Research

# Economy Watch

1 July 2025

# QSBO, and our RBNZ MPR Preview

- **We abandon our July rate cut call**
- **We still think the economy requires lower rates**
- **Our 2.75% expected end point remains**
- **But QSBO was no smoking gun**
- **And market pricing a big hurdle**
- **Especially given RBNZ reluctance at May MPS**

### *We change our rate call*

We've been waiting for today's QSBO to decide whether or not to maintain our view that the RBNZ will lower its cash rate at its July 9 meeting. To be completely honest all the QSBO has done is further muddy the waters. In the end, though, we have reached the conclusion that it will be hard for the RBNZ to cut at this meeting given that post the MPS it suggested market pricing would be a key driver of its decision. In some ways the RBNZ is in a comfortable spot. The market is not looking for a cut in July but still thinks another rate reduction is a done deal with the chance of more. The RBNZ thus will feel no need to rock the boat.

But we still believe a little more work is needed so will stick with our view of two further rate cuts, now August and October rather than July and August. This still leaves the track with a 2.75% low.

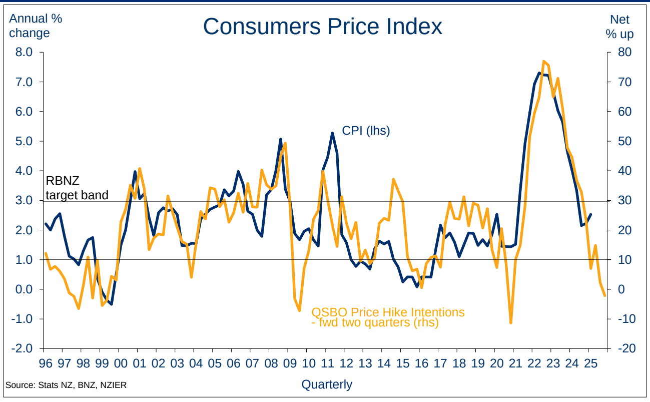
### *What did the QSBO say?*

In one line: the overall message from the QSBO is that growth is on the mend but inflation is dead.

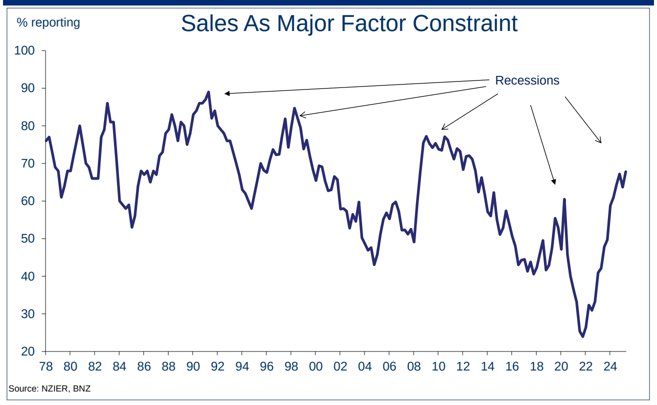
A net 1% of businesses report that they have lowered prices in the last quarter and a net 2% expect to do so again. This only happens during recessions. At face value the degree of intent is such that it implies a real threat to the lower bound of the RBNZ's target. However, in each of the last two times when intentions have been so low CPI inflation has only dipped to around the mid-point of the target band. Be that as it may, if that is what the data portends it is still a strong indication the RBNZ can allow rates to push lower.

Despite this, and the reporting of general malaise in the June quarter, for which 68% of businesses said a lack of sales was their major constraint on activity, there was still optimism for the way ahead.

Pricing expectations slump

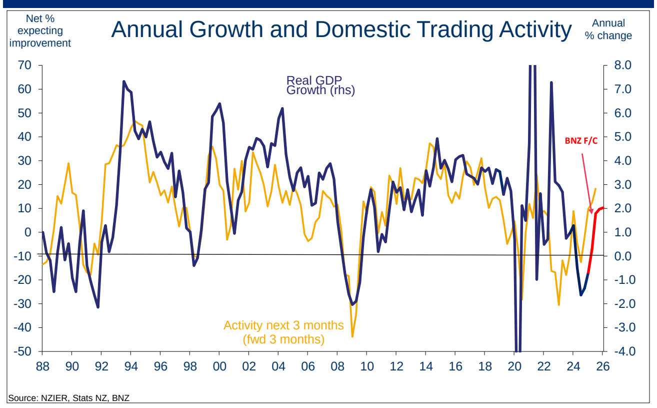



Sales weak



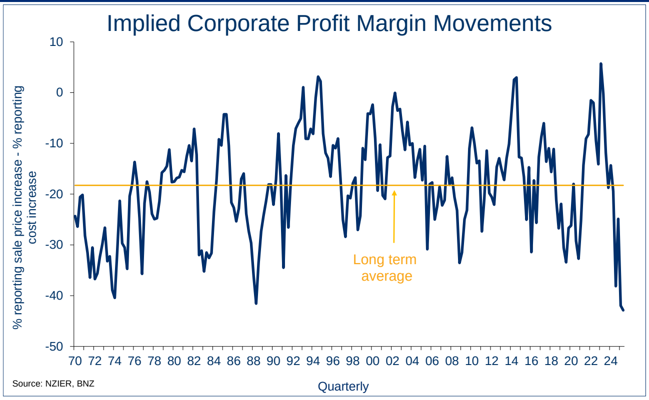

A net 18% of businesses believe their own activity will improve. This is consistent with GDP growth rising to around 3.0%. This is above our expectations.

Positive outlook



A really big question for us is the gap between the number of businesses reporting that costs are rising compared to the number who say they have increased selling prices. The gap is a record high.

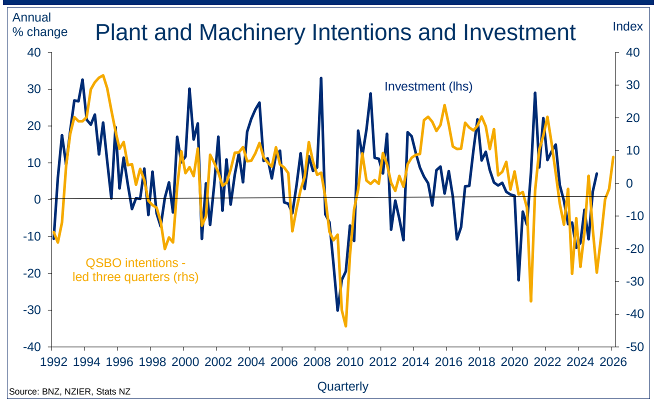
Margins slaughtered




The resolution to this must either be business failure or a lift in selling prices. Neither is great but the first requires a central bank easing the other a tightening. The truth will probably be down the middle.

As with the ANZ survey investment intentions have risen, even without direct farmer representation. The Government's policy change seems to have boosted investment intentions.

Investment intentions jump




On balance we would describe the QSBO as being dovish. But dovish enough to overcome the brick wall of market pricing? Probably not.

***This is why we think the Reserve Bank of New Zealand will pause at it its July 9 Monetary Policy Review***

Selected price indices for the month of May saw us revise our Q2 CPI pick up to 0.8%. This is now miles higher than the Reserve Bank's 0.5% pick for the quarter. But it gets more problematic than this. Our forecasts had assumed a trend decline in global oil prices. They hadn't assumed the Iran/Israel war. While it is possible the decline in oil prices resumes we have, for the time being, assumed relative stability in prices. This adds a further 0.1% to our September quarter and December quarter CPI forecasts.

We are now forecasting that annual CPI inflation will peak at 3.1% in the September quarter and it will still be 3.0% in December. The RBNZ is forecasting a September peak of 2.7%. If the RBNZ's inflation forecasts have moved in a similar manner to our own then the MPC will be more nervous about its control over inflation than they were at the May decision.

All this is exacerbated by the fact that inflation expectations tend to be adaptive. That is they follow in the same direction as published inflation. So this means inflation expectations could keep rising until we see the December quarter CPI print in January 2026.

As things stand consumer inflation expectations, according to the ANZ's survey, have already risen noticeably over the last few months and they are at levels usually deemed inconsistent with the Bank achieving its target.

We think the Bank overplays inflation expectations given measurement difficulties and their adaptive nature but we know that concerns over rising inflation expectations were a key driver of the reluctance in some quarters to lower rates last time. And, recall there was a dissenter who voted to hold rates unchanged last time round. That person won't be any more likely to vote for a cut this time around and may even have a few extra friends in the camp.

There are a number of articles floating around that suggest that wars are definitively inflationary. If those already spooked by rising inflationary expectations are influenced by these then their resistance to cut will be even higher.

But not only is inflation printing higher than anticipated so to did growth. Q1 GDP came in at 0.8% compared to an RBNZ expectation of 0.4%. Importantly much of the "surprise" can be attributed to stronger domestic demand via more robust private consumption than expected and a stronger investment outturn. All other things being equal, this would be seen as a more inflationary environment than previously thought.

Moreover, business surveys still suggest that growth is going to pick up to in excess of 3.0% in the not too distant future.

Uncertainty still reigns. It will do so for some time to come. Amongst other things is the ongoing uncertainty surrounding tariffs. Donald Trump is due to provide some clarity less than 24 hours after the RBNZ announces its decision. This might provide further reason to wait and see albeit there is zero guarantee that what is announced will be sustained.

Generally, though, it would be fair to say that trade uncertainty, while still elevated, has eased from May MPS levels.

Last, and definitely not least, Acting Governor Hawkesby suggested after the May Monetary Policy Statement that the Bank would be looking at market pricing for some guidance as to its next move. At this stage the market is pricing in just a 20% chance of a rate cut at the meeting. If it stays this way then it provides even more support for an on hold stance.

***This is why we think the RBNZ should still seriously contemplate easing***

Near term inflation may be problematic on the upside but we think it will be equally problematic on the downside by the second half of 2026. Indeed, we (and the RBNZ) are forecasting annual inflation to drop to below 2.0% mid next year.

There are multiple reasons for this. To start with we think that New Zealand commodity export prices will soon start to edge lower. This will seriously curtail some of the food price increases that have been driving inflation higher over the last few months. A lack of global demand may also drive other commodity prices lower, including oil. There is also some suggestion that output prices from China could fall.

A stronger NZD may yet also play its part in constraining New Zealand prices.

The labour market remains weak and will probably end up weaker than the RBNZ has assumed in its last set of forecasts. Monthly employment indicators suggest that Q2 employment growth will be zero at best. This compares with the 0.2% increase for the quarter that the RBNZ had forecast. The unemployment rate may not be significantly higher than predicted but only because the participation rate is dropping and net migration inflows look set to be lower than anticipated by the Bank.

Q1 GDP may have been surprisingly strong but the previous quarter's GDP was revised 0.2% lower. Moreover, it looks to us that Q2 GDP has stalled completely. We are forecasting zero change for the quarter. If we are right then the level of GDP by the end of Q2 will be just about where the RBNZ had assumed but the momentum would be awful.

There is a yawning output gap which will remain so if our GDP projections are right. Indeed the gap could end up bigger than the RBNZ has anticipated. A bigger output gap would add more downward pressure to medium term inflation.

And this won't come as a surprise to the Bank. We would be perplexed if the Reserve Bank didn't lower its short term GDP expectations. After the high frequency indicators are, largely, awful and the RBNZ's Kiwi GDP forecast currently sits at just 0.1%.

There have been a multitude of weak partials:

- Electronic card transactions are basically unchanged for two years
- Net migration inflows have been revised lower
- Employment is in decline
- Employment confidence is still at COVID levels
- Government retrenchment continues
- The PMI has fallen aggressively
- The PSI remains below the 50 breakeven level
- House prices are flatlining
- QSBO pricing intentions are very weak.

***RBNZ has created confusion***

As if all this isn't difficult enough to make sense of it doesn't help that the RBNZ created significant confusion at the time of its May Monetary Policy Statement that has left all and sundry a tad bamboozled as to what the Bank's thinking was in the first place. In and of itself the May Statement was clear and internally consistent.

It could best be summed up as "conditional on the economy evolving as expected the central bank would not only cut rates at the May meeting but also lower rates a further 25 basis points in the September quarter while leaving the door open to one last nudge lower before the end of the year".

What was less consistent and more difficult to understand was how the committee could simultaneously reach a consensus that the published rate track was an accurate reflection of their thoughts while stating there was no bias with regard to any future move.

There simply can't be no bias unless there is the same chance of a future rate hike as there is a rate cut. There is no way this assertion could be made.

And clearly, there must be a bias if the committee agreed to the representation of the future rate track.

We'll give the Bank the benefit of the doubt that what it meant to say was something like: "The interest rate track is our central view but given the current volatile environment there will necessarily be a much greater degree of uncertainty about future interest rate decisions".

Unfortunately, as the upcoming July review is not accompanied by updated forecasts and offers only a few paragraphs of explanation for the decision it is going to be difficult for the Bank to provide clarity as to where to next.

**So what will they do?**

To reiterate: we now believe the RBNZ will hold fire at its July meeting. But weakness in medium term inflation should still result in further rate cuts provided the RBNZ does not wait for inflation to settle near the 2% mid point of its target band.

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