

## Bank of Canada becomes first to signal a shift in tone

**Yesterday's marquee event was the NZ CPI data for Q1, which threw up few surprises for markets.** With the global recovery underway, commodity prices surging and widespread logistics disruption, some were watching for hints of a 'smoking gun' in the data pointing to an uptick in inflation. But there was a conspicuous absence of any proverbial firearms, with CPI readings exactly in line with market and ASB expectations (+0.8% qoq, +1.5% qoq), and below the RBNZ's forecast back in the February *MPS*. The most eyebrow-arching element of the release was the relatively soft print for tradable goods, with little evidence of higher freight costs putting prices under pressure just yet.

**We still reckon inflation will move higher over 2021.** With reports of stretched capacity, higher costs and supply constraints, we expect pressure to mount over the coming quarters. We see headline inflation moving above 2% over the rest of 2021 and much of 2022 but remaining comfortably within the RBNZ's 1-3% target band.

**All up, we expect the RBNZ will stay patient when it comes to shifting the OCR.** While the prospect of an uptick in inflation has attracted feverish speculation over the first part of the year, central banks globally are still wary of the risks of premature tightening and have continued to emphasise the level of ongoing uncertainty in their comments, with a focus on stemming recent lifts in yields. The RBNZ will keep a watchful eye on forward-looking inflation indicators but will remain of that ilk. **We expect the OCR to remain on hold until August 2022, with the risks still pointing to a later kick-off for its first post-COVID rate hike.**

**Market reaction to the CPI release was minimal, as befits an unsurprising result.** Swap yields moved lower as the market took the view that the absence of a 'smoking inflation gun' diminished the prospect of any shift in the RBNZ's dovish tone. In the bond market, yields fell and the curve flattened over the day, but moves were relatively limited. There was little currency movement evident, with the NZD/USD trading in a relatively tight 0.716-0.179 range (it's since gained ground overnight). Besides yesterday's CPI release, the other key antipodean data out were Aussie retail sales figures, which beat expectations at +1.4% mom (mkt: +1%).

**Overnight, bond yields eased back in Europe but are up in North America, as the Bank of Canada became the first major central bank to signal a move away from a dovish tone.** The BoC left its benchmark at 0.25% (as expected) but scaled back its bond-buying programme by a quarter, substantially lifted its economic forecasts and brought forward its timetable for rate hikes. All up the bank lifted its GDP forecast for 2021 by more than two percent up to 6.5% and signalled it believed the economy would be operating at capacity by the second half of 2022.

**The move is a significant development, given the BoC's peers (including both the Fed and the RBNZ) have been keen to hold the dovish line and emphasise the risks still facing the recovery.** According to Bloomberg, Canadian swaps pricing now has about three rate hikes priced over the next two years.

**The tone in markets elsewhere has been positive.** Equities have gained with sharemarkets higher across the board in North America and Europe. At the time of writing the Dow is up 0.80%, the S&P 500 has lifted 0.65% and the Nasdaq is up 0.80%. Anxieties about rising COVID cases (particularly in India) that may have triggered a bit of a wobble earlier in the week once again took a backseat.

**FX comment:** Unsurprisingly, the CAD was the big winner overnight as markets digested the improved Canadian economic outlook and the implications for interest rate differentials. Elsewhere, the more positive risk sentiment overnight saw the safe-haven currencies underperform. The upshot saw the kiwi gain ground on all its G10 peers besides the CAD. As at the time of writing, the NZD/USD had gained to 0.721 and the NZD/AUD had nudged up just shy of 0.930.

**Day ahead:** Nothing of note in the local market today, and it's not much livelier across the ditch, with NAB business confidence the only significant release. **Overnight, the ECB meeting will be the marquee event, with markets expecting policy settings to remain unchanged.** A number of releases follow in the US overnight, with home sales (mkt: -1.1% mom) and initial jobless claims (mkt: 610k) the most notable. Elsewhere in Europe, look out for consumer confidence (mkt: -11) and PMI data (mkt composite: 52.9). **Author:** [nathaniel.keall@asb.co.nz](mailto:nathaniel.keall@asb.co.nz)

Currencies			Currencies			Commodities			Equities		
NZD/USD	0.7211	0.5%	NZD/SEK	6.060	0.2%	NZX WMP	4145.0	-0.6%	Dow	34134	0.9%
NZD/AUD	0.9298	0.1%	NZD/DKK	4.455	0.5%	Gold \$/o	1795.1	0.9%	S&P 500	4164	0.7%
NZD/EUR	0.5992	3.0%	NZD/THB	22.6	0.6%	WTI Oil \$/b	61.2	-1.9%	NASDAQ	13919	1.0%
NZD/JPY	77.92	8.3%	AUD/USD	0.7754	0.4%	<b>Money Market (%)</b>			FTSE	6895	0.5%
NZD/GBP	0.5175	-0.8%	EUR/USD	1.203	0.0%	90 Day BB	0.34	0.01	CAC-40	6211	0.7%
NZD/CAD	0.9009	0.0%	USD/JPY	108.1	0.0%	OCR	0.25	0.00	DAX	15196	0.4%
NZD/CHF	0.6611	11.0%	<b>10 Yr Bond Yields (%)</b>			<b>ASB Swap Rates (%)</b>			H.Seng	28622	-1.8%
NZD/HKD	5.598	0.6%	NZ	1.59	-0.05	1yr	0.36	0.00	Nikkei	28509	-2.0%
NZD/SGD	0.9582	0.5%	US	1.56	0.00	2yr	0.49	0.01	ASX200	6997	-0.3%
NZD/CNH	4.679	0.5%	Aust	1.74	-0.05	5yr	1.12	0.00	NZX50	12535	-1.1%

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