BANCORP

BANCORP TREASURY SERVICES LIMITED

ECONOMIC ALERT

MPS — FEBRUARY 2019

13 February 2019 | www.bancorptreasury.com

"The Official Cash Rate (OCR) remains at 1.75 percent."

And ...

"We expect to keep the OCR at this level through 2019 and 2020."

And ...

"The direction of our next OCR move could be up or down."

Why ...

"Core consumer price inflation remains below our 2 percent target mid-point, necessitating continued supportive monetary policy."

And ...

"The risk of a sharper downturn in trading-partner growth has also heightened over recent months."

But ...

"Indicators of labour market tightness suggest that employment is near its maximum sustainable level."

Looking ahead ...

"Consumer price inflation is expected to rise to around the mid-point of our target range at 2 percent."

But ...

"There are upside and downside risks to this outlook."

In conclusion ...

"We will keep the OCR at an expansionary level for a considerable period."

Market Implications

Much dovishness was expected from today's *Monetary Policy Statement* ("MPS"). The RBNZ was expected to reflect on domestic data that has been weaker than expected compared to its November MPS projections and to join the growing list of central banks lamenting that the global risks have shifted more to the downside. However, the RBNZ simply restated its balanced stance and outlined the main upside and downside risks to its central outlook.

The MPS disappointed those who wanted, and had positioned for, a more doom and gloom statement. Markets cannot stand still for any length of time and so cannot comprehend a central bank's *"watch, worry, and wait"* stance.

The markets' response was an immediate lift in the New Zealand dollar and swap rates, with the NZD/USD up about 80 points and swap rates up 7 or 8 basis points in a few minutes. Some pull back is to be expected to this move, just as a rebound by the New Zealand dollar and swap rates was justifiable after their dramatic falls over the past fortnight.

Comment

The RBNZ still faces a dilemma. It said the *"next OCR move could be up or down"* but stuck to a central scenario that sees the OCR rising from 2021. That is because the two key elements of the Policy Targets Agreement are balanced. Inflation is subdued but *"employment is near its maximum sustainable level"* that threaten to introduce wage and cost pressures with resultant higher inflation.

Previous RBNZ Governors have talked about watching the output gap and output pressures because they are relatively reliable forerunners to rising inflation. Adrian Orr is no different. Even if the RBNZ's central scenario proves to be the correct path for growth, inflation and employment, it should come as no surprise because there will be a lot of economic data released before we are even close to an OCR move.

Despite the recent moves, the New Zealand dollar is mostly trading within recent ranges against its main cross-rates and swap rates are lower than at the end of 2018. Treasury risk managers must put aside day to day market machinations, sentiment and volatility, and focus on what they can influence, policy and the organisation's best interests rather than trying to second guess markets.