

## Monetary Policy Tightened in New Zealand

- The Reserve Bank of New Zealand raised the Official Cash Rate by 25 basis points to 0.50%, thereby kicking off a new hiking cycle.
- Despite near-term uncertainties, rising inflation and labour market tightness will warrant gradual tightening through 2022.

The Reserve Bank of New Zealand's (RBNZ) Monetary Policy Committee raised the Official Cash Rate by 25 basis points to 0.50% following the October 6 monetary policy meeting (chart 1), in line with our expectation. The hike follows the RBNZ's August policy decision to leave the key rate on hold due to uncertainties related to COVID-19. The next monetary policy meeting is scheduled for November 24; inflation and employment data releases for Q3 (to be published on October 18 and November 3, respectively) will be important in determining the timing of the RBNZ's next hike. Given persistent pandemic-related uncertainties, we expect the RBNZ to carefully monitor near-term developments and take a gradual approach to monetary tightening. We forecast the Cash Rate to reach 1.50% by the end of 2022.

New Zealand's economic recovery has hit a speed bump—reflecting the most recent COVID-19 wave that started in August and triggered broad movement restrictions—yet the economy's underlying fundamentals remain solid. While we recognize the adverse impact on the economy in the short-term caused by the lockdown and the evolving virus situation, we assess that the economy will rebound fast from the current soft patch, assisted by fiscal stimulus and still-accommodative monetary policy. We expect household spending to recover quickly along with an increasing vaccination coverage, underpinned by solid household finances and sound labour market conditions. Likewise, investment is set to pick up on the back of strong business balance sheets and rebounding confidence. Reflecting similar considerations, the RBNZ assesses that economic conditions in New Zealand warrant less-accommodative monetary policy. The central bank's key policy objectives are to keep annual inflation within the 1–3% target and to support maximum sustainable employment; with a quick economic recovery following the pandemic-triggered recession, both targets have now been met.

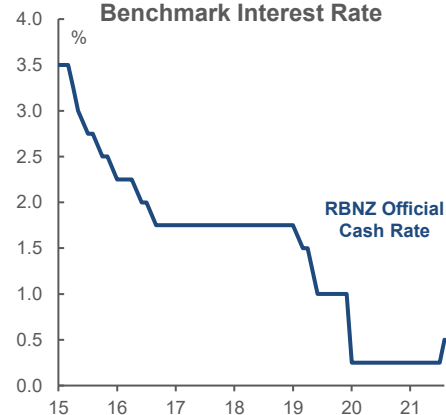
Inflationary pressures in New Zealand have intensified recently, with the consumer price index rising by 3.3% y/y in Q2 (chart 2), above the RBNZ's inflation target. We expect headline inflation to hover at 4% y/y through the rest of 2021 before easing to 2.5% by end-2022. While higher energy prices, transportation costs and housing-related factors play a key role in the recent pickup, we assess that solid domestic demand prospects and wage gains will keep inflation near the 2% target midpoint over the next few years. Meanwhile, New Zealand's labour market conditions remain solid despite some transitory lockdown-related softness in the short-term. With the unemployment rate at 4.0% in Q2, the nation's employment is near its maximum sustainable level. Meanwhile, labour shortages are putting pressure on wages, partially reflecting the fact that closed borders are preventing employers from tapping into the global labour pool. Indeed, the country's average weekly remuneration increased by 9.2% y/y in Q2, while another indicator, hourly wages in the private sector, showed salaries rising by 4.4% y/y (0.7% q/q) in Q2. As we approach 2022, we should get a clearer view on underlying price pressures in the economy. Despite elevated uncertainty, we currently assess that medium-term risks are skewed toward higher inflation and rising labour market tightness.

### CONTACTS

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Chart 1

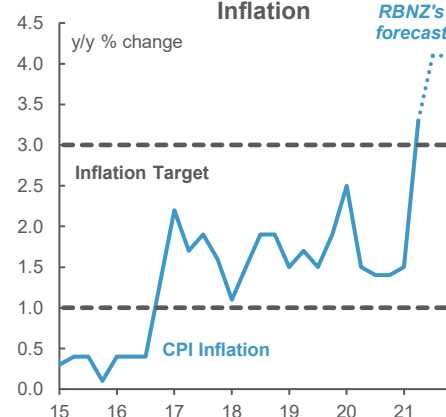
#### Reserve Bank of New Zealand's Benchmark Interest Rate



Sources: Scotiabank Economics, Bloomberg.

Chart 2

#### New Zealand's Headline Inflation



Sources: Scotiabank Economics, Bloomberg.

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