ASB expects OCR hikes from August following hawkish RBNZ assessment

NZ yields and the NZD jumped after the RBNZ signalled it will remove monetary stimulus, with the Large-Scale Asset Purchase (LSAP) programme to be halted by 23rd July 2021. The tone of the economic assessment was upbeat (despite COVID-19 risks), and also acknowledged tightening capacity pressures and firming inflation. As such, the RBNZ Monetary Policy Committee also deemed that a 'least regrets' approach would now be to reduce policy support "sooner". ASB now expects a 25bp OCR hike in August (to 0.50%), with a follow up 25bp hike in November 2021 (0.75%), but for a gradual path of hikes thereafter, with the OCR peaking at 1.50% by mid-2023. Risks are tilted to a more rapid pace of hikes and slightly higher OCR endpoint. There are 17bps of hikes currently priced in for August.

The hawkish RBNZ assessment contrasted with the more guarded Fed chair Powell's semi-annual testimony to Congress. The USD and US yields fell after Powell claimed that the US economic recovery was continuing, but it had not yet progressed enough for the Fed to begin dialling back (or tapering) its USD120bn in monthly asset purchases. Powell also viewed the recent pick-up in US inflation to be temporary. The Fed Beige book was more upbeat, alluding to the strengthening pace of US recovery in recent months, although labour and material shortages are becoming more acute.

The Bank of Canada held its major policy rate at 0.25% but acknowledged the improving outlook and scaled back its weekly asset purchases by one-third to CAD2bn. The Bank stuck to its 2022H2 timeline for policy rate hikes, and markets are now pricing in a 25bp hike within the next 12 months and 100bps of hikes in the next 2 years.

UK CPI inflation readings were firmer than expected (headline: 2.5% yoy, mkt: 2.2%, core: 2.3% yoy, core 2.0% yoy), with Bank of England Deputy Governor Ramsden seeing a 4% CPI inflation peak, stronger upside risks for the economy and prospective monetary policy tightening.

The 'not yet' message from the Fed on policy tapering provided a boost to US stocks, with the S&P500 touching record highs, as (mixed to date) Q2 corporate earnings start to roll in. There was little movement in European bourses overnight, but the prospect of reduced RBNZ policy support likely weighed on the NZSX 50 (-0.5%). **Climbing US fuel stocks and hopes of a potential OPEC+ deal to boost supply pushed oil prices.** Other commodity prices were supported by the lower USD.

US Treasury yields were lower following the Powell testimony (10Y 1.35%, down 6bps), with a curve flattening bias. European 10-year bond yields were a fraction lower. **The RBNZ message boosted NZ yields across the curve.** The key NZ 2-year swap yield is now about 10bps above pre-RBNZ levels, having earlier flirted with breaking though 1%. The lift in Australian yields was more modest, with widening NZ-AU interest rate differentials a key driver for the NZD/AUD.

With Q2 NZ CPI looming tomorrow we offer some thoughts. First, although uncertainty is high, there is clear upside risk to ASB's +0.8% qoq, 2.8% yoy pick. In fact, annual CPI inflation could push above 3%. Second, our core view is that annual CPI inflation will approach 3½% by the end of the year and remain above 2½% for most of 2022. Third, stretched capacity pressures add to the risk of NZ inflation being higher for longer, a risk the RBNZ alluded to yesterday.

FX Comment: The NZD jumped 60 pips after the RBNZ decision and held its own overnight amidst a period of generalised USD weakness, with the kiwi at the top of the G10 currency league. Since the RBNZ decision, the NZD has traded in a 0.6980 to 0.7045 USD range and has hovered around 94 Australian cents. Near-term NZD direction will hinge on the tone of global and local data ahead of tomorrow's Q2 NZ CPI print.

Day ahead: Quiet in NZ ahead of tomorrow's Q2 CPI report, with a tough test for today's $500m NZDM tender. At 1:30pm is the June Australian labour market report (employment: mkt: +20k, CBA: 45k; unemployment rate: mkt: 5.1%, CBA: 4.9%). Our CBA colleagues expect a Q3 hit to Australian GDP and employment from the greater Sydney lockdown, although incomes will be cushioned by government support payments. Chinese Q2 GDP (mkt: +1% qoq, 8.0% yoy), June retail sales, Industrial production and fixed asset investment are out at 2pm. The June UK labour market report is out and is likely to show further recovery as should US jobless claims. **Author**: mark.smith4@asb.co.nz

Currencies			Currencies			Commodities			Equities		
NZD/USD	0.7030	1.2%	NZD/SEK	6.059	0.8%	NZX WMP	3730.0	0.0%	Dow	34933	0.1%
NZD/AUD	0.9402	0.8%	NZD/DKK	4.417	0.7%	Gold $/o	1826.4	1.0%	S&P 500	4376	0.2%
NZD/EUR	0.5939	0.7%	NZD/THB	22.9	1.1%	WTI Oil $/b	73.2	-2.8%	NASDAQ	14664	0.0%
NZD/JPY	77.33	0.9%	AUD/USD	0.7476	0.4%	**Money Market (%)**			FTSE	7091	-0.5%
NZD/GBP	0.5073	0.9%	EUR/USD	1.184	0.5%	90 Day BB	0.39	0.07	CAC-40	6558	0.0%
NZD/CAD	0.8794	1.2%	USD/JPY	110.0	-0.6%	OCR	0.25	0.00	DAX	15789	0.0%
NZD/CHF	0.6428	0.8%	**10 Yr Bond Yields (%)**			**ASB Swap Rates (%)**			H.Seng	27787	-0.6%
NZD/HKD	5.460	1.2%	NZ	1.75	0.07	1yr	0.74	0.16	Nikkei	28608	-0.4%
NZD/SGD	0.9512	1.0%	US	1.35	-0.06	2yr	0.98	0.11	ASX200	7355	0.3%
NZD/CNH	4.541	0.7%	Aust	1.35	0.01	5yr	1.45	0.09	NZX50	12720	-0.5%

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