New Zealand Institute of Economic Research (Inc)
Media release

For release 10 am Monday 22 November 2021

Intense inflation pressures drive calls for higher interest rates

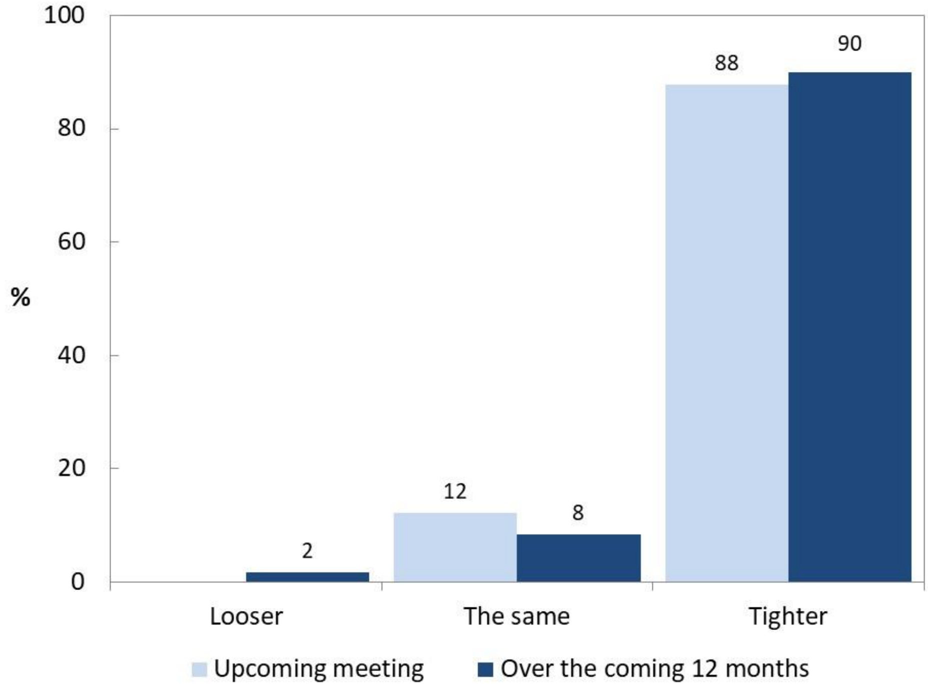
The Shadow Board is overwhelmingly calling for a tightening in monetary policy, primarily through higher interest rates. However, this view was not unanimous, with Shadow Board members in the business community who were more cautious about further tightening at the upcoming meeting. This was particularly the case for one member who has seen the negative effects of the prolonged lockdown in Auckland on small and medium enterprises (SMEs) and called for interest rates to remain on hold at the November meeting.

Inflation pressures have surged over the past year, reflecting a combination of strong demand, disruptions arising from port congestion, containment measures affecting operating capacity domestically, and acute labour shortages impacting firms' ability to expand production. Costs are rising, but robust demand has allowed businesses to pass higher costs onto customers by raising prices.

The latest Consumers Price Index (CPI) showed annual CPI reaching 4.9 percent for the year to September 2021, with indications of a further lift over the coming year. Meanwhile, extremely loose monetary policy has encouraged borrowing and pushed up asset prices, including housing. Although there remains some uncertainty over how the COVID-19 outbreak will evolve, the risk of these intense inflation pressures becoming entrenched and persisting throughout the years underpins the Shadow Board's calls for a tightening in monetary policy.

Figure 1 Overwhelming calls for tightening in monetary policy

% strength of policy preference on stance RBNZ should take



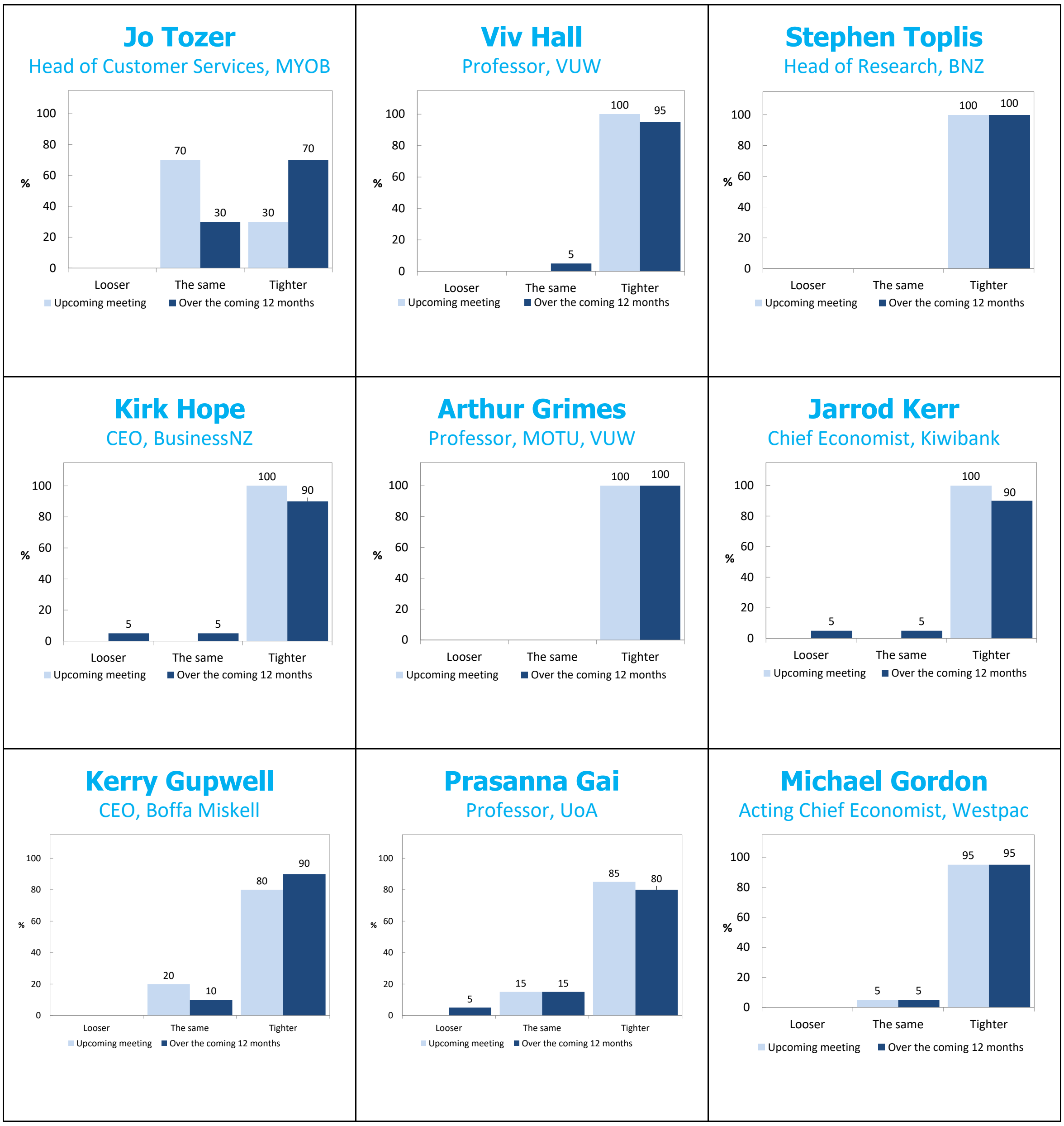
Source: NZIER *Monetary Policy Shadow Board*

For further information, please contact:

Christina Leung, Principal Economist & Head of Membership Services

christina.leung@nzier.org.nz, 021 992 985

Figure 2 Individual participants’ recommended rate settings –17 November 2021



Source: NZIER *Monetary Policy Shadow Board*

Table 1 Participant comments

Participant comments are optional.

Stephen Toplis	The only question is how much the Bank should tighten at the November meeting. The cash rate is below neutral. You can argue where neutral is, but it's not 0.5%. Rates need to be higher in order for the central bank to meet its mandate.
Viv Hall	Domestic and relevant global inflation pressures remain strong and persistent. A further immediate increase of 25bp in the OCR is required.
Kirk Hope	Inflationary pressures continue to rise and, if anything, are likely to persist for a significant period of time. Given that both inflation is outside the Reserve Bank's target band and employment is at (or in breach of) maximum sustainable employment, the Reserve Bank needs to move rates up towards more neutral levels soon; otherwise, there is a risk of having to go harder and faster. Ironically, the various current states of lockdowns are exacerbating supply chain issues which will continue to persist until borders are fully open. Given supply constraints domestically (and internationally), the demand for labour is likely to increase, further putting sustained pressures on wage rates. Inflationary pressures are likely to persist well beyond previous expectations.
Jarrod Kerr	We've seen an incredible run of economic data. Inflation is running a lot hotter than forecast, and the labour market is much tighter. Wages are rising. Another 25bp hike is more than justified. And any decision to hike will be supported by upward revisions to the RBNZ's forecasts and OCR track. Monetary policy should be normalised swiftly. The OCR track needs to be pulled forward to incorporate a swift return to 2% cash rate by mid-2022.
Jo Tozer	The latest MYOB Economic Snapshot found that 55% of local SMEs expect the economy to decline in the next 12 months, with almost a quarter (24%) expecting that decline to be significant. At the same time, 48% of SMEs surveyed reported their revenue was down on a year ago, down from just over a third (34%) in July. In this environment, constraining monetary policy that will increase the cost of finance for small businesses (many of which depend on financing through home mortgages and credit cards) will create additional pressure on an already stressed sector of the economy. While inflation is not a significant concern for SMEs at the moment, with just 15% saying it was having an impact on their confidence in the latest MYOB Economic Snapshot, it will likely be a different story in 2022. Our insights show that growing financial pressures on local businesses – including supply costs, operational and production costs, and the increases in the minimum wage – are expected to be soon passed onto customers through price increases as SMEs continue to look for some relief. MYOB's recent survey of more than 500 local SMEs revealed that 44% of SMEs will raise their prices over the next six months, including 56% of construction sector businesses and 54% of those in manufacturing.
Kerry Gupwell	With wide-area lockdowns potentially a thing of the past with the impending traffic light system, I am expecting a boost in consumer spending over summer, and the Christmas break, especially given the sense of "wealth" from house price increases. Concerns over inflation are top of mind, so a further tightening in monetary policy, including an increase in the OCR is needed.
Arthur Grimes	The RBNZ is faced with high and rising inflation. It should raise the OCR and sell some of the bond holdings it has amassed.

Michael Gordon	Even with the current Covid restrictions, the evidence continues to point to demand running hot in New Zealand. In these conditions, the question of whether some of the cost shocks emanating from overseas will be 'transitory' is beside the point – they may simply prove to be the spark that ignites an ongoing cycle of price and wage increases. Monetary policy can and should address this kind of inflation 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, 21 February 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.