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Reserve Bank of New Zealand Accelerates Monetary Tightening to Fight Inflation

- **The Reserve Bank of New Zealand raised the Official Cash Rate by 50 basis points to 1.50%, accelerating the pace of monetary normalization after three smaller rate hikes since last October.**
- **The central bank tries to reduce the risk of rising inflation expectations by bringing monetary tightening forward. The larger hike will also provide more policy flexibility for the coming quarters as the global economic environment is set to remain uncertain.**
- **As New Zealand's inflation remains high and the labour market is tight, more interest rate increases are in sight. We expect the Cash Rate to reach 2.75% by the end of 2022.**

The Reserve Bank of New Zealand's (RBNZ) Monetary Policy Committee raised the Official Cash Rate (OCR) by 50 basis points to 1.50% following the April 13 policy meeting (chart 1). We—and the analyst consensus—had anticipated a 25 bps hike. Before this move, the central bank had lifted the policy rate by 25 bps at each of the prior three meetings (in February, November, and October). Continued monetary tightening is needed in New Zealand in the face of elevated inflation and a tight labour market. Indeed, the RBNZ's policymakers assess that frontloading rate hikes is needed to help contain rapidly rising inflation expectations (chart 1). Moreover, the RBNZ sees that hiking more aggressively now builds policy buffers for the future given the uncertain global economic outlook. We expect further interest rate increases over the coming months, taking the OCR to 2.75% by the end of the year.

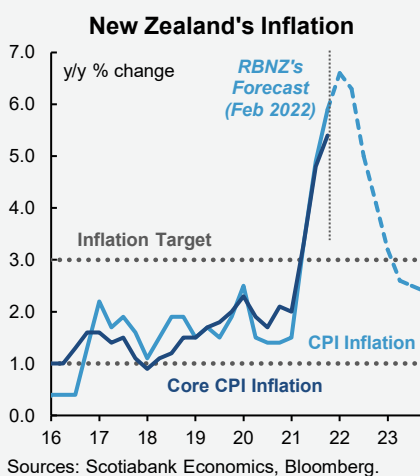
Inflation in New Zealand has picked up, and further acceleration is expected. Price pressures reflect both domestic and external factors, such as higher wage gains, rising capacity pressures, elevated inflation expectations, as well as global commodity price gains and supply chain bottlenecks. We estimate that headline prices rose 6.7% y/y in Q1 following a 5.9% gain in Q4 2021 (chart 2). Price pressures have intensified also at the core level, with the CPI excluding food, household energy, and vehicle fuels increasing by 5.4% y/y in Q4. CPI data for Q1 will be released on April 21. We expect headline inflation to remain in the 6.5–7.0% range in the first half of the year before starting to ease gradually thereafter. Inflation will likely return to the RBNZ's 1–3% target around mid-2023. However, rising inflation expectations pose a notable upside risk to the forecast.

New Zealand's economy is performing strongly on the back of still-low interest rates, solid balance sheets of households and businesses, supportive fiscal policy, as well as elevated prices for the nation's exports. Nevertheless, some softening in activity is in sight as rising mortgage rates are dampening New Zealand's real estate sector and global uncertainties are adversely affecting consumer confidence. Nonetheless, more cooling is needed to promote price stability as domestic capacity constraints persist. The RBNZ assesses that employment is above its maximum sustainable level. Therefore, the economy is facing labour shortages, which are causing rising wages and adverse impacts on economic output. According to the central bank's assessment, the gradual reopening of New Zealand's international borders will increase net immigration and labour supply only slowly. The country's unemployment rate—at 3.2% in Q4 2021—is at its lowest level on record and wage inflation is accelerating as firms are competing for workers. The labour cost data for Q1 will be published in early May and will play a key role in determining the size of future OCR hikes by the RBNZ. The wage index increased by 2.6% y/y in Q4 and is expected to show further acceleration through 2022. Another indicator, the country's average weekly wages, showed remuneration increasing by 5.7% y/y in Q4.

Chart 1



Chart 2



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