Reserve Bank cuts Official Cash Rate to 3 per cent - banks follow suit

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- **Further cuts from Reserve Bank likely**
- **ANZ reduces floating mortgage rate to 6.24 per cent**
- **KiwiBank brings it floating rate down to 6.15 per cent**
- **CASH RATE DROPS: WHAT IT MEANS FOR YOU**

The Reserve Bank cut the Official Cash Rate by 25 basis points to 3 per cent this morning and banks quickly followed suit, cutting their own floating mortgage rates.

New Zealand's biggest bank, the ANZ, cut its rates by 0.25 per cent to 6.24 per cent for its floating rate and 6.35 per cent for its flexible home loans.

The new rates will take effect for new customers from Monday July 27 and for existing customers from August 10.

KiwiBank also cut its rates 0.25 per cent, bringing floating rates down to 6.15 per cent, effective immediately for new customers and in two weeks' time for existing customers.

Reserve Bank Governor Graeme Wheeler hinted that further cuts to the Official Cash rate were likely, echoing concerns from some experts that the headwinds facing the New Zealand economy required a larger cut - possibly down to 2.75 per cent.

"A reduction in the OCR is warranted by the softening in the economic outlook and low inflation," Wheeler said in a statement. "At this point, some further easing seems likely."

Cash Rate drops: What it means for you

What has happened today? The Reserve Bank has cut the Official Cash Rate from 3.25 per cent to 3 per cent.
What does the OCR do? The OCR affects the price of borrowing money in New Zealand and traditionally is how the Reserve Bank tries to influence economic activity and inflation.
How does this affect interest rates offered from banks to the public? The OCR directly affects wholesale borrowing by commercial banks, which in turn flows through to the interest rates which banks offer you when you take out a mortgage or when you invest in a term deposit.
So an OCR cut will mean I pay less interest on my mortgage? Typically, yes. Although because banks also borrow offshore, overseas interest rates impact market rates here. A number of New Zealand banks have also cut their floating rates in the wake of this morning's cut.
What does this mean for savers? This is bad news for savers because while interest rates go down you will also likely get less interest when you put your money into a term deposit. This means investors will look at other ways of making a return, such as the property market or shares.

What does this mean for the New Zealand dollar? Lower interest rates put downward pressure on the New Zealand dollar. That is because lower returns on investments mean less money from overseas will come into the country and there is less demand for our dollar.
This means petrol prices could go up and a lower dollar means overseas trips are more expensive but makes New Zealand more attractive for foreign tourists because their currency goes further here. That being said, the New Zealand dollar rallied this morning because the language around the Reserve Bank's statement was less pessimistic than the market was expecting.

John Key on cash rate cut

Prime Minister John Key does not expect the drop in the official cash rate to have a significant impact on demand in Auckland's housing market.

Mr Key said high demand in Auckland was longstanding and lower interest rates did support people being able to buy houses but he expected any increase in demand to be "at the margins".

He said some banks had already dropped their interest rates in advance of the Reserve Bank's decision to drop in the base interest rate by 0.25 to 3 per cent.

"It probably continues to underpin demand for Auckland housing but I don't think it will make it significantly different than when the base rate was 3.25 per cent."

He said while the drop benefited those with mortgages and businesses, people who were saving would not be as happy.

"So in some cases, say for retired people, they'd probably like to see interest rates a bit higher."

He said overall the key to stimulate the economy was low interest rates and a low exchange rate.

Mr Key said he was not surprised at the Reserve Banks' decision and expected further drops would follow.

The Reserve Bank had traditionally either raised or lowered the rate several times in a row before moving the other way.

Despite the drop in dairy and economic slowdown in China, Key said the current economic climate did not have the same feeling as the Global Financial Crisis in 2008/09.

He said while dairy farmers were feeling the sting, other areas of the economy were thriving.

"Beef farmers are booming at the moment."

Wheeler's challenge

Wheeler kicked off an easing cycle last month as inflation stayed below his target band and falling dairy prices lead to a deterioration in the country's terms of trade, forecasting the 90-day bank bill rate, often seen as a proxy for the OCR, would fall to 3.3 percent in the December quarter before bottoming out at 3.1 percent in June 2016.

At the time, he told politicians he was watching a number of indicators including inflation signals, commodity prices and the falling currency in gauging whether to cut interest rates again.

Since then, inflation has continued to track below the central bank's target band, and whole milk powder prices slumped at the most recent GlobalDairyTrade auction, prompting traders to price in an outside chance Wheeler would cut the key rate by half a percentage point at today's meeting.

Wheeler today dropped his reference to the New Zealand dollar being unjustifiably and unsustainably high - criteria which warrant intervention - while saying its significant decline since April and lower interest rates have led to easier monetary conditions. The Reserve Bank reiterated the currency was at "unjustifiable and unsustainable levels" in its state of corporate intent, released last month, having removed the reference in the June 11 monetary policy statement.

"While the currency depreciation will provide support to the export and import competing sectors, further depreciation is necessary given the weakness in export commodity prices," Wheeler said.

The New Zealand dollar rallied after the Reserve Bank cut its official cash rate because language around the statement was less pessimistic than the market was expecting.

The Kiwi hit US66.40c immediately after the 9 am statement from US65.70c just before, later dropping back to US66.20c in the minutes following.

"The whole statement was a little bit less dovish than the market had expected," Sam Tuck, senior foreign exchange strategist at ANZ Bank, said.

Reserve Bank Governor, in a statement, said further depreciation was "necessary" given commodity price weakness, but the usual references to "unsustainable" and "unjustified" - a common feature of previous official cash rate reviews - were removed.

"The currency comment was significantly altered when the word 'unjustified' was dropped completely," Tuck said.

"Overall we don't expect that it changes the (downward) track for the New Zealand dollar," he said.

Chief executive of the Real Estate Institute of New Zealand, Colleen Milne, said the most important consideration for property markets in terms of interest rates seemed likely to be the extent of any further reductions over the next few months.

"Our soundings indicate that there are expectations that the official rate could come down to 2-2.5 percent," said Milne.

"In the short term lower interest rates would tend to put upward pressure on prices - particularly in Auckland, and perhaps also in regions where recent feedback suggests there has been some involvement from Auckland-based investors.

"Demand pressures remain high in comparison with the build rate for new dwellings."

Milne pointed also pointed out that about two-thirds of the population lived outside Auckland and their perceptions of market prospects could change.

"The reduced dairy payout, whilst not a key factor in the Auckland market, may be influential in the other regions," she said.

PM talks up economy

Prime Minister John Key this week tried to talk up the economy, saying the nation was growing at a "respectable rate" and that New Zealanders shouldn't talk themselves into "a gloomy mind-set" over the prospect of a weaker Chinese economy and Greece's latest bailout, which were weighing on global markets.

The Reserve Bank has been juggling the competing tensions of a strong dollar eroding export receipts against rapid house price gains in Auckland, and settled on imposing new lending restrictions on property investment loans as a means to try and cool the housing market from October.

Wheeler said Auckland house prices are still rising at a rapid pace, though outside the nation's biggest city house price inflation was "relatively low." Increased building activity is underway in Auckland, though "it will take some time for the imbalances in the housing market to be corrected," he said.

Video

Between March and July last year Wheeler hiked rates 100 basis points from a record low to 3.5 per cent, making New Zealand one of the first developed countries to lift interest rates since the global financial crisis in 2008, when credit markets collapsed.

Since September the central bank's tightening bias has been on hold, and last month it cut rates by 25 basis points, taking it to 3.25 per cent, while signalling further cuts could come.

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