08/2023

Monetary Policy SNAPSHOTS

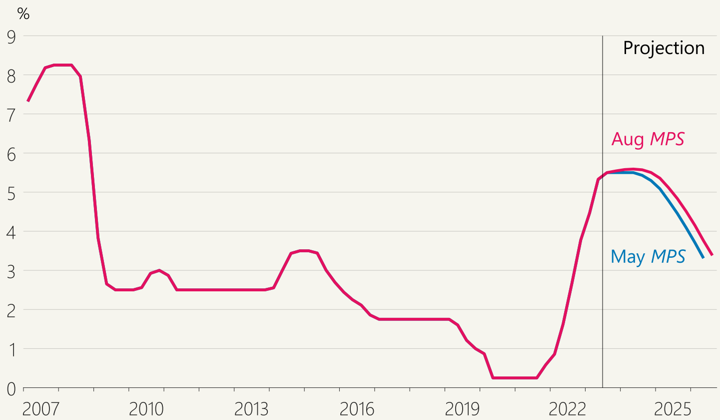
Official Cash Rate remains at 5.50%

The Monetary Policy Committee today agreed to maintain the Official Cash Rate (OCR) at 5.50%.

Figure 1

Official Cash Rate (OCR)

(quarterly average)



Source: RBNZ estimates.

The slowdown in domestic demand has broadened

But temporary factors are supporting economic growth

Labour supply is improving, and supply-chain bottlenecks have continued to ease

High interest rates are still required to meet our inflation and employment objectives

Latest key statistics

- Annual economic growth: 2.2 percent (Q1 2023)
- Annual inflation: 6.0 percent (Q2 2023)
- Unemployment rate: 3.6 percent (Q2 2023)

The current level of interest rates is constraining spending and hence inflation pressure, as anticipated and required. The Committee agreed that the OCR needs to stay at restrictive levels for the foreseeable future to ensure annual consumer price inflation returns to the 1 to 3% target range, while supporting maximum sustainable employment.

The slowdown in domestic demand has broadened

- Economic activity in New Zealand declined slightly in the first quarter of 2023. Recent data have been consistent with our outlook for low economic growth over the coming year.
- Higher interest rates have increased borrowers' mortgage payments, reducing what households have available to spend on other things. High interest rates also encourage those who can to save more, resulting in less spending.
- House prices have stabilised in recent months, at levels well below their late-2021 peak. This lower level of house prices is consistent with lower spending on housing-related goods and services.
- Higher interest rates, lower house prices and high construction costs have made it less appealing to build houses. The number of building consents has fallen, and residential construction is expected to decline.
- Higher interest rates have slowed demand, making businesses less willing to invest.
- Global growth is also expected to remain subdued over the rest of 2023, reducing demand for New Zealand's goods exports. Prices for New Zealand's key commodity exports have been falling since the second half of 2022, including for dairy and meat. Growth in China has been weaker than expected since the country reopened its border, and does not appear to have provided a boost to global commodity prices.

But temporary factors are supporting economic growth

- Although demand is slowing, there are several near-term factors that continue to support demand and inflation despite high interest rates.
- Exceptionally good pasture growth conditions in mid-2023 have supported dairy and meat production, and the volume of farm-based exports as a result. But these conditions are not expected to last, and lower export prices continue to reduce overall export receipts.
- The tourism recovery is supporting demand. International visitor numbers have remained elevated for this time of year, partly due to the FIFA Women's World Cup.
- Government spending levels continue to support demand, but to a lesser extent than in recent years as COVID-19-related spending has been largely phased out.
- The repair and rebuild from severe weather events in early 2023 is ongoing. Activity will be spread over many years, with infrastructure repairs expected to take a particularly long time.

Labour supply is improving, and supply-chain bottlenecks have continued to ease

- Labour shortages in New Zealand have eased but remain elevated. Additional labour supply is coming from more New Zealanders entering the labour force and from higher net immigration since the border reopened. But the overall effect of immigration on inflation is uncertain, as immigrants also create more demand in the economy. The number of job ads has declined as labour supply increases and businesses' demand for workers cools.
- Global supply-chain bottlenecks have continued to ease. Shipping costs have been falling since late 2022.
- Disruptions to commodity markets due to Russia's war against Ukraine have largely unwound and some commodity prices are close to their pre-war levels.

High interest rates are still required to meet our inflation and employment objectives

- The combination of weaker demand and improved supply has reduced inflation in New Zealand. Annual consumer price inflation eased from 6.7 to 6.0 percent in the June 2023 quarter. Declines in annual headline inflation have been led by large falls in imported inflation, including prices for fuel. Domestically generated inflation is falling more slowly.
- Inflation remains too high. While most measures of inflation expectations have declined in the last three months, they remain elevated. Most measures of core inflation have remained high, suggesting that inflation will take some time to return to the mid-point of the MPC's 1 to 3 percent target range.
- Inflationary pressures continue to be supported by a tight labour market, but to a diminishing extent. The unemployment rate rose slightly from 3.4 to 3.6 percent in the June 2023 quarter. Most indicators of labour market pressure have eased significantly since 2022.
- Overall, the New Zealand economy has evolved largely as expected at the time of the May *Statement*, although inflationary pressures are expected to be marginally higher over coming years. Interest rates may need to remain near current levels for slightly longer to slow demand. Lower demand will help reduce pressure on available labour and capital resources in the economy. This will help to lower inflation.