Economic Note

OCR Forecast View Change

19 December 2023

OCR cuts coming sooner as economy softens

- Q3 GDP and revisions show the economy has been losing momentum to a greater extent than envisaged.
- Inflation pressures will follow suit.
- Accordingly, we now expect the RBNZ will first cut the OCR in August 2024.

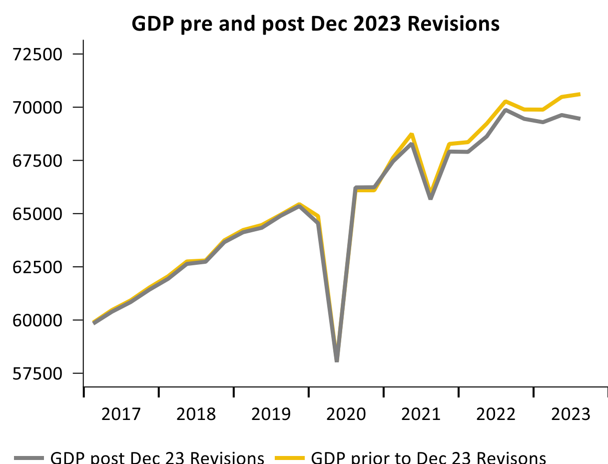
We have brought forward our forecast for the first OCR cut to August 2024, six months earlier than our previous view. We think the recent GDP release was significant: it showed momentum in the economy is grinding to a halt more rapidly than anticipated. We expect weakness will continue into 2024. If it does, inflation pressures are likely to reduce quicker than we had been previously thinking.

Although current headline inflation is still high, we are also seeing encouraging signs in recent monthly pricing data that show inflation is falling slightly quicker than the RBNZ had recently been expecting. And while there will be pockets of migration-driven concern for the RBNZ, such as rents and any potential rebound in construction costs, we expect that by the second half of next year the inflation outlook will be comfortable enough for the RBNZ to cut.

The landscape has changed significantly

The weaker than expected GDP, historical revisions, and the new suite of monthly pricing data Statistics NZ is now publishing all point to inflation pressures easing quicker than we had been expecting. The key considerations for us changing our OCR view are:

- Economic momentum has been a lot slower than previously thought, particularly for 2023. Q3 GDP fell 0.3%, against the +0.2% we expected (RBNZ +0.3%). The initially-published 0.9% growth for Q2 GDP got revised down to 0.5%, and there were further more minor downward revisions going back to 2021.
- We have revised down our GDP outlook, on the basis that momentum will remain weaker than previously thought.
- Even with record net inbound migration, GDP has still fallen over the last year. Looking at per-capita GDP, the pressure of tight monetary conditions is evident, with per-capita GDP already down 3% over the past year and likely to eventually exceed the 4% decline NZ experienced during the Global Financial Crisis.
- There is still a further lagged impact from debt servicing costs to still come through, as a forthcoming note from Mark Smith will highlight.
- The labour market will soften at a faster pace, slowing wage growth more quickly and reducing cost pressures. And businesses' ability to keep



Source: Macrobond, ASB

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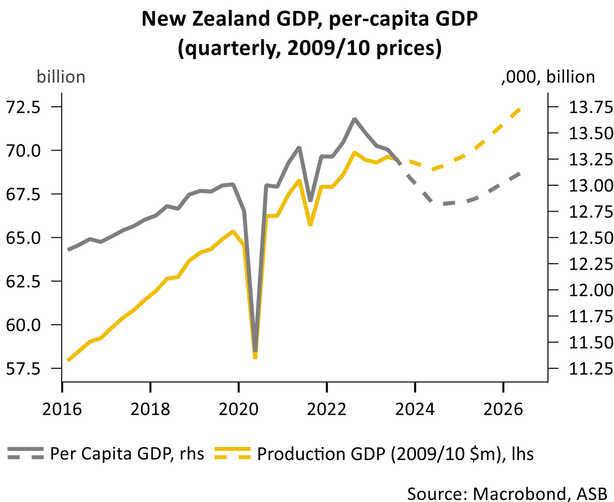
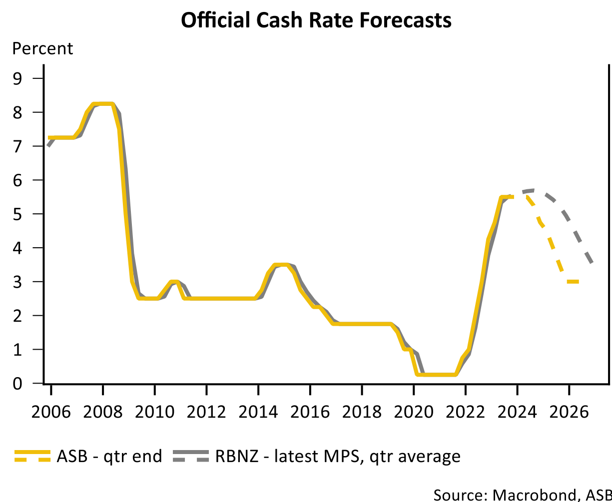
passing on various cost pressures will get harder while demand remains weak.

- The new Government has made it clear it is going to exercise considerable fiscal restraint, which the RBNZ will increasingly be able to bank on to help it contain inflation.
- The general message from monthly pricing indicators suggests that inflation is undershooting the RBNZ's expectations in the short term.

We do acknowledge that the RBNZ has started to get concerned about the demand-side impacts of migration. Yet those demand pressures still look relatively narrow (while the labour supply impact has been significant). Consumer spending is in outright contraction. Despite the added need for housing, dwelling consents have fallen sharply this year – so the near-term risk of a material pick-up in construction costs looks modest. Rental inflation is the only evident area of migration-driven inflation pressure. And the migration inflow itself is likely to slow: a weaker economy is a less appealing destination, and the government is prepared to tighten entry criteria to make the inflow more sustainable.

In short, we think the RBNZ is already putting enough squeeze on that it a) won't need to lift the OCR further, and b) will find itself cutting the OCR much sooner than it has been expecting.





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