ECONOMIC BULLETIN

Preview of RBNZ February 2025 Monetary Policy Statement (Wednesday 19 February, NZT 2:00pm).

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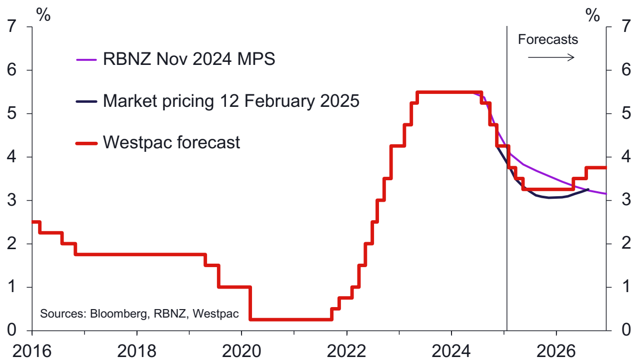
Another large step towards the neutral zone

- **We think it highly likely that the RBNZ will cut the OCR by 50bps to 3.75% next week but project a slower pace of easing after February.**
- **The RBNZ's near-term CPI forecasts will likely be revised slightly higher due to the weaker TWI and higher commodity prices balanced by weaker non-tradable inflation.**
- **We think the RBNZ will retain confidence that medium-term inflation will remain close to 2%.**
- **We see the RBNZ projecting an end 2025 OCR of around 3.25% and an unchanged terminal rate of about 3%.**
- **The Bank's short term economic growth projections may be revised down while the medium-term growth path may be revised up modestly with the lower exchange rate.**
- **The RBNZ will likely note significant risks associated with global trade policies, although few conclusions will be drawn given the significant uncertainties.**
- **The most likely dovish scenario is the RBNZ signals the intention to move the OCR to neutral more quickly by signalling a 3% OCR by mid-2025. This would signal a high chance of a further 50bp cut at the April review.**
- **An outside chance is the RBNZ cuts the OCR by more than 50bps to try and bring the OCR to neutral more quickly.**

Official Cash Rate forecasts



RBNZ decision and associated communication – our baseline scenario.

Our baseline scenario (65% probability) is that the RBNZ cuts the OCR by 50bp to 3.75% next week. We expect the RBNZ to revise down their OCR forecast profile to be consistent with the OCR reaching around 3.25% by the end of 2025 (compared with 3.55% in the November MPS). The ultimate endpoint for the OCR beyond 2025 is expected to remain unchanged at around 3%.

Developments since last year's November Monetary Policy Statement are likely to be interpreted by the Monetary Policy Committee as giving them sufficient confidence that a further large step towards the RBNZ's assessment of the neutral OCR remains appropriate. The RBNZ foreshadowed a 50bp cut in the OCR to 3.75% and we doubt the data would have swayed them from that view.

Messages in support of this move are likely to include:

- Inflation remains close to the middle of the 1-3% target range, with most available indicators giving confidence that inflation will remain in the target range over the medium term.

- Risks to the economic and inflation outlook are two-sided and imply the best course of action is to continue to move the OCR towards a neutral setting.
- Upside risks to headline inflation remain prominent, especially from the recent significant fall in the New Zealand dollar and waning tradable goods price disinflation. The RBNZ is likely to note that inflation expectations appear well contained at this stage despite those upside inflation risks.
- Non-tradable inflation is continuing to ease and is allowing continued downward adjustment of the OCR towards neutral. The revisions to past GDP data better explain why inflation was persistent through 2023 and early 2024 but also give confidence that core inflation will remain close to 2% over the foreseeable future.
- There are mixed signs of a return to economic growth, which is normal at economic turning points. Easier financial conditions and the strong terms of trade seem likely to underwrite a return to trend growth later in 2025. The labour market will likely be judged as evolving as expected and continue to lag developments in GDP growth.
- Significant risks are coming from the global geopolitical and trade environment that have the potential to negatively impact NZ export incomes, growth and medium-term inflation. However, the extent to which these risks are tangible remains unclear, as is the extent to which the exchange rate may buffer NZ from these external shocks. The MPC likely will not draw strong conclusions but maintain a watching brief.

This 50bp cut will leave the OCR just 25bps above the RBNZ's 2.5-3.5% estimated range for the neutral OCR. With re-entry to the RBNZ's neutral rate range now imminent, and two-sided risks to the evolution of growth and inflation, we expect the RBNZ to signal a return to a slower pace of easing for the balance of 2025. We don't think the RBNZ will be looking to move interest rates into stimulatory territory but would certainly acknowledge there are scenarios that might require that.

Alternative scenarios.

Around that baseline scenario, we see two other potential outcomes at next week's policy meeting:

- **Hawkish scenario (5% probability): 25bp cut.** The RBNZ elects to cut the OCR to 4% and signal ongoing 25bp cuts from then. This would likely be associated with an end 2025 OCR path in line with that projected in the November Monetary Policy Statement around 3.5%. Concerns around the higher forecast headline CPI through 2025 from the weaker exchange rate, higher oil prices and firm commodity/food prices and associated costs and expectations pressures might drive this scenario.
- **Moderately dovish scenario (20% probability): 50bp cut with a strong chance of another at the April Monetary Policy Review.** The MPC signals an intention to move more quickly to 3% by indicating a strong chance of a further 50bp cut in April and a 3% OCR by mid-year. This would be signalling an intention to move more quickly to the mid-point of their neutral range estimate of 3%. The year end target could be 3% with no clear bias shown in the OCR profile after May 2025.
- **Dovish scenario (10% probability): 75 to 100bp cut.** The MPC decides to rapidly move the OCR to the mid-point of its neutral range estimate. Worries about a near-term lift in headline inflation due to a weaker exchange rate would be dominated by concerns about the weak growth impulse seen in GDP over Q2-Q3 2024. A significant downward revision in Q4 and Q1 GDP from the 0.3% and 0.6% forecasts in November might drive this scenario. As also might the MPC taking a view that the coming geopolitical shocks are likely to significantly undermine export incomes even after any exchange rate adjustment. Having adjusted the OCR to the middle of the neutral range, the MPC might indicate readiness to take the OCR into stimulatory territory should data suggest that appropriate.

Key developments since the November Monetary Policy Statement.

Key economic developments since the RBNZ's last policy statement in November are noted below.

- **Inflation:** December quarter inflation was fractionally firmer than the RBNZ forecast (2.2%y/y vs forecast 2.1% y/y) due to higher than forecast prices for tradables. Non-tradables inflation was slightly lower than forecast (4.5%y/y vs forecast 4.7%y/y), and key measures of core inflation moved lower.
- **Inflation expectations/pricing indicators:** Pricing indicators have been mixed, with the QSBO survey measure remaining softer than pre-Covid norms but the ANZ survey measure firmer than pre-Covid norms. Explicit measures of inflation expectations have drifted higher, possibly due to recent increases in fuel prices. The ANZ's 1-year ahead business measure has increased 14bps to 2.67%.
- **Activity:** The latest GDP report included revisions that lifted GDP through 2022 and 2023 but pointed to a much deeper downturn through the middle quarters of 2024. On net, the level of GDP in the September quarter was 0.6% higher than forecast in the November MPS. We currently estimate that the economy grew 0.3% in the December quarter, in line with the RBNZ's November estimate.
- **The output gap:** The upward revisions to GDP in 2022 and 2023 imply that productivity growth was not as weak as previously estimated. This should cause the

RBNZ to slightly lift its assessment of potential output. The size of that revision relative to the 0.6% lift in the level of actual GDP will govern whether the RBNZ's estimate of the output gap is larger or smaller than that estimated in November. We suspect the RBNZ will conclude that the output gap is slightly more negative than estimated previously.

- **Sentiment indicators:** Year-ahead sentiment indicators in the ANZ business survey remain near historic cyclical highs. Westpac's measure of consumer confidence has improved in recent months but remains weaker than average. Indicators of current and near-term economic performance from the QSBO and Business NZ surveys also remain subdued, possibly suggesting some downside risk to the RBNZ's near-term growth forecasts.
- **Labour market:** The unemployment rate increased to 5.1% in the December quarter, in line with the RBNZ's forecast. Monthly filled jobs data appears consistent with the RBNZ's forecast that employment will stabilise around current levels, but that the unemployment rate will lift modestly further for a period given ongoing growth in the labour force. Wage growth continued to moderate in the December quarter (albeit slightly less than the RBNZ expected) and business surveys continue to point to further moderation ahead.
- **Housing market/population growth:** Anecdotes and developments in mortgage applications suggest that lower interest rates are triggering more buyer enquiry. However, amidst a plentiful supply of dwellings – the most in a decade – house prices have continued to track sideways. Migrant inflows appear to be tracking slightly below the RBNZ's November forecasts.
- **Commodity prices:** Export commodity prices have continued to improve in recent months, especially in the dairy sector. However, the overall terms of trade (measured on a National Accounts basis) appear to be evolving broadly as the RBNZ had forecast in the November MPS.
- **Exchange rate:** The trade-weighted exchange rate index (TWI) is currently around 2.6% below the 69.5 assumption made in the November MPS. The TWI assumption will modestly boost the RBNZ's growth forecasts and add around 0.3ppts to the RBNZ's forecast of annual inflation over the coming year.
- **Global developments:** The main development since November has been confirmation that President Trump plans to implement tariffs. Those measures could affect some of our key trading partners, like China. In addition, some New Zealand exporters could be directly affected (such as exporters of metal products). However, the final form of those tariffs, any retaliation that might ensue, and the exchange rate's response, remains uncertain, so the RBNZ's central assumption for trading partner growth is likely to be little changed from November.

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