

# New Zealand Fixed Income Monthly July 2024

Dovish pivot by central bank seen fuelling already high rate cut expectations

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7 August 2024

## RBNZ's latest Monetary Policy Review suggests dovish pivot on interest rates

The Reserve Bank of New Zealand (RBNZ) stood pat on interest rates in its latest Monetary Policy Review on 10 July, but it signalled a shift towards a more dovish stance, suggesting that a first rate cut could be conducted by the end of 2024. Although New Zealand's Official Cash Rate (OCR) has stood at 5.5% since May 2023, when it was hiked by 25 basis points (bps), RBNZ's latest meeting summary did not mention the possibility of further tightening. It also included an explicit observation that monetary policy was reducing domestic demand and consumer price inflation. The summary also expressed confidence that inflation would return to the RBNZ's target range of 1-3% per annum in the second half of 2024. Perhaps most importantly, the RBNZ followed a sentence on the need for monetary policy to remain restrictive with the following comment: "The extent of this restraint will be tempered over time consistent with the expected decline in inflation pressures". We feel that the affirmative tone of the word "will", for example, is particularly significant. This stands in contrast with the RBNZ's 22 May Monetary Policy Statement, in which the central bank commented that further OCR hikes may still be considered and did not forecast rate cuts before the second half of 2025.

## November 2024 seen as possible timing of first rate cut

The change in the RBNZ's tone raises questions about the likely timing and extent of future interest rate reductions. Market expectations for future OCR cuts are extremely high, with markets anticipating close to 166 bps of cuts over the coming year and another 66 bps in the following year. Given that the RBNZ meets seven times a year, this would involve the central bank making 25-point cuts in at least six out of seven meetings going forward. It would also require the cuts to start before the release of New Zealand's consumers price index (CPI) figure for the September 2024 quarter on 16 October. Our view is that a continued decline in inflation is a key condition for any tempering of monetary policy as the RBNZ appears to be taking a data-dependent approach. Given that the annual rate of inflation has eased in every three-month period since the March 2023 quarter and sat at 3.3% as of the June 2024 quarter, the market's high expectations for rate cuts are understandable. However, the RBNZ may be mindful of the risk of a shock such as a geopolitical event causing an upside jolt to CPI after the central bank has started cutting rates. It will also be aware that easing is already underway as a result of markets pricing in future cuts, for example through lower mortgage rates. Our central view remains that the first rate reduction will occur in November. There is also some risk that the RBNZ could start cutting in October. Although we have not ruled out a reduction in August, we believe that the likelihood of a cut being made at that timing is quite low.

## Timing and extent of rates to be determined by key events

Looking ahead, we intend to monitor a number of key events that will influence how fast and how far rates fall. One important development will occur when the RBNZ delivers its first cut and presents its forward view on rates. Action and communication by the Federal Reserve in the US will also be pivotal. On the domestic data front, New Zealand's unemployment numbers and its CPI for the September 2024 quarter will be key data points.

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