

# RBNZ speech on “least regrets” policy making

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## Contact

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## Heron now

### Bottom line

- The RBNZ stressed today that in times of uncertainty, a measured policy approach is appropriate – the adaptable approach of the white heron (kōtuku), rather than a ‘hawk’ (kahu) or ‘dove’ (kererū).
- We never thought a 50bp move was a likely start to the hiking cycle; this confirms it. Our OCR forecast is unchanged, with 25bp hikes to come in October and November, with steady hikes thereafter taking the OCR to 1.5% by August next year.

### “Inching in the right direction”

A speech today by Deputy Governor Christian Hawkesby entitled “A least regrets approach to uncertainty” outlined the uncertainties and learnings that have affected the outlook for monetary policy since COVID first hit the New Zealand economy.

The RBNZ has taken the same lessons from the COVID period as we have. When COVID hit, the assumption was that it would be a persistent demand shock and a temporary supply shock, and it’s turned out to be the opposite. That is a far more inflationary state of affairs. As a result, it’s now time to start normalising monetary policy.

This of course is not new new; it is entirely consistent with both the MPS and the comments made by RBNZ officials in the days following regarding looking through lockdowns and getting on with the job. For the market, the main interest today was any hints as to whether a 50bp kick-off was a likely start to the cycle next month, with the market having lurched in that direction following the very strong Q2 GDP outturn.

We never considered a 50bp hike a likely first move given the uncertainties and downside risks that remain highly pertinent – not to mention the fact that 50bp would be as much as a third of the journey back to neutral. The RBNZ made points today that support this view. They stressed that at times of great uncertainty, rather than being an aggressive “hawk” (kahu) or a peaceful “dove” (kererū), the bird for the job is the white heron (kōtuku), an adaptable creature.

Here’s the policy upshot:

“...when the outlook for the economy has been subject to large and uncertain changes, the risks are heavily skewed in one direction, and there is a material threat of not achieving your mandate. In that situation, the path of least regret is to move quickly and take large steps to provide more confidence that policy settings will be appropriate if the risks to the outlook eventuate. This approach is consistent with our actions through the early stages of COVID-19 in early 2020.”

“In contrast, the saying “tapuwae kōtuku” translates roughly to “considered steps”, as you assess the environment around you. In the world of setting monetary policy, this translates to having confidence in the outlook for the economy, and inching in the right direction based on how the economy is likely to evolve. This is consistent with the observation that when there is a typical amount of uncertainty, and the

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risks are evenly balanced, then central banks globally tend to follow a smoothed path and keep their policy rate unchanged or move in 25 basis point increments.”

In short: down the elevator and up the stairs. It’s long been the way monetary policy has been run, and remains the case today.

Risks currently are not “heavily skewed in one direction”. Inflation risks are to the upside, but growth risks are to the downside. A measured approach is the way to go.

Importantly, the RBNZ isn’t on a path of policy normalisation because the economy is back to “normal”, it’s normalising because the risks of not doing so (boom-bust risks) are beginning to outweigh the risks associated with the pandemic. But the economy remains vulnerable (particularly housing), so normalisation needs to happen in a considered and gradual way.

We continue to expect the RBNZ to raise the OCR in steady steps (starting with 25bp hikes October and November) to a peak of 1.5% by August next year.

As we have outlined previously, the risks to this profile are skewed to the downside. The ongoing COVID situation both here and overseas, risks to China’s growth outlook, and a housing market that is more fragile than it knows, all mean that a lot has to go right for the hiking cycle to continue for as long a year, even with inflation pressures undeniably strong and broad based.

### Market reaction

Markets reacted quickly to the speech, with the Overnight Indexed Swaps moving lower, and expectations for the magnitude of October’s hike dropping back below 25bps. That’s a big change from Friday, when markets were pricing in a 35bp hike in October (ie 40/60 odds of 50bp or 25bp hike).

We never thought a 50bp hike made sense, and as we noted in last week’s [Data Wrap](#), monetary policy currently is more about the journey (the direction are we heading in) than the destination (a strong view on the required end-point for the OCR, or how quickly we need to get there). This speech really confirms that, especially the point about “inching in the right direction based on how the economy is likely to evolve” in “considered steps”.



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