscal Update

The potential inflationary impacts of the relatively small (compared to recent Updates) bump in Government spending (capex in particular) signalled in the Pre-election Update got a lot of airtime in the November MPS. Not more than it deserved, but certainly a lot more than previous much larger increases to Government spending (eg Budget 2023 and earlier) got. Whatever the reason for that, it does highlight that it will certainly be helpful for the Committee if fiscal policy is better coordinated with monetary policy under the new Government.

The big question for the RBNZ: will the new Government's policy mix result in a larger or smaller aggregate demand impulse than previously thought? The problem is, if the RBNZ relies on the Treasury's Half-Year Update to inform that view, they may end up jumping the gun. That's because the Treasury has a very short timeframe between Ministers being sworn in and the likely finalisation date of the Half-Year Update forecasts. For that reason, we (and the RBNZ) should probably think about the Half-Year Update as a first pass at capturing the new policy direction, as opposed to the final word on it.

Perhaps the only significant piece of information for the RBNZ in the Half-Year Update will be the implications for fiscal settings over the next six months or so (ie the remainder of the current fiscal year), which we expect to be relatively small. The rest should probably be taken with a grain of salt, as by the time Budget 2024 rolls around in May, there could be some meaningful changes made to the Treasury's outlook.

Our working assumption is that the net impact of Government policy changes (eg tax and spending cuts) will be broadly neutral for aggregate demand, and that the risk going forward (ie beyond the Half-Year Update) is that spending cuts end up deeper than signalled. We suspect and hope that the new Government will adopt a stricter fiscal strategy (due by 31 March) and that it'll be only under exceptional circumstances that the forecast return to OBEGAL surplus is delayed beyond the currently projected 2026/27 fiscal year. Seven years in deficit (one more than following the GFC) is too many for the economic conditions. Sovereign credit ratings agencies are watching.

In sum, it would be risky for the RBNZ to hike in February purely because the Half-Year Update suggested fiscal settings were going to be a little more stimulatory than previously thought, as they may be faced with meaningful revisions to those hasty estimates in May's Budget.

25 December: Christmas. Cool your jet skis. You've been warned.

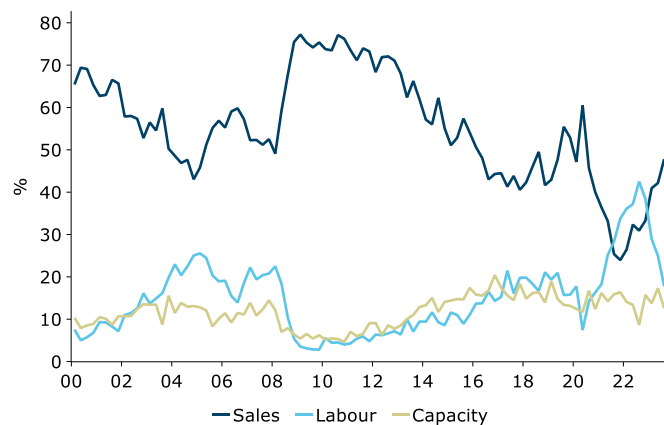
16 January: Q4 Quarterly Survey of Business Opinion (QSBO)

Capacity indicators in the Q3 QSBO generally went the right way for the RBNZ: labour as limiting factor continued to ease and capacity utilisation was subdued (which NZIER put down to "large firms' ability to increase output without incurring an increase in unit costs"). Pricing and cost indicators fell.

But it isn't the direction of capacity measures that's worrying the RBNZ, it's the pace. That will make interpreting the QSBO all the more difficult, because how fast is fast enough is ultimately a question of judgement.

As noted on page 2, in the November MPS, the RBNZ revised their output gap higher. While the QSBO release will give the Committee some data to calibrate that view, we're cognisant that the November MPS near-term output gap assumption appeared to put more weight on strong recent GDP data than the recent evolution of some key capacity indicators.

Figure 2. QSBO capacity indicators: limiting factors



Source: NZIER, Macrobond, ANZ Research

24 January: Q4 CPI

The RBNZ has pencilled in a 0.8% q/q increase in headline inflation in Q4 (ANZ: 0.6% q/q). An upward surprise that pushes out the forecast return of inflation to target any further could of course prove the catalyst for a February hike – we’ve had fair warning on that score! But as always, the details will matter. The RBNZ’s Q4 CPI forecast consists of a 0.9% q/q rise in non-tradables inflation (ANZ: 0.9%), and a 0.7% q/q lift in tradables (ANZ: 0.2%). Tradables inflation comes and goes pretty quickly; any upside miss on non-tradables inflation would be the much bigger worry for the RBNZ (as would stubbornly-high core inflation), as this kind of inflation tends to be sticky.

It’s also worth recalling that the RBNZ’s forward-looking focus means anything that changes the inflation outlook could matter just as much as any starting point surprise. Indeed, it is entirely possible that CPI comes in precisely as the RBNZ expect in Q4 (or even a little weaker) and they still feel a need to hike in February, if the medium-term inflation outlook has worsened. A stronger activity impulse (perhaps driven by a reacceleration in housing), a tighter labour market than expected (including stronger wage growth, which is a major source of non-tradables inflation), or a failure for capacity pressures to decline as fast as hoped are all potential catalysts.

7 February: Q4 Labour market

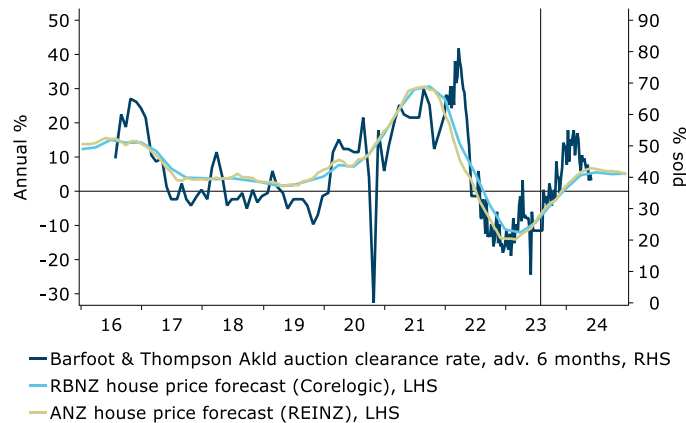
The RBNZ revised its unemployment rate forecast lower to 4.2% in Q4 (ANZ: 4.3%), on an upgrade to employment growth of 0.2% q/q (ANZ: -0.2% q/q). We think that inflationary impacts in the labour market have largely [run their course](#), but it’s worth noting that the RBNZ continued to categorise the labour market as above maximum sustainable employment (MSE) at the November MPS.

The RBNZ will want to see the labour market on the other side of MSE sooner rather than later. They need to see further evidence of softening labour demand, and continued easing across capacity measures such as underemployment and underutilisation, to feel confident wage growth will continue to moderate. Any material upside to employment or wage growth would likely put the RBNZ on alert, though that will need to be weighed against the fact that wages lag the rest of the economy significantly – and there’s also potentially some extra labour data volatility stemming from the roughly 20k temporary workers involved in the General Election. This may or may not show up in the HLFS.

Housing (multiple releases; REINZ is around the middle of each month)

We and the RBNZ have similar near-term house price forecasts now that the RBNZ has revised its numbers up. Fair to say, the housing outlook is uncertain at the best of times, but following the recent change in Government that is particularly true. The house price cycle turned a corner around May this year, but more recently the market has run out of puff a bit (figure 3).

Figure 3. House price inflation forecasts and Barfoot & Thompson auction clearance rate



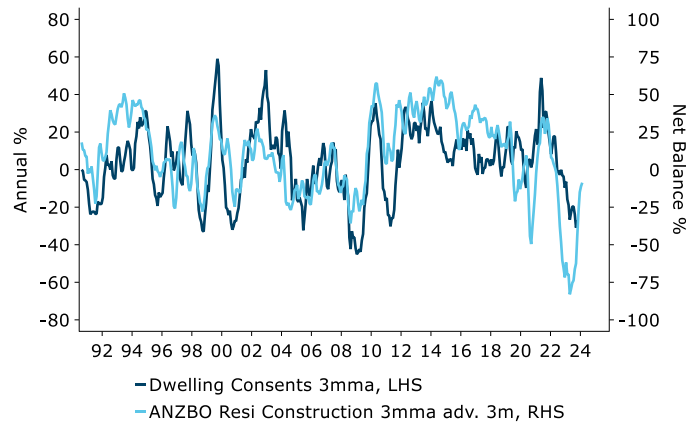
Source: Corelogic, REINZ, B&T, interest.co.nz, Macrobond, ANZ Research

So was the boost due to policy changes foreseen and thus done and dusted? Or is the market poised for lift-off now that a more housing investment-friendly policy backdrop is confirmed? Come the February MPS, we should have a better handle on that, as we'll have housing data covering up until January 2024 under our belts.

It's not just house prices that are a potential issue for the inflation outlook. The November MPS discussed risks around the outlook for rents more than once, given the upward revision to population growth. Rents have a weight of around 9.5% in the CPI. Because rents typically only change at most once a year, it's a slow-burn story. But while it might take a while to make a meaningful difference to inflation, it'll also take a long time to stop contributing, and insofar as the RBNZ is deeply concerned about persistence in inflation, that's potentially a problem.

And as for housing construction, that is a double-edged sword for the RBNZ. On the one hand, they're relying on a sharp slowdown in residential construction to cool construction costs, which dominate the housing component in the CPI. On the other hand, with the population growing so quickly, the worse the housing shortages, the more upward pressure there will be on house prices and rents. There's no easy fix, then. But it's worth noting that while the RBNZ is forecasting a massive hole in residential construction over 2024/25, there are early signs of green shoots that suggest that consents could be about to find a floor (figure 4, over).

Figure 4. ANZBO builders' residential construction expectations and dwelling consents



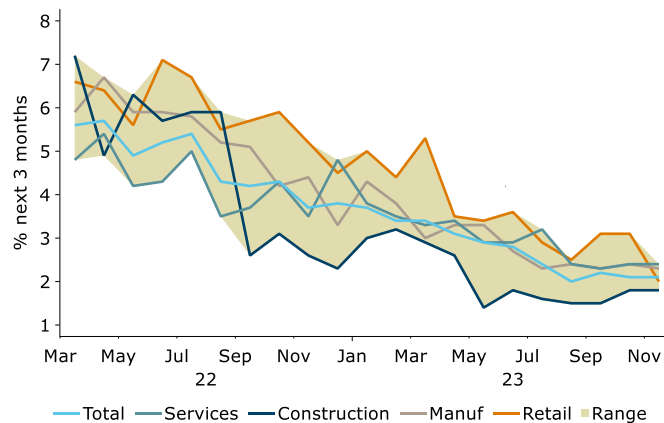
Source: Stats NZ, Macrobond, ANZ Research

Other higher-frequency data and developments:

High frequency indicators such as the Business Outlook Survey, consumer confidence, the Truckometer, PMIs, monthly inflation data, net migration, card spending, monthly employment indicators, commodity prices, monthly trade data, credit data, interest rate and FX market developments, and regulatory policy and other Government-related surprises, will all be key for weighing up how the economy is tracking too.

We won't attempt to go through them all here; we'll just do a little shout-out for a relatively new indicator out of our Business Outlook survey. We now ask for numerical pricing intentions over the next three months by sector – and there's been a bit of a flattening out in recent months, particularly in construction sector prices.

Figure 5. ANZBO numerical pricing intentions



Source: Macrobond, ANZ Research

Inflation expectations are also worth a good sniff, given the RBNZ expressed concern that they were “still elevated”, and that “expectations for inflation five and ten years ahead have edged higher in recent data, posing some upside risk to the inflation outlook.” While these longer-term expectations are still close to the target midpoint, any divergence from 2% is an affront. The next RBNZ expectations survey that contains these longer-term expectations is due on 13 February 2024.

Global data/exchange rate

The outlook for China and New Zealand's commodity prices is always relevant for the outlook, and the exchange rate matters too. But we would note that if the RBNZ decides the domestic economy is more inflationary than it thought, it would take a lot for these variables to move the dial.

Putting it all together

There is no one piece of data here that shouts "likely game changer" for the RBNZ, as it all matters when it comes to assessing the impact monetary tightening has had so far, and how that impact is evolving. And there are none where we look at the data and conclude a big surprise is likelier than not. Non-tradable inflation and unemployment are key data points, for example, but our forecasts are much the same as the RBNZ's.

And then of course there are the unobservables too – both how the RBNZ apportions any activity surprises to the demand or supply side of the economy, and assumptions regarding the neutral OCR. Watch 5y5y market pricing on the latter, as that's the input to the RBNZ's estimation suite that drove upward revisions to the long-run neutral OCR estimate, and thus the OCR track (though not 1:1) in both August and November.

Figure 6. NZ 5y5y swap pricing



Source: Bloomberg, Macrobond, ANZ Research

And finally, some data we will be watching particularly closely, insofar as we have a slightly different view from the RBNZ about how it is likely to evolve:

Capacity indicators: It's worth keeping an eye on all the RBNZ's labour market capacity indicators as described in our recent [Insight](#) note. We and the RBNZ agree that labour market pressures are waning rapidly; we just think the process is a little further along than the RBNZ does.

The housing market: While our forecasts are fairly similar to the RBNZ's, it is notable that we just revised our forecast down, while the RBNZ revised theirs up. While there are risks on both sides of our housing market outlook, we think the skew is slightly to the downside.

All up, it's very unlikely that there will be anything other than a mix of unders and overs by the time the RBNZ comes to reassess the inflation outlook in February, and judgment will play a role again. Our current judgment (which is also subject to change!) is that the RBNZ did jawbone the market just a touch, as demonstrated by the fact that we see less of a downturn in some segments of domestic demand such as residential construction, but don't yet view the odds of a hike as having risen back over 50%. But at the end of the day, the more the market ignores the RBNZ's warning that it may have to hike again, the easier monetary conditions are likely to become (as cuts get priced in and wholesale rates fall), and the more likely it is that a hike will actually be judged to be required.



Contact us

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Sharon Zollner
Chief Economist

Follow Sharon on Twitter
@sharon_zollner

Telephone: +64 9 357 4094
Email: sharon.zollner@anz.com

General enquiries:
research@anz.com

Follow ANZ Research
@ANZ_Research (global)



David Croy
Senior Strategist

Market developments, interest rates, FX, unconventional monetary policy, liaison with market participants.

Telephone: +64 4 576 1022
Email: david.croy@anz.com



Susan Kilsby
Agricultural Economist

Primary industry developments and outlook, structural change and regulation, liaison with industry.

Telephone: +64 21 633 469
Email: susan.kilsby@anz.com



Miles Workman
Senior Economist

Macroeconomic forecast co-ordinator, economic developments, GDP and activity dynamics, fiscal and monetary policy.

Telephone: +64 21 661 792
Email: miles.workman@anz.com



Henry Russell
Economist

Macroeconomic forecasting, economic developments, labour market dynamics, inflation and monetary policy.

Telephone: +64 21 629 553
Email: henry.russell@anz.com



Andre Castaing
Economist

Macroeconomic forecasting, economic developments, housing and monetary policy.

Telephone: +64 21 199 8718
Email: andre.castaing@anz.com



Kyle Uerata
Economic Statistician

Economic statistics, ANZ proprietary data (including ANZ Business Outlook), data capability and infrastructure.

Telephone: +64 21 633 894
Email: kyle.uerata@anz.com



Natalie Denne
PA / Desktop Publisher

Business management, general enquiries, mailing lists, publications, chief economist's diary.

Telephone: +64 21 253 6808
Email: natalie.denne@anz.com

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Last updated: 18 April 2023

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