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ECONOMIC ALERT

MPS — NOVEMBER 2019

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“The Monetary Policy Committee has decided to keep the Official Cash Rate (OCR) at 1.0 percent.”

Why ...

“Economic developments since the August Statement do not warrant a change to the already stimulatory monetary setting at this time.”

But ...

“Economic growth continued to slow in mid-2019 reflecting weak business investment and soft household spending.”

And ...

“Trading-partner growth has also slowed. Growth in global trade and manufacturing is weak and uncertainty remains high, dampening global business investment.”

However ...

“New Zealand’s export commodity prices have been robust, underpinning a positive terms of trade. The lower New Zealand dollar exchange rate this year is also providing a useful additional offset to the weaker global economic environment.”

And ...

“Employment remains around its maximum sustainable level while inflation remains below the 2 percent target mid-point but within our target range.”

In conclusion ...

“The Committee debated the costs and benefits of keeping the OCR at 1.0 percent versus reducing it to 0.75 percent. The Committee agreed that both actions were broadly consistent with the current OCR projection. The Committee agreed that the reduction in the OCR over the past year was transmitting through the economy and that it would take time to have its full effect.”

And ...

“We will add further monetary stimulus if needed.”

Looking ahead ...

“Domestic economic activity is expected to increase during 2020 supported by low interest rates, higher wage growth, and increased government spending and investment.”

And ...

“Interest rates will need to remain at low levels for a prolonged period to ensure inflation reaches the mid-point of our target range and employment remains around its maximum sustainable level.”

Market Implications

The Reserve Bank’s Monetary Policy Committee (“MPC”) once again caught the markets wrong footed. A 25 basis point cut was around 75% priced in today, up from 50% yesterday (before the inflation expectations data). All 5 big banks were expecting a cut.

The immediate impact was a sharp 80 point jump in the NZD/USD to 0.6420 and a strong move higher in swap rates. Across the curve, swap rates are up 15-20 basis points, with the biggest moves at the short end of the curve. BKBM will set materially higher tomorrow.

Comment

Despite the relatively balanced statement, the OCR remains at 1.00%. The statement is not too dissimilar to the tone of the statement accompanying the 50 basis point cut in August. No wonder the markets are having a hard time predicting this central bank’s actions.

The Committee appears relatively pleased with the effect of the August cut, noting that inflation has and will continue to pick up, with wages lifting.

The committee expects growth and inflation to pick up next year, which now brings into question whether there will be any more cuts at all. After the last two MPS’s, it’s anyone’s guess.