New Zealand Institute of Economic Research (Inc)
Media release

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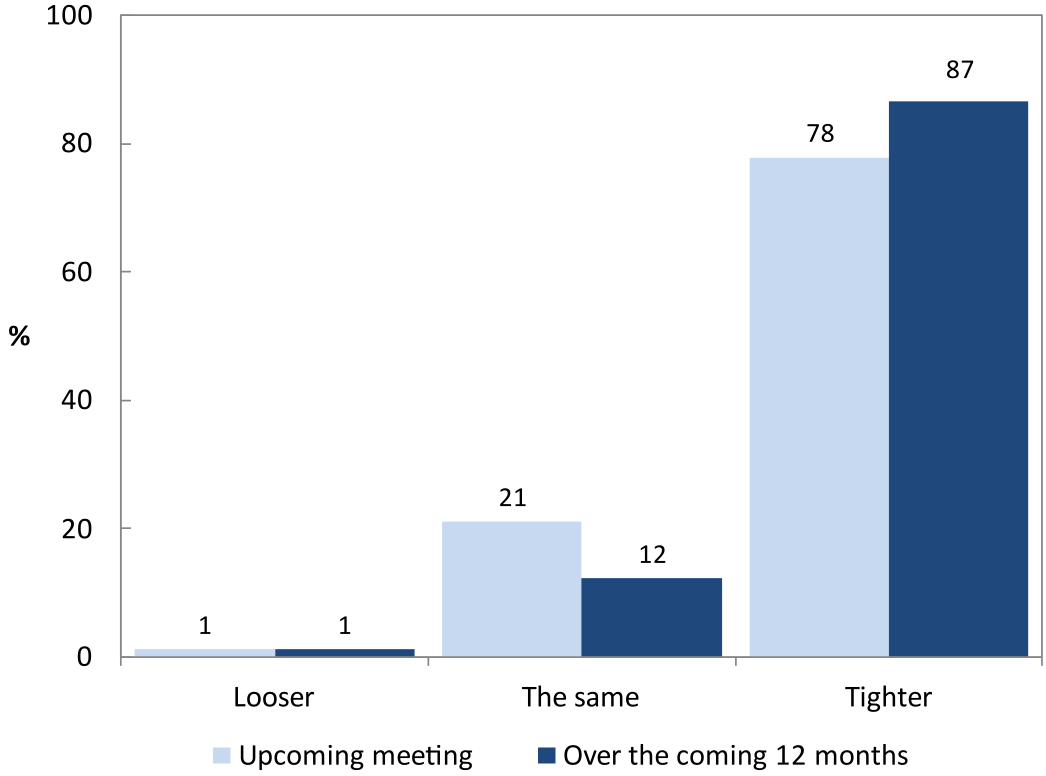
NZIER's *Shadow Board* calls for tightening at the upcoming meeting

The Shadow Board overwhelmingly calls for a tightening in monetary policy at the August *Monetary Policy Statement*, with many noting an OCR increase would be appropriate. That said, there remained a wide range of views amongst the Shadow Board. Recent developments point to a rise in inflation pressures in the New Zealand economy, reflecting the combination of strengthening demand and COVID-related supply constraints. These constraints include acute labour shortages as border restrictions limit the ability for workers to be brought in and global supply chain disruptions, affecting the ability of businesses to source inventory. Robust demand is allowing businesses to pass on higher costs more easily to customers by raising prices, suggesting inflation pressures will persist in the New Zealand economy.

Some Shadow Board members also highlighted the strength of the New Zealand labour market, which fulfils the other target the Reserve Bank has in achieving full employment. However, the risk of the COVID Delta strain making its way into the New Zealand community and the containment measures that come with it is a cause for caution for Shadow Board members in determining the appropriate pace and extent of tightening over the coming year.

Figure 1 Shadow Board sees tightening at next meeting as appropriate

% strength of policy preference on stance RBNZ should take



Source: NZIER *Monetary Policy Shadow Board*

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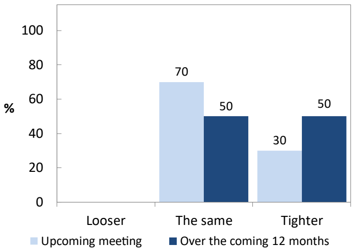
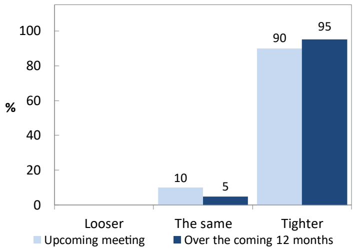
Figure 2 Individual participants' recommended rate settings – 11 August 2021

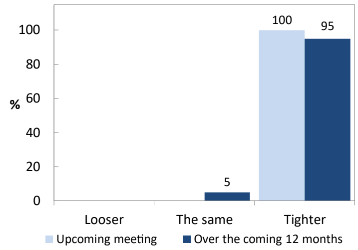
Jo Tozer
Head of Customer Services, MYOB



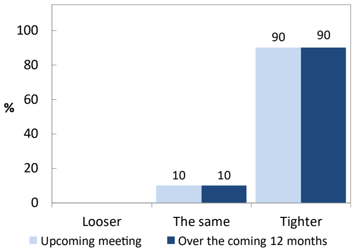
Viv Hall
Professor, VUW



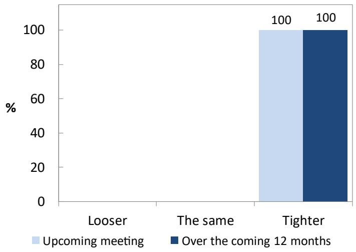
Stephen Toplis
Head of Research, BNZ



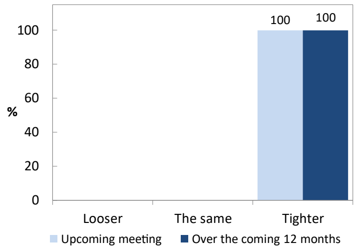
Kirk Hope
CEO, BusinessNZ



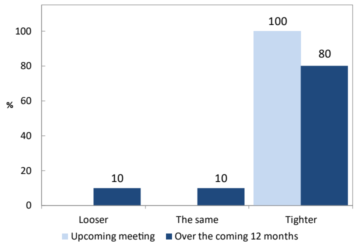
Arthur Grimes
Professor, MOTU, VUW



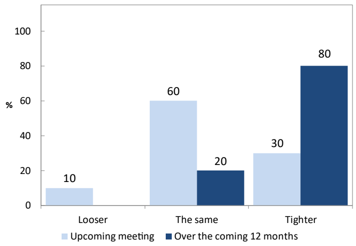
Jarrod Kerr
Chief Economist, Kiwibank



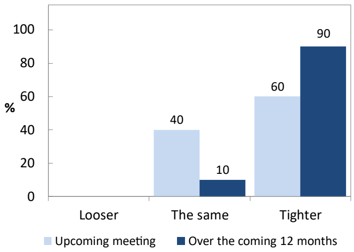
Kerry Gupwell
CEO, Boffa Miskell



Prasanna Gai
Professor, UoA



Michael Gordon
Acting Chief Economist, Westpac



Source: NZIER *Monetary Policy Shadow Board*

Table 1 Participant comments

Participant comments are optional.

Stephen Toplis	There is no longer any excuse not to raise interest rates in New Zealand. All targets have been met and, probably, breached. They will also stay that way. It's not appropriate for the RBNZ to start buying bonds back yet so it's all up to the OCR. The only reason why hindsight might show a tightening to be inappropriate at this juncture was if New Zealand went into an extended lockdown. Even then, it is probable that monetary conditions are too loose. We have maintained the view that monetary conditions would have to tighten in the next twelve months for some time now. We are certainly not going to change that view now.
Viv Hall	Monetary conditions have been too loose for too long, but external and Covid-related risks remain. Further monetary policy tightening should therefore be measured, as further significant appreciation of the exchange rate could be counterproductive. At most a 25 bp increase in the OCR is justified at this stage.
Kirk Hope	The Reserve Bank has to move on interest rates given the continued significant rise in inflationary expectations, and also given that NZ is arguably at, or close to, maximum sustainable employment. However, it is important that current rising inflationary pressures are seen for what they are. They are not a structural issue but more to do with regulatory policy decisions (closed borders) and supply side constraints given continuing logistical issues associated with international transportation issues and strictly limited labour inflows. In this respect, current inflationary pressures are likely to be short term until borders are reopened (including for labour) and supply chains completely restored.
Jarrod Kerr	There have been numerous data surprises since the RBNZ's last MPS in May. It's wise to ignore the first surprise. It's equally as wise to ignore the second. But you get to a point where you cannot ignore the new trend. And we're trending higher. Interest rates markets have paved the way for rate hikes, with a 25bp hike fully priced in August. All the RBNZ has to do is deliver. No surprises. The OCR is the most appropriate tool. Savers have suffered with record low deposit rates. And record low mortgage rates have fuelled a housing market in chronic shortage.
Jo Tozer	While the RBNZ will undoubtedly be under pressure to move its monetary policy in the latest round considering the impact on consumers, there is still little concern about the level of inflation among small businesses. In the latest MYOB Snapshot which surveyed more than 500 local SME owners and decision makers, just 14% said the level of inflation was having an impact on their business confidence. Over the coming year it is likely we'll see inflationary pressures move, and with skills shortages, international supply disruptions, and even the housing market (linked to both business financing and worker availability) all adding to cost pressures facing SMEs, a tightening of monetary policy is likely to be necessary. However, this should be balanced against some softening of business' economic expectations as the ongoing pandemic and the issues it is causing continue to impact local businesses.
Kerry Gupwell	With the recent strong labour market figures and inflation rate, the signs are clear to me that we need a tightening in monetary policy including an increase in the OCR. The question is how hard should they go with an increase? While it appears that the vaccine rollout is ramping up there is still a risk of further shutdowns as a result of COVID, so we will need to keep something in reserve should that happen.

Arthur Grimes	The RBNZ has been far too slow to react to the very evident inflationary pressures over recent months and now are well behind the curve. They need to tighten policy now to stop consumer price inflation becoming persistent in the same way that asset price inflation has become persistent (as a direct result of monetary policy) over recent years. The OCR needs to be raised and the Reserve Bank needs to buy bonds from the market to reduce the excess liquidity which they have created.
Michael Gordon	Domestic conditions alone warrant a tightening now. The main reason for caution is the risk of the Delta variant making its way through our border; given our still-low level of vaccination, it's likely that we'd have to resort to a strict lockdown to bring it under control. My personal preference would have been to wait until November, when our vaccination programme will be much further advanced. But that said, the cost of hiking too soon would largely be a reputational rather than an economic one, and the RBNZ has already indicated that it's willing to take that risk.
Prasanna Gai	No comment.

About the NZIER *Monetary Policy Shadow Board*

NZIER's *Monetary Policy Shadow Board* is independent of the Reserve Bank of New Zealand. Individuals' views are their own, not those of their respective organisations. The next *Shadow Board* release will be Monday 4 October 2021, ahead of the RBNZ's *Monetary Policy Review*. Past releases are available from the NZIER website: www.nzier.org.nz

Shadow Board participants put a percentage preference on each policy action. Combined, the average of these preferences forms a *Shadow Board* view ahead of each monetary policy decision.

The NZIER *Monetary Policy Shadow Board* aims to:

- encourage informed debate on each interest rate decision
- help inform how a Board structure might operate
- explore how Board members could use probabilities to express uncertainty.