Research

Interest Rate Research

1 July 2025

Outlook for Borrowers: July update

- **We have updated our OCR forecast track and now expect the RBNZ to pause at the July Policy Review.**
- **We still expect the OCR will reach a 2.75% terminal rate but have pushed back the timing till October.**
- **Activity appears to have slowed sharply in the June quarter and there is significant spare capacity in the economy.**
- **Headline CPI is likely to increase towards the top end of the RBNZ's target band in Q3, but medium-term inflation pressures are contained.**
- **NZ wholesale fixed rates have been rangebound in recent months. Borrowers should target dips towards the bottom end of the range to top up hedging.**
- **The bulk of the decline in NZ wholesale fixed rates has likely already occurred with the RBNZ easing cycle now increasingly mature.**

RBNZ Monetary Policy Outlook

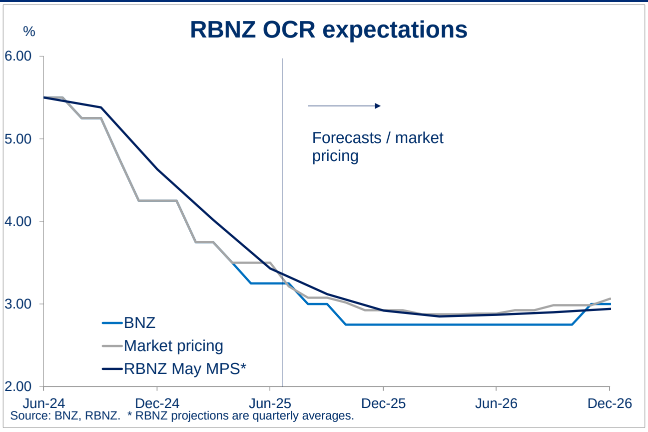
The outlook for NZ interest rates is being driven by a complex interplay between mixed domestic economic data, and heightened policy uncertainty amid trade tensions and geopolitical risks. The level of uncertainty was highlighted by the Reserve Bank of New Zealand (RBNZ) at the May Monetary Policy Statement (MPS), when the Official Cash Rate (OCR) was reduced by 25bp to 3.25%.

Developments for the economy have been mixed since the May MPS. March quarter GDP was stronger than the RBNZ had forecast. However, higher frequency indicators of economic activity have been subdued. Both the manufacturing and services PMIs had significant declines in May. The GDP-weighted composite fell to 44.3, the lowest level in the past year, and well into contractionary territory. The weakness contrasts with a still strong primary sector.

Partial inflation indicators, which cover around half of the CPI basket, were firmer than expected in May. We have increased our inflation forecast and expect headline CPI to increase 0.8% in the June quarter, which is above the RBNZ's 0.5% projection. Our revised profile peaks at a 3.1% annual rate for headline CPI in September, above the RBNZ's 2.7% projection.

The labour market remains soft and is likely to weigh on domestically driven price pressures. The move higher in headline CPI is expected to be transitory and inflation is forecast to return towards the 2.0% target over the medium term. The RBNZ will be alert as CPI temporarily moves up towards the top of the target band. The Bank will want to see inflation expectations and pricing intentions remain consistent with its target.

Expected OCR path



Source: BNZ, RBNZ. * RBNZ projections are quarterly averages.

We have updated our OCR forecast after the Quarterly Survey of Business Opinion on Tuesday. While the report pointed towards weak inflationary pressures, we don't believe it was sufficient for the RBNZ to cut the OCR in July, given the tone of the May statement. Furthermore, back in May the Bank noted market pricing, which indicates only a 15% chance of a 25bp cut at the meeting, as an input for its upcoming July decision.

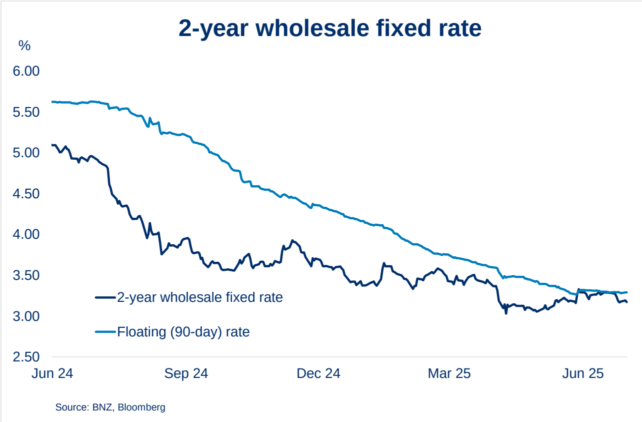
Terminal OCR pricing rebounded from the April low

Source: BNZ, Bloomberg

We still expect the OCR to reach a 2.75% low but have pushed back the trough to October. Market pricing implies a terminal OCR (low point in the easing cycle) near 2.85%. Q2 CPI (21 July) and labour market data (6 August) will be key data points ahead of the August MPS. The global macro backdrop will also be impactful. There should be greater clarity on US trade policy and the extent it will impact growth and inflation dynamics.

Short-Dated Wholesale Fixed Rates (1-3 yr)

Modest lower bias for front end rates



Front end NZ rates moved higher in the aftermath of the May MPS, after the RBNZ didn't commit to an easing bias, despite reducing its modelled OCR track. After peaking near 3.35%, 2-year fixed rates have since retraced towards the midpoint of the three-month trading range. Our OCR projections suggest modest downside risk for front end rates, but from a broader perspective, the easing cycle is likely entering its final stages.

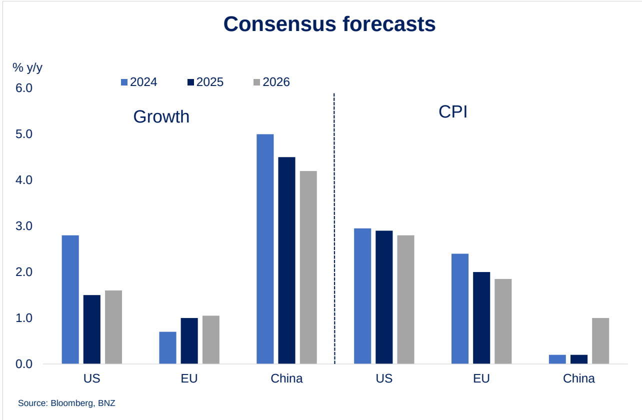
2-year rates down towards the recent lows near 3.0% would represent a good opportunity to top up hedging.

Long-Dated Wholesale Fixed Rates (5-10 yr)

5-year NZD fixed rates rangebound

5-year NZ fixed rates have largely been trading sideways since the downtrend stalled in September last year. Rates threatened to break lower in April but have since reverted to the midpoint of the range. The RBNZ easing cycle has been more impactful for shorter maturities, steepening the yield curve. This is typical - the sensitivity of longer rates to the front-end declines as the cycle matures. Shorter tenor rates are anchored by RBNZ policy while longer dated NZ rates are impacted by monetary policy as well as global macroeconomic trends.

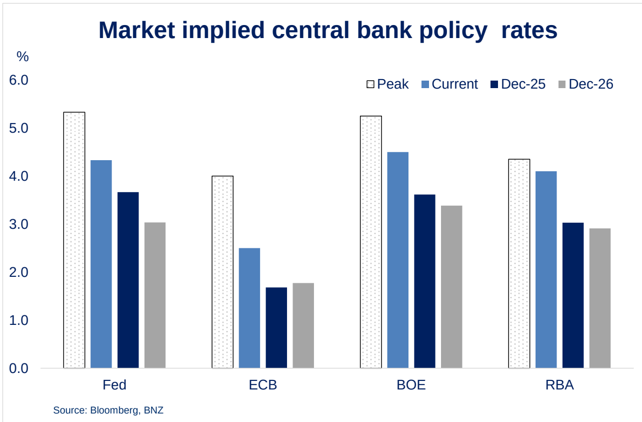
Sluggish growth, US disinflation stalled



Consensus economic growth forecasts are subdued for the major economic regions and have been revised lower since 'liberation day'. The US economy is expected to grow by 1.4% in 2025, the euro area by 1.0%, and China by 4.5%. China's growth is reliant on policy stimulus and external demand, rather than domestic driven activity. Global growth is forecast to be notably slower than the period preceding the pandemic volatility.

Although US CPI inflation has continued to moderate on an annual basis, higher tariffs are expected exert upward pressure in coming months, before the disinflationary trend resumes. CPI is forecast to stabilise just above 2% at the beginning of 2027. In the euro area, inflation is expected to remain near the 2% target in the second half of the year.

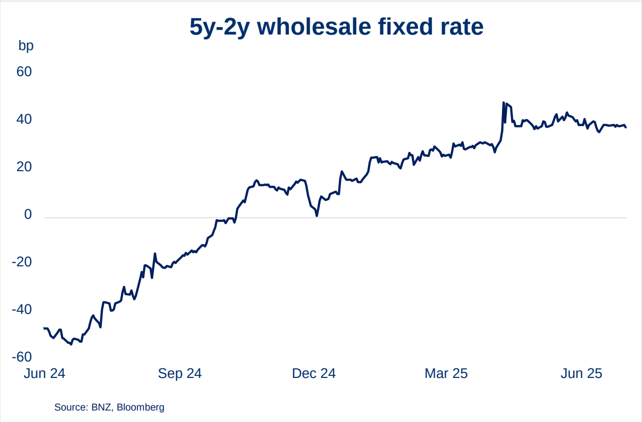
Global central banks maintain easing bias



The synchronised easing cycle amongst global central banks is relatively advanced in some countries, but the broad trend towards lower policy rates remains in place. The US Federal Reserve left rates on hold for the fourth consecutive meeting in June. Fed Policy makers have reduced their estimates for growth, lifted inflation projections and are waiting for greater clarity on how the administration's policies will affect inflation and the economy.

US front-end yields remain high relative to fundamental developments, and market pricing implies the Fed will ease policy by a cumulative 65bp in H2 2025. The easing bias from global central banks should limit the extent in which yields rise from here. However, concerns about fiscal deficits, and associated heavy government bond supply, are likely to keep curves structurally steep. Investors require a larger 'term premium' to invest in longer maturity fixed income.

Steeper NZ yield curve amid RBNZ easing cycle



We think NZ 5-year fixed rates are likely to remain range bound for now and borrowers should target levels below the midpoint of the well-established 3.40% to 3.90% range. A scenario where the RBNZ eases more than currently expected would likely be associated with a further steepening in the yield curve.

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