

Research Economy Watch

20 August 2025

RBNZ Doves Fly

- **Cash rate lowered by 25 basis points**
- **Another 25 in October looks almost certain**
- **RBNZ pencils in yet one more for November**
- **Faltering growth the key**
- **We lower our cash rate low to 2.5% accordingly**

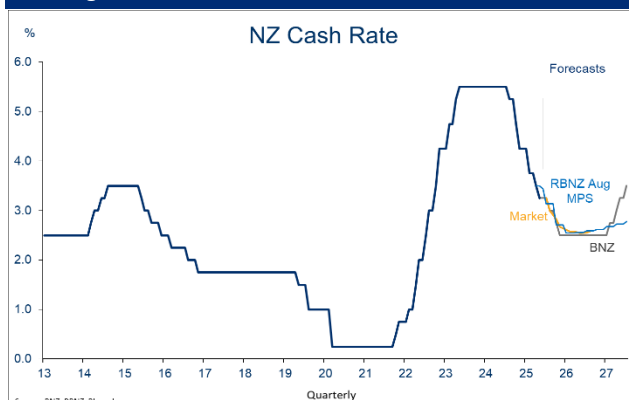
The RBNZ is back on the warpath. Not only did it cut its cash rate 25 basis points to 3.0% but, in today's Monetary Policy Statement, it gave a very strong indication there is even more to come. Accordingly, we are adding a further 25 point cut in November in addition to the cut we were already anticipating for October. This takes the low in the cash rate to 2.50%.

Most forecasters thought the cash rate needed to drop today and that the RBNZ would oblige. And we were strongly of the view that a further reduction to 2.75% would be signalled. What we didn't expect was the strength in conviction expressed by the Monetary Policy Committee. In particular, the fact that two of the six members voted for a 50 point cut came as a real surprise. This is only the second time the Committee has had two dissenters.

Additionally, the RBNZ's rate track shows a relatively strong expectation the cash rate will hit a low of 2.5% before the end of the year.

Given the strength of its convictions, and our previously published recognition that the risks to our rate track were downside, we see no reason not to follow suit in our expectations. We thus reduce our projected low to 2.5% (from 2.75%) taking us back to the forecast bottom we had back in September 2023.

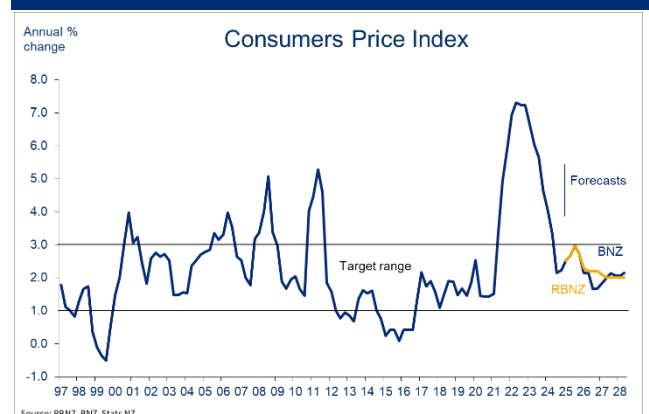
Heading to 2.5%



A glance at the RBNZ's forecasts for growth, inflation and the labour market suggests that relative to the Bank's central view, the balance of risk still lies to even lower, rather than higher, rates.

Really importantly, the RBNZ shares our view that annual CPI inflation will climb to 3.0%. It also admits "there is a material risk that it rises above the target". Inflation would thus have to rise well above 3.0%, and threaten to stay there, to spook the Bank particularly if it still believes, as do we, that the spike in inflation is transitory. Actually, we think there is a decent chance the RBNZ is overestimating inflation next year if domestic demand stays soft and commodity price inflation falls as we expect.

Inflation well behaved

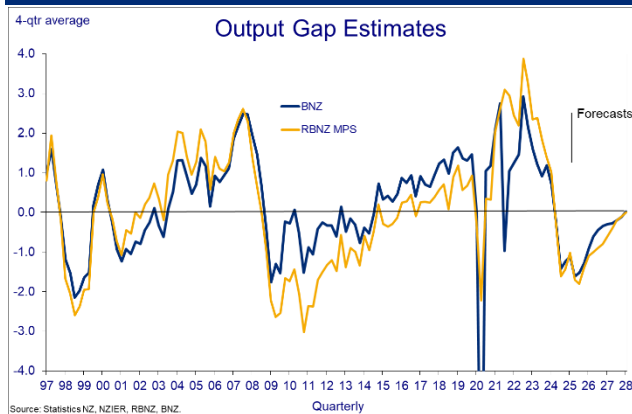


The Bank's view on the labour market and economic activity is broadly in line with our projections. Importantly, the Bank's activity expectations are weaker than they were at the time of the May MPS. Therefore the output gap is now wider and more persistent than it previously thought. This is undoubtedly a key driver of the Bank's decision to become more dovish.

The RBNZ has been seeing all the same data as have we and its commentary on business visits suggests the MPC was also hearing loud and clear the same level of angst. In our opinion, the volume of that feedback would have been highly influential on the Bank's decision.

It will come as no surprise to hear that a market which, yesterday, was reluctant to price two cuts in is now scurrying to price in three. Hence, yields have fallen across the curve albeit more so at the short end than the long. Surprisingly, a 25 point cut in October is still not fully priced. We think it should be.

A wide output gap



The NZD also responded as one might have expected dropping around 70 points against the USD. It will be worth keeping an eye on this. While the decline so far is not disconcerting it has helped the TWI fall to 67.6. As a point of reference, the RBNZ has assumed a TWI constant at 68.0 across the forecast horizon. Was it to trend lower then concerns about inflation could rise.

In the RBNZ's post-match press conference it was interesting to note that the RBNZ largely gave the green light to the market response.

In our opinion, the RBNZ did the "right" thing today. Yes, there are the first signs of green shoots in the economy but they need watering to sustain any growth there may be. The RBNZ has done this and thrown in a bit of fertilizer. How much more help is needed will be driven by the responsiveness of the economy to what has been announced so far.

While we are comfortable with our long-held view that more work is needed to be done, we can't stress enough that we are still very close to the bottom in the interest rate cycle. Once things take off, the economy's capacity to grow without creating inflation will be severely compromised so rate increases, when they eventually happen, may be a lot more aggressive than many now anticipate.

But that's all for another time. For now, one thing's for sure: Prime Minister Christopher Luxon will not be making any reference to a "too late Hawkesby!"

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