Economic Alert

MONETARY POLICY STATEMENT — JULY 2024

Wednesday, 10 July 2024

"The Committee reached a consensus to maintain the Official Cash Rate ("OCR") at 5.50 percent."

As expected:

"The Committee agreed that monetary policy will need to remain restrictive. The extent of this restraint will be tempered over time consistent with the expected decline in inflation pressures."

But there was some good news:

"The Committee agreed that New Zealand's restrictive monetary policy is reducing domestic demand and consumer price inflation. The Committee is confident that inflation will return to within its 1.0%-3.0% target range over the second half of 2024."

And some not so good news:

"The Committee noted that recent higher frequency indicators suggest that near-term growth in business activity has weakened. A range of business and consumer surveys, and higher frequency spending and credit data, all point to declining activity."

We won't mention non-tradeable inflation, but ...

"Domestic inflation measures remain more persistent, but growing excess capacity in the domestic economy provides greater certainty that they will sustainably decline."

Could this be construed as good news?

"The Committee discussed the balance of risks to the inflation outlook. Members noted a risk that domestically driven inflation could be more persistent in the near term. However, there is also a risk that price setting behaviour and inflation expectations could normalise more rapidly as headline inflation declines."

Comment:

While the statement emphasised that monetary policy needs to remain restrictive, at least it provided some positivity given the references that, "*the extent of this restraint will be tempered over time*" and that, "*inflation expectations could normalise more rapidly as headline inflation declines.*" True, there was no explicit references to OCR cuts, but there is a softening in tone from the May *Monetary Policy Statement*. Furthermore, the reference that inflation is projected to return to its 1.0%-3.0% band in the second half of this year does support the Reserve Bank of New Zealand's ("RBNZ") ability to cut the OCR given its mandate is to have inflation within its band over the medium term.

Simply put, this statement represents the RBNZ stepping back from the hawkishness of its May 'no cuts till 2025' statement, to laying the groundwork for the cutting cycle, but when this will ultimately start remains the question du jour!

Market Implications:

The 'dovishness' of the statement immediately weighed on the NZD as it dropped against its major trading partners. This saw NZD/USD fall through the 0.6100 level, while the NZD/AUD traded at an 18-month low of 0.9020. There was a similar move in the swaps market with rates immediately dropping 10bps-11bps at the short-end and 6-8bps at the longer-end to generate a flattening bias. The 2-year x 2-year forward starting swap has also fallen below the 3.90% level to be at 3.88%.