J.P.Morgan

Economic Research
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New Zealand Economic Update

RBNZ OCR announcement

The RBNZ today cut the official cash rate (OCR) 150bp to 5% (JPMorgan and consensus -150bp), taking monetary policy to an “expansionary” position. The OCR has now been lowered 325bp since July.

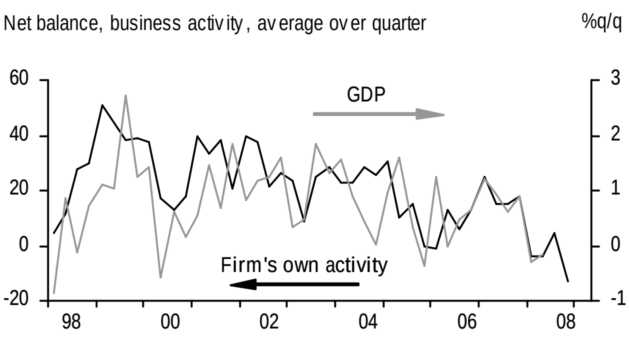
RBNZ Governor Alan Bollard said that “ongoing financial market turmoil and the marked deterioration in the outlook for global growth” played a large role in shaping the decision. Indeed, the announcement followed dismal news this week on global manufacturing, including another fall in the US ISM and record low PMIs in some of New Zealand’s major trading partners; this will “constrain” growth in economic activity in New Zealand.

The RBNZ is still wary that domestically generated inflation remains elevated, particularly local body rates and electricity prices. The Bank is confident, though, that annual inflation will return comfortably inside the target band of 1-3% in 2H09. As indicated by data last week, pipeline pressures and inflation expectations have started to ease and, on our forecasts, inflation will fall below the RBNZ’s target range by 4Q09. The rising prospect that inflation will fall significantly over the next year points to the need for more assertive policy easing.

The Kiwi economy already has contracted for two straight quarters and, on our forecasts, GDP should decline for at least another three. “Given recent developments in the global economy, the balance of risks to activity and inflation are to the downside,” according to the RBNZ. The RBNZ does forecast that New Zealand will recover “sharply” from recession. We forecast annual GDP growth to rebound to 2.8% in 2010 from just 0.3% in 2009.

In the near term, however, falling house prices and rising job losses make the outlook for already weak household spending particularly bleak. Lower interest rates and personal income tax cuts may provide something of a floor, but these will be undermined to a large extent by low confidence, mainly because of increased anxiety about job security. Indeed, firms look set to shed additional human capital, with 86% of respondents to the recent business survey expecting the unemployment rate to rise in the coming year (up from 79% previously).

New Zealand: NBNZ business outlook survey and GDP growth



The certifying analyst(s) is indicated by the notation “AC.” See last page of the report for analyst certification and important legal and regulatory disclosures.

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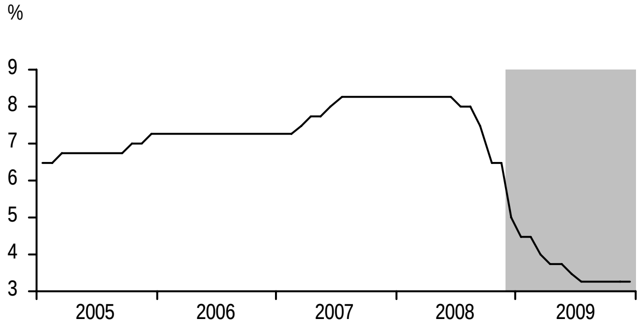
The RBNZ says that further adjustments to the OCR will depend on “emerging developments in the global and domestic economies and the response to policy changes already in place.” On that note, **we maintain our forecast of a terminal RBNZ cash rate of 3.25%.** One factor arguing against an even lower terminal cash rate is the forthcoming fiscal stimulus, which the RBNZ said would, alongside OCR cuts and the falling NZD, help to “provide substantial support to demand over the period ahead.” The government’s fiscal stimulus package is expected to inject about NZ$7 billion into the economy over the next two years, or about 4% of GDP.

New Zealand: RBNZ official cash rate



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