ANZ Research

# RBNZ MPR Preview and OCR call change

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Contact

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## When the facts change

### Key points

A lot has changed since the RBNZ's late-May Monetary Policy Statement.

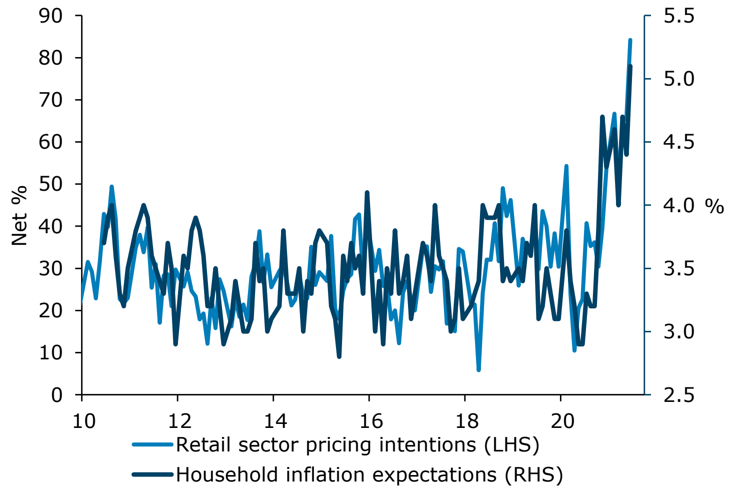
- We expect the RBNZ to acknowledge the stronger starting point, the tighter labour market, and rising inflation risks, and thereby set the scene for kicking off the hiking cycle this year.
- We have been emphasising for some time that the risks were becoming strongly skewed towards lift-off this year. Now that the market is there, it's more likely. We are now forecasting the RBNZ to start hiking in November, lifting the OCR in steady steps to 1.75% by February 2023.
- The market is already pricing in almost 90% odds of a hike by November, and "one and a half' hikes by February. As such, the hurdle for a hawkish surprise is high. We expect the MPR to validate, rather than spur on, expectations for earlier hikes (but post-MPR data could do that).

### A hot winter

It's only six weeks since the Reserve Bank surprised the market with a "hawkish" forecast showing the OCR steadily lifting from August next year. The picture has changed a lot since then!

- Q1 GDP came out at 1.6% q/q versus the RBNZ forecast of -0.6%. That indicates a more advanced, broad-based recovery than anticipated, which will mechanically bring forward the RBNZ's forecast for when the OCR needs to rise. We see no reason to discount the data.
- Pricing intentions in the ANZ Business Outlook survey have skyrocketed. A net 84% of retailers intend to raise their prices. Turns out, this maps closely to consumer inflation expectations, which have also soared (figure 1). The causality probably runs both ways, but the upshot is that this is not a difficult environment in which to pass on cost increases. The QSBO told the same inflationary story: strong demand and higher costs.

**Figure 1. Retailer pricing intentions and consumer inflation expectations**




Source: ANZ, Roy Morgan

- Job ads have continued to soar, suggesting the labour market is exceptionally tight. We've revised our labour market forecasts and now see the unemployment rate continuing to decline over this year. Matching issues are real, but employers increasingly seem willing to take a punt on anyone they can find.
- House sales have slowed, but low listings mean the market is still tight.
- ANZ card spending data shows consumers spending freely on durables, hospitality, apparel and services.
- Commodity prices have remained elevated and the NZD-TWI has drifted slightly lower.

## The May RBNZ commentary is now dated

Going through the text of the May MPS Policy Assessment, what's striking is the amount of commentary that looks due for an update:

- "the weak level of business investment" – not according to Q1 GDP data;
- "medium-term inflation and employment would likely remain below its Remit targets in the absence of prolonged monetary stimulus";
- "sectoral unevenness of economy recovery" – while firms exposed to international tourism are certainly hurting, it's all go everywhere else;
- "These price pressures [global raw materials, higher oil prices and shipping costs] are likely to be temporary and are expected to abate over the course of the year" – The timing of assumed normalisation of shipping conditions will likely be pushed out, with some pundits estimating these problems will take years to sort out.

With inflation expectations above the target midpoint and steadily rising, and pricing intentions sharply higher across the board, it's fair to say that the "temporary" characterisation of price pressures itself is starting to be up for debate. Does the RBNZ want to take the risk, when the economy is so strong? We suspect not.

The discussion of upside and downside factors and risks still looks apt, around global growth and vaccination progress, New Zealand's commodity export prices, COVID-19, tourism, and housing policy changes.

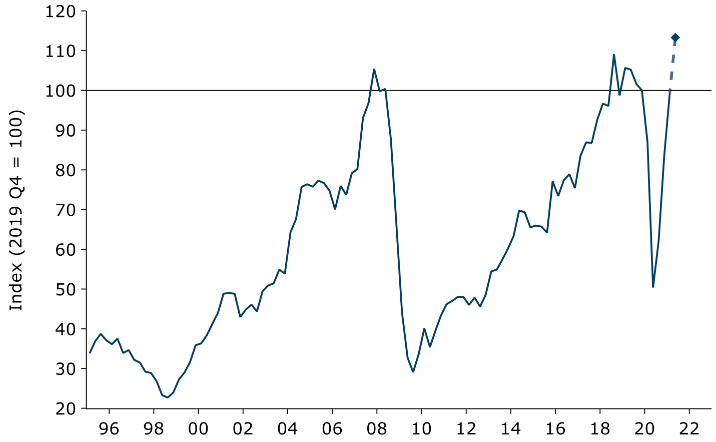
But where the rubber really hits the road for the OCR outlook is the final paragraph:

> The Committee agreed to maintain its current stimulatory monetary settings until it is confident that consumer price inflation will be sustained near the 2 percent per annum target midpoint, and that employment is at its maximum sustainable level. Meeting these requirements will necessitate considerable time and patience.

We don't doubt that CPI inflation is headed well above the target midpoint at this stage. The picture could obviously change quickly, but for now, inflation risks have flipped firmly towards it being too high for too long, rather than the reverse.

And as for employment, by our estimates the labour market is as tight as it's ever been, so the RBNZ can tick that box (figure 2). Yes, it may be as much to do with constrained labour supply as labour demand, but those labour supply issues are not going away any time soon, so it is what it is. It's going to drive wage growth, which is a sustained source of inflation pressure.

**Figure 2. Job vacancy/unemployment ratio**




Source: MBIE, Stats NZ, ANZ Research

To sum it up, "considerable time and patience" are no longer required. We've been talking for some time about the rapidly evolving risk that OCR hikes would be delivered this year. Ironically, now the market is there, it's a lot more likely. We are now forecasting the OCR to start lifting in November, with steadily quarterly hikes taking the OCR to 1.75%, by February 2023. There are risks on both sides around both the timing and the endpoint of hikes, and we'll have more to say about that as time goes on.

Following the Monetary Policy Review, CPI data next Friday and the labour market report on 4 August are pressure points that could well see the market, and quite possibly the economists, bring August into play. The RBNZ will probably want to choose words for the Review that leave their options open about the exact timing of lift off, as they will no doubt be looking forward to those data reads with as much anticipation as we are. Game on.

## Potential market reaction

Market pricing has moved a long way in a short time, having shifted sharply higher in the wake of this week's unequivocally strong NZIER QSBO survey. At the moment, the market is pricing in 22bps of hikes by November, 38bps (cumulatively) by February and around 57bps by May. In plain English, that's around 90% odds of a hike by November, "one and half" hikes by February, and "two and a bit" hikes by May. To put that in the global context, Australia has just 5bps of hikes priced in by February, so we stick out like proverbial sore thumb.

Given how much is now priced in, the hurdle to a hawkish surprise on the day is now very high. That doesn't mean we don't think it's possible for the RBNZ to drive up market expectations of hikes (and by association, short-end rates) if they are hawkish, but a lot is already priced in, and markets are likely to need hard data to ratchet expectations up another notch.

The two main data releases that are likely to cement market expectations in favour of November (or even August) are Q2 CPI, due just two days after the MPR, and Q2 labour market data, due in the first week of August. If these data cement the expected strength, we can easily envisage markets moving to price in 50/50 odds of a hike by August and 35-40bps of hikes by November. Indeed, at the moment, markets are taking a very glass-half-full view of the world. Assuming that remain the case, we expect short-end rates to continue grinding higher over coming weeks.

# Contact us

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