

The Rural Loan Report

May 2015



Benchmark Interest Rates*	Current	Month ago	Year ago	10-year Average	Outlook**
Official Cash Rate	3.50	3.50	3.00	4.47	↘
90-day bank bill	3.48	3.62	3.41	4.73	↘
1-year Swap Rates	3.38	3.59	3.72	4.85	↘
3-year Swap Rates	3.50	3.59	4.20	5.14	↘
5-year Swap Rates	3.69	3.67	4.45	5.34	↘

* Rates current as at 22 May 2015

**Outlook is over the next 6 months

Key points

- With inflation staying very low, we expect the Reserve Bank to cut the OCR later this year.
- In this event, we expect floating and short-term rates to fall.
- At this stage, we also expect longer-term rates to fall as well, but risks are that they don't necessarily decline.
- In general, we are in for lengthy period of low interest rates.

ASB expects the RBNZ to cut the OCR later this year

We now expect the Reserve Bank (RBNZ) will cut the Official Cash Rate (OCR) this year. We believe the risks of inflation taking too long to return to the 2% mid-point of the inflation target are now high enough to warrant a response.

Accordingly, we think the RBNZ will cut by 50bp, most likely 25bp in each of September and October. But an earlier start is conceivable. Overall, we put a 60% probability on any cuts occurring over the year.

Markets largely agree. At this juncture, markets have priced in at least one 25bp OCR cut by the end of the year and a high probability of another.

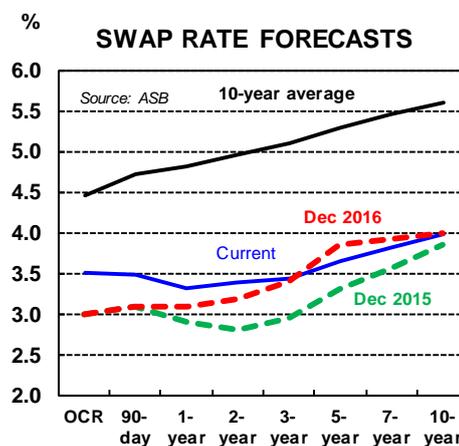
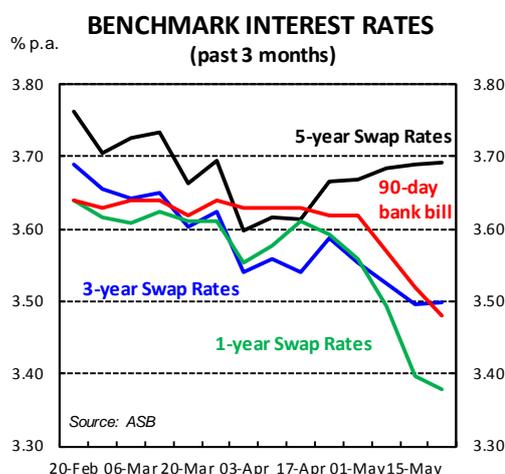
The main risk from a lower OCR is that the added stimulus would further fuel the housing market and push prices even higher. But the RBNZ and the Government have stepped up measures to contain the Auckland housing market. These measures, from our point of view, indicate that the RBNZ is unlikely to see the housing market as an impediment to cutting the OCR this year.

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 more risk that they don't necessarily decline. Medium- and long-term rates are more dependent on offshore events, particularly as they relate to US interest rates. At this stage, we expect the US Federal Reserve to begin lifting its rates late this year. However, should it move earlier than that, upward pressure will come on global and NZ longer-term rates sooner than we currently have factored in.

All things considered and by historical standards, we are in for a lengthy period of low interest rates.



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