

New Zealand Fixed Income Monthly February 2024

Patience to be required in 2024 with near-term rate movements unlikely

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8 March 2024

OCR kept on hold again in February with additional rate hikes unlikely

The Reserve Bank of New Zealand (RBNZ) maintained the Official Cash Rate (OCR) at 5.5% at its latest Monetary Policy Committee meeting on 28 February, meaning that New Zealand's interest rates have now been kept on hold for over nine months. Further upward movement in rates looks particularly unlikely in 2024. Although the last change in the OCR was a rise of 0.25 percentage points in May 2023, we do not expect to see further rate hikes unless dramatic changes occur in the economic data. We agree with the RBNZ's decision to keep the OCR unchanged and feel that most indicators are moving in the central bank's favour. One example is New Zealand's GDP, which came in lower than expected in the September 2023 quarter with a contraction of 0.3% compared to the June quarter. It is also clear that inflation is easing, with the most recent figures showing that New Zealand's consumers price index fell from an annual rate of 5.6% in the September 2023 quarter to 4.7% in the December 2023 quarter.

Downward movement in rates also unlikely in near term

Despite the low likelihood of hikes, the RBNZ is also unlikely to cut the OCR in the near term and has been working to dampen market expectations for a quick pivot to rate cuts. In its 28 February Monetary Policy Statement, for example, the RBNZ emphasised that interest rates will need to remain restrictive "for a sustained period of time" to ensure that a sustained decline in capacity pressures in New Zealand's economy brings inflation down to its 1% to 3% target. Given this background, we maintain our view that the next move in rates will be downward, albeit at a later timing than the market has recently been expecting. It is important to note that the RBNZ is not forecasting a start to rate cuts until 2025. In terms of the expected size of the cuts, we think that the RBNZ could eventually lower the OCR from its current level of 5.5% to a range of 3.5% to 4%. At the same time, if rates are reduced in the US and New Zealand's inflation eases further, the possibility remains that rate cuts could come to New Zealand slightly earlier than the RBNZ is currently indicating.

Patience to be required in 2024 with inflation easing but remaining high

Looking ahead to 2024, we expect the fixed income market to pan out similarly to 2023, in which returns were concentrated in certain months rather than occurring consistently throughout the year. Given how difficult it is to predict when those returns will occur, we believe that the key attribute to have in fixed income markets during 2024 will be patience. Although we think that central banks around the world as well as the RBNZ will bring inflation under control in 2024, we also expect that inflation in New Zealand will be biased towards the high side rather than the low side over the next five to ten years. We hold this view for a variety of reasons, including the likely need for New Zealand to counter the impact of climate change and to spend on infrastructure. This is why we expect monetary policy to remain relatively tight with the OCR eventually only falling about 1.5 to 2 percentage points below its current level.

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