

Research Economy Watch

8 October 2025

RBNZ cuts OCR to 2.50%

- **RBNZ cuts 50**
- **Remains open to further reductions**
- **We build in another 25bp cut in November**
- **Taking the OCR to a low of 2.25%**

For more than a year we have been forecasting the Official Cash Rate (OCR) to go below 3% by the end of 2025. It now is, with the RBNZ cutting the OCR by 50bps to 2.50% today.

On the day, the cut was greater than the market consensus of a 25bp cut, although it was a split poll and market pricing was 50/50 heading into the meeting. We also had a 25bp pencilled in, albeit warning of the clear risk of a 50bp cut. A 50bp cut was not a major surprise.

The Monetary Policy Committee discussed both options of reducing the cash rate by 25bps or 50bp. It reached consensus on 50.

The Bank may not have been spooked the drop in Q2 GDP, but it did note 'economic activity through the middle of 2025 was weak'. Importantly, the Bank also thinks that economic activity recovered modestly in Q3.

The Committee put more weight on the spare capacity and associated downside risk to medium term activity and inflation. The Bank noted 'with spare capacity in the economy, inflation is expected to return to around the 2 percent target mid-point over the first half of 2026'.

We don't have any issue with the thinking that spare capacity will pull-down medium-term inflation. Indeed, it has been our view for quite some time and hence why we have forecast the OCR to head lower.

In contrast, the Bank put relatively less weight on the lagged pass through of previous interest rate cuts, signs of recovery, constrained supply, and cost pressures. The Bank did note some of the weak activity in the middle of 2025 reflected domestic constraints on the supply of goods and services in some industries. And the record of minutes noted 'some members highlighted that constrained supply and cost pressure on businesses present upside risks to inflation'. We thought such things and an easing that is coming through a lower NZD may have tempered the pace of taking the OCR lower.

Importantly, the Bank signalled the potential for the OCR to be reduced further. 'The Committee remains open to further reductions in the OCR as required for inflation to

settle sustainably near the 2 percent target mid-point in the medium term.'

The broad message we take from this is that if things pan out as it is thinking the Bank is likely to lower the OCR further.

We have long discussed downside risk to our forecast 2.50% low in the cash rate. Given the OCR cut today and the Bank's messaging we now formally build in another 25bp cut in November which would take the OCR to a low of 2.25%. We then see the OCR at that level through 2026, before nudging higher in early 2027.

There is a heap of data between now and the November meeting to assess how the economy is evolving and its implications for the outlook for the cash rate. This includes two lots of PMI and PSIs, two monthly selected prices, Q3 CPI, inflation expectations, monthly filled jobs, Q3 HLFS, and a host of other high frequency indicators.

The RBNZ continues to look through expected higher near-term inflation. The Bank reiterated its central forecast for annual inflation to hit 3.0% in Q3 while adding that with two-sided risk 'there is a material possibility that September quarter inflation was outside the target band.'

It is moot whether a pending change in Governor and the larger gap between the November and February meetings played a part in this decision. Likewise, the change in committee make up with external member Hayley Gourley at her first meeting today after Bob Buckle's term finished at the end of last month. A consensus decision suggests the latter wasn't a key driver.

If the activity data continues to print weak, it will keep downward pressure on rate expectations. However, we do wonder about how much of the slower activity is a function of slower supply side growth. Today's slow working age population growth numbers is part of that so too some of tightness indicators in yesterday's QSBO.

The Committee discussed this noting 'the risk that potential output growth could slow by more than currently expected. Growth in potential output is being constrained by subdued investment, low productivity, and low population growth through net immigration. This limits the rate of growth the economy can sustain without generating additional inflationary pressure. In an

environment of constrained supply, inflation could stay elevated for longer as demand recovers.'

Whether that is how things pan out or not is a topic for another day. For now, the Bank has cut 50 and looks like doing a bit more in November. After November, new

Governor Dr Breman will take the helm and lead the committee in assessing economic conditions and policy in the New Year.

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Full text of today's RBNZ OCR Review:

Annual consumers price index inflation is currently around the top of the Monetary Policy Committee's 1 to 3 percent target band. However, with spare capacity in the economy, inflation is expected to return to around the 2 percent target mid-point over the first half of 2026.

Economic activity through the middle of 2025 was weak. In part, this reflects domestic constraints on the supply of goods and services in some industries, and the impact of global economic policy uncertainty. Household consumption is recovering, partly because of lower interest rates, and elevated commodity prices continue to support the primary sector. House prices are flat, and residential and business investment remain weak.

Economic growth in New Zealand's trading partners is proving resilient, partly because of strong investment in AI-related activity, but is expected to slow in 2026.

There are upside and downside risks to the inflation outlook in New Zealand. Cautious behaviour by households and businesses could slow the economic recovery, reducing medium-term inflation pressure. Alternatively, higher near-term inflation could prove to be more persistent.

On balance, the Committee reached consensus to reduce the OCR by 50 basis points to 2.5 percent. The Committee remains open to further reductions in the OCR as required for inflation to settle sustainably near the 2 percent target mid-point in the medium term.

Summary record of meeting — October 2025

Annual consumers price index (CPI) inflation remains within the Monetary Policy Committee's 1 to 3 percent target band. While inflation is currently near the top of the band, spare capacity is consistent with headline inflation returning towards the target mid-point in the first half of 2026.

Annual CPI inflation is expected to converge to the target midpoint

The Committee considers all economic developments as they relate to its medium-term inflation target. Annual CPI inflation is expected to converge to the mid-point of the target range in the first half of next year as tradables inflation pressures dissipate and spare capacity continues to moderate domestically generated inflation.

The Committee noted that headline inflation is projected to have reached 3.0 percent in the September 2025 quarter, reflecting large increases in administered prices, food prices, and the prices of other tradable goods and services. Excluding the influence of administered prices, quarterly non-tradables inflation has continued to decline and is at levels consistent with price stability.

There is significant spare capacity in the domestic economy

The Committee discussed the contraction in GDP in the second quarter of 2025, which was considerably larger than expected. The Committee noted that an unusually large seasonal balancing item contributed to the weakness in the headline figure. This is expected to be reversed during the remainder of the year and is not assumed to have material implications for monetary policy.

Additionally, some industry-specific factors may have constrained supply. For example, high milk prices and unfavourable weather conditions likely contributed to higher livestock retention and lower meat production. Limited access to domestic energy sources and higher energy prices are likely to have weighed on manufacturing more generally. These factors reflect lower supply capacity, rather than weaker demand.

Consequently, the Committee has revised its assessment of current spare capacity only marginally in response to new GDP and activity data, but note that the new data imply some downside risk.

More timely indicators suggest that economic activity recovered modestly in the September quarter, but there remains significant spare capacity in the New Zealand economy.

Lower interest rates will support a recovery in growth

The Committee discussed the transmission of monetary policy. Wholesale interest rates have fallen since the August Statement, particularly at shorter terms. This has resulted in lower rates on business lending, mortgage lending, and term deposits, supporting new borrowing and investment. The average interest rate on existing mortgages is expected to continue to decline over the coming year as mortgage holders re-fix onto lower rates, reducing debt servicing costs for households.

The Committee discussed the outlook for interest-rate-sensitive parts of the economy. Slow growth in disposable incomes and house prices continue to weigh on economic activity, but lower interest rates are supporting a recovery in consumption. Construction activity is projected to recover from mid-2026 as demand for dwellings recovers and house price growth resumes. The Committee expects this to reduce spare capacity in the economy and support an increase in business investment, even as export prices moderate from elevated levels, and government spending declines as a share of the economy.

Trading partner growth has been resilient but is expected to slow

The Committee discussed the impact of trade restrictions and tariffs on the global economy. Aggregate global trade volumes and economic activity have so far proven resilient. Growth forecasts for 2025 have been revised higher for many of our trading partners, particularly for China, Taiwan, and some other Asian economies. This reflects increased investment in AI-related industries, adaptation of trade flows and global supply chains to new tariffs and trade restrictions, and accommodative fiscal and monetary policy in some economies. However, growth expectations for 2026 have recovered to a lesser extent, with trading-partner growth expected to slow.

Global inflation has continued to decline through 2025. Inflation is especially low throughout Asia, and negative in China. Headline inflation in the United States has increased, but evidence suggests that pass-through of tariffs to consumer prices has so far been weaker than expected. To date, there is little evidence of a material impact of tariffs on the prices of New Zealand's imports or exports. The Committee continues to expect that the total net effect of global tariffs on the New Zealand economy will be disinflationary.

Economic activity in New Zealand has been subdued relative to other economies, resulting in a lower exchange rate. This, together with high commodity export prices, is providing some support to the domestic economy in the very near term, particularly in rural and exporting regions of New Zealand. If sustained, a lower exchange rate may limit the pass-through of lower international prices for imported goods to New Zealand.

There are upside and downside risks to the global growth outlook

The Committee discussed whether recent global developments presented upside or downside risk to inflationary pressure in New Zealand. On the upside, global economic activity has been stronger than anticipated and measures of uncertainty have fallen. In the near term, resilient global demand and a low New Zealand dollar exchange rate may provide more support than expected for New Zealand exports and growth, as well as higher inflation.

On the downside, there is uncertainty about how long elevated equity prices and increased investment activity in the AI technology sector will be sustained. In addition, political and institutional uncertainty in some economies and heightened geopolitical risk may contribute to higher term premia and increased volatility in bond markets. Furthermore, resilient global growth in 2025 may represent a difference in the timing, rather than the extent, of the negative impacts of trade restrictions on growth.

There are upside and downside risks to domestic inflationary pressure

The Committee discussed upside risks to domestic inflation. Businesses continue to face cost pressures from administered prices, such as local council rates, and some energy charges. The Committee's central expectation is that inflation reached 3.0 percent in the September quarter. Given the two-sided uncertainty around any forecast, there is a material possibility that September quarter inflation was outside the target band. If inflation was to remain higher for longer than expected, there is a risk that this influences inflation expectations and wage- and price-setting behaviour over the medium term.

The Committee discussed the risk that potential output growth could slow by more than currently expected. Growth in potential output is being constrained by subdued investment, low productivity, and low population growth through net

immigration. This limits the rate of growth the economy can sustain without generating additional inflationary pressure. In an environment of constrained supply, inflation could stay elevated for longer as demand recovers.

The Committee discussed downside risks to domestic demand and inflation. There remains a risk that excess precaution from households and businesses dampens consumption and investment by more than currently assumed. There is also a risk that declines in short-term interest rates may not provide sufficient support for growth. Borrowing and investment decisions are influenced by interest rates across the entire yield curve, and interest rates at the 5-year tenor have not fallen as far as rates at shorter maturities.

The Committee agreed to reduce the OCR by 50 basis points to 2.5 percent

In light of recent economic developments and the balance of risk, the Committee discussed the options of reducing the OCR by 25 basis points or by 50 basis points at this meeting.

The case for reducing the OCR by 25 basis points emphasised that past reductions in the OCR continue to transmit through the economy and there are signs of recovery in consumption and employment growth. Some members highlighted that constrained supply and cost pressures on businesses present upside risks to inflation. Financial conditions are influenced by the current level and expected future path of the OCR. Reducing the OCR by 25 basis points at this meeting, and signalling that further easing is likely in November, could be sufficient to deliver a sustained economic recovery while giving the Committee confidence that inflation will converge quickly to the 2 percent target mid-point.

The case for reducing the OCR by 50 basis points emphasised prolonged spare capacity and the associated downside risk to medium-term activity and inflation. Domestic inflationary pressures have continued to moderate as projected, giving the Committee more confidence that inflationary pressures are contained. Some members continue to put relatively more weight on the risk that excess precaution by households and businesses and, therefore, subdued economic activity and employment persists. A larger reduction in the OCR could mitigate this risk by providing a clear signal that supports consumption and investment.

On balance, on Wednesday 8 October the Committee reached consensus to reduce the OCR by 50 basis points to 2.5 percent. The Committee remains open to further reductions in the OCR as required for inflation to settle sustainably near the 2 percent target mid-point in the medium term.

Attendees:

MPC Members: Christian Hawkesby (Chair), Carl Hansen, Hayley Gourley, Karen Silk, Paul Conway, Prasanna Gai

Treasury Observer: James Beard

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