Reserve Bank of New Zealand
Te Pūtea Matua

05/2023

Monetary Policy SNAPSHOTS

Official Cash Rate set to remain restrictive

The Monetary Policy Committee today voted to raise the Official Cash Rate (OCR) from 5.25% to 5.50%.

Demand in the economy is slowing

But some factors are supporting economic growth

Labour supply is improving and supply-chain bottlenecks are easing

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

Latest key statistics

- Annual economic growth: 2.2 percent (Q4 2022)
- Annual inflation: 6.7 percent (Q1 2023)
- Unemployment rate: 3.4 percent (Q1 2023)

The Committee agreed the level of interest rates is constraining spending and inflation pressure. The OCR will need to remain at a restrictive level for the foreseeable future, to ensure that consumer price inflation returns to the 1-3% annual target range, while supporting maximum sustainable employment.

Demand in the economy is slowing

- Economic activity in New Zealand fell at the end of 2022. High interest rates, lower house prices and the higher cost of living are slowing demand.
- Higher interest rates have made mortgages more expensive for households, reducing the amount they have available to spend on other things. House prices have fallen, reducing spending by homeowners, because they feel less wealthy. Higher interest rates also encourage people to save more, reducing spending today.
- Lower house prices, higher interest rates and high construction costs have made house development less appealing. The number of building consents issued is falling, and residential construction is likely to decline. The rebuild work from the recent severe weather events in the North Island are expected to provide an only small offset to this broader decline.
- Higher interest rates have meant businesses are experiencing a general slowing in demand, making them less keen to invest. Global growth has been slowing and is expected to decline further over 2023, reducing demand for New Zealand's goods exports.

But some factors are supporting economic growth

- Although demand is slowing, there are several factors that continue to support demand and inflation.
- The rapid recovery in overseas visitor numbers since the border reopened has boosted demand. However, capacity constraints meant businesses struggled to meet the strong demand over summer, adding to inflationary pressure.
- The border reopening has also contributed to high net immigration, providing relief for some businesses short of labour. However, high net immigration also adds to demand in the economy, so the overall effect on inflation is uncertain.
- The severe weather events have had a devastating impact on the lives of many New Zealanders and have caused significant damage to livelihoods and infrastructure. The clean-up, repair and rebuild will add to economic activity. However, this activity will be spread over many years. In *Budget* 2023, the Government announced a $6 billion National Resilience Plan to help fund the rebuild. Overall, this is expected to add to higher than otherwise inflation in the economy.

Labour supply is improving and supply-chain bottlenecks are easing

- Bottlenecks in global supply chains have continued to ease, in part due to the reopening of China. Shipping costs for imports into New Zealand have declined sharply over recent months.
- Global commodity prices – in particular oil prices – have remained below their early-2022 peaks. The disruptions to trade due to Russia invading Ukraine have largely unwound. Many commodity prices are close to their levels prior to the war in Ukraine.
- Survey responses and discussions with businesses suggest that labour shortages in New Zealand have eased slightly. Additional labour supply is coming from increased labour force participation and higher net immigration since the border fully reopened in the second half of last year.

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 consumers price inflation declined from 7.2 percent in the December 2022 quarter to 6.7 percent in the March 2023 quarter. Prices for some goods and services that change a lot – such as petrol prices and airfares – have also declined.
- Inflation declined by more than expected, but it remains too high. While many measures of inflation expectations have declined in the last three months, they remain elevated. Most measures of persistent or 'core' inflation have stayed near recent peaks. Inflation is expected to take some time to return to the mid-point of the MPC's 1 to 3 percent target range.
- Inflationary pressure continues to be supported by a tight labour market, with employment above its maximum sustainable level. The unemployment rate remained very low at 3.4 percent in the March 2023 quarter. Although most indicators show that labour market pressures have eased since last year, they remain strong.
- Overall, high interest rates are still needed to further slow demand. This will help to reduce upward pressure on prices, leading to lower headline inflation.