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ECONOMIC ALERT

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

Why ...

“Employment is at or slightly above its maximum sustainable level while consumer price inflation is close to the 2 percent mid-point of our target range.”

But ...

“The Committee discussed the challenges facing the rural sector and the impact on the rest of the economy. The members noted the changes to environment policy, tightening credit conditions over 2019, recent dry conditions in parts of the North Island, floods in Southland, and the coronavirus outbreak. The members discussed how these challenges could dampen economic activity.”

However ...

“Economic growth is expected to accelerate over the second half of 2020 driven by monetary and fiscal stimulus, and the high terms of trade. The outlook for government investment is stronger following the Government’s announcements in December. There are also indications household spending growth will increase.”

And ...

“The Committee discussed the monetary policy implications if the impacts of the [coronavirus] outbreak were larger and more persistent than assumed and agreed that monetary policy had time to adjust if needed as more information became available.”

In conclusion ...

“The Committee discussed alternative OCR settings and the various trade offs involved. The Committee agreed that ongoing low interest rates were needed to keep inflation and employment close to their mandated targets.”

Market Implications

The Reserve Bank of New Zealand’s (“RBNZ”) Monetary Policy Committee (“MPC”) didn’t manage to surprise markets, instead meeting market expectation in holding the cash rate at 1.00%. A 25 basis point cut was only around 8% priced in today, and that has remained largely unchanged all through December and January. None of the five big banks were expecting a cut today.

The immediate impact was a 40 point jump in the NZD/USD to above 0.6460 and a 5-10bp jump in swap rates across the curve, with the bigger moves at the long end of the curve. The positive

market reaction is in response to the RBNZ’s higher projected OCR track than in the previous *Monetary Policy Statement* and its assumptions around a short lived coronavirus impact on the economy.

Comment

The tone of the statement is unsurprisingly positive as it looks like numerous sectors of the economy have recovered from the slump we saw in the middle to late last year.

The Committee appears relatively pleased with the effect of the cuts made in 2019, noting that inflation and the labour market seem to be tracking inline with expectations. The expected track for the OCR indicates they have finished cutting in this cycle, which has given the NZD and swap rates an upward nudge.

The committee expects growth to pick up throughout 2020 despite the global headwinds and the challenges facing the rural sector. Despite the recent scare of the coronavirus on global markets, the committee believes that if the duration of the virus exceeds their initial assumption, that monetary policy has time to adjust.

Overall, a positive tone from the RBNZ, mirroring a surprisingly upbeat tone from the Reserve Bank of Australia last week. Let’s hope recent events don’t see the economy swerve from its improving growth trajectory.