Economic Alert

MONETARY POLICY STATE MENT — AUGUST 2022

Wednesday 17 August, 2022

"The Monetary Policy Committee today increased the Official Cash Rate ("OCR") to 3.00 percent from 2.50 percent."

Because:

"Core consumer price inflation remains too high and labour resources remain scarce."

And we will go again:

"Committee members agreed that monetary conditions needed to continue to tighten until they are confident there is sufficient restraint on spending to bring inflation back within its 1-3 percent per annum target range."

But there is a sting in the tail:

"Household balance sheets on the whole are strong, but higher interest rates and rising costs of living are putting pressure on household finances, and are expected to reduce household spending and house prices. House prices have steadily dropped from high levels since November last year, and are expected to keep falling over the coming year towards more sustainable levels."

And it will get worse:

"While there is considerable uncertainty about the outlook for house prices, the central projection assumes that prices will continue to decline until the September 2023 quarter. This would result in a total decline of 15 percent from the December 2021 quarter peak, slightly more than assumed in the May Statement."

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"The Committee noted that a number of central banks had increased interest rates by more than 50 basis points recently, but that most of these countries had started increasing interest rates later than New Zealand did and were often starting at a lower level of interest rates."

Comment:

In raising the OCR by a fourth consecutive 50bps hike, the central bank maintains that it is appropriate to continue tightening rates further and has increased its projected OCR peak to 4.1% by mid-2023, from the previous forecast at 3.9%. The Committee also discussed the possibility that the neutral rate may be higher than they had previously thought, although staff had to do more work on their estimates. There was also an element of, *"don't blame us, everyone is raising interest rates"* in referencing the actions of other central banks, although the Committee acknowledged that firms are increasing wages more frequently.

Simply put, the three key take-outs are: Conditions need to tighten further; inflation remains too high and labour resources remain scarce; and indicators highlight broad-based domestic pricing pressures!

Market Implications:

Post the statements release, the hawkish tone prompted a short lived NZD boost, which just as quickly unwound. We also saw a modest firming of bond yields and swap pricing, in the region of 2-4 basis points across the curve, while the OIS pricing is fully pricing in a further 50bps hike at the next meeting in October.

At this stage the financial markets are taking a pragmatic approach to the RBNZ's acknowledgement that it has further work to do to moderate current inflation pressures, with market expectations roughly aligned with the RBNZ's continued tightening track into year end.

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