ECONOMIC BULLETIN

Preview of RBNZ May 2026 Monetary Policy Statement (Wednesday 27 May, NZT 2pm).

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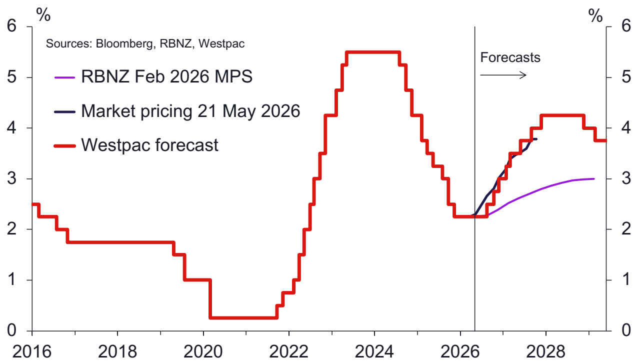
Waiting for evidence

- **We expect the RBNZ to leave the OCR unchanged at its meeting on 27 May.**
- **We expect a vote on whether to leave the OCR unchanged or increase it by 25bps to 2.5%.**
- **We expect an increase in the RBNZ's terminal OCR forecast by around 20bp to around 3.2%, reflecting higher inflation expectations estimates.**
- **The RBNZ's December 2026 OCR forecast is expected to rise by around 40-50 bp to around 2.8%.**
- **Despite this, we remain comfortable there will be three 25bp hikes by year-end.**
- **While we don't think the RBNZ will opt to raise the OCR, Kelly's personal view is a hike at this meeting would be well justified by the outlook for inflation.**

Official Cash Rate forecasts



RBNZ decision and communication.

My view is that the significant shift in the inflation outlook which has occurred since the OCR was cut below 3% in the second half of 2025 justifies a hike at the May meeting. However, the RBNZ's output gap focused framework, the absence of hard data on second-round inflation impacts, and the likely reliance on assumptions that will imply a significant fall in energy prices over the next year means we expect the OCR to remain unchanged next Wednesday. We expect a live debate at the Monetary Policy Committee on the option to raise the OCR to 2.5%, with the decision likely going to a vote.

The appendix to this note summarises the key data and developments since the RBNZ published the February MPS. There should be a marked shift in the RBNZ's forecasts given recent data and the onset of the Iran war. The short-term inflation profile will be revised up significantly to reflect headline inflation over 4% for most, if not all, of the balance of 2026. But at the same time the RBNZ will likely significantly revise down its forecast of 2026 GDP growth from the previous 2.8% to perhaps something like 1.8-2%. It's likely that predictions of a fall in the unemployment rate will be pushed out such that it ends 2026 in the 5.3-5.5% range – hence no fall in the unemployment rate this year.

Greater economic slack than previously expected will help mitigate the risks to inflation over the medium term. Even so, the RBNZ's forecasts for the OCR are likely to be revised up. First, we suspect that the terminal OCR will rise from the current 3% to something more like 3.2%, reflecting higher inflation expectations coming from the more elevated inflation forecast profile. More immediately, we suspect that the December 2026 quarter projection will lift by around 40-50bp to around 2.8%. This would signal two 25bp rises and a chance of a further increase through the balance of 2026.

Technically, one may be able to divine the implied probability of an increase at the next meeting in July from the RBNZ's published forecast for the September quarter OCR. As a guide, a 25% chance of a 25bp hike in July would be consistent with an average OCR in the September quarter of 2.39%, whereas a 50% probability would deliver 2.44%. We are cautious in interpreting the forecast in this way, as it may be that we see a smoothed model-determined path for the OCR at this near horizon, rather than a path that has been set as an explicit signal to the market. It would be best to read the Summary Record of Meeting and the commentary in the press conference to get the best guide on what the RBNZ anticipates for the July meeting. Our view is that the RBNZ could signal perhaps a 25% chance of a July move, but that most MPC members will be content to withhold judgment until September when more information will be available (notably the June quarter CPI).

On that score, based on our reading of the April Record of Meeting, we suspect that a vote will be required at this meeting. Our sense is that there will still be two members potentially interested in voting for a more proactive approach.

Key communication messages will likely include the following:

- The RBNZ will remain vigilant for signs on persistent inflation and second-round inflation impacts and will act decisively if such signs begin to emerge. This message is inevitable given how high inflation is going to be in the near term.
- Core inflation is currently inside the target range and is expected to not drift too far from the 1-3% target range. Medium-term expectations are likely viewed as broadly anchored, and the RBNZ will emphasise that it is important this remains the case.
- OCR increases are likely in 2026. Hence, they move away from the February view that perhaps just one increase might occur this year.
- The duration of the war is a key uncertainty that will shape the inflation outlook and policy reaction function. The RBNZ will likely emphasise that its policy stance can be expected to evolve as the outlook becomes clearer, and that the projections in the MPS are conditional on assumptions that may be invalidated.

Scenarios.

The outcome of this meeting is likely to be a relatively close-run thing, with the key point of contention likely being around the pace at which future OCR increases occur. We discussed the arguments that will likely be raging around the table in **our companion note** released earlier today. Given that baseline, we think the following alternative scenarios are possible:

- A dovish scenario is one where the OCR remains unchanged (possibly with no vote taken, as in April) and the MPC does not change its language much from the April Review. The terminal OCR might not rise far at all, as implicitly the RBNZ would signal a belief that inflation expectations remain anchored (in part due to the pre-existing slack in the economy) and the Iran war cost shock is transitory. The end-2026 OCR projection might only rise modestly, as the implication would be that a July hike is not really on the table as the issue would be considered again in September.
- A hawkish scenario is one where the OCR is increased and a sequence of follow-on 25bp increases is signalled. This could be consistent with a 3% OCR in September and perhaps slightly higher by the end of the year. This scenario would suggest the RBNZ is sufficiently concerned to get moving to neutral and that the neutral rate itself might be noticeably higher than 3%.

Kelly's take.

I think the OCR should be increased at the May meeting.

The inflation outlook has shifted dramatically since the second half of 2025 when the OCR was reduced below 3%. With the benefit of hindsight this should not have occurred. A key element of the argument we made to justify the 50bp cut last October was that it was an insurance move that could be reversed if the outlook changed. The outlook clearly has changed now that headline inflation is set to move above 4% for the balance of 2026. It would be much better to have the OCR near neutral today. Hence beginning to get there now seems a pressing priority.

I understand that the Iran war has delayed the economic recovery. However, that isn't in the mandate and there are clear risks that this cost shock, coming so soon after a long period of above-target inflation, will influence pricing behaviour in the economy.

I am pessimistic that the Iran war will be quickly resolved. Any positive news there should be considered a contingency as opposed to part of the core forecast. Headline inflation forecasts that assume a path for oil prices anything like what the futures curve implies have significant upside risks and should be discounted.

It's unclear exactly how high the OCR will ultimately need to go in 2027. But quickly getting the OCR towards neutral would put the RBNZ in a good position to respond to whatever happens in the future. Inflation and not growth should be the priority.

Appendix: Key developments since the February Monetary Policy Statement.

Activity: The December quarter GDP report was weaker than the RBNZ's expectations, with the economy growing just 0.2% – 0.3ppts less than expected – and the level of GDP 0.4% below expectations after accounting for historical revisions. The RBNZ expected cumulative growth of 1.6% over the first half of 2026, compared with Westpac's current forecast of growth of just 0.5%. The implication is that the RBNZ's estimate of the size of the negative output gap is likely to rise in the near term.

Labour market: The unemployment rate edged down to 5.3% in the March quarter, which was in line with the RBNZ's forecast. Employment growth of 0.2% was below the RBNZ's expectations, but this was offset by weaker-than-expected labour force participation. Private sector labour costs rose a subdued 0.4%q/q, which was in line with the RBNZ's forecast. We don't think these data would have shifted the dial much for the RBNZ.

Sentiment-based activity indicators: The NZIER's March quarter QSBO business survey reported an unsurprising slump in business confidence, together with smaller declines in firms' expectations of activity, hiring and investment. The ANZ's monthly business survey painted a similar picture in March and April (the May survey will be released next week, just ahead of the RBNZ's meeting). The ANZ measure of consumer confidence has also fallen sharply to a three-year low.

Housing market: The fall in consumer confidence appears to have impacted the housing market in April, with seasonally-adjusted sales declining about 4% (about 8% below year-earlier levels) and the average house price declining 0.4% after a small increase during the March quarter. Listing levels remain elevated at more than decade-highs, especially in the main urban areas, supported by reasonable levels of building activity at a time of slow population growth. In February the RBNZ forecast no growth in house prices this year. They are unlikely to revise this forecast higher.

Inflation: Headline inflation remained at 3.1% in the year to March, above the RBNZ's February forecast of 2.8% (and slightly above the revised forecast of 3.0% made at the April OCR Review). Non-tradables inflation was just 0.1ppts above the RBNZ's February forecast, with most of the variation due to a 0.7ppt upside surprise in tradables inflation (in part due to the sharp lift in fuel prices in March). Measures of core inflation generally nudged lower in the March quarter, but with most remaining in the upper part of the RBNZ's 1-3% target band.

Inflation expectations: The RBNZ's survey of 'expert' forecasters pointed to a sharp rise in 1-year ahead inflation expectations, a small rise in 2-year ahead expectations (to 2.53%) and small falls in 5- and 10-year ahead expectations. The RBNZ's survey of consumers pointed to a notable lift in near-term inflation expectations, but less so when it comes to medium-term expectations. The RBNZ's Business Survey pointed to a sharp lift in 1-year ahead inflation expectations and a smaller (26bps to 2.87%) increase in 2-year ahead inflation expectations. However, 5-year expectations nudged lower and 10-year ahead expectations fell 27bps. Firms responding to the ANZ's Business Survey indicate that they expect wage growth to remain subdued.

Terms of trade: The SNA terms of trade were 0.7% lower than expected in the December quarter. Given developments in the Middle East – in particular, the sharp rise in fuel prices – we estimate that the terms of trade are likely to be more than 1% below the RBNZ's expectations in the current quarter despite the resilience seen in New Zealand's key export commodity prices.

Financial conditions: Domestic financial conditions have mostly tightened since the RBNZ's February meeting. For example, the NZ50 equity index has declined 4.0%, the 2-year swap rate has increased 61bps to 3.57% and the 10-year bond rate has increased 37bps to 4.73%. Working in the opposite direction, the trade-weighted exchange rate index (TWI) has declined around 2%.

Fiscal policy: Budget 2026 will be delivered the day after the RBNZ's decision is delivered, but the Treasury's representative at the MPC meeting will have conveyed the broad fiscal parameters that will be revealed on Budget day. Based on our expectations for Budget 2026, we don't expect that the path of fiscal policy will have a significant influence on the MPC's deliberations at this meeting.

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