28 January 2010

RBNZ to Tighten…When Recovery Clear and Strong

- RBNZ sticks with 2.50%, and MPS script
- Leaving us comfortable with June tightening view
- Market still relatively firmer, but not wildly so
- Data crucial to test Bank's view of quickening GDP
- Also note Bollard's speech, tomorrow, for more clues

This morning's OCR review was admirably boring and commendably short. It was testimony to the Reserve Bank continuing to be right on top of things, as it plays things cool.

As widely expected, Governor Alan Bollard stuck fast to December's script (while keeping the OCR at 2.50%, for the record). So, provided the economic recovery continues to gather pace, the RBNZ will probably start budging its cash rate up around mid-year.

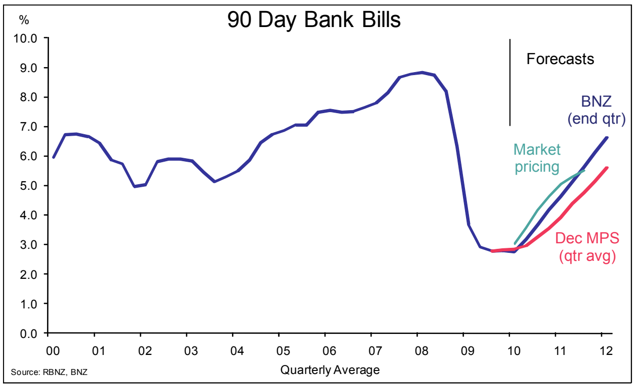
This certainly remains our core view on the economy, and RBNZ policy. Specifically, this leaves us comfortable with our long-held view of the Bank beginning to lift the OCR in June, by 25ps, followed by 25 point clips at the many meetings subsequent to that.

Relative to this, the markets remain relatively aggressive, albeit much less so than they were weeks ago. Market reaction was actually muted this morning, which the RBNZ will no doubt be pleased about. The currency barely budged. And a minor dip in wholesale yields on the back of the OCR text essentially reversed the small increases that came earlier this morning via the ripples from the steady FOMC policy announcement.

So, while the markets have over the last few weeks backed off the idea of a March hike, the April meeting is largely priced for a first OCR increase, with a cash rate peak toward 5.25% by around the middle of 2011.

As for the Reserve Bank's view, its commentary today, if anything, betrayed a fraction more comfort.

Sure, it sounded a bit more definite on a mid-year start to tightening by saying "we would expect to begin removing policy stimulus around the middle of 2010." But then this is exactly what the MPS had in its 90-day bank bill forecasts, even though Bollard, at the time, sounded a bit more hesitant on the front pager with "conditions may support beginning to remove monetary stimulus around the middle of 2010."



And of the inflation and housing niggles that made their way into the MPS, today's OCR review suggested a bit of relief already.

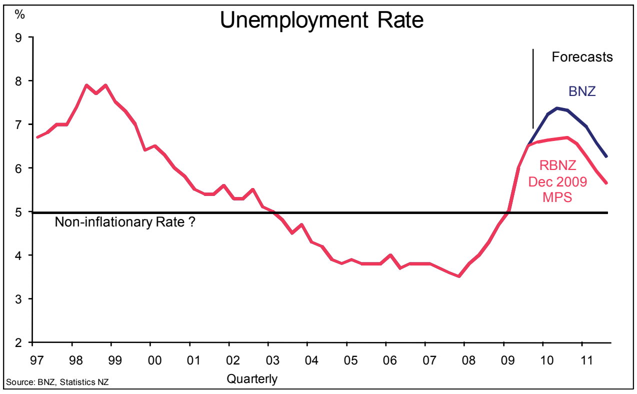
In December, Bollard noted "Annual CPI inflation is expected to remain below 2 percent until early 2011 and track within the target range over the medium term." Today he said "Annual CPI inflation is currently at the centre of the target band, and is expected to track comfortably within the band over the medium term" – comfortably being the new, operative, word.

As for housing, well Bollard didn't mention it at all today. Yet he did, with "housing strength", back in December. This may well suggest less worry that the housing market is about to race away again. This would not surprise us, given the housing indicators that have gone a bit flat over the last month or two – including home sales and mortgage approvals.

These, in turn, call into question the presumption of ongoing strong home price gains (which the Bank actually assumed into the start of 2010, in its MPS) and the sustainability of the improvement we've seen in consumer spending and confidence.

Nevertheless, the actual economic data will remain crucial for dictating OCR expectations. But bear in mind it is all in relation to what the RBNZ already expects to see, as portrayed in its December MPS – and that is a strengthening recovery (including quarterly GDP growth reaching 1.0% by mid this year), and moderate inflation pressure.

So it will take evidence of a bigger acceleration in economic activity, and/or inflation sparks, to force the



Bank to go earlier than currently indicated, and/or harder when it does. By the same token, any news that begins to question the GDP acceleration the RBNZ projects would presumably delay any tightening past mid-year. Of the two scenarios it would seem the latter has much less weight in peoples' thinking.

In respect of what local data looms ahead of the 11 March Monetary Policy Statement, the following seem important.

- This afternoon's credit aggregates can't be overlooked, as a sign of actual credit conditions (as opposed to the academic interpretations of an "extremely loose" OCR). The RBNZ again mentioned these this morning. We expect the aggregates remained subdued in December, with household credit advancing, but at a mild pace, business credit contracting on an annual basis, while lending to the agriculture sector keeps levelling off.
- Next Thursday's Q4 Household Labour Force Survey. Importantly, the December MPS implied elements of stability in this, with employment flat (rather than still falling) and the unemployment edging up just a fraction – to 6.6%, from 6.5%. It would be asking a lot to see "stronger" results than these. Indeed, we reckon the HLFS will be clearly weaker, with the jobless rate hitting 6.9%, as employment falls a further 0.3% in the quarter.
- January's housing reports, especially home sales. We suspect they will confirm a wavering start to the New Year.
- Consumer spending, with the 12 February retail trade report, for Decemebr/Q4, the obvious example. But also note the 10 February Electronic Card Transactions, for January.
- The 25 February NBNZ business survey. There's never one done for January, so this one will be the first comprehensive gauging of New Year business reports and expectations.
- Q4 GDP indicators – although the only hard ones ahead of the 11 March MPS are for manufacturing, construction, and international trade volumes and prices, and with just days to spare.

As well as the domestic data, of course, we'll need to keep a close eye on things global, including commodity prices, and how the NZ dollar looks in relation to this.

For more immediate further clues on what will be influencing the RBNZ, also note Bollard's speech tomorrow. While its theme of "Lessons from the Crisis" suggests a fairly broad-brushed, policy-related, discussion, there is always the potential for some specifics to ooze out.

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The full text of today's RBNZ OCR Review – OCR unchanged at 2.5 percent

The Reserve Bank today left the Official Cash Rate (OCR) unchanged at 2.5 percent.

Reserve Bank Governor Alan Bollard said: "The outlook for the New Zealand economy remains consistent with the projections underlying the December Monetary Policy Statement.

"Global activity continues to recover, helping push New Zealand's export commodity prices higher. Economic growth is most apparent in China, Australia, and emerging Asia. However, sustained growth throughout our trading partners is not assured, with many still facing impaired financial sectors and overall activity still reliant on policy support.

"Similarly, the New Zealand economy continues to recover. Policy stimulus and improving export earnings have seen a pickup in household spending. That said, households remain cautious, with credit growth subdued. Business spending remains weak.

"Annual CPI inflation is currently at the centre of the target band, and is expected to track comfortably within the band over the medium term.

"The economy is being assisted by both monetary and fiscal policy support. As growth becomes self sustaining, fiscal consolidation would help reduce the work that monetary policy might otherwise need to do.

"If the economy continues to recover in line with our December projections, we would expect to begin removing policy stimulus around the middle of 2010."

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