Economic Alert

MONETARY POLICY REVIEW — NOVEMBER 2021

Wednesday, 24 November 2021

The Monetary Policy Committee agreed to increase the Official Cash Rate ("OCR") to 0.75 per cent.

Key Point:

"The Monetary Policy Committee agreed to raise the Official Cash Rate (OCR) to 0.75 per cent. The Committee agreed it remains appropriate to continue reducing monetary stimulus so as to maintain price stability and support maximum sustainable employment."

Cutting to the chase:

"Headline CPI inflation is expected to measure above 5 percent in the near term before returning towards the 2 percent midpoint over the next two years. The near-term rise in inflation is accentuated by higher oil prices, rising transport costs and the impact of supply shortfalls. These immediate relative price shocks risk generating more generalised price rises given the current domestic capacity constraints."

Despite the lockdowns, the economy remains strong:

"Underlying economic strength remains supported by aggregate household and business balance sheet strength, fiscal policy support, and strong export returns."

"Capacity pressures have continued to tighten. For example, employment is now above its maximum sustainable level."

In summary:

"The Committee noted that further removal of monetary policy stimulus is expected over time given the medium term outlook for inflation and employment."

Comment:

While there was always a possibility the RBNZ would go boots in and hike 50 basis points, the fact they 'only' raised the OCR 25 points to 0.75% does give us comfort that the Governor is aware of the economic uncertainty that the current COVID-19 related lockdowns have created. Furthermore, we note that the minutes acknowledged that higher mortgage interest rates, continued strong home building, tighter lending rules and changes in tax settings should all act to moderate house prices over the medium term.

While the Committee discussed how fast interest rates need to be increased, it was also noted that households and businesses have already experienced a tightening in monetary conditions that could weigh on consumer spending in the coming months.

We feel the Governor has been both balanced and considered in his approach to the risks in the New Zealand economy although it should also be noted that the central bank has raised its OCR forecasts from that presented in August, albeit at a slower, more considered pace than market pricing implies. The RBNZ track has the OCR increasing to 2.00% by December 2022 and eventually topping out at 2.50% by the end of 2023. Annualised CPI is expected to peak at 5.7% in Q4 2021/Q1 2022 before retreating back below the 3.0% level in Q1 2023.

Market Implications:

With the NZD suffering at the hands of a strong USD in the days going into the MPS, the fact the Governor 'only' chose to hike 25bps added to the already weaker tone although, at this stage, the sell-off has lacked intensity.

While the increased OCR forecasts have underpinned the markets pricing, swap rates have eased back given the slower pace of the RBNZ's forecasts. This has seen interest rate swap rates ease back 3-4 pips across the curve from where they were trading prior to the announcement.

At this stage we feel the Governor has done a commendable job in managing the markets expectations. Let's hope the Q&A session proceeds in the same manner!