

New Zealand Fixed Income Monthly August 2024

RBNZ's rate cut unlikely to have immediate impact amid ongoing economic weakness

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Lower interest rates expected to take time to impact economy

One of the most significant developments for New Zealand's bond market in recent weeks was the Reserve Bank of New Zealand (RBNZ)'s decision to cut the Official Cash Rate (OCR) from 5.5% to 5.25% on 14 August. Given that it was the first change in the OCR since a quarter-point interest rate hike in May 2023, the cut marked a dovish pivot by the RBNZ after almost a year and a half of extremely restrictive financial conditions. In addition, the RBNZ's projections indicate that rates will be cut by 25 basis points at the central bank's next three monetary policy meetings, which will be held in October 2024, November 2024 and February 2025. However, the market is pricing in a more aggressive cutting trajectory than the RBNZ, primarily because it has a more negative outlook on New Zealand's economy than the central bank. Given that the RBNZ considers the medium-term neutral level for rates to be approximately 3%, the August rate cut appears to constitute a slight easing of the brakes rather than a large change. Conditions are still restrictive with the OCR at 5.25%. The first signs of recovery are likely to be seen in improvements in business and consumer confidence, but it will take some time for the impact to filter through to borrowers.

Key indicators paint picture of falling inflation amid economic weakness

New Zealand's key economic indicators paint a picture of declining inflation paired with ongoing economic weakness. The latest official data show that New Zealand's consumers price index (CPI) stood at an annual rate of just 3.3% in the June quarter. Furthermore, when the next data is released later in the year, the annual figure is set to drop off considerably from the high rate of 5.6% recorded for the September 2023 quarter. The RBNZ therefore expects annual CPI to decline to 2.3% by the September 2024 quarter. New Zealand's GDP has also been subdued, with official figures showing that growth was just 0.2% in the March 2024 quarter compared to the preceding three-month period. The data also show that quarter-on-quarter GDP growth was negative in three of the last five quarterly terms. In addition, the RBNZ is forecasting that the next two quarterly GDP figures will also be negative.

Government seen as broadly neutral for economy

As less than a year has passed since New Zealand voted in its current administration (a centre-right coalition led by the New Zealand National Party), it is also interesting to note the impact the government is having on the economy. The RBNZ suggested in its August Monetary Policy Statement that current government activity is broadly neutral for New Zealand's economy while also noting that a decline in government expenditure is dampening demand. On the other hand, the government has announced tax relief measures, such as increases in personal income tax thresholds, which the RBNZ observes are likely to support household spending. This suggests that the effects of lower government spending and tax cuts are broadly balancing each other out.

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