Review: RBNZ Monetary Policy Statement & OCR Call Change

19 February 2025

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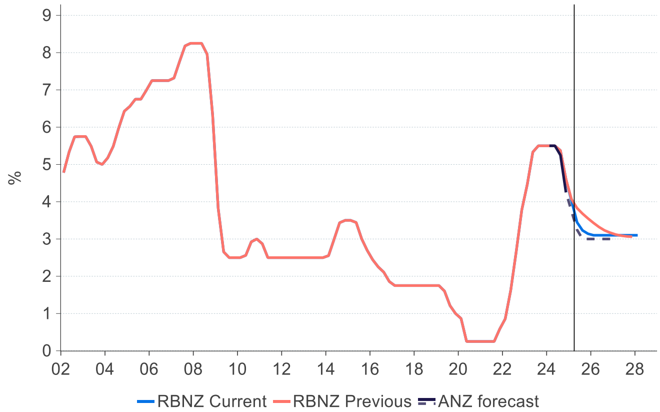
A 50bp cut delivered as signalled

- As universally expected, and as strongly signalled in November, the RBNZ cut the Official Cash Rate (OCR) by 50bp to 3.75% today.
- The tone of the accompanying forecasts and text was balanced, but also confident. The OCR track still bottoms out at 3.1% but falls more quickly than before. It's not full steam ahead, though: it's consistent with moving lower in smaller 25bp steps from here. The published OCR track was not very different from market pricing going into the decision, but a small fall in interest rates and NZD was nonetheless seen as the market breathed a sigh of relief that the RBNZ had not taken a leaf out of the RBA's hawkish book.
- Given the RBNZ's central estimate of the neutral OCR is 3%, a reasonable baseline forecast is that they will cut the OCR that far, given their clearly expressed confidence in the medium-term inflation outlook. We've updated our own OCR forecast accordingly, adding 25bp cuts in May and July (in addition to April), taking the OCR to 3%. We'll put out a brief 'scenarios' note tomorrow outlining risks on both sides around that forecast.

In brief

A 50bp cut today was universally expected, so the main interest was always going to be the hints about what comes next. The RBNZ's OCR forecast was lowered over the next year, as we expected, reflecting not least the decision today, but more generally a greater degree of confidence in the medium-term inflation outlook.

Figure 1. OCR forecast



Source: RBNZ, Macrobond, ANZ Research

Key quotes

- **OCR decision:** "On Wednesday 19 February the Committee reached a consensus to lower the Official Cash Rate by 50 basis points to 3.75 percent."
- **OCR outlook:** "If economic conditions continue to evolve as projected, the Committee has scope to lower the OCR further through 2025."
- **Domestic activity:** "Lower interest rates and higher export earnings are expected to support economic growth. The pace is expected to be modest, as potential GDP growth is constrained by ongoing weakness in productivity growth and lower net immigration."

- **Inflation outlook:** "Headline inflation is expected to increase in coming quarters but remain within the target band. This increase reflects a lower New Zealand dollar exchange rate and higher oil prices. The Committee expects these relative price shifts will not affect inflation over the medium term."

- **Inflation risks:** "The near-term increase in headline inflation is unlikely to significantly affect wage- and price-setting behaviour given excess capacity in the economy." "The Committee noted that the monetary policy remit directs it to discount disturbances in inflation that are expected to be temporary, in a manner consistent with meeting the medium-term inflation target."

- **Tail risks:** "Committee noted that geopolitical and climate-related risks pose uncertainty over the medium term. There may be higher relative price volatility and more unpredictability in headline inflation."

We have no beef with any of that. The RBNZ sounds very confident about the medium-term inflation outlook. The economy is clearly responding to lower interest rates, but is starting from a weak place, and how vigorous and sustained the recovery will be remains a matter of some conjecture. It makes sense for the RBNZ to remain open-minded on all those points now a lot of the legwork of getting the OCR lower is behind it.

RBNZ forecasts in brief

The RBNZ's updated outlook is similar to our own. Following on from the surprisingly weak Q3 GDP read (and negative revisions to Q2 growth) the RBNZ is expecting very similar GDP growth to us over the year ahead, pencilling in a 0.3% q/q expansion for Q4 (ANZ: 0.4%).

Its near-term CPI and labour market forecasts are also very similar. Like us, the RBNZ expects headline CPI inflation to accelerate to 2.7% in Q3 2025, before gradually easing towards the 2% target midpoint. And like us, this is driven by an acceleration in tradable inflation reflecting recent NZD weakness. The unemployment rate is expected to rise to 5.2% over the first half of 2025 (ANZ peak: 5.3%) before gradually falling towards 4.3% (a rate that we see consistent with stable inflation).

Altogether, the RBNZ's forecasts, including the output gap starting point and growth outlook, are little changed – it is a little messy to reconcile that with lowering the OCR track, but there is an element of tidying up the mismatch between November's published OCR track and the very strong signal at that press conference of a 50bp cut today.

See page 7 for charts comparing the RBNZ's latest forecasts against the November MPS and our own forecasts.

Risks

In line with its stated strategy, the RBNZ has taken the OCR a big step closer to its estimate of neutral (2.5-3.5%) and indicated it expects to continue cutting in smaller steps from here – while stressing the conditionality of that on the data flow.

The RBNZ outlined risks on both sides – the same risks that are on our radar, and some of which we will discuss in a scenarios document later this week:

- the pace of economic recovery as monetary restriction is withdrawn;

- risks to global growth and global asset markets from the impact of tighter global financial conditions; and

- increased barriers to trade and broader geoeconomic fragmentation, which the Committee noted are likely to reduce economic activity in New Zealand, though the inflation impacts are uncertain.

Our take and our updated OCR forecast

The RBNZ provided few surprises today. While the OCR was lowered from that published in November, it's consistent with the pace of cutting slowing to 25bp per meeting, in line with the RBNZ's stated strategy of cutting rapidly initially, but then slowing to a more cautious pace when approaching the neutral zone, at which point it naturally becomes less clear how much more is needed.

The RBNZ's estimate of neutral is 2.5% to 3.5%, and barring huge data surprises, further cuts seem very likely to eventuate. But how many and how fast? The market's estimate of that will continue to wax and wane with the data flow, undoubtedly. In our view the forecast that currently best balances the risks on both sides is a trough of 3%, reached via 25bp cuts in April, May and July. We'll put out an insight note this week outlining plausible scenarios on either side of that updated forecast, and what data to keep an eye on that will indicate which path we're on.

Financial markets

Short-end rates fell in the immediate aftermath of the RBNZ announcement, with the bellwether 2-year swap rate down 6bp to 3.48%. We think that was a logical response and would characterise it as a relief move. Indeed, while the RBNZ's new lower track only fell to match market pricing, there was plenty of nervousness in the market today that the RBNZ might follow the RBA's lead and take a more cautious stance, and today's track was sharply lower (38-45bp) over 2025. The NZD/USD and NZD/AUD exchange rates also fell initially (taking NZD/AUD to a new low for the year), but later bounced a touch.

Looking ahead, given our new OCR forecast calling for the RBNZ to keep cutting in sequential steps of 25bp until the OCR is at 3%, which is a faster pace of easing than implied by the RBNZ's track, we see scope for short-end rates to continue drifting lower over the coming weeks. With the Fed on hold and the RBA in a more cautious mood, differing policy biases speak to ongoing challenges for NZD/USD and NZD/AUD.

OCR 3.75% – OCR reduced further as inflation abates

Annual consumer price inflation remains near the midpoint of the Monetary Policy Committee's 1 to 3 percent target band. Firms' inflation expectations are at target and core inflation continues to fall towards the target midpoint. The economic outlook remains consistent with inflation remaining in the band over the medium term, giving the Committee confidence to continue lowering the OCR.

Economic activity in New Zealand remains subdued. With spare productive capacity, domestic inflation pressures continue to ease. Price and wage setting behaviours are adapting to a low-inflation environment. The price of imports has fallen, also contributing to lower headline inflation.

Economic growth is expected to recover during 2025. Lower interest rates will encourage spending, although elevated global economic uncertainty is expected to weigh on business investment decisions. Higher prices for some of our key commodities and a lower exchange rate will increase export revenues. Employment growth is expected to pick up in the second half of the year as the domestic economy recovers.

Global economic growth is expected to remain subdued in the near term. Geopolitics, including uncertainty about trade barriers, is likely to weaken global growth. Global economic activity is also likely to remain fragile over the medium term given increasing geoeconomic fragmentation.

Consumer price inflation in New Zealand is expected to be volatile in the near term, due to a lower exchange rate and higher petrol prices. The net effect of future changes in trade policy on inflation in New Zealand is currently unclear. Nevertheless, the Committee is well placed to maintain price stability over the medium term. Having consumer price inflation close to the middle of its target band puts the Committee in the best position to respond to future inflationary shocks.

The Monetary Policy Committee today agreed to lower the Official Cash Rate by 50 basis points to 3.75 percent. If economic conditions continue to evolve as projected, the Committee has scope to lower the OCR further through 2025.

Summary Record of Meeting – February 2025

Annual consumer price index (CPI) inflation is sustainably within the Monetary Policy Committee's 1 to 3 percent target range, and measures of core inflation are continuing to converge to the midpoint. Measures of firms' inflation expectations sit close to the target mid-point.

A period of restrictive interest rates has reduced demand in the New Zealand economy and contributed to lower inflation. Subdued global economic activity, falling net immigration, and lower government consumption have slowed domestic demand. Increased policy uncertainty associated with global trade developments is also expected to decrease business investment. Headline inflation is expected to increase in coming quarters but remain within the target band. This increase reflects a lower New Zealand dollar exchange rate and higher oil prices. The Committee expects these relative price shifts will not affect inflation over the medium term. Expectations of future inflation, the pricing intentions of firms, and the degree of spare productive capacity are consistent with the CPI inflation target being sustainably achieved. This provides the context and the confidence for the Committee to continue lowering the OCR, and at a faster pace than projected in November.

Global economic activity is expected to remain subdued

The Committee noted that GDP growth for many of our main trading partners remains below potential. In contrast, economic growth in the US has remained strong. Trading partner GDP growth is assumed to decline slightly over 2025. Global economic uncertainty has risen significantly since November, following recent trade policy announcements by the United States. In the near term, we expect that heightened economic uncertainty will constrain business investment amongst our trading partners and in New Zealand.

Global headline inflation has increased modestly, reflecting higher energy prices

The Committee discussed inflation amongst New Zealand's trading partners. Headline inflation has declined over the past year but has increased slightly in recent months. The recent increase in headline inflation in many of our trading partners is largely accounted for by higher fuel and energy prices. Market participants expect most central banks in advanced economies to continue reducing policy interest rates over the coming year. Market pricing implies that US policy rates are projected to fall by less than assumed at the time of the November Statement.

GDP growth in New Zealand is expected to rise, reducing spare capacity in the economy

The Committee discussed recent domestic economic developments. Domestic economic activity remains below trend. This reflects falling activity in interest rate sensitive sectors such as construction, manufacturing, retail trade, and business investment. In contrast, activity in the primary sector has increased. New Zealand's export prices have held up, despite subdued global growth. Global supply conditions in beef and dairy markets have supported export prices. This, coupled with a lower New Zealand dollar exchange rate, will increase export sector incomes in New Zealand.

Timely indicators of economic activity, including a range of business surveys, have improved in recent months. Lower interest rates and higher export earnings are expected to support economic growth. The pace is expected to be modest, as potential GDP growth is constrained by ongoing weakness in productivity growth and lower net immigration. Government spending is expected to decline as a share of the economy over the medium term, in line with the Half-Year Economic and Fiscal Update 2024.

GDP revisions better explain the evolution of core inflation over the past two years

GDP data was revised significantly since the November Statement. These revisions show that the level of New Zealand's economic activity in 2024 was higher than assumed in November. However, the revisions show the New Zealand economy experienced a larger contraction during the middle of 2024. Overall, there is significant spare capacity in the economy, and slightly more than we had assumed in November.

The new profile for GDP helps explain the evolution of core inflation and broader measures of capacity pressure over the past two years. The higher level of GDP over the start of 2024 aligns with the signal taken from high frequency data at the time. The subsequent decline in GDP over the middle of 2024 also aligns more closely with high frequency data, which was one of the factors that contributed to a downwards revision to the OCR outlook in August.

Employment remains subdued, but is expected to improve later this year

The Committee discussed conditions in the New Zealand labour market. Wage growth is slowing, consistent with lower demand for workers and lower CPI inflation. Employment levels and job vacancies have declined, reflecting subdued economic activity. As employment growth typically lags economic growth, it is expected to pick up in the second half of the year. Net immigration to New Zealand has reduced significantly from high rates over recent history. The number of migrant arrivals has slowed over the past year, and departures of New Zealanders have increased, partly in response to subdued labour market conditions relative to Australia.

Lower OCR continues to pass through to mortgage and term deposit rates

The Committee noted that wholesale interest rates in New Zealand have generally declined since the November Statement, in response to a lower OCR and weaker-than-expected economic activity. This decline in wholesale interest rates has been reflected in lower mortgage and term deposit rates. The average interest rate on outstanding mortgages has now peaked and is expected to decline over the next 12 months as borrowers refix their mortgage interest rates at lower levels.

The financial system remains stable

The Committee agreed that there is currently no material trade-off between meeting inflation objectives and maintaining financial system stability. Some households and businesses are continuing to experience financial stress. While non-performing loans remain low compared to past recessions, some financial stress will persist in the near term, even as the economy recovers. The banking system remains well capitalised and in a strong financial position to support customers.

Inflation is expected to remain within the target band

The Committee discussed domestic inflationary pressure. Headline CPI inflation and firms' inflation expectations at all horizons are close to the target mid-point. Measures of core inflation continue to converge on the target mid-point. Surveyed household inflation expectations remain more elevated and volatile.

Non-tradables inflation has fallen but remains high. With spare productive capacity remaining in the economy over the next 12 months, the Committee is confident that domestic inflationary pressures will continue to abate.

Headline inflation is expected to increase in coming quarters, reflecting a lower New Zealand dollar exchange rate and higher oil prices, but remain within the target band. However, underlying inflationary pressures are expected to continue to ease, and annual headline CPI inflation is forecast to remain near the 2 percent mid-point once the effect of recent increases in petrol prices on inflation wanes. The near-term increase in headline inflation is unlikely to significantly affect wage- and price-setting behaviour given excess capacity in the economy. The Committee noted that the monetary policy remit directs it to discount disturbances in inflation that are expected to be temporary, in a manner consistent with meeting the medium-term inflation target.

There are near-term risks to the economic outlook

The Committee discussed near-term risks to the outlook. The Committee noted that while lower interest rates are expected to underpin a recovery in the domestic economy, the speed and timing of the recovery is uncertain. In particular, recent revisions to June and September 2024 quarter GDP growth suggest momentum in the economy was considerably weaker than previously measured. The Committee noted that tighter international financial conditions presented downside risks to global growth, particularly for those countries with high debt levels or fixed exchange rate regimes. The Committee discussed global asset markets and the risk of a fall in equity prices if elevated earning projections are not realised, or if market participants reassess their appetite for risk.

There is a risk of increased trade barriers and broader geoeconomic fragmentation

The Committee discussed the risks posed by increased trade barriers. Over the medium term, these trade barriers could be increased much further. This is not currently incorporated into our central projection given uncertainty about the timing and magnitude of any potential changes. This uncertainty is heightened given trade protection is being used to pursue both economic and geopolitical goals.

Increased trade barriers will reduce global productive capacity. As a small open economy, New Zealand cannot avoid being affected by these international developments. Monetary policy cannot offset the long-term negative supply-side effects of higher barriers to international trade. More generally, global economic activity is likely to be more exposed to economic shocks given increasing geoeconomic fragmentation.

An increase in trade restrictions is likely to reduce economic activity in New Zealand. But the effects on inflation are uncertain, as these depend on how trade disruptions transmit through the global economy. Such shocks are likely to take time to materialise, giving the Committee flexibility to react as necessary. Any monetary response will depend on the impact of trade restrictions on medium-term inflationary pressures.

The global economy faces a range of structural challenges

The Committee discussed the long-term structural challenges faced by the economy in China and the broader region. In addition, the Committee noted that geopolitical and climate-related risks pose uncertainty over the medium term. There may be higher relative price volatility and more unpredictability in headline inflation. The Committee agreed that having consumer price inflation close to the middle of its target band puts it in the best position to respond to any shocks to inflation.

The Committee agreed to lower the OCR

With headline CPI inflation close to the midpoint, measures of core inflation converging on the midpoint, stable business inflation expectations, and significant spare capacity in the economy, the Committee agreed that a further reduction in the OCR was appropriate. The Committee agreed that a 50 basis point reduction would be consistent with their mandate of maintaining low and stable inflation, while seeking to avoid unnecessary instability in output, employment, interest rates and the exchange rate. If economic conditions continue to evolve as projected, the Committee has scope to lower the OCR further through 2025. On Wednesday 19 February the Committee reached a consensus to lower the Official Cash Rate by 50 basis points to 3.75 percent.

Attendees

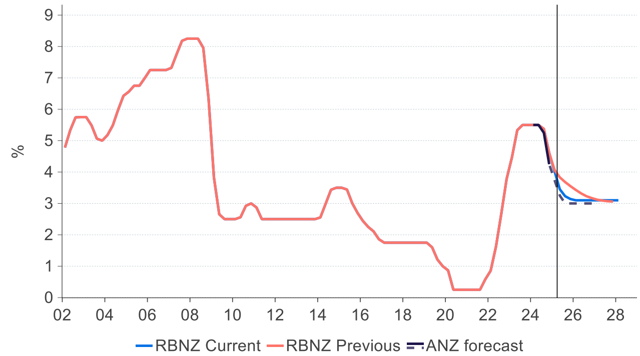
MPC Members: Adrian Orr (Chair), Bob Buckle, Carl Hansen, Christian Hawkesby, Karen Silk, Paul Conway, Prasanna Gai

Treasury Observer: James Beard

MPC Secretary: Adam Richardson

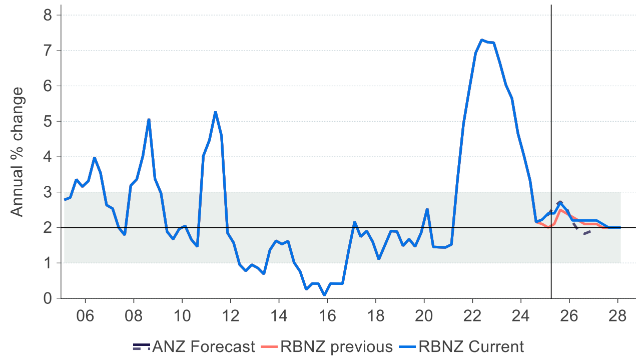
Key forecasts: Unders and overs but we're on the same page

The RBNZ's OCR projection incorporates recent 50bp cuts, a pivot to 25bp moves from April and the same end point



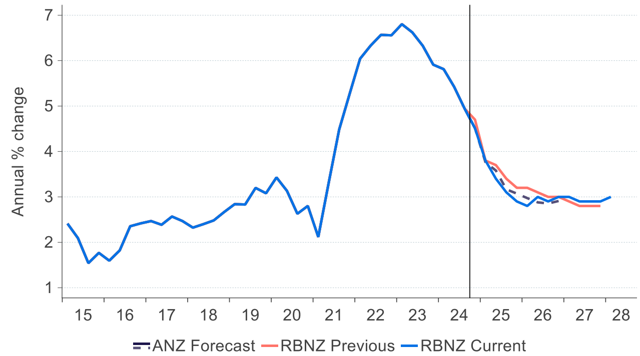
Source: RBNZ, Macrobond, ANZ Research

CPI inflation is a little higher in the near term…



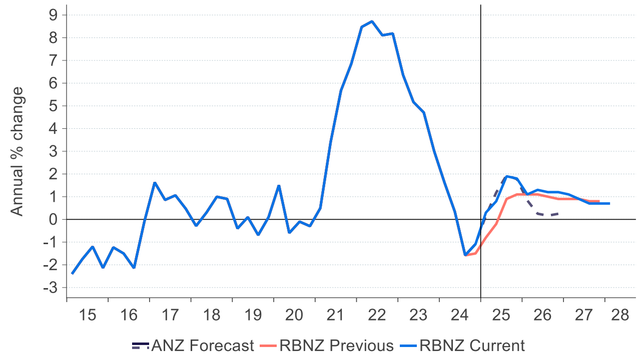
Source: RBNZ, Stats NZ, Macrobond, ANZ Research

…despite weaker near term non-tradable inflation



Source: RBNZ, Stats NZ, Macrobond, ANZ Research

Their tradable inflation forecast is very similar to ours in the near term, but stronger from 2026.



Source: RBNZ, Stats NZ, Macrobond, ANZ Research

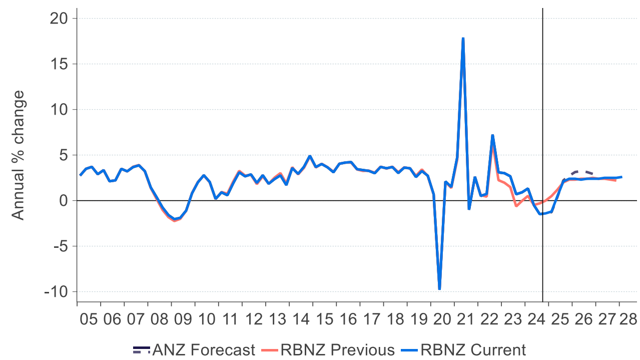
The unemployment rate outlook is little changed

Source: RBNZ, Stats NZ, Macrobond, ANZ Research

With LCI wage growth a little higher in the near term.

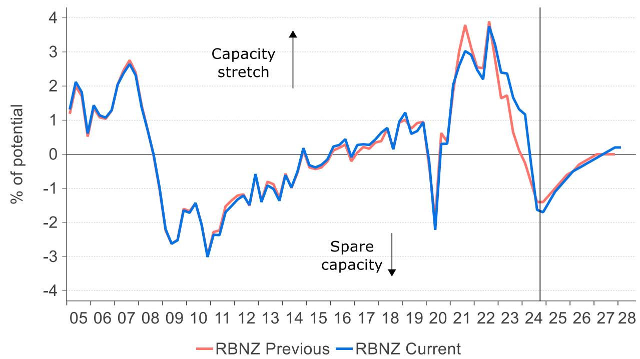
Source: RBNZ, Stats NZ, Macrobond, ANZ Research

GDP growth outlook is similar from 2026, but from a very different starting point…



Source: RBNZ, Stats NZ, Macrobond, ANZ Research

The RBNZ still see the output gap as "significantly negative"



Source: RBNZ, Macrobond, ANZ Research

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