
1 Policy assessment

The Official Cash Rate (OCR) will remain unchanged at 7.25 percent.

Medium-term inflation pressures remain persistent. While the short-term inflation outlook has improved, we are less optimistic about medium-term prospects. Economic activity has been stronger than expected, given the resilience in domestic demand, and medium-term inflation risks appear weighted to the upside.

A welcome decline in oil prices has improved the near-term inflation outlook. As foreshadowed in our October OCR Review, we expect to see a very low December quarter CPI figure. Annual inflation could be as low as 2 percent next year, which should help to restrain inflation expectations and therefore give some assistance in containing medium-term inflation pressures.

But household spending continues to show surprising resilience. The labour market remains very firm, with continued strong growth in incomes despite some easing in employment in the third quarter. There has been some improvement in business and consumer confidence. The housing market appears to have developed new momentum after slowing in the first half of the year. Houses are now selling as fast as at any time this year.

Many exporters are feeling pressure from the high exchange rate which, if sustained, could threaten the ongoing rebalancing of the economy. However, primary exporters are getting significant relief from favourable world commodity prices, which are now expected to continue for longer as a result of global supply shortages.

While overall medium-term inflation pressures have increased, the balance of risks also appears to be on the upside. The housing market could continue to defy predictions of a downturn, and domestic demand could be further boosted by a fiscal expansion over and above the stimulus that is already allowed for in our projections (based on the Government's 2006 Budget).

Looking ahead, our projections and risk assessment suggest that a firmer monetary policy stance could still be required to maintain downward pressure on inflation in the medium term. Further tightening cannot therefore be ruled out. This will depend on economic outcomes and in particular the emerging trends in housing and domestic demand indicators. Any easing of policy must remain some considerable way off.



Alan Bollard
Governor