Economic Analysis - New Zealand To Wait Until 2020 Before Easing Further

07 Aug 2019 | New Zealand | Monetary Policy

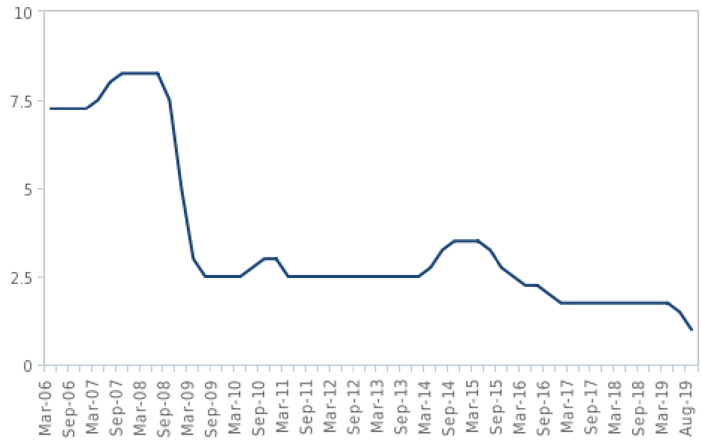
Key View

- We at Fitch Solutions expect the Reserve Bank of New Zealand to maintain its dovish policy stance through 2019, keeping its key policy rate on hold at 1.00%, following a 50 basis point cut at its August 7 monetary policy meeting.
- However, we expect further easing by mid-2020, with the reserve bank lowering its official cash rate by 25 basis points to 0.75%.
- Our view is informed by slowing growth in New Zealand's major trading partners, continued weak domestic business sentiment and downward pressure on oil prices, which will weigh on inflation.

We at Fitch Solutions expect the Reserve Bank of New Zealand (RBNZ) to maintain its dovish policy stance over the coming quarters. The RBNZ slashed its official cash rate by 50 basis points (bps) to 1.00% from 1.50% at its August 7 meeting. This was the second time the RBNZ cut in 2019, following a 25bps cut in May, and came as a surprise to most observers as the Bloomberg consensus had been for a 25bps cut. **While we expect the RBNZ to keep rates on hold at this level through 2019, we now expect them to cut by 25bps to 0.75% in the first half of 2020.** Our view is informed by continued slowing growth in New Zealand's major export partners, a weak business environment, and lower oil prices which will put downward pressure on inflation.

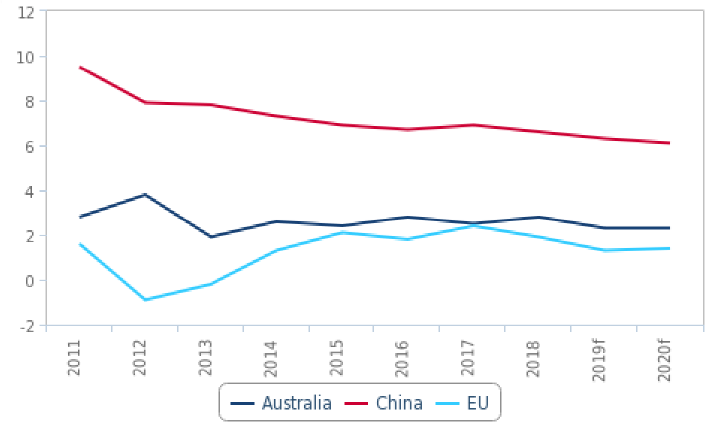
Clear Dovish Turn

New Zealand - Official Cash Rate (%)



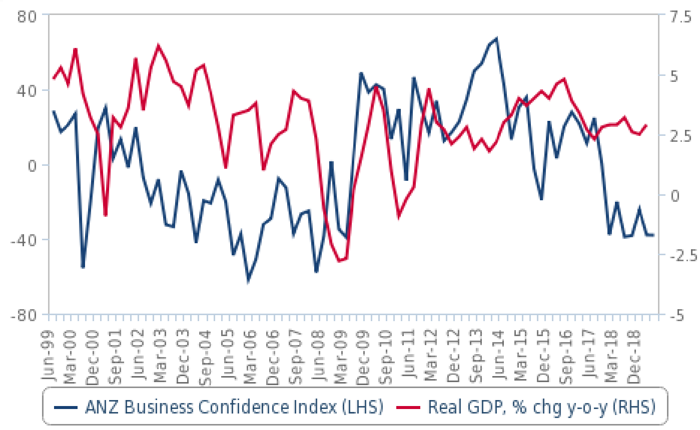
Source: Bloomberg, Fitch Solutions

We expect slowing growth in New Zealand's key trading partners to weigh on exports and support the RBNZ's decision to take a more accommodative monetary policy stance. We forecast global growth to slow to 2.7% in 2019, from 3.2% in 2018, amid escalating US-China trade tensions (*see 'New Tariffs Will Increase Headwinds To Global Growth', August 2*). In addition, we forecast the growth of New Zealand's largest trading partners, namely China, Australia, and the eurozone, which together account for about 45% of total exports, to slow to 2.3%, 6.3%, and 1.3% respectively in 2019, from 2.8%, 6.6%, and 1.9% in 2018. This is likely to reduce demand for New Zealand's exports, which comprises 31% of total GDP. The RBNZ acknowledged the impact of slowing global demand on New Zealand in its August monetary policy statement, stating that 'heightened global uncertainty was reducing investment and suppressing trading-partner growth'.



Source: Bloomberg, Fitch Solutions

In addition, we expect weak domestic business sentiment to weigh on employment growth and investment, thus keeping the RBNZ on an accommodative path. New Zealand's ANZ Business Confidence Index declined to -38.1 in June from -24.1 in December 2018, having been in contractionary territory since September 2017. This poor reading was led by the construction sector, with the residential construction index falling to -27.3 in May from -20.0 in April. This is likely to put downward pressure on investment and overall growth as businesses are likely cut back on capital spending if they expect business conditions to worsen. Reduced demand-side pressures, softening growth expectations, and a weaker domestic investment outlook will weigh on core inflation. This was again highlighted by the RBNZ in its monetary policy statement, which stated that 'if sentiment remained low...growth might not increase as anticipated over the medium term'.

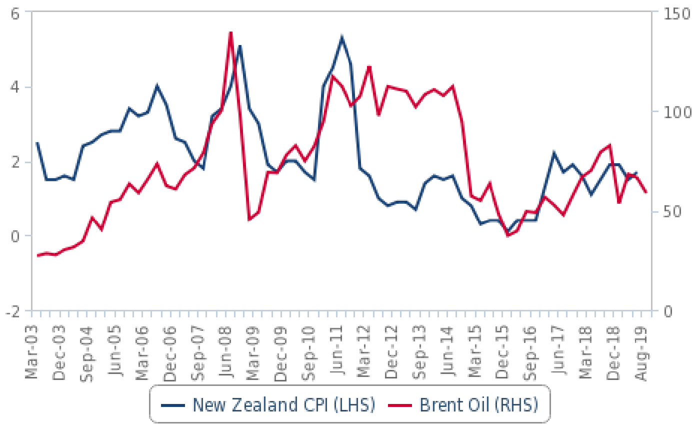


Source: ANZ, Bloomberg, Fitch Solutions

We expect low inflation over the coming quarters to lend support to our view for the RBNZ to keep rates accommodative. We forecast New Zealand's consumer price inflation to average 1.3% in 2019 from 1.6% in 2018 due to an expected fall in crude oil prices. Our **Oil & Gas team** has revised its Brent oil price forecast to average USD67.0 per barrel (/bbl) in 2019 and USD65.0/bbl in 2020, down from previous forecasts of USD70.0/bbl and USD76.0/bbl respectively, due to global trade tensions which have undercut both market sentiment and physical demand for oil (*see 'Brent: Global Trade Tensions Toppling Prices', August 5*). This will lead to decreased inflationary pressures in New Zealand, a net importer of oil, with imports of petroleum and petroleum-related products comprising the third largest category of total imports at 11.4%. With the July headline inflation rate reading coming in at 1.7% y-o-y, below the midpoint of the RBNZ's 1.0-3.0% range, this suggests that the RBNZ will keep rates low looking ahead.

Lower Brent Prices To Weigh On Inflation

New Zealand - Consumer Price Inflation (% chg y-o-y) & Brent Oil Price (USD/bbl)



Source: Bloomberg, Fitch Solutions

The risks to our forecast for one rate cut from the RBNZ in the first half of 2020 are tilted towards the downside. We note that the outlook for global growth is getting increasingly volatile, with the past week seeing an escalation in US-China trade tensions (*see 'Quick View: Currency Dispute A New Front In The US-China Trade War', August 6*). Furthermore, both the US and China still possess plenty of ammunition to escalate trade tariffs further. As New Zealand is a small open economy, an escalation in tensions would dampen its economic growth outlook and worsen labour market conditions, as well as lead to lower imported inflation. This would spur the RBNZ to cut rates sooner or by a larger degree than we anticipate.