Economic Alert

MONETARY POLICY STATEMENT — NOVEMBER 2022

Wednesday, 23 November 2022

"The Monetary Policy Committee today increased the Official Cash Rate (OCR) to 4.25% from 3.50%."

Because:

"The committee agreed that the OCR needs to reach a higher level, and sooner than previously indicated, to ensure inflation returns to within its target range over the medium term. To achieve its Remit objectives, actual and expected inflation needs to decline substantially."

As the key drivers remain embedded:

"High consumer price index (CPI) inflation and competition for workers are putting upward pressure on wages. While wage growth for people in the same job is generally not keeping pace with inflation, many people are changing jobs, or increasing their hours worked, to achieve real income growth."

And we should be prepared for further rate hikes:

"The RBNZ now sees the cash rate rising to 5.50% in 2023. Monetary conditions needed to continue to tighten further. The Committee gave consideration to an increase in the OCR of 75 or 100 basis points."

Which will come with further pain domestically:

"Household spending remains robust, especially considering the rise in debt servicing costs, the fall in house prices, and low levels of consumer confidence. As debt servicing costs rise, spending decisions for many households will be increasingly constrained."

Which means we should prepare for a recession ...

"Members noted that a reduction in aggregate demand is projected to cause GDP in the New Zealand economy to temporarily contract by around 1% from 2023. Members agreed that the exact timing and extent of negative GDP growth was difficult to predict, but historical evidence suggests risks are skewed toward a likely short period of contraction."

Comment:

Adrian Orr has now fully cemented his place in the New Zealand history books by undertaking the largest interest rate hike in the RBNZ's history. With no references to the global central banker rhetoric of 'we need to ascertain the full impact of the hikes undertaken earlier this year,' the Governor is in danger of becoming an outlier. Ultimately, this Governor is sticking to his guns and there are more hikes to come, but at some stage these interest rate hikes will bite ... and that's when it will get ugly. Strap yourselves in, its going to be a wild ride!

Market Implications:

Following the release of the statement, and the escalation to hiking in 75bps rather than the 'usual' 50bps, the full impact was felt in the interest rate markets with swap pricing reversing trend and returning towards their recent highs as the curve inverted further. At this stage, the OIS curve is suggesting the OCR will top out at 5.50% in Q2, which is in-line with the RBNZ's forecasts, although the back end is suggesting cuts as we enter 2024. This saw the 2-year swap pricing gap 26bps higher to 5.28%, the 5-years surge 23bps, while the 10-year swap 'only' rallied 15bps. This contributed to the 2-10 year spread inverting a further 8 bps to be at -78bps, supporting the consensus that New Zealand will most likely enter a recession in 2023.

Interestingly though, the FX markets aren't fully buying into the increased hawkishness from the RBNZ, with the NZD/USD a touch firmer at 0.6165 from 0.6150, although the NZD/AUD and NZD/JPY have broken above key-resistance levels.