
1 Policy assessment

The Reserve Bank has decided to cut the Official Cash Rate by 25 basis points to 5.25 per cent.

Reducing the OCR is an appropriate response to a softening in inflation pressures and provides some protection for the economy against downside influences.

The evidence has become clearer that growth is beginning to slow following a period of strength. This slowdown mainly reflects the rapid appreciation of the exchange rate over the past 18 months, leaving the export sector more exposed to the soft world economy. We are projecting further slowing but expect domestic activity to remain reasonably robust with rapid growth in the population supporting demand. However, businesses are less assured about future trading prospects and confidence measures have fallen away. With confidence fragile, the impact of events such as SARS and dry weather on activity could be amplified.

The reformulated Policy Targets Agreement requires us to target inflation with a medium term focus and to avoid unnecessary instability in output, the exchange rate and interest rates. This OCR decision is intended to help prevent an unnecessarily sharp downturn, while delivering inflation that remains comfortably within the target range over the next few years. Influencing our decision is increased certainty that the economy has started to turn down, and the presence of downside risks – foreign and local – whose effects may be exaggerated by fragile confidence. In addition, CPI inflation is expected to receive extra downward pressure over the year ahead as a direct result of the higher exchange rate, but this effect will be temporary.

Our current projections of the economy incorporate a further modest reduction in the OCR. Any such further reduction will be contingent on further evidence that medium term CPI inflation pressures are abating as our projections assume. We will take our cues from the activity and inflation data as they come to hand.



Alan Bollard
Governor