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Covid response: Reserve Bank admits 'more aggressive tightening might have reduced inflation sooner'

**Liam Dann**

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The Reserve Bank has today published an update on its progress in responding to recommendations from its review of monetary policy over the 2017 to 2022 period.

It has also released new work reviewing the MPC's response to above-target inflation from 2021 to 2024.

"In hindsight, an earlier or more aggressive tightening might have reduced inflation sooner," Reserve Bank chief economist Paul Conway said.

"But this would have been difficult given the data available at the time and could have conflicted with the MPC's mandate back then, which included maintaining maximum sustainable employment."

Some economists and commentators have criticised the RBNZ for leaving the official cash rate at stimulatory levels for too long as inflation took hold in 2021.

After cutting the OCR to a low of 0.25% to help businesses and households survive initial Covid lockdowns, the RBNZ started lifting the rate again from October 2021.

"The [Monetary Policy Committee's] strategy helped reduce inflation from its peak in 2022 and return it to within the 1 to 3% target band by September 2024," Conway said.

"This strategy kept longer-term inflation expectations near the target midpoint, which is key to medium-term price stability."

The 2022 Review and Assessment of the Formulation and Implementation of Monetary Policy proposed nine recommendations aimed at improving the Monetary Policy Committee's (MPC's) "ability to achieve its objectives in an environment of heightened uncertainty and more complex economic shocks", the RBNZ said in a statement.

"The MPC has gained valuable insights into how economic activity, price setting by businesses, and inflation expectations evolve during periods of high inflation and economic volatility," Conway said.

"We now have a deeper understanding of supply shocks and structural drivers of inflation and have expanded our use of high-frequency data for more timely and granular monitoring."

The RBNZ had developed new tools to estimate neutral interest rates and run scenario analysis, he said.

"These improvements ensure the MPC is well equipped to navigate future shocks while maintaining price stability."

The accuracy of the Reserve Bank's economic forecasts had significantly improved, as economic disruptions from the pandemic had subsided, Conway said.

"Communication of the MPC's strategy was generally clear, though with room for improvement, particularly in how the forward OCR track is conveyed.

"We are consistently assessing our performance in maintaining low and stable inflation, which is the best contribution we can make to improving New Zealand's long-run economic performance."

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The work released today provided a useful interim update before the next full review scheduled for 2027, Conway said.

Liam Dann is business editor-at-large for the NZ Herald. He is a senior writer and columnist, and also presents and produces videos and podcasts. He joined the Herald in 2003.

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