

New Zealand Economic Update

RBNZ OCR announcement

The RBNZ left the official cash rate (OCR) steady at 2.5% this morning as expected and maintained that, provided the economy continues to recover in line with the RBNZ's projections, policy stimulus will begin to be removed "around the middle of 2010." The absence of more hawkish commentary on the medium-term inflation outlook does, however, mean that a rate hike in March now carries significantly less risk. As such, we now forecast that the next tightening cycle will commence in April, rather than in March as previously forecast.

In the statement accompanying the 'no change' decision today, Dr. Bollard highlighted that "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." In our view, the medium term inflation outlook will become a growing concern for the RBNZ Governor. Annual CPI inflation will likely edge toward the top end of the RBNZ's 1%-3% target range over the medium term given that domestic prices are rising and excess capacity is diminishing. It is for this reason, primarily, that we maintain that the first rate hike will be delivered before official guidance suggests.

Apart from the inflation outlook, the statement today was relatively balanced. On the one hand, Dr. Bollard acknowledged the improvement in export earnings and household spending but, on the other, remained cautious on the outlook for trading partner growth and highlighted that credit growth remained subdued. Interestingly, there was no mention of the adverse impact of elevated NZD. In the December statement, Dr. Bollard noted that the currency had limited the scope for exports to contribute to the recovery; this, though, was absent in today's commentary.

With economic conditions offshore and at home improving, and the RBNZ likely to become less comfortable with the medium term inflation outlook in coming months, we maintain that the next tightening cycle will commence before "the middle of 2010," with the first OCR hike likely to be delivered in April. We acknowledge that a 50bp move at the commencement of the next tightening cycle is a risk, but a 25bp move should suffice given that the shift of borrowers toward shorter-dated borrowing and floating rate loans means the RBNZ will get more bang for its buck when it does tighten policy.

RBNZ official cash rate - New Zealand

pre-March 1999 = discount rate, percent per annum, eop



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