Research

Economy Watch

1 April 2025

April MPR Preview

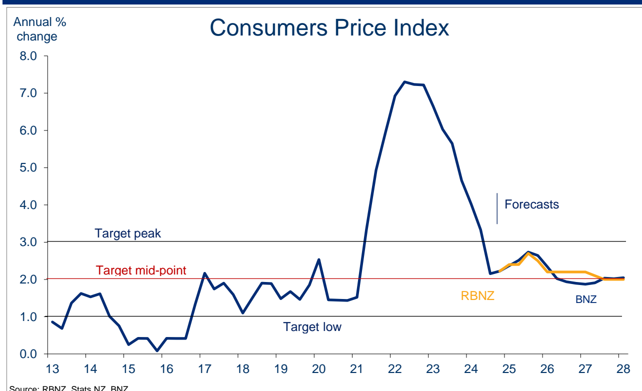
- **Steady as she goes**
- **25 point cut expected for April OCR review**
- **With a signal of more to come**
- **But the end point approacheth**
- **As capital changes portend monetary easing**

"If economic conditions continue to evolve as projected, the Committee has scope to lower the OCR further through 2025". These were the final words of the policy assessment contained in the February Monetary Policy Statement (MPS). In our opinion, the expected evolution has been sufficiently met. The Reserve Bank should cut its cash rate 25 basis points to 3.5% at the April 9 Monetary Policy Review (MPR). And the parting words of the February MPS should be repeated leaving the door wide open to further 25 point cuts in May and July.

It would be remiss to say the world has evolved exactly as expected but, on balance, it's near enough.

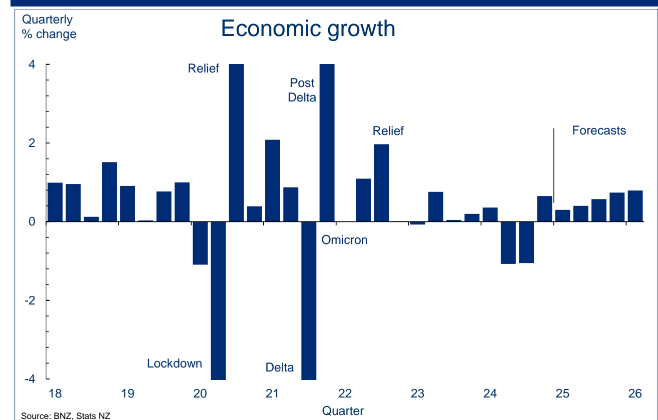
Most importantly, the broad trajectory of inflation appears to be on track. Volatility in fuel prices risks upsetting the apple cart but should be looked through and, similarly, the currency has been bouncing around a bit, nudging forecasters' expectations up and down with it. Fundamentally, though, there seems little reason to think inflation will escape from the 1-3% target band during the forecast horizon.

Inflation sorted



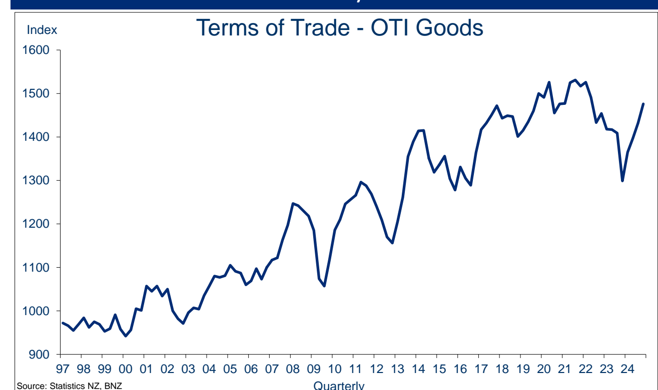
The big "surprise" since the MPS was the news that Q4 GDP rose 0.7%. The RBNZ was picking 0.3%. However, we ascribe much of the difference to a combination of seasonal adjustment issues and the spike in the balancing item which contributed 0.3 of the 0.7 growth. We thus expect a much lower increase in activity in Q1. We are currently forecasting the economy to expand just 0.3% for that quarter. If the RBNZ comes to the same conclusion then growth in the six months to end March will end up little different to the RBNZ's February projections.

Q4 GDP Rogue



We can't be certain of this, though, so there is a chance the RBNZ has some hawkish jitters around the GDP outturn. And there are other factors that could add to this concern. To start with, New Zealand's terms of trade appears to be strengthening more than the Bank had anticipated. This is being led by export prices, predominantly commodities, the inflationary impact of which would typically be offset by a rising NZD but this hasn't been the case. In addition, there is some suggestion the housing market may be a little more robust than the Bank has assumed. But it's all at the margin.

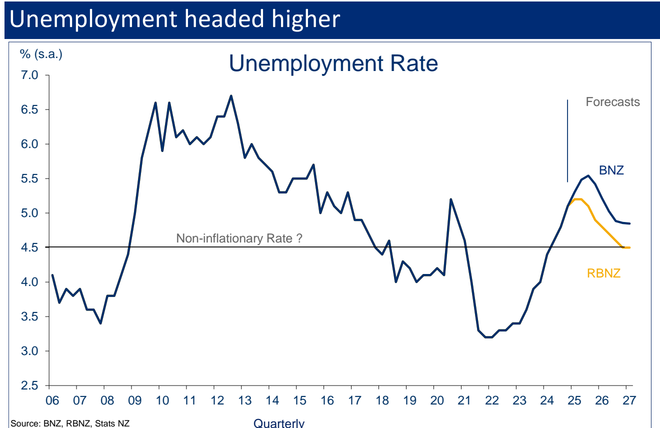
Terms of trade a tad inflationary



Also at the margin, the RBNZ will be a little bothered by the apparent increases in both consumer inflation expectations and business pricing intentions in recent ANZ surveys.

On the flipside, we still believe the unemployment rate will head higher than the Bank has forecast. The zero change in employment reported in the February employment indicators coupled with the downward revision to January's reported growth (0.1% down from 0.3%) support this view. We are picking a 5.5% peak in the unemployment rate compared to the Bank's 5.2%.

Unemployment headed higher



The state of the labour market is clearly weighing on employment expectations and consumer confidence as evidenced by Westpac's employment index falling to its lowest level since the COVID-induced slump of 2020 and both Westpac and ANZ consumer confidence measures still well below the breakeven 100 level.

We think consumer confidence weakness is being dominated by domestic events but the actions of one Donald Trump will also be affecting confidence. Whether the sentiment of domestic consumers is being impacted or not, US tariff policy certainly has the potential to dampen global economic activity, and possibly more so than the current consensus suggests. This was reflected in recent significant downward revisions to 2025 and 2026 US economic growth by the OECD.

Of course, weaker growth does not necessarily mean lower inflation. And whatever the US administration says it will do today may not be what it says it will do tomorrow. On this basis, one can only discuss economic and financial market risks regarding US policy at this juncture rather than reach firm conclusions, though it is likely that uncertainty alone will lower investment globally and with it GDP. It is the magnitude that is questionable. The recent rally in US rates' markets suggests investors are more focused on the growth risks and their longer term implications for inflation rather than the more immediate inflationary hit.

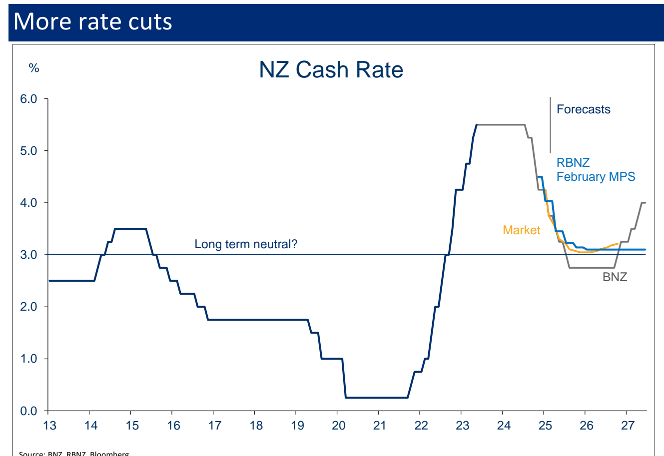
We will be surprised if anyone has any view other than the RBNZ will cut again at the upcoming meeting. From our perspective, the only real point of interest remaining in the New Zealand story is when will the Bank stop cutting. In February it implied a cash rate of 3.0% would be the low in the cycle. We doubt the Bank will do anything in the April MPR to suggest its expectation has changed but, equally, the absence of any interest rate track accompanying the MPR means there will be little signal on this anyway.

At this stage we continue to formally forecast a 2.75% low. We are tempted to give this a nudge higher to 3.0% but for every reason that pops up that says we should do so there is another that says we shouldn't.

Increasingly, the market seems reluctant to fully price in a 3.0% low in the cash rate. The current market bottom sits a smidgen above 3.0% but has regularly risen above 3.1%. While the RBNZ will not be unhappy with this, we doubt it would want the "last" rate cut priced out at this point in time. Was this to be the case then mortgage interest rates could well be repriced higher. We are not at all convinced the RBNZ wants that to happen now.

Equally, we doubt the RBNZ is overly enthusiastic about the speed at which the market is pricing interest rate hikes in 2026 albeit that such pricing may be telling us more about supply and demand conditions in interest rate markets than it tells us about "true" interest rate expectations.

More rate cuts



Looking forward, the ultimate driver of the low in the cash rate could be determined by whether or not the RBNZ succumbs to pressure and eases back on its published intent to have bank capital ratios rise aggressively. If the RBNZ does not follow through with its initial proposals then this would represent an effective easing in policy which, all other things being equal, would mean the cash rate would not need to be as low as previously forecast to achieve the same inflationary outcome. Following yesterday's announcement of a review of the capital requirements by the RBNZ, the chances of a shift in stance have increased.

Given that the decision is not due for release until the end of the year, the low in the cash rate should already have been reached by then but one has to presume the Bank will have a good feeling as to where the decision will fall earlier

than end-year so the possibility of a moderation in the Bank's stance could still influence the OCR outcome.

There is currently much discussion as to whether Adrian Orr's abdication will affect next week's RBNZ deliberations. Given the economic circumstances we think not. However, at the margin, because the RBNZ is awaiting the appointment of a new Governor, it would be reasonable to expect it would be a bit more cautious in its decision-making than might otherwise be the case. This being so, it adds a bit more weight to our expectation that the Bank will be reluctant to rock the boat at its April 9 meeting.

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