RBNZ Monetary Policy Statement Preview

15 February 2022

Contact
Sharon Zollner for more details.

Hikes coming, "steady" or not…

Summary

- We expect the RBNZ will raise the Official Cash Rate (OCR) 25bp to 1.00% at its Monetary Policy Statement (MPS) next Wednesday.
- The RBNZ has a big job to do, and we would not rule out a 50bp hike. But as in November, there are lower-risk ways the RBNZ could tighten conditions more aggressively if they feel it's necessary.

Rate rise inevitable

There is no serious debate about the fact that the New Zealand economy needs higher interest rates to rein in persistent inflation pressures. The issue at hand, as it was in November, is whether the RBNZ will hike by 25bp or 50bp.

It's been a long time between drinks for the RBNZ, with no opportunity to move the Official Cash Rate since late November. If there hadn't been a hole in their meeting calendar in January, we'd certainly have another hike under the belt by now. So should the RBNZ make up for lost time?

Odds implied by market pricing are currently around 70/30 in favour of a 25bp, rather than 50bp hike. As in November, we can't rule it out, but on balance, we think the RBNZ will opt for 25bp. Let's go through the arguments.

Arguments for 25bp	Arguments for 50bp
• **But you said:** The RBNZ has made it clear they prefer to move in steady 25bp steps unless the risks are a landslide in one direction. See our November MPS Preview for a discussion of our interpretation of those comments in the current cyclical context. • **Less risky alternatives:** Beyond moving the OCR itself, the forecast track has a huge impact. A more aggressive OCR forecast delivers more tightening upfront – with less risk of a U-turn in actual policy. • **Omicron chaos is just kicking off.** Relatively short-lived it may be, but it's going to be intense and enormously stressful for many firms, and a double hike might look a little tone-deaf in that context. • **Broader financial conditions have tightened materially.** The CCCFA and LVR rules have tightened credit availability. Swap rates suggest mortgage rates will rise. Long yields are up. Our Financial Conditions Index has tightened rapidly. • **The housing market** is already in retreat, with house sales falling and annual house price inflation rapidly losing steam. That's very unusual so early in a hiking cycle, when more typically the RBNZ is struggling to get traction. It's quite a game changer.	• **Q4 CPI inflation** came out at 5.9% (RBNZ exp: 5.7%), led by domestic inflation. Core measures are all outside the target band. • **The Nike argument.** If you're confident you have a big job to do, why not get going? A slower start means higher rates for longer, all else equal. • **The Bank of England nearly kicked off their hiking cycle with 50bp.** It was a close-run thing, with a 5-4 vote. The Fed's Bullard is in favour of a 50bp start in the US too. • **The RBNZ has shown it doesn't mind surprising the market.** And the market is on the fence anyway. • **Omicron is going to be inflationary, if anything.** The experience of the rest of the world means the RBNZ will be comfortable forecasting Omicron's negative impacts on demand to blow through fairly rapidly. • **The NZD is sharply lower.** That will add to imported inflation pressures. • **Energy prices keep rising.** Petrol prices have an outsized impact on household inflation expectations in particular, but also hit firms' costs.

In the "foot in each camp" category:

- **inflation expectations** in the RBNZ's survey rose, with the 5-year measure lifting from 2.17% to 2.30%. A 0.3% deviation from the target midpoint is not insignificant at that time horizon, but it would be an exaggeration to suggest it's into the danger zone.
- The **unemployment** rate, at 3.2%, was in line with RBNZ expectations but with slightly disappointing employment and wage growth. Still, unemployment is at a fresh record low.

Overall, while we can "never say never", we don't see any compelling reason for the RBNZ to change its approach from the November MPS, when they made it clear that steady steps were appropriate given the risks are decidedly to the downside for economic growth, even if inflation is to the upside.

Markets

The market's immediate focus will be the OCR decision itself and the RBNZ's revised OCR track. Market expectations are currently split as to whether we will see a 25bp or 50bp hike (roughly 70/30). Presuming market pricing doesn't change too much between now and decision day, that implies we will see a knee-jerk reaction one way or the other, and some volatility is thus to be expected. However, we suspect volatility will be mostly confined to the very short end of the curve, out to perhaps 3 or 6 months. Other key short-end rates like the 1 and 2-year swap will be more responsive to the RBNZ's OCR track, and if that gets revised up as we expect, we don't see a lot of scope for downward movement in them.

In the FX space, we expect the Kiwi to respond to the overall vibe – essentially, whether it is judged to be hawkish, which might ironically weigh on the NZD on the perception that a hard landing is more likely. We actually think a more cautious approach would likely be welcomed by currency markets, which have become less focussed on interest rates and interest rate differentials, and more focused on risk.

Beyond the OCR decision, we also expect the RBNZ to provide details on how it intends to manage down its LSAP bond holdings. While the RBNZ has not committed to provide that this month, they did say in November that "details on how bond holdings will be reduced will be provided early next year", and we take that to mean next week. Running down the LSAP portfolio represents an unwinding of quantitative easing or "QE", and can thus be thought of as quantitative tightening, or "QT".

We expect the Bank to say that it intends to be pragmatic and flexible around QT, and be responsive to how the economic outlook and market functioning evolves, rather than pre-committing to, for example, getting the portfolio down to a specific size by a specific date. Within that, we expect the Bank to clarify things like how it intends to sell down its bond holdings (if it decides to do so), and to explain what it intends to achieve by running its portfolio down.

With regard to the former, we assume that the Bank remains committed to not selling bonds in the open market (which would effectively see them competing with the Treasury for funding), and instead be restricted to selling bonds to the Treasury, as outlined in the Governor's letter to the Finance Minister in August 2020. With regard to the latter, we're not exactly sure what would be achieved by running down the LSAP portfolio ahead of its natural maturity profile, if that brings forward the burden on fiscal policy. Long-term bond yields are already significantly higher than they were a few months ago, and even if the RBNZ wanted them higher, it's not clear that they could effect that through QT (especially if they can't sell bonds in the open market, as we assume). Bottom line – if the RBNZ do look to accelerate the run-off, we'd expect them to explain what impact they think it will have on the economy and markets, and how that might impact future OCR decisions.

Presuming the RBNZ is only able to sell its holdings to the Treasury, there would only be an impact on markets and fiscal policy if the Treasury had to issue extra bonds to fund these purchases. However, we doubt the Treasury is planning to issue more bonds (remember, the Treasury holds all the cards here, and they only just cut their bond issuance projections in December). It is possible that the Treasury have already earmarked a portion of its cash and liquid assets to be able to fund an earlier run-down of the LSAP portfolio than is implied by the maturity profile of the portfolio. But if they have already done that, then it's already in issuance projections (as, incidentally, is the repayment of all maturing bonds, including those held by the RBNZ), so it won't have a knock-on impact. Further out, any sales of LSAP bonds ahead of their maturity will shift the timing of when those liabilities need to be funded by the Treasury.

Markets may well get spooked by the idea that QT is coming, but they shouldn't if it is gradual and off-market, as we expect. And remember, if the economy sours or market functioning falters, the RBNZ can always hold off, or elect to slow the run-off rate of the portfolio by reinvesting a portion of its maturing bonds, as the US Federal Reserve did post-GFC/pre-COVID.

At some stage in the future, the RBNZ may also look to tweak the way it remunerates ESAS balances (the balances of accounts that settlement banks like ANZ hold with the RBNZ). At the moment, all balances are remunerated at the OCR. That wasn't how it was before QE was introduced – back then, banks were remunerated up to the level of their individual cash tier (based on their size), and remunerated at a lesser rate on balances in excess of that, to discourage cash hoarding. But because the settlement cash level (SCL) was projected to (and did) rise rapidly as a result of QE, the RBNZ abandoned cash tiering when it embarked on QE, as it would have amounted to an unavoidable tax on banks.

However, now that the system is flooded (SCL is forecast to be around $45bn this week), cash often trades below the OCR, especially in the FX forwards market. That's not necessarily desirable as the RBNZ embarks on a tightening cycle. The RBNZ may look to re-introduce cash tiers and conduct large-scale open market operations ("OMOs") in a bid to soak up what it might view as excess liquidity. While this is likely to only be of passing interest to most observers, it would likely have an upward impact on where cash trades in the forwards, drive short-end basis swap spreads higher, and at the margin, slightly reduce how much work the OCR might need to do.

The merits of doing this sooner rather than later are debatable – we note, for example, that this would be going in the opposite direction to the FLP. But of course, so too is the OCR at the moment, and at some stage, it probably makes sense to restore things to how they were pre-COVID. And given any attempt to do so would represent another step towards tightening, albeit a minor one, doing it now might have appeal.

Contact us

Meet the team

We welcome your questions and feedback. Click here for more information about our team.

Sharon Zollner
Chief Economist

Follow Sharon on Twitter
@sharon_zollner

Telephone: +64 27 664 3554
Email: sharon.zollner@anz.com

General enquiries:
research@anz.com

Follow ANZ Research
@ANZ_Research (global)

David Croy
Senior Strategist

Market developments, interest rates, FX, unconventional monetary policy, liaison with market participants.

Telephone: +64 4 576 1022
Email: david.croy@anz.com

Susan Kilsby
Agricultural Economist

Primary industry developments and outlook, structural change and regulation, liaison with industry.

Telephone: +64 21 633 469
Email: susan.kilsby@anz.com

Miles Workman
Senior Economist

Macroeconomic forecast co-ordinator, fiscal policy, economic risk assessment and credit developments.

Telephone: +64 21 661 792
Email: miles.workman@anz.com

Finn Robinson
Economist

Macroeconomic forecasting, economic developments, labour market dynamics, inflation and monetary policy.

Telephone: +64 21 629 553
Email: finn.robinson@anz.com

Kyle Uerata
Economic Statistician

Economic statistics, ANZ proprietary data (including ANZ Business Outlook), data capability and infrastructure.

Telephone: +64 21 633 894
Email: kyle.uerata@anz.com

Natalie Denne
PA / Desktop Publisher

Business management, general enquiries, mailing lists, publications, chief economist's diary.

Telephone: +64 21 253 6808
Email: natalie.denne@anz.com

Important notice

Last updated: 27 January 2022

This document (which may be in the form of text, image, video or audio) is intended for ANZ's Institutional, Markets and Private Banking clients. It should not be forwarded, copied or distributed. The opinions and research contained in this document are (a) not personal advice nor financial advice about any product or service; (b) provided for information only; and (c) intended to be general in nature and does not take into account your financial situation or goals.

This document may be restricted by law in certain jurisdictions. Persons who receive this document must inform themselves about and observe all relevant restrictions.

Disclaimer for all jurisdictions: This document is prepared and distributed in your country/region by either: Australia and New Zealand Banking Group Limited (ABN11 005 357 522) (**ANZ**); or its relevant subsidiary or branch (each, an **Affiliate**), as appropriate or as set out below.

This document is distributed on the basis that it is only for the information of the specified recipient or permitted user of the relevant website (**recipients**).

This document is solely for informational purposes and nothing contained within is intended to be an invitation, solicitation or offer by ANZ to sell, or buy, receive or provide any product or service, or to participate in a particular trading strategy.

Distribution of this document to you is only as may be permissible by the laws of your jurisdiction, and is not directed to or intended for distribution or use by recipients resident or located in jurisdictions where its use or distribution would be contrary to those laws or regulations, or in jurisdictions where ANZ would be subject to additional licensing or registration requirements. Further, the products and services mentioned in this document may not be available in all countries.

ANZ in no way provides any financial, legal, taxation or investment advice to you in connection with any product or service discussed in this document. Before making any investment decision, recipients should seek independent financial, legal, tax and other relevant advice having regard to their particular circumstances.

Whilst care has been taken in the preparation of this document and the information contained within is believed to be accurate, ANZ does not represent or warrant the accuracy or completeness of the information Further, ANZ does not accept any responsibility to inform you of any matter that subsequently comes to its notice, which may affect the accuracy of the information in this document.

Preparation of this document and the opinions expressed in it may involve material elements of subjective judgement and analysis. Unless specifically stated otherwise: they are current on the date of this document and are subject to change without notice; and, all price information is indicative only. Any opinions expressed in this document are subject to change at any time without notice.

ANZ does not guarantee the performance of any product mentioned in this document. All investments entail a risk and may result in both profits and losses. Past performance is not necessarily an indicator of future performance. The products and services described in this document may not be suitable for all investors, and transacting in these products or services may be considered risky.

ANZ expressly disclaims any responsibility and shall not be liable for any loss, damage, claim, liability, proceedings, cost or expense (Liability) arising directly or indirectly and whether in tort (including negligence), contract, equity or otherwise out of or in connection with this document to the extent permissible under relevant law. Please note, the contents of this document have not been reviewed by any regulatory body or authority in any jurisdiction.

ANZ and its Affiliates may have an interest in the subject matter of this document. They may receive fees from customers for dealing in the products or services described in this document, and their staff and introducers of business may share in such fees or remuneration that may be influenced by total sales, at all times received and/or apportioned in accordance with local regulatory requirements. Further, they or their customers may have or have had interests or long or short positions in the products or services described in this document, and may at any time make purchases and/or sales in them as principal or agent, as well as act (or have acted) as a market maker in such products. This document is published in accordance with ANZ's policies on conflicts of interest and ANZ maintains appropriate information barriers to control the flow of information between businesses within it and its Affiliates.

Your ANZ point of contact can assist with any questions about this document including for further information on these disclosures of interest.

Country/region specific information: Unless stated otherwise, this document is distributed by Australia and New Zealand Banking Group Limited (**ANZ**).

Australia. ANZ holds an Australian Financial Services licence no. 234527. For a copy of ANZ's Financial Services Guide please click here or request from your ANZ point of contact.

Brazil. This document is distributed on a cross border basis and only following request by the recipient.

Brunei, India, Japan, Kuwait, Malaysia, Switzerland, Taiwan. This document is distributed in each of these jurisdictions by ANZ on a cross-border basis.

Cambodia. The information contained in this document is confidential and is provided solely for your use upon your request. This does not constitute or form part of an offer or solicitation of any offer to engage services, nor should it or any part of it form the basis of, or be relied in any connection with, any contract or commitment whatsoever. ANZ does not have a licence to undertake banking operations or securities business or similar business, in Cambodia. By requesting financial services from ANZ, you agree, represent and warrant that you are engaging our services wholly outside of Cambodia and subject to the laws of the contract governing the terms of our engagement.

Chile. You understand and agree that ANZ Banking Group Limited is not regulated by Chilean Authorities and that the provision of this document is not subject to any Chilean supervision and is not guaranteed by any regulatory or governmental agency in Chile.

Fiji. For Fiji regulatory purposes, this document and any views and recommendations are not to be deemed as investment advice. Fiji investors must seek licensed professional advice should they wish to make any investment in relation to this document.

Hong Kong. This document is issued or distributed in Hong Kong by the Hong Kong branch of ANZ, which is registered at the Hong Kong Monetary Authority to conduct Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) regulated activities. The contents of this document have not been reviewed by any regulatory authority in Hong Kong.

India. If this document is received in India, only you (the specified recipient) may print it provided that before doing so, you specify on it your name and place of printing.

Macau. Click here to read the disclaimer for all jurisdictions in Mandarin. **澳门.** 点击此处阅读所有司法管辖区的免责声明的中文版。

Myanmar. This document is intended to be general and part of ANZ's customer service and marketing activities when implementing its functions as a licensed bank. This document is not Securities Investment Advice (as that term is defined in the Myanmar Securities Transaction Law 2013).

New Zealand. This material is for information purposes only and is not financial advice about any product or service. We recommend seeking financial advice about your financial situation and goals before acquiring or disposing of (or not acquiring or disposing of) a financial product.

Important notice

Oman. ANZ neither has a registered business presence nor a representative office in Oman and does not undertake banking business or provide financial services in Oman. Consequently ANZ is not regulated by either the Central Bank of Oman or Oman's Capital Market Authority. The information contained in this document is for discussion purposes only and neither constitutes an offer of securities in Oman as contemplated by the Commercial Companies Law of Oman (Royal Decree 4/74) or the Capital Market Law of Oman (Royal Decree 80/98), nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market Law (issued vide CMA Decision 1/2009). ANZ does not solicit business in Oman and the only circumstances in which ANZ sends information or material describing financial products or financial services to recipients in Oman, is where such information or material has been requested from ANZ and the recipient understands, acknowledges and agrees that this document has not been approved by the CBO, the CMA or any other regulatory body or authority in Oman. ANZ does not market, offer, sell or distribute any financial or investment products or services in Oman and no subscription to any securities, products or financial services may or will be consummated within Oman. Nothing contained in this document is intended to constitute Omani investment, legal, tax, accounting or other professional advice.

People's Republic of China (PRC). This document may be distributed by either ANZ or Australia and New Zealand Bank (China) Company Limited (**ANZ China**). Recipients must comply with all applicable laws and regulations of PRC, including any prohibitions on speculative transactions and CNY/CNH arbitrage trading. If this document is distributed by ANZ or an Affiliate (other than ANZ China), the following statement and the text below is applicable: No action has been taken by ANZ or any affiliate which would permit a public offering of any products or services of such an entity or distribution or re-distribution of this document in the PRC. Accordingly, the products and services of such entities are not being offered or sold within the PRC by means of this document or any other document. This document may not be distributed, re-distributed or published in the PRC, except under circumstances that will result in compliance with any applicable laws and regulations. If and when the material accompanying this document relates to the products and/or services of ANZ China, the following statement and the text below is applicable: This document is distributed by ANZ China in the Mainland of the PRC.

Qatar. This document has not been, and will not be:

- lodged or registered with, or reviewed or approved by, the Qatar Central Bank (**QCB**), the Qatar Financial Centre (**QFC**) Authority, QFC Regulatory Authority or any other authority in the State of Qatar (**Qatar**); or
- authorised or licensed for distribution in Qatar, and the information contained in this document does not, and is not intended to, constitute a public offer or other invitation in respect of securities in Qatar or the QFC.

The financial products or services described in this document have not been, and will not be:

- registered with the QCB, QFC Authority, QFC Regulatory Authority or any other governmental authority in Qatar; or
- authorised or licensed for offering, marketing, issue or sale, directly or indirectly, in Qatar.

Accordingly, the financial products or services described in this document are not being, and will not be, offered, issued or sold in Qatar, and this document is not being, and will not be, distributed in Qatar. The offering, marketing, issue and sale of the financial products or services described in this document and distribution of this document is being made in, and is subject to the laws, regulations and rules of, jurisdictions outside of Qatar and the QFC. Recipients of this document must abide by this restriction and not distribute this document in breach of this restriction. This document is being sent/issued to a limited number of institutional and/or sophisticated investors (i) upon their request and confirmation that they understand the statements above; and (ii) on the condition that it will not be provided to any person other than the original recipient, and is not for general circulation and may not be reproduced or used for any other purpose.

Singapore. This document is distributed in Singapore by ANZ solely for the information of "accredited investors", "expert investors" or (as the case may be) "institutional investors" (each term as defined in the Securities and Futures Act Cap. 289 of Singapore). ANZ is licensed in Singapore under the Banking Act Cap. 19 of Singapore and is exempted from holding a financial adviser's licence under Section 23(1)(a) of the Financial Advisers Act Cap. 100 of Singapore. In respect of any matters arising from, or in connection with, the distribution of this document in Singapore, please speak to your usual ANZ contact in Singapore.

United Arab Emirates (UAE). This document is distributed in the UAE or the Dubai International Financial Centre (**DIFC**) (as applicable) by ANZ. This document does not, and is not intended to constitute: (a) an offer of securities anywhere in the UAE; (b) the carrying on or engagement in banking, financial and/or investment consultation business in the UAE under the rules and regulations made by the Central Bank of the UAE, the Emirates Securities and Commodities Authority or the UAE Ministry of Economy; (c) an offer of securities within the meaning of the Dubai International Financial Centre Markets Law (DIFCML) No. 12 of 2004; and (d) a financial promotion, as defined under the DIFCML No. 1 of 200. ANZ DIFC Branch is regulated by the Dubai Financial Services Authority (**DFSA**) ANZ DIFC Branch is regulated by the Dubai Financial Services Authority (**DFSA**). The financial products or services described in this document are only available to persons who qualify as "Professional Clients" or "Market Counterparty" in accordance with the provisions of the DFSA rules.

United Kingdom. This document is distributed in the United Kingdom by Australia and New Zealand Banking Group Limited (**ANZ**) solely for the information of persons who would come within the Financial Conduct Authority (**FCA**) definition of "eligible counterparty" or "professional client". It is not intended for and must not be distributed to any person who would come within the FCA definition of "retail client". Nothing here excludes or restricts any duty or liability to a customer which ANZ may have under the UK Financial Services and Markets Act 2000 or under the regulatory system as defined in the Rules of the Prudential Regulation Authority (**PRA**) and the FCA. ANZ is authorised in the United Kingdom by the PRA and is subject to regulation by the FCA and limited regulation by the PRA. Details about the extent of our regulation by the PRA are available from us on request.

United States. Except where this is a FX-related document, this document is distributed in the United States by ANZ Securities, Inc. (**ANZ SI**) which is a member of the Financial Regulatory Authority (**FINRA**) (www.finra.org) and registered with the SEC. ANZSI's address is 277 Park Avenue, 31st Floor, New York, NY 10172, USA (Tel: +1 212 801 9160 Fax: +1 212 801 9163). ANZSI accepts responsibility for its content. Information on any securities referred to in this document may be obtained from ANZSI upon request. This document or material is intended for institutional use only – not retail. If you are an institutional customer wishing to effect transactions in any securities referred to in this document you must contact ANZSI, not its affiliates. ANZSI is authorised as a broker-dealer only for institutional customers, not for US Persons (as "US person" is defined in Regulation S under the US Securities Act of 1933, as amended) who are individuals. If you have registered to use our website or have otherwise received this document and are a US Person who is an individual: to avoid loss, you should cease to use our website by unsubscribing or should notify the sender and you should not act on the contents of this document in any way. Non-U.S. analysts may not be associated persons of ANZSI and therefore may not be subject to FINRA Rule 2242 restrictions on communications with the subject company, public appearances and trading securities held by the analysts. Where this is a FX-related document, it is distributed in the United States by ANZ's New York Branch, which is also located at 277 Park Avenue, 31st Floor, New York, NY 10172, USA (Tel: +1 212 801 916 0 Fax: +1 212 801 9163).

Vietnam. This document is distributed in Vietnam by ANZ or ANZ Bank (Vietnam) Limited, a subsidiary of ANZ.

This document has been prepared by ANZ Bank New Zealand Limited, Level 26, 23-29 Albert Street, Auckland 1010, New Zealand,
Ph 64-9-357 4094, e-mail nzeconomics@anz.com, http://www.anz.co.nz