ANZ Research

Preview: RBNZ Monetary Policy Review

27 September 2023

Contact

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More worries, more waiting

Summary

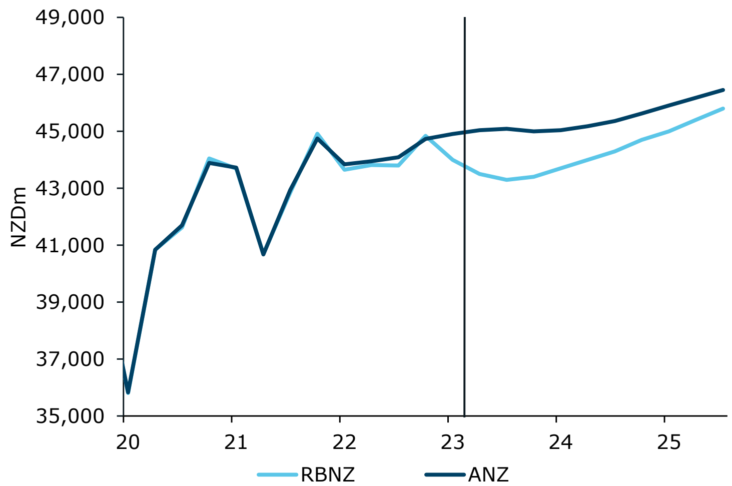
- We expect the RBNZ to keep the OCR unchanged at 5.5% at next week's Monetary Policy Review (MPR), while striking a more hawkish tone.
- Data since the August Monetary Policy Statement (MPS) has overall been stronger than anticipated, dairy prices aside. Potential wealth effects from the reheating housing market are concerning.
- We continue to expect a hike at the November meeting and risks are tilting towards even more being required in 2024.

Even a gentle second wind is potentially problematic

We expect the RBNZ to keep the OCR on hold next week, remaining in 'watch, worry and wait' mode. However, we're expecting the MPR to have a bit more 'worry' in it than the relatively sanguine August MPS. Except for dairy prices (which fell sharply but subsequently partly recovered), almost all major data since the August MPS has surprised to the upside.

- Last week's GDP data were stronger than expected, with the economy growing 0.9% q/q, well above the RBNZ's 0.5% q/q pick and above their potential GDP estimate of 0.8% q/q. Some of it could just be cyclone-related volatility. However, it's hard for the RBNZ to ignore the big miss on household consumption, which grew 0.4% q/q, well above its forecast for a fall of -1.8%. Household consumption tends to evolve smoothly, so it would be brave to assume it's a blip, but it's also true that the full impact of the RBNZ's previous tightening on household finances is only about 75% of the way through. So there's uncertainty, for sure. But our medium-term consumption forecast is now well above the RBNZ's August projection (figure 1). To be clear, consumption on a per capita basis is not strong. But the population has grown an estimated 2% in the past 12 months!

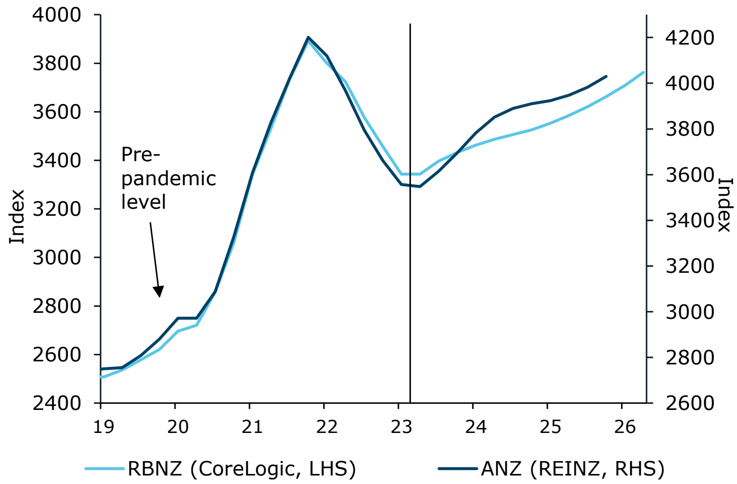
Figure 1. ANZ vs RBNZ private consumption forecast



Source: Stats NZ, RBNZ, ANZ Research

- High-frequency activity data for August have been stronger than expected. All the activity indicators in ANZ Business Outlook lifted in August, with expected own activity up 10 points. PSI and PMI are broadly unchanged, but the Truckometer heavy traffic index rose 6.2% m/m and electronic card transactions grew 0.7% m/m. One month of better data in one of these indicators is insignificant for the overall picture, but collectively they suggest the economy is more buoyant than the RBNZ's -0.3% pick for Q3 GDP (we've pencilled in 0.4% growth).
- Inflation pressures remain intense across the economy. August food prices rose 0.4% m/m (seasonally adjusted) and new rents (flow measure) rose a whopping 1.0% m/m, to be up 6.2% over the last year as huge population growth kicks in. ANZBO inflation expectations and pricing intentions continue to fall, but in absolute terms they remain problematically high. WTI oil prices have risen about 13% since the August MPS, which will cause petrol prices to rise further. While the RBNZ would of course prefer to look through this development, given it's bad for growth, high inflation and inflation expectations may constrain its options, particularly given evidence that petrol prices play an outsized role in shaping consumer inflation expectations and thus wage demands.

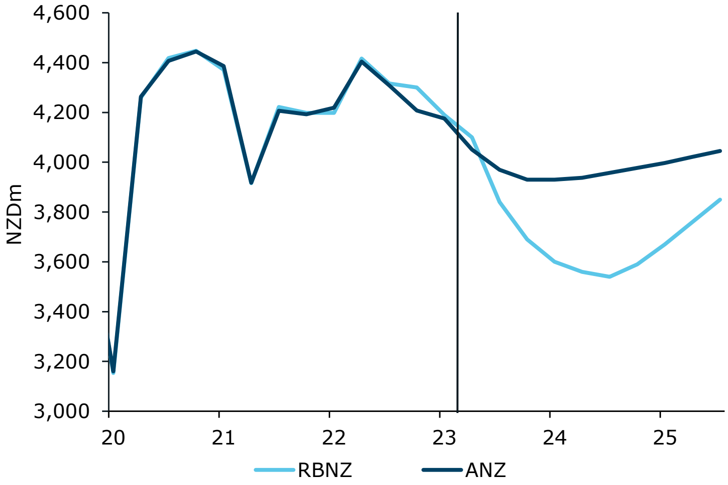
Figure 2. ANZ vs RBNZ house price forecast



Source: CoreLogic, REINZ, RBNZ, ANZ Research

- August's REINZ data was full of green shoots, with house prices rising 0.7% m/m. This has been fuelled by the almost 100,000 net migrants that have arrived in New Zealand in the last year, another upside surprise for the RBNZ. We've revised up our house price forecast, which was almost identical to the RBNZ's August projection. That's likely to translate into stronger (and more inflationary) residential construction activity than otherwise (figures 2 and 3). Our forecast for residential investment is certainly not strong, but we do not expect a decline as deep or long lasting as the RBNZ is not just assuming, but relying on as part of their inflation-fighting strategy.

Figure 3. ANZ vs RBNZ residential investment forecast



Source: Stats NZ, RBNZ, ANZ Research

- One of the few points of clear weakness since August's MPS is dairy prices, which are 3.4% below the assumed trough in the RBNZ's projection despite a recent bounce (USD dairy prices are now 7.4% above their low on 15 August). However, this has been partially offset by the roughly 1% fall in the TWI compared to the RBNZ projection, which will add to tradables inflation pressure, all else equal.

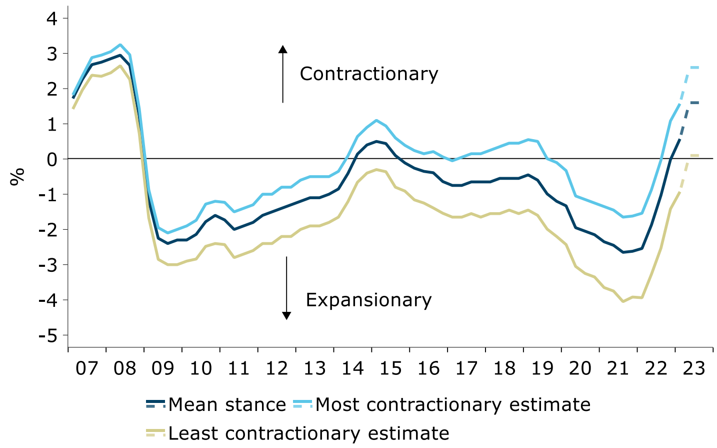
Between now and the MPR, the Committee will get another read of ANZ consumer confidence and the Business Outlook survey (including both activity and inflation indicators), monthly employment indicators and the Quarterly Survey of Business Opinion (QSBO). Weekly data indicates moderate softening in employment, while we're expecting a more upbeat QSBO, in line with other recent data. We're not expecting any of this to be a game-changer, but QSBO capacity indicators were surprisingly weak versus GDP last quarter, so seeing confirmation or negation of that could be pretty important.

Stepping back, the RBNZ has held monetary conditions around their current level since it first published its 5.5% OCR track in November 2022, albeit with some overs and unders between the NZD and mortgage rates. That was almost a year ago, yet the output gap remains positive, pricing pressures remain elevated, and the labour market remains tight (though less so as migration-driven supply improvements ease pressures, albeit while adding pressures elsewhere, particularly in housing). While lags vary, both we and the RBNZ have over the last year been incrementally pushing out our estimates of when capacity pressures will ease up. At some point this will become untenable; we're expecting the RBNZ to return to the hiking table with a 25bp hike in November.

To put that 25bp into context it's helpful to look at the level of rates currently. The neutral OCR[1] is rising and the RBNZ's mean assumption is that the OCR is 160bp into contractionary territory (figure 4, over). That is over 100bp less contractionary than in 2007, while core inflation today is around 300bp higher. The RBNZ has noted the considerable uncertainty in these estimates, and they naturally have a wider range today, given we have the benefit of hindsight for last cycle. On the RBNZ's most optimistic estimate the OCR may be as contractionary as in 2007. On their most pessimistic estimate the current level of the OCR is barely contractionary, and could even soon be judged as potentially expansionary if the next update brings another upward revision.

[1] The RBNZ defines the neutral OCR as "the level that is neither expansionary nor contractionary. It is conceptually the rate that, over time, would be consistent with no over- or under-utilisation of resources and stable inflation".

Figure 4. RBNZ OCR stance using short-term nominal neutral OCR suite



Source: RBNZ, Macrobond, ANZ Research

Note: The RBNZ only publishes estimates of the neutral OCR with a one-quarter lag. We have assumed that the RBNZ's neutral estimates remained constant in this quarter.

We were crossing our fingers that 5.5% would be enough to solve New Zealand's inflationary problems, but at this point, the data is suggesting that that will not be the case, at least not in a reasonable timeframe. If the OCR is indeed undercooked, high inflation risks becoming embedded in wage and price-setting behaviour. In that case, output and employment would need to be suppressed even longer to achieve the 2% inflation target, resulting in lower employment on average over the medium term.

That is, giving growth a chance could end up costing more in the long run if it's an over-optimistic take. But of course, a harder landing than necessary also has real costs. It's a trade-off, and the RBNZ has to weigh things carefully. But the fact is, since August, more has been added to one side of the scale than the other. The CPI data due to be released on 17 October is looking more important than ever for the outlook for peak-OCR.

What we're looking for in the Summary Record of Meeting

For markets, apart from the OCR decision itself, the most important thing will be the tone of the MPR. In rough order of importance, we are looking for:

1. Whether the Committee discussed any options other than a hold. For example, "*The Committee discussed whether to leave the OCR on hold or to increase it by 25bp",* would make it much likelier that the Committee delivers a hike in November. The freshly updated MPC Charter specifically instructs the Committee to include "the policy options discussed", which we hope will encourage transparency if there are differing opinions on the forward path of monetary policy.
2. Any discussion on how Committee sees the recent lift in oil prices feeding through into inflation and inflation expectations, and risks that the Q3 inflation print is higher than was projected in August.
3. Any discussion of whether the depreciation in the NZD since the August *Statement* is seen as sufficient to offset the disinflationary impact of lower dairy prices. The exchange rate affects not just dairy farmers, but also other exporters and importers, so the overall effect is difficult to judge.
4. Any commentary on the housing market, and in particular whether the evident upward pressure on both house prices and rents is seen as problematic or assumed to be a blip.

With the election so close, the temptation may be to say as little as possible. If the Committee chooses to deliver a minimalist Summary Record of Meeting, trying to thread the needle between upside and downside risks, we would expect short-term interest rates to fall.

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