BNZ MARKETS
Research
Economy Watch
28 May 2025

RBNZ: Delivers A Hawkish Cut

- **Cash rate lowered 25 basis points to 3.25%**
- **Rate track suggests possibility of one or two more cuts**
- **But RBNZ rhetoric is much more guarded**
- **Our forecasts unchanged**
- **But risk pendulum swings to less easing**

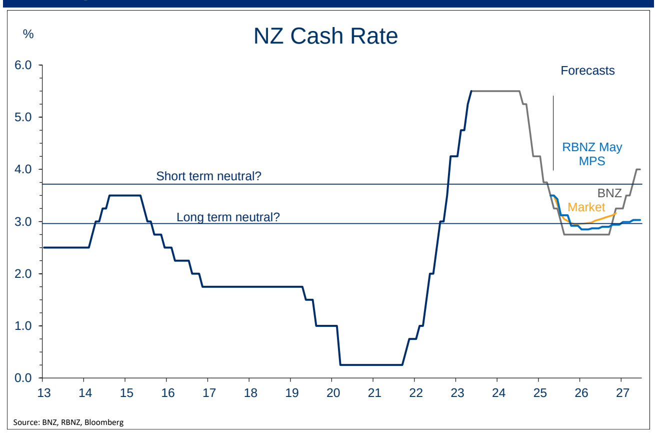
In its April Monetary Policy Review, the Reserve Bank Monetary Policy Committee said “As the extent and effect of tariff policies become clearer, the Committee has scope to lower the OCR further as appropriate. Future policy decisions will be determined by the outlook for inflationary pressure over the medium term”. The Bank didn’t repeat these words in its May policy assessment but it remains the centrepiece of its thinking.

The 25 basis point cut in the cash rate today, to 3.25%, was a near given. What everyone wanted to know was what next? The published modelled rate track, with a low of 2.85% implies further easing is likely. Indeed, it suggests up to two more rate cuts are in the offing. But the text of the statement is far less conclusive in its mood.

To start with it should be noted that the decision to cut was passed with a 5-1 vote with the dissenter wanting no change. There was no discussion of a 50-point move.

Perhaps more importantly, though, is that there is no suggestion whatsoever in the Bank’s short policy assessment about the direction or timing of the Bank’s next move. There is nothing to even confirm there will be another cut. Accordingly, the RBNZ has left itself full optionality to do almost anything at its next meeting.

Nearing the bottom

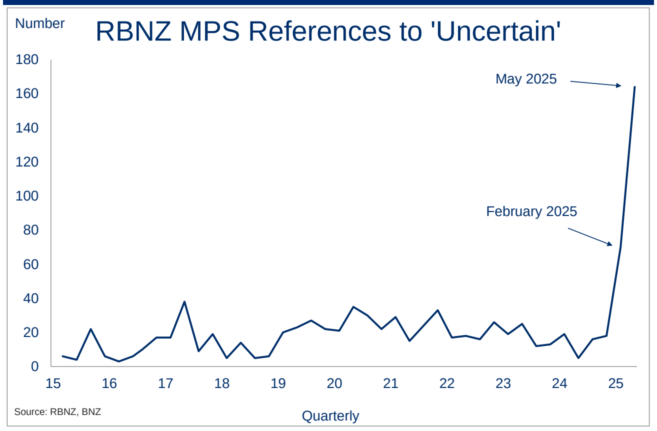


The two scenarios presented in the document further open up that optionality. Governor Hawkesby even stated categorically in the post-match press conference that the RBNZ does not have a bias regarding its next move.

Our central view is that there will be a further 25 point cut in rates at the July 9 meeting but we concede this is not at all a done deal. Making any decision at that meeting will be problematic to the extreme given that Trump will be announcing his “final” decision on tariffs less than 24 hours after the RBNZ meets.

Uncertainty was definitely the theme of today’s statement. The word uncertainty was used 164 times. That’s some achievement given that the document is only 58 pages, and the last 8 pages are all graphs and tables.

Uncertainty rules



As we have said ad nauseum of late our biggest concern about the outlook is that uncertainty itself will lower growth as businesses postpone both investment and hiring. The RBNZ acknowledges that this has been a key factor in its downward revision of expected growth.

The RBNZ now has a very low trajectory for growth for the next three published quarters. A 0.4% increase is expected for the March quarter, 0.3% for June and 0.2% for September. This is important because there is only a low chance the Bank will be surprised to the downside on these projections unless we are clobbered by a global downshift.

What this means is that the hurdle for the RBNZ to go to 2.5% is higher especially when there is not even any conviction yet to get the cash rate down to 2.75%. Prior to this statement we had said the balance of risk to our 2.75% forecast was evenly balanced. We now think the pendulum has now swung modestly towards 3.00% being the more likely alternative scenario.

Between now and July 9 the high frequency indicators will again take centre-stage. The problem is that there aren't a lot. We'll be most interested in the PMI (June 13) and PSI (June 16). May selected price indices (June 17) will be worth a watch too.

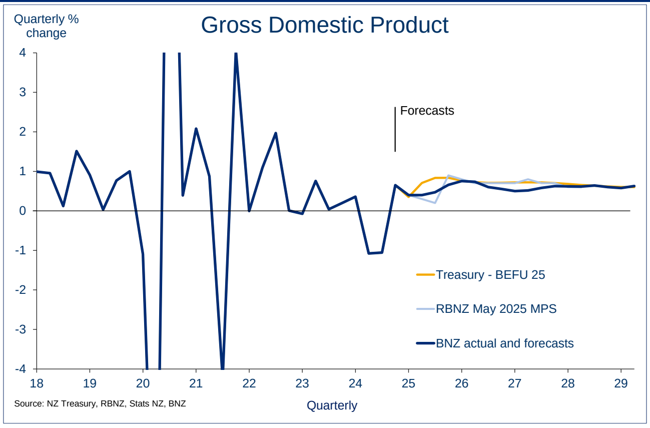
July 1's Quarterly Survey of Business Opinion could well be the most important date release between now and the next meeting as it will give us the most comprehensive overview as to expectations for growth, pricing, investment and hiring that we are going to get.

Q1 GDP is released on June 19. Both ourselves and the Reserve Bank are looking for a 0.4% increase in output. And who knows what the revisions will be like. We doubt historical GDP will shift the dial when there are so many more immediate issues to contemplate.

We were interested to know how the RBNZ would interpret the recent Budget. We thought it would be seen as relatively neutral compared to past fiscal assumptions. This proved to be the case.

Interestingly, though, the RBNZ has a similar view on growth as do we, namely that it will be lower than Treasury has assumed in the near term. If we and the central bank are closer to the truth then there will be further pressure on the Government's anticipated revenue streams, as we had suggested on Budget day.

Potential fiscal shortfall highlighted



Financial markets judged today's statement as being hawkish relative to expectations and are in the midst of trying to price out any chance of the cash rate falling below 3.0%. Given the general tenor of the document and the comments from the press conference this would seem an entirely apt response. Whether or not the RBNZ will feel comfortable with it is moot. Currently mortgage rates are priced off the expectation that the RBNZ would cut rates to near 2.75%. This is no longer the case.

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Full text of today's RBNZ OCR Review:

The Monetary Policy Committee today voted to lower the OCR by 25 basis points to 3.25 percent.

Annual consumers price index inflation increased to 2.5 percent in the first quarter of 2025. Inflation expectations across firms and households have also risen. However, core inflation is declining and there is spare productive capacity in the economy. These conditions are consistent with inflation returning to the mid-point of the 1 to 3 percent target band over the medium term.

The New Zealand economy is recovering after a period of contraction. High commodity prices and lower interest rates are supporting overall economic activity.

Recent developments in the international economy are expected to reduce global economic growth. Both tariffs and increased policy uncertainty overseas are expected to moderate New Zealand's economic recovery and reduce medium-term inflation pressures. However, there remains considerable uncertainty around these judgements.

Inflation is within the target band, and the Committee is well placed to respond to domestic and international developments to maintain price stability over the medium term.

Summary Record of Meeting – May 2025

Annual consumers price index (CPI) inflation remains within the Monetary Policy Committee's 1 to 3 percent target band. While measures of inflation expectations have increased, core inflation and spare productive capacity in the economy are consistent with inflation returning to the target mid-point over the medium term. Elevated export prices and recent reductions in the OCR are expected to support a modest pace of growth in the New Zealand economy, even as increased global tariffs are expected to slow global economic growth.

Higher global tariffs and policy uncertainty are expected to lower global growth

The Committee noted that projections for global economic activity have weakened since the February Statement, reflecting the shift towards protectionist policies in some major economies. There have been downward revisions to economic growth projections for China and the US, reflecting the scale of tariff increases between these two countries.

The Committee noted that, in addition to the direct effect of higher tariffs, increased policy uncertainty in the international economy is likely to weigh on global investment and consumption. As well as uncertainty about tariff retaliation, it was unclear how countries would respond with fiscal and monetary policies. For example, it is possible that China could respond to weaker economic activity with a sizeable fiscal stimulus. US fiscal policy could place strains on the sustainability of its public debt. More generally, the uncertain trajectory of geoeconomic fragmentation and the decline in the quality of macroeconomic institutional arrangements were likely to result in precautionary behaviour by firms and households. In aggregate, economic growth in New Zealand's main trading partners is expected to remain below potential over 2025.

Headline inflation within New Zealand's trading partner economies has fallen over the past year. Projections for inflation for most of our trading partners have been revised down in recent quarters. The main exception is the US, where higher tariffs are expected to increase inflationary pressure.

The New Zealand economy is starting to recover, after contracting over the middle of 2024

The Committee noted that spare productive capacity remains in the New Zealand economy. This is projected to dissipate over the medium term as the economy recovers. Elevated export commodity prices and lower interest rates are supporting overall economic activity in the New Zealand economy. The Committee noted that the full economic effects of cuts in the OCR since August 2024 are yet to be fully realised.

The Committee discussed conditions in New Zealand's labour market. Nominal wage growth is slowing, while firms report that it is easier to find workers. Employment growth is currently modest but expected to increase from the second half of the year in line with the broader economic recovery.

The announced increase in US tariffs will lower global demand for New Zealand's exports, particularly from Asia, constraining domestic growth. Heightened global policy uncertainty is expected to weigh on business investment and consumption in New Zealand.

On balance, the Committee expects the increase in global tariffs to result in less inflationary pressure in the New Zealand economy. However, as discussed below, there is significant uncertainty about this assessment, depending on whether the impact of tariffs proves to be predominantly demand- or supply-side in nature. The domestic monetary policy response will focus on the medium-term implications for inflation.

Domestic fiscal policy is assessed as being broadly neutral from a medium-term inflation perspective, relative to February Statement projections. The change announced in Budget 2025 enabling businesses to bring forward depreciation allowances is assumed to increase investment activity. However, the inflationary consequences of this policy are assumed to be offset by an announced reduction in government spending.

Annual CPI inflation is expected to remain in the target band, and converge to the mid-point

The Committee discussed domestic inflationary pressure. New Zealand's annual CPI inflation increased to 2.5 percent in the March 2025 quarter, largely in line with previous projections. Most annual core inflation measures continued to decline in the March 2025 quarter, and all are now within the target band for headline CPI inflation.

Annual CPI inflation is projected to increase to 2.7 percent in Q3 2025, then return to near the 2 percent target midpoint from 2026. The near-term increase in headline inflation includes higher food and electricity price inflation.

Non-tradables inflation is expected to continue to decline, consistent with spare productive capacity in the economy. Annual tradables inflation is projected to remain around 1 percent over the medium term, reflecting below average global growth and falling inflation within our trading partners.

The financial system remains stable

The Committee noted that most wholesale interest rates have fallen since the February Statement, resulting in lower mortgage and term deposit rates. The average interest rate on the stock of mortgages is expected to continue to decline in coming quarters as more mortgage holders refix at lower fixed-term interest rates. Close to half the stock of mortgages is due to reprice during the June and September 2025 quarters.

The Committee was briefed on financial system stability. While non-performing loans in the housing and small business sectors have increased in line with the past contraction in the economy, the banking system remains well capitalised and in a strong financial position to support customers. The Committee agreed that there is currently no material trade-off between meeting inflation objectives and maintaining financial system stability.

The Committee was briefed on the status of the Large Scale Asset Purchase programme. The Committee noted there has been increased volatility in domestic wholesale interest rates, reflecting increased global policy uncertainty. Despite this volatility, wholesale interest rate markets continue to function, without impeding monetary policy transmission.

Risks around the economic outlook are heightened

The Committee discussed several key risks around the central projection. Measures of business and household inflation expectations have increased. The Committee discussed whether this increase reflected factors like higher food prices and current reporting on the inflationary effect of tariffs in the US. The projections assume that medium-term inflation expectations remain consistent with the target mid-point. Some Committee members emphasised the risk that these increases reflect a more generalised and persistent increase in inflation expectations.

The Committee discussed the medium-term outlook for import prices. Members noted that a less productive global economy, against a background of deglobalisation, presents an upside risk to the current import price projection.

The Committee noted downside risks to the outlook for export prices. This reflects a weaker global growth outlook and the potential for a quicker international supply response to high prices from global meat and dairy producers.

The Committee noted the risk that large economic policy shifts in overseas economies could lead to additional volatility in financial markets. For example, concerns about US debt sustainability could lead to increased bond yields or declines in global asset prices.

There are alternative scenarios for the domestic outlook

In addition to the uncertain scale and duration of tariff policies, it is unclear how these will transmit to the New Zealand economy. Some members emphasised that the costs of trade could increase more than currently assumed, as global supply chains adapt to trade barriers and geoeconomic fragmentation. This could result in greater domestic medium-term inflationary pressure than in the central projection. Other members emphasised that policy uncertainty could lower global investment, and trade diversion could lower import prices by more than currently assumed. This could, instead, lower medium-term inflationary pressure relative to the central projection.

Two scenarios in the May Statement highlight how the realisation of these risks could affect the outlook for the domestic economy. These scenarios represent just two of many paths the economy may take as higher tariffs and uncertainty transmit through the system. They are intended to broadly highlight the trade-offs and considerations facing the Committee should these risks eventuate.

The Committee noted that, in practice, a broad range of factors contribute to its monetary policy decisions. Its response to any of these risks would depend on economic conditions at the time, the outlook for inflationary pressure, and its secondary objectives of avoiding unnecessary instability in the economy and having regard to financial system stability.

The Committee voted to reduce the OCR to 3.25 percent

The Committee agreed on the projected central path for the OCR.

The Committee discussed the options of keeping the OCR on hold at 3.50 percent or reducing it to 3.25 percent. The case for lowering the OCR to 3.25 percent highlighted that CPI inflation is in the target range and there is significant spare capacity in the economy. Measures of core inflation and wage inflation have continued to decline. In addition, there is a weaker outlook for domestic activity and inflationary pressure relative to the February Statement, because of international developments. Some members also emphasised that non-tradable inflation was currently being boosted by administered prices. Given these factors, a 25 basis point decline in the OCR was seen as consistent with medium-term price stability.

In considering the merits of holding the OCR unchanged at 3.50 percent for this meeting, some members noted that this would allow the Committee to better assess whether increased economic policy uncertainty was having a noticeable impact on household and firm behaviour. An unchanged OCR could also further consolidate inflation expectations around the target mid-point, and guard against the risk of higher-than expected inflation from the supply-side effects of increased tariffs.

On Wednesday 28 May, the Committee took the decision to vote on the two options. By a majority of 5 votes to 1, the Committee agreed to decrease the OCR by 25 basis points from 3.50 percent to 3.25 percent.

Inflation is within the target band, and the Committee is well placed to respond to both domestic and international developments to maintain price stability over the medium term.

Attendees

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Treasury Observer: Dominick Stephens
MPC Secretary: Adam Richardson

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