Monetary Policy Statement

March 2011[1]

This *Statement* is made pursuant to Section 15 of the Reserve Bank of New Zealand Act 1989.

Contents

Appendices

The Bank extends its sincere sympathies to all affected by the devastating earthquake that struck Christchurch on 22 February 2011.
Our condolences go especially to those who have lost family, friends and colleagues.

This document is also available on www.rbnz.govt.nz

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[1] Projections finalised on 2 March 2011. Policy assessment finalised on 9 March 2011.

1 Policy assessment

The Reserve Bank today reduced the Official Cash Rate (OCR) by 50 basis points to 2.5 percent.

The Reserve Bank extends its sympathies to all those affected by the Christchurch earthquake. Our condolences go especially to those who have lost family, friends and colleagues.

The earthquake has caused substantial damage to property and buildings, and immense disruption to business activity. While it is difficult to know exactly how large or long-lasting these effects will be, it is clear that economic activity, most certainly in Christchurch but also nationwide, will be negatively impacted. Business and consumer confidence has almost certainly deteriorated.

Even before the earthquake, GDP growth was much weaker than expected through the second half of 2010. Households have continued to be very cautious, with retail spending volumes and residential investment both declining. The export sector has benefited from very high commodity prices, however, farmers have focused on repaying debt rather than increasing spending. Also the early summer drought constrained farm output through this time. Signs that the economy was beginning to recover early in 2011 have been more than offset by the Christchurch earthquake.

In putting together the forecasts underlying this *Monetary Policy Statement*, the Bank has had to make many important assumptions based on limited information. Over the coming weeks and months, these judgments will be tested as new information comes to hand. For now, GDP growth is projected to be quite weak through the first half of the year. This will gradually build up to a very large reconstruction programme by 2012 that will last for some years and contribute to a period of relatively strong activity.

Future monetary policy adjustments will be guided by emerging economic data. We expect that the current monetary policy accommodation will need to be removed once the rebuilding phase materialises. This will take some time. For now we have acted pre-emptively in reducing the OCR to lessen the economic impact of the earthquake and guard against the risk of this impact becoming especially severe.

Alan Bollard

Alan Bollard

Governor

2 Overview and key policy judgements

Just as Canterbury was beginning to recover and rebuild from its September earthquake, a second, but much more destructive earthquake struck Christchurch on 22 February. Sadly, this earthquake has caused numerous fatalities.

The disruption to normal business activity in Canterbury has been immense and is likely to persist for some time. It is appropriate for monetary policy to become more supportive to offset the resultant negative impact of the earthquake on economic activity and inflation.

While the earthquake is clearly having a negative impact on the economy, it is very difficult to know how large or how long-lasting this impact will be. In putting together the forecasts underlying this *Statement*, the Bank has had to make many important assumptions based on quite limited information. For this reason – even more than normal – readers should view the forecasts as a thematic representation of the thinking behind the policy decision, rather than a strict prediction of the future. Consistent with this, discussion and presentation of the economic projections have deliberately been reduced in this *Statement*. The Bank expects to present a full set of projections in the June 2011 *Statement*.

Even before the February earthquake, 2010 GDP growth had been very modest, and was much weaker than had been projected. Indeed, assuming activity held steady in the December quarter, GDP increased by only 0.5 percent through calendar 2010.

A number of factors caused GDP growth to be so poor. Ongoing efforts by households to reduce debt meant retail spending increased only modestly, with many retailers reducing margins to help maintain sales volumes. Household caution, along with a 0.5 percentage point increase in the floating mortgage rate and changes to the taxation of property investment, also caused the housing market to slow sharply, such that house prices declined. Businesses were similarly conservative, with their employment and investment expenditure increasing only modestly. An early summer drought also contributed to weak GDP growth. Agricultural production slowed sharply toward the end of 2010 as dry conditions reduced grass growth.

More recently, however, signs of recovery had begun to emerge. Business confidence recovered somewhat, imports of capital equipment picked up, housing turnover stabilised, climatic conditions improved substantially, and credit and debit card spending increased. Furthermore, the Bank's January round of business visits was surprisingly positive. While hardly indisputable evidence that the economy was recovering, such developments were clearly an improvement on 2010.

February's earthquake has more than offset this recent recovery. Damage is substantial and the disruption to normal business activity is immense. Large parts of Christchurch's central business district have been destroyed. Several thousand homes will need to be completely rebuilt, with tens of thousands more needing substantial repairs. In addition, significant areas of land – particularly in the city's eastern suburbs – suffered liquefaction. Infrastructure, such as the waste and water systems and the electricity network, has been severely damaged.

Many businesses closed following the earthquake. Some business operators have been hindered by a lack of essential services, such as electricity, water and sewerage. Others have been affected by damage to or difficulty accessing their premises, or will have closed to allow staff time to focus on essential repairs and the cleanup of their homes and neighbourhoods.

Retail spending in Canterbury has slowed sharply. Electronic transaction data suggest the disruption to spending is about twice that seen following the September earthquake. While spending will undoubtedly recover as households restock and replace damaged items, reduced sales until then could prove very challenging for some businesses.

Construction sector activity has also been negatively affected. Any residential or commercial construction that was due to commence in Christchurch over the past two weeks has almost certainly not occurred. With resources devoted to emergency repairs and recovery, such construction activity could well be postponed for some months. More significantly, with repairs for the September earthquake about to commence, many in the construction sector will have been preparing for a surge in demand. The construction of temporary accommodation will offer some near-term relief to the industry.

The negative impact on tourism could also be quite persistent. Christchurch airport accounts for about 17 percent of all passenger movements, illustrating its role as a gateway for the South Island more generally. Many will be reluctant to pass through Christchurch, with some cancelling their travel to New Zealand altogether.

The earthquake is also likely to reduce consumer and business confidence more generally. Economic uncertainty could see households trim spending and firms delay investment plans. Such an effect could well be felt for many months.

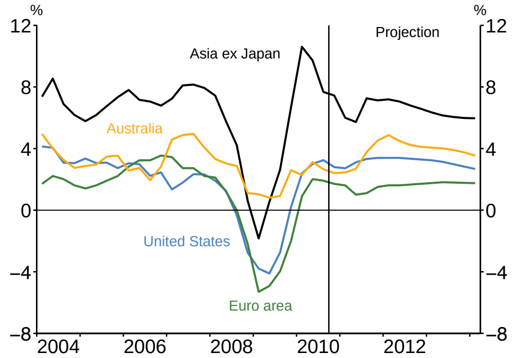
At this early stage it is difficult to quantify these effects. However, it is clear that the earthquake will have a large near-term negative impact on economic activity in 2011. Note that the full economic impact of the earthquake will be much larger than that shown by GDP statistics. GDP measures production, and makes no allowance for any damage or depreciation to an economy's capital stock. But focusing on the impact of the earthquake on GDP, it seems quite possible that GDP will contract in the March quarter.

Once the immediate negative impact of the earthquake subsides, several factors are likely to help the economy recover. Growth in the Asia-Pacific region continues to be robust, and is likely to remain so over the forecast horizon (figure 2.1). In addition, the US and Europe continue to grow more strongly than expected. Downside risks to the global outlook persist, however, with Western trading partners remaining highly indebted. Furthermore, oil prices have increased substantially over the past few weeks, following political tension in the Middle East and North Africa.

As a result of robust trading partner growth, merchandise export volumes have performed relatively well over the past year or so. Even the manufacturing sector, for which domestic sales have contracted substantially, continues to record export volume growth. Strong growth in the Asia-Pacific region is likely to see goods exports expand steadily.

Tourism activity will pick up in September as teams, officials and supporters visit New Zealand for the 2011 Rugby World Cup. Visitors are expected to add about $700 million to the economy during the six weeks of the event, about a third of a percent of GDP. The risk that these extra visitors crowd out other tourist spending is mitigated by the timing of the tournament, with September and October

Figure 2.1
GDP growth by region
(annual)

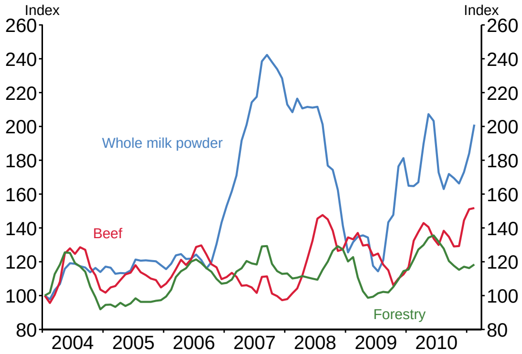


Source: Haver Analytics, RBNZ estimates.
Note: Asia ex. Japan comprises: China, Hong Kong, Indonesia, Malaysia, The Philippines, Singapore, South Korea, Taiwan, Thailand and Vietnam.

typically quieter months for the tourism industry. Beyond this, however, high debt in Western trading partners, along with some earthquake-induced discouragement of tourism, suggest services exports are likely to increase only modestly.

New Zealand's commodity export prices continue to increase. While strength in the currency has offset a good deal of the gains of the past 18 months, New Zealand prices are still quite favourable for a number of commodity exports (figure 2.2).

Figure 2.2
Selected New Zealand dollar commodity prices
(Jan 2004 = 100)



Source: USDA, Agri-fax, ANZ National Bank Ltd.

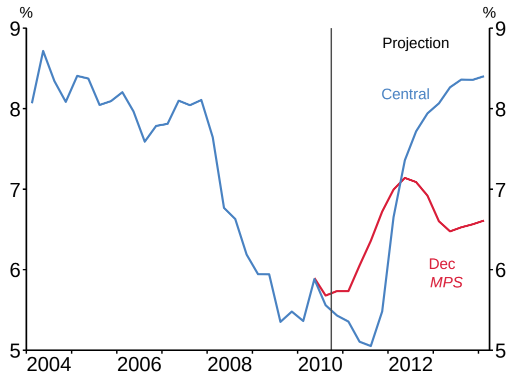
To date, farmer spending has held relatively steady, despite increased primary export revenue. While this has reduced the impulse of higher commodity prices to GDP, efforts by the agricultural sector to reduce debt and consolidate balance sheets are helping reduce the sector's vulnerability to any future adverse event. Export commodity prices are expected to remain favourable throughout the projection.

Eventual reconstruction activity in Canterbury will also add significantly to GDP. At this early stage, it is difficult to know exactly when rebuilding will commence. Experience from the September earthquake suggests it will be some months before building gets under way. However, much of the logistical planning for reconstruction from September will still be relevant, suggesting a more rapid start. The projections assume reconstruction begins in 2012. Repairs to essential infrastructure are likely to occur sooner than other non-residential construction.

It is clear, however, that substantial repairs and rebuilding are required. Once reconstruction does commence, building activity will increase markedly. Given the scale of reconstruction required, bottlenecks will inevitably develop. Insurance assessors will be in short supply, as will, in due course, builders and other trades people.

The projections assume construction sector activity quickly increases to an elevated share of GDP, similar to that experienced during the mid-2000s building boom, and holds there for several years (figure 2.3). At this rate it could take almost a decade to complete reconstruction. It is possible that reconstruction proceeds more rapidly than this. Globally, construction sector activity remains well below capacity. While it would be relatively expensive, New Zealand could import construction workers to help speed up reconstruction.

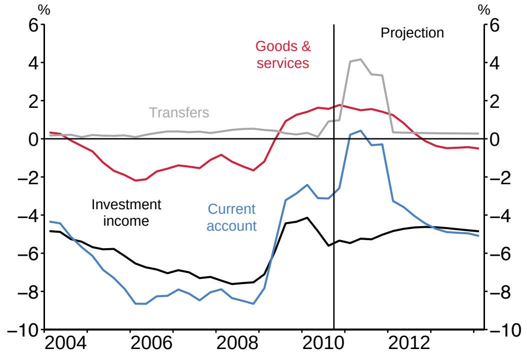
Figure 2.3
Residential and non-residential investment
(share of potential output, seasonally adjusted)



Source: Statistics New Zealand, RBNZ estimates.

New Zealand has a high incidence of dwelling insurance. In turn, a good deal of this insurance is hedged through international reinsurers. Because of this, earthquake insurance payments will induce large reinsurance inflows, which will be recorded in the transfers balance of the March quarter current account. The projection assumes a reinsurance credit of $6 billion in the March quarter. This, in combination with reinsurance transfers from the September earthquake, is expected to briefly push the annual current account balance into surplus (figure 2.4). The current account deteriorates thereafter as reconstruction causes increased imports of capital equipment and building materials.

Figure 2.4
Current account, trade, transfers and investment income balances
(annual, share of nominal GDP)



Source: Statistics New Zealand, RBNZ estimates.

Recovery and repairs are also likely to substantially impact the Crown accounts. Most notably, the Earthquake Commission will directly finance up to $3 billion of the repairs to residential property. In addition, the Crown is likely to contribute to repairs to public infrastructure and the cost of rescue and recovery.

Relative to the December *Statement*, GDP growth is expected to be much weaker over the coming year. This reflects weaker-than-expected growth through the second half of 2010, the near-term negative impact of the February earthquake and the resultant delay to reconstruction from the September earthquake. Beyond 2011, growth is expected to accelerate more rapidly than was projected in December, reflecting the now much more substantial reconstruction in Canterbury (figure 2.5).

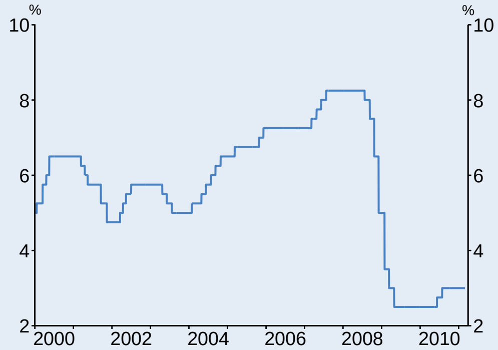
Box A

Recent monetary policy decisions

The OCR was held at a record low 2.5 percent from the April 2009 OCR review through to the June 2010 *Statement*. This low OCR was appropriate given the extent to which bank funding costs increased, the New Zealand economy contracted and inflationary pressures abated during the 2008/09 recession. Indeed, policy stimulus appears to have helped avoid inflation falling excessively, with annual CPI inflation remaining near the centre of the target band.

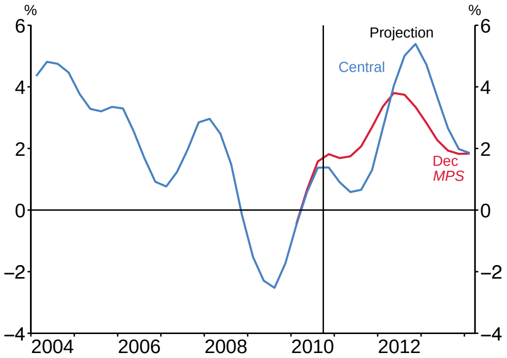
Following signs that the New Zealand economy had been expanding for more than a year, the OCR was increased by 25 basis points in June and July of 2010 (figure A1). The Bank judged that it was no longer appropriate to maintain the extraordinary level of support implemented during the recession. Since then, domestic demand has turned out much weaker than had been forecast and the OCR has remained unchanged.

Figure A1
Official Cash Rate



Source: RBNZ.

Figure 2.5
GDP growth
(annual average)



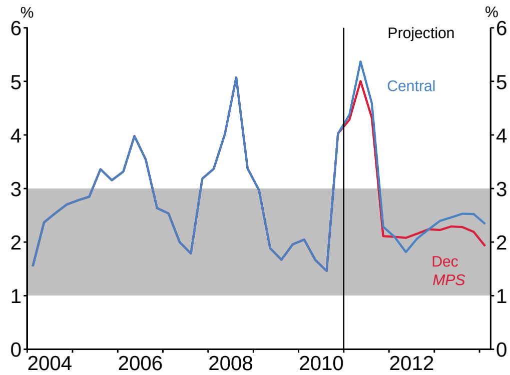
Source: Statistics New Zealand, RBNZ estimates.

Monetary policy judgements

Inflation is currently being boosted by the recent increase in the rate of GST (figure 2.6). Prior to the earthquake, the Bank had expected annual inflation to return rapidly toward the centre of the target band, once the impact of the GST increase had dropped out of the annual rate.

The earthquake will be causing some prices to increase. Most notably, rents – both for residential and commercial premises – are likely to increase over the next few weeks. This effect is likely to be felt outside of Christchurch given the flow of people temporarily leaving the area. In addition, the cost of insurance is likely to increase. Consistent with the

Figure 2.6
CPI inflation
(annual)



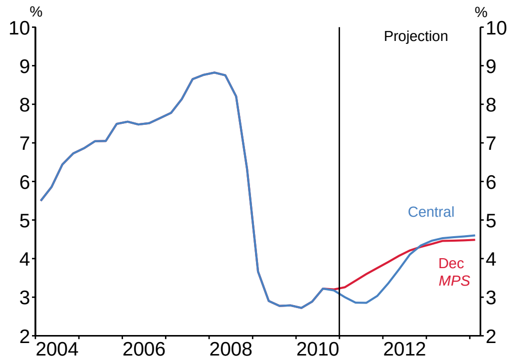
Source: Statistics New Zealand, RBNZ estimates.

Policy Targets Agreement, monetary policy will not react to such short-term price increases.

The earthquake's more persistent inflation impact, however, is the likely boost to inflationary pressure generated by the mobilisation of resources required for the rebuilding of Canterbury. Because reconstruction is likely to take many years, this inflation impulse could prove persistent. Given monetary policy's focus on the medium-term trend in inflation, it would therefore be inappropriate, all else equal, for monetary policy to be stimulatory during reconstruction.

In the near term, however, the earthquake is clearly having a negative impact on activity. It is difficult to know how large or how long lasting this impact will be, but there is a risk that the downturn is quite severe. To guard against this risk it is appropriate for monetary policy to become more supportive (figure 2.7). Lowering the OCR should be regarded as an insurance measure, designed to help offset the negative economic effects of the earthquake until such time as rebuilding – and a recovery in the broader economy – act to draw on the economy's surplus resources.

Figure 2.7
90-day interest rate



Source: RBNZ estimates.

New Zealand's current positively sloped yield curve enhances the ability of monetary policy to react to these negative effects. Relatively high longer-term interest rates have seen borrowers shorten the duration of their debt. This preference for floating rate mortgages means that any move in the OCR translates relatively quickly to the interest rates actually faced by households and firms. The Bank can ease policy knowing that the resultant reduction in effective interest rates can be reversed quite quickly once the economy begins to recover.

Finally, it should again be noted that in putting together the forecasts underlying this *Statement*, the Bank has had to make many important assumptions based on quite limited information. Over the coming weeks and months, these judgements will be tested as new information comes to hand. For now, though, monetary policy is acting pre-emptively to mitigate the broader economic impact of the earthquake.

Box B

The economic impact of the Canterbury earthquakes

The 22 February earthquake in Christchurch has caused significant damage and disruption, compounding the effects of the 4 September 2010 earthquake and subsequent aftershocks. In addition to the considerable impact these events have had on people's lives, there has been substantial damage to assets, as well as disruption to economic activity. This box discusses the assumptions made regarding the economic impacts of the 22 February earthquake. As these assumptions are made in an environment of very limited information, they are subject to considerable uncertainty.

Near term effects

With Christchurch home to 12 percent of the New Zealand population, disruptions in the city will have a sizeable impact on activity at a national level.

In the near term, the February earthquake will result in a marked reduction in economic activity. It is estimated that March quarter GDP will be 0.6 percent lower than would otherwise have been the case. This is mainly a result of reduced household and business spending, as well as lost exports and lost production in sectors such as real estate, construction and tourism. Although significant search and rescue activity is under way, such activity may not be well measured in GDP.

While the weakness in activity will be centred on Canterbury, other regions are also likely to be negatively affected. Disruption to activity will continue for some time as a result of reductions in wealth and confidence.

Some short-term increase in prices can be expected as a result of the earthquakes. Of note are the costs of insurance and rents.

- The damage to property will have created an immediate shortage of residential and commercial buildings, which is likely to place upward pressure on rents within the region. This effect is also likely to be felt outside of Christchurch given the flow of people temporarily leaving the area. Private rents account for 7.9 percent of the nationwide CPI.
- Insurance premiums for dwellings, contents and vehicles (accounting for around 0.8 percent of the CPI) are also expected to rise as the international cost of reinsurance increases. Such increases will not be limited to Canterbury.

Cost of reconstruction

The total cost of reconstruction is currently assumed to be $15 billion (about 8 percent of annual nominal GDP). This represents a substantial increase in the cost of reconstruction required following the September earthquake.

- The assumed cost of reconstruction of residential land and buildings is $9 billion.[1] This compares with a capital value of around $60 billion for residential property across the Christchurch City, Selwyn District and Waimakariri District council areas.
- The assumed cost of reconstruction of non-residential buildings is $3 billion. The capital value of privately owned commercial and industrial property in the area is about $15 billion. Additional to this are central government-owned assets such as schools, as well as publicly owned commercial assets.
- The assumed cost of reconstruction of infrastructure is $3 billion. The capital value of public infrastructure across the three affected council areas is about $4.6 billion.[2]

Much of the financial cost of the earthquake will be covered by insurance. Households will be largely covered by EQC and private insurance, although there will be some under- and noninsurance (particularly of contents). Many businesses will be insured for both business disruption and physical damage. Nevertheless, there are still likely to be significant financial losses as a result of the earthquakes,

1 Assuming there are 70,000 claims for about $10,000, 70,000 claims for about $40,000, 20,000 claims for about $250,000, and an additional 20,000 claims are for land remediation work of about $25,000.

2 Privately owned infrastructure, such as the electricity network, is not included in this figure.

spread across private households and firms, central and local government, and foreign re-insurance companies.

Timing of reconstruction

Reconstruction is assumed to begin in 2012. Initially, ongoing aftershocks will delay the start of reconstruction work. In addition, a substantial amount of demolition and land stabilisation must be carried out before reconstruction can begin, particularly in areas where there has been liquefaction. The process of obtaining insurance assessments, consents and plans is also likely to delay reconstruction.

Reconstruction work will initially boost residential investment and essential infrastructure spending, with residential investment rising to an elevated share of the economy's potential level of output, similar to the levels seen during the mid-2000s construction boom. At this assumed rate of work, residential reconstruction is completed in five to six years (figure B1)

A more gradual increase in commercial building is assumed, such that non-residential reconstruction continues beyond 2020 (figure B2).

Figure B1
Residential investment
(share of potential GDP, seasonally adjusted)

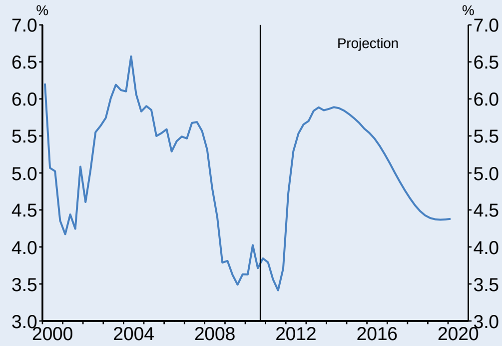
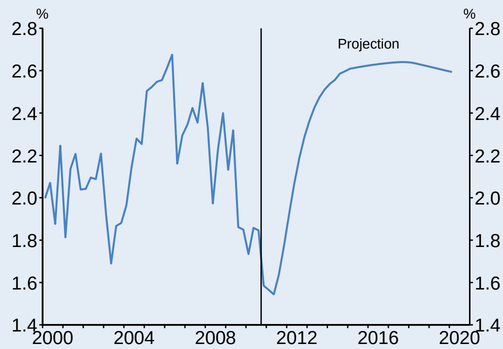


Figure B2
Non-residential investment
(share of potential GDP, seasonally adjusted)

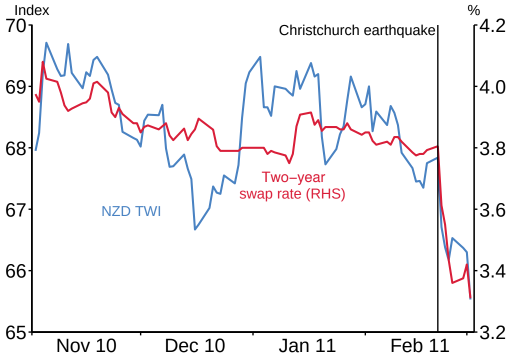


3 Financial market developments

Overview

The Christchurch earthquake has had a significant impact on local financial markets (figure 3.1). Interest rates have fallen sharply across the yield curve, with shorter-term interest rates falling most significantly. As a result, the interest rate curve has become more steeply positively-sloped since the December *Statement*. In currency markets, the New Zealand dollar has also fallen significantly in response to the earthquake and soft economic data in the lead-up to the disaster.

Figure 3.1
NZ dollar trade weighted index and two year swap rate



Source: Bloomberg.

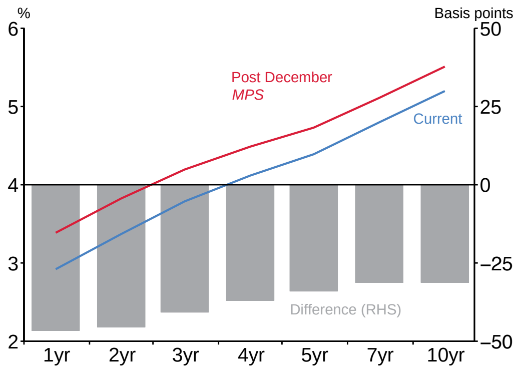
Globally, there has been a generalised improvement in sentiment. One of the key drivers of this has been further signs that the recovery in the major developed economies has gained momentum. Economic data, which has generally bettered market expectations, and improved corporate earnings have helped to lift equity markets and commodity prices to new post-crisis highs. Yields on government bonds have generally risen in both developed and emerging market countries since the December *Statement* on the back of an improved growth outlook and rising inflation expectations. However, civil unrest in the Middle East and North Africa has sparked some renewed risk aversion in financial markets more recently, prompting a sharp rise in oil prices and some retracement in equity markets from their highs.

Domestic financial markets

Interest rates declined sharply following the Christchurch earthquake, particularly shorter-term wholesale interest rates, reflecting concerns that the disaster would add a significant headwind to the economy. But even before the earthquake, a series of relatively weak domestic indicators published over late 2010 and early 2011 had already prompted markets to scale back OCR expectations. Overall, this has seen the market not only take out all the OCR increases that had previously been expected during 2011, but it has priced in a significant chance of policy easing in the near term.

Longer-term wholesale interest rates have not fallen to the same extent, supported by rising longer-term rates in key global markets and a view that any near-term monetary policy easing will need to be reversed once the economy recovers. However, the timing of a return to higher rates is now significantly delayed relative to the market pricing at the time of the December *Statement*. As a result, the wholesale yield curve has steepened (figure 3.2). While longer-term swap rates have fallen, there has been little downside in longer-term government bond yields.

Figure 3.2
Wholesale interest rate curve

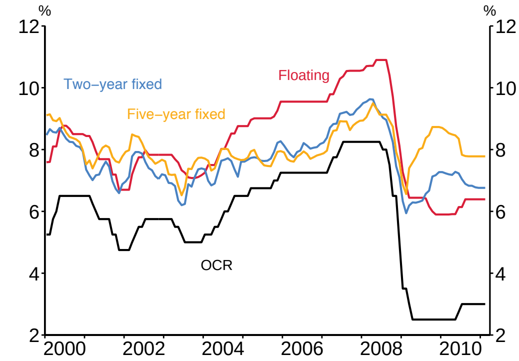


Source: Bloomberg.

The steep wholesale yield curve, if sustained, is likely to ensure the mortgage interest rate curve remains positively sloped (figure 3.3). This should lead borrowers to continue to favour floating rate mortgages. In recent months, the proportion of borrowers on floating rate mortgages has continued to rise, reaching more than 47 percent at the end of January 2011 – exceeding the highs seen in 2000. This has resulted in an ongoing decline in the average mortgage duration (figure 3.4).

Figure 3.3

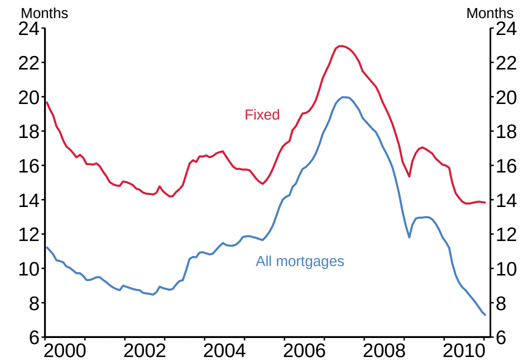
Mortgage rates offered to new borrowers



Source: RBNZ.

Figure 3.4

Average mortgage duration



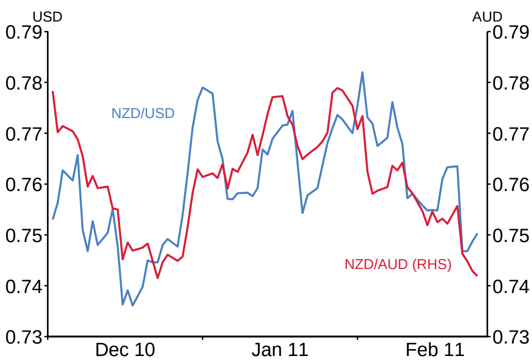
Source: RBNZ.

Foreign exchange market

Despite earlier strength, the New Zealand dollar has fallen sharply following the earthquake. The fall was particularly pronounced against the Australian dollar, as the earthquake was seen as further widening the growth and interest rate gap between the two countries. This has seen the NZD/AUD cross-rate fall to a 10-year low (figure 3.5).

Figure 3.5

NZD/USD and NZD/AUD



Source: Bloomberg.

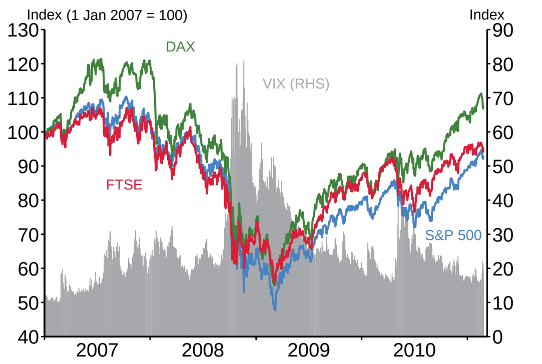
The NZ dollar has also weakened relative to the US dollar, but not to the same extent as the NZD/AUD. This divergence reflects a further depreciation in the US dollar since the December *Statement*, as improved global risk sentiment has encouraged investors to continue to move funds out of safe-haven currencies. While political tension in the Middle East and North Africa has encouraged some flight to safety, this support to the US dollar has generally been offset by its subsequent weakness against the euro. The EUR/USD has strengthened sharply so far this year, driven by upside surprises on euro area inflation and increasing market expectations that the European Central Bank will start raising its policy rate.

International financial market developments

Global markets appear to be increasingly confident that economic recovery in developed economies is gaining momentum. Further improved economic data, coupled with strong corporate earnings and revenue growth in the US and Europe, have seen major equity markets climb further since the December *Statement*, to reach their highest levels since mid 2008. As an indication of the recovery in risk appetite, the VIX index of implied volatility on S&P500 options has fallen back to around the lows seen before the emergence of Europe's peripheral sovereign debt problems in May last year (figure 3.6).

Figure 3.6

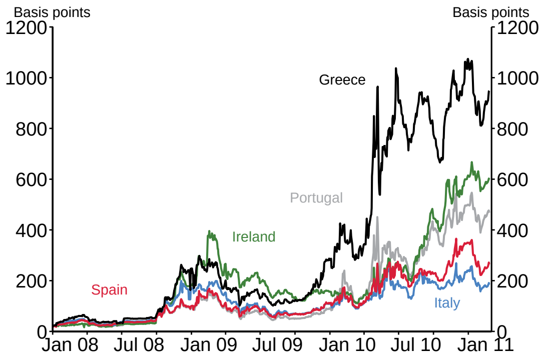
Global equity markets and VIX index



Source: Bloomberg.

Reduced sovereign debt concerns have also helped to support the rally in risky assets. Much of this improvement came after a number of successful bond auctions carried out by the peripheral European countries, indicating that these governments were still able to access capital markets for funds. In addition, market expectations of an expansion of the European Financial Stability Facility have helped to ease fears, with markets speculating that the finalised programme will alleviate funding pressure for peripherals (figure 3.7). These developments have reduced the pressure on credit default swap and bond spreads for the eurozone peripherals, although the fact that the level of bond yields for these economies remains elevated suggests that markets still see the situation as fragile.

Figure 3.7
Sovereign credit default swap spreads



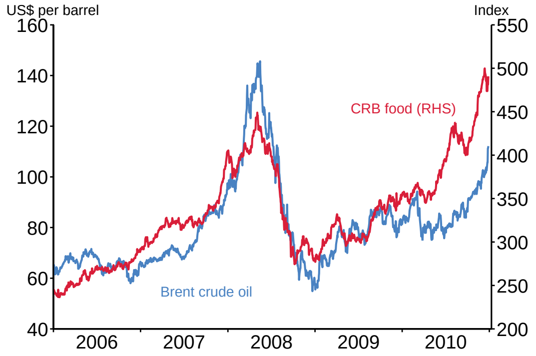
Source: Bloomberg.

More recently, rising civil unrest in the Middle East and North Africa has prompted some increase in risk aversion. There are fears that political turmoil could spread to other countries in these regions and, more specifically, cause further disruption to oil production and transport in the Middle East. Oil prices have climbed sharply in relation to these supply fears, while signs of an increasingly robust global economy are seen as underpinning demand. Besides energy prices, agricultural commodity prices have also continued to move higher in response to supply disruptions following extreme weather in key growing regions (figure 3.8). The rise in commodity prices has been a major factor driving inflation higher in emerging Asian economies, prompting some central banks to further tighten monetary policy. With food price inflation running at double-digit rates in some countries, markets expect further policy tightening in these countries.

Government bond yields in major economies have increased as the global growth outlook has improved and safe-haven demand has declined. Also contributing to the rise has been growing concerns that global inflationary pressures are building. US and European yields have increased, despite continued support from the Federal Reserve's purchases of Treasuries and expectations that the current $600bn purchase programme will be delivered.

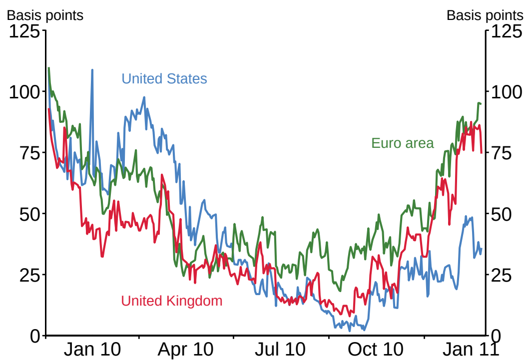
Market participants have also become increasingly concerned about rising inflation pressures in Western economies. Rising global commodity prices and stronger growth have led to upside inflation surprises in some of these economies. In response, inflation expectations have crept higher in recent months, prompting markets to bring forward the timing of expected rate hikes from central banks (figure 3.9). The shift in expectations has been particularly pronounced in Europe where comments from officials at the European Central Bank and the Bank of England have led to speculation that monetary policy will be tightened sooner than previously expected.

Figure 3.8
Global oil and food commodity prices



Source: Bloomberg.

Figure 3.9
Market pricing for policy rate moves
(over the next 12 months)



Source: Bloomberg.

4 Current economic conditions

February's earthquake is having a substantial negative impact on economic activity. The earthquake is causing significant disruption to business activity in the Canterbury region, which normally accounts for about 15 percent of the domestic economy. Significant damage to infrastructure and buildings, along with a focus on recovery and clean-up will dampen usual production and spending for some time.

The earthquake also creates substantial uncertainty about the economic outlook. As a result, firms are likely to postpone investment plans until the regional impact and outlook are clearer. Any scheduled residential construction will almost certainly have been postponed, given the uncertainty over land conditions and the diversion of resources to rescue and recovery.

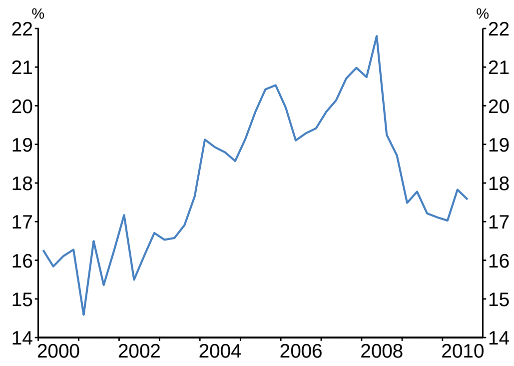
Tourist spending is also likely to have fallen markedly. Travellers will be cancelling or cutting short their holidays and business visits. In addition, any disruptions and delays to air services will negatively impact tourism activity in the South Island more generally.

Small and medium-sized businesses affected by the earthquake are likely to struggle. Damage to buildings and restrictions to access will mean they are unable to operate. Flow-through activity from other businesses will also be hampered. In addition, staff may not be able to work due to the destruction of dwellings and the lack of basic services. Businesses without sufficient insurance cover are likely to face closure.

More generally, the earthquake will cause a significant drop in regional confidence, with potential spillover nationally, which will further dampen activity. Uncertainty over job prospects and welfare access, a lack of services and disruption to day-to-day life, significant damage to residential and commercial property and a host of other factors will dampen business and consumer confidence for some time.

Even before the earthquake the New Zealand economy was relatively soft, essentially tracking sideways over the last three quarters of 2010. Domestic demand has been very weak, reflecting caution on the part of both businesses and households. Businesses faced with weaker-than-expected final demand and limited profit growth have been reluctant to invest (figure 4.1).

Figure 4.1
Business investment
(seasonally adjusted, share of potential GDP)

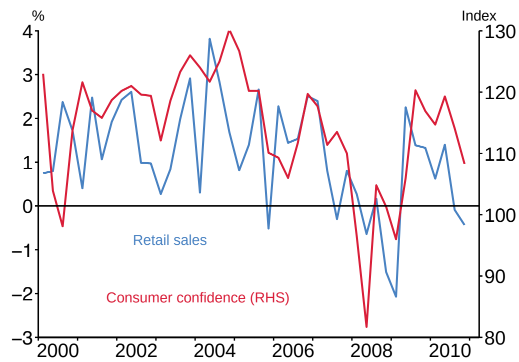


Source: Statistics New Zealand, RBNZ estimates.

In the household sector, high debt levels have constrained spending as households look to consolidate. In addition, weakness in the housing market has negatively impacted on household wealth and confidence. House prices have fallen over the past year while turnover in the housing market has been very low, potentially driven by increased mortgage rates, a slowdown in immigration and changes to the taxation of property investment.

Household caution has had a substantial negative impact on growth in a number of industries. Retailers have struggled as household spending has been constrained and consumer confidence has deteriorated (figure 4.2).

Figure 4.2
Retail sales growth and consumer confidence
(quarterly, seasonally adjusted)



Source: Statistics New Zealand, Westpac McDermott-Miller.

The construction sector has been weak as the deterioration in the housing market has resulted in low levels of residential investment. In addition, the manufacturing sector has contracted further over the past year. Domestically focused manufacturers have struggled, given weak demand and a high exchange rate which has hampered competitiveness.

Strong external conditions have partly offset the effects of a cautious household and business sector. New Zealand's trading partners continued to grow through the second half of 2010. Growth in Asia remained elevated, while demand accelerated in the United States. Indicators generally point to continued strong trading partner growth.

Activity has recently firmed in Asia. Domestic demand continued to expand, as labour markets strengthened. Forward indicators point to continued growth early in 2011, with external demand improving after a mid-2010 lull. While China has tightened monetary conditions somewhat following rising inflation, GDP still expanded almost 10 percent in 2010.

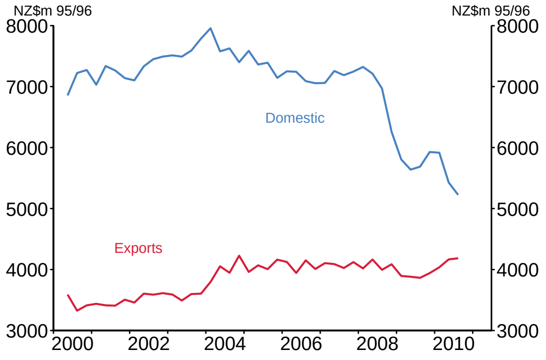
Global food prices have climbed sharply in recent months, and are now higher than before the global financial crisis. Supply has been restricted by climatic disruptions, and exacerbated by stockpiling in some countries. With demand for food continuing to increase due to the global economic recovery, food price inflation has emerged as a concern in the Asian region.

Australian output growth is now expected to be lower in the near term due to severe flooding in January. Coal exports from Queensland were curtailed, but have now largely resumed. More generally, retail sales growth has slowed, pointing to persistent consumer caution.

The United States economy strengthened through the end of 2010, following a period of slower growth in the middle of the year. The United States has now surpassed its pre-recession level of output. While unemployment remains high, labour market indicators generally suggest a gradual recovery is taking place. Europe continues to recover, led by a strong German economy. Sovereign debt concerns currently look to be relatively well-contained within the smaller European economies.

This strength in the world economy has seen New Zealand's exporting firms perform relatively well, providing an offset to weak domestic demand. This can be seen most notably in the manufacturing sector. Domestic sales volumes have fallen about 30 percent since the beginning of 2008. In contrast, manufactured exports have risen above pre-recession levels (figure 4.3).

Figure 4.3
Quarterly manufacturing sales
(seasonally adjusted)



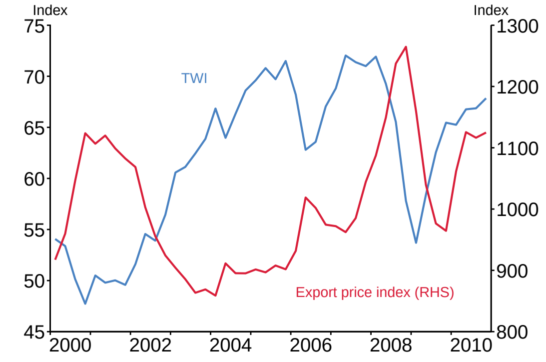
Source: Statistics New Zealand, RBNZ estimates.

Conditions are also positive for primary sector exporters. While export volumes have increased only modestly, export prices have continued to rise, boosting primary sector incomes. Generally, the drivers of the rise in global food prices discussed above have also resulted in ongoing strength in New Zealand's export commodity prices.

However, the elevated level of primary sector income has not flowed through to other sectors of the economy, as has been the case in the past. Primary producers are focused on consolidating balance sheets rather than spending.

In addition, an elevated exchange rate has offset some of the rise in export commodity prices (figure 4.4). Other export price indicators also suggested a stronger improvement in the terms of trade over the past year than has been experienced. The prices implied by these indicators have not flowed through to the prices received by exporters.

Figure 4.4
TWI and OTI Export price

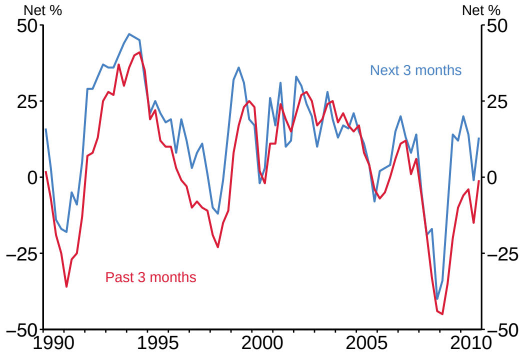


Source: Statistics New Zealand, RBNZ.

Services exports have remained low, hampered by the high level of the TWI and low numbers of traditionally high-spending visitors from North America and Europe. Exports of services will likely fall further, as travellers postpone or delay visits to New Zealand following the Christchurch earthquake. Exports of education services are also likely to be negatively affected.

There have been some signs recently of an improvement in domestic activity. Business confidence has risen, with firms reporting stronger conditions over the end of 2010 and a more positive outlook for the coming year (figure 4.5). In line with this improved outlook, there are signs that firms have begun to invest. In particular, imports of capital and transport equipment have increased.

Figure 4.5
Domestic trading activity



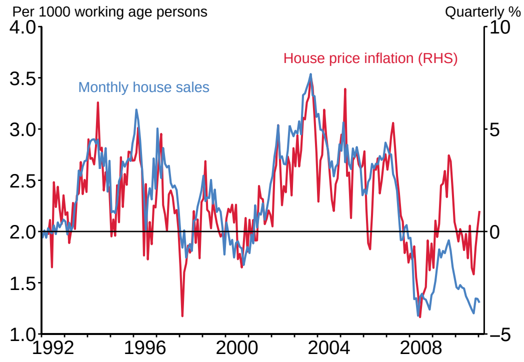
Source: NZIER.

In addition, firms were upbeat in the Reserve Bank's latest round of business visits. A number of companies noted a pick-up in sales and were expecting to expand their workforce and undertake some investment. This was an improvement relative to earlier rounds of business visits.

There have also been some signs of stabilisation in the housing market. House prices are showing signs of levelling off and house sales have appeared to find a base (figure 4.6). In addition, while days to sell remain high, they have fallen recently, implying the market is stabilising.

Overall, however, New Zealand's economic performance has been weak over the past year. It is estimated that GDP held steady in the December quarter of 2010. In addition, the earthquake will offset the nascent recovery in domestic activity. It is estimated that the earthquake will subtract 0.6 percentage points from Q1 quarterly GDP growth.

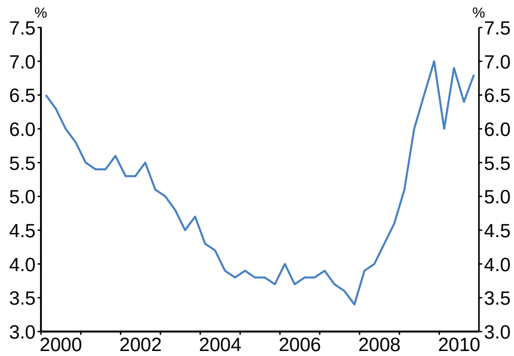
Figure 4.6
House sales and house price inflation *(seasonally adjusted)*



Source: REINZ, Statistics New Zealand.

Given these developments, it is likely that there remains significant spare capacity in the economy. Current surplus capacity is estimated to be at a level similar to that at the depths of the 2008/9 recession. Consistent with this, the unemployment rate is similar to that of 2009 (figure 4.7).

Figure 4.7
Unemployment rate *(seasonally adjusted)*

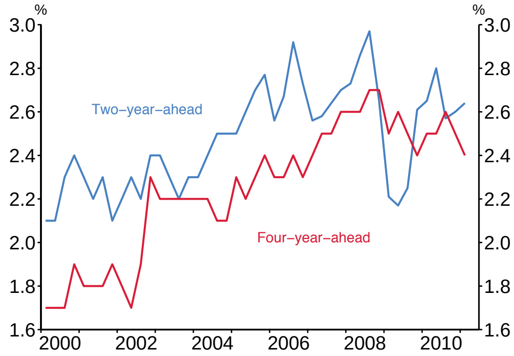


Source: Statistics New Zealand.

With significant spare capacity in the economy, underlying inflation pressure is relatively modest. Annual CPI inflation increased strongly in the December quarter, rising to 4 percent. However, this increase largely reflects the rise in the rate of GST in October. Feedback from businesses suggests the weak trading environment meant the GST increase was not fully passed through to consumer prices. Taking this into account, it is estimated that annual inflation increased only modestly to 1.6 percent when the impact of GST and other policy changes are excluded.

In addition, survey measures of inflation expectations have remained relatively stable (figure 4.8). This suggests the recent increase in the headline inflation rate has not placed further upward pressure on inflation expectations. The evolution of these measures and how they are reflected in firm and household behaviour is something the Reserve Bank will monitor closely.

Figure 4.8
Inflation expectations
(annual)



Source: AON Hewitt, RBNZ.

Table 4.1

Measures of inflation and inflation expectations

(annual)

	2009 Jun	Sep	Dec	2010 Mar	Jun	Sep	Dec
CPI	1.9	1.7	2.0	2.0	1.7	1.5	4.0
CPI components							
CPI non-tradable	3.3	3.0	2.3	2.1	2.2	2.5	4.6
Non-tradables housing component	1.0	0.6	0.8	1.2	1.4	1.7	2.7
Non-tradables ex housing, cigarettes and tobacco component	4.3	4.2	2.9	2.6	2.2	2.1	4.8
CPI tradable	0.2	-0.1	1.5	2.0	1.0	0.3	3.3
Petrol	-17.0	-19.0	3.3	11.5	9.5	5.8	14.2
Other inflation measures							
Factor model estimate of core CPI inflation	2.3	2.0	2.0	1.9	1.9	2.0	3.0
CPI trimmed mean (of annual price change)	2.2	2.0	2.2	2.3	1.8	1.7	3.9
CPI weighted median (of annual price change)	2.9	2.8	2.2	1.7	1.3	1.6	3.2
CPI ex food, petrol and government charges	1.6	1.9	1.7	1.3	1.4	1.0	2.8
CPI ex food and energy	2.1	2.5	2.1	1.7	1.7	1.4	3.1
GDP deflator (derived from expenditure data)	2.0	0.8	-1.3	0.3	1.6	2.2	n/a

	2009 Jun	Sep	Dec	2010 Mar	Jun	Sep	Dec	2011 Mar
Inflation expectation measures								
RBNZ Survey of Expectations - inflation one-year-ahead	1.8	1.8	2.1	2.1	2.9	3.9	3.4	2.9
RBNZ Survey of Expectations - inflation two-years-ahead	2.2	2.3	2.6	2.7	2.8	2.6	2.6	2.6
AON Hewitt survey - inflation one-year-ahead	2.2	1.7	1.6	2.2	3.4	5.0	4.3	2.6
AON Hewitt survey - inflation four-years-ahead	2.6	2.5	2.4	2.5	2.5	2.6	2.5	2.4
NBBO - inflation one-year-ahead (quarterly average)	2.6	2.6	2.6	2.6	2.8	3.1	2.9	n/a

Appendix A
Summary tables*

Table A
Composition of real GDP growth

(annual average percent change, seasonally adjusted, unless specified otherwise)

	Actuals							Projections			
March year	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Final consumption expenditure											
Private	6.3	4.5	4.4	2.5	3.3	-1.1	0.3	1.1	0.6	1.9	0.7
Public authority	5.0	4.5	4.9	4.4	4.7	4.2	0.3	2.3	3.9	-1.6	-0.8
Total	6.0	4.5	4.5	2.9	3.6	0.1	0.3	1.4	1.4	1.0	0.3
Gross fixed capital formation											
Market sector:											
Residential	14.9	2.8	-5.3	-1.4	4.4	-23.4	-13.2	8.6	2.1	46.7	7.7
Business	12.0	10.6	9.9	-1.7	8.3	-5.1	-9.2	3.7	6.0	15.9	1.6
Non-market government sector	14.5	10.8	6.5	-6.8	-10.5	20.4	-8.1	2.0	6.0	4.1	4.1
Total	12.8	8.7	6.2	-2.0	6.2	-7.3	-9.8	4.4	5.4	20.0	3.0
Final domestic expenditure	7.6	5.5	5.0	1.7	4.2	-1.8	-2.1	2.1	2.3	5.4	1.0
Stockbuilding[1]	0.2	0.2	-0.5	-0.7	0.7	-0.2	-1.9	0.7	1.0	0.2	0.0
Gross national expenditure	7.7	6.0	4.7	0.7	5.4	-2.0	-3.5	3.0	2.8	5.6	1.0
Exports of goods and services	1.1	4.9	-0.1	3.0	3.2	-3.5	4.7	1.6	3.4	2.5	2.4
Imports of goods and services	12.9	12.4	4.2	-1.4	9.9	-4.2	-9.5	7.9	5.6	6.2	0.4
Expenditure on GDP	4.0	3.5	3.3	2.2	3.1	-1.6	1.1	0.9	2.0	4.4	1.7
GDP (production)	4.3	3.8	3.3	0.8	3.0	-1.5	-0.5	0.9	2.7	4.7	1.9
GDP (production, March qtr to March qtr)	5.3	2.5	2.4	1.7	2.2	-3.2	1.8	-0.1	5.4	2.8	2.2

[1] Percentage point contribution to the growth rate of GDP.

* Notes for these tables follow on pages 20 and 21.

Table B

Summary of economic projections

(annual percent change, unless specified otherwise)

	Actuals							Projections			
March year	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Price measures											
CPI	1.5	2.8	3.3	2.5	3.4	3.0	2.0	4.4	2.1	2.4	2.3
Labour costs	2.1	2.5	3.0	3.0	3.5	3.1	1.3	2.2	2.2	2.2	2.6
Import prices (in New Zealand dollars)	-10.3	0.6	6.9	0.2	0.5	12.4	-8.3	0.4	6.9	4.7	5.2
Export prices (in New Zealand dollars)	-5.0	5.0	3.4	4.3	11.9	6.6	-8.4	6.7	4.3	2.0	3.4
Monetary conditions											
90-day rate (year average)	5.3	6.5	7.3	7.6	8.6	6.7	2.8	3.1	3.0	4.2	4.6
TWI (year average)	63.6	67.1	70.1	65.6	71.6	61.6	62.9	67.5	67.1	65.2	63.5
Output											
GDP (production, annual average % change)	4.3	3.8	3.3	0.8	3.0	-1.5	-0.5	0.9	2.7	4.7	1.9
Potential output (annual average % change)	3.3	3.1	2.7	2.2	1.8	1.5	1.4	1.6	1.8	1.9	2.0
Output gap (% of potential GDP, year average)	1.9	2.6	3.3	1.8	3.0	-0.1	-1.9	-2.6	-1.8	0.7	0.5
Labour market											
Total employment (seasonally adjusted)	3.4	3.6	2.8	2.0	-0.2	0.7	-0.1	0.8	2.5	3.3	1.4
Unemployment rate (March qtr, seasonally adjusted)	4.3	3.9	4.0	3.9	3.9	5.1	6.0	6.7	6.2	4.9	4.9
Trend labour productivity	1.1	0.9	0.8	0.7	0.6	0.5	0.5	0.5	0.6	0.7	0.8
Key balances											
Government operating balance (% of GDP, year to June)	3.9	4.7	4.4	3.5	3.1	-2.1	-3.4	-6.5	-4.4	-2.3	-1.4
Current account balance (% of GDP)	-4.3	-6.1	-8.6	-7.9	-7.9	-7.8	-2.4	0.2	-3.3	-4.7	-5.1
Terms of trade (OTI measure, annual average % change)	3.9	5.8	-0.8	1.8	7.8	3.2	-9.1	12.2	-1.8	-3.3	-1.8
Household saving rate (% of disposable income)	-7.4	-6.0	-8.3	-8.9	-4.0	-4.5	-2.2	-1.6	-0.5	2.0	4.0
World economy											
Trading partner GDP (annual average % change)	3.6	3.7	3.8	3.8	4.2	0.2	1.0	4.2	4.2	4.4	4.0
Trading partner CPI (TWI weighted, annual % change)	1.4	2.1	2.5	1.9	3.3	0.9	1.7	1.5	1.8	1.8	2.1

Notes to the tables

CPI	Consumer Price Index. Quarterly projections rounded to one decimal place.
TWI	Nominal trade weighted index of the exchange rate. Defined as a geometrically-weighted index of the New Zealand dollar bilateral exchange rates against the currencies of Australia, Japan, the United States, the United Kingdom and the euro area.
90-day bank bill rate	The interest yield on 90-day bank bills.
World GDP	RBNZ definition. 16-country index, export weighted. Seasonally adjusted.
World CPI inflation	RBNZ definition. Five-country index, TWI weighted.
Import prices	Domestic currency import prices. *Overseas Trade Indexes*.
Export prices	Domestic currency export prices. *Overseas Trade Indexes*.
Terms of trade	Constructed using domestic currency export and import prices. *Overseas Trade Indexes*.
Private consumption	*System of National Accounts*.
Public authority consumption	*System of National Accounts*.
Residential investment	RBNZ definition. Private sector and government market sector residential investment. *System of National Accounts*.
Business investment	RBNZ definition. Total investment less the sum of non-market investment and residential investment. *System of National Accounts*.
Non-market investment	RBNZ definition. The *System of National Accounts* annual nominal government non-market/market investment ratio is interpolated into quarterly data. This ratio is used to split quarterly expenditure GDP government investment into market and non-market components.
Final domestic expenditure	RBNZ definition. The sum of total consumption and total investment. *System of National Accounts*.
Stockbuilding	Percentage point contribution to the growth of GDP by stocks. *System of National Accounts*.
Gross national expenditure	Final domestic expenditure plus stocks. *System of National Accounts*.
Exports of goods and services	*System of National Accounts*.
Imports of goods and services	*System of National Accounts*.
GDP (production)	*System of National Accounts*.
Potential output	RBNZ definition and estimate.
Output gap	RBNZ definition and estimate. The percentage difference between real GDP (production, seasonally adjusted) and potential output GDP.
Current account balance	*Balance of Payments*.
Total employment	*Household Labour Force Survey*.
Unemployment rate	*Household Labour Force Survey*.
Household saving rate	*Household Income and Outlay Account*.

Government operating balance	Operating balance before gains and losses. Historical source: The Treasury. Adjusted by the Reserve Bank over the projection period.
Labour productivity	The series shown is the annual percentage change in a trend measure of labour productivity. Labour productivity is defined as GDP (production) divided by *Household Labour Force Survey* hours worked.
Labour cost	Private sector all salary and wage rates. *Labour Cost Index*.
Real gross domestic income	The real purchasing power of domestic income, taking into account changes in the terms of trade. *System of National Accounts*.
Quarterly percent change	$(\text{Quarter}/\text{Quarter}_{-1} - 1)*100$
Annual percent change	$(\text{Quarter}/\text{Quarter}_{-4} - 1)*100$
Annual average percent change	$(\text{Year}/\text{Year}_{-1} - 1)*100$

Source: Unless otherwise specified, all data conform to Statistics New Zealand definitions, and are not seasonally adjusted.
Rounding: All projections data are rounded to one decimal place.

Appendix B
Companies and organisations contacted by Reserve Bank staff during the projection round

2 Degrees Ltd

Air New Zealand Ltd

Barfoot and Thompson

Christchurch & Canterbury Tourism

Colliers International Property Management Ltd

Debtworks (NZ) Ltd (Dunedin)

Employers and Manufacturers Association (Northern)

Ezibuy Ltd (New Zealand)

Fisher & Paykel Finance Ltd

Fletcher Building Ltd

Foodstuffs South Island Ltd

Fulton Hogan Ltd

Hudson New Zealand Ltd

Kelly Services NZ

LJ Hooker (NZ) Ltd

Mainfreight Ltd

Ministry of Tourism

New Zealand Council of Trade Unions

New Zealand Retailers Association

Noel Leeming Ltd

Pan Pac Forest Products Ltd (Napier)

Paymark Ltd

PGG Wrightson Ltd

Ports of Auckland Ltd

Recruitment and Consulting Services Association Ltd

Registered Master Builders Federation Inc

Skyline Enterprises Ltd (Queenstown)

Smith City Group Ltd

The Warehouse Group Ltd

Veda Advantage Ltd

Weston Milling Ltd

Appendix C
Reserve Bank statements on monetary policy

OCR unchanged at 3.0 percent

9 December 2010

The Reserve Bank today left the Official Cash Rate (OCR) unchanged at 3.0 percent.

Reserve Bank Governor Alan Bollard said: "Interest rates are now projected to rise to a more limited extent over the next two years than signalled in the September Statement.

"The pace of economic growth appears to have moderated. Corporate investment intentions are now below average. Household spending also remains weak, with household credit still flat and housing market activity slowing further. House prices may decline a little further in the near term. This continued household and business caution suggests current low interest rates are having a less stimulatory effect than in the past.

"On the positive side, activity in New Zealand's trading partners continues to expand. Growth in the Asia-Pacific region remains strong, and growth in the US and UK has turned out a little stronger than was projected. Consistent with this, export commodity prices, which were already very high, continue to increase. While this is encouraging, downside risks to global growth and export prices persist.

"Repairs to earthquake damage in Canterbury are expected to add to GDP growth over the projection period. The earthquake appears to have caused about $5 billion of damage to infrastructure, and residential and commercial property.

"While the near-term outlook for GDP growth has softened, beyond this, higher export volumes and earthquake repairs are expected to push GDP growth above that projected in the September Statement. As growth recovers, current spare capacity will gradually be used up, causing underlying inflation to pick up. More immediately, the recent increase in the rate of GST will cause headline CPI inflation to spike higher temporarily, although there is little evidence of this spike affecting price and wage setting behaviour.

"While interest rates are likely to increase modestly over the next two years, for now it seems prudent to keep the OCR low until the recovery becomes more robust and underlying inflationary pressures show more obvious signs of increasing.

"The New Zealand dollar has appreciated significantly since the September Statement. Sustained strength in the currency is inhibiting the rebalancing of economic activity towards the tradable sector. Accelerated elimination of New Zealand's fiscal deficit could help improve national savings, thereby easing current pressure on interest rates and the New Zealand dollar, and reducing New Zealand's dependence on international borrowing."

OCR unchanged at 3.0 percent

27 January 2011

The Reserve Bank today left the Official Cash Rate (OCR) unchanged at 3.0 percent.

Reserve Bank Governor Alan Bollard said: "The outlook for the New Zealand economy remains consistent with the projections underlying the December Monetary Policy Statement.

"Domestic economic activity was weaker than forecast through the second half of 2010. September quarter GDP declined unexpectedly, and retail spending appears to have fallen in the December quarter.

"Forward indicators of activity have firmed somewhat. Trading partner activity continues to expand and New Zealand's export commodity prices have increased further. Within New Zealand, business confidence, across a range of industries, has picked up and imports of capital equipment have grown. Furthermore, there are tentative signs that housing market activity has stabilised, after having trended lower for some months.

"The recent increase in the rate of GST has caused headline CPI inflation to spike higher as expected, but underlying inflation remains comfortably inside the target band.

"As noted previously, while interest rates are likely to increase modestly over the next two years, for now it seems prudent to keep the OCR low until the recovery becomes more robust and underlying inflationary pressures show more obvious signs of increasing."

Appendix D
The Official Cash Rate chronology

Date	OCR (percent)	Date	OCR (percent)	Date	OCR (percent)
17 March 1999	4.50	4 September 2003	5.00	24 April 2008	8.25
21 April 1999	4.50	23 October 2003	5.00	5 June 2008	8.25
19 May 1999	4.50	4 December 2003	5.00	24 July 2008	8.00
30 June 1999	4.50	29 January 2004	5.25	11 September 2008	7.50
18 August 1999	4.50	11 March 2004	5.25	23 October 2008	6.50
29 September 1999	4.50	29 April 2004	5.50	4 December 2008	5.00
17 November 1999	5.00	10 June 2004	5.75	29 January 2009	3.50
19 January 2000	5.25	29 July 2004	6.00	12 March 2009	3.00
15 March 2000	5.75	9 September 2004	6.25	30 April 2009	2.50
19 April 2000	6.00	28 October 2004	6.50	11 June 2009	2.50
17 May 2000	6.50	9 December 2004	6.50	30 July 2009	2.50
5 July 2000	6.50	27 January 2005	6.50	10 September 2009	2.50
16 August 2000	6.50	10 March 2005	6.75	29 October 2009	2.50
4 October 2000	6.50	28 April 2005	6.75	10 December 2009	2.50
6 December 2000	6.50	9 June 2005	6.75	28 January 2010	2.50
24 January 2001	6.50	28 July 2005	6.75	11 March 2010	2.50
14 March 2001	6.25	15 September 2005	6.75	29 April 2010	2.50
19 April 2001	6.00	27 October 2005	7.00	10 June 2010	2.75
16 May 2001	5.75	8 December 2005	7.25	29 July 2010	3.00
4 July 2001	5.75	26 January 2006	7.25	16 September 2010	3.00
15 August 2001	5.75	9 March 2006	7.25	28 October 2010	3.00
19 September 2001	5.25	27 April 2006	7.25	9 December 2010	3.00
3 October 2001	5.25	8 June 2006	7.25	27 January 2011	3.00
14 November 2001	4.75	27 July 2006	7.25		
23 January 2002	4.75	14 September 2006	7.25		
20 March 2002	5.00	26 October 2006	7.25		
17 April 2002	5.25	7 December 2006	7.25		
15 May 2002	5.50	25 January 2007	7.25		
3 July 2002	5.75	8 March 2007	7.50		
14 August 2002	5.75	26 April 2007	7.75		
2 October 2002	5.75	7 June 2007	8.00		
20 November 2002	5.75	26 July 2007	8.25		
23 January 2003	5.75	13 September 2007	8.25		
6 March 2003	5.75	25 October 2007	8.25		
24 April 2003	5.50	6 December 2007	8.25		
5 June 2003	5.25	24 January 2008	8.25		
24 July 2003	5.00	6 March 2008	8.25		

Appendix E
Upcoming Reserve Bank *Monetary Policy Statements* and Official Cash Rate release dates

The following is the Reserve Bank's schedule for the release of *Monetary Policy Statements* and Official Cash Rate announcements for 2011-12:

2011

Thursday 28 April 2011	OCR announcement
Thursday 9 June 2011	*Monetary Policy Statement*
Thursday 28 July 2011	OCR announcement
Thursday 15 September 2011	*Monetary Policy Statement*
Thursday 27 October 2011	OCR announcement
Thursday 8 December 2011	*Monetary Policy Statement*

2012

Thursday 26 January 2012	OCR announcement
Thursday 8 March 2012	*Monetary Policy Statement*
Thursday 26 April 2012	OCR announcement
Thursday 14 June 2012	*Monetary Policy Statement*

Dates for 2012 are provisional, subject to confirmation in August 2011.

The Reserve Bank reserves the right to make changes to this schedule, if required, due to unexpected developments. In that unlikely event, the markets and the media will be given as much warning as possible.

The announcement will be made at 9:00 am on the day concerned. Please note that the Reserve Bank reserves the right to make changes, if required due to unexpected developments. In that unlikely event, the markets and the media would be given as much warning as possible.

Appendix F
Policy Targets Agreement

This agreement between the Minister of Finance and the Governor of the Reserve Bank of New Zealand (the Bank) is made under section 9 of the Reserve Bank of New Zealand Act 1989 (the Act). The Minister and the Governor agree as follows:

1 Price stability

(a) Under Section 8 of the Act the Reserve Bank is required to conduct monetary policy with the goal of maintaining a stable general level of prices.

(b) The Government's economic objective is to promote a growing, open and competitive economy as the best means of delivering permanently higher incomes and living standards for New Zealanders. Price stability plays an important part in supporting this objective.

2 Policy target

(a) In pursuing the objective of a stable general level of prices, the Bank shall monitor prices as measured by a range of price indices. The price stability target will be defined in terms of the All Groups Consumers Price Index (CPI), as published by Statistics New Zealand.

(b) For the purpose of this agreement, the policy target shall be to keep future CPI inflation outcomes between 1 per cent and 3 per cent on average over the medium term.

3 Inflation variations around target

(a) For a variety of reasons, the actual annual rate of CPI inflation will vary around the medium-term trend of inflation, which is the focus of the policy target. Amongst these reasons, there is a range of events whose impact would normally be temporary. Such events include, for example, shifts in the aggregate price level as a result of exceptional movements in the prices of commodities traded in world markets, changes in indirect taxes, significant government policy changes that directly affect prices, or a natural disaster affecting a major part of the economy.

(b) When disturbances of the kind described in clause 3(a) arise, the Bank will respond consistent with meeting its medium-term target.

4 Communication, implementation and accountability

(a) On occasions when the annual rate of inflation is outside the medium-term target range, or when such occasions are projected, the Bank shall explain in Policy Statements made under section 15 of the Act why such outcomes have occurred, or are projected to occur, and what measures it has taken, or proposes to take, to ensure that inflation outcomes remain consistent with the medium-term target.

(b) In pursuing its price stability objective, the Bank shall implement monetary policy in a sustainable, consistent and transparent manner and shall seek to avoid unnecessary instability in output, interest rates and the exchange rate.

(c) The Bank shall be fully accountable for its judgements and actions in implementing monetary policy.

Hon Bill English

Minister of Finance

Dr Alan E Bollard

Governor

Reserve Bank of New Zealand

Dated at Wellington this 18th day of December 2008