ANZ chief economist Sharon Zollner says 'good on' the Reserve Bank for recognising the scale of the inflation problem 'and fronting up to the fact that hoping inflation just goes away is likely to lead to worse outcomes in the end'

30th Nov 22, 2:56pm by David Hargreaves

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The Reserve Bank (RBNZ) deserves kudos "for not shirking their responsibilities" over inflation, the chief economist of the country's largest bank says.

"Good on them for recognising the scale of the inflation problem, and fronting up to the fact that hoping inflation just goes away is likely to lead to worse outcomes in the end," Sharon Zollner says in an **ANZ NZ Insight publication**.

"They are not wrong that the real cost to the economy – ie people – of losing inflation-targeting credibility would outweigh the cost of accidentally causing a harder landing than necessary," Zollner says amid a detailed crunch of the outlook for the Official Cash Rate in the wake of the **RBNZ's record 75 basis point hike of it last week**.

She says, however, that the RBNZ's in a "high-stakes game, and the risk of oversteering at this point is absolutely real".

"The uncertainty is enormous, and even if policy is actually set perfectly to achieve the best possible outcome, it won't look like it in real time – and will never be known after the fact either.

"The fact is, as things stand, the choice is between a bad outcome and a worse one. Inflation targeting currently is like that old joke about asking the old man in the village for directions to the post office. 'Well, son, I wouldn't start from here'," Zollner said.

She said it would be nice to be able to say with a high degree of certainty "that we know where things are going and what the ‘right’ thing for the RBNZ to do is".

"But that’s just not realistic. We’re in unprecedented times. The RBNZ just delivered its biggest OCR hike ever, at a time when house prices are already down double-digits.'

But Zollner did say "that the risk profile is tilting".

"Though no forecasters have covered themselves in glory in the past year, it has been one-way traffic in terms of forecast revisions. The next 12 months look far more nuanced.

"At some point, given central banks are having to drive looking in the rear-vision mirror at inflation outcomes, odds are they’re going to miss the turn. And the RBNZ is driving faster than most."

Zollner said the RBNZ had "startled all comers" with its hawkishness last week.

The ANZ economists are now forecasting a peak OCR of 5.75%, compared with the RBNZ's own forecast last week of 5.5%. The OCR is currently 4.25%.

Zollner said the RBNZ was aiming to engineer a “shallow” recession next year – "but a controlled burn could jump the fire-break".

"The key vulnerability in the New Zealand economy is the level of house prices – google global housing risks and there you’ll find it, in bright red.

"The good news is that house prices are already down 12% from their peak in an extremely orderly fashion. Very few people have been in a ‘must-sell’ situation and so have been reluctant to accept sharply lower offers, preferring in many cases not to sell.

"The prolonged stand-off between wary buyers and offended sellers has resulted in an ideal adjustment path back towards something more sustainable.

"It’s enough to reduce economic growth, certainly, by changing the maths around new builds, but so far, there’s very little blood on the floor.

"However, the potential exists for nasty feedback loops between the labour market and the housing market. If enough homeowners were to lose their jobs and have to sell at whatever the going price is on the day, house prices could start to gap lower, taking confidence and more jobs with them."

Zollner said on the ANZ's current forecasts (a 22% fall in nominal house prices and strong wage growth), "the real house price index falls an impressive 32% from its peak".

"But to get back to 2010 levels (before the angst about housing affordability really intensified) real house prices would need to fall about another 20%. So our forecast should certainly not be interpreted as a limit on how far things could go."