New Zealand Institute of Economic Research (Inc)
Media release

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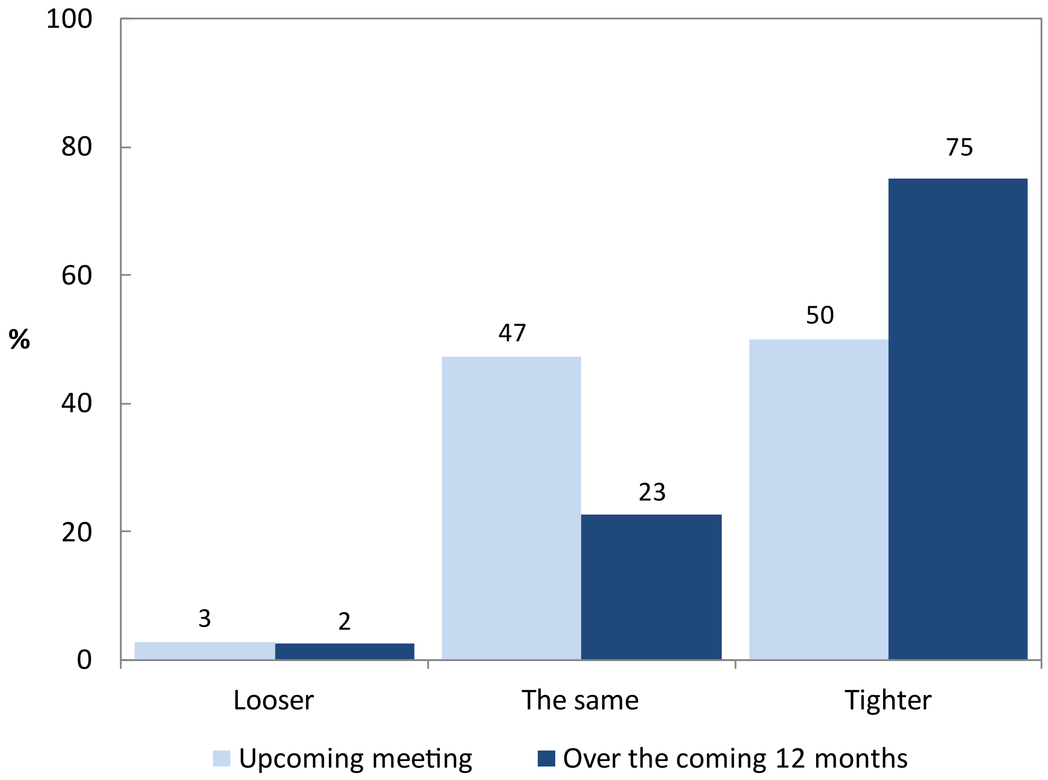
NZIER's *Shadow Board* calls for tightening within the coming year

There are growing calls amongst Shadow Board members for the Reserve Bank to tighten monetary policy given the pick-up in inflation pressures in the New Zealand economy. Many on the Shadow Board now see a tightening in monetary policy at the upcoming July meeting as appropriate. Beyond that, an overwhelming majority thinks monetary policy should be tightened within the coming year.

Supply constraints stemming from acute labour shortages and COVID-related supply chain disruptions have driven up costs for businesses. Inflation pressures resulting from supply constraints alone would not warrant an increase in interest rates, given it will dampen demand. However, there are signs in recent months that strong demand has allowed firms to pass on higher costs onto customers by raising prices. These developments suggest higher inflation pressures are likely to persist in the New Zealand economy. Nonetheless, the risk of further COVID-19 outbreaks in New Zealand was highlighted by some Shadow Board members as a reason to remain cautious when deciding when the Reserve Bank should start raising interest rates.

Figure 1 Increased calls for tightening of monetary policy as inflation pressures rise

% strength of policy preference on stance RBNZ should take



Source: NZIER *Monetary Policy Shadow Board*

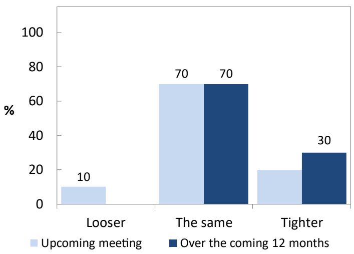
For further information, please contact:

Todd Krieble, Deputy Chief Executive

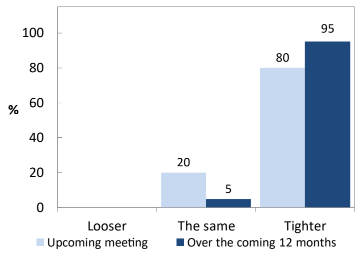
todd.krieble@nzier.org.nz, 027 742 6415

Figure 2 Individual participants' recommended rate settings – 7 July 2021

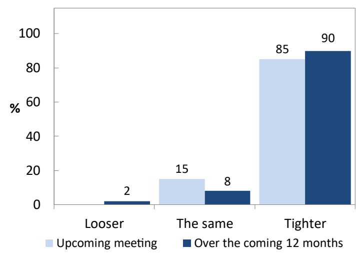
Jo Tozer
Head of Customer Services, MYOB



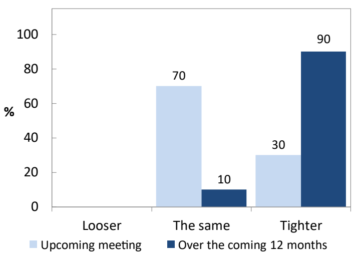
Viv Hall
Professor, VUW



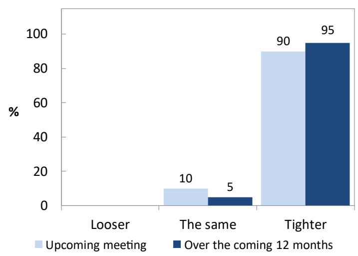
Stephen Toplis
Head of Research, BNZ



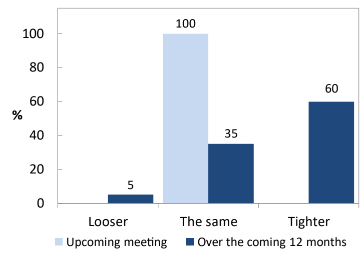
Kirk Hope
CEO, BusinessNZ



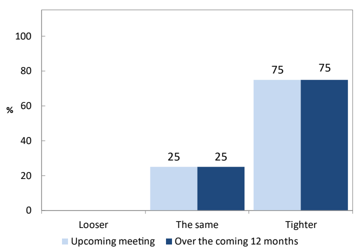
Arthur Grimes
Professor, MOTU, VUW



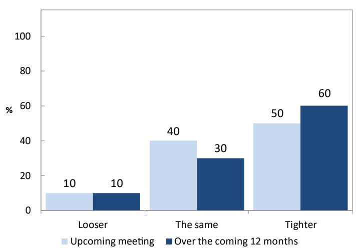
Jarrod Kerr
Chief Economist, Kiwibank



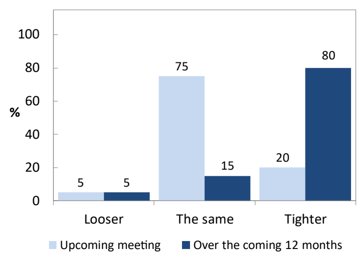
Kerry Gupwell
CEO, Boffa Miskell



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	It would be hard to formally tighten at this stage given the RBNZ's published May MPS stance, but it can certainly progress the rhetoric towards a tightening bias. A clear indication that the LSAP programme could be tapered sooner than currently postulated would also be appropriate. We maintain our long held view that the RBNZ needs to raise its cash rate sooner rather than later. With others now coming to that conclusion, it may help the RBNZ follow that course of action. Before raising rates, however, it would be appropriate to more formally moderate the LSAP programme.
Viv Hall	Inflation pressures continue to increase, as do inflationary expectations. There is some evidence that these may not be temporary. So, speed up the winding back of LSAP and do not extend FLP. Modest upward movements in the OCR should follow during 2022.
Kirk Hope	Inflationary expectations continue to rise for a range of reasons (mainly from supply-side issues) but the Reserve Bank is in a difficult position as to when to move on interest rate rises. While there are risks in pulling the trigger too early given that the NZ economy is still very vulnerable with the slow roll-out of the COVID-19 vaccination programme, waiting too long risks considerable harm being caused by having to move rates up significantly, particularly given that household debt is at an historical high.
Jarrod Kerr	The Reserve Bank is tapering its LSAP program, with very little reaction in rates markets. Lift off for the OCR requires a little more time and thought. We expect lift off from May next year. Still well ahead of every other major central bank. We need to see how inflation is tracking into 2022 after the "transitory" cost push inflation we're experiencing now. We need to see how the labour market is performing, how wages are responding, and how long it will take to further open our borders to workers, students and tourists. Long story short, we have plenty of time to wait and assess.
Jo Tozer	For local SMEs, growth remains fairly constrained, with the latest MYOB Business Monitor showing that over a quarter (27%) were expecting their profitability to fall in the last quarter. After the risk of further COVID-19 lockdowns, maintaining a steady revenue is the biggest challenge local SMEs expect to face this year. While they are also concerned about the impact of rising house prices on both consumer confidence and their ability to attract staff in their region, reduced consumer spending as a potential flow-on consequence of rising interest rates is the greater risk for SMEs at present. Looking further ahead, the situation is more balanced for SMEs. Rising inflation is registering as a concern now, and that will likely grow as inflationary pressures rise. However, with the majority relying on bank overdrafts, credit cards, and personal loans or mortgages over the family home as key sources of business funding - and with interest rates, overall cost and the ability to make repayments the biggest sources of concern around small business finance - it is important to recognise that local SMEs are also vulnerable to interest rate hikes.
Kerry Gupwell	It is time to start tightening things up, subject to COVID, by continuing to wind back LSAP and taking a closer look at the OCR as inflationary pressures continue to increase. Concerns continue to grow on supply shortages (labour and materials) which is in my view suppressing growth and putting pressure on margins that may lead to price rises.

Arthur Grimes	Interest rates are currently too low in the face of rising inflationary pressures, both internationally and domestically, and should be increased. Monetary policy needs to be set with a view to conditions 3-6 quarters ahead and prospective inflationary pressures indicate that a tightening is warranted. In addition, bonds should be resold back into the market to reduce liquidity.
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 16 August 2021, ahead of the RBNZ's *Monetary Policy Statement*. 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.