



Data source: Bloomberg, SFE Corporation

### Hold 'em here boys

The Reserve Bank held the official cash rate at 2.5% today. The sudden pause in monetary policy easing is primarily the result of the signs of stabilisation in the global economy. Given the increasing prevalence of "green shoots" the Bank believes that the 525 basis points of easing in the OCR, combined with expansionary fiscal policy, will be sufficient to prevent a unnecessary contraction in economic activity. As a result, the easing cycle appears to be completed. However, we do not expect the official cash rate to begin rising again until June 2010.

The Reserve Bank's outlook for the New Zealand economy has deteriorated slightly from March, with unemployment now expected to peak at 7.2% (compared to 6.8% in the March forecasts) and economic activity forecast to decline by 1.3% over the March 2010 year (compared to a 0.2% expansion).

However, the Bank now feels that the "balance and magnitude" of risks have moved in New Zealand's favour. The likelihood of a Great Depression style global slowdown has fallen markedly and there are increasing signs that some important trading partners are on the verge of climbing out of recession (the US, UK, Asia). These signs are the primary reason the Bank didn't feel the need to cut the official cash rate in response to its lower growth forecasts.

Once again, the Bank stated that it would keep the official cash rate at or below its current level well into 2010. By doing this the RBNZ may feel that it has some ability to push down longer-term interest rates. However, the market does not seem to believe the Bank and is pricing in 60 basis points of OCR hikes over the next 12 months.

However, it appears to us that the balance of risks falls on the other side, with further cuts to the OCR in the short term more likely than increases. Should the New Zealand dollar remain strong without any improvement in commodity prices it is possible the Bank will be forced to act by cutting the OCR further.

We agree with the Bank's negative appraisal of the near-term economic outlook, and as a result we believe that they will be able to keep rates down for some time. As a result, we do not see the first increase in the official cash rate until June 2010.

