

New Zealand Fixed Income Monthly May 2025

Monetary and fiscal policies seen working together as rate cutting cycle nears end

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Latest interest rate reduction seen as hawkish given scale of cuts to date

May was an eventful month for New Zealand's bond market, marked by key events such as the release of the latest Monetary Policy Statement (MPS) by the Reserve Bank of New Zealand (RBNZ) on 28 May. This followed the New Zealand Treasury's announcement of the 2025 Budget just six days earlier. The RBNZ lowered the Official Cash Rate (OCR) by 25 basis points to its current level of 3.25%. Although the move was widely expected, we feel it is reasonable to see the reduction as a hawkish one. As it was the latest of six consecutive cuts in which the OCR was lowered from 5.5% to 3.25% in the space of less than a year, we believe we are moving closer to the point at which the RBNZ will consider pausing the cycle to observe the benefits the current monetary policy settings can bring to the economy. For us, another key factor is that the central bank has previously indicated that it deems the "neutral" level for interest rates, at which monetary policy is seen as neither expansionary nor contractionary for the economy, to stand somewhere between 2.5% and 3.5%, and the OCR is already within that range.

Central bank's tone also seen hinting at future pause to cutting cycle

In our view, the tone of the MPS also suggests that the current interest rate cutting cycle may be nearing its end. One significant point to note is that the RBNZ's monetary policy already appears to be impacting mortgage interest rates. Specifically, the MPS includes an observation that the average interest rate on New Zealand's stock of mortgages is likely to continue to decline in the coming quarters as increasing numbers of borrowers refix at lower fixed-term rates, with close to 50% of the mortgage stock due to be repriced in the June and September 2025 quarters. Given these considerations, we believe that the key point to note on the OCR has now become the length of time at which it is likely to remain stimulatory.

Fiscal approach in 2025 Budget seen working in tandem with monetary policy

With the New Zealand Treasury unveiling the country's 2025 Budget less than a week before the MPS release, May also provided an opportunity to observe the potential synergy between the country's fiscal and monetary policies. In our opinion, it is important for neither of the two policies to dominate the other in order for the RBNZ's inflation, growth and employment objectives to be met, and we feel that this equilibrium was broadly achieved with the Budget. One example of this is the relative lack of new spending in the Budget, which we believe will be beneficial for the RBNZ's inflation objective.

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