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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...

*“Global economic and economic risks have increased.”*

## And...

*“There is now a real risk that global economic activity slows sharply.”*

## However...

*“The New Zealand Economy has performed relatively well while headline inflation has increased somewhat since the June Statement.”*

## Looking ahead...

*“If recent global developments have only a mild impact on the New Zealand economy, it is likely that the OCR will need to increase. For now, given the recent intensification in global economic and financial risks, it is prudent to continue to hold the OCR at 2.5 percent.”*

## Market Implications

Today’s Reserve Bank Monetary Policy Statement reversed the expectations for a faster and higher path for the 90 day rate that was forecast in the June statement. It is now heading back towards being more

in line with market pricing and thus the reaction of financial markets to the latest statement has been fairly muted.

The NZD/USD and NZD/AUD fell approximately 30 basis points immediately after the announcement and have remained stable since then. Interest rates have also been fairly stable with easing at the long end of the curve causing a slight flattening.

Markets will now turn back to the bigger picture happening in Europe and the US. Risk aversion resulting from the sovereign debt crisis and the repercussions of a default are likely to be the biggest drivers of markets for some time.

## Comment

Alan Bollard’s recent trip to Jackson Hole for the annual meeting of central bank heads has obviously had a significant impact on his view of the world. While the Reserve Bank remains upbeat about the outlook for the New Zealand economy, indicating that the high export prices and, in time, the reconstruction in Christchurch will provide impetus to demand in the future, it quite clearly sees the risks developing offshore. This has heightened the risks to the New Zealand economy, both from a slow-down in export growth, as well as a potential increase in bank funding costs.

One significant change to the statement from the OCR review in July was the exclusion of comments about reversing

the emergency rate cut of 50 basis points made in response to the Christchurch earthquake. In the post statement interview Bollard brushed this off saying that it was to avoid confusion in the media, but the Reserve Bank is clearly happy to remain at the current interest rate setting until there is more certainty about the outlook for the global economy and how this will affect New Zealand.

The Reserve Bank stated that *“Sovereign debt concerns in Europe and the weakened global outlook have caused international bank funding markets to tighten.”* If this flows through to increased bank funding costs in New Zealand then this will act as a brake to credit growth and therefore less need for the Reserve Bank to raise the cash rate.

The Reserve Bank will continue to have to balance the constraints on the domestic economy of a high New Zealand dollar and a slowing of trading partner growth against the effects of an improving domestic economy and rising underlying inflation. However the central interest rate theme of lower for longer remains clearly in place.