

---

# 1 Policy assessment

The Reserve Bank today reduced the Official Cash Rate (OCR) by 50 basis points to 3 percent.

The world economy deteriorated very rapidly late last year, amid ongoing losses and extreme volatility in international financial markets. While monetary and fiscal policy responses in many countries have been substantial we still expect the adverse economic forces generated by the crisis to remain dominant throughout 2009. The timing and extent of global recovery remain highly uncertain.

In New Zealand, the impact of difficult trading conditions is showing through clearly in reduced export revenues, weak business sentiment, and sharply curtailed investment and employment. Further house price falls and increased precautionary saving by households are driving a weakness in spending. Inflation pressure is abating rapidly as a result.

The OCR has now been reduced 525 basis points in little more than six months, taking interest rates to very stimulatory levels. Further falls in the lending rates faced by households and businesses are in the pipeline. While credit growth is easing in line with the weak economy, we expect financial institutions to continue lending on sound business propositions, to support the recovery.

In addition to the substantial change in monetary policy settings, there has been a large amount of stimulus from fiscal policy. These policy changes, together with the sizeable exchange rate depreciation, will act to support the New Zealand economy: therefore, we expect to see activity troughing in the middle of this year and then gradually picking up thereafter. However, the scale of the global financial crisis is such that there is great uncertainty about future economic developments and there is a risk that the recovery may occur later and be more protracted than we anticipate.

As economic activity troughs, we expect the rapid easing of monetary policy to slow. Any future cuts will be much smaller than observed recently. We do not expect to see in New Zealand the near-zero policy rates of some countries. New Zealand needs to retain competitiveness in the international capital markets. We will assess the need for further cuts in the OCR against emerging developments in the global and domestic economies and the responses to policy changes already in place.

Alan Bollard



Governor