27 November 2024

RBNZ Delivers Another 50 Point Cut

- **Cash rate cut 50 basis points to 4.25%, as expected**
- **More easing projected and expected next year**
- **But pace less clear**
- **Another 50 possible in February, but a long time away**

The Reserve Bank of New Zealand today slashed another 50 basis points off its cash rate today, reducing it to 4.25%. We think this was the right thing to do and is what we thought was by far the most likely outcome. Nothing to change our view of more easing to come.

We have been of the view that economic spare capacity continues to grow and will do so for some time. Inflation is well contained, so too inflation expectations, and the unemployment rate is set to rise further over coming quarters. This allows room to reduce the OCR.

The RBNZ seems to agree with that assessment noting that 'economic activity in New Zealand remains subdued and output continues to be below potential. With excess productive capacity in the economy, inflation pressures have eased.'

The RBNZ projects further easing ahead. The Bank noted that 'if economic conditions continue to evolve as projected, the Committee expects to be able to lower the OCR further early next year.

The pace remains a matter of conjecture. We see the RBNZ interest rate projections implying another cut in February, with a roughly even chance of a 25 or 50 cut as far as we can tell. It looks to us that the RBNZ is giving itself flexibility on the policy path ahead.

However, in the press conference, RBNZ Governor Orr suggested that their projections are consistent with a 50-point move. This must increase the odds of such. It is tempting to build in a 50-point cut for February, but the meeting is a long time away with a lot of significant information to absorb before then. This includes keeping an eye on the currency, with the potential for easier monetary conditions to come via this channel. The Bank has maintained a TWI projection of 69.5.

For now, we maintain our forecast of a series of 25 basis point cuts at each meeting through to October to a low of 2.75%. We certainly wouldn't rule out a 50 point move in February. Equally, we continue to ponder our low point that we have had for a long time now but again acknowledge the possibility of nudging it a touch higher in due course.

Beyond the near term, the RBNZ's projected track is lower than its August's projection as we thought it would be, given the two consecutive 50 point moves to-date. But the projected easing through next year is generally slower than recent moves. By Q4 2025, the RBNZ projects the cash rate to average 3.55%, lower than August's 3.85%. The low point in the Bank's track is still close to 3% (3.06% by end 2027). It is interesting that the Bank's projections do not show a cash rate going below its current 2.9% estimate of long term neutral.

For a market hunting the possibility of a 75 point move today, today's 50-point move came as something of a disappointment. Wholesale interest rates rose sharply immediately post release, but trimmed increases on the Governor's February comment in the press conference. All up, short term swap rates are up around 5-8 basis points.

Forward indicators for the economy are growing in strength but contemporaneous measures are far from optimistic. As we said in our MPS preview, this is a challenging time for the central bank. There is no doubt further easing will be required to fertilise the new growth but there is less clarity as to the requisite pace or extent of that easing. The RBNZ chose to cut 50 basis points today and further easing is projected.

As always, the way ahead for policy will be data and event dependent. And there is plenty of it ahead of the next scheduled RBNZ meeting in February. The latest quarters for GDP, CPI, labour market, and the QSBO will all be important. There's also the government's HYEFU and a host of international factors to monitor including geopolitical risks and Trump re-entering the White House in January.

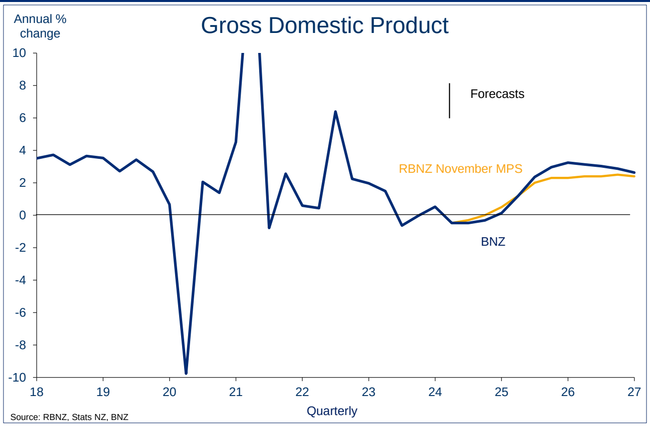
The RBNZ sees economic recovery starting about now, as do we. But the pace and extent are uncertain.

To add to the murkiness, Stats NZ published an outline of their annual revisions to real GDP this morning. There were chunky including the annual average growth for the year to

March 2024 revised up from 0.3% to 1.4%. That points to a stronger standpoint for the economy, to March 2024. It is not clear what the revisions will imply for the output gap.

It might be less negative which could have implications for policy. We will give this more thought in due course, but we may have to wait until we get the full quarterly GDP series in December. Notably annual real growth in the expenditure measure of GDP for the year to March 2024 was unchanged at 0.7%. A less negative output gap implied by GDP, or not, will not alter other indicators pointing to more slack like lower capacity utilisation and a rising unemployment rate. The direction of travel for policy remains clear enough – removing restraint. But how fast and how far remains to be seen.

Near term softness



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Full text of today's RBNZ OCR Review:

The Monetary Policy Committee today agreed to reduce the Official Cash Rate by 50 basis points to 4.25 percent.

Annual consumer price inflation has declined and is now close to the midpoint of the Monetary Policy Committee's 1 to 3 percent target band. Inflation expectations are also close to target and core inflation is converging to the midpoint. If economic conditions continue to evolve as projected, the Committee expects to be able to lower the OCR further early next year.

Economic activity in New Zealand remains subdued and output continues to be below its potential. With excess productive capacity in the economy, inflation pressures have eased. Domestic price and wage setting behaviours are becoming consistent with inflation remaining near the target midpoint. The price of imports has fallen, also contributing to lower headline inflation.

Economic growth is expected to recover during 2025, as lower interest rates encourage investment and other spending. Employment growth is expected to remain weak until mid-2025 and, for some, financial stress will take time to ease.

Global economic growth is expected to remain subdued in the near term. Geopolitical conditions and policy uncertainty could contribute to increased economic and inflation volatility over the medium term.

The Monetary Policy Committee agreed that having consumer price inflation close to the middle of its target band puts it in the best position to respond to any shocks to inflation.

Summary Record of Meeting – November 2024

Consumer price inflation is sustainably within the Monetary Policy Committee's 1 to 3 percent target range, and measures of core inflation are converging on the midpoint. Restrictive monetary policy and subdued economic activity overseas have slowed domestic demand. Lower import prices have also contributed to lower inflation. Expectations of future inflation, the pricing intentions of firms, and spare productive capacity are consistent with the inflation target being sustainably achieved. This provides the context and the confidence for the Committee to further ease monetary policy restraint.

Global economic activity expected to remain subdued

Economic growth rates in the US and China are expected to slow over the year ahead, while the growth outlook for Europe remains sluggish. Headline inflation is close to target in most advanced countries, but some persistence in services inflation remains. Central banks are reducing interest rates, although the pace of monetary policy easing varies across countries due to differences in economic conditions. Global sovereign debt levels have increased markedly since 2020 and continue to expand. This creates risks of higher global bond yields and risk premia.

Significant spare productive capacity expected over the next year

Domestic economic activity remains below trend, as a result of weakness in demand for durable goods consumption and investment. This has been reflected in falling activity in interest rate sensitive sectors such as construction, manufacturing, and retail trade. In contrast, some services sectors have continued to grow.

Considerable spare productive capacity remains in the economy, although this is expected to steadily reduce over the projection period. Consistent with feedback from business visits, high frequency indicators suggest that the economy has stabilised in recent months. Economic growth is expected to recover from the December quarter, in part due to lower interest rates, but there is uncertainty around the exact timing and speed of the recovery.

The Committee noted that the projections incorporate the fiscal assumptions from the 2024 Budget Economic and Fiscal Update.

Labour market conditions easing

Wage growth is slowing, consistent with inflation returning to the target midpoint. Employment levels and job vacancies have declined, reflecting subdued economic activity. Unemployment is expected to continue rising in the near term since the labour market typically takes longer to recover than output. Net immigration to New Zealand has reduced significantly from high rates over recent history. The rate of migrant arrivals has slowed, and departures of New Zealanders have increased, partly in response to subdued labour market conditions relative to Australia.

Lower OCR passing through to mortgage rates

Market interest rates have declined in response to actual and expected OCR reductions. The decline in mortgage rates has been less than for wholesale rates, in part reflecting changes in the composition and cost of bank funding. The average rate on outstanding mortgages has now peaked at 6.4 percent and is expected to decline to 5.8 percent over the next 12 months as borrowers refix their mortgage interest rates at lower levels in line with a falling OCR.

No trade-off between meeting inflation objectives and financial stability

The Committee noted the findings of the Bank’s November 2024 Financial Stability Report. Some households and businesses are experiencing financial stress. While non-performing loans remain low compared to past recessions, further financial stress is likely to emerge even as the economy recovers. The banking system remains well capitalised and in a strong financial position to support customers experiencing distress. The Committee agreed that there is currently no material trade-off between meeting inflation objectives and maintaining financial stability.

Inflation is expected to remain near the midpoint

Headline consumer price inflation has declined to close to the target midpoint, measures of core inflation are converging on the target midpoint, and inflation expectations at all horizons are close to the target midpoint. With significant spare productive capacity expected in the economy over the next 12 months, the Committee is confident that remaining inflation pressures will abate. Feedback from recent surveys and business visits suggest domestic price and wage setting behaviours are becoming consistent with inflation remaining sustainably at target.

There are near-term risks to the economic outlook

The Committee discussed two key uncertainties to the near-term outlook. While domestic price setting behaviour is now more in line with the Committee’s inflation objective, members discussed uncertainty about the persistence of some components of inflation. The Committee also noted that, while lower interest rates are expected to underpin a recovery in the domestic economy, the exact speed and timing of the recovery is subject to uncertainty.

There is a risk of greater inflation volatility over the medium term

Geopolitical risks and climate-related energy and food risks pose uncertainty over the medium term. There may be higher relative price volatility and more unpredictability in aggregate inflation. The Committee agreed that having consumer price inflation close to the middle of its target band puts it in the best position to respond to any shocks to inflation.

The Committee agreed to lower the OCR

With headline inflation close to the midpoint and measures of core inflation converging on the midpoint, the Committee has more confidence to continue removing monetary policy restraint. The Committee agreed that a 50 basis point cut is consistent with their mandate of maintaining low and stable inflation, while seeking to avoid unnecessary instability in output, employment, interest rates and the exchange rate.

If economic conditions continue to evolve as projected, the Committee expects to be able to lower the OCR further early next year.

On Wednesday 27 November the Committee reached a consensus to lower the Official Cash Rate by 50 basis points to 4.25 percent.

Attendees

MPC members: Adrian Orr (Chair), Bob Buckle, Carl Hansen, Christian Hawkesby, Karen Silk, Paul Conway, Prasanna Gai
Treasury Observer: Tim Ng
MPC Secretary: Chris Bloor

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