Research

Interest Rate Research

9 July 2026

Outlook for Borrowers: Post July MPR

- **The RBNZ increased the OCR by 25bp to 2.50% in a consensus decision, broadly in line with analyst expectations and almost fully priced by markets.**
- **The Bank retained a data-dependent tightening bias, signalling that further OCR increases are likely, although the timing remains uncertain.**
- **Market pricing for the RBNZ hiking cycle has largely converged with the Bank's modelled OCR track from the May MPS.**
- **We expect a sequence of 25bp hikes at upcoming meetings. The OCR peak remains uncertain, but we think it will be above current market pricing.**
- **The retracement in 2- and 5-year fixed rates over the past month has created an opportunity to top up hedging, with rates likely to move gradually higher through the year.**

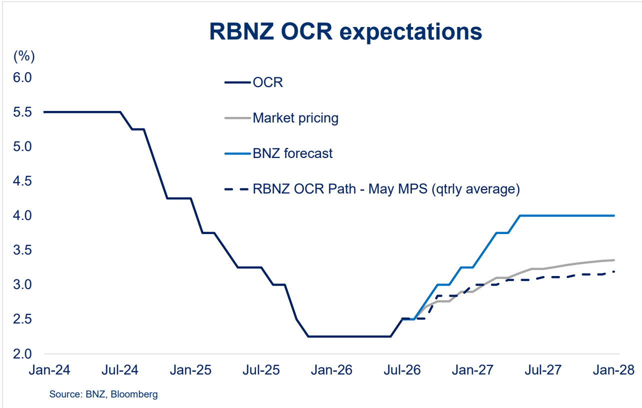
RBNZ Monetary Policy Review

The Reserve Bank of New Zealand (RBNZ) raised the Official Cash Rate (OCR) by 25bp to 2.50% at the July Monetary Policy Review (MPR), the first rate hike in three years. The Committee judged that it was time to begin reducing stimulatory settings to ensure inflation returns to target over the medium term. Unlike the split vote in May, the decision was reached by consensus. We expect this to be the first hike in a sequence of 25bp increases.

Most economists surveyed by Bloomberg had expected a hike, while market pricing implied around a 75% chance of a 25bp increase. The Bank retained a tightening bias, while emphasising that the policy path remains data dependent. It noted that "while further OCR increases appear likely at upcoming meetings, their timing is highly uncertain" and that future decisions will depend on how "price-setting behaviour and excess productive capacity affect medium-term inflation pressures."

Because the announcement was a Policy Review, the Bank did not publish a full set of updated forecasts. However, it did provide inflation projections for the June and September quarters which were well below the May Statement forecasts thanks to the recent decline in oil prices. The outlook for medium-term inflation pressures was described as uncertain and will depend on the extent to which recent cost increases feed through into prices and the offset provided by the spare capacity in the economy.

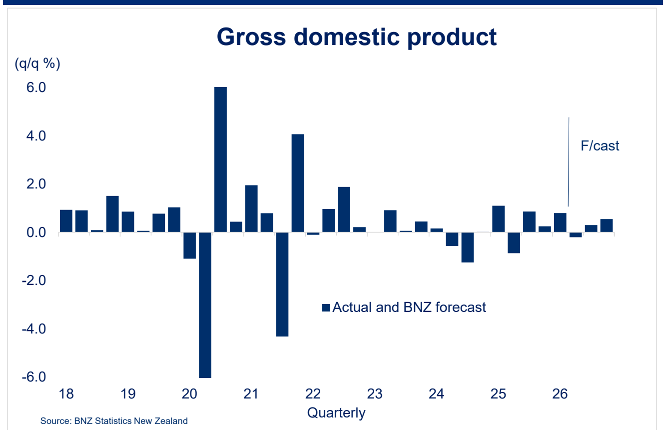
Hiking cycle underway



Economic overview

The economy entered the Middle East conflict with more momentum than previously thought, with Q1 GDP rising 0.8% and late-2025 growth revised higher. While this stronger starting point provides some reassurance, the near-term outlook is likely to soften as higher fuel costs, weaker confidence and pressure on real incomes weigh on activity. We forecast GDP to contract slightly in Q2 though the recovery in Q3 is looking increasingly assured as several indicators point to a pickup in growth momentum.

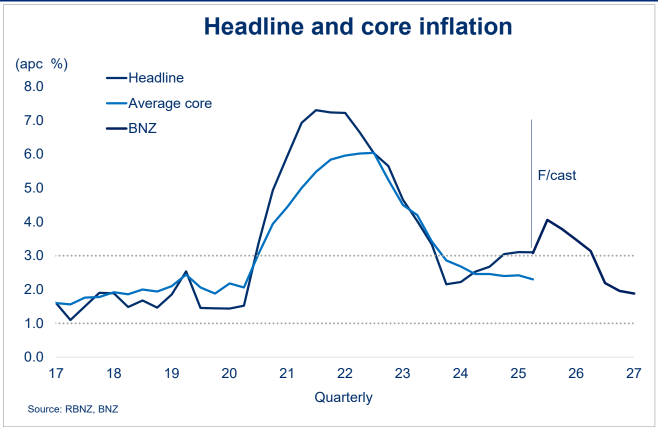
Slowdown through mid-2026 before late-year recovery



Headline inflation, which has sat at the top of the RBNZ's 1–3% target band for several quarters, is expected to spike higher in Q2 due to the energy shock. This should mark the peak, with annual CPI expected to decline through the remainder of the year as fuel prices ease, although we still expect inflation to remain above the top of the target band. The average of the core inflation measures monitored by the central bank were contained in Q1, easing to 2.3% y/y though is expected to rise in Q2.

The key issue for the RBNZ is less the near-term CPI peak than whether earlier cost increases, NZD weakness and price-setting behaviour feed into medium-term inflation pressures. Inflation expectations have remained well behaved, while wage inflation is expected to stay subdued due to the weak labour market. We forecast unemployment to rise from 5.3% to 5.7% by year-end, the highest level in more than a decade.

Headline inflation expected to peak in Q2 at 4.1%



OCR forecast

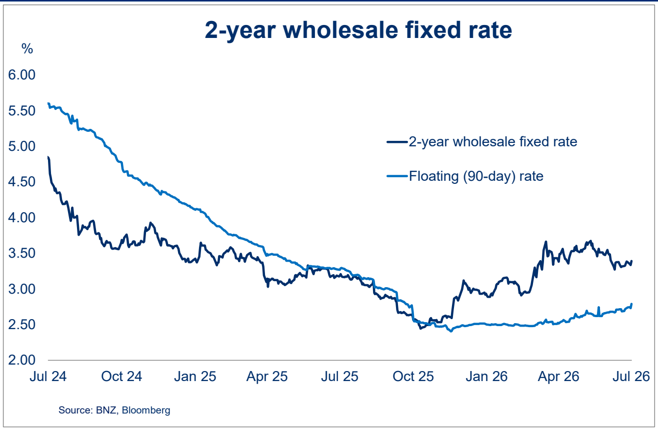
We expect the RBNZ to continue raising the OCR over coming meetings, although the pace will remain data dependent. Our forecasts assume a sequence of 25bp increases, taking the OCR to a peak of 4.0% by May next year. However, the extent of spare capacity means the risks around the terminal rate are skewed lower than our published track. Overnight index swap pricing implies around an 80% chance of a 25bp hike at the September Monetary Policy Statement (MPS) and a cumulative 43bp of tightening across the remaining three meetings this year.

Key domestic data ahead of the 2 September MPS include Q2 CPI on 21 July, labour market data on 5 August, and the RBNZ's inflation expectations survey on 13 August. The QSBO on 14 July will provide a read on activity, capacity pressures, pricing intentions and cost pass-through. High-frequency indicators, including PMIs and monthly inflation partials, will also help assess whether the shock is feeding into broader activity and price-setting behaviour.

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

Oil prices have been a key macro driver of front-end rates, closely tracking market pricing for the RBNZ policy path. Two-year rates traded above 3.70% in mid-May, alongside the peak in oil prices, before falling below 3.30% and stabilising ahead of the MPR. With oil prices having partially unwound the conflict-driven spike, their near one-for-one relationship with short-end rates should weaken, provided the increasingly fragile US-Iran ceasefire holds.

2-year rate likely to find a base near current levels

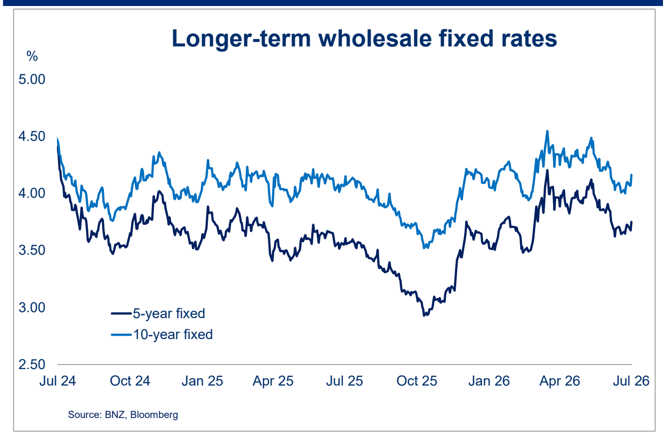


The retracement in front-end rates has coincided with reduced mortgage-related hedging from bank balance sheets. The average fixed maturity of the mortgage stock has moved back towards long-run norms, after being skewed to shorter tenors late last year, while the steeper mortgage curve has reduced households' incentive to extend into longer-term fixed rates. At the same time, the scale of the move has encouraged speculative positioning aimed at extending the recent decline in rates.

In our core OCR scenario, the cashflow-based fair value estimate for 2-year rates is around 3.75%, although this excludes several technical market factors. A more benign cycle, with the OCR peaking at 3.50%, would imply fair value closer to 3.45%, near current levels. While outcomes remain uncertain, we see value in topping up hedging on dips. The RBNZ is likely to at least return the OCR towards its 3.1% long-term estimate of neutral. The policy-horizon neutral rate may also be higher.

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

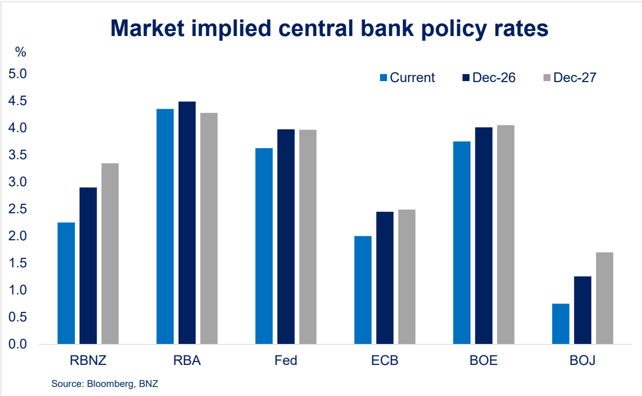
Long end rates back within pre-conflict ranges



Although RBNZ policy is an important driver of longer-dated NZ fixed rates, global growth, inflation and major central bank settings are also influential further along the yield curve. Since peaking near 4.10% in May, 5-year rates have broadly tracked the retracement in the front-end, and returned to the pre-conflict trading range. We think the recent decline creates an opportunity for borrowers to increase hedge levels.

Market pricing points to a tightening bias across major central banks, limiting the downside for global yields. The European Central Bank raised rates in June, while the US Federal Reserve, under new Chair Kevin Warsh, shifted in a more hawkish direction at the June FOMC. The split in the Fed's 2026 rate projections - with nine officials favouring hikes - highlighted growing discomfort within the Committee about the persistence of above-target inflation.

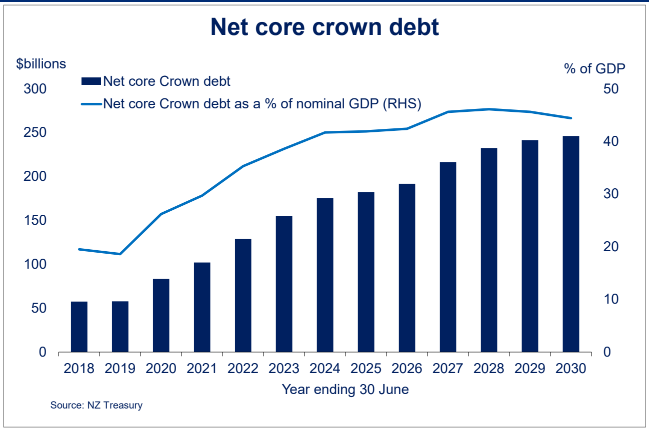
Market pricing indicates a tightening bias for global CBs



The 10-year US Treasury yield - a key reference point for fixed income markets - has largely traded within a 30bp range either side of 4.25% over the past 12 months, with limited directional bias since the sharp repricing through 2022 and 2023. Current levels are at the top of the range. Even if the Fed does hike - though we expect the funds rate to remain steady through 2026 - the 10-year yield is more likely to stay within its recent range, with the curve flattening rather than long-end yields moving materially higher.

The spread between NZ and US 10-year rates is tight from an historical perspective but less so when adjusted for the expected path of the OCR and Fed Funds rate. However, the RBNZ is expected to undertake a series of rate hikes, from a Cash Rate starting point some way below neutral. The Fed, by contrast, is likely to increase rates only modestly, if at all. This suggests NZ-US spreads are more likely to widen from current levels.

Non-residents are marginal buyer for increased issuance



Elevated government financing requirements should also limit downside for longer-dated NZ rates and keep the yield curve relatively steep. Non-resident investors are the key marginal buyers of NZ government bonds and are likely to require compensation to absorb ongoing issuance, particularly as rising debt burdens and higher sovereign bond supply across advanced economies underpin term premia.

Taken together, the balance of risk is that the retracement lower in longer-dated NZ rates is largely complete. Range bound global yields are unlikely to provide an offset to domestic tightening, while elevated NZGB issuance and the prospective need for non-resident demand should keep term premia supported. This leaves the long end underpinned and a gradual rebuild in NZ-US spreads as the RBNZ tightening cycle progresses.

The 5-year part of the curve remains a common hedge point for corporate borrowers. The 2s5s slope has compressed towards 35bp, suggesting much of the flattening has already occurred. The retracement in 5-year fixed rates creates an opportunity to top up cover. We retain a modest upward bias and expect 5-year rates to move into a higher trading range, spending sustained periods above 4.0%.

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