
1 Policy assessment

The Official Cash Rate (OCR) has been reduced by 50 basis points from 8.0 percent to 7.5 percent.

The New Zealand economy is experiencing a marked slowdown, led primarily by the household sector. The outlook for the global economy has deteriorated further in the wake of continued financial market turmoil. In addition, the New Zealand business sector is coming under pressure from both rising costs and falling demand. While domestic activity is likely to pick up late this year as a result of personal tax cuts, increased government spending and rising rural incomes, we expect a prolonged period of household sector adjustment and below-average growth.

The weakness in economic activity is expected to translate into lower inflation pressures in the medium term. Headline inflation is expected to peak around 5 percent in the current September quarter before trending down thereafter. However, food price inflation, exchange rate depreciation and higher wage costs will tend to keep headline inflation at elevated levels through 2009.

With medium-term inflation pressures expected to ease, it is appropriate to move towards a less restrictive monetary policy stance. Compared to the June *Monetary Policy Statement*, we have brought forward some of the projected interest rate reduction, but have not altered the expected overall decline. We believe this response is warranted in light of the tightness of current credit conditions and the time it will take to affect the actual interest rates faced by households and businesses.

Looking ahead, the scale and timing of further official cash rate reductions will depend on signs of declining inflation pressures and on exchange rate adjustments.

Alan Bollard



Governor