OCR good news for borrowers

Home loan rates don't look like going up anytime soon following today's official cash rate announcement from the Reserve Bank.**Thursday, October 30th 2014,**

As expected the central bank left the OCR at 3.50%, however the key change was new language used by the bank.

RBNZ governor Graeme Wheeler dropped the phrase "some further policy tightening will be necessary to keep future average inflation near the two percent target mid-point and ensure that the economic expansion can be sustained" and replaced it with: "A period of assessment remains appropriate before considering further policy adjustment."

The comments surprised economists who described the statement as "dovish". As noted in the mortgagerates.co.nz survey of economists future OCR hikes have been pushed further into the future and the estimated peak for the OCR, or the neutral cash rate, has been reduced to around 4- 4.5%.

The bank's statement repeats September's language on the currency. It remains "unjustified and unsustainable" and the bank continues to expect further significant depreciation.

Here are the key points made by economists about today's announcement

ASB – Nick Tuffley

Markets were surprised by the dovish tone of the OCR statement. The subdued inflation environment has seen the RBNZ water down its tightening bias substantially.
The central bank is still considering further policy adjustment this cycle, but has opened the door to the possibility that it won't need to raise the OCR any further.
We expect two further OCR increases this cycle given our forecast of a pick-up in inflation from late 2015. Part of that pick-up will reflect the boost to tradable inflation from a material fall in the NZD.

Nonetheless, the subdued inflation environment at present highlights there is little urgency for further tightening. We shifted our OCR view to a 25bp hike in September 2015 and a further final hike in March 2016 after last week's very benign inflation outcome.

We see the risks to our forecast of further OCR increases as balanced. Inflation could yet pick up materially for a variety of reasons. But the longer the RBNZ remains on hold the greater will become the conviction that growth, migration and the housing market are past their peak, and the less likely future OCR increases would become.

BNZ – Stephen Toplis

The RBNZ has been spooked by the fact that it can't find any inflation. Unlike the Fed, who this morning intimated that the near term drop in inflation was transitory, the RBNZ thinks it might be more permanent.

Accordingly, it has, for all intents and purposes, said it is on hold for the foreseeable future.

We think (its change of wording) translates into a very strong commitment not to raise interest rates again unless there are clear signs that inflation is going to go through the mid-point of the target band.

If one takes this literally then the RBNZ is either not going to hike again until 2016 or, in fact, at all.

We are genuinely surprised by how relaxed the RBNZ is about future inflationary pressure, accordingly we are pushing back our first rate hike to December 2015 and lowering the peak in our rate cycle to 4.25% (from 4.5%). In so doing, we also acknowledge that the risk to this forecast is downside.

Perhaps the most important comment that the Bank made today is that “Output growth is expected to moderate over coming years, towards a more sustainable rate”.

Not only does this reflect our view that GDP growth is close to peaking (albeit that it will remain robust for a year or two) but it also suggests to us that the RBNZ has raised its view as to where New Zealand’s potential growth rate is. Hence, it gets less inflation from the same growth rate than it did before, requiring, in turn, a lower interest rate profile.

We reiterate that our own interest rate profile remains highly dependent on the NZD falling and falling quite aggressively. We remain of the view that this will be the eventual catalyst for the RBNZ to pull the trigger. Not surprisingly the RBNZ today reiterated the view that it believes the NZD to be “unjustified and unsustainable” and that it is expected to moderate over coming years.

The RBNZ has now set itself a very high hurdle indeed before it contemplates raising interest rates again. This means that it will be very much later rather than sooner before it will be convinced to act. And the later it gets the more likely the NZ economy will be well and truly into its expected slowdown phase so the less likely rates will need to be raised at all.

HSBC – Paul Bloxham

The RBNZ seems very comfortable. With the economy still growing at an above trend pace and inflation at the lower end of the target band, why wouldn't they be? It seems that the persistent strength of the currency, combined with the RBNZ's pro-active 100bps of tightening this year, has put New Zealand's economy in a plumb position, at least for now.
Overall, the RBNZ’s outlook is similar to our own. We expect that growth will slow gradually, but will remain above-trend for some time yet. Inflation remains surprisingly well-contained but should lift slowly as the economy’s spare capacity is eroded and a lower NZD lifts the cost of imported goods and services. With inflation low and likely to rise only slowly, we expect that the RBNZ will leave the cash rate unchanged until the second half of 2015, when we expect further hikes.

Westpac – Dominick Stephens

We interpret (the wording change) as indicating that the RBNZ now holds only the barest of tightening biases. Significantly, there is now no explicit reference to lifting the OCR.
However, there are a couple of clues within the new policy guidance sentences that do indicate that the RBNZ considers the next move is more likely to be up than down.
First of all, the indication that inflation is expected to rise serves to rule out OCR cuts in the foreseeable future. Second, the words further policy adjustment must refer to an upward move in the OCR.

Markets were prepared for a dovish statement, but the removal of any explicit reference to future hikes was a modest surprise. The two-year swap rate fell three basis points, and could fall further in the days ahead.