Economic Alert

MONETARY POLICY STATEMENT — AUGUST 2021

Wednesday, 18 August 2021

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

Key Points:

- *"The Monetary Policy Committee agreed to retain the current stimulatory level of monetary settings, keeping the Official Cash Rate ("OCR") at 0.25 per cent for now."*
- *"The need to reinstate COVID-19 containment measures in some regions highlights the serious health and economic risks posed by the virus."*
- *"The Committee agreed that their least regrets policy stance is to further reduce the level of monetary stimulus so as to anchor inflation expectations and continue to contribute to maximum sustainable employment. They agreed, however, to keep the OCR unchanged at this meeting given the heightened uncertainty with the country in a lockdown."*

The positives:

- *"Global monetary and fiscal settings remain at accommodative levels."*
- *"The Committee noted that the New Zealand economy had rebounded more strongly than most countries."*
- *"Recent data for the New Zealand economy suggest demand is robust and the economic recovery has broadened."*

But these days, there is always a warning:

"The Committee remains alert to the supply disruptions that COVID-19 can create, and the dampening effect this can have on confidence."

In summary:

The OCR is on hold *"in the context of the Government's imposition of Level 4 COVID-19 restrictions on activity across New Zealand"*, but *"the Committee agreed they are confident of meeting their inflation and employment remit with less need for the existing level of monetary stimulus."*

Market Implications:

After the initial reaction to the Committee's decision to maintain the OCR at 0.25%, the NZD fell sharply, but upon closer inspection of the statement, it soon became apparent that this was merely a pause due to the recent delta outbreak and that if we hadn't entered the lockdowns, the Committee would have raised rates.

The last paragraph of the statement was explicit … we ultimately wanted to raise the OCR to *"reduce the level of monetary stimulus"*, but we chose to pause given the *"heightened uncertainty."*

This saw the initial weakness quickly reverse itself as markets retreated to their pre-statement levels. This saw the NZD recover from a low of 0.6864 against the USD to its pre-statement level of 0.6925, while the 2-year swap rallied from 1.07% to 1.21%.

Comment:

With much of the recent economic momentum driven by strong domestic spending, businesses beginning to show increased confidence to invest and to hire more workers, and with continued strong international demand for our commodity exports, the Reserve Bank of New Zealand ("RBNZ") clearly feels the need to pre-emptively start the tightening cycle. A point emphasised via the RBNZ's very own OCR forecast, which projects the cash rate to increase 0.60% by December 2021, with further increases every quarter until December 2022, before the cash rate eventually tops out at 2.1% in March 2024. We suspect the RBNZ would view this last rate as their new 'neutral' rate. However, the models were put together before the latest COVID-19 outbreak, which could change the outlook.

With such strong OCR forecasts, it's possible Mr. Orr may well have hiked 50 basis points if we hadn't had the outbreak in the last 24-hours!