

Interest Rate Research

21 August 2025

Outlook for Borrowers: Post August MPS

- The RBNZ delivered a dovish 25bp rate cut, reducing the OCR to 3.0%. The decision was not unanimous - two Committee members preferred a 50bp reduction.
- The Bank maintained an easing bias and noted there is scope to lower the OCR further. The modelled OCR track was revised significantly lower.
- We have added a rate cut to our forecast rate track and expect the RBNZ to cut rates by 25bp in October and November, taking the OCR to a low of 2.50%.
- Market pricing for the terminal OCR has fallen towards 2.55%, aligning with the RBNZ's projections and our updated forecast.
- Wholesale 2- and 5-year fixed rates have declined to fresh multi-year lows. We think these are attractive levels to increase fixed rate exposure as the end of the easing cycle is largely discounted.

RBNZ Monetary Policy Statement

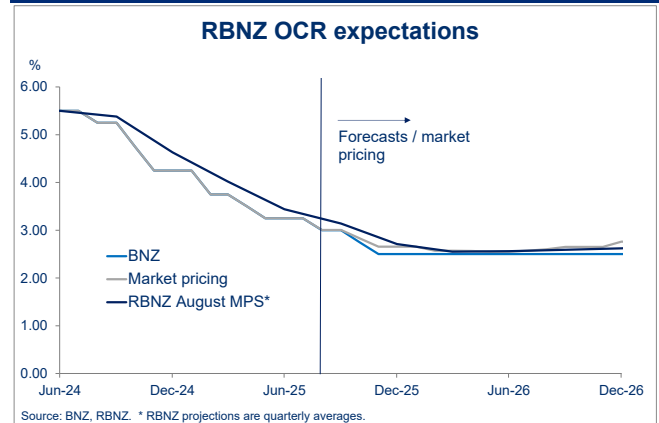
The Reserve Bank of New Zealand (RBNZ) reduced the Official Cash Rate (OCR) by 25bp to 3.0% at the Monetary Policy Statement (MPS) on Wednesday. The rate cut was expected by economists and was close to fully discounted by pricing in the overnight index swap (OIS) market. However, the decision was reached by a 4-2 majority. The dissenting Committee members preferred to reduce the OCR by a larger 50bp adjustment.

Along with the split decision, the accompanying statement and projections mark a dovish pivot after leaving rates on hold at the July Policy Review. The central bank outlined if medium-term inflation pressures continue to ease as expected, there is scope to lower the OCR further. The RBNZ's modelled OCR track was revised significantly lower. The projected terminal rate is 2.55% in Q1 2026, 30bp below the forecast trough from the May MPS.

The change in tone reflects ongoing subdued economic activity. Updated forecasts for the output gap are more negative, and will persist for longer, compared with May. The Bank expects headline inflation will converge with the midpoint of its 1-3% target band over the next year as tradables inflation moderates. The output gap is expected to weigh on domestically driven inflation.

The RBNZ has a clear easing bias. The modelled OCR track is broadly consistent with two 25bp rate cuts by the end of year, assuming the economy evolves in line with the Bank's forecasts.

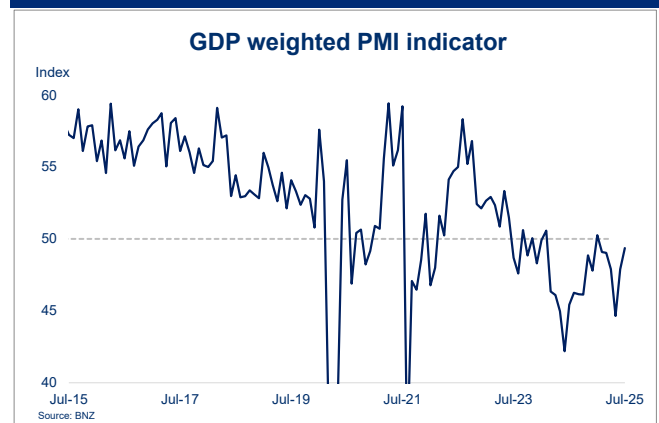
Expected OCR path



Economic overview

After the pickup in GDP growth around the turn of the year, the economy appears to have hit a flat patch in Q2. BNZ is forecasting a modest 0.2% contraction in the quarter, which aligns closely with the RBNZ's -0.3% Nowcast model, and the updated projections from the MPS. High frequency activity indicators have improved at the margin in July, but levels are weak, and risks for our growth forecasts are skewed to the downside.

Composite PMI signalling weak activity

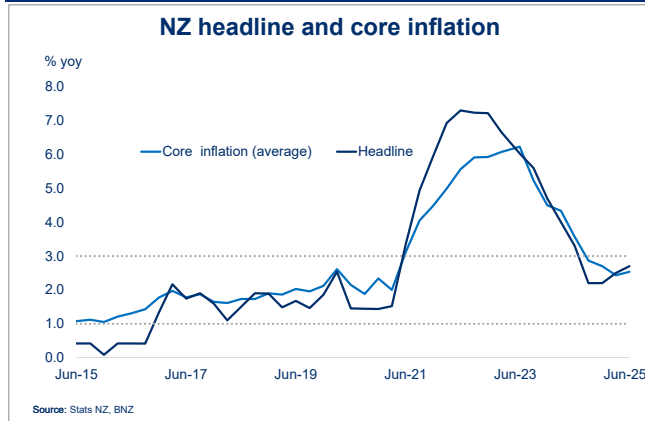


The economy is expected to make a gradual recovery through H2 2025 as lower interest rates support consumption and investment. The sectors that are reporting the weakest level of activity relative to a year ago are those that are typically most sensitive to interest rates. Consumer confidence will need to pick up

significantly to be consistent with trend-like private consumption, the largest GDP component.

The labour market, which lags the economic cycle, remains weak. Although the unemployment rate only edged higher to 5.2% in the June quarter, underlying details were soft. The participation rate declined and hours worked fell for a sixth successive quarter. The economy has shed twenty-seven thousand jobs over the past year, weighing on consumer confidence, at a time when the price of inelastic goods and services has been increasing rapidly.

Increase in headline CPI transitory, core measures benign



Headline CPI reached 2.7% in Q2 and we expect it will peak next quarter at 3.0%. However, the increase is likely to be transitory, and we forecast a return to the RBNZ's 2% target in 2026. The large negative output gap and relatively weak wage growth - the labour cost index increased 2.3% in Q2 - are likely to weigh on inflation pressures. Stalling commodity price growth will restrain food prices, after previous large increases, and underlying core measure of inflation are benign overall.

OCR forecast

Market pricing for terminal OCR declines towards 2.5%



We have updated our OCR forecasts in response to the dovish RBNZ statement and added an additional 25bp cut at the November MPS, resulting in a 2.50% base. The OIS market is pricing around 17bp of easing for the next meeting and a terminal Cash Rate near 2.55%. Monthly activity and employment data, inflation partials for August,

June quarter GDP and the Quarterly Survey of Business Opinion are the main economic releases ahead of the October Policy Review. Q3 CPI won't be available until after the meeting.

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

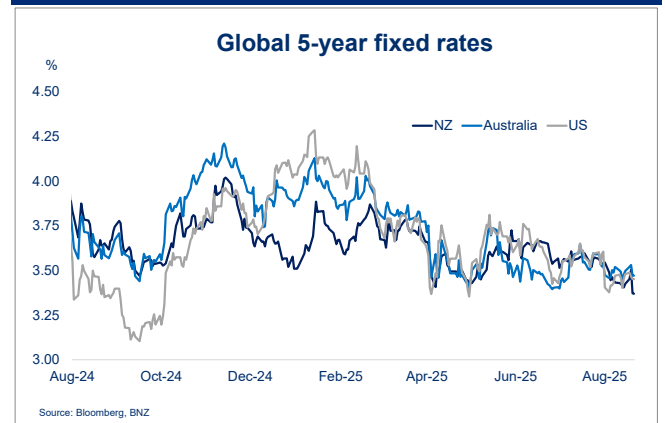
2-year rates at fresh cycle lows post-RBNZ



2-year NZ fixed rates have traded to fresh multi-year lows below 3.0% in the aftermath the RBNZ decision. There is room for the market to firm up pricing for 25bp cuts at the next two meetings which would be associated with further modest downside in 2-year rates towards 2.80%. But with a wider lens, the RBNZ easing cycle is likely reaching the final stages and is well discounted by market pricing. Risks for 2-year rates are increasingly balanced, and current levels are attractive to increase fixed rate exposure.

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

5-year fixed rates at the bottom of the range

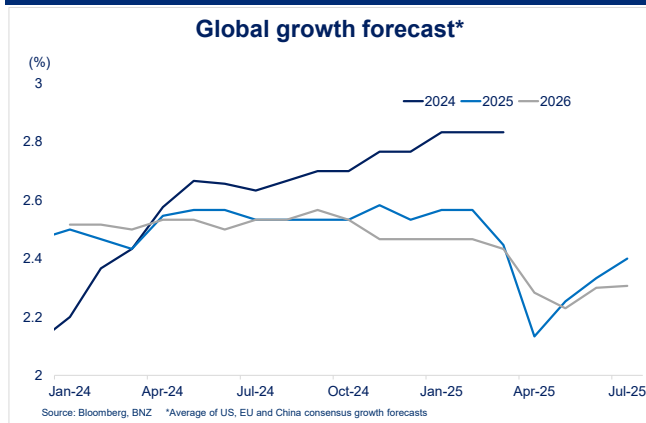


Longer dated NZ and international fixed rates are closely correlated, meaning global growth, inflation and central bank policy decisions are important for the outlook. Global rates declined, amid the extreme market volatility surrounding the tariff announcements in April and have largely remained range bound in the intervening period.

The weak labour US market report in July, which incorporated large downward revisions to payroll growth for previous months, has increased expectations the US Federal Reserve (Fed) will resume cutting rates in September. The prospect of two or more Fed rate cuts this

year has contributed to global 5-year fixed rates trading towards the bottom end of recent ranges.

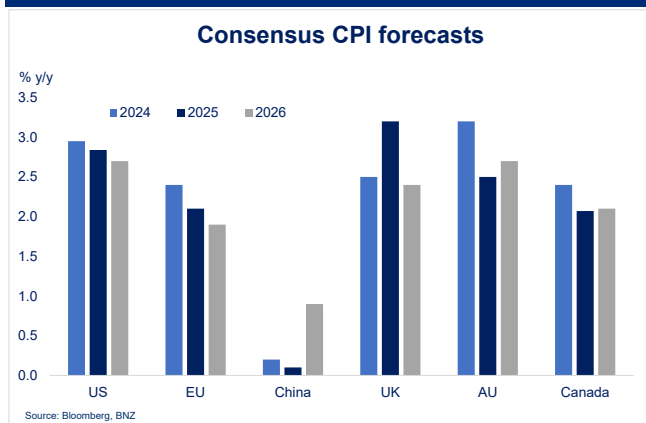
Global growth forecasts recover but are subdued overall



Growth in NZ's major trading partners has declined, relative to last year. Although consensus 2025 growth forecasts have partially recovered, as the chance of a large-scale trade war diminished, risks are skewed towards the downside. Higher tariffs, and broader economic policy uncertainty, are expected to weigh on economic activity. Consensus GDP forecasts for the US this year are 1.6%, a slowdown from the 2.8% expansion in 2024.

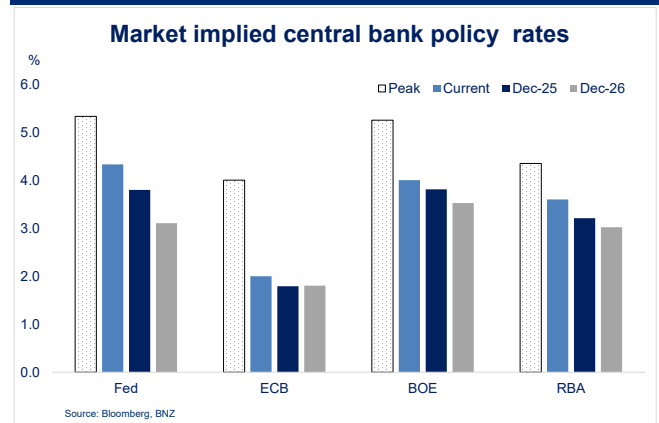
Headline and core CPI measures across advanced economies, except for the US, are gradually converging on central bank targets. The passthrough to US consumer prices from tariffs has been limited so far. However, this is expected to increase over the second half of 2025 and into 2026. Outside of the US, tariffs are expected to have a modest disinflationary impact given weaker global demand.

Inflation gradually converging on central bank targets



Market pricing implies a synchronised easing bias from global central banks. However, outside of the US where policy rates are elevated relative to the Federal Open Market Committee's (FOMC) longer term estimate for the Fed Funds Rate, the easing cycle for most central banks is becoming mature. Pricing suggests the European Central Bank easing cycle is close to complete with larger policy rate reductions anticipated in the UK (-50bp) and Australia (-60bp). The Fed is expected to resume easing at the September FOMC, and the market is pricing close to five 25bp cuts, by the end of next year.

Synchronised easing bias for global central banks



The asymmetric easing bias from central banks should limit the extent which fixed rates increase from current levels. Global yield curves have been steepening, which is typical in easing cycles. Longer fixed rates exhibit decreasing sensitivity to rate cuts as the easing cycle progresses. In addition, they incorporate a yield premium for heavy government bond supply, ongoing quantitative tightening as COVID-era policies are unwound and uncertainty about the outlook for key macro variables.

For these reasons, in conjunction with the extent of RBNZ easing already priced, we don't think there is much further downside for longer dated NZ fixed rates. Current levels near 3.35% represent a good opportunity to increased 5-year fixed exposure. If the market prices a lower terminal OCR rate, we expect the NZ yield curve to steepen further. A risk to our view is a more pronounced slowdown in global activity, requiring global central banks to set more stimulatory policy settings.

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