



29 January 2009

150 point cut pleasing, but system needs to change

The Reserve Bank has cut the Official Cash Rate (OCR) by 150 basis points today, but evidence from overseas suggests this will do little to really spark the economy. The New Zealand Manufacturers and Exporters Association (NZMEA) welcome the cut, but recognise the ineffectiveness of interest rate based inflation control, and the need for systematic changes to improve our inflation control system before another cycle begins. Further cuts will be needed to move closer to the interest rates of our trading partners.

NZMEA Chief Executive John Walley says, "Our interest rates are slowly catching up with other Central Banks around the world, however, even with their interest rates much closer to zero there is little impact on the availability of credit as the banks hang on to all the margin, handouts, broader securities and guarantees they can get. This leaves little real stimulus to the economy before fiscal policy changes kick in. This sensible cut today will take more pressure off the New Zealand dollar supporting something of an export led recovery, given overseas markets hold up."

"Monetary policy clearly can't do much in a deflationary environment as interest rates cannot be negative. This leaves additional measures such as increasing government spending, liquidity efforts by Central Banks printing money and accepting a broader range of securities, sovereign deposit guarantees, and other handouts, as the only real options in this economic climate."

"Up until the credit crisis hit, strong credit growth indicated monetary policy was doing a poor job of restraining inflation. It took almost three years with an OCR of over seven percent before the economy as a whole even started to respond; throughout that time exporters suffered badly from an overvalued currency. Low cost foreign credit poured into the country chasing our high interest rates and fuelled the largest housing bubble, normalised to average income, in the world.ⁱ This debt burden incurred in the housing boom and the damage the high dollar did to the export sector will negatively impact the New Zealand economy for years to come."

"In the 'good' times the flood of credit coming into the country made it easy and cheap for banks to lend. Sadly, broader tax incentives in New Zealand poured this debt into non-productive assets. The only way forward is to focus on rebuilding the real economy," says Mr. Walley.

"We need to internalise our inflation control systemⁱⁱ before we endure another damaging cycle, and we must shift investment incentives to the real economy. Failure on either front will see our economic performance slip ever lower."

ⁱ The Economist, 'Structural Cracks', May 22 2008

ⁱⁱ 'Interest Linked Savings Scheme, A Policy Framework for Economic Growth and Development', <http://www.mea.org.nz/document.ashx?id=435>