

Our Take Kiwibank economics.

Next week's RBNZ decision will weigh up the supply and demand shocks... both are negative.

The RBNZ will keep the cash rate on hold at 2.25% next week. But it's where they go to next, and when, that has us on edge. The RBNZ will most likely pull forward their expected rate hikes, in light of the inflation risks. Indeed, the consensus amongst economists is for a pre-emptive strike against inflation. We disagree. This is not Covid. We're seeing demand destruction (not creation).

The Kiwi economy was in the "early stages" of recovery. And now we're fighting our way through another shock to the system. **It is simply too early to assess the inflationary pulse, and the likely unwind. It is too early to gauge the impact on demand. And it is too early to see the adverse effects in the labour market. Therefore, it's too early for the RBNZ to hike.** Given the shock to demand, we expect the inflation surge to prove temporary. Inflation will likely fall back to 2% in 2027.

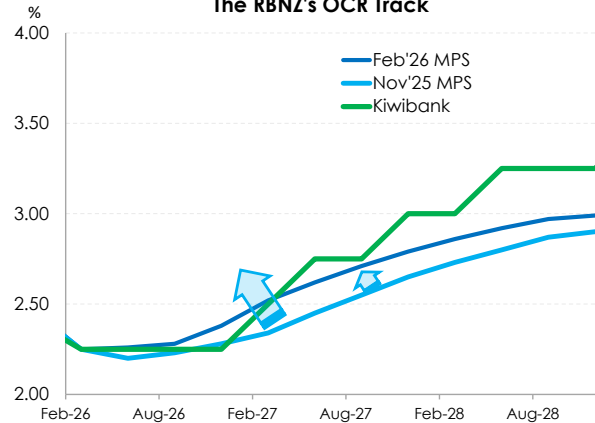
Wholesale rates markets are pricing in more than even the most hawkish economist. There's significant room to move. If called out, rates could fall 20-30bps swiftly.

Uncertainty kills growth. And the heightened uncertainty is causing many businesses and households to delay or cancel projects, and adjust spending patterns. Delayed spending may cause a contraction in activity over 2Q and 3Q 2026. It reminds us of 2024 and 2025. The economic recovery has hit yet another speed bump.

This is a supply shock, that is causing demand destruction. This is not Covid. The war in the Middle East continues, without an end in sight. And we expect to see a lot more back and forth on that front. Markets are behaving in a mostly desensitized way. The price of oil is fluctuating, while the US stock markets hit record highs. Negotiations continue to fail, for now. And US stock markets are not forcing the issue. Trump seems to follow the S&P 500. He escalates on a whim, and deescalates as stocks fall. Stocks aren't falling (yet).

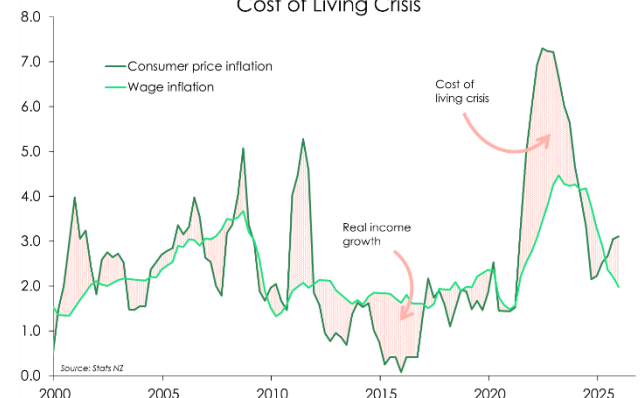
At this stage, oil inventories are being drawn down slowly. But the price is having an impact. There has been significant demand destruction in poorer Asian countries, and across Africa. The poor, demand less, as the rich simply pay the higher price. That theme is playing out within Aotearoa as well. Poorer households suffer more.

The RBNZ's OCR Track



Domestically, the data is challenging to interpret. It's far too early to see the full impacts of the ongoing supply shock. The pace of growth slowed to a 1.3%yoy to end 2025. The economy is simply smaller and more fragile than we (and the RBNZ) had expected. We entered the new year expecting a gradual recovery. The data showed dairy and tourism led the expansion, while the construction sector continued to decline. Both dairy and tourism, along with most of the economy, now face significant challenges. We are seeing demand destruction rather than an uptick in activity. We entered the year with the expectation that the RBNZ would hold rates steady, to allow the economy to fully recover, before beginning to tighten early in 2027. The impact of the war in the Middle East and subsequent oil supply disruptions means that the argument for tightening has intensified. Most bank economists are calling for rate hikes from July. We disagree. Although we must acknowledge the risks. We believe adding costs (now interest rate costs) to a cost of living crisis (following food,

Cost of Living Crisis



rates, insurance and many other price hikes) will do more harm than good. And rate hikes will only restrain demand further, when it's a supply shock that's causing the damage.

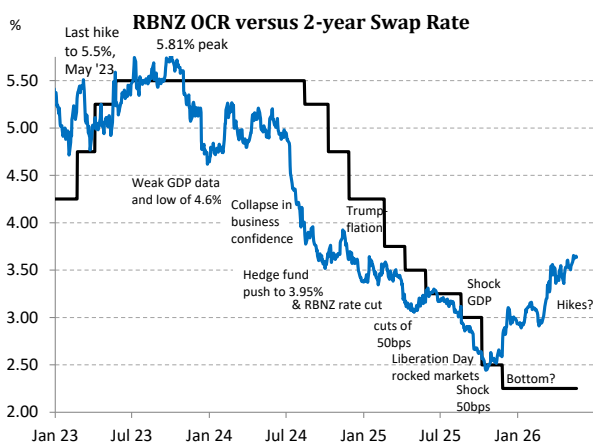
We hope that this supply-side shock, will be short-lived. We hope... In the meantime, **it is simply too early to assess the inflationary pulse, and the likely unwind. It is too early to gauge the impact on demand. And it is too early to see the adverse effects in the labour market. Therefore, it's too early for the RBNZ to hike.** If they do hike in July or September, they will be pre-empting inflation's second round effects. Time will tell, and they have time to tell.

Give with one hand, take with the other.

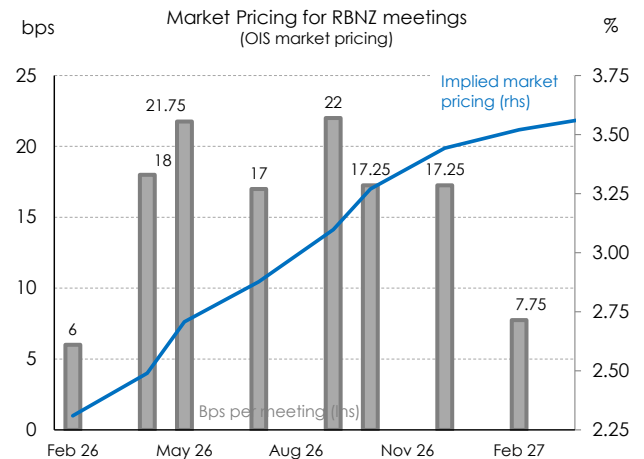
The RBNZ's growth forecasts will be revised lower... The recovery we meant to have has hit a speed bump, and fallen into a pothole. The economy most likely contracted in the second quarter. And that widens the output gap. Any thoughts of recovery are dependent of a swift end to the war in the Middle East. Fiscal policy is not a problem for inflation, but it is for demand, with the Government pledging prudence and cost cuts. Again, this is not Covid.

But the risks to inflation are (seemingly) one-sided. We now forecast a peak in the current quarter of around 4.5%. And the return to 2% has become a 2027 story. All economists had forecast a return in inflation to 2% this year, before the war. Those underlying disinflationary forces have only intensified, in our opinion. The RBNZ's forecast return to 2% will be delayed... but by how long, will provide an insight into their perceived risks, and potential policy response.

There's little doubt that the RBNZ's OCR trajectory will be pulled forward. The trajectory in February's MPS was even below our forecast. The risk is that the RBNZ pulls the OCR forward to pre-empt a move (or three) in coming months, not quarters. We can only hope that they remain cautious and willing to wait, worry, and watch.



Wholesale rates are on another level.

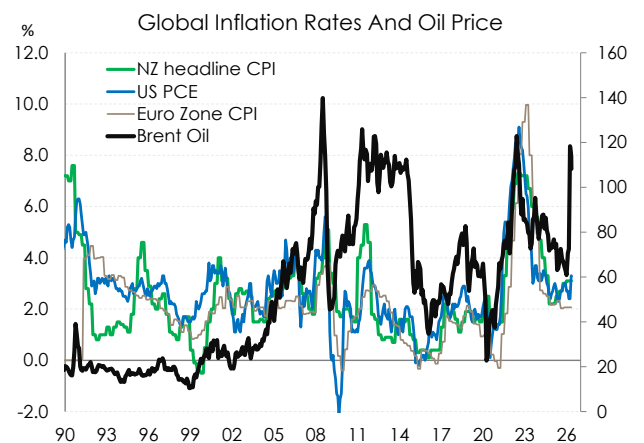


When we look at wholesale rates in NZ, we see too much priced in. Even the most hawkish bank economists have 3 hikes and done. They stop at 3%. The Kiwi OIS rates market has 3.5 hikes to 3.10% by December, and a continuation to 3.5% by mid-2027. That's well above the consensus. If the hawks are right, and they hike to 3%, short dated rates are 50bps overcooked. If we're right, short dated rates are a long way from home.

Some of the movement in wholesale rates reflects some illiquidity. But that only lasts for so long. If we get clearer guidance from the RBNZ next week, we could get some of the larger offshore players (hedge funds) re-entering the market to scoop up all those beautiful bps on the table.

What's the risk? They hike more than 125bps... they take the cash rate to 3.75% or above. Highly unlikely.

What's the reward? With every pause, you get paid for being received.





Kiwibank economics.



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