RBNZ cuts OCR 25 bps and says "some further easing seems likely"; says further fall in NZ$ still necessary; cuts GDP growth view to 2.5% from 3%

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By Bernard Hickey

The Reserve Bank of New Zealand has cut the Official Cash Rate by 25 basis points to 3% as widely expected and has foreshadowed more rate cuts later this year.

But it also softened its call for a lower New Zealand dollar, which led to an immediate rise of around half a cent to 66.3 USc.

The bank chose not to cut by the 50 basis points that some had hoped, arguing that the sharp fall in the New Zealand dollar this year and higher oil prices would help lift annual inflation to close to the mid-point of the bank's 1-3% target range by early 2016.

Despite the currency fall, the Reserve Bank said further depreciation was needed given the weakness in commodity prices since the Reserve Bank's last full Monetary Policy Statement (MPS) on June 11.

Governor Graeme Wheeler said global economic growth remained moderate with only a gradual pick up in activity forecast. He highlighted recent developments in China and Europe that had led to heightened uncertainty and increased financial market volatility.

The New Zealand economy was growing at an annual rate of around 2.5% and was supported by low interest rates, construction activity and high net migration. The bank saw growth running at around 3% in its June MPS.

"However, the growth outlook is now softer than at the time of the June Statement," Wheeler said in the bank's seven paragraph 'in-between' statement, which is more limited than the full quarterly Monetary Policy Statements.

"Rebuild activity in Canterbury appears to have peaked, and the world price for New Zealand's dairy exports has fallen sharply," he said.

Wheeler noted headline inflation was currently below the bank's target range, "due largely to previous strength in the New Zealand dollar and a large decline in world oil prices."

He said inflation was expected to rise towards the mid-point of the range by early 2016 because of the New Zealand dollar's fall and those lower oil prices dropping out of the annual figure. "A key uncertainty is how quickly the exchange rate pass-through will occur," Wheeler said.

He commented that Auckland house prices continued to increase rapidly, but inflation outside Auckland remained generally low. "Increased building activity is underway in the Auckland region, but it will take some time for the imbalances in the housing market to be corrected," he said.

The significant fall in the New Zealand dollar since April and lower interest rates had significantly eased monetary conditions, he said.

"While the currency depreciation will provide support to the export and import competing sectors, further depreciation is necessary given the weakness in export commodity prices."

The Governor made no mention of the currency being unjustifiably and unsustainably high, as he has done in previous statements. The bank's June 11 MPS said "significant downward adjustment is justified" and needed to put New Zealand's net external position on a more sustainable path.

There was no mention of the net external position in today's statement. The Governor then summed up by saying: "A reduction in the OCR is warranted by the softening in the economic outlook and low inflation. At this point, some further easing seems likely."

The bank's June 11 statement said the first cut of 25 basis points to 3.25% was needed to ensure medium term inflation converged to the middle of the target. It also said then that it expected "further easing may be appropriate," which would "depend on the emerging data."

There was no mention of further easings being dependent on emerging data in today's statement.

Parsing the statements

The key differences between the June 11 statement and today's July 23 statement:

1. RBNZ cut its current GDP growth view to 2.5% from 3%

2. Wheeler called for further NZ dollar depreciation, but dropped the tougher language about a "further significant downward adjustment being justified"

3. The bank said the Christchurch rebuild activity appeared to have peaked, which it did not mention in its opening statement on June 11

4. The bank said "some further easing seems likely," which was slightly firmer than its June 11 statement, which said further easing "may be appropriate," but would "depend on the emerging data." Today's statement included no such caveat.

Economist reaction

ASB Chief Economist Nick Tuffley said the Reserve Bank had maintained a clear easing bias. He said the immediate lift in the New Zealand dollar and New Zealand wholesale interest rates after the statement, likely reflected "the market unwinding a small speculative position of a 50 basis point rate cut."

"Given the RBNZ has signalled further rate cuts, and we see downside to the RBNZ's inflation outlook, there remains scope for the NZD and NZ interest rates to continue to move lower over time," Tuffley said.

Westpac Chief Economist Dominick Stephens said the bank was clearly signalling deeper cuts than the 3% mid-point suggested in its June MPS.

"The RBNZ's policy guidance is now a rather blunt "At this point, some further easing seems likely." This is a clear signal for another cut in September," Stephens said.

"The RBNZ generally softened its rhetoric on the exchange rate. The RBNZ moved away from the key words "unjustified and unsustainable", instead opting to to say "further depreciation is necessary," he said.

"This Statement was not as dovish as markets were prepared for, particularly concerning the exchange rate. The exchange rate has risen half a cent, and swap rates have risen five basis points," he said, adding he didn't agree with the OCR profile implied by that market reaction.

"There was nothing in this statement to cause us to alter our forecasts. We are not surprised that the RBNZ sees the need for further cuts. However, we are also unsurprised that the RBNZ has moved relatively cautiously at this one-page OCR Review. We are braced for bolder articulation of the RBNZ's plans at the full Monetary Policy Statement in September, or in a speech in the week or two ahead."

Stephens stuck with his view the OCR would fall to 2% with a 50 basis point cut possible on September 10 with the next MPS.

ANZ Senior Economist Mark Smith said the Reserve Bank's easing bias was clear to see in the statement, "although it was perhaps not as dovish as some had expected."

Smith said ANZ still expected the OCR to return to 2.5%.

"The RBNZ has upped its rhetoric on cuts – “further easings seems likely” is a step up from “further easing may be appropriate”, but it doesn’t smack of them being in a hurry to cut," Smith said.

He said the bank's language on the New Zealand dollar was changed "with the market-sensitive words of “unjustified” and “unsustainable” not included."

"The RBNZ still wants the NZ$ to fall given the commodity price backdrop, but it appears the RBNZ’s pressing need for a sharp decline has eased."