Economic Alert

MONETARY POLICY REVIEW — JULY 2021

Wednesday, 14 July 2021

The Reserve Bank of New Zealand lays the groundwork for the potential start of a hiking cycle.

Key Points:

- *"The Reserve Bank will halt additional asset purchases, under the Large Scale Asset Purchase (LSAP) programme, by 23 July 2021."*
- *"The Committee will keep the Official Cash Rate (OCR) at 0.25 percent, and the Funding for Lending programme unchanged."*
- *"The Committee noted that medium-term inflation and employment would likely remain below its Remit objectives in the absence of some ongoing monetary support. However, the Committee agreed that the level of monetary stimulus could now be reduced to minimise the risk of not meeting its mandate."*

A positive start:

"Recent data indicates the New Zealand economy remains robust despite the ongoing impact from international border restrictions. Aggregate economic activity is above its pre-COVID-19 level. Household spending and construction activity are at high levels and continue to grow. Business investment is now responding to capacity pressures and labour shortages, and measures of economic confidence continue to improve."

"Global monetary and fiscal settings remain at accommodative levels supporting the recovery in economic activity."

And the good news continued:

"The Committee agreed that the recent rate of growth in house prices remains unsustainable. Members noted that some of the factors supporting the ongoing house price increases have eased."

In summary:

"Members reiterated their opinion that the OCR is the preferred tool when responding to economic conditions in the future. The Committee agreed that some monetary stimulus remains necessary to best ensure CPI inflation will be sustained at the 2.0% per annum target midpoint, and that employment is at its maximum sustainable level. However, the Committee also agreed that the level of monetary stimulus could now be reduced to minimise the risk of not meeting its mandate."

Market Implications:

While the weekly purchases of the LSAP programme had slowed significantly, members have now signalled an explicit end date which highlights the positive outlook for the domestic economy. The fact that New Zealand is the first country to halt its asset purchases further emphasises this point.

This saw both the NZD and local swap rates rally as speculators rushed to adjust their positions after the recent bout of weakness.

The NZD cemented gains against all of its major trading partners breaching the 0.7000 level against the USD and 0.9400 against the AUD.

The fixed income markets also rallied strongly with the swap curve 5-9 points higher, with a flattening bias, while bonds were even stronger with yields 8-10 points higher.

Comment:

Without a doubt, the withdraw of the LSAP programme is a step forward in the New Zealand recovery, as it is logical to halt asset purchases before the members start contemplating OCR hikes. As with all central bank statements, the RBNZ has not ruled out using the LSAP programme in the future, stating *"members noted that the LSAP programme remains an important tool for supporting the efficient functioning of the New Zealand debt market if required and remains an important monetary policy tool if needed."*

Within this environment, with the RBNZ halting asset purchases and the local market pricing rate hikes years in advance of the other developed economies, one can't help but feel that somehow the currency isn't fully buying into the forecasts!