Research

Economy Watch

9 October 2024

RBNZ accelerates easing cycle

- **Cash rate cut 50 basis points to 4.75%**
- **Further 50 point cut likely in November**
- **But RBNZ gives no explicit forward guidance**
- **A sub neutral rate will be necessary to close the output gap**
- **So there's a lot more to come yet**

The Reserve Bank of New Zealand today slashed its cash rate by 50 basis points to 4.75%. We think this is exactly the right thing to do and stick with our view that there is much more to come. As we have said before, the RBNZ will not relax until monetary conditions are no longer restraining the economy. We are still some way from this.

The problem for the Reserve Bank in cutting interest rates so aggressively is that it would not have wanted to inflame the rate cutting expectations already priced into the market any further. While the rates curve is rallying modestly at the moment, the Bank has broadly achieved its objective by simply not providing any specific forward guidance.

Sure, a further 50 point cut in November is now almost fully priced in by the market but the expectation for such is only marginally stronger than it was prior to today's release.

While there was no specific guidance about how much and when there will be further rate cuts there is plenty of indication that there will be further rate reductions. To start with, the RBNZ's media release was headlined "Monetary restraint reduced". This is a clear acknowledgement that monetary conditions remain restrictive. When put alongside the fact that "members agreed that increasing excess capacity is leading to lower inflationary pressure" it can only mean the Bank expects to lower rates further.

Moreover, the Bank goes on to say that "an OCR of 4.75 percent is still restrictive and leaves monetary policy well-placed to deal with any near term surprises". This is a clear signal from the Bank that there would be no need to raise interest rates from current levels even if it got a near term inflationary surprise.

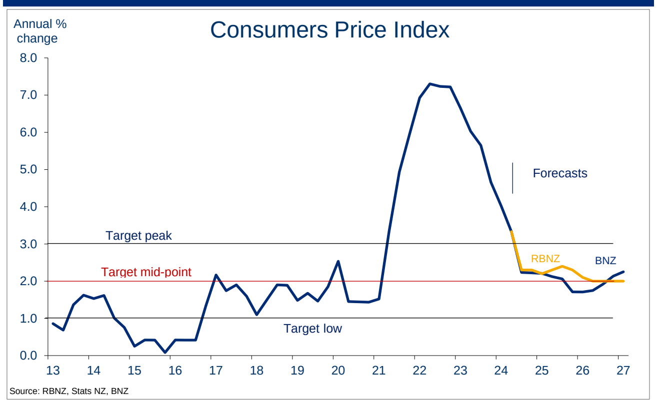
There were those who believed the Bank might need to wait for inflation to get into the target band before it would lower rates so much. It was our view that this was a red-herring as it was obvious inflation was well under control, for now at least. The RBNZ clearly shared this view in noting that the "Committee assesses that annual consumer price inflation is within its 1 to 3 percent inflation target range and converging on the 2 percent midpoint". Indeed "members are confident that inflation is converging to target".

While the central bank will never set monetary policy simply because of market pricing, market pricing can definitely influence decisions at the margin. We think this to be the case in this instance. With the market moving in the "right" direction the Bank reminded folk that policy needs to seek "to avoid unnecessary instability in output, employment, interest rates and the exchange rate". Also it "noted that current short term market pricing is consistent with this decision."

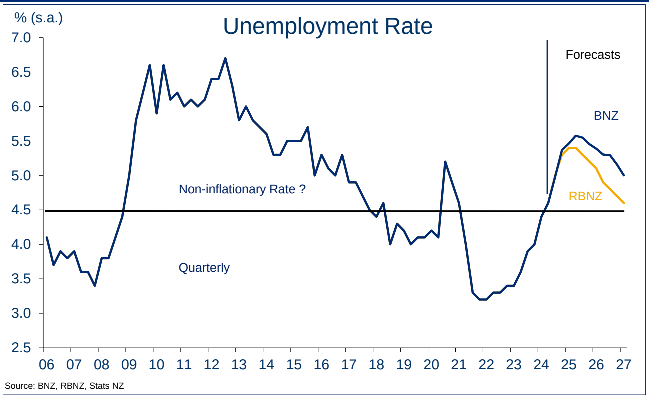
In our preview of the Monetary Policy Review we felt the RBNZ would place more weight on the findings of NZIER's QSBO which showed a rapidly deteriorating labour market and slumping price expectations, as opposed to ANZ's more upbeat survey. Committee commentary on surveyed declines in pricing intentions tend to support that view.

Our forecast rate track is unchanged. We continue to project a further 50 basis point reduction in November with 25 point cuts at each meeting thereafter until such time that the cash rate troughs at 2.75%. Of course, there will be some noise along the way that will eventually disrupt this path but such noise is unlikely to appear before the next meeting.

Near term inflation well-behaved



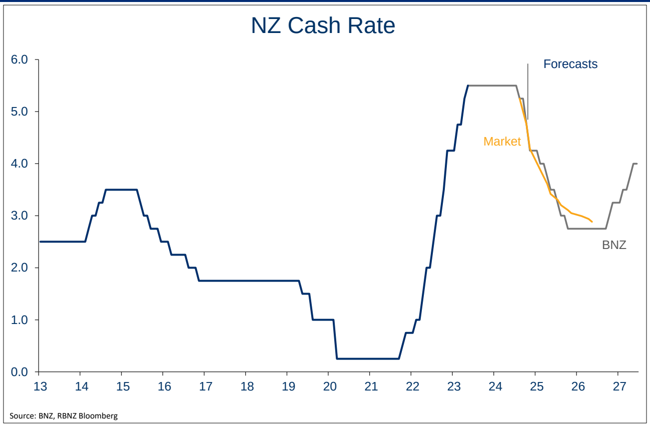
Unemployment continues to rise



We will not die in a ditch defending our view of the 2.75% trough in rates. There is a wide margin of error around this projection. But what we would say is that, if the RBNZ is to play its part in closing the economy's output gap, it will need monetary settings to be stimulatory. Moving rates to neutral and stopping there will be insufficient to meet the RBNZ's objectives.

The key data between now and the November 27 meeting are the CPI on October 16 and the November 6 labour market reports. While we will be watching these closely we are not expecting any outcome that will markedly change our, or the Reserve Bank's, view of the world.

Much more to come



stephen_toplis@bnz.co.nz

Full text of today's RBNZ OCR Review:

The Monetary Policy Committee today agreed to cut the Official Cash Rate (OCR) to 4.75 percent. The Committee assesses that annual consumer price inflation is within its 1 to 3 percent inflation target range and converging on the 2 percent midpoint.

Economic activity in New Zealand is subdued, in part due to restrictive monetary policy. Business investment and consumer spending have been weak, and employment conditions continue to soften. Low productivity growth is also constraining activity.

Some exporters have benefited from improved export prices. However, global economic growth remains below trend. The outlook for the United States and China is for growth to slow, while geopolitical tensions remain a significant headwind for world economic activity.

The New Zealand economy is now in a position of excess capacity, encouraging price- and wage-setting to adjust to a low-inflation economy. Lower import prices have assisted the disinflation.

The Committee agreed that it is appropriate to cut the OCR by 50 basis points to achieve and maintain low and stable inflation, while seeking to avoid unnecessary instability in output, employment, interest rates, and the exchange rate.

Summary Record of Meeting – October 2024

Members of the Monetary Policy Committee agreed that the stance of monetary policy has been consistent with ensuring low and stable inflation. Since the August Monetary Policy Statement, the New Zealand economy has evolved largely as expected. The Committee agreed that excess capacity has dampened inflation expectations, and price and wage changes are now more consistent with a low-inflation environment. New Zealand's annual consumer price inflation is assessed to currently be within the Committee's 1 to 3 percent target band and is expected to converge to the target midpoint.

Members observed that global economic activity remains below trend

Global economic growth remains below its long-run trend and is expected to remain so for the year ahead. Economic growth in the United States and China is expected to slow. The disinflationary process in advanced economies has led to further reductions in official policy interest rates.

The Committee agreed that domestic activity is weak

Members agreed that increasing excess capacity is leading to lower inflationary pressure in the New Zealand economy. Economic growth is weak, in part because of low productivity growth, but mostly due to weak consumer spending and business investment. High-frequency indicators point to continued subdued growth in the near term. Some exporting businesses have been supported by higher export prices, particularly in the dairy industry.

Labour market conditions are expected to ease further, with filled jobs and advertised vacancy rates continuing to decline. More generally, weak house price growth, lower levels of net immigration, and ongoing fiscal consolidation from spending restraint, are expected to constrain aggregate demand growth.

The Committee noted that while wholesale and bank interest rates have declined, financial conditions remain restrictive, and credit demand remains subdued. The current preference for shorter-term mortgage rates by borrowers will increase the speed with which changes in the OCR influence household cashflows over coming months.

Members are confident that inflation is converging to target

The Committee agreed that monthly price indices signal a continued decline in consumer price inflation in New Zealand. Recent business visits suggest that weak demand is restricting the pass-through of increased input costs to prices faced by consumers. This is consistent with business surveys, which show a declining share of businesses intending to increase prices. Business price-setting behaviour is now more consistent with the Committee's inflation remit.

The Committee assesses headline consumer price inflation to be within its 1 to 3 percent target band in the September 2024 quarter and to remain around the midpoint in the medium-term.

The Committee considered global and domestic risks

Members discussed how recent events in the Middle East could pose significant risks to both global economic activity and energy prices. Should conflict escalate, oil prices and shipping costs could rise, and adverse investor sentiment could trigger asset price corrections and tighter financial conditions. Members noted that the current market pricing of risk was especially sensitive to downside economic surprises.

Uncertainty about the effectiveness of recent policy actions in China also posed downside risks to New Zealand's export growth, as well as export and import prices. Heightened uncertainty around the US elections, and the implications for US trade and fiscal policies, could also be significant for international financial markets and global economic activity.

Members noted that while domestic price-setting behaviour is now more in line with its mandate, there are still risks that further adjustments might be faster or slower than currently expected.

Members agreed to ease monetary restraint

The Committee agreed that the economic environment provided scope to further ease the level of monetary policy restrictiveness, consistent with its mandate of low and stable inflation.

The Committee discussed the respective benefits of a 25-basis point versus a 50-basis point cut in the OCR. They agreed that a 50-basis point cut at this time is most consistent with the Committee's mandate of maintaining low and stable inflation, while seeking to avoid unnecessary instability in output, employment, interest rates, and the exchange rate. The Committee noted that current short-term market pricing is consistent with this decision.

The Committee acknowledged that the outlook is broadly consistent with the August Monetary Policy Statement. Members agreed that an OCR of 4.75 percent is still restrictive and leaves monetary policy well-placed to deal with any near-term surprises. The Committee confirmed that future changes to the OCR would depend on its evolving assessment of the economy.

On Wednesday 9 October 2024, the Committee reached a consensus to reduce the Official Cash Rate by 50 basis points, from 5.25 percent to 4.75 percent.

Attendees

MPC members: Adrian Orr (Chair), Bob Buckle, Carl Hansen, Christian Hawkesby, Karen Silk, Paul Conway, Prasanna Gai
Treasury Observer: James Beard
MPC Secretary: Marea Sing

Contact Details

BNZ Research

Stephen Toplis
Head of Research

Doug Steel
Senior Economist

Matt Brunt
Economist

Jason Wong
Senior Markets Strategist

Stuart Ritson
Senior Interest Rate Strategist

Mike Jones
BNZ Chief Economist

Main Offices

Wellington
Level 2, BNZ Place
1 Whitmore St
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Toll Free: 0800 283 269

Auckland
80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Toll Free: 0800 283 269

Christchurch
111 Cashel Street
Christchurch 8011
New Zealand
Toll Free: 0800 854 854