

Monetary Policy On Hold In New Zealand

- The Reserve Bank of New Zealand left the Official Cash Rate unchanged at 0.25%—in line with our forecast but against the consensus expectation of a hike—reflecting uncertainties arising from the COVID-19 situation.
- The RBNZ revised its forecasts notably, indicating that it will start lifting the policy rate by the end of 2021, vs. its earlier projection of Q3 2022. We expect a hike at the next policy meeting in October.

The Reserve Bank of New Zealand's (RBNZ) Monetary Policy Committee left the Official Cash Rate unchanged at 0.25% following the August 18 monetary policy meeting (chart 1), in line with our expectation. The analyst consensus had anticipated a hike. The RBNZ's decision follows the July policy step of halting of additional government bond purchases under the Large Scale Asset Purchase programme. While the central bank opted to take a break from monetary normalization this month, we assess that an interest rate hike is near, assuming that New Zealand's COVID-19 situation remains under control; we forecast the RBNZ to raise the policy rate following the next monetary policy meeting scheduled for October 6.

While the New Zealand economic recovery has been fast and robust, today's decision reflects uncertainties related to the global COVID-19 situation. The rapidly spreading delta variant poses downside risks to New Zealand's economic outlook as the country's level of vaccinations is still low (only around 17% of the population is fully vaccinated, below a global average); indeed, the August 17 announcement of a short nation-wide lockdown highlights the virus-related risks. Nevertheless, we assess that New Zealand's economy is well-positioned to deal with the current setback.

The domestic side of the economy is solid, justifying monetary normalization in the near future. The RBNZ assesses that employment is "at or above" the maximum sustainable level, thereby meeting the central bank's labor market objective. Indeed, the unemployment rate dropped to 4.0% in Q2 while labour shortages are putting pressure on wages; closed borders are preventing employers from tapping into the global labour pool. Inflationary pressures in New Zealand have intensified recently, with the consumer price index rising by 3.3% y/y in Q2 (chart 2), above the RBNZ's 1–3% inflation target. We expect headline inflation to hover close to 4% y/y through the rest of 2021 before easing to 2.5% by the end of 2022. While higher energy prices, transportation costs and housing-related factors play a key role in the recent pickup, we assess that solid domestic demand and wage gains will keep inflation near the 2% target midpoint over the next few years.

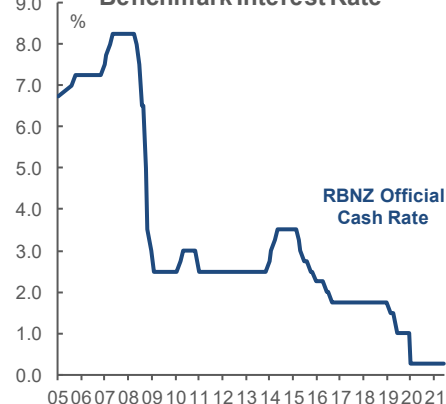
In the Monetary Policy Statement that accompanied the rate decision, the RBNZ revised its rate forecasts notably. Previously, the central bank had expected a rate hiking cycle to commence in Q3 2022; the revised forecast points to a more imminent kickoff in Q4 2021. We had argued that revising the forecasts before starting the hiking cycle would underpin the central bank's credibility, an important consideration for the progressive RBNZ that has been a monetary policy trendsetter since being the first central bank to adopt inflation-targeting more than 30 years ago. According to the RBNZ's fresh guidance, the Cash Rate will reach its estimated neutral level of 2% by Q3 2023.

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Chart 1

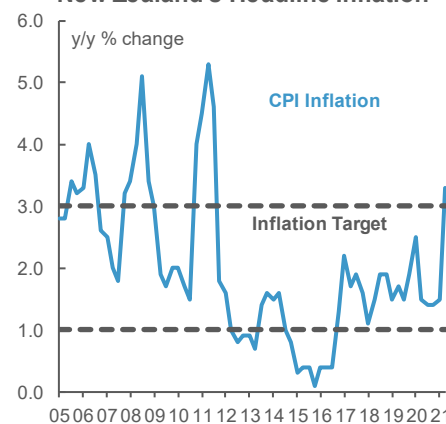
Reserve Bank of New Zealand's Benchmark Interest Rate



Sources: Scotiabank Economics, Bloomberg.

Chart 2

New Zealand's Headline Inflation



Sources: Scotiabank Economics, Bloomberg.

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