Economic Alert

MONETARY POLICY STATEMENT — MAY 2021

Wednesday 26 May, 2021

The Monetary Policy Committee agreed to maintain the current stimulatory level of monetary settings.

Key Points:

"The Committee will keep the Official Cash Rate (OCR) at 0.25 percent, and the Large Scale Asset Purchase and Funding for Lending programmes unchanged."

"Fiscal and monetary stimulus are continuing to underpin the global recovery."

A positive start:

"Economic activity in New Zealand has returned to close to its pre-COVID-19 level."

"The Committee discussed the key factors underpinning the economic recovery and agreed that the outlook was unfolding broadly as outlined in the February Statement. The improvement in global and domestic economic indicators, such as New Zealand's terms of trade, have provided members more confidence in this outlook."

But tempered by some warnings:

"The sectors most exposed to international tourism remain weak, despite the recent re-opening of travel with Australia. Business investment also remains below its pre-COVID-19 level, although recent indicators of investment intentions suggest signs of recovery."

"Reports of specific skill and seasonal worker shortages have the potential to put upward pressure on some wage costs. The economy is experiencing pockets of both labour shortages and employment slack, consistent with the economic disruption caused by COVID-19."

In summary:

"The current economic outlook implies that continued monetary stimulus remains necessary to meet our inflation and employment objectives sustainably over the medium term."

Market Implications:

"The Committee noted that on current projections the OCR eventually increases over the medium term but agreed that this is conditional on the economic outlook evolving broadly as anticipated."

Without doubt, the most interesting aspect of the statement was the inclusion of the RBNZ's OCR projections beyond 12 months. These projections suggest the OCR may start rising in the second half of 2022, topping out near 1.75% in mid-2024 as the RBNZ gains greater confidence in its outlook for the economy with *"reduced risk of extreme downside shocks."*

The surprising inclusion of 2022 OCR hikes in their projections saw the NZD immediately jump on the crosses as, according to the projections, the RBNZ will be the first central bank to hike post the pandemic, and will have a cash rate around 1.5% higher than the RBA at the point it has signalled as the start of its hiking cycle. New Zealand swap rates also jumped between 10 and 14-basis points across the curve with the belly outperformed as the 2-year vs 5-year spread steepened 4.5bp while 5-year vs 10-year flattened 4bp.

Comment:

While there is no doubt the overall tone of the statement was slightly more optimistic, with the RBNZ pointing to several areas for upside, it also emphasised that it would maintain its stimulus *"until it is confident that consumer price inflation will be sustained near the 2 percent per annum target midpoint, and that employment is at its maximum sustainable level. The Committee agreed it will take time before these conditions are met."*

Within this environment, the financial markets have taken the OCR projects at face value and have already started pricing in hikes in 2022. But we still have the RBA and Federal Reserve maintaining their views that they won't hike rates until 2024, which raises the ultimate question, do we think the RBNZ will front-run the other central banks?