

New Zealand economic update

RBNZ OCR announcement

RBNZ on hold, and acknowledges increased uncertainty on the global stage

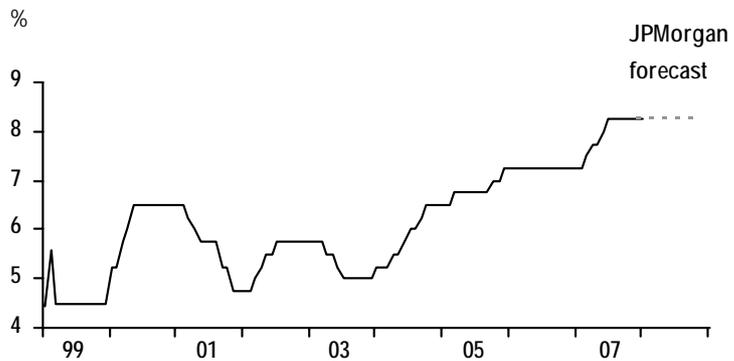
The RBNZ this morning left the official cash rate (OCR) unchanged at a record high 8.25% (JPMorgan and consensus 8.25%). The commentary reinforced the bank's tightening bias delivered in the December monetary policy statement, but acknowledged increased uncertainty around the growth outlook due to developments on the international stage. The key takeaway comment from the commentary was the final line, which stated, "Although CPI inflation is expected to remain above 3 percent during 2008, we believe that the current level of the OCR remains consistent with future inflation outcomes of 1 to 3 percent on average over the medium term."

Governor Bollard mentioned the cooling in the housing market, but emphasized his continued concern over the upside risks to the inflation trajectory from an expansionary fiscal policy, rising food and energy prices, and the introduction of the Emissions Trading Scheme - which will add further pressure to inflation next year. The continual mention of an expansionary fiscal policy should send shivers down a few spines in the parliamentary Beehive as the RBNZ will not tolerate excessive government spending in an election year (New Zealand's parliamentary election is likely to be held in October 2008). Although not our forecast, another tightening would be a result of the RBNZ counteracting an overly stimulatory fiscal package, and be damaging to the government's re-election chances.

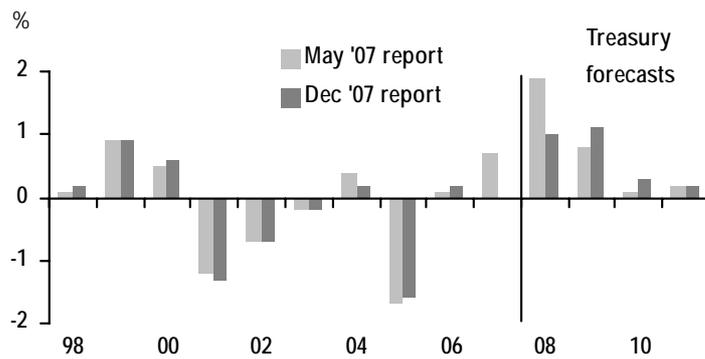
One key development to watch over the course of 2008 is the evolution of the government's expansionary fiscal policy heading into the election. The government should heed lessons learned in Australia, where fiscal policy largesse leading into the election contributed to the RBA tightening that probably had adverse effects come election day. The RBNZ will continue to focus on fiscal developments like a hawk, and lock horns with the government over the extent of fiscal stimulus likely to be unleashed this election year.

ith regards to international developments, Governor Bollard stated that the level of uncertainty has increased. "Since the December Monetary Policy Statement there has been ongoing turbulence in international financial markets and a deterioration in the outlook for the United States and European economies. We will be watching these developments closely, particularly their implications for the Asian and Australian economies and for world commodity prices." Provided the Asia-Pacific region holds strong over coming quarters, the RBNZ will remain on hold and likely maintain a mild tightening bias.

RBNZ official cash rate



New Zealand: Treasury fiscal impulse forecasts



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