
1 Policy assessment

The Reserve Bank has decided to leave the Official Cash Rate unchanged at 5.75 per cent. In addition, the Bank's projections show no change in short-term interest rates over the period ahead – reflecting our sense that the risks for the future direction of the OCR are evenly balanced.

The new Policy Targets Agreement directs the Bank to target future CPI inflation outcomes of 1 to 3 per cent on average over the medium term. Looking ahead, current policy settings appear consistent with that objective. In essence, strong domestic demand is expected to be offset by offshore developments, keeping inflation pressures in check.

Unlike most trading partners, the New Zealand economy has performed well in 2002. Activity has continued to benefit from the surge in export earnings over the past two years and from the recent rapid population growth. To date, weak global conditions have not had as large an impact on the local economy as we might have expected.

Strong activity has left businesses with limited scope to meet increases in demand without incurring extra costs and firms have been reporting ongoing difficulties in finding skilled and unskilled labour. These pressures are contributing to higher prices in some domestic-based industries, such as services.

However, the soft international economy, falls in some commodity prices and the path of the exchange rate have produced a fall in the inflation rate for tradable items. These offsetting factors have seen annual CPI inflation remain steady at a relatively high level.

Economic growth is likely to slow over the coming year, to a little below its average, reflecting international market conditions and a moderating of the demand pressures associated with strong population growth. The rise in the exchange rate over recent months, if sustained, will also put downward pressure on inflation over the next few quarters and exert some braking effect on activity and inflation further out. From a starting point of some considerable pressure on resources, inflation pressures evident in some parts of the economy are likely to subside somewhat, although perhaps not immediately.

The new PTA provides monetary policy with a little more flexibility in the way it responds to changing economic conditions. Our intention is to operate policy in a flexible manner in order to meet our obligations under the PTA. We will continue to reassess economic developments and respond appropriately.



Alan Bollard
Governor