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BANCORP TREASURY SERVICES LIMITED

ECONOMIC ALERT

OCR REVIEW - JUNE 2017

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"The Reserve Bank today left the Official Cash Rate ("OCR") unchanged at 1.75 percent."

Why ...

"Longer-term inflation expectations remain well-anchored at around 2 percent."

And ...

"House price inflation has moderated further, especially in Auckland."

And ...

"The increase in headline inflation in the March quarter was mainly due to higher tradables inflation, particularly petrol and food prices. These effects are temporary."

Looking ahead ...

"Non-tradables and wage inflation remain moderate but are expected to increase gradually. This will bring future headline inflation to the midpoint of the target band over the medium term."

And ...

"This moderation [in house price inflation] is projected to continue, although there is a risk of resurgence given the on-going imbalance between supply and demand."

And ...

"The growth outlook remains positive, supported by accommodative monetary policy, strong population growth, and high terms of trade."

And ...

"Monetary policy is expected to remain stimulatory in the advanced economies, but less so going forward."

And ...

"Major challenges remain [globally] with on-going surplus capacity and extensive political uncertainty."

In conclusion ...

"Monetary policy will remain accommodative for a considerable period."

And ...

"Numerous uncertainties remain and policy may need to adjust accordingly."

Market Implications

The headline announcing an unchanged OCR, the RBNZ's final sentence that *"numerous uncertainties remain and policy may need to adjust accordingly"* and a return to commenting on the higher NZD *("a lower New Zealand dollar would help rebalance the growth outlook towards the tradables sector")* caused the NZD to weaken. However, that initial reaction was quickly reversed by upbeat comments in the RBNZ statement about the *"positive"* outlooks for growth, non-tradables inflation, wage inflation and house prices.

The statement reinforced the RBNZ's neutral, 'wait and see' monetary policy stance that will bring key domestic data into focus, starting with the June CPI numbers next month. In the meantime, offshore developments will continue to dominate local interest rates and credit markets.

Comment

The RBNZ statement was a subtle dig at market pricing and economists that have ignored the RBNZ's repeated assertions about a steady OCR and current domestic and global uncertainties and have predicted OCR rises well before the RBNZ's forecast timing.

The RBNZ's message is clear — the OCR is not going anywhere soon and it will be closely monitoring inflation expectations, house price inflation (especially in Auckland) and domestic capacity pressures. Let's hope international developments do not disrupt the RBNZ's status quo.

Our long held view of 'lower for longer' still holds for the OCR, floating rates and short term swap rates. Focus for borrowers should be on the long part of the curve, given recent falls in swap prices. Borrowers will continue to benefit from the lower base interest rates, but higher credit margins will go some way to offset this. As ever though, we urge borrowers to maintain a continual, close watch on debt projections.