

The Rural Loan Report

January 2016



Benchmark Interest Rates (%)*	Current	Month ago	Year ago	10-year Average	Outlook**
Official Cash Rate	2.50	2.50	3.50	4.21	↘
90-day bank bill	2.74	2.76	3.67	4.45	↘
1-year Swap Rates	2.74	2.80	3.76	4.56	↘
3-year Swap Rates	2.90	2.96	3.85	4.89	↘
5-year Swap Rates	3.15	3.21	3.90	5.12	→

*Rates current as at 12 January 2016

**Outlook is over the next 6 months

Key points

- We expect floating and short-term rates to fall over 2016.
- We base this expectation on our view that the Reserve Bank will cut the OCR by 50bp to 2% this year.
- At this stage, we also expect medium and some longer-term rates to fall as well, but risks are that they don't necessarily decline.

ASB expects the RBNZ to cut the OCR by 50bps in 2016

We expect two 25bp Official Cash Rate (OCR) cuts in 2016, taking the OCR down to 2%. The main reason likely to prompt these cuts, in our view, is that we expect inflation to remain very low this year. Indeed, we expect that inflation may come in below the Reserve Bank's (RBNZ) target.

Importantly, **we expect that the fall in the NZ dollar will not generate as much inflation as the RBNZ expects.** Moreover, any impact that is generated is likely to be transitory.

In addition, **we expect the unemployment rate to rise over the next 18 months, keeping a lid on wages.** In turn, low wages are likely to keep local inflation pressures subdued.

However, we expect that it will take a while for the RBNZ to come around to this view. Firstly, the RBNZ will want to wait and assess the impact of last year's OCR cuts. If we are correct, the RBNZ will be disappointed with what it sees, prompting it into action.

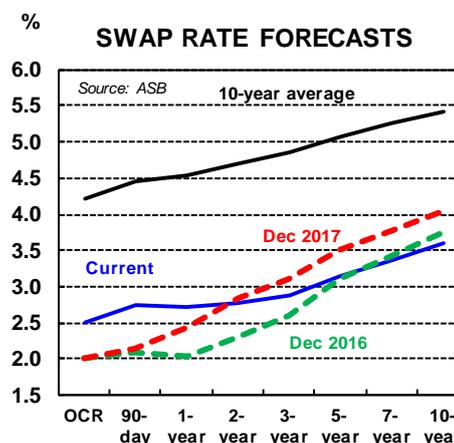
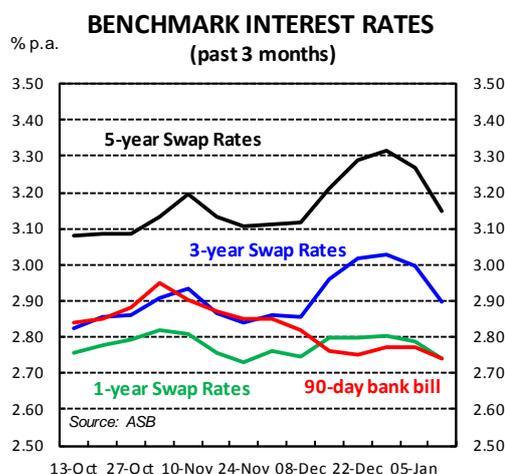
We expect this to occur around the middle of this year. As a result, **we have pencilled in the two 25bp cuts for June and August.**

Interest Rates Outlook

If the RBNZ cuts the OCR, **we expect the floating rates and very short-term fixed rates to fall over the next six months.**

Longer-term rates are also likely to fall over the year, but we see some risk that they don't necessarily decline. Medium- and long-term rates depend both on NZ interest rate movements and offshore events. In particular, US interest rate movements are important. At this stage, we expect RBNZ cuts to roughly offset the US Federal Reserve lifting its rates. However, should US rates lift by more or sooner than the NZ rates fall, then NZ longer-term rates may come under more and or sooner upward pressure than we currently have factored in.

Putting the various scenarios aside, **we are in for a lengthy period of low interest rates by historical standards.**



ASB Economics & Research			Phone	Fax
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659	(649) 302 0992
Senior Economist	Jane Turner	jane.turner@asb.co.nz	(649) 301 5853	
Senior Economist	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5660	
Rural Economist	Nathan Penny	nathan.penny@asb.co.nz	(649) 448 8778	
Economist	Kim Mundy	kim.mundy@asb.co.nz	(649) 301 5661	



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ASB Economics
ASB North Wharf, 12 Jellicoe Street, Auckland

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