



ECONOMIC ALERT

OCR REVIEW - DECEMBER 2011

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“The Reserve Bank today left the Official Cash Rate (“OCR”) unchanged at 2.5 percent.”

Why...

“Global conditions have deteriorated.”

And...

“Continuing difficulties related to sovereign and bank debt in a growing number of European economies have resulted in high levels of volatility in financial markets.”

And...

“A softening in international economic activity, including in the Asia-Pacific region.”

And...

“The exact timing, and magnitude, of the rebuild of Canterbury remains uncertain.”

Looking ahead...

“The growth outlook is dominated by expectations of prolonged recession in Europe and slow growth in the United States.”

And...

“Annual CPI inflation excluding policy changes is projected to remain around the middle of the target band.”

In conclusion...

“It remains prudent for now to keep the OCR on hold at 2.5 percent.”

Market Implications

The Reserve Bank of New Zealand (“RBNZ”), as universally expected, kept the OCR at 2.50% again and downgraded its projections for New Zealand and its major trading partners because *“there is increasing evidence that tight funding conditions for European banks are flowing through to the rest of the world, including the US and emerging markets.”*

Local markets took heart from the Monetary Policy Statement (“MPS”), especially the clear endorsement of the economic scenario implied by current market pricing. The New Zealand dollar was little changed after the MPS but swap rates fell a few points, emboldened by the RBNZ’s endorsement of its stance on the global and domestic outlooks and the implied OCR path next year.

Market focus remains on Europe. Until a comprehensive plan is developed to resolve the European debt crisis, investor sentiment will continue to swing, causing volatility in financial markets and justifying the RBNZ’s cautiousness.

Comment

The RBNZ delivered a sobering statement with few positives and a lot of caution about the outlook for New Zealand and its major trading partners.

Like all central banks, the RBNZ is concerned about the threats to global growth, credit markets and bank funding should there be a deterioration in Europe’s sovereign and bank debt situations and the US economic recovery.

The MPS, though sobering, was less downbeat than implied by market pricing for the OCR and the 90 day bank bill rate. Significantly, the RBNZ conceded that the need for March’s 50 basis point OCR cut has shifted from Canterbury’s rebuild to Europe. The ongoing themes for interest rates to be at historic lows for a very long time and for the New Zealand dollar to be guided by offshore events remain intact.

The lingering uncertainty in financial markets, especially surrounding Europe, and the RBNZ’s cautiousness highlight the importance of appropriate risk management practices, with the most important being continuous monitoring of business activity, cashflows and liquidity.

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