

Economic Note

RBNZ OCR COVID RESPONSE

18 August 2021

RBNZ likely to pause given COVID community case

- **We expect the RBNZ will opt to keep the OCR on hold on Wednesday August 18, rather than lift it.**
- A suspected community delta COVID case (and 4 infections linked to it so far) and the snap Level 4 lockdown mean the RBNZ is making a decision in the blind about the extent of the outbreak.
- Assuming the lockdown is relatively short, we'd expect the RBNZ to lift the OCR from October.

We expect the RBNZ will hold fire on August 18, keeping the OCR steady at 0.25%. Given that NZ has entered into a snap Level 4 lockdown (the strictest level in NZ), it is logical that the RBNZ will pause until more certainty over the extent of the community COVID outbreak and lockdown is established. The whole of NZ will be in Level 4 for at least 3 days, with Auckland and the Coromandel Peninsula region in Level 4 for at least 7 days. With the Government stepping in with financial support, it also makes little sense for the RBNZ to work in the opposite direction by triggering a lift in borrowing rates.

Provided the lockdown is short and doesn't change the underlying economic picture, we would still anticipate the OCR reaching 1.5% by the end of 2022. But the situation is still very fluid. At this point there are 4 new cases that are all close contacts of the original case identified, and include a fully-vaccinated nurse working at Auckland Hospital. That shows the virus has already spread, which starts tilting the situation to one in which some form of restrictions are likely to continue until the Government is certain any community transmission has been stamped out.

Key points

The original suspected community case and lockdown have come within 24 hours of when the RBNZ is scheduled to release its monetary policy decision. Other linked infections have already been identified and, given they are of the more infectious delta variant, more cases are likely to be identified over coming days. That means that right now the RBNZ is set to make its decision at the height of uncertainty about the threat from the outbreak. It is always possible the RBNZ even postpones making a decision on August 18th, to enable it to make a decision with fuller facts in place, although the Finance Minister indicated on Tuesday night the announcement will still go ahead as scheduled.

NZ has a few lessons from its own lockdowns and those of others. Moving quickly in the face of a delta variant outbreak will increase the chance of stamping out any community transmission, and NZ has in the past shown a high degree of compliance with the restrictions imposed. This gives hope that a highly restrictive lockdown will not need to be in place for very long.

NZ's past short-ish Auckland-centric lockdowns (August last year, February/March this year) have shown that the lasting economic impacts are relatively light. Spending tends to merely get deferred, with a catch-up period occurring once restrictions ease. Provided this lockdown is short, it is likely the underlying economic picture would remain one of an economy that has hit capacity constraints and no longer needs the Official Cash Rate to stay as low as 0.25%.

Hence, provided this lockdown is short-lived with little lasting economic impact, we still expect the RBNZ to proceed

with a quick start to its tightening cycle. That could involve a 25bp hike or even 50bp hike at the following October 6 Review, or even a 25bp hike ahead of the October meeting. However, the longer the lockdown the less urgency there would be. A prudent working assumption until more facts are known would be an initial series of three 25bp increases over October, November and February.

Also, provided the lockdown is short and doesn't change the underlying economic picture, we would still anticipate the OCR reaching 1.5% by the end of 2022.

Events are going to be fluid, and even just overnight more developments have emerged – and more details may come out even ahead of the RBNZ's scheduled announcement. The RBNZ will be able to give clearer guidance with today's announcement (assuming it goes ahead) as to both how it sees the underlying outlook and how it may adapt to the current lockdown. Watch this space – and don't give in to the urge to buy toilet paper.

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