ANZ Research

RBNZ Monetary Policy Review Preview

6 July 2022

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One of the easier decisions

Summary

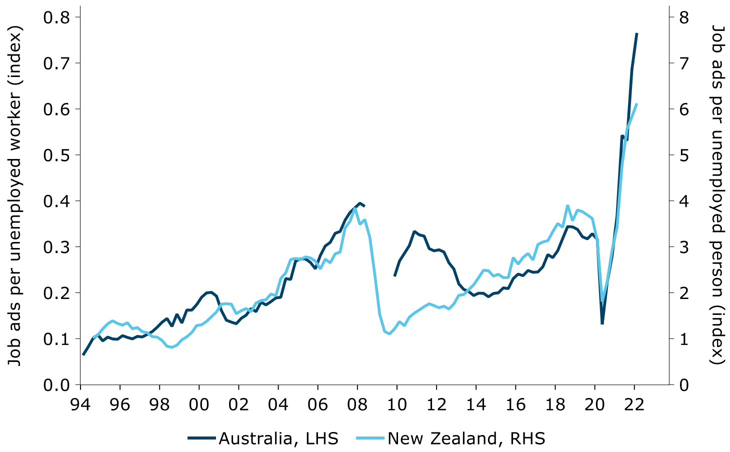
- We expect the RBNZ will raise the Official Cash Rate (OCR) 50bp to 2.50% at its Monetary Policy Review (MPR) next Wednesday.
- On balance, the data since the May MPS has not suggested any meaningful easing in inflation pressure.
- Indeed, if the RBNZ did publish forecasts at interim meetings, the OCR track would likely be a little higher, if anything.

One of the easier decisions

The RBNZ is on a roll with its 50-pointers, and the data-flow since the May Monetary Policy Statement has not provided any compelling reason to diverge from that strategy.

- While the US Federal Reserve hiked 75bp last month, they have a lot more catching up to do. Monetary conditions have been tightening in New Zealand for around a year now. While the market was briefly pricing a matching 75bp hike here, both economist expectations and market pricing are now firmly in favour of a 50bp move, making it the path of least resistance. And a 75bp could damage the "we got this" narrative.
- But the RBNZ can't slow down yet either. Cost and inflation indicators out of both our ANZ Business Outlook survey and the NZIER's Quarterly Survey of Business Opinion continue to show no let-up. The glass-half-full take is that the indicators have more or less stopped rising, but the RBNZ needs them to fall markedly.
- The labour market remains incredibly tight. The Monthly Employment Indicator rose in both April and May as Omicron disruption waned. Business owners may be downbeat about profitability, but they're still looking to hire, and expected wages are high as firms fight for insufficient workers. The Australian labour market has gone just as nuts (figure 1), with half a million job vacancies there inevitably contributing to and exacerbating sustained labour market tightness on our side of the ditch.

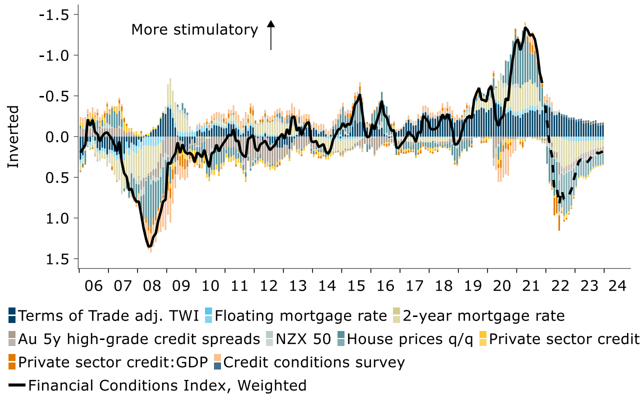
Figure 1. Australian vs NZ: job vacancies per unemployed person



Source: ABS, Stats NZ, Macrobond, ANZ Research

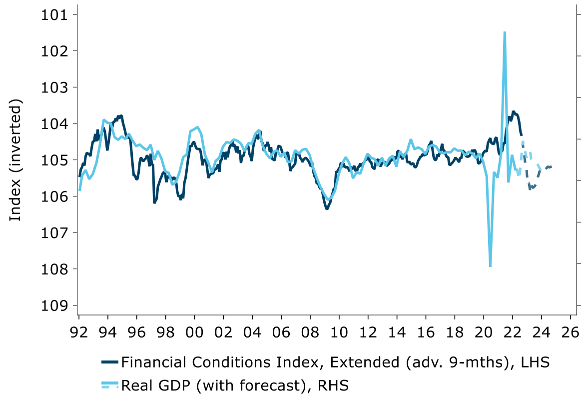
- The NZD has fallen ~2.3% on a trade-weighted basis since the May MPS, while the GlobalDairyTrade price index has fallen 4.0%. But in level terms the disconnect between New Zealand's still-high export commodity prices and the low NZD is a significant offset to overall financial conditions (figures 2-4).

Figure 2. ANZ NZ Financial Conditions Index



Source: Stats NZ, Bloomberg, Macrobond, ANZ Research

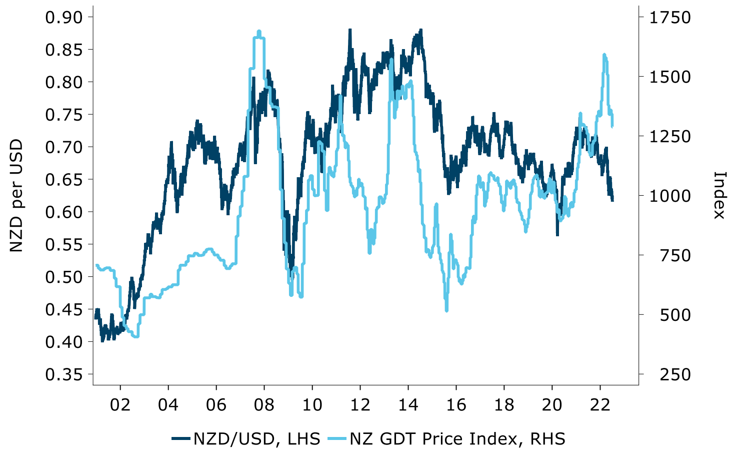
Figure 3. ANZ FCI and GDP



Source: Stats NZ, Bloomberg, Macrobond, ANZ Research

Note: The FCI includes ANZ forecasts for the TWI, terms of trade, mortgage rates and house prices. All other variables are held constant.

Figure 4. You had one job, NZD

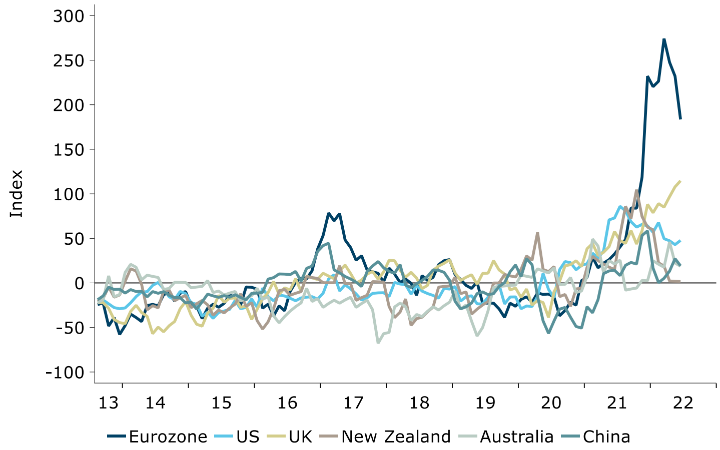


Source: Global Dairy Trade, Bloomberg, Macrobond, ANZ Research

At some point, assuming things continue to evolve smoothly (quite a big assumption in these volatile and unpredictable times, to be fair) the RBNZ will feel comfortable transitioning to a slower pace of monetary policy tightening (ie 25bp hikes) as the balance between near-term growth risks and medium-term inflation risks becomes more nuanced than it is currently. We are predicting that will occur at the October Monetary Policy Review, as we are picking the RBNZ will get traction on cooling both household spending and construction activity a little faster than they are currently assuming.

But a slowdown in the pace of hiking does require no more upside inflation surprises, and globally these have remained positive in recent weeks (though past their worst in most cases) (figure 5). Given New Zealand's CPI is quarterly, offshore inflation surprises can provide some leading information on the risk profile around the local CPI release, even though core inflation pressures emerged in New Zealand ahead of most other places. The euro area is much more vulnerable to energy shocks than New Zealand is, but upward surprises have dominated elsewhere as well.

Figure 5. Global inflation surprise indexes



Source: Bloomberg, Macrobond, ANZ Research

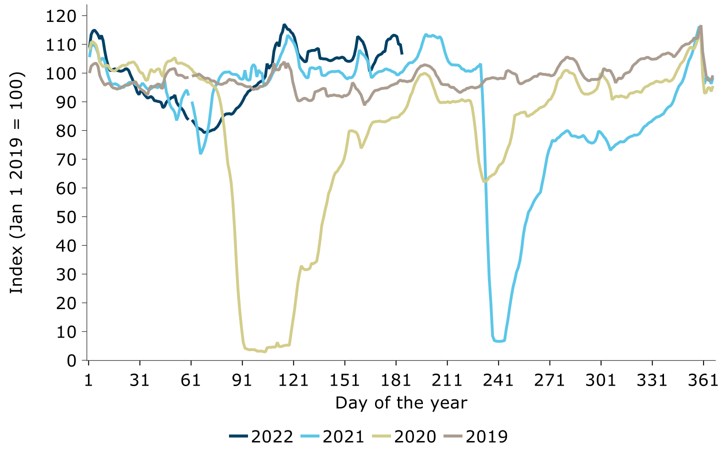
While the RBNZ certainly has a big job to do, they are starting to get traction on dampening the demand side of the economy. House prices and consumer and business sentiment are all weaker, with higher interest rates undoubtedly a contributing factor. Indeed, on balance indicators of economic activity point to downside risks to both our and the RBNZ's May MPS GDP outlooks. But some of the slowdown in activity is due to inflationary supply-side constraints such as labour shortages – the -0.2% q/q Q1 GDP outturn being a prime example – so the RBNZ can't just assume lower growth means lower inflation pressures. Depending on how direct inflation indicators evolve, they may have to continue to tap the brakes even as the economy sours.

The RBNZ won't be expecting to see inflation indicators retreat meaningfully yet – monetary policy typically operates with a 12-18 month lag in that regard. It's likely that both the housing and the labour markets will need to take some heavy hits before the RBNZ will feel comfortable the job is done. In the absence of a miracle growth spurt on the supply side of the economy, waning demand will have to be a large part of the transmission towards getting inflation and the economy back on a stable and sustainable path.

But there is no reason to think the RBNZ isn't on track to lower demand in the economy. House sales are down almost a third versus a year ago; house prices are down about 5.5% from their peak and still falling. That'll impact both consumption and construction.

Indeed, consumer confidence is already around record lows, with key spending indicators very weak. It's not showing up in the high-frequency discretionary spending data yet (figure 6), but it's just a question of timing. The RBNZ needs lower consumption, and they'll keep hiking until they get it, through some combination of wealth effects, the cash-flow impacts of higher mortgage rates, and lower job security, though they can't hope to finesse the mix.

Figure 6. Weekly ANZ card spending on hospitality



Source: Macrobond, ANZ Research

Of course, tradables inflation is (unusually) nearly half of the New Zealand CPI inflation story too. The heat is starting to come out of global commodity prices (New Zealand's too, with the GlobalDairyTrade index down 4.1% this week), as fears of a global hard landing and a US recession grow. Weaker global manufacturing activity indicators suggest shipping costs will start to ease in the second half of this year. The main global inflation tail-risk continues to be energy prices, with geopolitical concerns to the fore. While oil prices are currently slightly below where they sat at the time of the May MPS in USD terms, the weaker NZD is keeping the pressure on.

Overall, we expect the RBNZ to strike a similar tone to the May Monetary Policy Statement – ie overwhelmingly hawkish. There will be a time for nuance and balance, but with inflation yet to peak, cost indicators still sky-high, and inflation expectations yet to turn downwards, this isn't it.

Markets

Global interest rate markets have been exceptionally volatile in recent weeks. On some days, it hasn't been the economic outlook that's driving markets, rather it has been fear and extreme illiquidity. But illiquidity aside, market sentiment has been fickle, oscillating between being fearful that inflation might become so broad-based that interest rates may need to go higher for longer, to being fearful that a hard landing might cap the need for rate hikes (or even see them reversed). We don't really see that volatility going away any time soon. Recently, hard-landing fears have started to dominate, impacting New Zealand markets too. The two-year swap rate has been as high as 4.55%; it currently sits at round 3.90%.

If there is a silver lining to a 50bp rate hike, it is that if the RBNZ chooses its language carefully, it could allay fears of even larger hikes going forward. We don't necessarily expect the RBNZ to explicitly rule out a 75bp hike, but if it highlights that it is satisfied with the pace (and overall magnitude) of hikes to date (remembering that the RBNZ was an early starter this cycle), that ought to help contain future blow-outs in short-end rates. But it's too soon for the RBNZ to "blink" just because asset prices are wobbling. That means it's also a bit too soon to declare that we've seen the highs in term interest rates.

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