
1 Policy assessment

The Reserve Bank today reduced the Official Cash Rate (OCR) by 50 basis points to 2.5 percent.

The Reserve Bank extends its sympathies to all those affected by the Christchurch earthquake. Our condolences go especially to those who have lost family, friends and colleagues.

The earthquake has caused substantial damage to property and buildings, and immense disruption to business activity. While it is difficult to know exactly how large or long-lasting these effects will be, it is clear that economic activity, most certainly in Christchurch but also nationwide, will be negatively impacted. Business and consumer confidence has almost certainly deteriorated.

Even before the earthquake, GDP growth was much weaker than expected through the second half of 2010. Households have continued to be very cautious, with retail spending volumes and residential investment both declining. The export sector has benefited from very high commodity prices, however, farmers have focused on repaying debt rather than increasing spending. Also the early summer drought constrained farm output through this time. Signs that the economy was beginning to recover early in 2011 have been more than offset by the Christchurch earthquake.

In putting together the forecasts underlying this *Monetary Policy Statement*, the Bank has had to make many important assumptions based on limited information. Over the coming weeks and months, these judgments will be tested as new information comes to hand. For now, GDP growth is projected to be quite weak through the first half of the year. This will gradually build up to a very large reconstruction programme by 2012 that will last for some years and contribute to a period of relatively strong activity.

Future monetary policy adjustments will be guided by emerging economic data. We expect that the current monetary policy accommodation will need to be removed once the rebuilding phase materialises. This will take some time. For now we have acted pre-emptively in reducing the OCR to lessen the economic impact of the earthquake and guard against the risk of this impact becoming especially severe.

Alan Bollard



Governor