

New Zealand Fixed Income Monthly May 2024

New Zealand's long struggle with interest rates and inflation seen easing in 2024

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New Zealand on course to see lower interest rates

New Zealand's fixed income market has largely struggled in 2024 so far. This comes after bonds saw significant falls in November and December 2023. The market appears to have overpriced the prospect of interest rate cuts early in 2024. In its most recent rate decision on 22 May, however, the Reserve Bank of New Zealand (RBNZ) maintained the Official Cash Rate (OCR) at 5.5%. This means that the OCR has been at its current, elevated level for a year. Even so, we have a high conviction that the OCR will be lowered from its current level in the next six to 18 months. There is growing confidence that New Zealand will cut interest rates, largely because its economy is significantly weaker than before, particularly in comparison to the US and the rest of the world. New Zealand's GDP, for example, declined by 0.3% compared to the preceding quarter in the three months ended in September 2023 and by 0.1% compared to the prior quarter in the three months ended in December 2023. In contrast, consumers in the US have proved surprisingly resilient and the US economy is still thought to be on course for a soft landing. Until recently, it was widely assumed that the US would be the first economy to reduce interest rates.

Inflation seen easing back into central bank's target range by end of 2024

New Zealand's persistently high inflation raises the question as to when the RBNZ will feel that the time is right for a rate cut. Data released on 17 April showed that the consumers price index (CPI) remained above the RBNZ's target range of 1-3% per annum in the March 2024 quarter with an annual rate of 4.0%. This gap of one to two percentage points between the actual inflation level and the target band has proved stubborn. However, in the RBNZ's latest Monetary Policy Statement released on 22 May, the central bank emphasised that certain areas of the economy are now underpinning high inflation while price rises are easing in other areas. Specifically, the central bank commented that price rises were easing for goods and services imported from overseas, but it pointed out that domestic inflation was still seeing upward pressure in areas that are less sensitive to interest rates. These include dwelling rents, council rates and insurance costs, which are typically indexed or less competitive in nature than prices in other parts of the economy. It is also worth noting that we are seeing remarkable uniformity in economic and inflationary outcomes globally, and that many central banks are experiencing the same battle with sticky domestic inflation that is occurring in New Zealand. Although New Zealand's inflation numbers are set to remain elevated over the next six months, the RBNZ commented in its Monetary Policy Statement that annual CPI should fall back into its 1-3% target range by the end of 2024. More specifically, the expectation in the market is that inflation will retreat to the 2.5-3% level later in the year.

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