
1 Policy assessment

The Official Cash Rate (OCR) has been reduced from 6.5 percent to 5.0 percent.

Ongoing financial market turmoil and the marked deterioration in the outlook for global growth have played a large role in shaping today's decision. Activity in most of our trading partners is now expected to contract or grow only very slowly over the next few quarters.

Economic activity in New Zealand will be further constrained as a result, compared with our view in October.

Inflation is abating here and overseas as a consequence of these developments. We now have more confidence that annual inflation will return comfortably inside the target band of 1 to 3 percent some time in the first half of 2009 and remain there over the medium term. However, we still have concerns that domestically generated inflation (particularly local body rates and electricity prices) is remaining stubbornly high.

Today's decision brings the cumulative reduction in the OCR since July to 3.25 percent, and takes monetary policy to an expansionary position. Given recent developments in the global economy, the balance of risks to activity and inflation are to the downside. Thus it is appropriate to deliver this reduction quickly to support the economy and keep inflation from falling below the target band.

Monetary policy is working together with the depreciation of the New Zealand dollar and the fiscal stimulus now in train, to provide substantial support to demand over the period ahead and to create the conditions for some rebound in growth as global conditions improve.

To ensure the response we are seeking, we expect financial institutions to play their part in the economic adjustment process by passing on lower wholesale interest rates to their customers.

Further movements in the OCR will be assessed against emerging developments in the global and domestic economies and the response to policy changes already in place.

Alan Bollard



Governor