



# ECONOMIC BULLETIN

Updated OCR forecast profile.

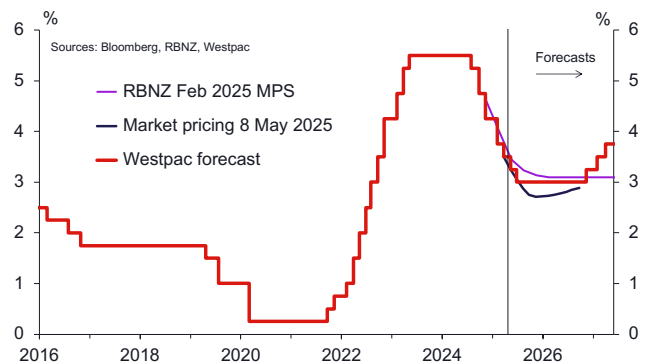


9 May 2025 | **Kelly Eckhold**, Chief Economist | +64 9 348 9382 | +64 21 786 758 | [kelly.eckhold@westpac.co.nz](mailto:kelly.eckhold@westpac.co.nz)

## Pencilling in an extra OCR cut to 3% while risks persist

- Past data look consistent with a gradually recovering economy as expected.
- In the near term, inflation looks set to remain in the top half of the 1-3% range.
- But downside risks from global growth suggest the RBNZ may continue easing beyond May.
- We have pencilled in an additional cut of the OCR to 3% in July as we doubt uncertainty will be resolved by then.
- We also have pushed back the timing of the forecast tightening cycle to end 2026 – after the next General Election.

Official Cash Rate forecasts



Next Tuesday we will be releasing updated economic forecasts in our May *Economic Overview*. These forecasts will update for the evolution of the economy since February as well as making a first cut at quantifying the downside risks to the domestic economy stemming from the potentially weaker and more uncertain global trade environment. It's entirely unclear what state the global economy will be in 3-6 months from now and what that could mean here in New Zealand. Some weakness in global trading partner growth looks inevitable but the extent of that weakness and the ultimate impact on New Zealand is totally up for grabs.

We have tried to balance between two scenarios: a baseline scenario of a continued economic recovery; and an alternative scenario of a decent sized global downturn that slows the domestic recovery. That latter scenario, if realised, would imply further cuts to the OCR into what would be quite stimulatory territory (remembering our view of the neutral OCR remains at 3.75%).

In practice, we don't think the RBNZ will be able to see its way through the fog of war by July or even August. Hence, it's likely they will continue to cut the OCR beyond the 3.25% trough in the OCR we previously forecast. We have pencilled in an additional 25bp cut to 3% in July (noting

that August is also a real possibility) to reflect that the RBNZ will likely continue to perceive downside risks for a while after May.

### **The baseline view – continued recovery.**

The New Zealand economy continued its slow-but-steady recovery up until the trade shock hit. Data in April generally confirmed the view that growth was continuing – albeit with some normal month-to-month volatility. Consumer confidence picked up, business confidence remained robust, the manufacturing and composite PMIs remained in expansionary territory, while activity in the housing market has continued to gradually rise. Economic indicators haven't all been positive, however. For instance, consumer spending took a step back in March. At the same time, labour market conditions have been more mixed – the March quarter saw a modest gain in employment and the unemployment rate remained unchanged at 5.1%, but wage growth continued to cool, and the number of hours worked declined.

This picture of gradually improving economic activity has been in line with our expectations from earlier this year. Given that inflation pressures show no signs of undershooting the RBNZ's 2% target mid-point, it's likely we would have been nearing the end of the easing cycle in the absence of current trade shock.

Interest rates have fallen a long way and are delivering significant stimulus that's just hitting the bloodstream right now. The RBNZ delivered the expected 25bp cut to 3.5% at its April meeting as had been signalled in the February Monetary Policy Statement. That brings the total amount of OCR cuts delivered this cycle to 200bps. With large numbers of borrowers due to re-fix their mortgages over the next few months, the associated cuts in mortgage costs will generate a significant increase in monthly disposable income for many households. In fact, for the average household with a mortgage, that fall in their minimum repayments would be equivalent to roughly 4% of their annual income. That compares favourably with other periods of monetary easing in the last 30 years. Indeed, it was only the large reduction seen in the wake of the Global Financial Crisis that has been larger.

Lower interest rates have come at a time when commodity markets are delivering the key NZ primary sector a boom in incomes that's helping underpin growth. **Spending in the regions** where the primary sector and tourism gains have a higher weight shows strength compared to the major urban areas.

### **The downside risks.**

But nevertheless, growth remains narrowly based and remains vulnerable to a setback. Concerns that such a setback could be upon us have arrived now, with threats

to the global outlook coming from record high levels of trade policy uncertainty amidst the wildly fluctuating trade policy and tariff outlook. The direct impact of New Zealand's 10% tariff is unwelcome but, in the end, manageable. It's the possible indirect effects that are of greater importance.

Markets will remain alert for the potential that the uncertain operating environment is impinging on the nascent recovery in consumption and investment. Businesses indicated some risks here in the ANZ's April business confidence survey where firms that responded later in April took a much more pessimistic view on the outlook for investment and employment than those who answered earlier in the month.

But critical will be the extent to which weaker global growth reduces the terms of trade that's contributing to the recovery thus far. News to date has been encouraging. Export prices haven't fallen and by and large orders have not been cancelled. While damage has been done in some areas (for example, for some local manufacturers with facilities based in Asia but exporting to the United States), opportunities beckon for others. For example, suppliers of beef and dairy products to China may see increased demand, replacing highly-tariffed exports from the US.

The behaviour of the exchange rate will be critical in managing the damage done by the indirect tariff effects. The volatility in the exchange rate in the last month is testament to the uncertainty on the outlook. The NZD/USD exchange rate fell below 55 cents in early April on the tariff announcements but recovered to just above 60 cents as sentiment regarding the US dollar soured and as better news emerged on the tariff front. On a trade weighted basis, the NZD has traded in a 6% range in the last month. While our forecast is for the NZD to track around current levels versus the USD for the remainder of this year, there is a risk of further weakness and volatility. We see further trend weakness in the NZD on a trade weighted basis around a volatile path as views wax and wane on the US dollar and global uncertainty.

We have considered a downside scenario for the global economy that is perhaps around a quarter of the intensity seen during the GFC, which would slow growth and push inflation somewhat lower in New Zealand. That downside scenario is realistic, but by no means certain. The actual outcome could be better or worse than assumed – both in terms of the size of the hit to trading partner growth and its impact on the economy.

The starting point for inflation is still uncomfortably high for the RBNZ. For various reasons, domestic inflation continues to fall more slowly than expected given past weakness in the economy. While we see cyclical elements of inflation moving lower, there are plenty of other sources of inflation that are more persistent – for example in less competitive parts of the economy including in

areas dominated by central and local government. On its own, that persistence in domestic inflation pressures would not argue for further cuts into more stimulatory territory, especially when compounded by the rise in prices for food and other commodities.

### **The implications for monetary policy now.**

We should consider and put some weight on the downside risks for global growth. It's those risks that markets have responded to recently and which the RBNZ MPC will likely act on when cutting the OCR a further 25bp at their May meeting.

We had thought that the easing cycle would be over by mid-2025. But trade uncertainty is likely to persist for longer than that, which means the downside risks will be with us until at least August and possibly longer. A corollary is that once reaching this new lower trough, the OCR could remain there for longer. Given a General Election is likely in late 2026 it seems prudent to assume at this point the tightening cycle might begin at the end of 2026 as opposed to mid-2026 as previously assumed. We also note that Treasury and the Minister of Finance have been vocal in suggesting that interest rates should be cut in the event of the downside risks crystallising. It's likely the interim RBNZ Governor and the MPC will have that in mind when determining the best path forward.

It's by no means clear that the downside risks will eventuate, but we expect the RBNZ to continue to move methodically in the easing direction while those downside risks remain. A move in the OCR to 3% now seems likely by August. We don't expect a lurch lower - it would take tangible signs of a more significant impact on the NZ economy and critically the inflation outlook to cause the MPC to move more quickly. It will be important to ensure the MPC's actions now don't necessitate the need for an aggressive rise in interest rates down the track should conditions not prove as weak as feared by markets. Policy is likely stimulatory now.

# CONTACT

**Westpac Economics Team** | [westpac.co.nz/economics](https://westpac.co.nz/economics) | [economics@westpac.co.nz](mailto:economics@westpac.co.nz)

**Kelly Eckhold**, Chief Economist | +64 9 348 9382 | +64 21 786 758 | [kelly.eckhold@westpac.co.nz](mailto:kelly.eckhold@westpac.co.nz)

**Satish Ranchhod**, Senior Economist | +64 9 336 5668 | +64 21 710 852 | [satish.ranchhod@westpac.co.nz](mailto:satish.ranchhod@westpac.co.nz)

**Darren Gibbs**, Senior Economist | +64 9 367 3368 | +64 21 794 292 | [darren.gibbs@westpac.co.nz](mailto:darren.gibbs@westpac.co.nz)

**Michael Gordon**, Senior Economist | +64 9 336 5670 | +64 21 749 506 | [michael.gordon@westpac.co.nz](mailto:michael.gordon@westpac.co.nz)

**Paul Clark**, Industry Economist | +64 9 336 5656 | +64 21 713 704 | [paul.clark@westpac.co.nz](mailto:paul.clark@westpac.co.nz)

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