

The Rural Loan Report

February 2017



Benchmark Interest Rates (%)*	Current	Month ago	Year ago	10-year Average	Outlook**
Official Cash Rate	1.75	1.75	2.50	3.65	→
90-day bank bill	2.02	1.98	2.62	3.87	→
1-year Swap Rates	2.14	2.18	2.57	3.98	→
3-year Swap Rates	2.63	2.66	2.63	4.37	→
5-year Swap Rates	3.00	2.99	2.79	4.64	→

*Rates current as at 10 February 2017

**Outlook is over the next 6 months

Key points

- All rates remain very low compared to average.
- From here, we expect rates to largely track sideways over the next six months or so.
- We see the greatest risk of rising rates at the longer end, with that risk later in the year rather than sooner.

We expect rates to largely track sideways

Over the next six months or so, we expect most rates to largely track sideways. In particular, we expect the Reserve Bank (RBNZ) to remain on hold for the foreseeable future.

In its February statement, the RBNZ effectively said so itself. "Monetary policy will remain accommodative for a considerable period." In other words, the Reserve Bank expects to keep the Official Cash Rate (OCR) at its current rate of 1.75% at least over 2017, but potentially over 2018 and into 2019 as well.

Moreover, while inflation is back inside the RBNZ's target band, the RBNZ will still want to ensure that it sits sustainably around the 2% midpoint of the range. Indeed, inflation has only just crept back inside the range last quarter, after spending two years outside the range.

Meanwhile, offshore factors may push longer-term rates higher, but that may not be until later in the year. In particular, our longer-term rates are likely to reflect moves in US interest rates.

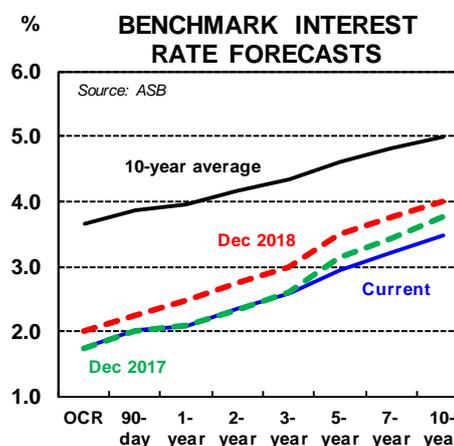
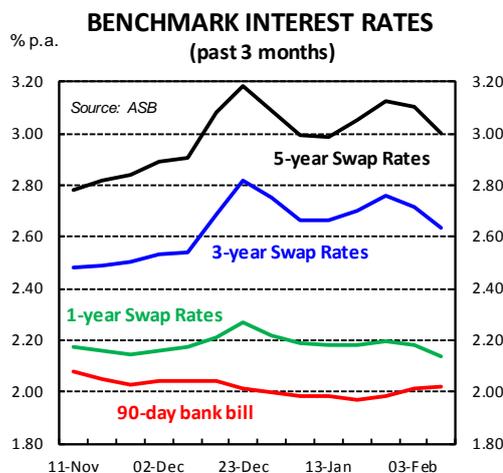
On that front, we expect the US Federal Reserve to lift its benchmark rates twice this year. In the US, the economy is gradually improving, allowing the Federal Reserve to lift interest rates.

At the same time, President Trump has big spending plans, including tax cuts and infrastructure. These plans are likely to generate further short-term US growth and inflation. In turn, this extra growth and inflation may spur additional interest rate hikes by the Federal Reserve.

Interest Rate Outlook

However, rising longer-term rates off current levels is a story most likely for later in the year. With that in mind, it pays to remember that current rate levels already include the sharp jump late last year in response to Trump's election win.

For now, we expect interest rates to broadly track sideways. As a result, we expect interest rates to remain low by historical standards over the first half of 2017.



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