

Economic Note

RBNZ November Monetary Policy Statement Review

23 November 2022

Speak loudly and swing a big stick

- The RBNZ lifted the OCR by 75bp and sounded extremely hawkish – including discussing a 100bp hike
- Rising inflation expectations have contributed to the added urgency
- From here we expect the RBNZ to lift the OCR by 75bp in February and 50bp in April

The RBNZ matched economists' expectations with its 75bp hike. But the RBNZ's stance was very hawkish, including discussing the potential for a 100bp hike. The RBNZ saw even greater urgency to lift the OCR, noting "that the OCR needs to reach a higher level, and sooner than previously indicated".

The RBNZ's OCR forecasts imply a peak of 5.5%, considerably ahead of market pricing prior to the meeting. From a strong activity starting point the RBNZ is forecasting a recession next year: its focus is very much on getting inflation under control, after being surprised by how resilient the economy has been to date.

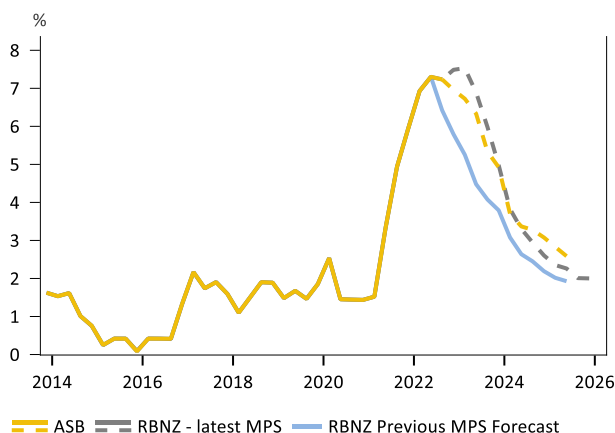
From here we expect the RBNZ to hike the OCR by 75bp in February and by 50bp April, to a peak of 5.5% (from our previous market-topping 5.25% forecast). We do note that our inflation forecasts are lower than the RBNZ's in the near term, so there is the risk that the RBNZ doesn't quite get to 5.5%. But from the vantage point right now, the RBNZ is demonstrating clear urgency. There is three months of time to pass until the next decision, and the data flow will give a steer on whether continued urgency will remain appropriate in February.

A clear message

The RBNZ has received a clear message from the data, and in turn given out a clear message that it is even more "resolute" to get on top of inflation. It has wielded the big stick of a 75bp OCR increase, discussed the merits of an even larger 100bp stick, and talked tougher about the need to get on top of inflation. Subtly has been tucked away for the summer.

As we flagged in our Preview, inflation expectations have become more of a concern. They were added to the opening paragraph of the policy assessment. The Monetary Policy Committee meeting record showed that MPC members discussed that the longer inflation remains high, the more likely that (high) inflation expectations become ingrained. The discussion included an explicit reference to needing to get inflation expectations back down: "the Committee agreed that to achieve its Remit objectives, actual and expected inflation need to decline substantially".

Consumer Price Index Inflation Forecasts



Source: Macrobond, ASB

These comments explain the aggressive OCR outlook and why the RBNZ has forecast inflation to return to the 1-3% target band just after mid-2024. To achieve that outcome, the RBNZ has forecast a period of shallow contraction in the economy in 2023 that follows a period of solid growth driven by the resilient household sector, supportive fiscal settings and the opening of the NZ border. The RBNZ has made an explicit trade-off of reducing demand in order to tame inflation – and reduce the chance of elevated inflation expectations making the job of taming inflation even harder than it already is and exerting an even bigger cost on the economy. Although the RBNZ discussed that productivity improvements and other supply-side improvements would help to reduce inflation pressures, it wasn't expecting material support from the supply side.

The RBNZ's own OCR outlook

The published OCR track was revised up to a 5.5% peak in the second half of 2023, well above the 4.1% peak in the August MPS. Backing out the decisions by each meeting suggests that after the 75bp November hike (to 4.25%), a sequence of 50bp hikes will be delivered in early 2023 (February, April and potentially May). After peaking at 5.50% in mid-2023, OCR cuts are then flagged from August 2024 with the OCR ending the projection period at 4.25%.

The MPS projections are consistent with our forecasts but, in the spirit of increasingly front-loading policy tightening, we now expect a 75bp February 2023 hike (instead of 50bp) and have kept our 50bp hike call for April, with the OCR to peak at 5.50%. We still expect OCR cuts from later in 2024, but this remains conditional on the inflation outlook. RBNZ OCR projections have increasingly come around to this view.

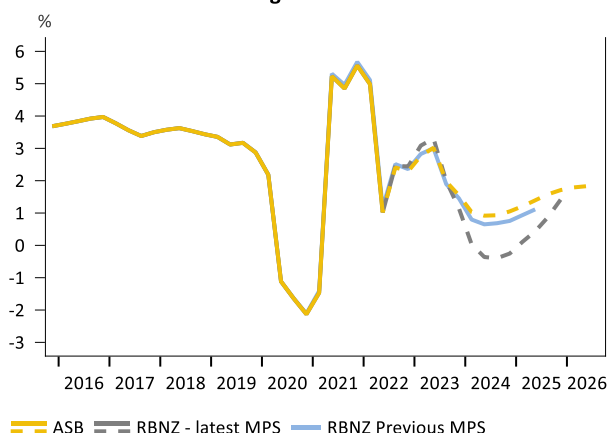
Already factoring in a higher neutral OCR?

The meeting record made reference to “the persistence of inflationary pressures resulting in a higher short-term nominal neutral interest rate”. The RBNZ had previously indicated that it was going to revisit its estimates of the neutral OCR by February 2023. This comment suggests the RBNZ has started to (implicitly at least) factor in a higher neutral rate into its projections (currently around 3% according to our estimates versus the 2% used in the August MPS), which could partially explain the RBNZ's higher-than-expected OCR forecast track.

Going forward: 75bp and 50bp

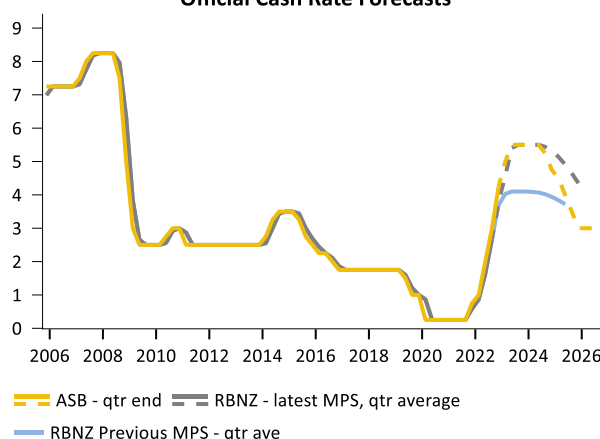
The RBNZ's job clearly isn't done yet in our assessment, and according to the RBNZ's own forecasts. We have tweaked our forecast to expect a slightly more frontloaded rate hike profile. It is by no means certain

NZ Annual Average GDP Growth Forecasts



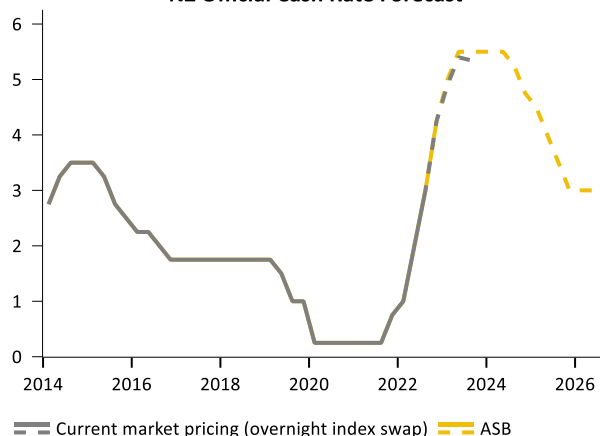
Source: Macrobond, ASB

Official Cash Rate Forecasts



Source: Macrobond, ASB

NZ Official Cash Rate Forecast



Source: Macrobond, ASB

the RBNZ will hike by that amount again. But, given the long wait until the February 22 MPS announcement date and the RBNZ's added urgency, it seems the more likely outcome at this point in time.

It is of course going to be the data that influences what the RBNZ are likely to do. There will be Q4 CPI inflation data (January 25), Q4 unemployment/wages (February 1) and all-important Q1 2023 inflation expectations data (RBNZ survey on February 14) to influence the decision.

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