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ECONOMIC ALERT

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

Why...

“The global economy remains fragile and risks to the outlook remain.”

And...

“The European debt crisis has also increased the cost of international funding, which will likely pressure funding costs for New Zealand banks over the coming year.”

And...

“Reassuringly, inflation pressures have remained well contained. Inflation has declined and now sits below 2 percent.”

In conclusion...

“Given ongoing uncertainty around global conditions and the moderate pace of domestic demand, it remains prudent to keep the OCR on hold at 2.5 percent.”

Market Implications

The Reserve Bank of New Zealand (“RBNZ”), as universally expected, again kept the OCR at 2.50% in a statement that contained no surprises unlike the Federal Reserve earlier this morning. The RBNZ again reminded us

of the delicate monetary policy balance that will be required over 2012 and listed the factors that it will be closely watching over coming months.

In all, the RBNZ’s statement had a reassuring effect on markets although it was overshadowed by the various Federal Reserve announcements that pushed down the USD and longer bond and swap rates.

The Reserve Bank’s reassurances and balanced outlook will make it easier for the NZD to appreciate and difficult for short rates to rise over coming weeks, at least until another ‘left-field’ offshore shock.

Comment

The overall message from the RBNZ was that the OCR is likely to remain at 2.50% for most, or all, of 2012 which will pin 90 day and short swaps rates to at or near current levels for many months.

Looking ahead, the RBNZ warned that, even though “*market sentiment has improved slightly*,” the external risks remain from the “*fragile*” global economy and the European debt crisis that “*has also increased the cost of international funding*”.

The RBNZ clearly has to balance modest growth in the domestic economy, the timing of the rebuilding of Canterbury, “*well contained*” inflation pressures and external economic and market risks.

Like all central banks, the RBNZ has to juggle various influences while being ready to respond to any more shocks and to remove some monetary policy stimulus should the outlook start looking rosy.

The downbeat global economic outlook and the soft domestic landscape mean that the hope of ‘recovery’ is again delayed and expectations of higher domestic interest rate will continue to be pushed further out. Loose monetary policy will continue to be required for some time yet.

As long as the OCR appears stable, borrowers should remain mindful of the upward pressure on bank funding margins and how these will translate through to total corporate borrowing costs. Borrowers should also be equally mindful of the threat to longer rates when growth and inflation eventually return.