

Interest Rate Research

28 May 2026

Outlook for Borrowers: Post May MPS

- The RBNZ left the OCR unchanged at 2.25% in a finely balanced decision, with three committee members voting for a 25bp hike.
- Although the committee differed on timing, there was clear consensus on the need for higher rates to prevent an increase in medium-term inflation.
- The RBNZ’s modelled OCR track points to a more front-loaded tightening cycle.
- We have brought forward our first 25bp hike to July, while leaving the projected peak in the OCR at 4.0%.
- A much higher OCR trajectory is already well discounted by the market.
- While the bulk of the repricing is behind us, somewhat higher NZ fixed rates are likely in coming months.
- Borrowers should use dips towards the bottom of the post-conflict range to add to 2- and 5-year hedging.

RBNZ Monetary Policy Statement

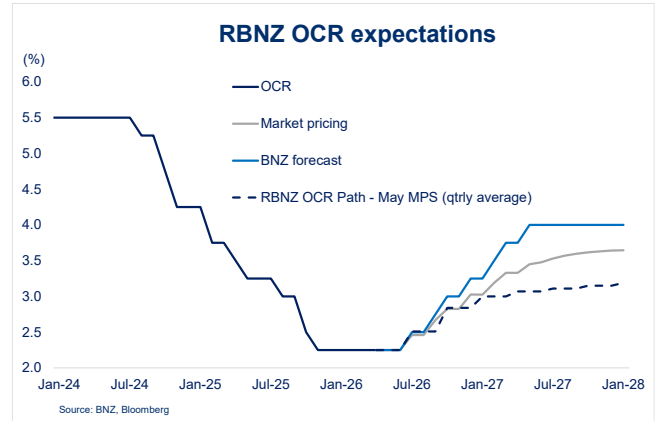
The Reserve Bank of New Zealand (RBNZ) left the Official Cash Rate (OCR) unchanged at 2.25% at Wednesday’s Monetary Policy Statement (MPS). While this outcome was widely expected by economists and broadly reflected in market pricing, the decision was finely balanced. The three external members of the six-member committee voted for a 25bp hike, with Governor Breman casting the deciding vote. The Bank also noted that “the OCR will most likely need to increase sooner and by more than envisaged in the February Monetary Policy Statement.”

Although the committee differed on timing, there was a clear consensus on the need for higher rates to prevent increased near-term costs from feeding into medium-term inflation. The RBNZ’s updated modelled OCR track implies a high probability of hikes in both July and September, bringing forward the tightening cycle relative to the February MPS. It also suggested that most of the tightening will be delivered this year, though the endpoint lifted to 3.28% from 3.00% previously.

Although the split vote was more hawkish than expected, the updated OCR track broadly aligns with market pricing for this year. We have brought forward our forecast for the first hike to July, from September previously, and expect a steady sequence of 25bp increases at each meeting, taking the OCR to a peak of 4.0% by mid-next year. The overnight index swap market is pricing around 20bp of tightening for

July and around 75bp cumulatively by December, broadly consistent with the RBNZ’s modelled OCR track.

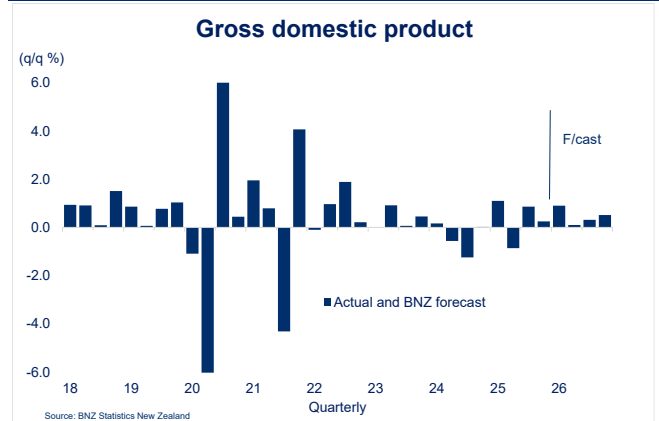
A July start to the hiking cycle appears likely



Economic overview

The economy faces headwinds from geopolitical tensions in the Middle East, and high-frequency indicators continue to point to weak activity. We have downgraded our calendar-year GDP forecast to 1.7% y/y from 2.3% pre-conflict. The GDP-weighted PMI rebounded in April but remained subdued at 48.6, consistent with soft growth through the middle of the year. The services PMI employment subindex has now been below 50 for 29 consecutive months, reinforcing the weak hiring intentions signalled by the Quarterly Survey of Business Opinion (QSBO) and pointing to further softening in the labour market.

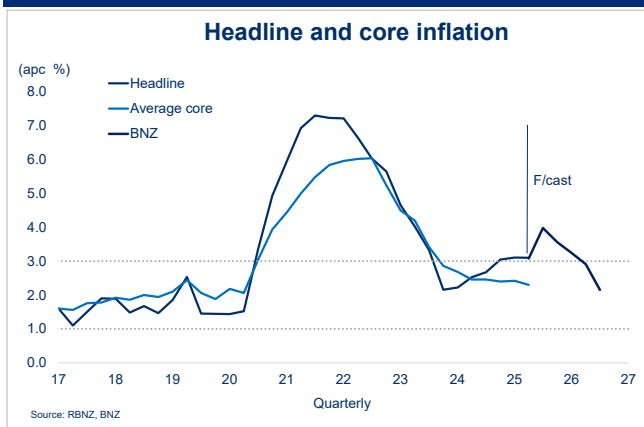
Subdued growth forecast through the middle of the year



Consumer confidence has fallen towards pandemic-era lows. Elevated inflation, particularly for essential items within the CPI basket, is weighing on sentiment. The prolonged stagnation in residential property prices has limited gains in household wealth and dampened consumption alongside a tightening in financial conditions. A weaker labour market is adding to the pressure. We now expect the unemployment rate to peak at 5.7% by year-end, up from 5.3% in Q1, which is likely to further restrain wage growth.

Headline inflation, which has sat at the top of the RBNZ’s 1–3% target band for several quarters, is likely to spike higher in Q2 due to the energy shock. We expect quarterly CPI to rise 1.4%, lifting annual inflation to 4.0% y/y. Although Q2 is likely to mark the peak, headline inflation is expected to remain above 3.0% for the rest of the year. Measures of core inflation eased to 2.3% in Q1 though are likely to rise, while medium- and longer-term inflation expectations in the RBNZ’s Survey of Expectations remained near to the midpoint of the target band.

Headline CPI consistently near top of target band



The RBNZ’s updated economic projections in the MPS provide the baseline against which incoming data will be assessed ahead of the 8 July Monetary Policy Review (MPR). Q1 GDP is due in mid-June, although monthly PMIs will provide more timely signals on activity. The partial inflation release for May, covering around half the CPI basket, will also be closely watched. Key releases such as the next QSBO and Q2 CPI will not be available until after the July MPR.

Short-Dated Wholesale Fixed Rates (1–3 years)

Two-year wholesale fixed rates have retraced from the cycle high near 3.70% reached earlier in May. Softer domestic activity data, together with partial inflation readings pointing to a lower Q2 CPI peak, have contributed to the move lower. Lower oil prices since mid-May have also helped. Since the conflict began, 2-year rates have broadly traded in a 3.35% to 3.70% range. The RBNZ’s clear tightening bias should limit the extent to which short rates can fall from current levels.

While 2-year rates are likely to remain within this higher trading range, we do not expect an extended move to the topside. Much of the RBNZ tightening cycle is already priced, with the market discounting around 150bp of hikes by the end of next year and an OCR near 3.65%. That is above the RBNZ’s modelled path released alongside the MPS. In addition, balance sheet flows linked to hedging fixed-rate mortgages, which put upward pressure on front-end rates late last year, have moderated.

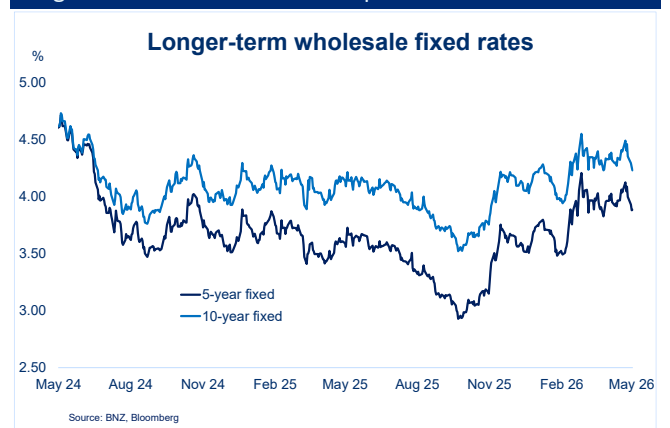
2-year trading range has moved higher



Borrowers should use dips to add to hedging. The bottom of the post-conflict range near 3.40% – around 10bp below current levels – would be an attractive target. While elevated day-to-day volatility may create tactical opportunities, a sustained decline in front-end rates appears unlikely. This would require the market to price a lower peak OCR alongside downgrades to the growth and inflation outlook.

Long-Dated Wholesale Fixed Rates (5–10 years)

Long end rates to remain above pre-conflict levels

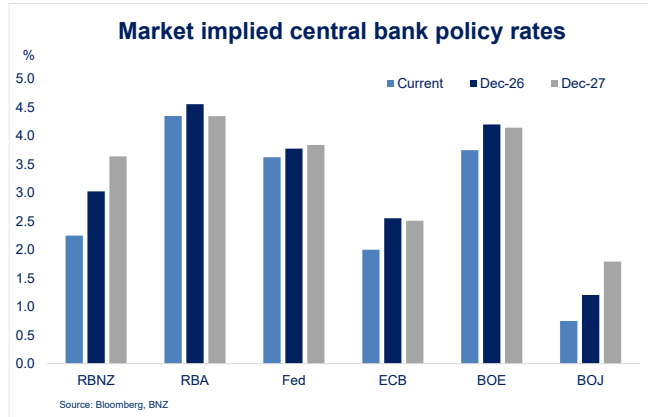


The rise in 5- and 10-year wholesale fixed rates since the conflict began has been less pronounced than at the short end, resulting in a flatter yield curve. We think 5-year rates have shifted into a higher 3.80% to 4.20% trading range, consistent with the move higher in early March. Dips towards the April low near 3.80% would present an

opportunity to top up hedging. While lower levels may be available at times, we retain a modest upward bias for longer-dated rates and expect 5-year rates to spend sustained periods above 4.0%.

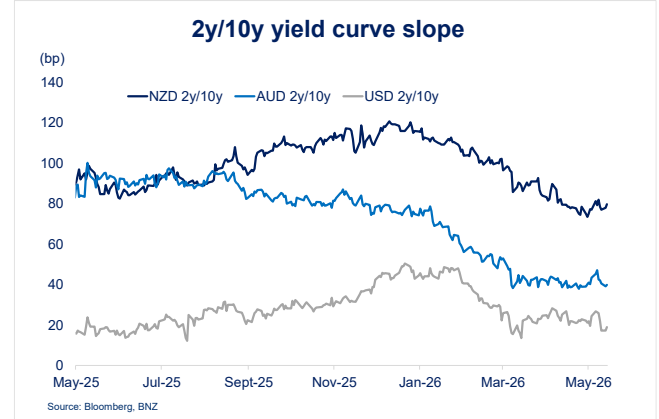
Market pricing indicates that major central banks, including the Fed, ECB and BoJ, are likely to either remain on hold or tighten policy in 2026, limiting the scope for a material decline in global yields, which influence longer-dated NZ rates. Although consensus global growth forecasts have been revised down since earlier in the year, the changes have not been large. By contrast, the rise in inflation forecasts has been more material and is expected to drive a synchronised mini-tightening cycle across major central banks.

Market pricing indicates a tightening bias for global CBs



The key global benchmark, the 10-year US Treasury, recently traded above 4.50%, its highest level since early 2025. Although yields have since retraced, we do not expect a return to pre-conflict levels anytime soon. Oil prices are likely to take time to fall sustainably below US\$80 per barrel, even if a peace deal further de-escalates geopolitical tensions. In addition, rising debt burdens and increased sovereign issuance are likely to keep upward pressure on term premia and longer-dated interest rates, as many governments face political constraints on fiscal consolidation.

NZ 2y/10y curve relatively steep



The NZ yield curve needs to incorporate a premium to remain attractive to non-resident investors, a key source of marginal demand for NZ government bonds. Issuance has been elevated since the pandemic, and there are upside risks to government borrowing given the weaker macro backdrop. We expect NZ Debt Management to favour a front-loaded issuance profile in the new fiscal year, keeping the curve relatively steep compared with other developed markets.

Our forecasts incorporate a lift in 5- and 10-year rates through 2026. However, much of the RBNZ tightening cycle is already priced, and term premia are elevated, which should limit any sustained rise from current levels. While not our core scenario, a material fall in long-end NZ rates would likely require a sharp slowdown in global growth and a repricing of central bank expectations. If the market were to price a lower OCR on domestic factors, we would expect the yield curve to steepen, with a more muted move for 5- to 10-year rates.

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