Monthly Economic Indicators

THE TREASURY
Kaitohutohu Kaupapa Rawa

April 2014

Executive Summary

- **Recent developments continued to suggest a strong pace of growth in the March quarter.**
- **While annual inflation eased to 1.5% in the quarter, rising demand is expected to lead to greater price pressures, and the Reserve Bank raised the OCR again in April.**
- **International economic data were broadly positive, although risks remain in some areas.**

Data releases in April point to continuing strong economic growth in the March quarter, boosted by household consumption, residential construction, improvements in the labour market and the elevated terms of trade.

Domestic demand and inflationary pressures are projected to rise. The Quarterly Survey of Business Opinion shows that business confidence remained close to a two-decade high in the March quarter, while consumer confidence was also at an elevated level and likely boosted by a stronger labour market. These and other indicators reinforce expectations of strong investment and household consumption in 2014.

While annual inflation eased to 1.5% in the March quarter, increasing capacity constraints are likely to gradually lead to greater price pressures. The Reserve Bank raised the Official Cash Rate by 25 basis points in April following the start of its monetary tightening cycle in March, which – as it continues – will moderate domestic demand.

Goods exports rose 15% in the year to March, driven by robust demand from China. Strong growth in short-term visitor arrivals points to higher tourist spending in the March quarter, which boosts services exports. However, dairy auction prices are easing from historically elevated levels.

All told, recent developments suggest an above-potential rate of real growth in the March quarter, and the outlook for 2014 and 2015 appears slightly stronger than expected in the *Half Year Economic and Fiscal Update.*

Developments in the international economy were positive in April. The Australian labour market showed tentative signs of recovery and US activity strengthened as the harsh winter receded. China's growth in the March quarter was close to target at 7.4% on a year ago.

This month's Special Topic looks at forward guidance on monetary policy by central banks in major advanced economies during and after the global financial crisis.

New Zealand Government

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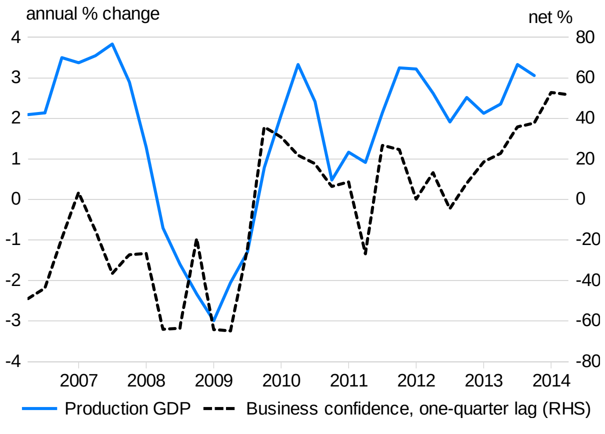
Ongoing signs of strong expansion in activity

Economic activity appears to have continued to expand at a similar, fast pace in the March quarter as in the December quarter. Strong net migration inflows and residential construction and the historically high terms of trade led to elevated levels of consumer and business confidence. Altogether, data released over April continued to point to strong growth in private consumption and business investment, and also rising inflationary pressures in 2014. However, the economic outlook also includes headwinds that will eventually impact on growth, including easing dairy prices, monetary tightening and an expected slowdown in house price growth. Nevertheless, recent developments appear slightly stronger than in the Treasury's *Half Year Economic and Fiscal Update* (HYEFU) forecasts, and reinforce expectations of slightly higher real GDP growth in 2014 and 2015. An updated set of forecasts will be included in the *Budget Economic and Fiscal Update* to be released on 15 May.

Buoyant business confidence and activity...

Business sentiment was buoyant in early 2014. The Quarterly Survey of Business Opinion (QSBO) showed that business confidence in the economic outlook over the next 6 months was close to a 20-year high in the March quarter, while expectations of trading conditions reached a 14-year high. Buoyant business sentiment reflects elevated export prices, higher consumer spending and the pick-up in residential construction, and points to strong GDP growth in coming quarters (Figure 1).

Figure 1: Business confidence and GDP



Sources: Statistics NZ, NZIER

The ANZ Business Outlook also showed that business confidence was high in April. Despite easing 2.5% points, a net 64.8% of respondents expressed optimism on future conditions. A rising trend in confidence was evident across most industries, particularly the retail and construction sectors, which is a sign of the strong momentum in domestic demand. However, the recent easing in dairy prices from an elevated level led to a drop in confidence in the agricultural sector.

Business activity also strengthened in March. The BNZ-BusinessNZ Performance of Manufacturing Index (PMI) rose 1.9 points to 58.4 and has remained in expansionary territory for 19 consecutive months, while the Performance of Services Index (PSI) rose by 5.5 points to 58.3, the highest since late 2007. The two indices indicate strong growth in manufacturing and services activity.

...and ongoing labour market improvement...

There were also further signs of a stronger labour market. ANZ job advertisements increased 1.1% in March to be up 13.2% on a year ago, with the growth in adverts picking up since late 2013. In addition, improvements in the employment series in the BNZ-BusinessNZ PMI from the middle of last year, and greater difficulty in finding both skilled and unskilled workers (according to the QSBO), both reflect solid growth in the demand for labour. Overall, recent data suggest continuing strong employment growth in 2014. March quarter labour market data will be released on 7 May.

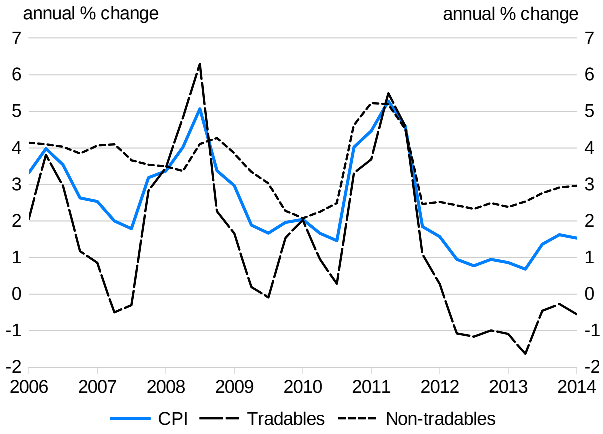
...in addition to elevated consumer sentiment...

Elevated consumer sentiment reinforced expectations of an upswing in household consumption in 2014. The seasonally-adjusted ANZ-Roy Morgan Consumer Confidence Index was close to a 9-year high at 134.3 despite having eased 1.2 points in April. While total electronic card spending dipped 0.2% in March, it was still up by a solid 0.9% in the March quarter. All told, economic data continued to convey a robust near-term outlook for household consumption.

...point to price pressures in coming quarters

The annual rate of Consumers Price Index (CPI) inflation was down slightly to 1.5% in the March quarter (Figure 2), despite the positive momentum in the domestic economy. The quarterly CPI increase of 0.3% was driven by higher tobacco excise duties and a rise in housing costs, and would have been negative if these categories were excluded. Annual tradables inflation fell 0.3% points in the March quarter to -0.6%, owing primarily to the strong New Zealand Dollar (NZD) and the ongoing discounting of durable goods by retailers. However, annual non-tradables inflation was up by 0.1% point to 3.0%, reflecting higher rents and property rates, and price increases in services.

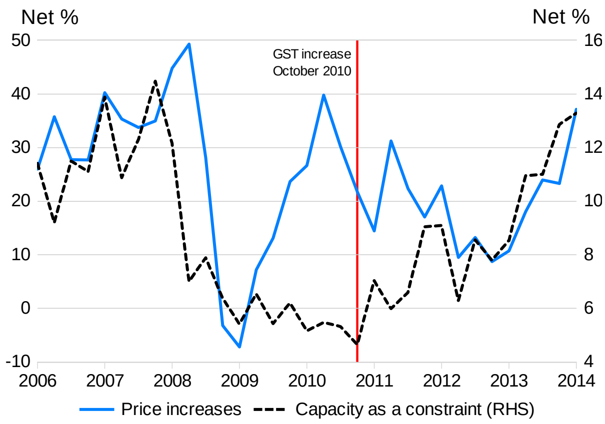
Figure 2: Consumer price inflation



Source: Statistics NZ

Inflationary pressures are expected to increase later in 2014 and in 2015 as strong growth in domestic demand leads to increasing capacity constraints in the economy. An increasing percentage of QSBO respondents expect capacity to be the main constraint on expanding output in coming quarters, which is leading to higher pricing intentions (Figure 3).

Figure 3: QSBO capacity constraints and pricing intentions



Source: NZIER

Rising wages, as the labour market picks up, are likely to further lift non-tradables inflation, particularly for services, while an anticipated end to exchange rate appreciation in the near term is also expected to lead to a rise in tradables inflation.

Monetary tightening is expected to continue...

In response to this rising inflationary pressure, the Reserve Bank of New Zealand raised the Official Cash Rate (OCR) on 24 April by a further 25 basis points to 3.0%, following the start of its monetary tightening cycle in March. The Reserve Bank's projections of 90-day rates in its Monetary Policy Statement released in March suggest that the OCR will be increased through until mid-2016 by an additional 200 basis points, although the higher NZD and the weaker inflation outturn in the March quarter may have an effect on future policy decisions. The market has priced in around 80 basis points of additional OCR increases (as of 30 April) to 3.8% by March 2015. Forecasters on average expect the OCR to peak at 5% in late 2016, above a widely perceived neutral rate of 4.5%.

...eventually leading to some moderation in domestic demand...

Rising interest rates will increase borrowing costs for firms and households, and support the high exchange rate to an extent, which will lead to a degree of moderation in economic momentum. Nevertheless, private consumption is expected to remain strong in the near term, supported by the Canterbury rebuild and strong inward migration. Also positively, long-term interest rates are likely to rise by only a small margin, although short-term lending rates are already increasing.

...especially in housing demand

The Reserve Bank's loan-to-value ratio (LVR) restrictions appear to have had a larger impact than initially expected as house sales dropped 10% from a year ago in March, according to the latest REINZ survey, led by lower-priced properties. However, the shift in the composition of sales towards higher-priced properties led to *higher* annual growth in the REINZ house price index in March (up 1.0% point to 9.2%). The Quotable Value measure of house prices, which adjusts for this distortion, showed that annual price growth moderated in the December quarter. There is currently a degree of uncertainty around house price data, although price growth is still expected to soften given weaker turnover in the market and rising mortgage rates.

Housing demand will be supported to an extent by the level of net migration. The seasonally-adjusted net inflow of 3,840 permanent and long-term migrants in March was the second highest monthly gain on record. Net migration in the year to March was also elevated at 31,910, driven by a lower net loss of migrants to Australia owing to its soft economic outlook. High net migration inflows are expected to support house prices and reinforce the positive momentum in domestic demand.

On the housing supply side, the number of dwelling consents surged 8.3% in March to be up 37% on March 2013. Growth in consents in the March quarter was more modest at 0.6% owing to a large drop in the highly volatile apartments component. Total consents are now at levels similar to late 2007, driven primarily by Auckland and the earthquake rebuild in Christchurch. The turnaround in consents is positive for residential investment growth over the middle of this year, and is expected to contribute to GDP growth.

Robust growth in export values in the March quarter...

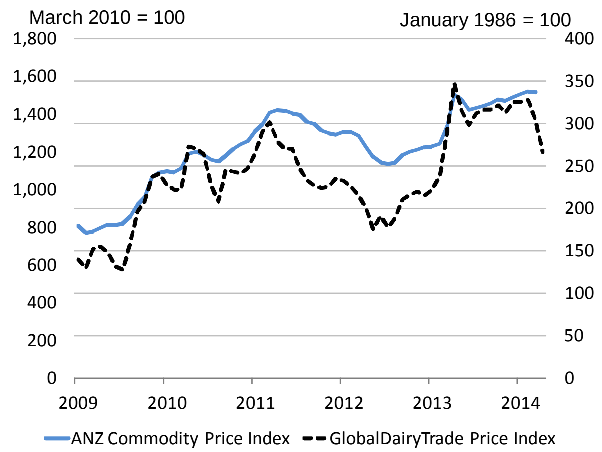
High commodity prices lifted the goods trade surplus to an elevated level in the March quarter, which points to a narrowing in the annual current account deficit in the first quarter of 2014. Overseas Merchandise Trade data showed 16% annual growth ($635 million) in export values in February, and 15% ($671 million) in March. The strength in goods exports was driven by strong demand from China, with shipments to China up 54% annually compared to the March quarter of 2013. The annual goods trade surplus rose $188 million to $920 million in March as growth in exports outstripped that of imports.

Growth in services exports is likely to have been solid in the March quarter. Short-term visitor arrivals fell 3.0% in the March month, but remained 5.4% higher in the year to March owing to a 14% increase in Chinese visitors. The number of short-term visitors rose 4.3% in the March quarter overall, and will likely boost total tourist spending despite the high exchange rate.

...although dairy prices have eased

Global dairy prices have started to ease following their rise to historically high levels in 2013 (Figure 4). The GlobalDairyTrade (GDT) price index has fallen consecutively for the last five bimonthly auctions, to be down 25% in the middle of April from a 5-year high in April 2013. The ANZ World Commodity Price Index eased 0.1% in March, due primarily to a 3.6% fall in dairy prices, with a broad lift in meat and seafood prices. Signs of falling commodity prices support expectations of an early to mid-2014 peak in the terms of trade, which are expected to gradually decline in the second half of the year as dairy supply expands both in New Zealand and abroad.

Figure 4: Dairy and general commodity prices

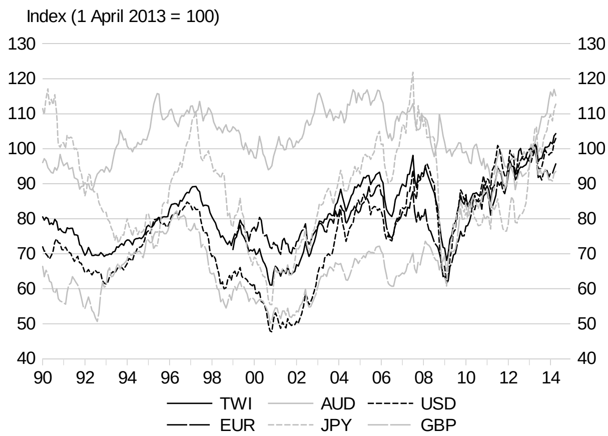


Sources: ANZ, GlobalDairyTrade

TWI is at a post-float high

Robust growth in export values, the tightening of monetary policy ahead of other advanced economies and the generally positive outlook for economic growth have resulted in the NZD Trade Weighted Index (TWI) reaching elevated levels. The TWI was at a record post-float level of 78.7 in the March quarter, and rose a further 1.9% to a new record high of 80.2 in April. Its recent increases were owing to NZD strength against all the major currencies (Figure 5), although its level has eased slightly recently. The NZD/USD rate was at a high level of 0.86 on average in April, with the earlier weakness in US economic data and more dovish comments by the Federal Reserve in the month contributing to the USD weakness.

Figure 5: NZD vs. major currencies



Source: Reserve Bank of New Zealand

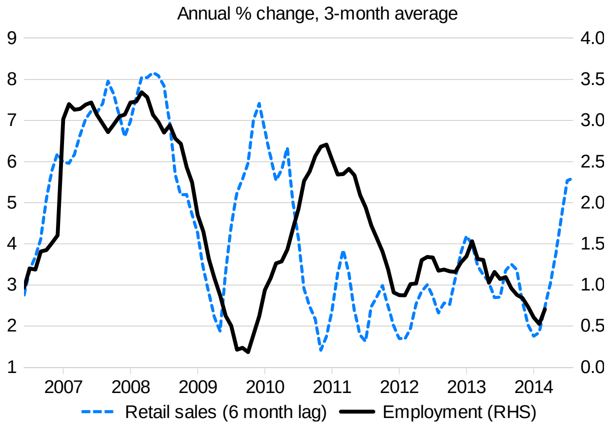
Positive global economic developments...

Global activity was strong towards the end of the March quarter. The Australian jobs market showed a tentative recovery and China's GDP exceeded expectations, while the US economy rebounded as the effect of the harsh winter receded.

...as low interest rates supported the recovery in Australia...

Easy credit conditions continued to bolster private-sector spending in Australia. Low mortgage rates led to strong annual growth in new housing lending and new home sales in February. The modest 0.2% growth in retail sales followed a strong January outturn and maintained their upward trend (Figure 6). The NAB business conditions index rose, although confidence continued to fall from its post-election highs.

Figure 6: Australian retail sales and employment growth



Source: Haver, Australian Bureau of Statistics

The recovery in spending and activity may be starting to support the labour market (Figure 6). Employment rose 0.2% in March, sustaining its upswing in February and beating expectations of a flat outturn. The unemployment rate fell 0.3% points to 5.8%. Analysts expect jobs growth to strengthen as activity recovers, but many still predict a rise in the unemployment rate over 2014. Annual inflation rose to 2.9% in the March quarter, but below expectations (3.2%), which – together with the recent AUD appreciation – reinforces the RBA's stated intention to hold its policy rate at a low level for some time.

...and China's Q1 GDP beat expectations...

The Chinese economy grew 7.4% from a year ago in the March quarter, above analyst expectations, but still historically soft and reflected slow growth in industrial production (IP), retail sales and investment, and low PMIs. Exports and imports plunged 6.6% and 11.3% from a year ago in March, respectively, which negatively affected global equity prices. However, export data were distorted by false export invoicing last year (to hide illegal capital flows) and should not be taken at face value.

The Chinese government provided limited support to ensure that growth meets the 2014 target of 7.5%. Authorities introduced a small fiscal stimulus package and cut the required reserve ratio for selected rural banks. The PBoC has room to ease monetary policy, as annual inflation in March (2.4%) was below target (3.5%) and measures in the housing market appear to have been effective at dampening housing demand.

...while US activity rebounds...

Growth in the US economy was only 0.1% at an annualised rate in the March quarter as a result of the harsh winter, but activity has picked up as the effects of the bad weather receded. The ISM manufacturing PMI (53.7) and the non-manufacturing PMI (53.1) indicated solid growth in activity in March. IP rose 0.7%, retail sales rebounded 1.1%, and consumer confidence improved in April. Non-farm payrolls grew by a solid 192,000 in March, although were lower than expectations, and the unemployment rate was steady at 6.7%. However, the housing market remained soft, with a sharp drop in home sales, and the annual growth in house prices has started to slow.

Fed Chair Yellen restated the need for monetary accommodation after her earlier comments were perceived as less supportive, and the Fed's March meeting minutes were seen as dovish. These releases supported the low USD and the strong US equity market. The Fed pared monthly asset purchases by US$10 billion to $45 billion starting in May.

...but Japan's outlook softens after tax rise

While activity in Japan appeared solid in the March quarter, the outlook is weaker. Retail sales surged 6.3% in March ahead of the sales tax rise on 1 April, and the manufacturing PMI was strong (53.9). Growth in IP was strong over the March quarter at 2.9% and continued its rising trend. Looking ahead, the BoJ remains upbeat on the economic outlook and expects low interest rates to boost investment. However, firms in the March Tankan survey expect trading conditions to deteriorate in coming quarters, reflecting concerns about the tax rise and the recovery. While the sales tax and inflation have risen, nominal wage growth remained relatively weak.

Euro area recovery amidst low inflation...

Disinflationary risks are becoming more evident in the euro area. Annual inflation was low in March and April at 0.5% and 0.7% respectively, and producer prices have contracted for ten consecutive months, while some peripheral economies (e.g. Spain and Greece) experienced deflation. The ECB refrained from policy action at its April meeting, but noted the lower-than-expected inflation and that it has considered QE. Governing Council members also indicated concerns over the strong euro that is suppressing tradables inflation and exports.

Economic data were positive despite the weak inflation. IP was up 1.7% annually in February, retail sales were positive (0.4%), while the manufacturing PMI (53.3) and the services PMI (53.1) indicated solid growth in activity in April. The unemployment rate remained at 11.9% in February.

...helped by cyclical pick-up in the UK

The UK economy grew at a strong pace of 0.8% in the March quarter, as had been indicated by various business indicators: the manufacturing PMI (55.3), the services PMI (57.6), the construction PMI (62.5), and a 0.9% expansion in IP in February. The average unemployment rate in the three months to February dropped 0.3% points from the three months to January to 6.9% and real wages are beginning to rise as inflation has fallen (to 1.6% in March).

Economic momentum is set to continue

Broadly positive economic data for both the NZ and the global economy in April continued to point to an above-potential rate of growth in New Zealand in the March quarter, driven by strong external demand for commodities, residential investment and household consumption, the last two of which are boosted by elevated net migration. Buoyant business and household sentiment also reflect the current strong economic momentum. A gradually strengthening international economy is also positive for the outlook. Rising capacity constraints, the beginning of monetary tightening and slower growth in house prices are expected to merely constrain the strong pace of growth, as solid economic momentum remains.

Special Topic: Forward Guidance on Monetary Policy

Since 2008 many central banks in advanced economies have been *explicitly* indicating their future monetary policy intentions. Explicit forward guidance (FG) about why and how long they plan to continue with their monetary stimulus is intended to avoid market interest rates increasing earlier than required. This change has been useful in providing additional information about the unconventional monetary stimulus that has persisted long after the global financial crisis (GFC) in many advanced economies. Before the GFC, the Reserve Bank of New Zealand (RBNZ) (along with Sweden's Riksbank and Norway's Norges Bank) was in the small minority of central banks that published FG in the form of interest rate forecasts. Now central banks which are constrained with policy rates close to zero are using FG as a monetary tool to manage long-term interest rates.

This note introduces the different forms of FG that have been used by central banks since the GFC, their merits and disadvantages, and a comparison with FG in New Zealand. Two key points emerge. First, central banks have been adapting their FG as they face the challenges of communicating the likely conditions for continuing with their monetary stimulus. Second, more recently the RBNZ has been providing time-contingent forward guidance on its policy rate, supplementing its regular interest rate projections, in response to the GFC, Canterbury earthquakes and rapid increases in house prices.

The concept of forward guidance

FG shapes future interest rate expectations

Central banks now use FG to indicate in words their future monetary policy stance (policy rates and quantitative interventions) conditional upon the economic outlook. By announcing their future monetary stance, central banks aim to influence expected short-term interest rates that are a key component of long-term rates.[1] It is mostly those central banks with short-term policy rates constrained at the effective lower bound since the GFC in 2008, and which wish to continue with their current stimulus, that are using FG to push down long-term interest rates. On the other hand, FG, in terms of published interest rate forecasts, is merely intended to form an input into the market's interest rate expectations rather than to actively influence them.

The key challenge for central banks in managing long-term interest rates is that the markets *believe* in the FG, while the central banks themselves do not pre-commit to a stance that they have to retract later (Woodford, 2013). When stimulus drives inflation above target, markets tend to expect the central banks to renege on their FG. Equally, managing an orderly unwinding of the stimulus during the economic recovery phase without market disruption through FG also remains challenging for these central banks.

The forms of forward guidance

FG evolved from open-ended to time-contingent and to state-contingent guidance in the major advanced economies

Since the GFC, central banks have adopted three forms of FG[2] to specify the duration of their current stimulus depending upon the stage of the crisis in their economies. The central banks in economies in deep crisis (Bank of Japan and the European Central Bank) have maintained open-ended time commitments for continuing with their monetary stimulus since they were uncertain when the recovery would start. This open-ended stance has provided them with flexibility to respond to unforeseen developments, but the ambiguity of such a stance makes it difficult to interpret.

The central banks which are more certain about their economic recoveries (the Bank of Canada and Riksbank) have provided time-contingent guidance by specifying the date until which they intend to continue with monetary stimulus. However, such guidance may not be credible if economic conditions change close to that date, making markets uncertain how central banks would respond. To make their guidance more credible, the central banks which are more certain about the stage of recovery in their economies [US Federal Reserve Board (Fed) and Bank of England (BoE)] have tied reviewing their expansionary stance to an indicator, such as the unemployment rate crossing a threshold value, that can provide a warning about stretched supply capacities before inflationary pressures set in (Table 1).

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[1] Central banks are using both FG and quantitative easing (QE) to influence long-term rates. FG focuses on reducing expected short-term rates, while QE aims to lower long-term rates by reducing the term premia. Under QE, central banks buy assets and increase the funding available in the financial system.

[2] These forms of FG publicly *commit* central banks to a future policy rate stance ('Odyssean'), and differ from those showing merely central banks' macroeconomic forecasts and their likely policy actions ('Delphic') (Justiniao, *et.al* 2012).

Table 1: Forms of forward guidance

	Open-Ended	Time-Contingent	State-contingent
Nature	Indicates qualitatively the future monetary stance and broadly the conditions for change.	Indicates a future date for a review of the stance.	Ties the review of the stance to economic outcome once the chosen indicators cross their threshold values.
Merit	Allows flexibility in response.	Simple to interpret.	Helps market to update expectations.
Demerit	Difficult to interpret.	May not be credible if economic conditions change closer to that date.	May be difficult to interpret if the public is unaware of current values of indicators.
Central banks (Date adopted)	Bank of Japan (April 1999); Federal Reserve (August 2003); European Central Bank (July 2013).	Bank of Canada (April 2009); Riksbank (Sweden) (April 2009); Federal Reserve (August 2011).	Federal Reserve (December 2012); Bank of England (August 2013).

Source: Bank of England (2013)

Since the GFC, the Fed's FG progressed from an open-ended stance in December 2008 to a time-contingent stance in August 2011 and to state-contingent guidance in December 2012. At that time it kept the threshold for the unemployment rate at 6.5% for reviewing its current stance subject to the medium-term inflation projection being not more than 2.5%.[3]

The BoE introduced FG in the state-contingent form in August 2013. It kept the threshold target for the unemployment rate at 7% for reviewing its expansionary stance, subject to the achievement of medium-term price stability (expected CPI inflation 18-24 months ahead of not more than 2.5% and medium-term inflation expectations being anchored) and financial stability conditions (controllable by supervisory and regulatory tools).

Problems in using the unemployment rate as a guide for state-contingent FG surfaced when rapid falls in the unemployment rates in the US and the UK were driven by people withdrawing from the workforce rather than increases in employment. This led both the Fed and the BOE to link their forward monetary stance to multiple indicators.

Three factors have made FG more challenging than originally anticipated. First, in order to keep real long-term rates low, central banks have maintained higher than normal inflation targets for longer than markets would normally accept. Second, inflation is becoming less sensitive to output contractions and rising unemployment (IMF, 2014). Central banks initially included the unemployment rate, but then had to include other labour market indicators in order to monitor capacity utilisation more accurately. Financial indicators have also been included to monitor pressures on financial stability. Third, central banks have realised that they have to distinguish their guidance for the policy rate and quantitative stimulus. Addressing these issues, central banks, particularly the Fed and the BoE, have updated their guidance in recent months. As a result, the forms of FG are again becoming more open-ended about how long the central banks will continue with their stimulus.

The RBNZ has been providing FG in the form of interest rate forecasts and monetary policy judgements but has not used indicator-based guidance other than the inflation target

Since June 1997 the RBNZ has regularly published the interest rate (90-day bank bill rate) forecasts that it considers consistent with keeping inflation within the target range over the medium term. By doing so, it commits to the inflation target and quantifies the required future monetary policy adjustments. Alongside this, the RBNZ has given equal importance to the qualification of the risks surrounding those interest rate forecasts for shaping expected interest rates.

Since 2008 the RBNZ has also conveyed explicitly its judgements about future policy rates and their determinants as the New Zealand economy was hit by both domestic and international economic shocks. The judgements mattered for shaping interest rate expectations, particularly as the RBNZ kept the Official Cash Rate (OCR) unchanged at a historically low level for three years. The FG in those judgements played a key part in the RBNZ's signalling the timing of the OCR hike that occurred in March 2014.

[3] In December 2008, the Fed indicated that "weak economic conditions" were "likely to warrant exceptionally low levels of the Federal Funds rate for some time." In August 2011, it specified the time period for keeping its policy rate exceptionally low to "at least through mid-2013". In December 2012, it indicated that it would keep its policy rate exceptionally low until unemployment rate reached 6.5% subject to inflation projections of no more than 2.5% between one and two years out and evidence of well anchored long-term inflation expectations.

In some of its previous forward guidance, the RBNZ made explicit comments about the likely future track of interest rates; for example, in its March 2009 response to the GFC, it indicated that future OCR cuts would be smaller with no likelihood of reaching zero lower bound; in its response to the Christchurch earthquakes in March 2011, it stated that the OCR reduction was an insurance against near-term negative effects on the economy; in March 2013, it said that the OCR would remain unchanged until the end of the year; in December 2013, it said that demand and inflation pressures should warrant a withdrawal of stimulus beginning in 2014; and in March 2014, that the OCR will need to increase by 200 basis points over the next two years.

Through the above policy judgements, the market became more certain about the timing and the extent of the OCR tightening. Notably, however, the RBNZ has refrained from explicitly tying future monetary policy intentions to any economic indicators other than inflation.

The RBNZ is now giving guidance on the impact of the housing loan restrictions on monetary policy

The RBNZ coordinates the use of monetary and macro-prudential policies, formalised through the *Policy Targets Agreement, 2012* and the *Memorandum of Understanding on Macro-prudential Policy, 2013.* Monetary policy targets price stability and macro-prudential policy targets financial stability, but the two are coordinated to better achieve each other's objectives without compromising their own primary objectives. The RBNZ guides the extent to which its interest rate forecasts are based on support from macro-prudential policies or, in turn, support the latter's financial stability objective.

Accordingly, the RBNZ avoided increasing the OCR earlier than otherwise warranted, since the prudential policies restricting high loan-to-value ratio (LVR) mortgage lending, which it introduced in 2013 to dampen house price inflation and credit growth, were also expected to reduce the associated wealth and credit effects on overall demand and CPI inflation. After the RBNZ started its OCR tightening in March 2014, the LVR restrictions are expected to dampen house price inflation and reduce the CPI inflation pressures, similar in effect to a 25-50 basis points increase in the OCR (Spencer, 2014). With assistance from financial stability policies, a lower OCR would be required for targeting inflation. Conversely, progressive OCR increases are likely to dampen house price inflation and help in phasing out the LVR restrictions in a timely manner. This coordination is expected to increase the efficiency of the conduct of monetary policy.

The efficacy of forward guidance

More specificity in FG increases certainty around the monetary outlook but reduces the flexibility of central banks

With more specific guidance, a central bank reduces uncertainty but also increases the chances of a loss of credibility if it deviates from its indicated monetary stance at the trigger dates or as the indicator values are approached. If the market misinterprets time and threshold amendments, then FG would fail to shape long-term interest rates as expected. For instance, when the Swedish Riksbank cut its policy rate in April 2009 and projected it to remain unchanged until 2011, the market rates went up as the reduction in the policy rate was less than was expected. When the Fed did not taper its asset purchases in September 2013, as was widely expected, it confounded the market. After contrary market reactions, these two central banks amended their FG to regain market credibility for their monetary stance. Regardless of the form, what matters is that central banks convey the conditionality and possibility of change in the FG settings credibly. To ensure credibility, the RBNZ has been issuing quantitative and qualitative forms of FG consistent with its inflation mandate.

FG impacted long-term interest rates during the crisis and is expected to remain effective during normal times as well

Barring a few episodes, studies show that markets have reacted similarly to FG and quantitative easing (QE), and policy rate announcements in the advanced economies during the GFC (IMF, 2014). FG backed by QE reduced long-term bond yields, and FG is expected to remain a useful monetary policy tool even in tranquil times. For New Zealand, the market impact of the RBNZ's interest rate projections was found to be relevant up to two quarters into the future, with the impact reducing after the outbreak of the global financial crisis (Detmers and Nautz, 2012). The RBNZ's use of FG to convey monetary policy judgements on the OCR, as a supplementary tool to its interest rate forecasts, could provide additional information to the market on the interest rate outlook. Also, the RBNZ will be able to rely on FG more readily in the future to communicate how the OCR and macro-prudential instruments are likely to be coordinated in pursuit of price stability and financial stability objectives respectively.

Conclusion

Since the GFC, central banks in major advanced economies with policy rates at the effective lower bound have been using FG to communicate their intentions about the turning points in their future monetary policy. Second, FG forms evolved from open-ended to time-contingent and state-contingent guidance aiming at increasing market certainty around the monetary outlook. However, as the monetary stimulus has persisted in these economies, guidance is again becoming more open-ended in terms of an indicator watch-list to signal a change in monetary stance. Third, the RBNZ provided time-contingent forward judgements about the OCR as the New Zealand economy was hit by the GFC and Canterbury earthquake shocks. These judgements supplemented its regular FG in terms of interest rate forecasts and have been useful in shaping market expectations, especially in the light of the OCR remaining unchanged for three years, as well as signalling the impending hike that occurred in March 2014. The RBNZ is also providing FG on coordination of monetary and prudential policies in the context of LVR restrictions implemented to restrict home lending and house price increases.

While it is too early to evaluate the efficacy of FG, studies show that FG and QE together have been successful in influencing long-term interest rates during the global financial crisis. FG is expected to remain useful as policy rates rise back to normal levels. For New Zealand, as judgements about monetary policy supplement the regular forecasts, it is expected that FG would increase the efficiency of the conduct of monetary policy.

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Monthly Economic Indicators is a regular report prepared by the Modelling and Forecasting team of the Treasury.

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New Zealand Key Economic Data

30 April 2014

Quarterly Indicators

		2012Q3	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4	2014Q1
Gross Domestic Product (GDP)								
Real production GDP	qtr % chg[1]	0.2	1.2	0.5	0.4	1.2	0.9	...
	ann ave % chg	2.8	2.6	2.3	2.2	2.6	2.7	...
Real private consumption	qtr % chg[1]	0.1	1.3	0.9	1.0	0.4	1.2	...
	ann ave % chg	3.1	2.9	2.6	2.6	3.1	3.4	...
Real public consumption	qtr % chg[1]	0.2	0.2	-0.8	0.5	2.1	-0.5	...
	ann ave % chg	-0.9	-1.0	-0.6	-0.2	0.5	0.8	...
Real residential investment	qtr % chg[1]	3.8	2.8	7.6	-0.5	7.4	0.1	...
	ann ave % chg	14.0	15.7	19.3	17.9	17.5	17.4	...
Real non-residential investment	qtr % chg[1]	-2.2	1.1	0.8	7.4	0.1	0.9	...
	ann ave % chg	4.5	4.6	3.7	3.8	5.3	6.9	...
Export volumes	qtr % chg[1]	3.4	-0.7	2.0	-3.6	-0.4	3.1	...
	ann ave % chg	3.2	2.2	2.5	2.6	1.0	1.0	...
Import volumes	qtr % chg[1]	1.2	0.5	1.9	2.2	4.1	0.2	...
	ann ave % chg	2.2	2.6	1.2	2.4	4.6	6.3	...
Nominal GDP - expenditure basis	ann ave % chg	3.3	2.3	2.1	1.7	2.8	5.2	...
Real GDP per capita	ann ave % chg	2.0	1.9	1.6	1.6	1.9	2.0	...
Real Gross National Disposable Income	ann ave % chg	2.0	1.1	0.6	1.7	3.1	5.3	...
External Trade								
Current account balance (annual)	NZ$ millions	-7,744	-8,590	-8,349	-8,243	-8,870	-7,546	...
	% of GDP	-3.7	-4.1	-3.9	-3.9	-4.1	-3.4	...
Investment income balance (annual)	NZ$ millions	-9,645	-9,300	-9,327	-8,896	-8,972	-9,307	...
Merchandise terms of trade	qtr % chg	-3.2	-1.2	4.2	4.6	7.5	2.4	...
	ann % chg	-9.2	-8.9	-2.8	4.3	15.8	20.0	...
Prices								
CPI inflation	qtr % chg	0.3	-0.2	0.4	0.2	0.9	0.1	0.3
	ann % chg	0.8	0.9	0.9	0.7	1.4	1.6	1.5
Tradable inflation	ann % chg	-1.2	-1.0	-1.1	-1.6	-0.5	-0.3	-0.6
Non-tradable inflation	ann % chg	2.3	2.5	2.4	2.5	2.8	2.9	3.0
GDP deflator	ann % chg	-1.1	-2.2	0.1	0.2	3.2	6.9	...
Consumption deflator	ann % chg	0.4	0.6	0.4	0.1	0.6	0.8	...
Labour Market								
Employment (HLFS)	qtr % chg[1]	-0.4	0.5	0.2	0.4	1.2	1.1	...
	ann % chg[1]	0.0	0.4	0.4	0.7	2.4	3.0	...
Unemployment rate	%[1]	7.2	6.8	6.2	6.4	6.2	6.0	...
Participation rate	%[1]	68.4	68.2	67.9	68.1	68.6	68.9	...
LCI salary & wage rates - total (adjusted)[5]	qtr % chg	0.5	0.5	0.4	0.4	0.4	0.5	...
	ann % chg	1.9	1.8	1.8	1.7	1.6	1.6	...
QES average hourly earnings - total[5]	qtr % chg	1.1	-0.1	0.8	0.2	1.6	0.2	...
	ann % chg	2.8	2.6	2.1	2.1	2.6	2.9	...
Labour productivity[6]	ann ave % chg	3.1	3.4	2.3	1.6	0.6	-0.4	...
Retail Sales								
Core retail sales volume	qtr % chg[1]	0.3	1.1	0.9	2.1	-0.2	0.7	...
	ann % chg	1.7	1.8	2.5	4.4	4.3	3.7	...
Total retail sales volume	qtr % chg[1]	0	1.8	0.8	1.5	0.2	1.2	...
	ann % chg	2.2	3.2	3.5	4.2	4.7	3.9	...
Confidence Indicators/Surveys								
WMM - consumer confidence[3]	Index	103	111	111	117	115	120	122
QSBO - general business situation[4]	net %	8.0	18.5	22.8	35.9	37.8	52.8	51.7
QSBO - own activity outlook[4]	net %	13.2	5.7	12.2	23.6	28.7	29.9	35.3

Monthly Indicators

		2013M10	2013M11	2013M12	2014M01	2014M02	2014M03	2014M04
External Sector								
Merchandise trade - exports	mth % chg[1]	-0.1	2.2	5.7	-4.9	2.7	4.8	...
	ann % chg[1]	22.4	16.1	15.8	21.4	16.3	15.2	...
Merchandise trade - imports	mth % chg[1]	-5.8	8.6	-2.1	0.5	3.8	1.1	...
	ann % chg[1]	5.6	-2.8	19.3	3.9	7.9	13.1	...
Merchandise trade balance (12 month total)	NZ$ million	-1014	-274	-317	257	617	805	...
Visitor arrivals	number[1]	222,820	230,250	231,230	237,320	241,630	234,400	...
Visitor departures	number[1]	223,440	231,850	239,620	233,450	247,020	241,970	...
Housing								
Dwelling consents - residential	mth % chg[1]	0.6	11.9	6.7	-8.5	-1.6	8.3	...
	ann % chg[1]	15.4	36.7	47.4	25.0	14.7	35.5	...
House sales - dwellings	mth % chg[1]	0.5	-7.5	-0.9	3.7	-5.7	-1.5	...
	ann % chg[1]	2.0	-6.6	-1.1	-4.3	-7.6	-10.0	...
REINZ - house price index	mth % chg	1.6	1.2	-1.0	-2.4	2.1	3.4	...
	ann % chg	9.9	9.6	9.2	7.7	8.2	9.2	...
Private Consumption								
Electronic card transactions - total retail	mth % chg[1]	1.9	0.7	0.6	-0.4	0.8	0.0	...
	ann % chg	7.0	6.7	5.5	6.1	5.7	5.1	...
New car registrations	mth % chg[1]	7.2	2.7	-1.2	2.6	4.0	3.2	...
	ann % chg	16.2	23.0	20.3	20.2	23.6	26.8	...
Migration								
Permanent & long-term arrivals	number[1]	8,300	8,190	8,310	8,230	8,490	8,740	...
Permanent & long-term departures	number[1]	5,320	5,440	5,370	5,080	4,960	4,890	...
Net PLT migration (12 month total)	number	17,490	19,478	22,468	25,666	29,022	31,914	...
Commodity Prices								
Brent oil price	US$/Barrel	109.16	107.96	110.67	108.11	109.05	107.49	*107.71*
WTI oil price	US$/Barrel	100.55	93.87	97.75	94.64	100.82	100.80	*102.11*
ANZ NZ commodity price index	mth % chg	-1.0	0.5	1.7	0.6	0.9	-2.6	...
	ann % chg	20.8	20.3	22.6	23.9	24.4	11.6	...
ANZ world commodity price index	mth % chg	1.4	-0.3	1.0	1.2	0.9	-0.1	...
	ann % chg	23.0	21.6	21.6	22.6	22.4	13.8	...
Financial Markets								
NZD/USD	$[2]	0.8349	0.8265	0.8229	0.8283	0.8288	0.8517	*0.8620*
NZD/AUD	$[2]	0.8784	0.8856	0.915	0.9347	0.9239	0.9395	*0.9254*
Trade weighted index (TWI)	June 1979 = 100[2]	77.25	77.21	77.51	78.41	77.96	79.70	*80.21*
Official cash rate (OCR)	%	2.50	2.50	2.50	2.50	2.50	2.75	3.00
90 day bank bill rate	%[2]	2.67	2.66	2.73	2.88	2.93	3.05	*3.24*
10 year govt bond rate	%[2]	4.65	4.71	4.76	4.64	4.57	4.58	*4.55*
Confidence Indicators/Surveys								
ANZ - business confidence	net %	53.2	60.5	64.1	...	70.8	67.3	64.8
ANZ - activity outlook	net %	47.1	47.1	53.5	...	58.5	58.2	52.5
ANZ-Roy Morgan - consumer confidence	net %	122.3	128.4	129.4	135.8	133.0	132.0	133.5
Performance of Manufacturing Index	Index	56.1	57.0	56.5	56.4	56.5	58.4	...
Performance of Services Index	Index	58.0	56.4	57.5	58.0	52.8	58.3	...

qtr % chg — quarterly percent change
mth % chg — monthly percent change
ann % chg — annual percent change
ann ave % chg — annual average percent change

1 Seasonally adjusted
2 Average (11am)
3 Westpac McDermott Miller
4 Quarterly Survey of Business Opinion
5 Ordinary time
6 Production GDP divided by HLFS hours worked

Sources: Statistics New Zealand, Reserve Bank of New Zealand, NZIER, ANZ, Haver, Westpac McDermott Miller, ANZ-Roy Morgan, REINZ, BNZ-Business NZ