
1 Policy assessment

The Reserve Bank has decided to leave the Official Cash Rate unchanged at 5.75 per cent

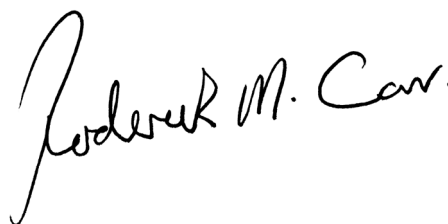
Since our May *Statement*, prospects for the international economy have become increasingly clouded, with sharp falls in equity markets and heightened investor nervousness in the US and elsewhere. Although the New Zealand economy has performed well over the past year, the odds of an international slowdown have increased, which would have adverse consequences for the performance of the New Zealand economy.

This renewed global uncertainty occurs at a time when the outlook for inflation has been of concern. Indicators of core inflation have edged up to around 3 per cent following a sustained period of higher-than-average pressure on the country's productive resources.

Gauging the extent to which the path for inflation will be affected by recent global developments is no easy task. Quite plausibly, the impact of recent global developments will remove much of the existing upwards pressure on inflation. But, conversely, the economy may continue to grow at a pace that maintains pressure on resources. Indeed, some of the recent drivers of strong domestic economic activity, including the sharp turnaround in net immigration, may not dissipate rapidly even in the event of softer international conditions.

Monetary policy involves carefully weighing the competing risks. On balance, we feel that current global developments, recent falls in export prices, an exchange rate higher than on average last year, and the lagged effects of the interest rate increases earlier this year are likely to dampen inflation pressures sufficiently going forward. In May it looked likely that further increases in interest rates would be required over the coming year to keep inflation within the target band, but that prospect now looks less likely. That was also the judgement we were coming to at our last OCR review in July, albeit for somewhat different reasons.

*We will continue to monitor global markets and the local economy, and assess the inflation outlook. For now, the prudent response is to pause, and to watch and wait.

A handwritten signature in black ink that reads "Rod Carr". The signature is written in a cursive, flowing style.

Rod Carr
Acting Governor