

OCR unchanged, Bollard drops wording rates could fall further

Reserve Bank Governor Alan Bollard kept the official cash rate unchanged at a record low 2.5%, as expected, and dropped wording in his statement that rates could fall further, stoking speculation borrowing costs will rise sooner as the economy recovers.

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"There are welcome signs that economic activity is growing again," Bollard said a statement released in Wellington today. Still, "there remain significant vulnerabilities and challenges to be worked through" globally which could drag on New Zealand's economy.

He dropped the wording of the past few statements that interest rates will remain "at or below" current levels until late next year, saying there was "no urgency to begin withdrawing monetary policy stimulus and we expect to keep the OCR at the current level until the second half of 2010."

Bollard has to chart a careful course on the timing of interest rate increases. The economy climbed out of recession in the second quarter, business and consumer confidence is rebounding and house prices picking up. On top of that, inflation unexpectedly accelerated in the third quarter.

Still, risks remain, including a jobless rate forecast to top 7% next year and Bollard wants to avoid fanning speculation for early rate increases, which would drive up the kiwi dollar and crimp export growth.

"It's all about managing expectations," said Craig Ebert, market economist at Bank of New Zealand, before the statement was released. The RBNZ has to acknowledge the OCR can't stay low until the end of 2010, "not with firmer signs of economic recovery coming through," he said. At the same time, it has to "douse expectations of a tightening cycle beginning in earnest early next year."

Before today's statement, traders had been betting the central bank would hike the OCR by 2.35 percentage points in the next 12 months, based on the Overnight Index Swap curve. The scale of expected tightening has grown in the past month as Australia's central bank raised rates unexpectedly and said demand is reviving in New Zealand's largest export market.

The trade-weighted index of the New Zealand dollar, the central bank's preferred measure of the currency, has climbed about 32% from its lows in March. Exporters, including farming groups, this week urged Bollard to cut rates further to weaken the currency.

House prices jumped at an annual pace of 10% in the third quarter, partly stoked by a drop in new listings as owners held on to properties through the downturn rather than realise lower values.

According to Real Estate Institute figures, house prices in September surged 44% in September from the same month a year earlier.

By keeping the OCR unchanged at a record low, Bollard risks widening the gap with Australia's 3.25% benchmark rate from the current 75 basis point gap.

Speculation is growing that the Reserve Bank of Australia will lift rates again as soon as next week after government figures showed the consumer price index rose a bigger-than-expected 1% in the third quarter.