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Official Cash Rate on hold at 0.25 percent

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The Monetary Policy Committee agreed to retain the current stimulatory level of monetary settings, keeping the Official Cash Rate (OCR) at 0.25 per cent for now. Today's decision was made in the context of the Government's imposition of Level 4 COVID restrictions on activity across New Zealand.

The Committee will assess the inflation and employment outlook on an ongoing basis, with a view to continue to reduce the level of monetary stimulus over time so as to best meet their policy remit. This follows the recent halting of additional government bond purchases under the Large Scale Asset Purchase (LSAP) programme in July.

Global monetary and fiscal settings remain at accommodative levels, supporting international spending and investment. Rising vaccination rates across many countries have provided economic impetus. The rise in activity has continued to support demand and prices for New Zealand's export commodities.

However, the need to reinstate COVID-19 containment measures in some regions highlights the serious health and economic risks posed by the virus. Persistent and elevated health risks are promoting ongoing global supply chain disruptions, and are acting to constrain productive capacity and prolong inflationary pressures. Today's re-introduction of Level 4 restrictions to activity across New Zealand is a stark example of how unpredictable and disruptive the virus is proving to be.

The Committee noted that the New Zealand economy had rebounded more strongly than most countries, with less domestic disruption caused by COVID-19 to date. Employment is currently at or above its maximum sustainable level, and consumer price inflation expectations remain anchored near 2 percent, the midpoint of the target range.

Recent data for the New Zealand economy suggest demand is robust and the economic recovery has broadened, despite some weakness persisting in the sectors most exposed to international tourism. Household spending and construction activity are at high levels and continue to grow, and business investment is responding to increased demand.

Capacity pressures are now evident in the economy, particularly in the labour market where job vacancies remain high despite the recent decline in unemployment and underemployment. Wages are rising consistent with the tight labour market conditions.

Broader inflation pressures are being accentuated in the near-term by one-off price rises such as higher oil prices, and temporary factors such as supply shortfalls and higher transport costs. Near-term consumer price inflation is expected to rise above the Committee's target range before returning towards the 2 percent midpoint around mid-2022.

The Committee agreed they are confident of meeting their inflation and employment remit with less need for the existing level of monetary stimulus. However, the Committee remains alert to the supply disruptions that COVID-19 can create, and the dampening effect this can have on confidence. House prices are also above their sustainable level, heightening the risk of a price correction as supply increases.

The Committee agreed that their least regrets policy stance is to further reduce the level of monetary stimulus so as to anchor inflation expectations and continue to contribute to maximum sustainable employment. They agreed, however, to keep the OCR unchanged at this meeting given the heightened uncertainty with the country in a lockdown.

More information:

- Download the August 2021 *Monetary Policy Statement* (PDF 8MB)

Summary Record of Meeting

The Monetary Policy Committee discussed economic developments since the May *Statement.* The Committee noted that the global economy has continued to recover, supported by rising vaccination rates in many countries, a gradual relaxation of mobility restrictions, and continued monetary and fiscal support.

The Committee noted the considerable uncertainty that exists regarding the longer-run impacts of COVID-19, particularly with the emergence of new variants. Globally, periods of health-related mobility restriction are likely to continue for some time, creating ongoing short-term economic disruptions, supply cost pressures, and lower productive capacity.

The Committee agreed that in New Zealand the recent economic data suggest domestic demand is robust and that the economic recovery has broadened in recent months. While weakness still persists in sectors most heavily exposed to international tourism, activity in most industries now exceeds pre-COVID levels.

Domestic economic activity has been underpinned by strong household spending, high levels of construction, and strong demand for New Zealand's commodity exports. Recent data has also shown a pick-up in business investment, which broadens the base of aggregate demand and suggests businesses are responding to emerging capacity constraints.

The Committee noted uncertainty related to the emergence of new cases of COVID-19 in the community and the move back into Alert Level 4. The reinstatement of the Government Wage Subsidy Scheme and COVID-19 Resurgence Support Payments is expected to significantly buffer the loss of income associated with the lockdown.

The Committee agreed that capacity constraints were building in the economy. Pressures are particularly acute in the labour market, where job vacancies remain high alongside declines in unemployment. Falling underemployment provides a greater level of confidence that spare capacity is being absorbed. Employment is assessed as being at or above its maximum sustainable level in the current environment.

Wage inflation has increased in line with the tightening in the labour market, but the Committee expressed uncertainty about whether higher wage growth will be sustained.

The Committee noted that capacity constraints are contributing to rising headline inflation. Mirroring global developments, inflationary pressure in New Zealand has been accentuated in the near term by one-off factors such as higher oil prices, and temporary factors such as supply shortfalls and rising transport costs. This is expected to push inflation above 4 percent in the near-term, before returning towards the 2 percent midpoint of the target band from mid-2022. Medium and long-term inflation expectations remain anchored at 2 percent.

The Committee reflected that experience over the past 12 months has provided more confidence about the resilience of domestic demand in the face of health-related restrictions. The Government Wage Subsidy proved effective in supporting domestic incomes and providing job security through periods of lockdown, which has enabled a rapid recovery in consumer spending. This scheme has been rapidly reinstated in light of the current lockdown. While some households suffered income losses and accumulated debt, many households retain a larger buffer of savings, which could provide ongoing support to consumption.

The Committee acknowledged that restrictions on the movement of people across the New Zealand border will only be removed gradually, and subject to ongoing health-related uncertainty. However, they also agreed that, to date, increased domestic spending has provided a significant offset to the loss of international tourism earnings. The closure of the border has also reduced international labour mobility, creating capacity shortages in some industries that have traditionally been reliant on migrant labour.

In light of this experience, members expressed caution about the level of remaining supply capacity in the New Zealand economy. The economic disruption caused by the ongoing global health issues has increased skill mismatches, which has likely reduced maximum sustainable employment in the near term. The Committee discussed the risk that the productive capacity of the economy is lagging domestic demand, which could lead to more persistent inflation pressure.

The Committee discussed the current, and risk of future, outbreaks of COVID-19 in New Zealand, and how monetary policy should respond. The Committee agreed that fiscal policy (government spending and transfer payments) has proved to be a very effective tool to respond to any immediate reduction in demand in the event of outbreaks. A monetary policy response may be required if a health-related lockdown has a more enduring impact on inflation and employment.

As required by their Remit, members assessed the impact of monetary policy on the Government's objective to support more sustainable house prices. The Committee noted the Reserve Bank's assessment that the level of house prices is currently unsustainable. Members noted that the Reserve Bank is currently consulting on further bank lending restrictions to help mitigate the financial stability risks associated with unsustainable house prices.

The Committee noted that a number of factors are expected to weigh on house prices over the medium term. These include strong house building, slower population growth, changes to tax settings, and the ongoing impacts of tighter bank lending rules. Rising mortgage interest rates, as monetary stimulus is reduced, would also constrain house prices to a more sustainable level. Members expressed uncertainty about how quickly momentum in the housing market will recede and noted a risk that any continued near-term price growth could lead to sharper falls in house prices in the future.

The Committee reiterated that the OCR is currently the preferred tool to adjust the level of stimulus in the economy. The principles governing the suite of monetary policy tools will continue to guide their use. In line with those principles, the Funding for Lending Programme (FLP) will remain in place under its current terms until the drawdown window expires next year. The Committee directed staff to develop an operational strategy to help inform decisions regarding the management of Government and Local Government Funding Agency (LGFA) bonds purchased under the Large Scale Asset Purchase (LSAP) programme, consistent with the Committee's desired stance of policy and supporting the functioning of markets.

The Committee discussed the stance of monetary policy. Members noted that they now had more confidence that rising capacity pressures will feed through into inflation, and that employment is at its maximum sustainable level. Members concluded that they could continue removing monetary stimulus, following their decision to halt additional purchases of Government bonds under the LSAP programme at their July meeting.

The Committee discussed the merits of an increase in the OCR at this meeting and considered the implications of alternative sequencing of OCR changes over time. The Committee agreed that their least regrets policy stance is to further reduce monetary policy stimulus to reduce the risk that inflation expectations become unanchored. However in light of the current Level 4 lockdown and health uncertainty the Committee agreed to leave the OCR unchanged at this meeting.

On Wednesday 18 August, the Committee reached a consensus to:

- Maintain the OCR at 0.25 percent;

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- Direct staff to develop an operational strategy to inform decisions on the management of Government and LGFA bonds purchased under theLSAP programme; and
- Maintain the existing Funding for Lending Programme conditions.

- **Attendees:**

  Reserve Bank staff: Adrian Orr, Geoff Bascand, Christian Hawkesby, Yuong Ha

  External: Bob Buckle, Peter Harris, Caroline Saunders

  Observer: Bryan Chapple

  Secretary: Chris Bloor
- **Media contact:**

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Reference source:

Weir J 2021, *Official Cash Rate on hold at 0.25 percent*, Reserve Bank of New Zealand, viewed 18 August 2021, <https://mailchi.mp/rbnz.govt.nz/media-statementofficial-cash-rate-on-hold-at-025-percent-13798693?e=427f6f0c62>