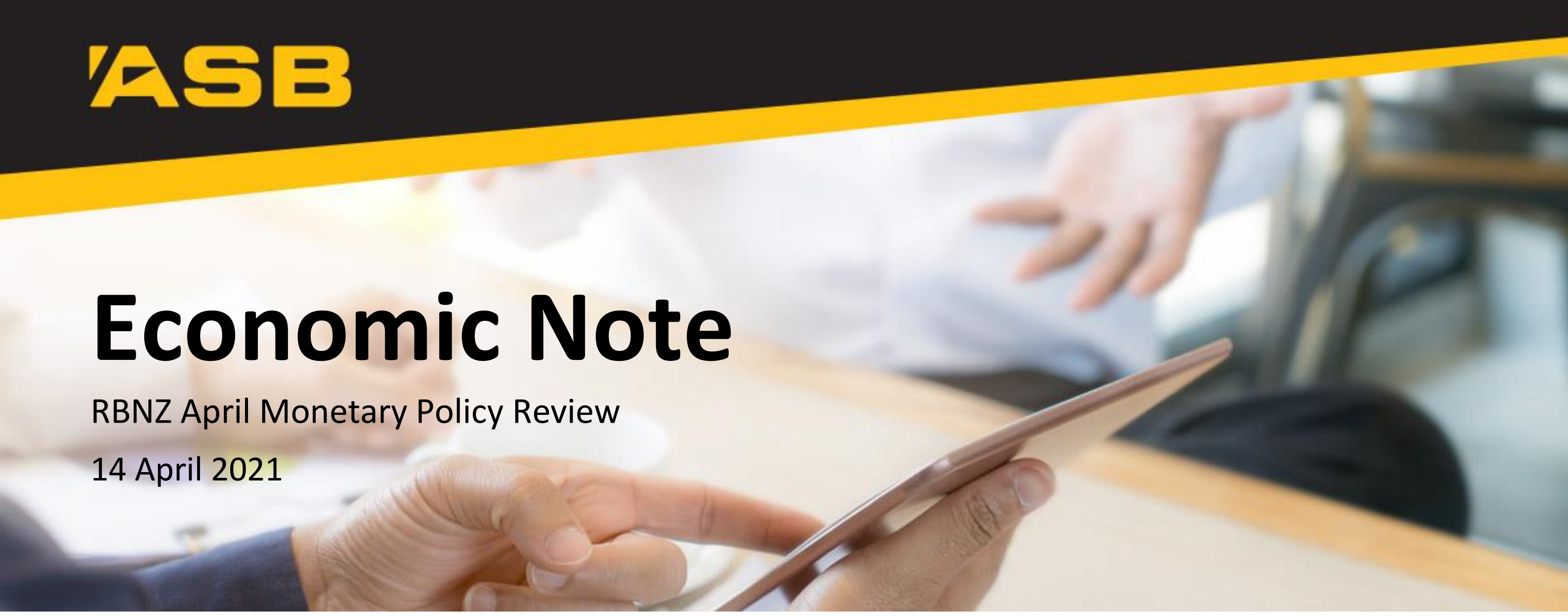


# Economic Note

RBNZ April Monetary Policy Review

14 April 2021

## The long and winding inflation road

- The RBNZ reiterated that a higher OCR is a long way off and that it stands ready to add stimulus if needed.
- The global outlook is brighter, some pockets of inflation are appearing, but the housing outlook is unclear.
- We expect the RBNZ will be on hold until at least August 2022. There is a lot of water to flow under the bridge.

**The RBNZ kept all its monetary policy settings steady and emphasised that stimulatory monetary policy will be needed for some time, as expected.** The February Monetary Policy Statement's policy stance and flagging of a preparedness to lower the OCR further "if required" remained in place.

The RBNZ sees the medium-term economic outlook as similar to its February Statement outlook, though it noted that domestic spending momentum slowed heading into summer. Meanwhile, the global outlook is better (but still highly uneven and uncertain), and NZ commodity prices are benefitting from strong demand.

The housing outlook is a fresh source of uncertainty in the wake of the Government's recent moves to discourage residential property investment purchases. At this point the RBNZ will be waiting to see what impact those moves have. Similarly, the RBNZ will watch to see what net impact the two-way flows of people in the trans-Tasman bubble has on economic activity.

The RBNZ has acknowledged that there are price pressures in the near term stemming from logistics challenges and higher oil prices. Nevertheless, the RBNZ sees medium-term inflation and employment as likely to remain below their targets without ongoing monetary stimulus.

We continue to expect the OCR will remain at 0.25% until August 2022, with the balance of probabilities tilted to a later start to OCR hikes than that. That timing is still nearly a year and a half away and, as we know all too well, much can happen in that timeframe – for better or worse. The RBNZ continues to make it clear that it is erring on the side of caution and will not be rushing to remove monetary stimulus.

### The key messages

The RBNZ's key points are:

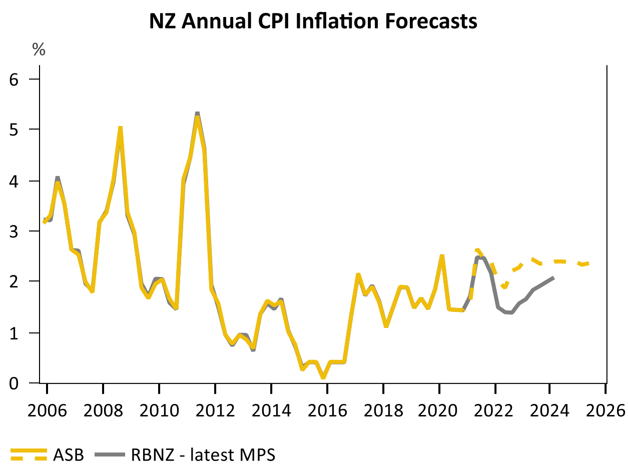
- Monetary stimulus will be in place for some time until the RBNZ is confident it is meeting its inflation and employment objectives;
- The OCR could still be cut if necessary;
- The global outlook is better, while domestic activity over the summer period was softer;
- It is a wait-and-see game for the economic impacts of the recently-announced housing policy changes and start of the trans-Tasman travel bubble;
- Inflation is getting pushed up in the short term, but the RBNZ still sees the need for ongoing monetary support to hold inflation up around the target mid-point.

Nick Tuffley – Chief Economist – 021 891 881 – (649) 301 5659 nick.tuffley@asb.co.nz
Mark Smith – Senior Economist – 027 578 5635 – mark.smith4@asb.co.nz

Put simply, there is nothing that has happened since February that has changed the RBNZ's view of the economic and monetary policy outlook, with the travel bubble and housing changes something to wait to gauge their significance. Indeed, the RBNZ is of the view that the medium-term outlook for growth is broadly similar to the scenario presented in the February *Statement*.

## Looking through cost-push inflation and focusing on the medium-term

Although the economy is likely to have a patchy performance this year, some bubbles of inflation pressure are becoming evident. Global disruption to production and shipping have increased importation costs and restricted the availability of finished goods and materials. Oil prices have lifted on global optimism (and anticipation of higher energy demand). Furthermore, pockets of skill shortages are emerging, which are likely to squeeze wages higher. In addition, the minimum wage has gone up again. We see annual inflation spiking to 2.6% in mid-2021, and trending at or above 2% thereafter.




Source: Macrobond, ASB

For the time being, we expect the RBNZ will look through the short-term squeeze on prices, particularly as the underlying trend for economic activity this year appears pretty flat. However, there is the risk that inflation pressures continue to build. We, and the RBNZ will be keeping close tabs on wider inflation indicators, including inflation expectations (that are currently "at or below the 2% target midpoint") to determine how sustainable inflationary pressures will be.

Employment is also deemed to be below its maximum sustainable level, with uneven outcomes across the economy, with some firms having difficulty finding skilled labour because of border restrictions and skills mismatches. Employment is only expected to increase gradually over the medium term, necessitating continued policy support.

## The housing elephant to address

For the RBNZ, the recent strength of house prices has escalated from merely being an influence on the economic outlook. High house prices have become a financial stability concern. They have also prompted the Government to draw the RBNZ into helping achieve the Government's housing policy objectives (which are to "support more sustainable house prices, including by dampening investor demand for existing housing stock, which would improve affordability for first-home buyers"). Much of what the RBNZ will actively do in response to high house prices is likely to fall into the financial stability realm and may extend to restrictions on interest-only loans to residential property investors or use of debt-to-income limits. We await the May Financial Stability Report with interest.

From the narrower monetary policy perspective, the Government's recent investor-focused measures will have altered the outlook for house prices, cooling the market quicker with potential flow-on impacts to consumer spending and construction activity. But, with the housing policy changes only just announced and with no public Regulatory Impact Assessment of the most material change (removing interest expense deductibility), the RBNZ is taking a wait-and-see approach. Our own forecast changes essentially brought our house price outlook roughly back in line with the RBNZ's February forecast, which itself looked like it was well undercooking the hot market up until the Government's policy announcement. So, the RBNZ may not need to adjust its own house price and economic view that much. That outlook will be more firmed up for the fuller Monetary Policy Statement for release on 26 May.

## LSAP and FLP important parts of RBNZ policy

The RBNZ repeated the pledge to target up to $100bn of asset purchases under the LSASP programme by June 2022. Importantly, the RBNZ retained the flexibility in the timing of weekly asset purchases, with staff continuing to adjust purchases after considering 'market functioning'. The RBNZ has slowed the pace of weekly asset purchases (at just over $400m), although purchases remain above the (trimmed down) weekly bond tender (around $300m). We expect the RBNZ will likely further trim asset purchases, with a view to halting the programme ahead of OCR hikes in August 2022.

Despite the climb in local and global interest rates and steeper yield curves, the RBNZ threw down the gauntlet to banks, noting that bank funding costs remained near historic lows, likely courtesy of the Funding for Lending Programme. There was a stern message to banks with the summary record of meeting noting “any increase in bank lending rates would be premature given the current economic outlook”.

## Limited market reaction

Market reaction to the RBNZ statement was muted, with NZD/USD initially dipping and then recovering to circa 0.2c above pre-announcement levels.  Yields on the NZ 2-year swap were about 2 basis points lower.

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| ASB Economics & Research | | | Phone |
|---|---|---|---|
| Chief Economist | Nick Tuffley | nick.tuffley@asb.co.nz | (649) 301 5659 |
| Senior Economist | Mark Smith | mark.smith4@asb.co.nz | (649) 301 5957 |
| Senior Economist | Jane Turner | jane.turner@asb.co.nz | (649) 301 5853 |
| Senior Economist | Mike Jones | mike.jones@asb.co.nz | (649) 301 5660 |
| Senior Economist, Wealth | Chris Tennent-Brown | chris.tennent-brown@asb.co.nz | (649) 301 5915 |
| Economist | Nat Keall | nathaniel.keall@asb.co.nz | (649) 301 5720 |
| Data & Publication Manager | Judith Pinto | judith.pinto@asb.co.nz | (649) 301 5660 |

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