Economic Alert

MONETARY POLICY STATEMENT — MAY 2024

Wednesday, 22 May 2024

"The Monetary Policy Committee today agreed to keep the Official Cash Rate (OCR) at 5.50 percent."
It was the seventh consecutive meeting the central bank has left the cast rate unchanged.

And the reason:

"Persistence in non-tradable inflation remains a significant upside risk."

And there is more pain to come:

"The average interest rate across the stock of mortgage borrowers continues to increase and is near its projected peak of 6.5%. Bank funding costs are expected to increase over the forecast period as funding sources normalise, with a reversion to higher cost wholesale and term deposit funding."

Inflation remains too high … due to non-tradeable inflation:

"Both tradable and non-tradables inflation contributed to the decline in headline CPI inflation. However, annual non-tradables inflation declined only slightly to 5.8%, which was higher than the 5.3% forecast."

And a warning:

"The Committee discussed the possibility of increasing the OCR at this meeting" even though, "The Committee noted that annual headline CPI inflation was expected to return to the target band in the December quarter of this year."

Globally:

"Global economic growth was below trend last year and is expected to slow further in 2024. However, the economic outlook varies among New Zealand's trading partners."

To conclude:

"The members agreed they remain confident that monetary policy is restricting demand. A further decline in capacity pressure is expected, supporting a continued decline in inflation." But it's just not moving fast enough!

Comment:

While there had been hopes the central bank may start laying the groundwork to an earlier rate cut than the track signalled in February, the Committee hit that suggestion for six, even putting a potential hike on the table!

There is no doubt that non-tradeable inflation is the major issue that is concerning the Committee, but while they are still expecting inflation to return to the 1.0%-3.0% band within 2024, the central bank upgraded their OCR, CPI, and neutral cash rate projections, which was a surprise.

To some extent, there are contradictions in the RBNZs outlook given inflation is expected to return to its band by Q4 2024, while non-tradeable inflation, as they acknowledged, is less sensitive to interest rates.

Make no mistake, this statement was a lot more hawkish than anyone expected, and while it is not unusual, the RBNZ is once again the outlier amongst its central bank peers (apart from the RBA - although the Australian cash rate is a lot lower). Unfortunately, businesses, SMEs, and householders will have to bear the costs for this.

Market Implications:

Bond yields, swap prices, and the NZD all gapped higher on the hawkishness of the statement. At this moment in time, the initial spikes have started to lose some momentum, but we still have the Q&A session to come which could re-ignite volatility once again.

Currently, bond yields have firmed 4-6bps, although the biggest moves have been seen in the swaps market with pricing 8-10bps higher. At this stage, the NZD has firming 0.75% on all of the pairs.