
1 Policy assessment

The Reserve Bank has decided to leave the Official Cash Rate unchanged at 5 per cent.

New Zealand has enjoyed an extended period of strong economic growth. Signs that growth is slowing, which will reduce inflationary pressures, have led us to cut the OCR on several occasions this year, adding stimulus to the economy.

Our latest assessment is that the economy is continuing to cool, although not as sharply as previously thought. Exports remain under pressure, due to the higher exchange rate and a relatively slow global recovery. But domestic activity is stronger than expected with sentiment improving now that events such as SARS and the electricity shortages have dissipated. Ongoing population growth has been fuelling a sharp rise in residential and construction activity throughout the country and has supported household spending. While population growth looks likely to slow, sharp increases in property prices and a backlog of demand in the construction sector have the potential to maintain inflation pressure in the domestic economy for some time yet.

Current monetary policy settings are consistent with medium-term inflation remaining comfortably within the target range, with the risks to inflation balanced. Although imported inflation is currently weak due to the higher exchange rate, inflation pressures remain robust across a range of domestic industries, especially housing and construction.

Looking forward, there is a possibility that the current strength in the domestic economy proves stronger and more enduring than we are anticipating. Conversely, further appreciation of the exchange rate could potentially exert an even greater braking effect on the external sector. We will closely monitor the balance of pressures across these two sectors and their implications for the medium term inflation outlook as we update our policy outlook over the months ahead.



Alan Bollard
Governor