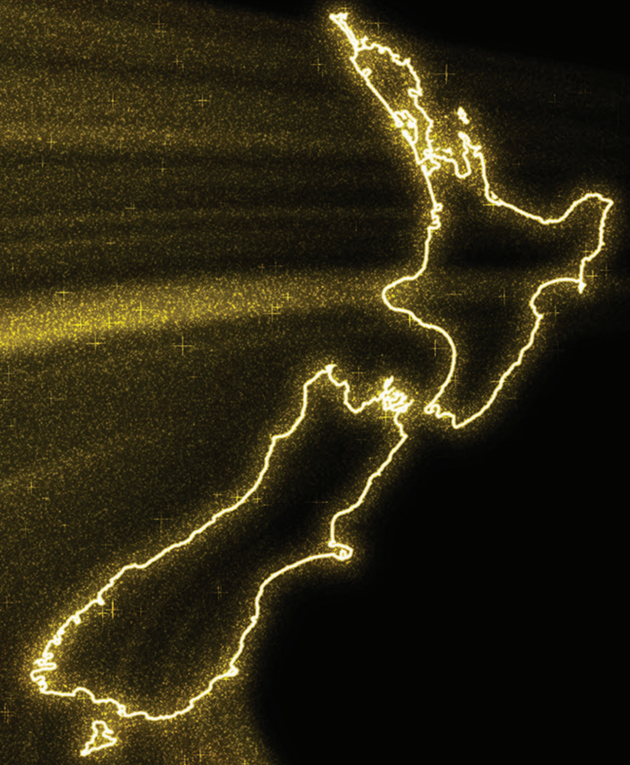
SALT
INSIGHT

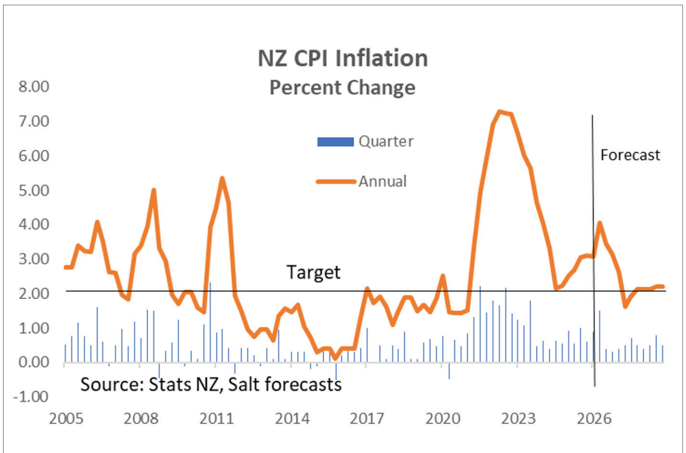
By: **Bevan Graham**, Economist
25 May 2026



A less than ordinary MPS

It's as close to a certainty it can get when talking about monetary policy that the next move in interest rates in New Zealand is up. That view is shaped by a combination of factors including current stimulatory monetary conditions, the recovering economy (albeit in a somewhat constrained and lacklustre manner), the low growth speed limit (aka potential growth) of the economy and resilient inflation.

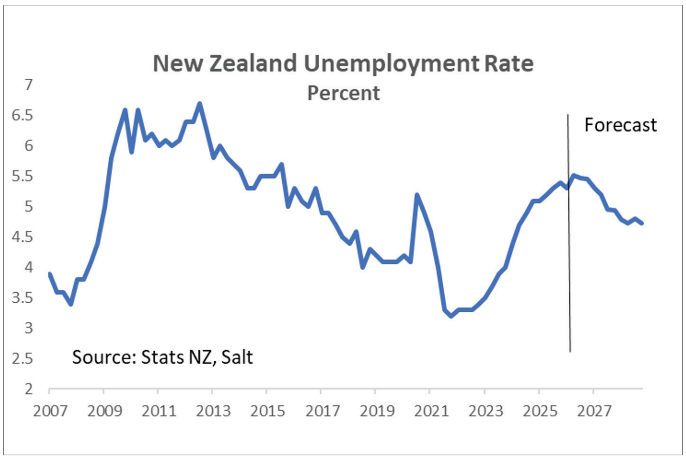
More recently, the war in Iran and the associated increase in fuel prices has thrown a stagflationary shock into the mix. Headline inflation will likely hit around 4.0% in the year to June, June quarter GDP growth will be close to zero, with a reasonable chance it will print negative, while the unemployment rate will likely move higher in the June quarter as employment intentions have collapsed and the working age population rises on stronger net inward migration.



That all makes the implications for monetary policy somewhat ambiguous. At the heart of the matter for an inflation-targeting central bank are the implications for second-round inflation effects. As is well understood, central banks will generally "look through" temporary supply shocks if they believe inflation expectations remain anchored and the hit to activity proves short-lived. Much depends on the duration of the conflict, the persistence of higher energy prices and whether households and businesses begin adjusting wage and price setting behaviour accordingly.

A number of factors are important here, however. This is not Covid 2.0. When the pandemic hit, the New Zealand economy was growing strongly, spare capacity was limited and the unemployment rate was sitting around 4%. In other words, the economy entered that shock from a position of underlying strength, even if activity was subsequently disrupted by lockdowns and supply chain distortions.

Today's environment looks very different. This latest supply shock is occurring at a time when the economy remains fragile, growth momentum is weak and there is already meaningful spare capacity in the system. The unemployment rate is now sitting at 5.3% and likely still heading higher, while household cashflows and business confidence remain under pressure. That should, at first blush, reduce the risk that higher fuel prices alone generate the kind of persistent, broad-based inflation pressures seen after Covid.



At the same time, the RBNZ cannot be complacent. Inflation was already proving sticky before the war, particularly across non-tradable components, and the economy's low potential growth rate means it does not take much demand to generate inflation pressure. The OCR is now sitting below most estimates of neutral and financial conditions have eased materially over recent quarters. That creates an uncomfortable backdrop for a central bank facing another inflation shock, even if the near-term growth impulse weakens.

That makes the timing of the first hike more uncertain, though we expect this week's RBNZ Monetary Policy Statement (MPS) will shed some light on the topic. The most recent set of projections from the February MPS (i.e. pre-war) had them starting the hiking cycle from late this year. That will be brought forward – the question is how far. There is a wide range of opinion amongst forecasters and market participants. For a while, markets were pricing a greater than 50% chance that the RBNZ would start raising rates this month, though that probability has more recently pulled back to around 25%, and professional forecasters are picking anything from May to September for the first move. We have September pencilled in, though it's not a view I'd be prepared to thump the table on. Let's see what Wednesday 2pm brings.