Economic Bulletin.

30 September 2021

Circling round for another go – Preview of RBNZ Monetary Policy Review, October 2021.

- We expect the Reserve Bank to lift the OCR by 25 basis points to 0.50% at next Wednesday's review.
- The latest Covid lockdown delayed the RBNZ's plans in August, but doesn't fundamentally alter the pressures that the RBNZ is facing.
- Strong demand and growing inflation pressures mean that ultra-low interest rates are no longer needed.
- The case for a larger move hasn't been ruled out, with the economy coming from a much stronger starting point than was expected in August.
- But the lingering risks around the Delta variant argue for a cautious approach for now.

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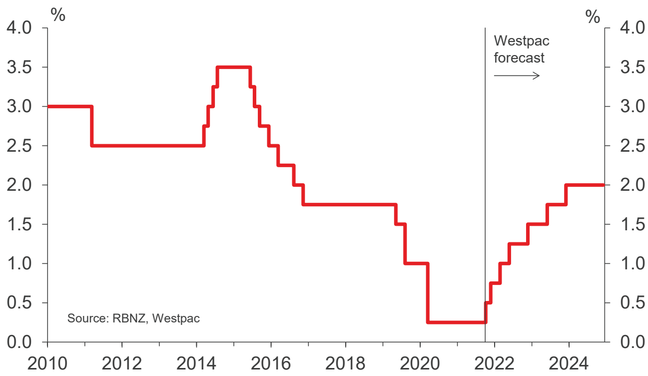
Official Cash Rate



With the economy running hot and inflation pressures rising, the Reserve Bank was clearly on the way to delivering an interest rate hike at its August *Monetary Policy Statement*. A fresh outbreak of Covid-19 forced it to take evasive action at the last minute. But this was only ever likely to be a delay to the RBNZ's plans, and at next Wednesday's review it will attempt to stick the landing this time.

We expect the RBNZ to increase the Official Cash Rate by 25 basis points to 0.50%, with a signal of more to come in the following months. The RBNZ won't be publishing new forecasts this time, but we would expect the statement to at least endorse the August projections, which showed the OCR rising to around 2% by late 2023. This would be widely expected, and bang in line with current market pricing.

In past weeks, markets had been leaning towards the possibility of a 50 basis point move – as indeed they had ahead of the August review. That was further inflamed by the whopper 2.8% rise in June quarter GDP, showing that the economy was running well ahead of forecast prior to the current Covid lockdown.

Market pricing receded after a speech by RBNZ Assistant Governor Hawkesby, which appeared to advocate for a more cautious approach. Last year, in the depths of the pandemic and with the risks skewed to the downside, bold action was warranted. But today, with more known about the economic impact of lockdowns, and the risks seen as more two-sided, central banks can return to their normal practice of moving in small, steady steps.

That still doesn’t rule out a 50 basis point move at some point. If the RBNZ judged that demand in the economy was coming from a much stronger starting point than expected, or that ‘transitory’ inflation pressures were becoming more persistent, it could decide that it needed to move faster. Indeed, Hawkesby had previously said that the Monetary Policy Committee seriously considered a 50 basis point hike in August – presumably following the same framework.

However, we think that ongoing Covid risks warrant a more cautious approach than the RBNZ showed in its initial post-August comments. The common wisdom is that this lockdown will play out in the same way as previous ones: activity will be suppressed for a short period, restrictions will be lifted, demand will quickly rebound, and the RBNZ will be back to facing the same pressures as before. But that’s not a given. As we’ve seen elsewhere, the Delta variant has proven much trickier to rein in, and our vaccination rate is still a long way from where it needs to be to provide effective levels of protection. Indeed, we made these points back in July – before the latest outbreak – and they will remain a consideration over the coming months.

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