Economic Alert

MONETARY POLICY STATEMENT — MAY 2023

Wednesday, 24 May 2023

"The Monetary Policy Committee today increased the Official Cash Rate (OCR) by 0.25% from 5.25% to 5.50%."

Because:

"The OCR will need to remain at a restrictive level for the foreseeable future, to ensure that consumer price inflation returns to the 1-3% annual target range."

And there was some positive news:

"Global economic growth remains weak and inflation pressures are easing," while *"inflation is expected to continue to decline from its peak."*

Given the hiking cycle is starting to impact:

"Consumer spending growth has eased, residential construction activity has declined, while house prices have returned to more sustainable levels," while, *"Businesses are reporting slower demand for their goods and services. Businesses report that a lack of demand, rather than labour shortages, is now the main constraint on activity."*

But in amongst the good news, there was a warning:

"Core inflation pressures will remain until capacity constraints ease further."

To conclude:

"The Committee is confident that with interest rates remaining at a restrictive level for some time, consumer price inflation will return to within its target range of 1-3% per annum, while supporting maximum sustainable employment."

Comment:

Having announced last October that his OCR target was 5.50%, the Governor adopted a classic case of "I told you so" and signalled having reached his level, he intended to pause the hiking cycle in forecasting an average OCR at 5.50% for the rest of the year. We suppose the most surprising thing was the statement was so explicit!

The RBNZ is forecasting 5.50% will be the peak with cuts from the September quarter 2024 as labour pressures ease with a lack of demand being the main constraint on activity. The RBNZ expects inflation will return to its target band by September 2024.

While there is the acknowledgment that the OCR will need to remain restrictive for the foreseeable future, there is no doubt that the convictions of the Governor suggest it would take something exceptional for Mr. Orr to revert to a fresh round of rate hikes.

Interestingly, the RBNZ inflation forecasts are significantly lower for the balance of 2023, although they are similar to the prior forecasts from 2024 onwards, while the OCR projections aren't significantly lower until early 2025, when they fall away sharply. The RBNZ continues to forecast a recession with June and September 2023 GDP prints in negative territory.

Market Implications:

Upon the initial announcement, the NZD immediately fell -1.00% against all of its trading partners, except the AUD which was dragged lower with the NZD. The NZD/AUD is currently -0.75% lower at time of writing.

The interest rate swap market has also come under concentrated selling pressure, unwinding much of the post -6% OCR call and budget rallies. The 2-year swap, having rallied from a low of 4.90% on the 15-May to 5.55% prior to the announcement, has since fallen 40bps to 5.19%, while the 5-years, which has surged from 4.23% to 4.69% over the same time, has since fallen to 4.43%.