Economic Alert

MONETARY POLICY REVIEW — APRIL 2022

Wednesday, 13 April 2022

The Monetary Policy Committee today increased the Official Cash Rate ("OCR") to 1.50 percent.

Because:

"The Committee agreed that their policy 'path of least regret' is to increase the OCR by more now, rather than later, to head off rising inflation expectations and minimise any unnecessary volatility in output, interest rates, and the exchange rate in the future."

The sooner we get to neutral, the better:

"The Committee remained comfortable with the outlook for the OCR as outlined in their February Monetary Policy Statement. They agreed that moving the OCR to a more neutral stance sooner will reduce the risks of rising inflation expectations."

And we're going again:

"Members noted that inflation is above target and employment is above its maximum sustainable level. As such, the Committee confirmed that further increases in the OCR are needed in order to meet their mandate."

But, there was a warning:

"A larger move now also provides more policy flexibility ahead, in light of the highly uncertain global economic environment."

Comment:

The RBNZ played to the markets expectations and delivered a 50 basis point hike to lift the OCR to 1.50% as "*this 'stitch in time' approach is consistent with near-term financial market pricing."*

After all of the warnings about inflation, supply-chain and capacity constraints and labour shortages, there was a slightly 'dovish' tone to the statement, with the suggestion that by front-loading the current hiking cycle to hit neutral earlier, it will give the central bank greater policy flexibility in light of the highly uncertain global outlook.

Simply put, it was a dovish 50 basis point hike!

Market Implications:

And this has followed through to the financial markets, with the interest rate market suggesting that yields are about to peak soon. Yes, there will be further hikes as highlighted by the market pricing in an 81% chance of a further 50 basis points at the next meeting, but the theory that a greater hike now reduces the chances of larger hikes later has seen the 2-year bond yield drop almost 10 points while the 5 and 10-year yields have eased 7 and 3 pips respectively. Swap rates have also dropped, with the front end of the curve down 11 points while the long-end has eased 9 pips to steepen the curve.

It was a similar story with the NZD, which initially spiked 0.50% although those gains were soon given up. At the time of writing the NZD is only marginally firmer than it was prior to the announcement.

Given the implicit warning in the statement that the Committee are looking beyond this year, and the possibility that the yield curve may have already peaked as the market looks through the hiking cycle to the next slowdown and accompanying rate cuts, it will be interesting to see how the currency holds up overnight.