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ECONOMIC ALERT

OCR REVIEW - OCTOBER 2011

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

Why...

“Given the ongoing global economic and financial risks, it remains prudent to continue to keep the OCR at 2.5 percent for now”

Looking ahead...

“...if global developments have only a mild impact on the New Zealand economy, it is likely that gradually increasing pressure on domestic resources will require future OCR increases.”

But...

“...there is a real risk that the European sovereign debt crisis could cause a further slowing in global activity, putting downward pressure on New Zealand’s commodity export prices.”

Market Implications

The Reserve Bank of New Zealand, as universally expected, left the OCR unchanged at 2.50%. There was no apparent change in the RBNZ’s view of the outlook for the economy or economic policy. RBNZ Governor Alan Bollard reaffirmed the point made in September’s *Monetary Policy Statement*

that an OCR rise is still possible if global conditions do not inflict a major drag on the domestic economy.

The market viewed the RBNZ comments positively. The NZD/USD rose around 60 points, to touch 0.8000. The NZD/AUD also climbed around 60 points, just shy of 0.7700. Short term interest rates rose slightly and longer terms were also up.

Market focus remains on the developments of the European debt crisis. Until a comprehensive plan is developed investor sentiment will continue to swing, causing volatility in financial markets.

Comment

The universal expectation was for no change to the OCR, more so after lower than expected New Zealand and Australian inflation data in recent days. So Bollard’s words were the more keenly awaited.

The comments took on a slightly more hawkish tone. The RBNZ noted that September’s quarterly inflation data show that inflation pressures have subsided, and it expects that underlying inflation will settle around 2.0%, squarely within the target 1.0% to 3.0% band. Notably, this time the RBNZ did not mention the strength of the currency.

In the last MPS domestic activity had surprised on the upside, while some of today’s comments reflected the more subdued conditions over the last six weeks. The Reserve Bank said “*Domestic*

activity has continued to expand only at a modest pace despite relatively strong commodity prices”, and that local business confidence had “*fallen back somewhat*”. Still, the reconstruction of Christchurch is expected to boost the economy looking ahead.

Once again comments were made about the risks of increased bank funding costs domestically in the next year due to the difficult global market conditions.

Today’s statement reinforces the view that there is no urgency to raise rates, with the focus being on international economic developments rather than the domestic economy. The Reserve Bank has, however, left the door open for rate hikes - if and when required.