

SALT INSIGHT

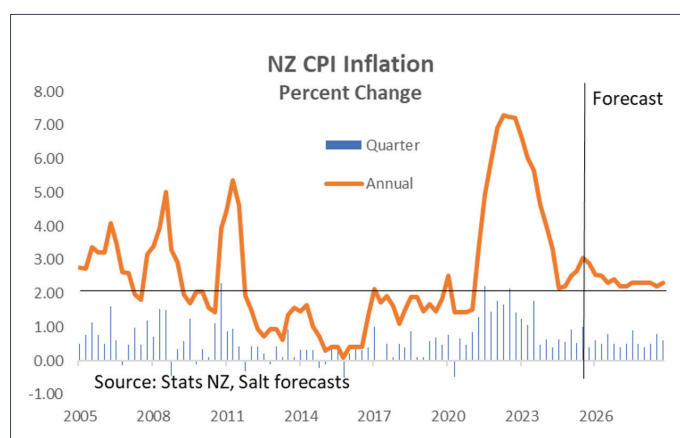
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One more and done?

The New Zealand economy is turning a corner, and we are now close to the bottom of the easing cycle. When the Reserve Bank of New Zealand front-loaded its 50bp cut in October, it signalled that more easing was likely. Taking that guidance at face value, a further 25bp cut next week looks the path of least resistance, accompanied by a dovish signal that the door remains open to additional easing if required. With the long summer hiatus between RBNZ meetings approaching (surely something the incoming Governor will want to revisit), the Bank will also be reluctant to risk any tightening in financial conditions over the break.

That said, we continue to view this as a “one-more-and-done” scenario. The data has begun to improve in what was always likely to be a slow, grinding recovery. Early indications of a labour-market turnaround are emerging, with job ads and hours worked lifting, while several activity indicators have nudged higher. Consumer spending has come off its lows but remains subdued, held back by weak population growth and a flat housing market, both of which are limiting the traction from the 300bps of easing delivered so far.

On the inflation front, the annual increase in the CPI hit 3.0% in the year to September, the top of the RBNZ’s 1–3% target band. We share the view that this is the peak and expect the annual rate to move lower over the coming months.



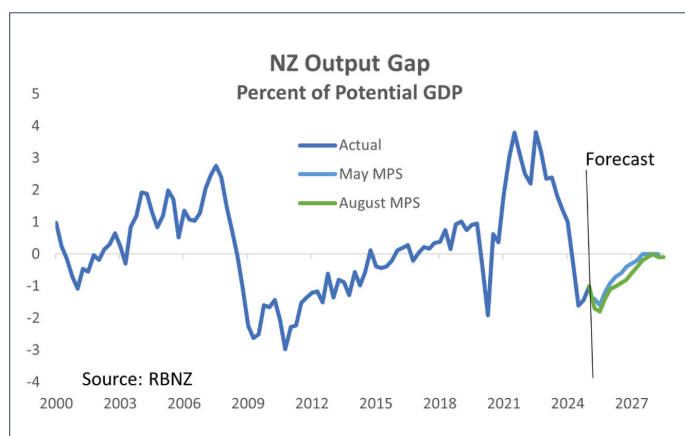
Two risks bear watching: household inflation expectations and business margins. Expectations remain well behaved for now, with no evidence of drift following the recent uptick in headline inflation. Expanding business margins, however, are a more material risk—particularly as the recovery gains momentum through next year. Businesses want to recover greater profitability, after years of doing it tough.

Also, the New Zealand dollar is weaker than the Reserve Bank assumed in August, with the Trade Weighted Exchange Rate Index (TWI) currently averaging just under 3% below those projections. This will add to inflation in the period ahead.

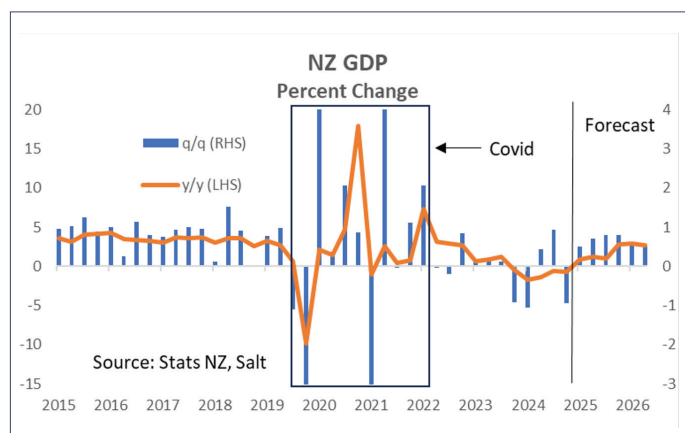
As always, the RBNZ must look ahead, setting policy

today to deliver target-consistent inflation over the medium term. Two variables dominate that assessment, the amount of spare capacity in the economy (the output gap) and the economy's potential growth rate, or the rate of GDP growth consistent with stable at-target inflation. Both are unobservable and must be inferred from imperfect data.

The output gap appeared to take a sizeable hit after June-quarter GDP showed a -0.9% contraction, compared with the RBNZ's forecast of -0.3%, following reported growth of +0.9% in the March quarter. As we noted at the time, we believe the first-half GDP data exaggerated the true volatility in underlying activity. The economy was clearly softer in the June than the March quarter, but a swing from +0.9% to -0.9% strains credulity. And nearly half of the June decline was driven by the "balancing item", which is likely to be revised away or offset in subsequent releases. The RBNZ would thus be unwise to take the full June contraction at face value when calibrating the output gap.

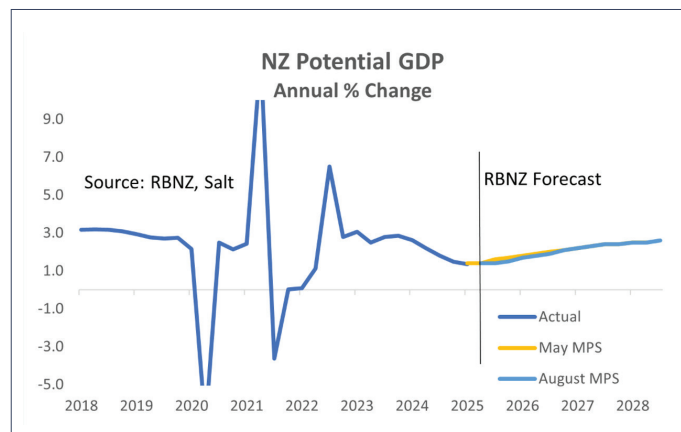


Moreover, the September quarter looks set to come in stronger than the RBNZ's previous forecasts. The Bank was expecting +0.3% quarter-on-quarter growth; we think something closer to +0.6% is more realistic based on current indicators.



This brings us to potential growth. Potential output is driven largely by labour-force growth and productivity. Right now, labour-force growth is subdued due to low

net migration, and New Zealand has long struggled on the productivity front. We expect the RBNZ to lower its estimate of potential growth in next week's forecasts, reflecting weaker-than-expected migration and no material change in productivity trends.



Against that backdrop, while a 25bp cut next week looks locked in, the hurdle for further easing is high. Additional cuts become likely only if the tentative signs of recovery falter.

The RBNZ must be careful not to over-ease. Monetary conditions are already stimulatory (though the degree is debatable) and pushing rates too low in an economy with weak potential growth risks amplifying the future cycle in both interest rates and output.

Our baseline remains that rate increases will likely be required from early 2027. Given variable lead times in monetary policy, easing a touch too far into early 2026 could potentially necessitate larger upward moves in the OCR, the following year.

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