Economic Alert

MONETARY POLICY STATEMENT — FEBRUARY 2022

Wednesday, 23 February 2022

The Monetary Policy Committee today increased the Official Cash Rate ("OCR") to 1 percent.

And to support this tightening:

"The Committee also agreed to commence the gradual reduction of the Reserve Bank's bond holdings under the Large Scale Asset Purchase (LSAP) programme – through both bond maturities and managed sales."

Despite the short-term Omicron economic disruptions:

"Headline CPI inflation is well above the Reserve Bank's target range but will return towards the 2 percent midpoint over coming 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 movements risk generating more generalised price rises, especially given the current domestic capacity constraints."

Despite the lockdowns, the economy remains strong:

"The Committee agreed that further removal of monetary policy stimulus is expected over time given the medium-term outlook for growth and employment, and the upside risks to inflation."

Looking further ahead:

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

Comment:

After almost three months of silence from the RBNZ, it was a welcome return to the podium and good to get an insight into its thoughts and concerns.

While the decision to raise the OCR 25 basis points to 1.00% was expected, it should be noted that the decision was *"finely balanced"* between a 25 and 50 point hike, while the Committee also affirmed that it is willing to move the OCR in larger increments if required in the coming quarters. The Bank also upgraded its forecasts projecting the OCR will reach 2.25% by the end of 2022, and 3.25% by December 2023. Importantly, the RBNZ also sees inflation peaking at 6.6% this quarter, and it doesn't expect it to return to its 1.0%-3.0% band until Q2 2023!

On the issue of local house prices, the RBNZ confirmed they remain above their sustainable level, although the RBNZ now expects prices to ease over time, as they have over the past couple of months, and that mortgage lending growth will continue to slow.

Looking objectively at the statement, the danger for the RBNZ is that the current capacity constraints remain in place longer than anticipated. Within this environment it is hard to see the unemployment rate rising, as the RBNZ is projecting, when there is a lack of immigrant workers, and we may even start losing local workers to international markets as they open sooner than New Zealand does.

Market Implications:

While the statement was a little more 'hawkish' than had been expected, given that the RBNZ's OCR track exceeded the pre-statement pricing and the announcement of its intention to start selling down its balance sheet, the markets' reaction to the statement was rather subdued, especially in the currency markets.

The NZD spike was fairly consistent across the board, with the NZD/USD reaching 0.6775 and NZD/AUD firming above the 0.9350 level to 0.9360, but in the broad range of intra-day flows, the immediate reaction was underwhelming.

Most of the 'action' was seen in the belly of the interest rate curve with the 2, 3 and 4-year swap pricing out-performing (up 5bps), while the 1 and 10-years gains were only modest. Potentially the sale of the central bank's LSAP holdings may pressure long-term rates but only at the periphery.