Economic Alert

MONETARY POLICY REVIEW — APRIL 2023

Wednesday, 5 April 2023

"The Monetary Policy Committee today increased the Official Cash Rate (OCR) by 0.50% from 4.75% to 5.25%."

Because:

"Demand continues to significantly outpace the economy's supply capacity, thereby maintaining pressure on annual inflation."

And:

"The OCR needs to be at a level to reduce inflation."

Unfortunately, key drivers remain embedded:

"Inflation is still too high and persistent, and employment is beyond its maximum sustainable level."

And we should be worried because:

"The recent severe weather events in the North Island have led to higher prices for some goods and services. This higher near-term CPI inflation increases the risk that inflation expectations persist above our target range."

Which will come with further pain domestically:

"Economic growth is expected to slow through 2023, given the slowing global economy, reduced residential building activity, and the ongoing effects of the monetary policy tightening to date."

But the Governor is not going to back down now:

"Wholesale interest rates have fallen significantly since the February Statement, and this could put downward pressure on lending rates. As a result, a 50bps increase in the OCR was seen as helping to maintain the current lending rates."

Comment:

Today's MPR statement will be one for the history books … for when the RBNZ drove the economy headfirst into a recession.

To some extent, the committee's decision to hike more than expected has been driven by the recent weather-related events which have led to higher prices for some goods and services, and the recent banking stress in the US and Europe that resulted in lower wholesale interest rates internationally. The issue is these events are driven by necessity and international implications ... not something that local interest rates will have any control over. And with the recent cut in oil production, and wage inflation becoming an issue, the outlook remains bleak.

Furthermore, with global growth expected to contract, demand for New Zealand's key commodity exports will likely fall, and with the rate hike, what little money our exporters make will invariably be lost through higher exchange rates.

The central bank even acknowledged that the fall in GDP in Q4 2022 implied the level of economic activity was lower than assumed in the February Statement, and significantly lower than the RBNZ's own forecast, but despite this fact, the members observed that inflation remains embedded, and employment is beyond its maximum sustainable level, hence the justification for oversized rate hike.

While central bankers tend to over hike until something crashes, we only hope enough people are wearing their seatbelts!

Market Implications:

The outsized rate hike saw the NZD rally strongly. The NZD/USD has broken out of its recent 0.6100-0.6300 range, the NZD/AUD has traded above 0.9400, while the NZD/EUR and NZD/GBP have bounced from their recent lows. We should also expect a further squeeze when the international markets open tonight. Interest rates have also gapped higher, with the 2-yr IRS rallying 20bps, the 5-yrs 12bps higher, and the 10-yrs squeezing 9bps to ensure the local yield curve retains its inverted nature as it continues to price in recession.

It should also be noted that the statement offered no forward guidance, which suggests the old adage, *"if you don't have anything good to say, don't say anything at all"* is probably appropriate!