9 April 2025

RBNZ more dovish

- **RBNZ cuts 25bp to 3.50%**
- **Signals downside risk to inflation and growth**
- **So its rate expectations must be lower**
- **We stick with our three more cuts track to 2.75%**
- **But downside risks certainly growing**

Who'd want to be a central banker making a decision today? The pessimist could easily conclude that the tariff war will have much greater negative implications for the global economy than currently understood and that central banks should ease very aggressively as soon as possible. Conversely, it could be argued that supply driven inflationary pressures counsel tighter monetary conditions irrespective of the growth implications. After all, the control of inflation, not growth, is the number one objective of the central banking community.

Confusing matters more, what is the neutral rate now? We had little idea before. We've got even less idea now.

The only redeeming feature for the Reserve Bank of New Zealand in producing today's Monetary Policy Review is that it didn't need to publish an accompanying set of economic forecasts and a rate track. It's got until the May Monetary Policy Statement to do this. Good luck!!

With all that in mind, we think the Reserve Bank's response to the current chaos, as delivered in today's Monetary Policy Review, is about as appropriate as it could be:

- It lowered the cash rate 25 basis points to 3.50%
- It acknowledged the confusion that currently reins
- Barring any shocks it expects to continue easing
- But it warned that the balance of risk is that both growth and inflation will fall below expectations permitting a more aggressive interest rate approach, if necessary

All of this leaves us sticking with our expectation that rates fall a further 25 basis points in each of the next three meetings to a low of 2.75% by August. This is not to express any degree of comfort with this projection. Our once non-consensus view of a sub 3.0% low was partly predicated on US tariffs creating damage to the global economy. We remain convinced of this but concede we never thought the extent of such tariffs would be as great as they currently seem to be. On this basis, we now think there is probably more downside risk to our base case rate track than upside. This was previously not the case.

It is apparent to all that the current tariff fiasco is bad news for growth. And even if all the stupidity of the last few days was reversed tomorrow the remaining uncertainty would still have a negative effect on output.

What is far less certain is what the impact on inflation will be, both here and abroad. In short, will the negative growth impact weigh on prices more than the tariffs and productivity losses push inflation higher? And even if prices rise will this be permanent or temporary? And last but not least, if we get stagflation will central banks be able to hold their mettle and stick doggedly to their inflation-fighting dogma?

The Reserve Bank's Summary Record of Meeting suggests, not surprisingly, that while there was agreement amongst committee members as to the direction of impact on growth of the tariffs there was disagreement on the price response.

To quote the summary "Most members of the committee consider that recent global policy developments have shifted the balance of risk for New Zealand inflation lower over the medium term. Others note that, while uncertainty around the inflation outlook has increased, the risks remain balanced at this stage".

If we are to take this literally it means that no one in the committee was convinced that upside inflation risks dominated. It also means that four of the six thought downside risks dominated.

We remain heartened that the central bank has reinforced the importance of targeting medium term inflation. There had been recent suggestions by some that the Reserve Bank should have stalled its rate cuts because of the expected short term lift in annual CPI inflation. We were not believers in this as we saw those increases as being transitory.

As noted above, the problem from here on in is whether any tariff-driven price increase can be considered as transitory? Realistically, only time will tell.

It's only seven weeks until the next MPS. Almost anything could happen in that period and probably will. For now, we are forecasting a further 25 point cut at that meeting taking the cash rate to 3.25%. But, like everyone else, we will be following global developments very closely.

Following today's announcement market pricing now sits on the rate track we have kept with for all of this year. This leaves us with little to say about how one should play the market other than repeating our view that there is now a very real risk that rates go lower than we are currently forecasting, and stay their longer.

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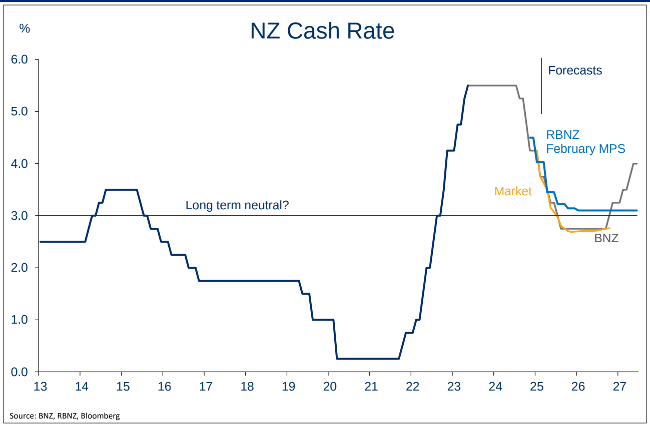
More cuts to come



Full text of today's RBNZ OCR Review:

The Monetary Policy Committee today agreed to reduce the Official Cash Rate by 25 basis points to 3.5 percent.

Annual consumer price inflation remains near the mid-point of the Monetary Policy Committee's 1 to 3 percent target band. Firms' inflation expectations and core inflation are consistent with inflation remaining at target over the medium term.

Economic activity in New Zealand has evolved largely as expected since the February Monetary Policy Statement. Higher-than-expected export prices and a lower exchange rate have supported primary sector incomes and overall economic growth. While monetary restraint has been removed at pace, household spending and residential investment have remained weak.

The recently announced increases in global trade barriers weaken the outlook for global economic activity. On balance, these developments create downside risks to the outlook for economic activity and inflation in New Zealand.

Having consumer price inflation close to the middle of its target band puts the Committee in the best position to respond to developments. As the extent and effect of tariff policies become clearer, the Committee has scope to lower the OCR further as appropriate. Future policy decisions will be determined by the outlook for inflationary pressure over the medium term.

Summary Record of Meeting – April 2025

Annual consumer price inflation remains near the mid-point of the Monetary Policy Committee's 1 to 3 percent target band. Firms' inflation expectations and core inflation are consistent with inflation remaining at target over the medium term. The recently announced increases in global trade barriers have weakened the outlook for global economic activity and, on balance, create downside risks to the outlook for inflation in New Zealand over the medium term.

Domestic economic activity has evolved largely as projected in February

The Committee discussed developments in domestic economic activity. Higher-than-expected export prices and a lower exchange rate have supported primary sector incomes and overall economic growth. However, household spending and residential investment have been weaker than expected.

The Committee noted that substantial spare productive capacity remains in the economy. This reflects the preceding period of restrictive interest rates, subdued global economic activity, and lower government consumption as a share of the economy. Overall, expectations of future inflation and the degree of spare productive capacity in the economy are consistent with annual CPI inflation remaining close to the target midpoint over the medium term.

Recent declines in interest rates and higher export earnings are expected to support economic growth. The pace of growth is expected to be modest, as potential GDP growth is constrained by ongoing weakness in productivity growth and low net immigration. The Committee noted that the full economic impact of cuts in the OCR since August 2024 are yet to be fully realised.

Recent increases in tariffs and uncertainty about global trade policy have weakened the outlook for global economic activity

Against this backdrop, the recently announced increases in tariffs in the United States, retaliation from several trading partners, and heighted geoeconomic uncertainty will have a significant negative impact on global growth. This will have adverse effects for domestic economic activity.

The implications of increased tariffs for global and domestic inflation are more ambiguous

The Committee noted that the impact of increased tariffs on global inflation is unclear at this point, particularly given the recency of the announcement and the possibility of further changes in global trade policy settings. The implications for inflation will vary by country.

Several factors stemming from tariff increases could put upward pressure on global prices over the medium term. Prices will rise in tariff-imposing countries, reflecting the higher cost of imports. Increased trade protectionism and uncertainty will also lower the productive capacity of the global economy. The costs of trade could also rise as global supply chains adapt to increased trade restrictions and geoeconomic fragmentation.

The Committee noted that there were several factors that could offset these cost and supply-side elements. For New Zealand, demand for our exports is likely to decrease, reflecting weaker activity in our trading partner economies, especially in Asia. Increased uncertainty around global trade policy will also weigh on investment and spending, as will declines in asset prices.

Trade diversion effects could also lower the prices of New Zealand's imports, as some global exports targeted by tariffs are redirected to our market. Lower global oil prices will also lower New Zealand import prices.

The global policy response will be an important consideration in gauging the implications of increased tariffs for medium-term inflation in New Zealand. For example, an easing in fiscal and monetary policy in our trading partners could mitigate some of the expected downturn in global economic activity. The Committee noted fiscal policy had been eased in China and Europe recently. Structural reforms, trade, and industrial policy responses may also offset some of the impacts of increased trade barriers.

The recent decline in the New Zealand dollar will help to cushion the immediate effect of decreased global demand for New Zealand exports. Lower oil prices will also support domestic consumption and production.

The Committee was briefed on the financial market reaction to the tariff announcements. While price movements in currency, equity and fixed-income markets have been large there are currently no significant signs of dysfunction in financial markets.

The monetary policy response to tariffs will focus on the medium-term implications for inflation

Most members of the Committee consider that recent global policy developments have shifted the balance of risk for New Zealand inflation lower over the medium term. Others note that, while uncertainty around the inflation outlook has increased, the risks remain balanced at this stage.

The Committee noted that the increase in tariffs will take time to work through the global economy. The direct price increases for economies imposing tariffs and the dampening impact of increased economic uncertainty on global demand will occur relatively quickly. The adaptation of global supply chains to increased trade barriers will take longer to work through. It was noted that monetary policy cannot offset the long-term negative supply-side effects of higher barriers to international trade.

The Committee agreed to lower the OCR

The Committee noted that the preceding cuts to the OCR have yet to have their full effect on the economy.

With CPI inflation close to the mid-point of the target range, significant spare capacity in the economy, and a weaker activity outlook stemming from global trade policy, the Committee agreed that a further reduction in the OCR was appropriate.

The Committee agreed that a 25 basis point reduction in the OCR would be consistent with their mandate of maintaining low and stable inflation. As the extent and effect of tariff policies become clearer, the Committee has scope to lower the OCR further as appropriate. Future policy decisions will be determined by the outlook for inflationary pressure over the medium term.

Attendees

Members of MPC: Christian Hawkesby (Chair), Bob Buckle, Carl Hansen, Karen Silk, Paul Conway, Prasanna Gai
Treasury Observer: James Beard
MPC Secretary: Adam Richardson

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