WELLS FARGO

International Commentary — May 28, 2025

New Zealand Central Bank to Slow its Policy Rate Descent

Summary

- In a widely expected decision this week, the Reserve Bank of New Zealand (RBNZ) lowered its Official Cash Rate by 25 bps to 3.25%. This marks 225 bps of cumulative easing during the current cycle. While the accompanying statement and updated economic projections suggested that further monetary easing remains likely, they were also notable in that they signaled the central bank's monetary easing cycle could be nearing its end.
- We see inflation pressures waning in the coming months, owing in part to a softening labor market that has led to an easing in the pace of wage growth. At the same time, there are also indications--from business confidence measures and activity indicators--that the New Zealand economy has started to stabilize after a very weak period of economic growth.
- In our view, this combination of softer price and wage growth pressures and stabilizing economic growth is consistent with further but cautious RBNZ easing through the end of 2025. To that point, we see the central bank transitioning to a once-per-quarter rate cut pace. We look for two more 25 bps rate cuts from the central bank this year, in August and November, which would see the policy rate reach a low of 2.75%.

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Reserve Bank of New Zealand Delivers Once Again

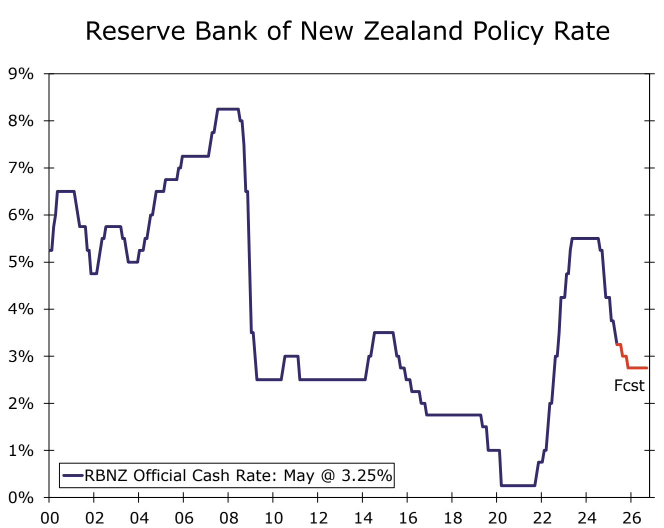
In a widely expected decision, the Reserve Bank of New Zealand (RBNZ) lowered its Official Cash Rate by 25 bps to 3.25%. That is the sixth straight meeting the RBNZ has lowered its policy rate, and brings the cumulative easing during the current cycle to 225 bps. While the accompanying statement and updated economic projections suggested that further monetary easing remains likely, they were also notable in that they signaled the central bank's monetary easing cycle could be nearing its end.

Among the key elements of the RBNZ's announcement, the central bank said:

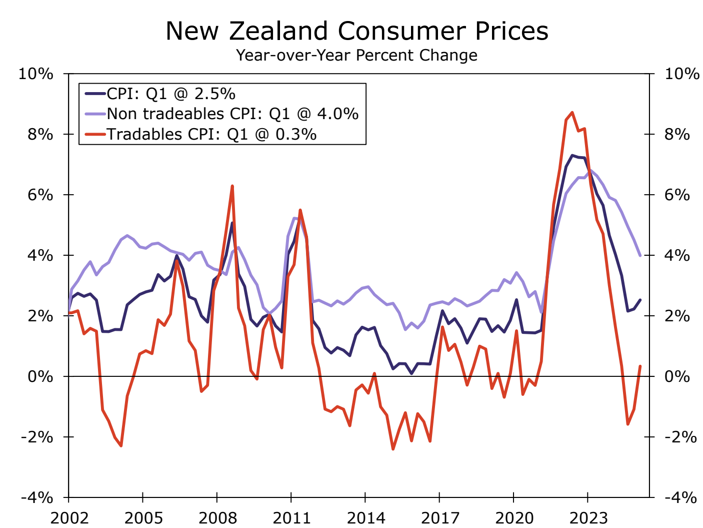
- Core inflation is declining and there is spare productive capacity in the economy. These conditions are consistent with inflation returning to the mid-point of the 1 to 3 percent target band over the medium term.
- The economy is recovering after a period of contraction. High commodity prices and lower interest rates are supporting overall economic activity.
- Recent developments in the international economy are expected to reduce global economic growth.
- Inflation is within the target band, and the Committee is well placed to respond to domestic and international developments to maintain price stability over the medium term.

The RBNZ's updated economic projections still pointed to an overall easing bias. The Official Cash Rate is projected to decline to 2.9% by Q4-2025, implying at least one, and perhaps two, more 25 bps rate cuts over the rest of this year. That moderate further easing reflects the RBNZ's forecast that CPI inflation will edge slightly higher in the near term, reaching 2.7% year-over-year in Q3-2025, before settling back close to the 2% target over the medium term. Q1 GDP is forecast to rise 0.4% quarter-over-quarter, and grow modestly in Q2 and Q3, before the pace of growth picks up from late 2025.

Of note, there were also indirect indications from RBNZ policymakers the central bank's easing cycle might be nearing its end. RBNZ Governor Hawkesby said “we have done a lot of work” and that “we're in a good position such that we can respond to developments as they occur.” In addition, when asked whether the policy rate was approaching a neutral level, chief economist Conway said “we are definitely into that zone.” Overall, we believe this week's announcement suggests the RBNZ policymakers will give even more careful consideration as it decides whether, and when, to lower interest rates at upcoming monetary policy meetings.



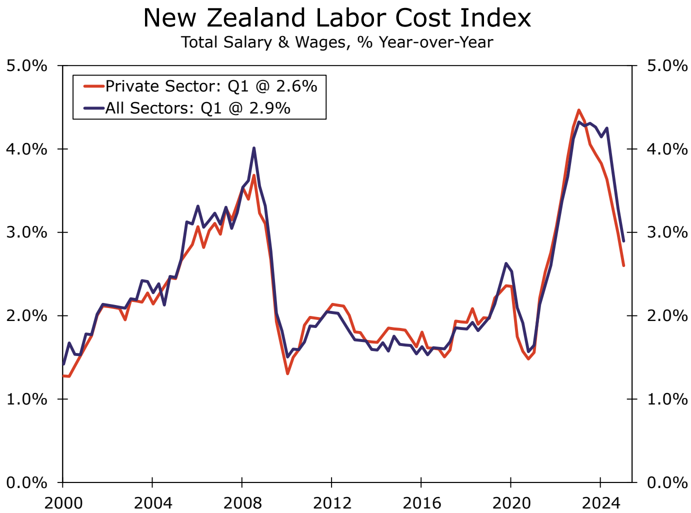
Source: Bloomberg Finance L.P. and Wells Fargo Economics



Source: Datastream and Wells Fargo Economics

Inflation Pressures to Ease Further, Even as Economy Stabilizes

We agree with the RBNZ's overall assessment that further monetary easing appears more likely than not. After a period of weak economic growth, various measures suggest the economy is currently operating in a state of excess capacity. Employment has declined a cumulative 0.7% over the past four quarters, which has seen the unemployment rate rise to 5.1%, near its most recent peak seen during the pandemic. Against this backdrop of excess capacity and a softening labor market, wage growth is also decelerating. The Q1 Labor Cost Index showed private sector salaries and wages slowing to 2.6% year-over-year, while for all sectors, salaries and wages slowed to 2.9%. Thus, even in the absence of a pickup in productivity, there are reasons to expect underlying inflation pressures to ebb further, which we think would translate to a further deceleration in non-tradables inflation and core inflation measures.



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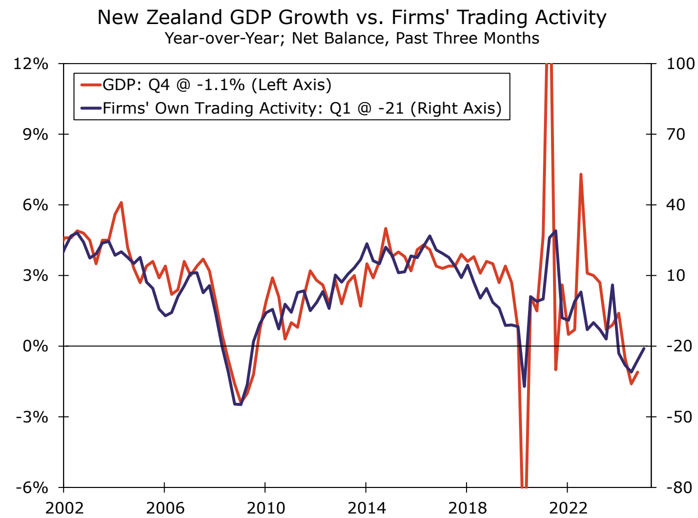

Source: Bloomberg Finance L.P. and Wells Fargo Economics

At the same time, there are also indications that the New Zealand economy has started to stabilize after a very weak period of economic growth. Q4 GDP rose 0.6% quarter-over-quarter after two straight quarterly declines. Quarterly business confidence improved further to +19 in Q1 from +16 in Q4. Moreover, firms assessment of their own trading activity was less negative during the first quarter, at -21. As we have highlighted previously, this latter metric is especially important, as firms' assessment of their own activity has historically tended to be the more reliable guide to overall GDP growth. Admittedly this quarterly business confidence survey was conducted from late February through late March, during a period when tariff and trade tensions were front-of-mind, but ahead of the Liberation Day tariff announcements. Given some de-escalation in trade and tariff tensions since early April however, we believe the message of a stabilizing New Zealand economy from early 2025 is still valid. In addition, other indicators—while mixed—are also consistent with our view of economic stabilization. Q1 real retail sales rose 0.8% quarter-over-quarter, which was much stronger than the flat outcome expected by economists. The New Zealand Activity Index, which aggregates high frequency and timely data, firmed further to 1.6% year-over-year in April, from 1.4% in March. Finally, the New Zealand PMI readings have been mixed in recent months, as the manufacturing PMI improved to 53.9 by April, while the services PMI slipped to 48.5. Overall however, we see enough evidence to suggest that New Zealand economic growth is at least stabilizing and, indeed, there could even be some potential for GDP growth to exceed relatively subdued expectations in the quarters ahead.

Taken together, we view the combination of ebbing wage and price pressures and a stabilizing economy as consistent with a continued but slower pace of RBNZ policy rate cuts. We remain comfortable with our base case, which envisages the central bank transitioning to a once-per-quarter policy rate cut pace. Our outlook for the next several monetary policy meetings is for a pause in July, a 25 bps rate cut in August, a pause in October, and a 25 bps rate cut in November, for the policy rate to reach a low of 2.75% by the end of this year. We also view the risks around this view as relatively balanced. Should trade and tariff tensions de-escalate on a more sustained basis, and U.S. and global economic activity prove stronger than expected, so too could New Zealand's economy perform more strongly and the central bank truncate its easing cycle. On the flip side, given New Zealand's soft labor market and slowing wage growth, and should trade tensions resurface, a more prolonged easing cycle remains possible. In summary, while we are comfortable the Reserve Bank of New Zealand is near the end of its monetary easing path, the exact destination will still depend to a significant extent on how trade and tariff tensions evolve in the months ahead.

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