



RBNZ Observer Update

Hiking phase underway

The RBNZ raised its cash rate by 25bps to 2.75%, as expected. The economy is continuing to pick up strongly and the RBNZ is now on a path to return rates towards more normal levels to keep inflation contained. On the timing of future rate hikes, the RBNZ noted that 'the speed and extent to which the OCR will be raised will depend on economic data' – although the RBNZ's own interest rate forecasts suggest further hikes are likely in coming meetings. We expect the central bank to follow-up with an additional 75 bps of hikes in 2014, with the next move likely in April.

**RBNZ raises OCR
+25bp
to 2.75%**

Facts

- The RBNZ increased its overnight cash rate by 25 basis points to 2.75%, with all 15 surveyed economists expecting such a move (including HSBC).
- On the policy outlook the bank noted 'the speed and extent to which the OCR will be raised will depend on economic data and our continuing assessment of emerging inflationary pressures'.
- The projected path for the 90-day interest rates was increased by around 10-20 basis points in the RBNZ's new set of economic forecasts. The RBNZ see close to 125 basis points of hikes through 2014 and around 250 basis points by the end of their projection horizon in Q1 2017.
- The central bank is projecting slightly stronger economic growth in the near term, tracking around 3.3% through 2014. The RBNZ are also projecting stronger inflation, with inflation expected to return to the middle of the target band by June 2014.

Implications

New Zealand's economy looks to be at the beginning of a boom and the RBNZ has responded to the strong pick-up in demand by raising the cash rate by 25 basis points to 2.75% today - making it the first developed world central bank to raise rates in this cycle.

A number of factors are supporting strong growth in the New Zealand economy including: post-earthquake reconstruction; very elevated export prices; and rising household spending, supported by a recent rapid run-up in house prices, an improving labour market and still low interest rates. These factors together have seen business conditions reach 20-year highs suggesting strong growth in the New Zealand economy in 2014. With the economy already at capacity, cost pressures are likely to rise quickly if left unchecked.

**Adam
Richardson**



Economist
HSBC Bank Australia Limited
+612 9006 5848
adamrichardson@hsbc.com.au

**Paul
Bloxham**



Chief Economist, Australia & New Zealand
HSBC Bank Australia Limited
+612 9255 2635
paulbloxham@hsbc.com.au

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The RBNZ has responded to this by beginning to normalise interest rates from current low levels. The central bank's own interest rate projections imply around 125 basis points of hikes through 2014. Since their December set of forecasts, the central bank is a bit more positive on the outlook for domestic activity - raising their forecasts for growth and inflation. At the same time, a stronger economy and greater inflation pressure has led to a stronger outlook for interest rates, with the 90-day rate profile raised around 10-20 basis points through the forecasts. By the end of 2015, the bank expects to raise interest rates by around 200 basis points - as it acts to offset the inflationary impact of a strengthening economy.

In terms of timing, the RBNZ noted that 'the speed and extent to which the OCR will be raised will depend on economic data and our continuing assessment of emerging inflationary pressures'. Nonetheless, the bank's interest rate forecasts and comments from today's press conference suggest further rate hikes are likely in coming months.

Given the extent of pick-up in demand in the economy at the moment and the signal provided by the RBNZ's own interest rate forecasts, we expect the RBNZ to follow through with a rate hike in April, and raise rates by a further 75 basis points in 2014.

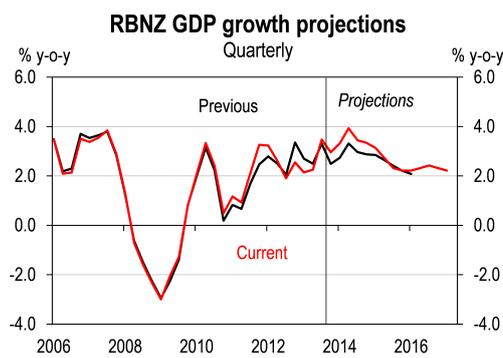
Bottom line

The RBNZ raised the cash rate by 25 basis points, to 2.75%, as expected.

The central bank is more positive on the near-term growth outlook and lifted its projections for 90-day interest rates.

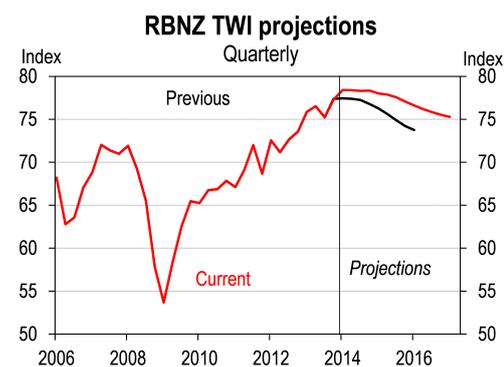
With demand continuing to pick-up strongly, we expect the RBNZ will raise rates by a further 75 basis points in 2014, with the next hike likely to occur in April.

Figure 1: RBNZ GDP growth projections



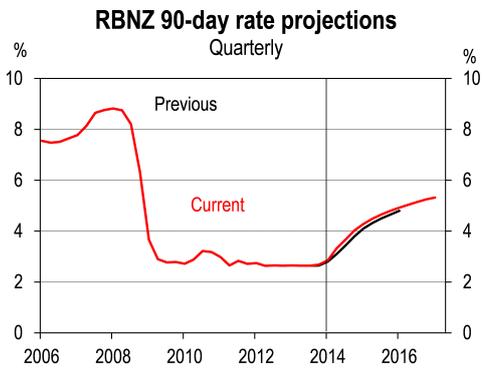
Source: RBNZ

Figure 2: RBNZ NZ dollar TWI projections



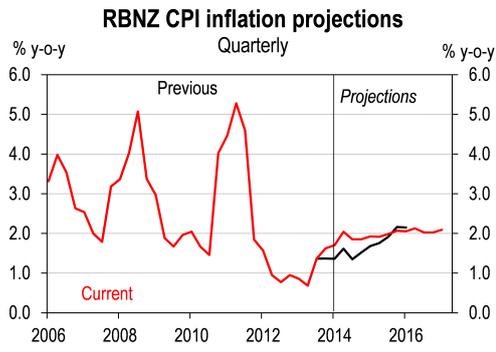
Source: RBNZ

Figure 3: RBNZ 90-day rate projections



Source: RBNZ

Figure 4: RBNZ CPI inflation projections



Source: RBNZ

Disclosure appendix

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Issuer of report

HSBC Bank Australia Limited

Level 32

HSBC Centre

580 George Street

Sydney, NSW 2000, Australia

Telephone: +61 2 9006 5888

Fax: +61 2 9255 2205

Website: www.research.hsbc.com

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