
1 Policy assessment

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

On 23 January 2003, we stated that "If the exchange rate remains at around present levels or appreciates further, and if the evidence points to reduced pressures on resources and medium-term inflation, then there may be scope for a cut in the OCR later in the year."

Today's decision reflects that fact that the two-part criterion described above has not yet been fully met. The exchange rate has indeed appreciated further, but, so far, evidence of reduced inflation pressures has not been forthcoming.

The domestic economy has been more robust than we thought. Rapid population growth, rising employment and the earlier strength in the export sector have fuelled strong household consumption and supported higher residential investment and housing market activity. Capacity utilisation is high and demand for labour is strong. Consequently, inflation in industries serving the domestic economy is relatively high at around 4 per cent.

Thus the stronger currency and the stronger domestic economy continue to pull inflationary pressures in opposite directions. CPI inflation is projected to fall over the next few quarters, reflecting the impact of the exchange rate on import prices, and to settle comfortably within the target range over the medium term. However, we do not yet have sufficient certainty about this medium-term path of inflation to warrant a cut in interest rates now.

This assessment could change over the months ahead and the Bank will be carefully watching economic developments. As we said earlier, when we see reduced pressure on resources and medium-term inflation, then there may be scope for a cut in the OCR later in the year.



Alan Bollard
Governor