



11 June 2009

Data Flash (New Zealand)

Key points

- The RBNZ left the Official Cash Rate (OCR) at 2.5%, as we and the market had expected. Crucially, the RBNZ retains the view that *"We expect to keep the OCR at or below the current level through until the latter part of 2010."*
- In the key policy assessment section at the beginning of the *Monetary Policy Statement* (reproduced in full at the end of this note), the RBNZ chose to highlight the following points.
 - *"The economic outlook remains weak both in New Zealand and in other countries. However, there are signs that international economic activity is stabilising, and international financial conditions are improving."*
 - *"We expect the NZ economy to begin growing again toward the end of this year but the recovery is likely to be slow and fragile."*
 - *"For the first time in some months we can also identify some clear upside opportunities for activity...ultimately, however, we do not think such a rebound in spending would prove sustainable given the soft outlook for employment, wages, and farm incomes and high levels of household debt."*
 - *"The recent rise in the NZD ...risks delaying or even reversing the projected increase in exports, putting the sustainability of the recovery at risk."*
 - *"We expect to keep the OCR at or below the current level through until the latter part of 2010."*
- Tables 1 and 2 below summarise the RBNZ projections for the economy and policy settings. In our view the key points to note are:
 - The Bank has a higher track for the NZD than previously, with a much more subdued lift in the 90 day rate providing a projected offset in terms of overall monetary conditions. This produces similar medium-term inflation projections to those published in the March MPS.
 - The Bank has a much weaker forecast for growth in 2009/10 than in the March MPS.
 - The forecasts imply that the projected low in the OCR is 2.5%, with the first lift in the OCR coming at the end of 2010.

Our initial reaction

- We will review today's Statement in more detail in a Dataflash later today. However, our initial reaction is that there is nothing in this statement to cause us to change our expectation that the RBNZ's easing cycle is now most likely at an end.
- Critically, while the Bank still thinks the "risks to activity remain weighted to the downside", it is now prepared to admit to the possibility of upside surprises. In our view this makes the RBNZ less inclined to cut rates again unless it thinks it needs to counter the rise in the NZD or somehow offset the pressures from rising market rates.
- The market reaction some 30 minutes after the MPS has seen the front of the curve sell-off by 5-10bp and the NZD rally by around 50pts.

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Table 1: Growth and inflation

		Actual 2006/07	Actual 2007/08	Forecast 2008/09	Forecast 2009/10	Forecast 2010/11	Forecast 2011/12
March Qtr							
PRODUCTION	RBNZ Jun	2.4	2.1	-2.6	0.8	4.0	3.6
GDP % yoy	RBNZ Mar	2.3	2.1	-2.2	3.2	4.6	3.4
	DB Jun	2.3	2.1	-2.5	0.6	3.7	3.2
CPI Inflation	RBNZ Jun	2.5	3.4	3.1	1.2	2.3	2.2
% yoy	RBNZ Mar	2.5	3.4	3.1	1.6	2.2	2.1
	DB Jun	2.5	3.4	3.0	2.0	2.2	1.8

Source: Deutsche Bank, RBNZ

Table 2: 90 Day & TWI projections

	RBNZ Jun		RBNZ Mar MPS		DB Jun	
	TWI	90-Day Bill Rate	TWI	90-Day Bill Rate	TWI	90-Day Bill Rate
H1 2008 Average	70.6	8.8	70.6	8.8	70.6	8.8
H2 2008 Average	61.8	7.3	61.8	7.3	61.8	7.3
H1 2009 Average	55.9	3.3	52.6	3.4	54.6	3.3
H2 2009 Average	57.1	2.8	49.2	3.0	55.9	2.8
H1 2010 Average	54.7	2.8	47.5	3.2	56.6	2.8
H2 2010 Average	52.8	2.9	47.9	3.8	57.0	3.9
H1 2011 Average	51.9	3.5	49.0	4.6	58.4	5.2
H2 2011 Average	51.9	3.9	50.1	5.3	58.2	5.8

Source: Deutsche Bank

RBNZ Policy Assessment

The Official Cash Rate (OCR) will remain unchanged at 2.50 percent.

Reserve Bank Governor Alan Bollard said: "The economic outlook remains weak both in New Zealand and in other countries. However, there are signs that international economic activity is stabilising, and international financial conditions are improving. We expect the New Zealand economy to begin growing again toward the end of this year but the recovery is likely to be slow and fragile. Many key economic indicators such as unemployment are projected to keep deteriorating well into 2010.

"There remain some material downside risks to activity and inflation, but for the first time in some months we can also identify some clear upside opportunities for activity. One such area is a potential rebound in household spending and residential investment as a result of the rise in net immigration and the pick-up in the housing market. Ultimately, however, we do not think such a rebound in spending would prove sustainable given the soft outlook for employment, wages and farm incomes and high levels of household debt.

"On balance, the risks to activity remain weighted to the downside.

"The recent rise in the New Zealand dollar creates an unhelpful tension with our projections. A stronger dollar at a time of weak global growth risks delaying or even reversing the projected increase in exports, putting the sustainability of recovery at risk.

"Overall, recent developments point to lower inflationary pressure than previously projected. Annual CPI inflation is likely to fall temporarily below the bottom of the target band later this year, but we expect it to return to inside the band by early 2010 and remain comfortably there over the remainder of the projection.

"We have cut the OCR by a large amount over the year. We expect the effects to pass through to more borrowers over coming quarters as existing fixed-rate mortgages come up for re-pricing. Although rising longer-term interest rates overseas are placing upward pressure on longer-term lending rates here, there is room for further reductions in shorter-term lending rates.

"The low OCR and stimulatory fiscal policy are the main sources of support to the New Zealand economy at present. It is likely to be some time before the recovery becomes self-sustaining and monetary policy support can be withdrawn.

"We therefore consider it appropriate to continue to provide substantial monetary policy stimulus to the economy. The OCR could still move modestly lower over the coming quarters. As we said at the time of the April OCR decision, we expect to keep the OCR at or below the current level through until the latter part of 2010."

Appendix 1

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