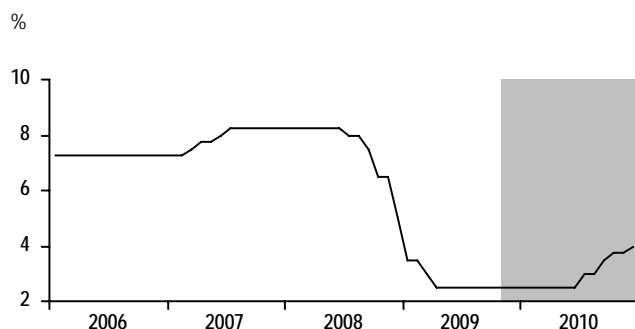


New Zealand Economic Update

RBNZ OCR announcement

The RBNZ left the cash rate unchanged at 2.5% as expected today, and shifted to what we believe is a soft easing bias. Governor Bollard now expects to keep the OCR “at” the current level, rather than “at or below” the current level, as in previous commentary, until the second half of 2010. The tweaking of the commentary signaled that the OCR has troughed, and paves the way for the Governor to shift to a neutral stance in December.

New Zealand: RBNZ official cash rate



Dr. Bollard acknowledged today improved global economic conditions and financial market sentiment, though highlighted that “significant vulnerabilities and challenges” persist. On the domestic economy, the Governor noted the increase in household spending and the pick up in housing market activity. There was no mention that this pick up in housing market activity was temporary, as suggested previously by the RBNZ.

Indeed, a sustained rise in house prices in New Zealand would hamper a much-needed rebalancing of growth toward exports and away from debt-fuelled household spending. This is a key source of concern for the RBNZ, particularly given the strength of the NZ dollar, which the RBNZ Governor reiterated today was dampening the prospect of an export-led recovery, and the rebalancing of growth needed to promote sustainable growth.

Our forecast remains that the RBNZ will shift to a neutral policy stance in December, before kicking off the next tightening cycle with a 50bp rate hike in July 2010. With annual CPI inflation expected to track comfortably within the RBNZ’s target 1-3% oya range over the medium term, and the removal of some of the current fiscal stimulus to reduce the work that monetary policy needs to do, moves of greater than 50bp are unlikely.

The RBNZ currently sees no “urgency” to start withdrawing monetary policy stimulus. That said, a stronger than expected run of housing market data would increase the chances of an earlier OCR hike. We believe that any recovery in household spending will be limited by rising unemployment and softer wage growth, but will be watching the housing market indicators closely in coming months. If Bollard wants to avoid another debt-induced household spending spree, stemming from a sustained rise in house prices, a rate hike should be delivered before mid-2010.

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