

Our Take

Kiwibank economics.

The RBNZ are still playing catch up. Hopefully 2.25% is the bottom. But maybe not. Maybe we need 50bps

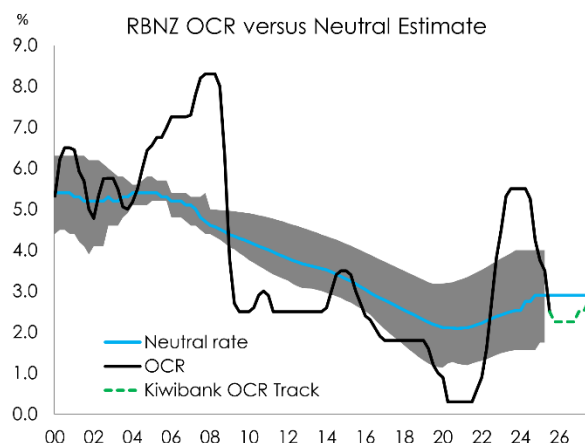
- The RBNZ's final monetary policy decision for the year is fast approaching. A 25bps cut is widely expected. The focus is acutely on what the RBNZ will say and signal for next year.
- The new OCR track will be lowered. It has to. The RBNZ has already delivered more than the previous track implied. And in October the RBNZ signalled further 'reductions' in the cash rate – plural. We'd expect a lower terminal rate with the RBNZ keeping the door open to more easing.
- The recovery remains fragile. Greenshoots are emerging, but are few and far between. We hope a 2.25% cash rate will be enough for activity to spread. But we may need more. How the economy evolves over the summer period remains pivotal to the path of future policy decisions.

Next Wednesday, the RBNZ will take the stage for the last time this year. We're expecting a 25bps cut to bring the cash rate down to 2.25%. The meeting will also mark Christian Hawkesby's swansong as Governor of the RBNZ. Hawkesby passes the reins to Dr Anna Breman on December 1st. Though it's not until February next year that she will make her mark on monetary policy.

A cut to 2.25% next week is perfectly priced by markets and requires little justification. The Kiwi economy still needs more support. Yes, the Reserve Bank has delivered a significant amount of easing. 300bps to be exact. But for the majority of this year, the cash rate remained at restrictive levels. It is only after the cut to 2.5% in October that policy moved beyond neutral ground and into more stimulatory territory.

We had long advocated for such a move to 2.5%. But the move came too little too late from the RBNZ. And the delay has cost us. The recovery we anticipated for this year stalled, activity lost momentum and Kiwi households and businesses have suffered further. All of which has put the Reserve Bank in a position of needing to do even more. They didn't do enough, the economy stalled again, and now they're having to do more to mop up the mess.

We are aware that we are advocating for further stimulus against a backdrop of inflation sitting at 3% - the top end of the RBNZ's target band. But the recent move higher was well expected and should prove temporary. Movements in

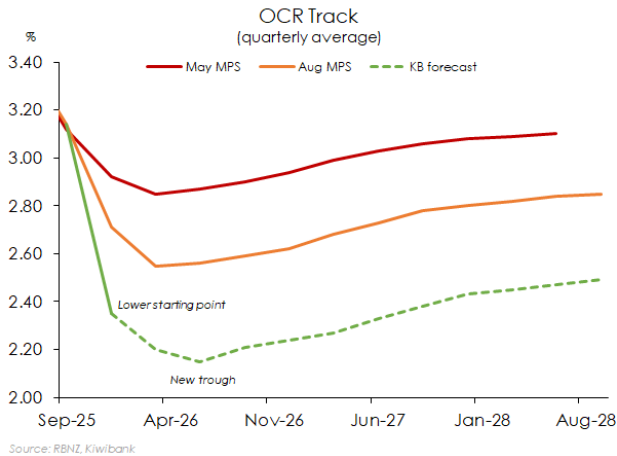


the more volatile components of the CPI have driven the rise in headline inflation. Domestic and underlying core inflation, however, continue to cool. And importantly, despite the lift in headline, surveyed inflation expectations remain well anchored at the 2% target midpoint. With that, and the significant spare capacity sloshing in the economy, we continue to expect inflation to return to the RBNZ's 2% target in 2026. And risks remain that inflation even undershoots 2% over the course of the year. Especially given the weakness, and slack, in the labour market. Despite positive signs of stabilisation, considerable slack in the labour market remains. Slack which should give the RBNZ further confidence to deliver a cut next week.

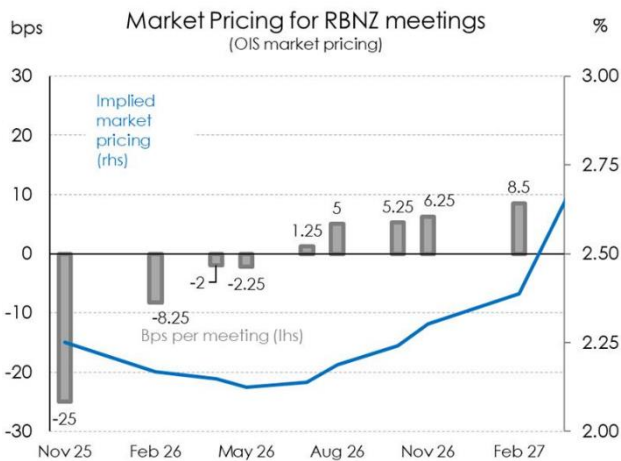
The question on everyone's mind right now is, **will the move to 2.25% be enough?** We hope it will. But we may need more.

Accompanying the decision will be a fresh OCR track – the RBNZ's forecast of the cash rate. We expect the track to be lowered (again) for two key reasons. First, the track must be lowered simply because of the October 50bps cut. The previous track troughed at 2.55%. The October cut took the cash rate below that to 2.5%. And next week's cut would take it even lower. So naturally, the new track begins with a lower starting point. Secondly, let's not forget the RBNZ's forward guidance at the last meeting – *"The Committee remains open to further reductions in the OCR"*. The key word here being "reductions" – plural. With this grammatical nugget in mind, we'd expect the RBNZ to keep the door open to further rate cuts in 2026. We expect the terminal rate to drop to about 2.15%, implying a modest

easing bias. Anything below that would signal firm intention to cut below 2.25%.



A track that troughs at 2.15% would largely be delivering on current market pricing. The OCR endpoint priced into the OIS strip currently sits at 2.12%. So 2.15% is not too different. The overall reaction in financial markets should be fairly muted.



But if the RBNZ's statement still highlights the need for optionality, and possible cuts (plural), then swap rates can fall back a bit. The 2yr swap rate has recently climbed to above 2.60%, unwinding the post-October MPR fall to be 15pts above the cycle-low. A dovish tone from the RBNZ could send rates back to those October lows. And arguably, that's the right (needed) reaction to anchor retail rates at current levels, or even pull them lower. A track that signals a more aggressive easing bias in 2026 would certainly trigger a 10-20pt rally in wholesale interest rates, and the Kiwi dollar's wings would be clipped as the RBNZ pulls even further away from its peers.

We hope we won't need further easing next year. And that 2.25% is enough to turn the economy around. But evidence of a turnaround have been few and far between. The balance of risks to the economic outlook are tilted to the downside. The summer will be an important one for data-watching. But more stimulus could very well be needed to appropriately water these green shoots and see them spread.

So why not another 50bp move? Why not, indeed. It's certainly within the realms of possibility, and should be on the table for discussion by the RBNZ's MPC next week. Another "surprise" 50bp move gets the cash rate to 2%, without the long wait until February's decision. A 50bp move to 2% would clear the decks, and clean the slate for incoming Governor, Dr Anna Breman. The RBNZ's mistakes over the past 2 years have been centred around the inability to recognise the recession, and an inability to respond to the recession after it became painfully clear. The RBNZ has done too little too late, and has only just (in October) taken policy into stimulatory territory. A stance we should have seen long ago. Is 2.25% really going to be enough? We'd hope so. Is 2% required? Maybe. But why not get us there, cut with confidence, to fuel confidence. It's just the sort of shock treatment the economy needs. So even if we're not calling for it, and hope with fingers crossed that a 2.25% cash rate will do enough... we certainly like the idea to getting another outsized move to crank things up a bit. And if it works, you just start hiking again, a little earlier than expected.



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