
1 Policy assessment

The Official Cash Rate (OCR) remains unchanged at 3.0 percent.

While the global and domestic economies continue to recover, the outlook has weakened since our June Statement. We consider it appropriate at this point to keep the OCR on hold.

The earthquake that struck Canterbury on 4 September has significantly disrupted economic activity and is likely to continue to do so for some time yet. Many homes and businesses have been damaged, as have significant parts of Canterbury's public infrastructure. Eventual reconstruction and repairs will require considerable resources over the next year or two, particularly in the construction sector. If, in the aftermath of the earthquake, the prices of some goods and services increase temporarily, monetary policy would remain focused on the medium-term trend in inflation. The Policy Targets Agreement explicitly instructs the Bank to look through temporary price increases generated by a natural disaster.

Looking more generally at the domestic economy, the household sector remains cautious, with consumer spending soft, house sales falling and house prices remaining flat. With continued soft demand for credit, this suggests household spending will not increase to the extent previously projected.

The pace of expansion in the global economy appears to have slowed in recent months with forward indicators of US growth, in particular, deteriorating noticeably. Nevertheless, continued strong growth in Australia and China will support demand for New Zealand exports, reinforcing the continued contribution of high export commodity prices.

Overall, despite the weakened outlook, we still expect that growth will progressively absorb current surplus capacity over the next few years. In addition, changes to indirect taxes and earthquake impacts will cause headline inflation to spike higher over the coming year. Previous experience of GST increases, the fact that annual CPI inflation has been near 2 percent for the past year and a half, and the subdued state of domestic demand suggest this inflation spike will have little impact on medium-term inflation expectations.

Over time, it is likely that further removal of monetary policy support will be required. The pace and extent of further OCR increases is likely to be more moderate than was projected in the June Statement.

Alan Bollard



Governor