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Inflation subsides but at what cost?

The latest inflation figures from Statistics New Zealand have been released showing that inflation for the year until March 2009 has dropped to three percent. The New Zealand Manufacturers and Exporters Association (NZMEA) say that the length of time taken for inflation to return to the target band and the damage caused to the economy in the process demonstrate the ineffectiveness of the Official Cash Rate (OCR) as an inflation control mechanism.

NZMEA Chief Executive John Walley says, “It has taken two years and a recession to get inflation back inside the target range. That suggests we need to modify the Reserve Bank Act.”

The OECD’s Economic Survey of New Zealand released yesterday recommended further monetary policy easing to stimulate growth and predicted that the OCR would bottom out at two percent.

“The call for further OCR reductions is certainly justified,” says Mr. Walley, “but if our external deficit means we are unable to drop rates to stimulate growth, even when inflationary pressures have dropped away, then we are compelled to make systematic changes.”

“Our investment income deficit has doubled since 2000 due to interest rates consistently higher than our competitors. Now when stimulatory conditions are needed to bring us out of the crisis, interest rates cannot be reduced to the levels we see overseas because we need to fund that deficit.”

“A system that disengages interest rates from inflation control is needed to break this cycle. Discussions with Finance Minister Hon. Bill English today suggest that some measures are being considered but this debate needs a far greater sense of urgency.”

“In the meantime hopefully we will see the Reserve Bank follow the OECD’s advice and calls from manufacturers, farmers and exporters generally, to drop the OCR to two percent at the end of the month.”