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Assessing the economic and political environment in New Zealand

MONETARY POLICY STATEMENT EXTRA | September 10 2015 | Confidential to HUGO members

Automatic stabilisers kicking in; weaker dollar leads to inflation bounce; 25bps OCR cut may be the last of this magnitude

The September Monetary Policy Statement forecasts a relatively orthodox rebound from the impact of much lower than expected dairy prices this year, with a much weaker exchange rate than forecast in June over the next three years, considerably higher tradables inflation than previously expected, and lower growth in the near term followed by a stronger than previously forecast bounceback in the year to March 2018.

The 90 day bill rate remains below 3% throughout the forecast period, 50 basis points below the June MPS. Auckland house price inflation should moderate, but without a sharp correction. The RBNZ says "further depreciation is appropriate" for the exchange rate, but there is no talk now of over-valuation or currency unsustainability. **In political terms**, the RBNZ is not forecasting the kind of downside scenario recently warned of by some economists, with **economic growth on an upward trajectory going into late 2017**, the timing for the next general election. **However, Budget surpluses elude the govt in this term**.

Key points:

- The OCR is cut 25 basis points at this announcement to 2.75% and "at this stage, **some further easing in the OCR seems likely**". However, graphs in the MPS suggest the OCR may not fall as low as 2.5% unless there is an unexpected downside shock to the global economy, in which case an OCR closer to 2% may transpire;
- The **NZ economy is presumed to be growing at around 2%p.a. at present**, versus 3% assumed at the June MPS and 2.5% in its July statement. No recessionary quarters are forecast over the period to March 2018. Annual growth is forecast to bottom out at 2.1% in the March 2016 year (3.2% forecast in June), rebounding relatively strongly to 3.1% in the March 2018 year (2.7% previously forecast);
- The other **largest changes, compared to the June MPS, are in the outlooks for the exchange rate – much weaker – and a consequent much larger impact in the year ahead on tradables inflation**. The TWI is forecast to fall from 69 today to 64.9 by Sept 2017, whereas the June MPS had the TWI above 70 throughout the forecast period. As a direct consequence, the RBNZ now forecasts import prices in the year to March 2016 will rise 17.4% in NZD terms, (9.4% previously forecast), although there is "considerable uncertainty … around the timing and magnitude of the exchange rate pass-through". The timing of US Federal Reserve interest rate increases is a key uncertainty.;
- A slower, longer expansion in construction sector activity is expected, underpinned by growth in Auckland ;
- The 90 day bill rate is assumed to fall to 2.6% by Sept 2016 and remain at that level over the forecast period;
- Annual CPI inflation is forecast to reach the mid-point of the 1-3% target range a little earlier than previously forecast, hitting 2.1% in the year to Sept 2016 (1.9% forecast previously), and peaking at 2.2% in the year to Dec 2016;
- The RBNZ assumes no fiscal surplus in the govt accounts in this parliamentary term, compared with a small surplus in the 2017 fiscal year at the last MPS. The govt's books are assumed to be in balance in the 2018 fiscal year;
- Export commodity prices are judged to have bottomed out already, but the anticipated price recovery will take longer and be weaker than previously expected. The global economy is presumed to grow at recent average rates and oil prices rebound slowly to US$60 a barrel over the forecast period;
- Labour market impacts are muted somewhat by the judgement that net migration has peaked. Unemployment is forecast to peak at 6.1% in the year to March 2016, falling back to 5.4% in March 2018;
- **Household savings are presumed to remain positive**, if a little weaker than previously forecast.

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