
1 Policy assessment

The Reserve Bank today left the Official Cash Rate (OCR) unchanged at 2.5 percent.

As foreshadowed in the September *Statement*, global conditions have deteriorated. Continuing difficulties related to sovereign and bank debt in a growing number of European economies have resulted in high levels of volatility in financial markets. There has also been a softening in international economic activity, including in the Asia-Pacific region.

Global developments are having some negative impact on New Zealand, though to date it has been limited. Business confidence has declined and investment spending is likely to remain weak for some time. In addition, tightness in international markets means funding costs for New Zealand banks will increase to some degree over the coming year.

There remains a high degree of uncertainty around the global outlook and, as discussed in the scenario in this *Statement*, there is a risk that conditions weaken further.

Domestically, economic activity continues to expand, though at a modest pace. Although off their peaks, export commodity prices remain elevated. In addition, the depreciation of the New Zealand dollar provides some support for the tradable sector of the economy. Over time, repairs and reconstruction in Canterbury will also provide a significant boost to demand for an extended period.

Annual headline inflation is estimated to have returned within the Bank's 1 to 3 percent target band in the December quarter. Underlying inflation continues to sit close to 2 percent. In addition, wage and price setting pressures have remained contained.

Given the current unusual degree of uncertainty around global conditions and the moderate pace of domestic demand, it remains prudent for now to keep the OCR on hold at 2.5 percent.

Alan Bollard



Governor