ANZ Research

RBNZ Monetary Policy Statement Preview

15 February 2023

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Still resolute

Summary

- We expect the RBNZ will raise the Official Cash Rate (OCR) 50bp to 4.75% at its Monetary Policy Statement (MPS) next Wednesday. In terms of alternatives, a 75bp hike is more likely than +25bp, in our view.
- On balance, local data since the November MPS have pointed towards inflation pressures not being quite as bad as the RBNZ assumed. But inflation pressures are far too strong, and we are certainly not expecting the RBNZ to go 'soft'.
- A hawkish tone is likely, along with only a marginally lower OCR track, if it's lowered at all. And it's no small beer for the RBNZ to deliver a double hike when they've already raised 400bp, house prices are down 15% and still falling, and business and consumer confidence are on the floor.

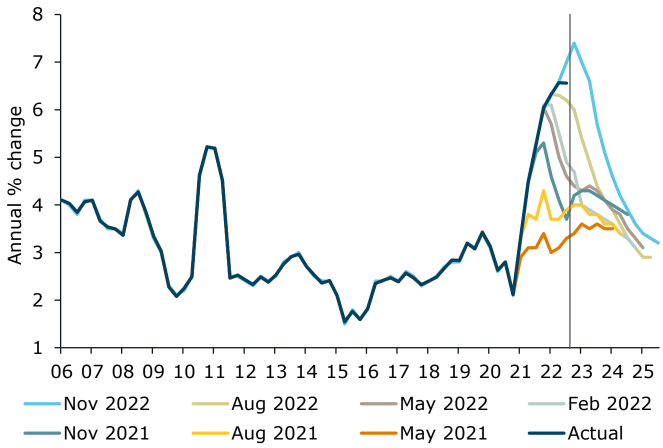
Getting closer to BAU

While a 75bp hike in November was well anticipated, the RBNZ startled all observers with its aggressive OCR forecast, high inflation forecast, and talk of "deliberately engineering" recession. Clearly sick of a relentless run of upside surprises on inflation, it leap-frogged everyone.

That certainly raised the bar for further upside surprises, and indeed, on balance, the data since then could be summed up as 'not as bad as feared'.

- Q4 CPI data at 7.2% was below the RBNZ's 7.5% forecast, and the details were not as bad as feared (see our Review). Crucially, annual non-tradables inflation came in flat at 6.6% (RBNZ 7.0%), and core inflation measures were a mixed bag, rather than all relentlessly charging higher. Obviously still not great data, but could have been worse – and crucially, the RBNZ had forecast it to be so.

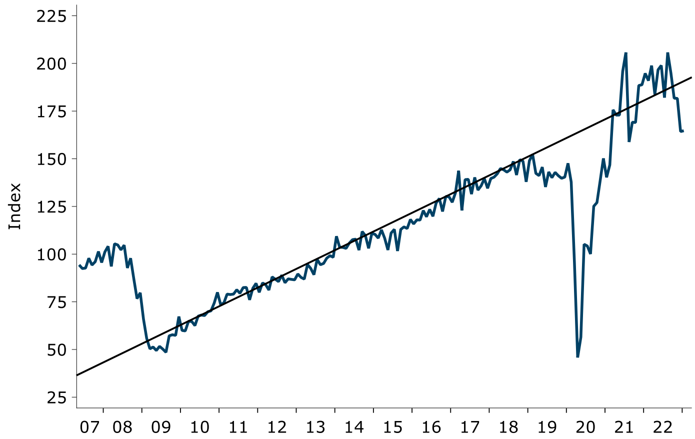
Figure 1. RBNZ non-tradable inflation forecasts since 2021



Source: RBNZ, Stats NZ, ANZ Research

- Q4 labour market data still showed a very stretched labour market, but again, not quite as extreme as feared. Indeed, a few cracks started to appear. Unemployment ticked up by 0.1ppt (rounding error, to be fair), and the underutilisation rate ticked up from 9.0% to 9.4%. Both were higher than a year earlier. Wage growth was mixed relative to RBNZ forecasts, but clearly still not consistent with inflation at target. Job ads have clearly turned, but it remains unclear how much unmet labour demand has to be worked through before disinflationary spare capacity starts to emerge. Employment intentions have dropped sharply, but no more than is consistent with RBNZ forecasts.

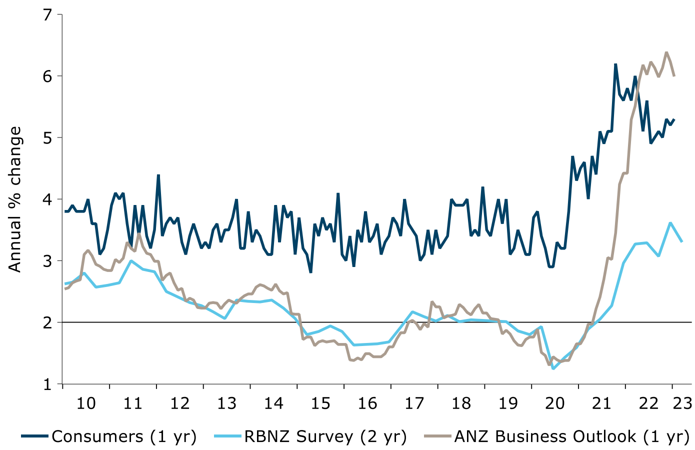
Figure 2. MBIE job ads index (ANZ seasonal adjustment)



Source: MBIE, Macrobond, ANZ Research

- Evidence on consumer spending has been mixed. Consumer confidence, like business confidence, dropped sharply after the November MPS but has subsequently bounced slightly. December card spending fell 2.3%; January card spending bounced 2.6%, but still implies falling retail volumes. Anecdote suggests big-ticket retail is struggling.
- Direct inflation indicators such as pricing intentions have dropped only a little and remain far too high; inflation expectations amongst businesses and consumers remain stuck around 6% and 5% respectively (figure 3). The RBNZ's preferred measures of inflation expectations from its own survey fell in Q4 (2-year from 3.62% to 3.3%, and 5-year a smidge to 2.36%). Inflation expectations feed directly into the RBNZ's estimate of the short-term neutral OCR, and thereby its assessment of how much boost or drag policy settings are exerting on the economy. In November, the RBNZ published its best guess: that its foot is on the brake beyond 3.6% (a good reason to downsize from catch-up mega-hikes).

Figure 3. RBNZ survey, business and consumer inflation expectations



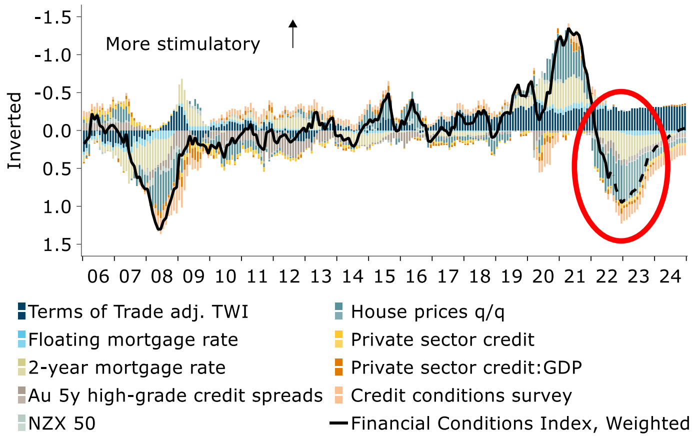
Source: RBNZ, Macrobond, ANZ Research

- The NZD trade-weighted index has been above the MPS forecast quite consistently since November.

In the category of 'neither here nor there':

- Q3 GDP came in much stronger than expected (2% q/q vs. RBNZ 0.8%), but it was very noisy. The data is unlikely to drive any large revisions to the RBNZ's estimate of the output gap. However, the strong tourism story in the data certainly corroborated the RBNZ's fears about demand and supply being out of whack in this sector, and potentially inflationary.
- The minimum wage will rise 7.1% on 1 April. While the RBNZ might have preferred a smaller lift, it's in line with broader wages and thus probably doesn't represent much in the way of additional impetus to wage growth.
- The housing market continues to slow, but as expected. January saw a bounce in house sales and a smaller decline in prices, but we don't see any cause to change our forecasts as yet. It's worth noting that our forecast 22% peak-to-trough fall in house prices represents a significant tightening in financial conditions and thus a negative for GDP (via a reduction in collateral values) – almost as much as the lift in mortgage rates (figure 4). The Financial Conditions Index is calibrated to match GDP in 'normal' times.

Figure 4. ANZ Financial Conditions Index (including forecast)



Source: Stats NZ, Bloomberg, Macrobond, ANZ Research

NB: Held constant in forecast: equities, credit conditions, credit spreads

- There's not a lot of new news on oil prices or import/export prices.
- Building consents are starting to fall more meaningfully, as expected; we expect them to continue to do so.
- The Performance of Manufacturing Index lifted back over 50 in January, though new orders remained weak. The Services Index bounced to 54.5 (52.0 previously). New orders for services have slowed, but remain comfortably in expansionary territory.

There has also been some data that's more inflationary than expected:

- Fiscal stimulus is looking slightly stronger than previously thought, but there isn't a great deal of new news in it. There's undoubtedly a lot more news to come, but the RBNZ doesn't forecast changes in fiscal policy.
- Recent and ongoing weather events will clearly be negative for GDP in the short run, due to significant disruption over a large area. The events will be inflationary overall, via insurance, goods shortages, transport disruption, construction costs and fruit and vegetable prices, among other impacts. There could also be confidence effects. Our early assessment is that it presents upside risk to the eventual peak in the OCR. But with the impacts so uncertain we don't expect it to play into the immediate RBNZ decision or have a large impact on the forecasts at this stage.

- January saw a big bounce in the flow measure of rents, though not in the stock measure that feeds into CPI. The flow measure (ie new tenancies) can provide leading information, however, so it's worth keeping an eye on.
- As always, there is a huge amount of uncertainty regarding how the RBNZ will interpret the data flow, as well as strategic considerations – which still argue for barking very loudly in the hope that means fewer bites will be needed down the track. Our back-of-the-envelope estimate is that the news flow since November (the Q4 CPI and labour data plus the TWI) could knock as much as 30bp off the OCR track, all else equal (note the track peaked at 5.5% in the November MPS). However, there's heaps of wiggle room, and strategically the RBNZ may prefer to stick with something close to its previous peak, and rather show inflation returning to target a little more quickly, in order to give the market no excuse to rally on the day.

We'd expect the RBNZ to again underline that cuts remain a faraway prospect, as it will not want to see the longer end of the yield curve slump – an obvious risk with any downshift in the size of hikes. We've already seen some mortgage rate cuts in recent weeks.

The Reserve Bank's inflation-targeting credibility remains on the line, with falling inflation still a forecast, not a given. It's entirely possible that some unhelpful inflationary development could come along (such as a jump in oil prices, or strong net migration changing the mood in the housing market, or a construction cost inflation holding up due to the flood rebuild) that could make the RBNZ conclude that it has yet more work to do. As things stand, there's no clear evidence the economy is hitting a wall. It's certainly climbing a mountain of sharp mortgage rollovers, but it's far too soon to conclude that the era of surprising resilience in the labour market and thereby amongst consumers is done and dusted.

Accordingly, we expect the RBNZ to reiterate a hawkish stance. As in November, there is little to be gained from doing otherwise at this point.

With analysts united in expecting a 50bp hike, and markets leaning that way, 50bp is the path of least resistance, insofar as any other decision has to clear the "avoiding unnecessary volatility" hurdle.

If we do get a surprise, it's much more likely to be 75bp than 25bp, in our view, given a) the fact inflation is still above 7%, b) the RBNZ estimates that the OCR isn't particularly far into contractionary territory yet, and c) there's really not much in the way of evidence that the economy is slowing more rapidly than expected or intended.

Why might they stick with 75bp despite what have been on balance helpful starting point surprises? Strategic thinking along the lines of "while the going's good" could provide a justification, as could the familiar "least regrets" analysis – the idea being that it's easier to cut rates quickly than it is to fix previous tardiness, if you're worried about inflation expectations getting away on you. The criticism of this way of thinking is that it is likely to lead to over-active policy and overshooting. That's a genuine concern too, of course. Or thirdly, the Committee could decide to hike that extra bit as a form of insurance against the likely medium-term inflationary impacts of the weather events. But with the disaster so raw and the effects so uncertain, that seems unlikely.

On balance, we think a 50bp hike, a firmly resolute tone and a barely lower OCR track would be a sensible compromise. After all, the RBNZ has another OCR decision in just six weeks' time, now the long summer break is out of the way. It would be a relatively simple matter to ramp that up to a larger hike if the data warrants.

Markets

With markets split between 50 and 75bps, the decision itself will matter, and with 56bps priced in at last night's close, a small amount of downside relief at the short end is likely if we do indeed see a 50bp hike.

Short-end rates would have had scope to move quite a bit lower had they not reacted as strongly as they did to yesterday's RBNZ inflation expectations survey. We note that before the survey, markets were pricing in a 5.26% OCR by April (ie another 101bp of hikes). We suspect market expectations for April might settle at around 35-40bp (ie a toss-up between 25 and 50bp) if we see a 50bp hike next week, which implies April OIS will settle at between 5.10% and 5.15%. However, April closed at 5.20% last night, and that really only gives it scope to adjust lower by a similar sort of magnitude that February will on a 50bp hike. But it should still adjust lower.

The bellwether 2yr swap closed at 5.14% last night. Notwithstanding the likelihood that it goes higher today following US moves in the wake of CPI data there, it has come a long way from the circa 4.70% rate it bottomed out at only 12 days ago. As we noted at the time, we thought it was far too low then, but it has now corrected appropriately. And even though we expect the OCR to peak at 5.25%, markets have a tendency to want to price in the next cycle, and that is likely to keep a lid on the 2 year, especially with markets still fearful of the possibility of a 75bp hike.

Longer-dated swaps and bonds will be more responsive to global moves. While any reaction on the day will be in the same direction as the shorter end, with the RBNZ likely to remain fairly firm and not yet in a position to declare victory over inflation, we see the longer-term risks to long-end interest rates as still skewed to the topside.

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