Economic Alert

MONETARY POLICY STATEMENT — MAY 2022

Wednesday 25 May, 2022

"The Monetary Policy Committee today increased the Official Cash Rate ("OCR") to 2.0 percent."

Because:

"It remains appropriate to continue to tighten monetary conditions at pace to maintain price stability and support maximum sustainable employment," the RBNZ said. *"The Committee is resolute in its commitment to ensure consumer price inflation returns to within the 1-3% target."*

With more hikes to come:

"A larger and earlier increase in the OCR reduces the risk of inflation becoming persistent, while also providing more policy flexibility ahead in light of the highly uncertain global economic environment."

But it's not without its risks:

"The pace of global economic growth is slowing. The broad-based tightening in global monetary and financial conditions is acting to slow spending growth"

And domestically...

"headwinds are strong. Heightened global economic uncertainty and higher inflation are dampening global and domestic consumer confidence. Asset prices, in particular house prices, have also declined, reflecting in part higher mortgage interest rates and increased supply of housing."

But for now:

"The Committee viewed the projected path of the OCR as consistent with achieving its primary inflation and employment objectives without causing unnecessary instability in output, interest rates and the exchange rate. Once aggregate supply and demand are more in balance, the OCR can then return to a lower, more neutral, level."

Comment:

The RBNZ delivered to market expectations by delivering another 50 basis point hike to lift the OCR to 2.00%. The move continues its *"least regrets"* framework, with the committee *"resolute in its commitment to ensure consumer price inflation returns to within the 1 to 3 percent target range."*

The commentary is certainly less dovish than it was six weeks ago! The key indication of this is the forecast terminal OCR rate now up to 3.9%, from previous indications of 3.4%. The RBNZ again highlighted the need to push through sharper hikes sooner, to control inflation expectations and give "flexibility" in light of the uncertain global outlook.

The RBNZ is *"resolute"* in its commitment to controlling inflation, but questions remain about the fragility of the economy and, in particular the housing market, in the face of a nearly 4% OCR. Can New Zealand's indebted mortgage borrowers sustain those sorts of interest rates?

Market Implications:

Swap rates unsurprisingly climbed on the higher OCR track. With the RBNZ now projecting a further 140 basis points of hikes this year and another 55 basis points of hikes in 2023. If delivered as projected, this would be the largest and quickest hiking cycle on record.

The 2 year swap is up 18 basis points, and the 10 year up 10 basis points, to 3.68% and 3.75% respectively, however, there could be a bit further to go if the market is to believe the RBNZ. While large, these moves only partially offset the circa 50 basis point fall in swap rates seen over the past week.

The NZD/USD was sold off in the hours leading into the announcement, however, this sharply reversed and then some, with the pair climbing from 0.6425 at 1.59pm, to as high as 0.6499 before profit taking took over. Watch for further upward drift as the full 55 page report is digested.