

Baby steps

Preview of RBNZ Monetary Policy Statement, Nov 2018

Dominick Stephens, Chief Economist +64 9 336 5671

- Recent data on the New Zealand economy and inflation has been clearly stronger than the RBNZ expected.
- Consequently the November MPS has to be at least a little more hawkish than the August missive.
- But any change will be minor and confined to the details. We expect the RBNZ to stick to the same broad outlook for monetary policy.
- The RBNZ's OCR forecast may be slightly higher than the August forecast.
- But the all-important comment that the next move in the OCR could be "up or down" will probably be retained.
- For markets, the balance of risks is skewed towards swap rates and the NZD rising a little.
- Labour market data will print one day before the MPS, and could influence the tone of the press release, Chapter 1, and the Governor's comments at the press conference.

Over the past few months New Zealand's economic and inflation data has headed north, and has been clearly stronger than the Reserve Bank's forecasts. June quarter GDP came in well ahead of the RBNZ's expectation, September inflation was 0.9% compared to the RBNZ's forecast of 0.4%, and the exchange rate is lower than the RBNZ expected. Most second-tier data, such as electronic card transactions and building consents, have been strong. And fixed mortgage rates have fallen sharply, which will be a source of stimulus for house prices.

Next week's *Monetary Policy Statement* will no doubt acknowledge these facts, and consequently may be a touch more hawkish than the August *MPS*. However, any change will be minor, and will be confined to the details of the document. We expect the RBNZ to stick to the same broad monetary policy outlook, including restating the all-important phrase that the next move in the OCR could be "up or down". We expect the key features of the *MPS* to be:

- In the September OCR review, the key policy paragraph was "*We expect to keep the OCR at this level through 2019 and into 2020. The direction of our next OCR move could be up or down.*" We expect the RBNZ will say more or less the same thing next week.
- The RBNZ has concluded all recent missives by saying that it "*intends to keep the OCR at an expansionary level for a considerable period.*" That will be repeated.
- The RBNZ's August OCR forecast was flat at 1.8%, before starting to rise in September 2020. That putative date for OCR rises could be brought forward by one or two quarters.
- The RBNZ will probably state that it has upgraded its inflation forecast. That is partly due to rising petrol prices, which the RBNZ will look through. However, the RBNZ may also acknowledge that core inflation has been a little stronger than anticipated. The RBNZ will make it clear that these signs of rising inflation are welcome.
- In the September OCR Review the RBNZ acknowledged that GDP growth had exceeded forecast, but tempered that by saying downside risks to growth remain. We expect similar words next week.
- The August *MPS* featured uneven alternative scenarios. In the downside scenario, the OCR fell by 100 basis points, while in the upside scenario the OCR was only

50 basis points higher. We would expect balanced scenarios next week.

The RBNZ tends to alter its stance only in fits and starts. It tends to stick to one point of view for an extended period, and then to lurch to a new view only every once in a while. In the periods between those large changes of stance, the Reserve Bank tends to make only minor adjustments to the monetary policy outlook.

The RBNZ's most recent major change of stance occurred in August. At that time the RBNZ admitted that the economy was simply not accelerating in the fashion it has previously forecast (belatedly, in our view). Consequently, the RBNZ said that the OCR was going to have to remain low for longer than previously expected – and could even be cut. The other reason for this change of stance was probably the new Governor and the new set of targets under which the RBNZ is operating.

With the last major “reset” having occurred so recently, it seems unlikely that the RBNZ would make major changes to the monetary policy outlook now, even though the recent run of strong data has been quite marked.

The RBNZ will also be cautious in its assessment of the recent run of strong data, and may want to see the strong data continue for longer before reacting. The RBNZ may cite a range of risks to the economic outlook. Recent economic data may have been strong, but business confidence is desperately low, and now consumer confidence has also fallen. There is a risk that that could portend a weakening of the domestic economy. Global risks include declines in US share prices over the past week or two, emerging market volatility, and the escalating trade war between the US and China. And the RBNZ will be cautious about recent signs that core inflation is rising, given that inflation was so low for so long.

Known unknowns

Next week's *MPS* will be unusual, since it comes the day after the September quarter labour market figures. The RBNZ's forecasting and drafting process will be all but complete by that time, and will have to be prepared without knowledge of the unemployment rate. But there will still be time for the

RBNZ to change the press release, Chapter 1 of the *MPS*, and the Governor's comments at the press conference.

The RBNZ will be very keen to take account of the labour market figures because it is operating under a dual mandate now. It needs to get any commentary right, because there is a three month gap until the next monetary policy missive in February. And the RBNZ will be keen to be seen as taking account of the labour market, to please the Government that recently altered the mandate.

All of this means that the last-minute labour market data *could* have an influence on the overall tone that the RBNZ sets on the day.

Our forecast is for the unemployment rate to rise from 4.5% to 4.6%. That would count as an important downside development for the RBNZ, tempering the otherwise strong flow of data we have seen recently. But there is a great deal of uncertainty about unemployment numbers from quarter to quarter, and markets should be sensitive to any large move.

The other “known unknown” is the RBNZ's December quarter survey of inflation expectations. The RBNZ will know the results by the time it prepares its forecasts, whereas we do not. Businesses are complaining ever more loudly about rising costs, so we would not be surprised if elements of this survey have increased. If so, the case for a small hawkish shift from the RBNZ would strengthen.

Market reaction and scenarios

A statement along the lines we are expecting would generate only a small market reaction – perhaps two basis points higher in swap rates. We see little risk of the RBNZ surprising markets on the dovish side, given what has happened to the data. The risk scenario is one in which the RBNZ reacts strongly to recent data, and adjusts one of the key policy guidance phrases to become less dovish. There is only a small chance of that happening, but it would generate a large market reaction. Consequently, we think the balance of risks is slanted toward swap rates and the exchange rate rising on the day, rather than falling.

Dominick Stephens
Chief Economist

Contact the Westpac economics team

Dominick Stephens, Chief Economist +64 9 336 5671

Michael Gordon, Senior Economist +64 9 336 5670

Satish Ranchhod, Senior Economist +64 9 336 5668

Anne Boniface, Senior Economist +64 9 336 5669

Paul Clark, Industry Economist +64 9 336 5656

Any questions email: economics@westpac.co.nz

Past performance is not a reliable indicator of future performance. The forecasts given in this document are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Disclaimer

Things you should know

Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141 ("Westpac").

Disclaimer

This material contains general commentary, and market colour. The material does not constitute investment advice. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Country disclosures

Australia: Westpac holds an Australian Financial Services Licence (No. 233714). This material is provided to you solely for your own use and in your capacity as a wholesale client of Westpac.

New Zealand: In New Zealand, Westpac Institutional Bank refers to the brand under which products and services are provided by either Westpac or Westpac New Zealand Limited ("WNZL"). Any product

or service made available by WNZL does not represent an offer from Westpac or any of its subsidiaries (other than WNZL). Neither Westpac nor its other subsidiaries guarantee or otherwise support the performance of WNZL in respect of any such product. The current disclosure statements for the New Zealand branch of Westpac and WNZL can be obtained at the internet address www.westpac.co.nz. For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement. Download the Westpac NZ QFE Group Financial Advisers Act 2008 Disclosure Statement at www.westpac.co.nz.

China, Hong Kong, Singapore and India: This material has been prepared and issued for distribution in Singapore to institutional investors, accredited investors and expert investors (as defined in the applicable Singapore laws and regulations) only. Recipients in Singapore of this material should contact Westpac Singapore Branch in respect of any matters arising from, or in connection with, this material. Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking licence and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activities. This material is intended only to "professional investors" as defined in the Securities and Futures Ordinance and any rules made under that Ordinance. Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking Regulatory Commission (CBRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

UK: The contents of this communication, which have been prepared by and are the sole responsibility of Westpac Banking Corporation London and Westpac Europe Limited. Westpac (a) has its principal place of business in the United Kingdom at Camomile Court, 23 Camomile Street, London EC3A 7LL, and is registered at Cardiff in the UK (as Branch No. BR00106), and (b) authorised and regulated by the Australian Prudential Regulation Authority in Australia. Westpac is authorised in the United Kingdom by the Prudential Regulation Authority. Westpac is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by

Disclaimer continued

the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

This communication is being made only to and is directed at (a) persons who have professional experience in matters relating to investments who fall within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (b) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this communication or any of its contents. The investments to which this communication relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this communication or any of its contents. In the same way, the information contained in this communication is intended for "eligible counterparties" and "professional clients" as defined by the rules of the Financial Conduct Authority and is not intended for "retail clients". With this in mind, Westpac expressly prohibits you from passing on the information in this communication to any third party. In particular this communication and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction. This communication is made in compliance with the Market Abuse Regulation (Regulation (EU) 596/2014).

Investment Recommendations Disclosure

The material may contain investment recommendations, including information recommending an investment strategy. Reasonable steps have been taken to ensure that the material is presented in a clear, accurate and objective manner. Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts in interests associated with the provision of investment recommendations.

- (i) Chinese Wall/Cell arrangements;
- (ii) physical separation of various Business/Support Units;
- (iii) and well defined wall/cell crossing procedures;
- (iv) a "need to know" policy;
- (v) documented and well defined procedures for dealing with conflicts of interest;
- (vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

U.S.: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission ("CFTC") as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC ("WCM"), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 ("the Exchange Act") and member of the Financial Industry Regulatory Authority ("FINRA"). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not be subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.