

RBNZ speech “The monetary policy remit and 2% inflation”

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Focused on the task at hand

Bottom line

- RBNZ Governor Adrian Orr gave an on-the-record [speech](#) and Q&A session today at the Waikato Economic Forum.
- The speech covered the changing drivers of inflation, the ongoing appropriateness of the 2% target, and the year ahead for the RBNZ. There were no comments on the near-term monetary policy outlook, unsurprisingly, though there were plenty of comments reiterating their determination to bring inflation down.
- We continue to forecast two more 25bp OCR hikes, in February and again in April.

Summary

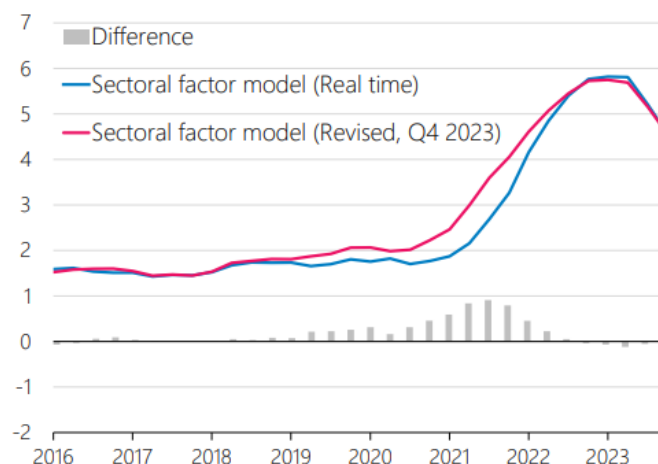
Today’s speech by RBNZ Governor Adrian Orr entitled “The monetary policy remit and 2% inflation” outlined, as advertised, three things:

- how the dynamics of inflation have changed from being driven by transitory global factors to more stubborn domestic ones.
- Why flexible inflation targeting centred on 2% still makes sense.
- The year-ahead agenda across the RBNZ’s range of responsibilities.

It wasn’t at all surprising that the discussion of the first and second points hit some hawkish notes about the importance of getting inflation down, that there is still a long way to go in the fight, that there is still work to do to truly anchor inflation expectations, and that the last yards of the inflation battle may be the most difficult. But there was nothing new here.

One interesting chart illustrated how the RBNZ’s sectoral factor model of core inflation has been revised over time, and how this was part of the RBNZ underestimating emerging persistent inflation pressures. It serves as a reminder to markets and other observers that any one measure of core inflation will have its strengths and weaknesses rather than being the ultimate ‘truth’.

Figure 1. Core inflation in New Zealand (real time and updated estimates, annual %)



Source: RBNZ

The Governor made a range of interesting points that while not new to people who watch monetary policy closely, are helpful to lay out:

- The role of the different measures of inflation: “measures of core inflation help us identify how much of headline inflation is persistent, while non-tradable and tradable inflation help identify where inflationary pressures are emerging from. Non-tradable inflation can also provide signals to the strength of the domestic drivers of core inflation.”
- “All measures of core inflation have ... fallen over 2023. While these declines in core inflation are moving us in the right direction, tackling the tail end of these persistent inflation pressures in the domestic economy remains key to achieving 2 percent inflation. Just how persistent these pressures might be depends on how factors, such as capacity pressures and inflation expectations, evolve going forward.”
- “While a medium-term focus does not prescribe a specific ‘time-to-target’, we always aim to get inflation back to the 2 percent midpoint in reasonable time to mitigate the risks from inflation expectations becoming unanchored... there is no single ‘optimal’ time horizon for inflation to return to target. Instead, it depends on the changing nature of the shocks impacting on the economy.”
- “the Reserve Bank recommended amending the Remit to clarify the primacy of *achieving* the inflation target over *supporting* Maximum Sustainable Employment (MSE). ... This primacy of the inflation target helps to anchor inflation expectations.”
- There was an interesting discussion of the costs and benefits of higher or lower inflation targets, with the conclusion that a 2% midpoint “remains appropriate”.
- “Monetary and fiscal policy coordination is critical for our small, open economy.”
- “inflation remains a top priority for Te Pūtea Matua. The past few years have seen the emergence of persistent core inflation off the back of the COVID-19 pandemic. Tackling the persistent inflationary pressures and bringing levels of ‘core’ inflation in line with our target is an important part of bringing inflation back down to 2 percent.”

There was only time for one question, in the answer to which the Governor observed that households are generally coping well with the rise in rates (which is about three quarters of the way through) and that the small rise in non-performing loans that has been seen has generally been due to job losses rather than mortgage repricing.

Market reaction

This speech was not aimed at impacting financial markets and the Governor will likely be chuffed that he didn’t cause a ripple in rates or FX markets.



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