Monetary Policy Statement, December 1994[1]

This Statement is made pursuant to Section 15 of the Reserve Bank of New Zealand Act 1989.

Executive summary

Over the past three years, New Zealand has experienced an impressive resurgence of growth combined with price stability. This achievement substantially reflects the consequences of wide-ranging structural reforms over the past decade.

Economic indicators in the period since our last *Monetary Policy Statement*, however, provide increasing evidence that inflationary stresses in the economy are beginning to emerge. Unless such stresses are contained, New Zealand's hard-won achievement of price stability - with all the benefits for sustainable growth and employment which that provides - will be jeopardised. In such circumstances, the only prudent course for monetary policy is to lean in the direction of restraint.

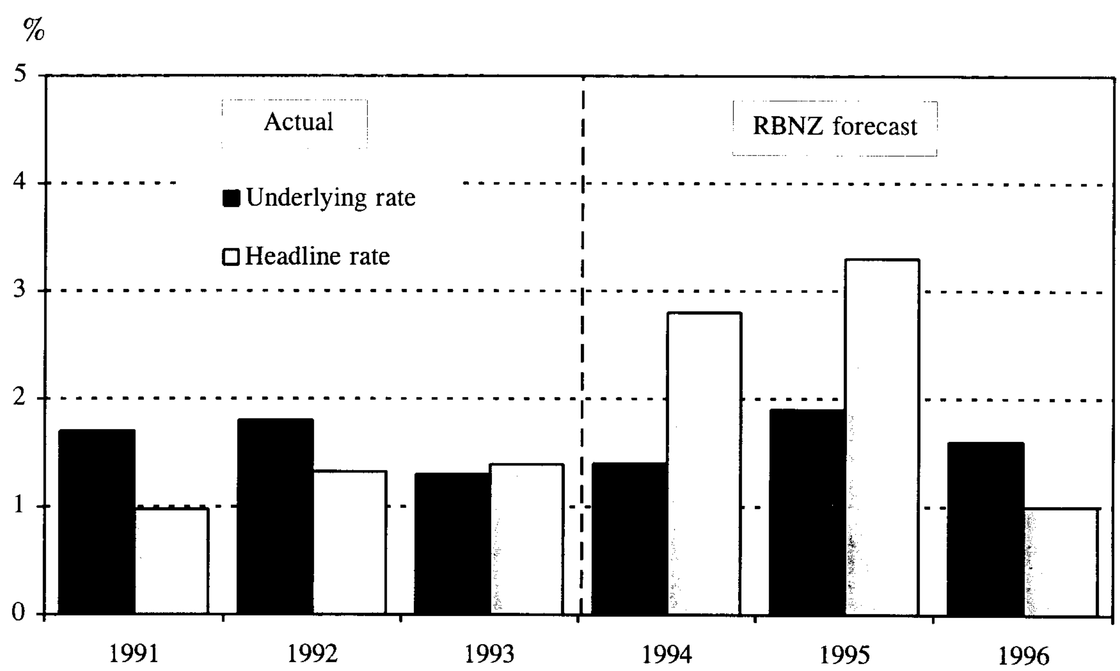
Increases in interest rates and the external value of the New Zealand dollar in recent months will work in the direction of dampening an acceleration of inflation. The inflation outlook presented in Section III of the *Statement*, however, suggests that the firming of monetary conditions up to late November, when the projection was completed, would be barely sufficient to keep underlying inflation within the target range, and with no allowance being made for risks and uncertainties in the inflation projection.

On this basis, the Bank's assessment is that firmer monetary conditions are required than embodied in the inflation projection. For this reason, the Bank regards the substantial firming of conditions that has taken place since completion of the projection as warranted and timely.

It is the Bank's view that monetary conditions will need to remain broadly in line with the current situation if we are to have confidence that underlying inflation will remain within the 0 to 2 percent target range.

The longer-term prospects for monetary conditions will hinge in particular on the degree to which inflationary stresses, currently visible in particular sectors of the economy, influence prices and wages more generally. Also relevant will be the extent to which prices and wages react to the headline as opposed to the underlying rate of inflation; the latter more accurately reflects the ongoing trend of inflation. While hopeful that these risks will not be realised, the Bank will remain vigilant and ensure that the stance of policy is adjusted to meet any threat to the objective of price stability.

Figure 1 **Consumer price inflation (percentage change in year to December)**



1 Text finalised on 6 December 1994, based on data available to 5 December. Inflation projection based on data available to 28 November.