

International Commentary — May 26, 2021

Kiwi Central Bank Turning Hawkish

Summary

- The Reserve Bank of New Zealand (RBNZ) is the latest central bank preparing for a shift to less accommodative monetary policy, with this week's monetary policy announcement including a notable change in policy bias.
- The RBNZ held its Official Cash Rate steady at 0.25% and kept the limit for its Large Scale Asset Purchase program at NZ\$100 billion. However, in publishing conditional projections for the Official Cash Rate for the first time since the pandemic began, the central bank signaled that interest rates could begin to rise from the second half of 2022, and that it might not fully utilize its NZ\$100 billion purchase limit.
- Today's announcement represents upside risk to our NZD/USD exchange rate forecast, which currently anticipates the NZ dollar gaining to \$0.7700 over the medium-term.

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RBNZ Steady For Now, But Laying the Groundwork for a Rate Rise

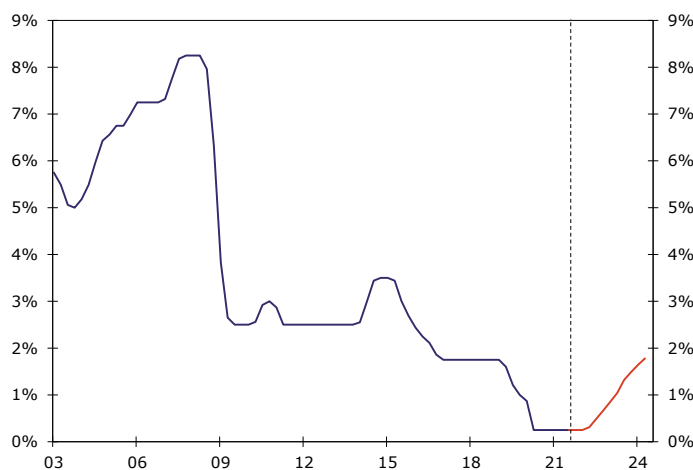
The Reserve Bank of New Zealand (RBNZ) announced its latest monetary policy decision this week and, while there was no change in policy stance at this meeting, there were some notable changes in the central bank's policy bias. The RBNZ kept its Official Cash Rate at 0.25%, and also maintained the limit for its Large Scale Asset Purchase program at NZ\$100 billion.

However, the central bank signaled that policy interest rates could begin to rise as soon as the second half of 2022. In its accompanying Monetary Policy Statement, for the first time since the pandemic began the RBNZ provided conditional projections for the path of the Official Cash Rate. Those projections see the policy rate at 0.31% in Q2-2022 and 0.49% in Q3-2022, essentially factoring in a full 25 basis point rate increase by Q3 of next year. There was also a notable change in the RBNZ's qualitative interest rate guidance. The central bank said that it "agreed to maintain its current stimulatory monetary policy settings", whereas in April it said it was prepared to lower the policy interest rate if required. Moreover, in terms of the summary record of the meeting, policymakers said the policy interest rate is the preferred tool to respond to economic developments in either direction—a more balance outlook than previously.

The RBNZ also said it is unlikely to meet its NZ\$100 billion limit for asset purchases by June 2022 (cumulative purchases so far currently total just over NZ\$53 billion). While at first glance this might seem like a hawkish tilt, and at the margin it is, we also note this potential undershoot comes in the context of reduced New Zealand government bond issuance following the government's 2021 Budget. Thus the demand/supply balance for NZ government bonds is less affected, and this central bank statement referring to its Large Scale Asset Purchase program may be less hawkish than appears at first glance.

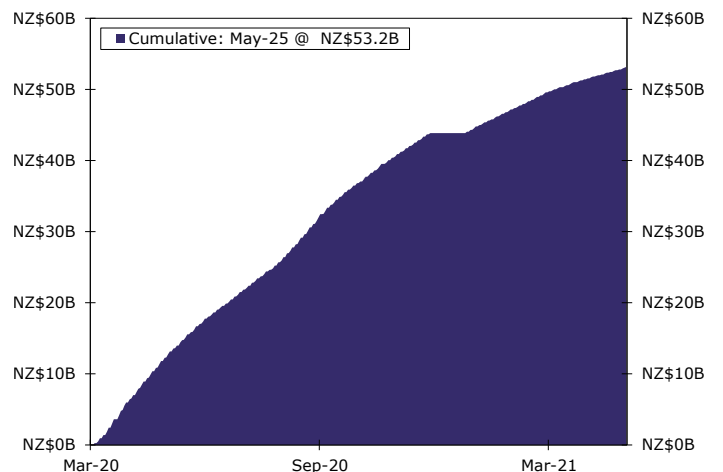
Finally, with respect to economic projections, the RBNZ expects GDP to contract in Q1 before growth resumes in Q2. For calendar 2021 the RBNZ forecasts GDP growth of 3.4%, while the GDP growth forecast for 2022 is 3.5%. After a near-term rise in inflation which sees the CPI peak at 2.6% year-over-year in Q2-2021, CPI inflation is expected to ease back below 2% by 2022. For us, **given the clear policy signals offered by the Reserve Bank of New Zealand, we now expect at initial 25 basis point increase in the Official Cash Rate in Q3-2022, taking that rate to 0.50%.** Moreover, in our *May International Economic Outlook* we highlighted an upside scenario for the NZ dollar in which any significant shift in the RBNZ's policy bias (in a hawkish direction) could see the NZ currency gain close to \$0.8000 over the medium-term. While our formal FX forecasts are unchanged for now, this week's developments are clearly at least consistent with that upside scenario.

RBNZ Official Cash Rate Projection



Source: Reserve Bank of New Zealand and Wells Fargo Securities

RBNZ LSAP Cumulative Purchases



Source: Reserve Bank of New Zealand and Wells Fargo Securities

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