Reserve Bank of New Zealand
Te Pūtea Matua

02/2023

Monetary Policy SNAPSHOTS

Reserve Bank increases the Official Cash Rate

The Monetary Policy Committee today increased the Official Cash Rate (OCR) from 4.25 percent to 4.75 percent.

Demand in the New Zealand economy has been robust, but there are early signs of slowing

The tourism recovery has supported the services industry, but global growth is easing

The severe storms across the North Island are expected to increase inflation and disrupt production in the near term, and add to activity during the rebuild

Higher interest rates are needed to sustainably reduce inflation and support maximum sustainable employment

Latest key statistics

- Annual average economic growth: 2.7 percent (Q3 2022)
- Annual inflation: 7.2 percent (Q4 2022)
- Unemployment rate: 3.4 percent (Q4 2022)

The Committee agreed that the OCR still needs to increase, as indicated in the November *Statement*, to ensure inflation returns to within its target range over the medium term. While there are early signs of price pressure easing, core consumer price inflation remains too high, employment is still beyond its maximum sustainable level, and near-term inflation expectations remain elevated.

Demand in the New Zealand economy has been robust, but there are early signs of slowing

- Demand in the New Zealand economy was robust in 2022. Economic growth has been supported by household spending and construction activity, strong government spending and a swift recovery in international tourism since the the border reopened.
- Household spending has been resilient to date. However, there are signs that it may be slowing, reflecting lower house prices, high inflation and rising interest rates. Worker shortages continue to limit economic activity, but labour market pressures have eased slightly.
- Businesses' perceptions of economic conditions have worsened as the outlook for consumer spending, exports, and building activity has weakened.

The tourism recovery has supported the services industry, but global growth is easing

- The number of international visitors has increased rapidly since the border reopened. This has supported the recovery in the tourism sector and activity in associated services industries, in particular transportation, accommodation and restaurants. Pent-up demand for travel and reduced capacity have contributed to higher airfares, accommodation and other tourism-sensitive prices.
- Slowing global demand has led to a decline in international prices for some of our key commodity goods exports like dairy, meat and logs. It is likely that demand for our exports will increase following the recent easing of COVID-19 restrictions in China.

The severe storms across the North Island are expected to increase inflation and disrupt production in the near term, and add to activity during the rebuild

- The severe storms in the North Island have had a devastating impact on the lives of many New Zealanders and our thoughts are with those affected.
- These storms have led to destruction and disruption across a variety of industries and infrastructure. This will lead to shortages in some goods and services in the near term, and upward price pressures are likely to stay high as a result. Rebuild work will increase activity over coming years.
- Significant economic losses have resulted from these storms. The best contribution monetary policy can make right now is to free up resources elsewhere in the economy by slowing demand through higher interest rates. This will also limit further increases in the cost of living over the medium term.

Higher interest rates are needed to sustainably reduce inflation and support maximum sustainable employment

- Inflation remains widespread and too high, at an annual rate of 7.2 percent. Measures of 'core' inflation, which strip out prices that are volatile like fuel and food, have also remained elevated.
- High 'core' inflation, inflation expectations, and temporary price pressures associated with the recent storms suggest that headline inflation will stay high in the near term, and is likely to begin to decline significantly only from the second half of 2023.
- The labour market remains extremely tight, with employment above its maximum sustainable level. The unemployment rate was 3.4 percent in the December 2022 quarter. Worker shortages led to an acceleration in wage growth, supporting household incomes but adding upwards pressure to domestic inflation through increased business costs.
- Overall, the New Zealand economy has evolved largely as expected at the time of the November *Statement*. Although CPI inflation was slightly lower than expected in the December 2022 quarter, the starting point for economic activity was stronger. Higher interest rates are needed to ensure that inflationary pressures ease and employment returns to its maximum sustainable level.