What the Reserve Bank said about interest rates

- Thursday, August 11th 2016

The Reserve Bank has reduced the Official Cash Rate (OCR) by 25 basis points to 2%.

Global growth is below trend despite being supported by unprecedented levels of monetary stimulus. Significant surplus capacity remains across many economies and, along with low commodity prices, is suppressing global inflation. Some central banks have eased policy further since the June Monetary Policy Statement, and long-term interest rates are at record lows. The prospects for global growth and commodity prices remain uncertain. Political risks are also heightened.

Weak global conditions and low interest rates relative to New Zealand are placing upward pressure on the New Zealand dollar exchange rate. The trade-weighted exchange rate is significantly higher than assumed in the June Statement. The high exchange rate is adding further pressure to the export and import-competing sectors and, together with low global inflation, is causing negative inflation in the tradables sector. This makes it difficult for the Bank to meet its inflation objective. A decline in the exchange rate is needed.

Domestic growth is expected to remain supported by strong inward migration, construction activity, tourism, and accommodative monetary policy. However, low dairy prices are depressing incomes in the dairy sector and reducing farm spending and investment. High net immigration is supporting strong growth in labour supply and limiting wage pressure.

House price inflation remains excessive and has become more broad-based across the regions, adding to concerns about financial stability. The Bank is consulting on stronger macro-prudential measures that should help to mitigate financial system risks arising from the rapid escalation in house prices.

Headline inflation is being held below the target band by continuing negative tradables inflation. Annual CPI inflation is expected to weaken in the September quarter, reflecting lower fuel prices and cuts in ACC levies. Annual inflation is expected to rise from the December quarter, reflecting the policy stimulus to date, the strength of the domestic economy, reduced drag from tradables inflation, and rising non-tradables inflation. Although long-term inflation expectations are well-anchored at 2%, the sustained weakness in headline inflation risks further declines in inflation expectations.

Monetary policy will continue to be accommodative. Our current projections and assumptions indicate that further policy easing will be required to ensure that future inflation settles near the middle of the target range. We will continue to watch closely the emerging economic data.

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