BANCORP

BANCORP TREASURY SERVICES LIMITED

# ECONOMIC ALERT

## MONETARY POLICY STATEMENT - AUGUST 2018

9 August 2018 | www.bancorptreasury.com

### "The Official Cash Rate (OCR) remains at 1.75 percent."

**And ...**

*"The direction of our next OCR move could be up or down."*

**Why ...**

*"While recent economic growth has moderated, we expect it to pick up pace over the rest of this year and be maintained through 2019."*

**And ...**

*"Risks remain to our central forecast. The recent moderation in growth could last longer. Conversely, there is a chance that inflation could increase faster if cost pressures can pass through into higher prices and impact inflation expectations."*

**And ...**

*"There are welcome early signs of core inflation rising. Inflation will increase towards 2 percent over the projection period as capacity pressures bite. This path may be bumpy, however."*

**And ...**

*"We will look through this volatility as appropriate, and only respond to any persistent movements in inflation."*

**Looking ahead ...**

*"We expect to keep the OCR at this level through 2019 and into 2020, longer than we projected in our May Statement."*

**And ...**

*"We will keep the OCR at an expansionary level for a considerable period."*

## Market implications

The ultimate focus for markets was the Reserve Bank's projected OCR track. It has shifted the timing of the first (full) OCR rise from the March 2020 quarter to the December 2020 quarter.

A secondary focus concerned the Reserve Bank's tone and risk bias, which were more dovish than markets had expected.

The shift in the Reserve Bank's OCR forecast prompted an immediate fall in the New Zealand dollar and local interest rates, with swap rates across the curve down to levels last seen in November 2016. Notably, the 10 year swap rate fell comfortably below 3.00%.

## Comment

Like every central bank, the Reserve Bank is facing a number of external and domestic challenges and dilemmas. Similar concerns have been well documented by other central banks over the past fortnight, specifically the Bank of Japan, Federal Reserve, Bank of England and Reserve Bank of Australia.

Domestically, our Reserve Bank faces signs of slowing domestic economic growth and rising inflation. It considers that *"the risks to the growth outlook are tilted to the downside,"* although *"tradables inflation is expected to increase over the medium term, but remain below its historical average."*

Just when market pricing for the OCR was coming into line with the Reserve Bank's forecast, the Reserve Bank has further embraced its mantra of 'lower for longer.' Again, forecasts and market pricing have proved wrong, which reinforces the need for treasury managers to make certain what they can influence, i.e., forecast accuracy, honest risk preferences, prudential policies and flexible hedging strategies.