

Review: RBNZ Monetary Policy Review and OCR call change

8 October 2025

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Front-loading

- The RBNZ cut the Official Cash Rate (OCR) 50bp to 2.50% today, with balanced messaging that left open the option of a pause, a 25bp or a 50bp cut at the next meeting in November, depending on how the data evolves. Overall, it can best be characterised as front-loading the easing they forecast back in August, rather than signalling strongly that they believe they will need to do more.
- We are forecasting a follow-up 25bp cut in November taking the OCR to 2.25%, with that to mark the end of the easing cycle. We see risks on both sides of that. If the data continues to disappoint, another 50bp cut is possible. But it's entirely possible that activity data will start to surprise to the upside from here – the bar for that is low.

In brief

Markets and economists were split going into today's meeting between a 25bp or a 50bp cut, with the data easily justifying either decision. The Committee discussed both options but reached consensus on 50bp without requiring a vote. The discussion is summed up by these paragraphs in the Summary Record of Meeting:

The case for reducing the OCR by 25 basis points emphasised that past reductions in the OCR continue to transmit through the economy and there are signs of recovery in consumption and employment growth. Some members highlighted that constrained supply and cost pressures on businesses present upside risks to inflation. Financial conditions are influenced by the current level and expected future path of the OCR. Reducing the OCR by 25 basis points at this meeting, and signalling that further easing is likely in November, could be sufficient to deliver a sustained economic recovery while giving the Committee confidence that inflation will converge quickly to the 2 percent target mid-point.

The case for reducing the OCR by 50 basis points emphasised prolonged spare capacity and the associated downside risk to medium-term activity and inflation. Domestic inflationary pressures have continued to moderate as projected, giving the Committee more confidence that inflationary pressures are contained. Some members continue to put relatively more weight on the risk that excess precaution by households and businesses and, therefore, subdued economic activity and employment persists. A larger reduction in the OCR could mitigate this risk by providing a clear signal that supports consumption and investment.

After yesterday's soft demand-side indicators in the QSBO we described today's decision as approaching a coin-toss, while sticking with our 25bp cut view. And both the above arguments are entirely valid. The RBNZ is clearly valuing strategic optionality, as we thought they would. Our take was that a dovish 25bp cut would maximise that, but the Committee has instead chosen to deliver a 50bp cut that we'd described as 'front-loading': they are "open" to further easing, but stopped well short of promising it. That means they could deliver nothing, a 25bp cut or a 50bp cut in November and refer back to what they said this month without blushing, assuming the data between now and then supports their case.

The market went into the announcement with 36bp of cuts priced in, with the low point in the OCR assumed to be 2.19% in May. Following today's decision, all forward expectations fell, as did the Kiwi.

Key quotes

- **OCR decision:** “On balance, the Committee reached consensus to reduce the OCR by 50 basis points to 2.5 percent.”
- **OCR outlook:** “The Committee remains open to further reductions in the OCR as required for inflation to settle sustainably near the 2 percent target mid-point in the medium term.”
- **Inflation outlook:** “Annual consumers price index inflation is currently around the top of the Monetary Policy Committee’s 1 to 3 percent target band. However, with spare capacity in the economy, inflation is expected to return to around the 2 percent target mid-point over the first half of 2026.”
- **Domestic activity:** “Economic activity through the middle of 2025 was weak. In part, this reflects domestic constraints on the supply of goods and services in some industries, and the impact of global economic policy uncertainty.”
- **Output gap:** “[T]he Committee has revised its assessment of current spare capacity only marginally in response to new GDP and activity data, but note that the new data imply some downside risk.”
- **Global outlook:** “Economic growth in New Zealand’s trading partners is proving resilient, partly because of strong investment in AI-related activity, but is expected to slow in 2026.”
- **Risks:** “There are upside and downside risks to the inflation outlook in New Zealand. Cautious behaviour by households and businesses could slow the economic recovery, reducing medium-term inflation pressure. Alternatively, higher near-term inflation could prove to be more persistent”

Our take

Today’s Monetary Policy Review will fade quickly into the rear-view mirror as the focus turns squarely to the data flow to determine the next move (starting with Q3 CPI in 12 days’ time), and that is how it should be. The decision to front-load easing was of course dovish but the signals about what comes next were neither dovish nor hawkish. The RBNZ hasn’t overreacted to the GDP data, taking a fair amount of column space to discuss why it might be overstating weakness, and that they haven’t changed their minds much about the current degree of spare capacity in the economy. At face value, that implies that if they had published an OCR track today, it wouldn’t necessarily dip much below 2.5%.

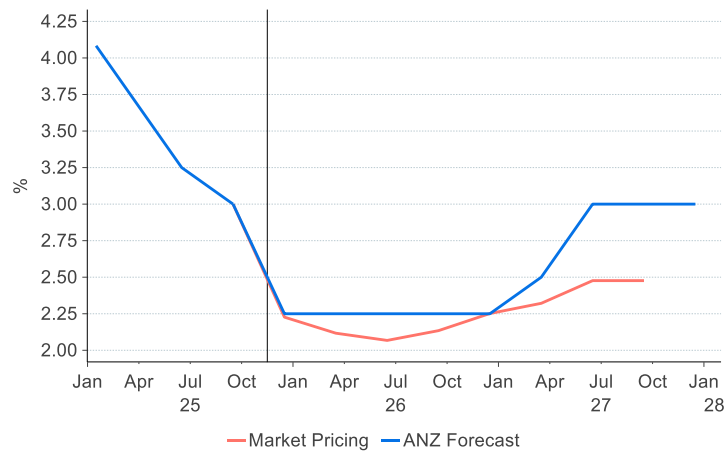
The Committee is keeping an open mind as to what the next move should and will be, as are we. Turning points are very messy, and this is not the time of the cycle to be hubristic about one’s ability to forecast precisely what’s needed or what will be delivered, particularly given the long lags with which monetary policy decisions work their way through the economy.

But forecast we must, so we are pencilling in another 25bp cut in late November, with that to mark the end of this easing cycle. By then, we expect more evidence to have accumulated that the economy is indeed responding to previous easing (and by February, even more so). Even if things are still a bit mixed and patchy, the temptation to wait and see how things go is likely to be strong.

We can see risks on both sides of our forecast for a 25bp cut in November. The QSBO suggested downside risks to Q3 GDP, but a cut is not a given: this 50bp cut was effectively sold as front-loading of the easing they forecast in August. The Committee noting only that they were “open” to further easing, not that they expected to deliver it. If the data starts to pick up meaningfully, they won’t cut. We’d note that the bar for upside surprises is low, given how subdued growth forecasts are. We’re certainly not hawkish, but we’re wary of doubling down on dovish views at the most pessimistic point of the cycle.

Market pricing will undoubtedly wax and wane with the data over the weeks ahead, and there will be plenty of both noise and signal. But stepping back and looking at the big picture, the economy is past the worst. There's uncertainty about exactly what the bottom of the monetary policy cycle will look like. But barring significant new shocks to the outlook, we can all agree we're a heck of a lot closer to the end of the easing cycle than we are to the start.

Figure 1. OCR: Market pricing and ANZ forecast



Source: RBNZ, ICAP, Bloomberg, Macrobond, ANZ Research

Financial markets

Short-end interest rates fell immediately, with the 2-year swap rate down around 7bp to a new cycle low of 2.56%. While that was a logical reaction to today's outsized cut, the RBNZ stopped short of explicitly signalling another cut, opting instead just to say that they were open to it. In the context of a market that has now moved to price in a 27bp cut in November and an OCR low point of 2.10%, the onus will now be on the data to demonstrate that financial conditions will need to be materially easier. That doesn't mean that we think the short end has gone too far, necessarily, but our interpretation of the RBNZ's frame of mind isn't quite as dovish as the market's.

Not surprisingly, the Kiwi fell on the decision. It has been very sensitive to market expectations for the OCR over recent weeks, and it was dragged lower as short-end interest rates fell, settling at around 0.5750, broadly matching lows seen last month.

Media Release – OCR reduced to 2.5%

Annual consumers price index inflation is currently around the top of the Monetary Policy Committee's 1 to 3 percent target band. However, with spare capacity in the economy, inflation is expected to return to around the 2 percent target mid-point over the first half of 2026.

Economic activity through the middle of 2025 was weak. In part, this reflects domestic constraints on the supply of goods and services in some industries, and the impact of global economic policy uncertainty. Household consumption is recovering, partly because of lower interest rates, and elevated commodity prices continue to support the primary sector. House prices are flat, and residential and business investment remain weak.

Economic growth in New Zealand's trading partners is proving resilient, partly because of strong investment in AI-related activity, but is expected to slow in 2026.

There are upside and downside risks to the inflation outlook in New Zealand. Cautious behaviour by households and businesses could slow the economic recovery, reducing medium-term inflation pressure. Alternatively, higher near-term inflation could prove to be more persistent.

On balance, the Committee reached consensus to reduce the OCR by 50 basis points to 2.5 percent. The Committee remains open to further reductions in the OCR as required for inflation to settle sustainably near the 2 percent target mid-point in the medium term.

Summary record of meeting – October 2025

Annual consumers price index (CPI) inflation remains within the Monetary Policy Committee's 1 to 3 percent target band. While inflation is currently near the top of the band, spare capacity is consistent with headline inflation returning towards the target mid-point in the first half of 2026.

Annual CPI inflation is expected to converge to the target midpoint

The Committee considers all economic developments as they relate to its medium-term inflation target. Annual CPI inflation is expected to converge to the mid-point of the target range in the first half of next year as tradables inflation pressures dissipate and spare capacity continues to moderate domestically generated inflation.

The Committee noted that headline inflation is projected to have reached 3.0 percent in the September 2025 quarter, reflecting large increases in administered prices, food prices, and the prices of other tradable goods and services. Excluding the influence of administered prices, quarterly non-tradables inflation has continued to decline and is at levels consistent with price stability.

There is significant spare capacity in the domestic economy

The Committee discussed the contraction in GDP in the second quarter of 2025, which was considerably larger than expected. The Committee noted that an unusually large seasonal balancing item contributed to the weakness in the headline figure. This is expected to be reversed during the remainder of the year and is not assumed to have material implications for monetary policy.

Additionally, some industry-specific factors may have constrained supply. For example, high milk prices and unfavourable weather conditions likely contributed to higher livestock retention and lower meat production. Limited access to domestic energy sources and higher energy prices are likely to have weighed on manufacturing more generally. These factors reflect lower supply capacity, rather than weaker demand.

Consequently, the Committee has revised its assessment of current spare capacity only marginally in response to new GDP and activity data, but note that the new data imply some downside risk.

More timely indicators suggest that economic activity recovered modestly in the September quarter, but there remains significant spare capacity in the New Zealand economy.

Lower interest rates will support a recovery in growth

The Committee discussed the transmission of monetary policy. Wholesale interest rates have fallen since the August Statement, particularly at shorter terms. This has resulted in lower rates on business lending, mortgage lending, and term deposits, supporting new borrowing and investment. The average interest rate on existing mortgages is expected to continue to decline over the coming year as mortgage holders re-fix onto lower rates, reducing debt servicing costs for households.

The Committee discussed the outlook for interest-rate-sensitive parts of the economy. Slow growth in disposable incomes and house prices continue to weigh on economic activity, but lower interest rates are supporting a recovery in consumption. Construction activity is projected to recover from mid-2026 as demand for dwellings recovers and house price growth resumes. The Committee expects this to reduce spare capacity in the economy and support an increase in business investment, even as export prices moderate from elevated levels, and government spending declines as a share of the economy.

Trading partner growth has been resilient but is expected to slow

The Committee discussed the impact of trade restrictions and tariffs on the global economy. Aggregate global trade volumes and economic activity have so far proven resilient. Growth forecasts for 2025 have been revised higher for many of our trading partners, particularly for China, Taiwan, and some other Asian economies. This reflects increased investment in AI-related industries, adaptation of trade flows and global supply chains to new tariffs and trade restrictions, and accommodative fiscal and monetary policy in some economies. However, growth expectations for 2026 have recovered to a lesser extent, with trading-partner growth expected to slow.

Global inflation has continued to decline through 2025. Inflation is especially low throughout Asia, and negative in China. Headline inflation in the United States has increased, but evidence suggests that pass-through of tariffs to consumer prices has so far been weaker than expected. To date, there is little evidence of a material impact of tariffs on the prices of New Zealand's imports or exports. The Committee continues to expect that the total net effect of global tariffs on the New Zealand economy will be disinflationary.

Economic activity in New Zealand has been subdued relative to other economies, resulting in a lower exchange rate. This, together with high commodity export prices, is providing some support to the domestic economy in the very near term, particularly in rural and exporting regions of New Zealand. If sustained, a lower exchange rate may limit the pass-through of lower international prices for imported goods to New Zealand.

There are upside and downside risks to the global growth outlook

The Committee discussed whether recent global developments presented upside or downside risk to inflationary pressure in New Zealand. On the upside, global economic activity has been stronger than anticipated and measures of uncertainty have fallen. In the near term, resilient global demand and a low New Zealand dollar exchange rate may provide more support than expected for New Zealand exports and growth, as well as higher inflation.

On the downside, there is uncertainty about how long elevated equity prices and increased investment activity in the AI technology sector will be sustained. In addition, political and institutional uncertainty in some economies and heightened geopolitical risk may contribute to higher term premia and increased volatility in bond markets. Furthermore, resilient global growth in 2025 may represent a difference in the timing, rather than the extent, of the negative impacts of trade restrictions on growth.

There are upside and downside risks to domestic inflationary pressure

The Committee discussed upside risks to domestic inflation. Businesses continue to face cost pressures from administered prices, such as local council rates, and some energy charges. The Committee's central expectation is that inflation reached 3.0 percent in the September quarter. Given the two-sided uncertainty around any forecast, there is a material possibility that September quarter inflation was outside the target band. If inflation was to remain higher for longer than expected, there is a risk that this influences inflation expectations and wage- and price-setting behaviour over the medium term.

The Committee discussed the risk that potential output growth could slow by more than currently expected. Growth in potential output is being constrained by subdued investment, low productivity, and low population growth through net immigration. This limits the rate of growth the economy can sustain without generating additional inflationary pressure. In an environment of constrained supply, inflation could stay elevated for longer as demand recovers.

The Committee discussed downside risks to domestic demand and inflation. There remains a risk that excess precaution from households and businesses dampens consumption and investment by more than currently assumed. There is also a risk that declines in short-term interest rates may not provide sufficient support for growth. Borrowing and investment decisions are influenced by interest rates across the entire yield curve, and interest rates at the 5-year tenor have not fallen as far as rates at shorter maturities.

The Committee agreed to reduce the OCR by 50 basis points to 2.5 percent

In light of recent economic developments and the balance of risk, the Committee discussed the options of reducing the OCR by 25 basis points or by 50 basis points at this meeting.

The case for reducing the OCR by 25 basis points emphasised that past reductions in the OCR continue to transmit through the economy and there are signs of recovery in consumption and employment growth. Some members highlighted that constrained supply and cost pressures on businesses present upside risks to inflation. Financial conditions are influenced by the current level and expected future path of the OCR. Reducing the OCR by 25 basis points at this meeting, and signalling that further easing is likely in November, could be sufficient to deliver a sustained economic recovery while giving the Committee confidence that inflation will converge quickly to the 2 percent target mid-point.

The case for reducing the OCR by 50 basis points emphasised prolonged spare capacity and the associated downside risk to medium-term activity and inflation. Domestic inflationary pressures have continued to moderate as projected, giving the Committee more confidence that inflationary pressures are contained. Some members continue to put relatively more weight on the risk that excess precaution by households and businesses and, therefore, subdued economic activity and employment persists. A larger reduction in the OCR could mitigate this risk by providing a clear signal that supports consumption and investment.

On balance, on Wednesday 8 October the Committee reached consensus to reduce the OCR by 50 basis points to 2.5 percent. The Committee remains open to further reductions in the OCR as required for inflation to settle sustainably near the 2 percent target mid-point in the medium term.

Attendees:

MPC Members: Christian Hawkesby (Chair), Carl Hansen, Hayley Gourley, Karen Silk, Paul Conway, Prasanna Gai

Treasury Observer: James Beard

MPC Secretary: Evelyn Truong

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