WESTPAC ECONOMIC BULLETIN

RBNZ Monetary Policy Review, Oct 2022.

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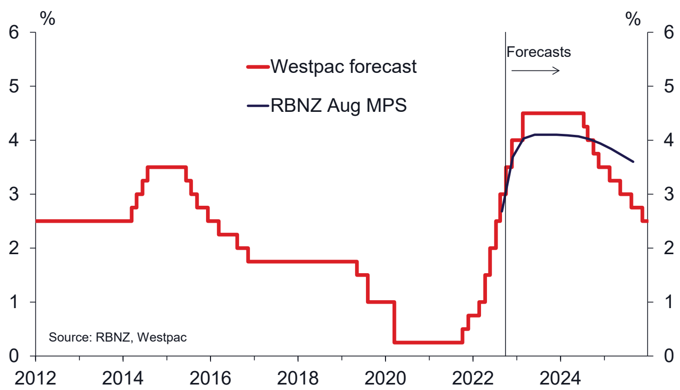
Eyes on the prize.

- The Reserve Bank increased the OCR by another 50 basis points to 3.50%, and signalled more to come.
- Inflation pressures in the local economy remain intense, with strong demand running up against constrained capacity.
- The RBNZ didn't give a clear signal on where it expects the OCR to peak.
- But the fact that it discussed a 75 basis point hike today suggests that it still sees itself as some way from where it needs to be.
- We continue to expect a 4.5% peak, with further 50 basis point increases in November and February.

OCR forecasts



Today's policy review showed that the Reserve Bank remains laser-focused on the extent of inflation pressures in the New Zealand economy. The Committee lifted the Official Cash Rate by another 50 basis points to 3.5%, and repeated that it would continue moving "at pace" until it's satisfied that interest rates are high enough to bring inflation back to target.

The RBNZ's statement didn't give any direct indication of where it now thinks the peak will be. However, the record of the meeting was unusually explicit in noting that the Committee had debated between a 50 or a 75 basis point hike this time. The latter was argued on a 'stitch in time' basis: a larger increase now could reduce the need for a higher peak in the OCR cycle overall. This is the same reasoning that was applied when the RBNZ switched up from 25 to 50 basis point moves earlier this year.

This strongly suggests that the RBNZ expects a higher peak in the OCR than they did before. In the August *Monetary Policy Statement*, the RBNZ projected a peak of just over 4% by the second half of next year. If that was still the number they had in mind, then moving to 3.75% in one go would do very little in terms of trimming the peak in the cycle. Stepping up the pace of rate hikes – or even discussing it – makes more sense in an environment where the RBNZ is quite some distance from where it thinks it needs to be.

So this was effectively a 'hawkish' shift in the RBNZ's thinking, without being too precise about the scale of it. That shift won't have come as a surprise to the market: many local forecasters (including us) have moved towards a peak above 4% over the recent weeks, and financial markets have been pricing in a peak well into the high 4's.

As a result, the market response to the announcement was fairly short-lived. The New Zealand dollar initially rose by more than 1% to around 58 cents against the US dollar, but this has already been unwound. Meanwhile, wholesale interest rates rose by a few basis points, but quickly turned around and are now a little lower than before the announcement.

The key point to take from today's statement is that the RBNZ is firmly focused on setting monetary policy for local conditions. The statement was filled with references to strong demand, constrained capacity, labour shortages, and elevated core inflation. There was much less emphasis on overseas conditions, or – surprisingly to us – the sharply lower exchange rate over recent weeks.

The RBNZ is certainly not insensitive to the darkening outlook for the global economy. Indeed, it's notable that of the two options for the OCR that were discussed today, the more conservative option won out. But the extent of the inflation challenge in New Zealand meant that 50 basis points was the conservative option.

Nor does the RBNZ appear to have been swayed much one way or another by what its overseas peers are doing. The RBNZ has marched to the beat of its own drum throughout this policy tightening, starting many months ahead of others like the US Federal Reserve. As a result, it hasn't been under the same kind of pressure to play catch-up.

On the other hand, there was very little chance of the RBNZ following the example of its Australian counterpart, which surprised many by scaling back to a 25 basis point hike at yesterday's review. Among other things, the RBA cited the fact that Australia is not seeing the same degree of wage inflation as in other advanced economies. New Zealand is very much one of those 'others'.

Today's decision doesn't change our thinking on the OCR. Last week we revised up our forecast to a peak OCR of 4.5% for this cycle, to be reached with further 50 basis point increases in November and February. It's quite possible that the Committee will again discuss a 75 basis point move in November – not least because of the unusual three-month gap until the next scheduled review. But on balance we see a 50 point move as the more likely option.

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