MACROECONOMICS

New Zealand's Reserve ((1)_______________) Bank yesterday raised interest rates to 7.25 %, the highest (2)_______________ interest rates in the developed world, in its attempt to use (3)_______________ policy to reduce very strong (4)_______________ spending and rising (5)_______________.

Allan Bollard, the governor of the Reserve Bank, said the (6)_______________ rate rise, the ninth recent tightening of monetary policy, was necessary to slow down consumer spending. The hope is to moderate (7)_______________ pressures that were significantly adding to aggregate (8)_______________. Various indicators explain why the Reserve Bank is worried. The 2005 inflation rate is above the Reserve Bank's target of 3 %; (9)_______________ savings are at negative levels; house prices are up 16 %; and consumer credit growth has increased in the last year by 15.3 %, creating an increasingly large (10)_______________ gap.

The Organisation for Economic Cooperation and Development (OECD) believes the tightening of monetary policy will have the desired effect, and expects a fall in forecast (11)_______________ growth (actual growth) from 4.4 % to 2.8 %.

Some economists are, however, very unhappy about the latest interest rate rise. Specifically, they are concerned that it will attract large inflows of (12)_______________, which will, in turn, affect the (13)_______________ and price competitiveness of New Zealand (14)_______________.

Source: adapted from Ray Marcelo, Financial Times, 9 December 2005

Central consumer currency demand demand-side economic exports foreign capital household inflation inflationary interest monetary nominal

KEY

MACROECONOMICS

New Zealand's Reserve (Central) Bank yesterday raised interest rates to 7.25 %, the highest nominal interest rates in the developed world, in its attempt to use monetary policy to reduce very strong consumer spending and rising inflation.

Allan Bollard, the governor of the Reserve Bank, said the interest rate rise, the ninth recent tightening of monetary policy, was necessary to slow down consumer spending. The hope is to moderate demand-side pressures that were significantly adding to aggregate demand. Various indicators explain why the Reserve Bank is worried. The 2005 inflation rate is above the Reserve Bank's target of 3 %; household savings are at negative levels; house prices are up 16 %; and consumer credit growth has increased in the last year by 15.3 %, creating an increasingly large inflationary gap.

The Organisation for Economic Cooperation and Development (OECD) believes the tightening of monetary policy will have the desired effect, and expects a fall in forecast economic growth (actual growth) from 4.4 % to 2.8 %.

Some economists are, however, very unhappy about the latest interest rate rise. Specifically, they are concerned that it will attract large inflows of foreign capital, which will, in turn, affect the currency and price competitiveness of New Zealand exports.