
1 Policy assessment

The Official Cash Rate (OCR) will remain unchanged at 8.25 percent.

The outlook for economic activity has deteriorated somewhat since we reviewed the OCR in January. The main reasons are weaker prospects for world growth, tighter credit conditions, a sharper-than-expected slowing in the housing market, and recent dry weather conditions. On balance, we now expect GDP growth of around 2 percent over the next three years.

Despite the weaker outlook for activity, we expect headline inflation to remain high, partly due to the inclusion of the planned emissions trading scheme in our projection. Higher food and energy prices are also contributing to near-term inflation. Furthermore, over the medium term, a tight labour market, strength in commodity prices, and the impact of announced government spending plans and assumed personal tax cuts will add to inflationary pressure. Excluding the effects of the emissions trading scheme, inflation is projected to return close to the mid-point of the target band by 2010.

There is more uncertainty than usual at present, with downside risks to activity and upside risks to inflation. The main downside risks are a further deterioration in the world economy, tighter credit conditions, and the potential for a more severe downturn in the housing market. Conversely, further strength in labour costs, additional fiscal stimulus, and high inflation expectations represent key upside risks to underlying inflation.

Given this outlook, we expect that the OCR will need to remain at current levels for a significant time yet to ensure inflation outcomes of 1 to 3 percent on average over the medium term.

Alan Bollard

A handwritten signature in black ink that reads "Alan Bollard". The signature is written in a cursive, flowing style.

Governor