

Thursday 13 March 2014

## **Borrowers who have never before encountered rising interest rates could get a shock this cycle, the Reserve Bank says.**

Thursday 13 March 2014 Landlord *By Susan Edmunds*

It today raised the official cash rate (OCR) from 2.5% to 2.75%.

The accompanying monetary policy statement was hawkish, pointing to prices for export commodities, construction growth, a tightening labour market and rapid immigration.

Governor Graeme Wheeler said it was the first significant tightening in five years.

About three-quarters of borrowers are on floating or rates fixed for less than one year, so the impact of rises will be felt quickly.

He said borrowers' debt servicing capacity would be monitored closely.

But he said runaway inflation was the biggest potential risk to the economic recovery and the Bank wanted to do what it could to contain that pressure to ensure the recovery ran as long as possible.

"Inflationary pressures are increasing and are expected to continue doing so over the next two years. In this environment, it is important that inflation expectations remain contained."

He acknowledged that the Reserve Bank would be the first central bank in the developed world to raise rates this cycle, and the fears that could affect the already-high currency.

But he said the moves had been well signalled so there should be no significant increase in the dollar as a result of them being implemented.

Wheeler noted that house price inflation had slowed but said the pressure had not come off the market entirely.

House price inflation was running at about 8.4%, he said, but modelling had indicated that if the loan-to-value restrictions had not been introduced, it might be more like 11%. Wheeler said the Bank felt the rules were working and would not want to remove them until there was a better balance between supply and demand in the housing market.

The Bank is forecasting 100bps to 125bps of hikes this year, which would take the rate to between 3.5% and 3.75%.

It is forecasting a 90-day rate of 5.3% in March 2017, and more OCR increases beyond that time, a steeper rise than the markets have been pricing in.