May 8, 2019

Reserve Bank of New Zealand Eases Monetary Policy

- **The Reserve Bank of New Zealand lowered the benchmark interest rate by 25 basis points to 1.50% and maintained a slight easing bias.**
- **Domestic and global growth concerns pose a threat to the central bank's employment and inflation objectives, necessitating the additional monetary stimulus.**

The Reserve Bank of New Zealand (RBNZ) lowered the Official Cash Rate by 25 basis points to 1.50% following today's monetary policy meeting, taking the benchmark interest rate to a new record low (chart 1). The rate cut was preceded by a clear easing bias expressed at the prior meeting in March. We assess that the RBNZ's communications continue to have a dovish tone, with forecasts implying potential for a further rate cut over the coming quarters.

Today marked the first decision for the new Monetary Policy Committee (MPC), which was established after New Zealand's revised monetary policy framework became effective on April 1, 2019. The MPC consists of four members from the RBNZ and three external members. The new policy framework includes an employment objective to complement's the RBNZ's inflation-targeting policy approach. The MPC will conduct monetary policy in order to maintain price stability, keeping annual CPI inflation in the 1–3% range over the medium-term, while supporting maximum sustainable employment. Under the new framework, the MPC will explicitly express its labour market projections.

The decision to ease monetary policy reflects rising concerns regarding the health of the economy. The MPC noted that domestic economic growth momentum has continued to slow, while the external backdrop—driven by persistent trade concerns—remains uncertain. Despite the fact that New Zealand's labour market is currently near its maximum employment level, the challenging economic environment will likely adversely impact employment conditions over the coming months; accordingly, the MPC needed to inject further monetary stimulus into the economy in order to continue meeting the new maximum employment objective.

New Zealand's weak inflationary pressures allowed for further monetary easing. Headline inflation remains within the RBNZ's 1–3% y/y target, yet at 1.5% y/y in Q1 2019 the inflation rate is below the 2% mid-point (chart 2). The RBNZ expects inflationary pressures to build only slowly on the back of lower capacity pressure and slower domestic real GDP growth, with headline inflation projected to reach the 2% mark only in Q2 2021.

Against the rather muted backdrop, the RBNZ has left the door open for one more benchmark rate reduction, should domestic and global developments necessitate it. Indeed, the RBNZ's projections show the Official Cash rate averaging 1.4% in 2020.

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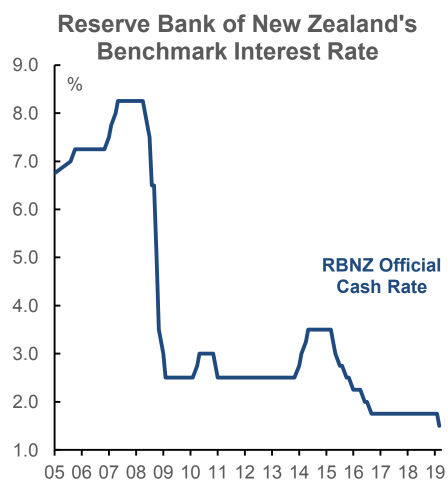
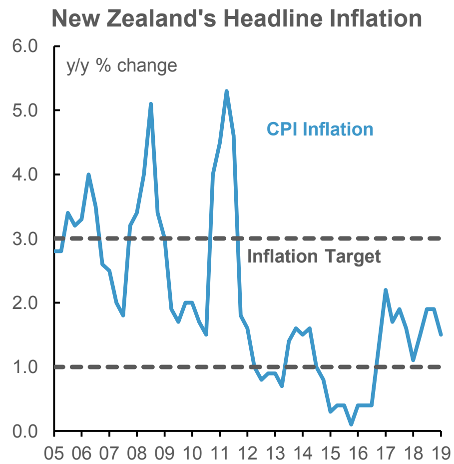
Chart 1



Sources: Scotiabank Economics, Bloomberg.

Chart 2



Sources: Scotiabank Economics, Bloomberg.