Reserve Bank of New Zealand
Te Pūtea Matua

Monetary Policy Statement.

February 2025

Policy assessment.
OCR 3.75% — OCR reduced further as inflation abates

The Monetary Policy Committee today agreed to reduce the Official Cash Rate by 50 basis points to 3.75 percent.

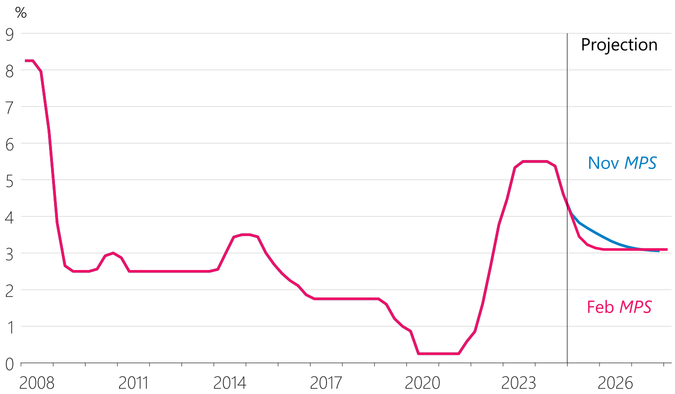
Annual consumer price inflation remains near the mid-point of the Monetary Policy Committee's 1 to 3 percent target band. Firms' inflation expectations are at target and core inflation continues to fall towards the target mid-point. The economic outlook remains consistent with inflation remaining in the band over the medium term, giving the Committee confidence to continue lowering the OCR.

Economic activity in New Zealand remains subdued. With spare productive capacity, domestic inflation pressures continue to ease. Price and wage setting behaviours are adapting to a low-inflation environment. The price of imports has fallen, also contributing to lower headline inflation.

Economic growth is expected to recover during 2025. Lower interest rates will encourage spending, although elevated global economic uncertainty is expected to weigh on business investment decisions. Higher prices for some of our key commodities and a lower exchange rate will increase export revenues. Employment growth is expected to pick up in the second half of the year as the domestic economy recovers.

Global economic growth is expected to remain subdued in the near term. Geopolitics, including uncertainty about trade barriers, is likely to weaken global growth. Global economic activity is also likely to remain fragile over the medium term given increasing geoeconomic fragmentation.

Figure i.1
Official Cash Rate (OCR)
(quarterly average)



Source: RBNZ estimates.

Consumer price inflation in New Zealand is expected to be volatile in the near term, due to a lower exchange rate and higher petrol prices. The net effect of future changes in trade policy on inflation in New Zealand is currently unclear. Nevertheless, the Committee is well placed to maintain price stability over the medium term. Having consumer price inflation close to the middle of its target band puts the Committee in the best position to respond to future inflationary shocks.

The Monetary Policy Committee today agreed to lower the Official Cash Rate by 50 basis points to 3.75 percent. If economic conditions continue to evolve as projected, the Committee has scope to lower the OCR further through 2025.

Meitaki, thanks.

Adrian Orr
Governor

Monetary Policy Framework

The Monetary Policy Committee operates and makes decisions under the Monetary Policy Framework that comprises the following key components:

- the *Remit*;
- the *Charter*;
- the *Code of Conduct*; and
- the monetary policy strategy.

The corresponding documents to these components and additional information can be accessed on our website under the Monetary Policy Framework.

Report and supporting notes published at:

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Thank you to RBNZ staff for photography in this report.

Cover: Buried Village of Te Wairoa. Photo: Allison Heydon

Monetary Policy Statement.
February 2025

Contents

The projections were finalised on 13 February 2025. The Official Cash Rate (OCR) projection incorporates an outlook for monetary policy that is consistent with the MPC's monetary policy assessment, which was finalised on 19 February 2025.

Chapter 01

Summary record of meeting

Te Pukatea Bay. Photo: Hamish Fitchett

Chapter 1.
Summary record of meeting

Annual consumer price index (CPI) inflation is sustainably within the Monetary Policy Committee's 1 to 3 percent target range, and measures of core inflation are continuing to converge to the mid-point. Measures of firms' inflation expectations sit close to the target mid-point.

A period of restrictive interest rates has reduced demand in the New Zealand economy and contributed to lower inflation. Subdued global economic activity, falling net immigration, and lower government consumption have slowed domestic demand. Increased policy uncertainty associated with global trade developments is also expected to decrease business investment. Headline inflation is expected to increase in coming quarters but remain within the target band. This increase reflects a lower New Zealand dollar exchange rate and higher oil prices. The Committee expects these relative price shifts will not affect inflation over the medium term. Expectations of future inflation, the pricing intentions of firms, and the degree of spare productive capacity are consistent with the CPI inflation target being sustainably achieved. This provides the context and the confidence for the Committee to continue lowering the OCR, and at a faster pace than projected in November.

Global economic activity is expected to remain subdued

The Committee noted that GDP growth for many of our main trading partners remains below potential. In contrast, economic growth in the US has remained strong. Trading partner GDP growth is assumed to decline slightly over 2025. Global economic uncertainty has risen significantly since November, following recent trade policy announcements by the United States. In the near term, we expect that heightened economic uncertainty will constrain business investment amongst our trading partners and in New Zealand.

Global headline inflation has increased modestly, reflecting higher energy prices

The Committee discussed inflation amongst New Zealand's trading partners. Headline inflation has declined over the past year but has increased slightly in recent months. The recent increase in headline inflation in many of our trading partners is largely accounted for by higher fuel and energy prices. Market participants expect most central banks in advanced economies to continue reducing policy interest rates over the coming year. Market pricing implies that US policy rates are projected to fall by less than assumed at the time of the November *Statement*.

GDP growth in New Zealand is expected to rise, reducing spare capacity in the economy

The Committee discussed recent domestic economic developments. Domestic economic activity remains below trend. This reflects falling activity in interest rate sensitive sectors such as construction, manufacturing, retail trade, and business investment. In contrast, activity in the primary sector has increased. New Zealand's export prices have held up, despite subdued global growth. Global supply conditions in beef and dairy markets have supported export prices. This, coupled with a lower New Zealand dollar exchange rate, will increase export sector incomes in New Zealand.

Timely indicators of economic activity, including a range of business surveys, have improved in recent months. Lower interest rates and higher export earnings are expected to support economic growth. The pace is expected to be modest, as potential GDP growth is constrained by ongoing weakness in productivity growth and lower net immigration.

Government spending is expected to decline as a share of the economy over the medium term, in line with the *Half-Year Economic and Fiscal Update* 2024.

GDP revisions better explain the evolution of core inflation over the past two years

GDP data was revised significantly since the November *Statement*. These revisions show that the level of New Zealand's economic activity in 2024 was higher than assumed in November. However, the revisions show the New Zealand economy experienced a larger contraction during the middle of 2024. Overall, there is significant spare capacity in the economy, and slightly more than we had assumed in November.

The new profile for GDP helps explain the evolution of core inflation and broader measures of capacity pressure over the past two years. The higher level of GDP over the start of 2024 aligns with the signal taken from high frequency data at the time. The subsequent decline in GDP over the middle of 2024 also aligns more closely with high frequency data, which was one of the factors that contributed to a downwards revision to the OCR outlook in August.

Employment remains subdued, but is expected to improve later this year

The Committee discussed conditions in the New Zealand labour market. Wage growth is slowing, consistent with lower demand for workers and lower CPI inflation. Employment levels and job vacancies have declined, reflecting subdued economic activity. As employment growth typically lags economic growth, it is expected to pick up in the second half of the year. Net immigration to New Zealand has reduced significantly from high rates over recent history. The number of migrant arrivals has slowed over the past year, and departures of New Zealanders have increased, partly in response to subdued labour market conditions relative to Australia.

Lower OCR continues to pass through to mortgage and term deposit rates

The Committee noted that wholesale interest rates in New Zealand have generally declined since the November *Statement*, in response to a lower OCR and weaker-than-expected economic activity. This decline in wholesale interest rates has been reflected in lower mortgage and term deposit rates. The average interest rate on outstanding mortgages has now peaked and is expected to decline over the next 12 months as borrowers refix their mortgage interest rates at lower levels.

The financial system remains stable

The Committee agreed that there is currently no material trade-off between meeting inflation objectives and maintaining financial system stability. Some households and businesses are continuing to experience financial stress. While non-performing loans remain low compared to past recessions, some financial stress will persist in the near term, even as the economy recovers. The banking system remains well capitalised and in a strong financial position to support customers.

Inflation is expected to remain within the target band

The Committee discussed domestic inflationary pressure. Headline CPI inflation and firms' inflation expectations at all horizons are close to the target mid-point. Measures of core inflation continue to converge on the target mid-point. Surveyed household inflation expectations remain more elevated and volatile.

Non-tradables inflation has fallen but remains high. With spare productive capacity remaining in the economy over the next 12 months, the Committee is confident that domestic inflationary pressures will continue to abate.

Headline inflation is expected to increase in coming quarters, reflecting a lower New Zealand dollar exchange rate and higher oil prices, but remain within the target band. However, underlying inflationary pressures are expected to continue to ease, and annual headline CPI inflation is forecast to remain near the 2 percent mid-point once the effect of recent increases in petrol prices on inflation wanes. The near-term increase in headline inflation is unlikely to significantly affect wage- and price-setting behaviour given excess capacity in the economy. The Committee noted that the monetary policy remit directs it to discount disturbances in inflation that are expected to be temporary, in a manner consistent with meeting the medium-term inflation target.

There are near-term risks to the economic outlook

The Committee discussed near-term risks to the outlook. The Committee noted that while lower interest rates are expected to underpin a recovery in the domestic economy, the speed and timing of the recovery is uncertain. In particular, recent revisions to June and September 2024 quarter GDP growth suggest momentum in the economy was considerably weaker than previously measured. The Committee noted that tighter international financial conditions presented downside risks to global growth, particularly for those countries with high debt levels or fixed exchange rate regimes. The Committee discussed global asset markets and the risk of a fall in equity prices if elevated earning projections are not realised, or if market participants reassess their appetite for risk.

There is a risk of increased trade barriers and broader geoeconomic fragmentation

The Committee discussed the risks posed by increased trade barriers. Over the medium term, these trade barriers could be increased much further. This is not currently incorporated into our central projection given uncertainty about the timing and magnitude of any potential changes. This uncertainty is heightened given trade protection is being used to pursue both economic and geopolitical goals.

Increased trade barriers will reduce global productive capacity. As a small open economy, New Zealand cannot avoid being affected by these international developments. Monetary policy cannot offset the long-term negative supply-side effects of higher barriers to international trade. More generally, global economic activity is likely to be more exposed to economic shocks given increasing geoeconomic fragmentation.

An increase in trade restrictions is likely to reduce economic activity in New Zealand. But the effects on inflation are uncertain, as these depend on how trade disruptions transmit through the global economy. Such shocks are likely to take time to materialise, giving the Committee flexibility to react as necessary. Any monetary response will depend on the impact of trade restrictions on medium-term inflationary pressures.

The global economy faces a range of structural challenges

The Committee discussed the long-term structural challenges faced by the economy in China and the broader region. In addition, the Committee noted that geopolitical and climate-related risks pose uncertainty over the medium term. There may be higher relative price volatility and more unpredictability in headline inflation. The Committee agreed that having consumer price inflation close to the middle of its target band puts it in the best position to respond to any shocks to inflation.

The Committee agreed to lower the OCR

With headline CPI inflation close to the mid-point, measures of core inflation converging on the mid-point, stable business inflation expectations, and significant spare capacity in the economy, the Committee agreed that a further reduction in the OCR was appropriate. The Committee agreed that a 50 basis point reduction would be consistent with their mandate of maintaining low and stable inflation, while seeking to avoid unnecessary instability in output, employment, interest rates and the exchange rate. If economic conditions continue to evolve as projected, the Committee has scope to lower the OCR further through 2025. On Wednesday 19 February the Committee reached a consensus to lower the Official Cash Rate by 50 basis points to 3.75 percent.

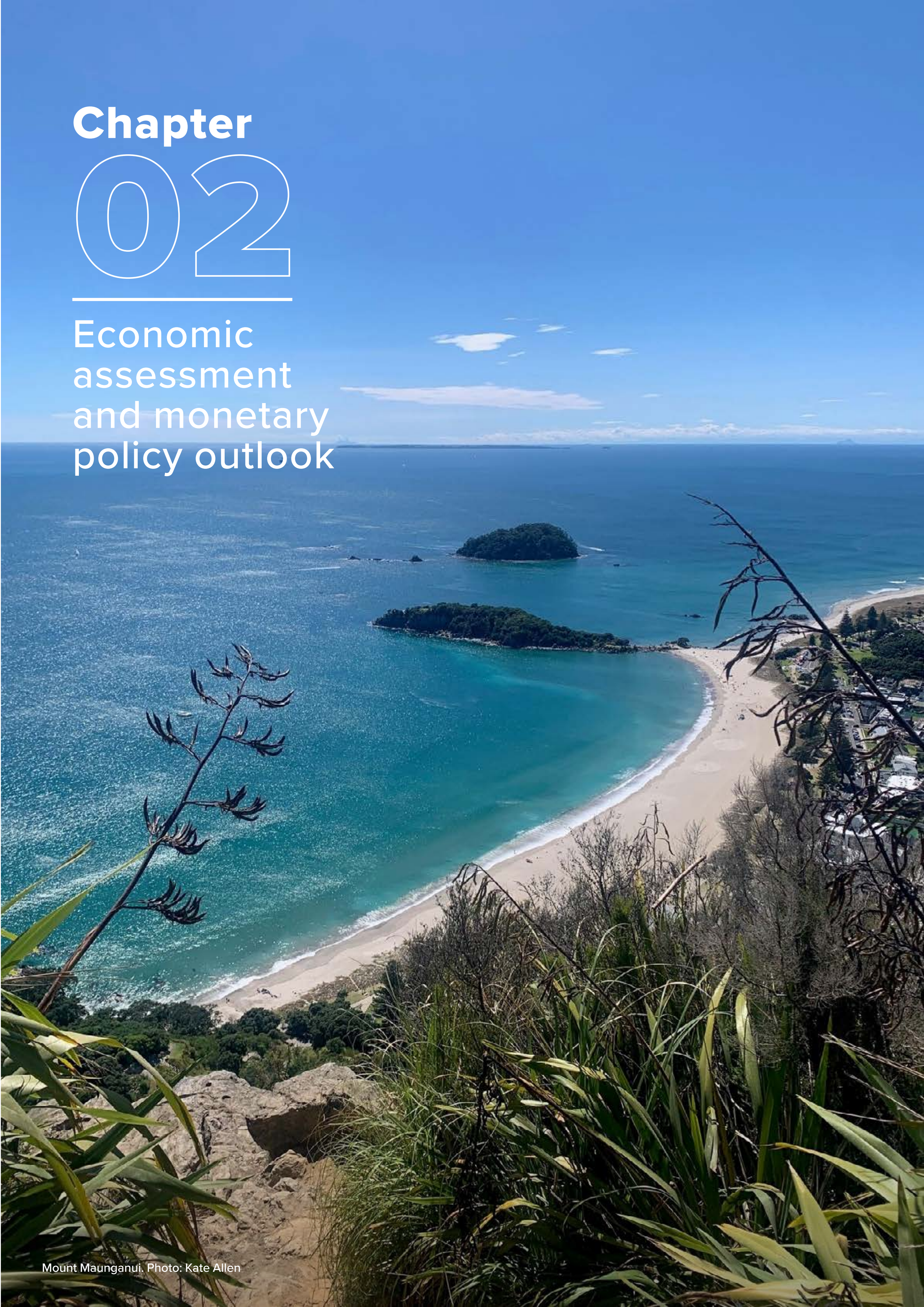
Attendees:

Reserve Bank members of MPC:
Adrian Orr (Chair), Christian Hawkesby, Karen Silk, Paul Conway

External MPC members:
Bob Buckle, Carl Hansen, Prasanna Gai

Treasury Observer:
James Beard

MPC Secretary:
Adam Richardson



Chapter 02

Economic assessment and monetary policy outlook

Mount Maunganui. Photo: Kate Allen

Chapter 2.
Economic assessment and monetary policy outlook

Key points

An extended period of restrictive interest rates has reduced demand in the New Zealand economy and contributed to lower inflation. Subdued global growth, lower net immigration, and lower government consumption have also reduced demand. Combined with subdued prices for imports, easing domestic inflation has resulted in annual Consumers Price Index (CPI) inflation of 2.2 percent in the year to the December 2024 quarter, within the MPC's 1 to 3 percent target range. Businesses' expectations for headline inflation at all horizons remain near the 2 percent target mid-point.

Revisions to Gross Domestic Product (GDP) data suggest that economic activity in New Zealand has been higher, despite a larger contraction during the middle of 2024. Overall, these revisions suggest that capacity pressures were higher over 2023 and early 2024 than we had assumed. The revised data better explain the evolution of domestic inflation during this time. The larger decline in GDP in mid-2024 also better aligns with a range of timely indicators that fell over this period. These timely indicators now point to some recovery in growth in the final quarter of 2024 and into 2025.

Recent developments in international trade policy have markedly increased uncertainty about the global economic outlook. Economic activity in our main trading partners is expected to remain below potential, and place downward pressure on global inflation. Services inflation is easing gradually, while goods inflation has declined rapidly over the past year. Advanced economy central banks have eased monetary policy and most official interest rates are expected to be reduced further. Despite subdued global economic activity, supply and demand factors for some New Zealand commodity exports, notably dairy and beef, have led to higher export prices in recent months.

Higher global tariffs will affect the New Zealand economy, with indirect effects likely to be most important. Tariffs would likely lower growth in our main trading partner economies. This would reduce demand for our exports, and therefore economic growth in New Zealand over the medium term. However, the effect on inflation is ambiguous over the medium term. It depends on factors such as the degree of trade diversion, supply-chain adjustment, and financial market responses.

There is significant spare capacity in the New Zealand economy. The output gap — the difference between GDP and the economy's potential output — is estimated to have been about -1.7 percent of potential at the end of last year, reflecting the large decline in economic activity. The subsequent reduction in firms' demand for labour contributed to the increase in the unemployment rate to 5.1 percent in the December 2024 quarter. Other measures of spare capacity in the labour market also increased.

Annual non-tradables inflation continued to decline to 4.5 percent in the year to the December 2024 quarter. Annual tradables inflation remained negative in the year to the December 2024 quarter, largely accounted for by declines in fuel prices during 2024. All annual core inflation measures continued to decline in the December 2024 quarter, and are within or very near the target band for headline CPI inflation.

Conditional on our economic outlook, we project that the OCR will continue to decline. The MPC has been reducing the OCR since August 2024 as inflationary pressures have eased. The degree of spare capacity in the economy and adaptation of wage- and price-setting behaviour to a low-inflation environment are consistent with inflation returning sustainably to the 2 percent target mid-point. Lower interest rates are assumed to increase demand and output in the economy.

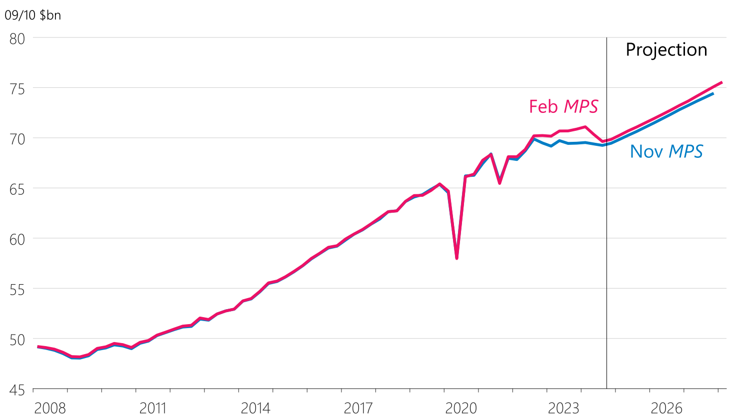
Economic assessment

Revisions to GDP data suggest that economic activity in New Zealand has been higher, despite a larger contraction during the middle of 2024.

Revisions suggest that the level of production GDP was 2.3 percent higher in the March 2024 quarter than previously measured (figure 2.1)**.** These revisions imply that the economy grew relatively steadily between 2022 and early 2024, rather than being broadly flat. The profile of the revisions suggests that the output gap was more positive during this time than had been assumed. This revised profile for the output gap better explains the high and broad-based domestic inflation experienced during that period (see box A).

The larger decline in economic activity during the middle of 2024 aligns more closely with the weakness observed in a range of other, more timely, activity indicators.[1] However, the 1.0 percent contraction in GDP in the September 2024 quarter was larger than assumed in the November *Statement*. Production in the manufacturing, construction, and retail trade sectors was particularly weak. These sectors tend to be more sensitive to monetary policy. However, some of the weakness was also due to disruptions in energy supply and extremely high electricity prices experienced during the September quarter. Activity in the primary sector increased by 1.0 percent, mainly accounted for by growth in the dairy and forestry sectors.

Figure 2.1
Production GDP
(seasonally adjusted)



Source: Stats NZ, RBNZ estimates.

Note: Production GDP is a measure of the volume of production and is expressed in 2009/2010 prices.

1 See box A in the August 2024 *Statement*.

Box A
Revisions to GDP data

Since the November *Statement*, GDP has been revised to a higher level.[2] These revisions reflect the use of more accurate economic data that become available later (a process known as 'annual benchmarking') and methodological changes. The new data imply that GDP growth was stronger than previously measured by Stats NZ from 2022 until the March 2024 quarter. As a result, the revised level of production GDP was 2.3 percent higher in the March 2024 quarter than previously measured. This is large compared to previous revisions.

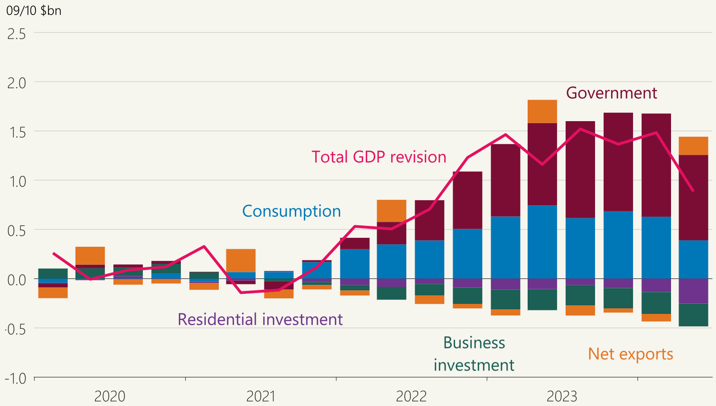
The revisions to GDP do not have a material effect on our estimate of the output gap in the most recent quarter, because we rely on a broad suite of indicators to estimate capacity pressure in the economy. Using a suite of indicators is more robust to uncertainty about the current level of GDP. However, the revised profile of GDP (and larger contraction in GDP in the September 2024 quarter than assumed in the November *Statement*) means that our profile for the output gap has changed over recent years.

The output gap is now estimated to have been significantly more positive over 2023 and early 2024, but to have declined more sharply over the middle of 2024 (figure 2.4). We estimate that the output gap declined from 1.3 percent of potential at the end of 2023 to -1.7 percent at the end of 2024. Our estimate of the current output gap is close to the average of our suite of indicators.

The revised profile of GDP and the output gap over 2023 and early 2024 better explain high domestic inflation during that time. At the time of the May 2024 *Statement*, annual non-tradables inflation was still elevated at 5.8 percent in the year to the March 2024 quarter. This had been much higher and more broad-based across components than we expected. At the time, we attributed some of this to potential GDP having been lower, and the output gap having been higher as a result (see box A of the May 2024 *Statement*). However, this still did not fully explain high non-tradables inflation at the time. The revised output gap profile better explains inflation dynamics over the past few years.

The revisions also alter our broader understanding of the economy. For example, they suggest that labour productivity — while still weak — did not decline by as much as previously estimated. Consistent with this, potential GDP growth is assumed to remain low, but slightly higher than assumed in the November *Statement*. The revisions have also significantly changed the composition of GDP in New Zealand since 2022. This can be seen clearly in the revisions to expenditure GDP. Expenditure GDP was also revised higher, but to a lesser extent than production GDP.[3] Across the expenditure components, household consumption, government consumption, and government investment were revised higher, while business and residential investment were revised lower (figure A.1).

Figure A.1
Contributions to revisions in expenditure GDP
(quarterly, seasonally adjusted)



Source: Stats NZ, RBNZ estimates.

2 See Gross domestic product: September 2024 quarter | Stats NZ.
3 In theory, production and expenditure GDP should be equal.

We expect economic growth to recover during 2025

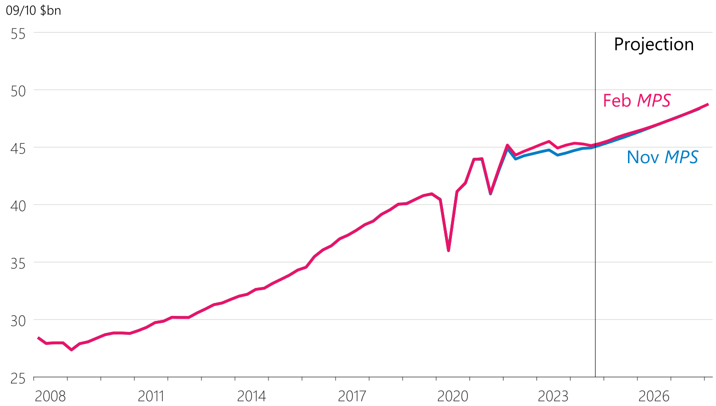
Timely indicators of economic activity have improved slightly in recent months, although most remain subdued. Reported activity in the ANZ Business Outlook, the Performance of Services Index, electronic card transactions, and the ANZ Truckometer all suggest that economic activity recovered somewhat in the December 2024 quarter. However, the Performance of Manufacturing Index and reported activity in the Quarterly Survey of Business Opinion (QSBO) indicate further weakness in the quarter. Within the QSBO, businesses continue to say that orders are the factor most limiting production, consistent with subdued demand.

Economic growth is expected to increase during 2025, as lower interest rates and stronger earnings for some exporting industries support demand. Actual and expected declines in the OCR have led to lower mortgage and deposit interest rates at shorter terms in recent months (see chapter 3). Lower interest rates will take time to fully transmit to economic activity. Activity in some sectors will be more sensitive to lower interest rates than others. The lower New Zealand dollar exchange rate and improved global prices for some of our key export commodities will also support export sector earnings (see chapter 4.2). Higher earnings are likely to support an increase in investment and overall domestic spending.

Household spending has been weak

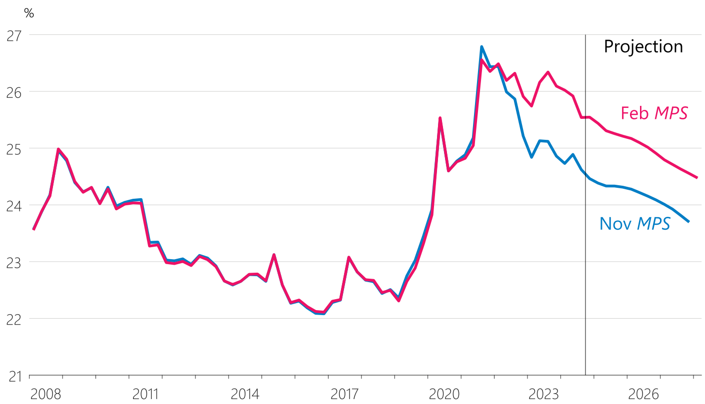
Household consumption was revised up in recent years but has declined in recent quarters. Household consumption declined 0.3 percent in the September 2024 quarter, and has been easing on a per capita basis since 2023. Weak household spending reflects restrictive interest rates, a weak labour market, subdued growth in asset prices, and below-average population growth. Household consumption is assumed to increase over the projection, supported by lower interest rates (figure 2.2).

Figure 2.2
Private consumption
(seasonally adjusted)



Source: Stats NZ, RBNZ estimates.

Figure 2.3
Government consumption and investment
(share of potential, seasonally adjusted)



Source: Stats NZ, RBNZ estimates.

Government consumption has declined, but from a higher level

Government consumption declined by 1.9 percent in the September 2024 quarter. However, higher government expenditure (consumption and investment) was the largest contributor to the upwards revision in expenditure GDP since 2022 (figure A.1). According to the *Half Year Economic and Fiscal Update (HYEFU)* 2024, real government consumption is also expected to remain higher than assumed in *Budget* 2024. Overall, government expenditure is assumed to continue to decline slowly as a share of potential GDP but remain at a higher level than in the November *Statement* (figure 2.3).

Private investment has fallen

Business and residential investment declined by 4.9 and 2.0 percent, respectively, in the September 2024 quarter. Both were also revised down since 2022, with the latest data pointing to greater weakness than previously measured. The recent decline in business investment reflects weak demand due to restrictive interest rates and the related easing in capacity pressures. Weak residential investment also reflects restrictive interest rates, declining real house prices, and slower population growth.

Business and residential investment are assumed to recover over the medium term. Business investment is assumed to increase as lower interest rates and higher export earnings support demand, and reduce excess capacity. However, elevated uncertainty related to global trade policies is assumed to lead to businesses delaying, altering, or cancelling some investment plans (see chapters 4.1 and 5). Residential investment is assumed to recover as lower interest rates and increasing house prices support demand for new building.

There is significant spare capacity in the New Zealand economy

Capacity pressures have declined significantly since the start of 2024. We estimate that the output gap is currently about -1.7 percent of potential GDP. Our suite of capacity pressure indicators and the large decline in GDP during the middle of 2024 are consistent with a slightly more negative output gap in the most recent quarter than assumed in the November *Statement* (figure 2.4).

The output gap is assumed to start closing in 2025, as demand recovers and potential GDP growth remains low. GDP growth is assumed to exceed potential GDP growth from the start of 2025, as lower interest rates and stronger export earnings support demand. Potential growth is assumed to remain lower than it has been over history, due to subdued productivity growth and lower growth in labour supply due to low net immigration.

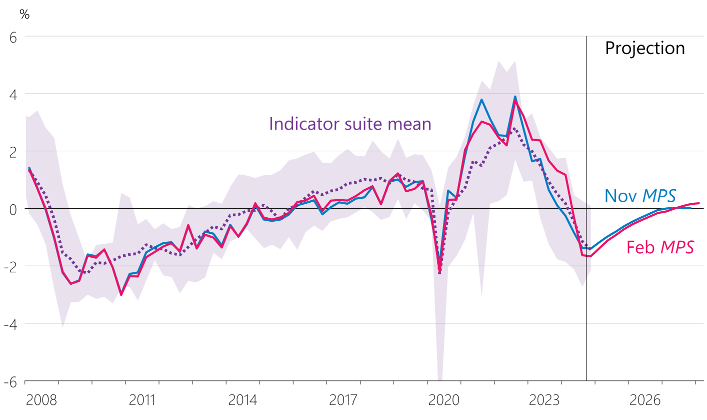
Labour market conditions have weakened

Business demand for labour has declined as economic conditions have weakened. Employment fell 1.1 percent in the year to the December 2024 quarter. Declining employment is most evident for younger cohorts, particularly those aged 15 to 19 years. Job vacancies have continued to decrease in recent months and remain well below pre-COVID-19 levels. Participation in the labour market has also fallen slightly, consistent with some people leaving the labour market due to weaker job prospects.

Figure 2.4

Output gap and indicator suite

(share of potential, seasonally adjusted)



Source: Stats NZ, NZIER, MBIE, RBNZ estimates.

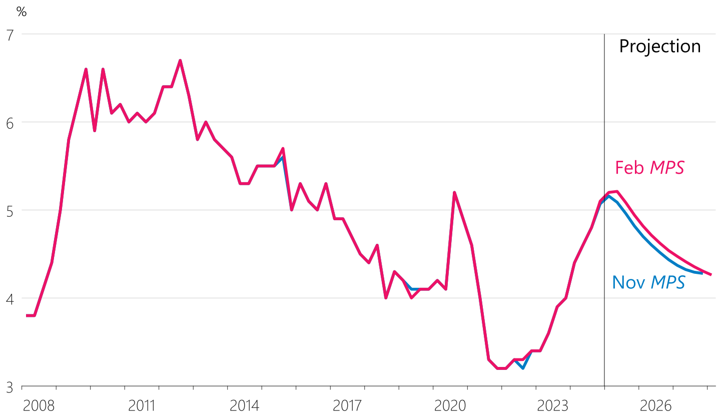
Note: The shaded area shows the range of indicators in the suite. The vertical line shows the final quarter of published GDP data.

A wide range of measures suggest that labour market capacity pressures eased substantially during 2024 (figure 2.6)**.** Most measures of the labour market are weaker than their median levels since 2000. The unemployment rate increased to 5.1 percent in the December 2024 quarter (figure 2.5). Businesses continue to report that it is easy to find workers, and movement between jobs has slowed. The weakness in economic activity during the middle of 2024 is assumed to continue to flow through to weaker labour market conditions. The unemployment rate is assumed to peak at 5.2 percent in the June 2025 quarter before declining in line with a recovery in economic growth.

Figure 2.5

Unemployment rate

(unemployed people as a share of the labour force, seasonally adjusted)

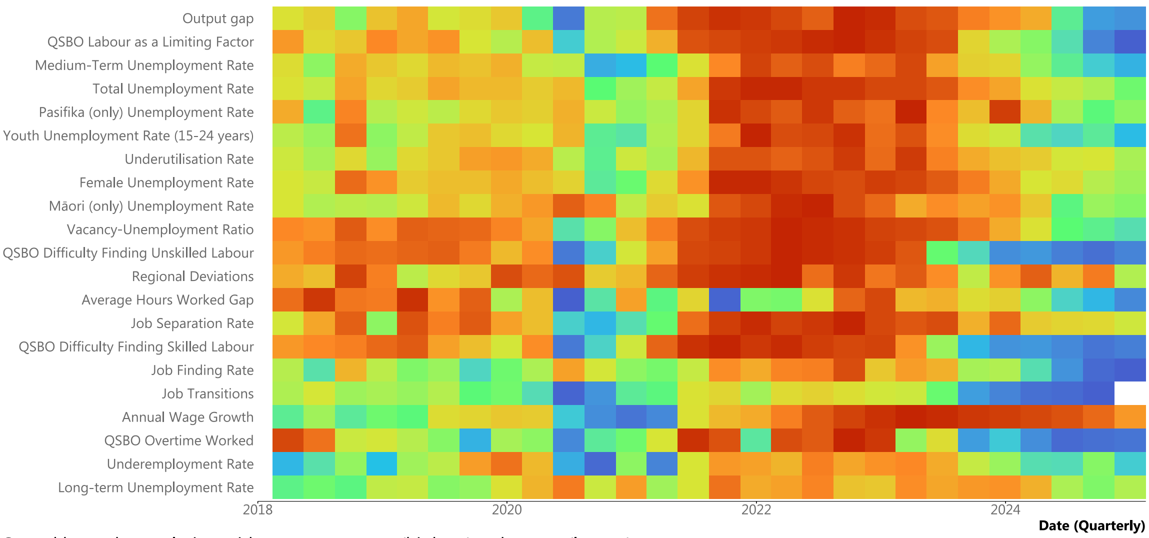


Source: Stats NZ, RBNZ estimates.

Figure 2.6

Labour market indicators

Fill colour shows the standardised value for each variable compared to the ***weakest****,* ***median*** *&* ***strongest*** *since 2000.*



Sorted by rank correlation with output gap, top (highest) to bottom (lowest).

Source: Stats NZ, NZIER, MBIE, RBNZ estimates.

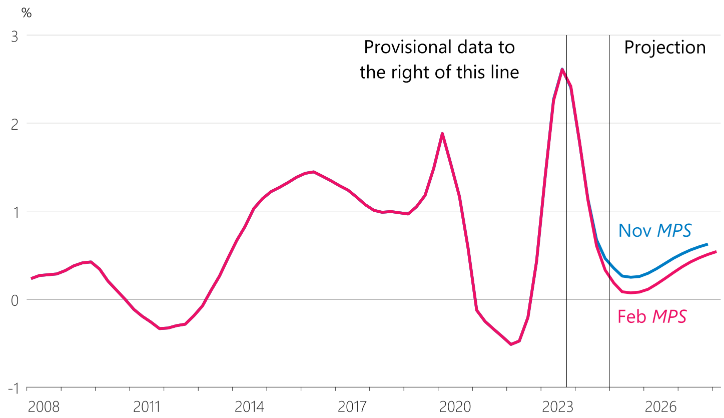
Note: See Ball (2024), 'Assessing and communicating labour market indicators of inflationary pressure', *Analytical Note*, Reserve Bank of New Zealand.

Low demand for labour and low inflation are contributing to slower nominal wage growth. Annual same-job wage growth, as measured by the Labour Cost Index (LCI, ordinary and overtime, private sector) was 3.0 percent in the December 2024 quarter, relative to a peak of 4.5 percent in early 2023. Growth in broader wage measures has also declined. Wage growth is assumed to decline further, reflecting the usual lags between labour market pressure and wage adjustments.

Net immigration continues to slow

Following a surge in 2022 and 2023, net immigration has declined rapidly (figure 2.7)**.** The decline in net immigration reflects both a decline in arrivals and an increase in departures. This likely reflects weakness in New Zealand's labour market compared to other countries, most notably Australia. Trans-Tasman divergences in labour market conditions have historically had a strong influence on migration of New Zealand citizens.

Figure 2.7
Net immigration
(annual, share of working-age population)



Source: Stats NZ, RBNZ estimates.

Declining net immigration is assumed to have broadly offsetting effects on inflationary pressure. Slower population growth is reducing consumption growth and demand for housing. However, slowing net immigration is also resulting in slower labour supply growth and therefore, lower growth in potential output. Net immigration is assumed to increase gradually in the latter half of the projection as the New Zealand labour market recovers.

Global growth remains below trend

Economic conditions vary across New Zealand's trading partners, but overall growth in our main trading partners remains below potential (see chapter 3)**.** Economic growth in the US has remained strong, with the unemployment rate remaining relatively low at 4.1 percent. GDP growth in China was slightly stronger than expected at the end of 2024. However, recent data suggest that domestic demand remains weak, reflecting subdued consumer spending and ongoing stress in the property market. Economic conditions in the euro area remain weak. Economic growth in Australia has also been subdued, with growth largely accounted for by increased government spending.

We assume that trading-partner GDP growth declines slightly over 2025, although there is downside risk to this assumption. Notwithstanding considerable uncertainty around global trade policy and its economic implications (see chapters 3 and 4.1), the global growth outlook is broadly similar to that at the time of the November *Statement*. Market participants expect most central banks in advanced economies to continue to reduce policy interest rates towards more neutral levels over the coming year, although the outlook for US policy rates is higher than it was at the time of the November *Statement*.

Headline inflation in New Zealand's trading partners has declined over the past year, but has increased slightly in recent months. The recent increase in headline inflation in many of our trading partners is largely accounted for by higher fuel and energy inflation. Services price inflation has remained above pre-COVID-19 levels, but continues to decline gradually in many of our trading-partner economies.

Global conditions have contributed to lower inflation in New Zealand, but this disinflationary impulse is waning

Declining inflation in our key trading partners and lower global oil prices over 2024 have contributed to lower tradables inflation. We assume that world prices for our imports will continue to decline over the coming year as global inflationary pressures ease. Although there is always considerable uncertainty about the outlook for our import prices, this uncertainty is heightened due to recent developments in global trade policy (see chapter 4.1).

While global growth has remained subdued, world prices for some of New Zealand's key export commodities have increased. Resilient demand and constrained global supply for dairy and beef have led to higher prices for these commodities over 2024 (see chapter 4.2). Ongoing supply constraints are assumed to support prices for dairy and beef throughout 2025, although outlooks for commodity prices are always highly uncertain. Higher global prices and a lower exchange rate are assumed to support income to these exporters, which is expected to increase investment and consumption over the medium term.

The New Zealand dollar exchange rate has depreciated about 3 percent on a trade-weighted basis since the November *Statement*. Market expectations for lower domestic interest rates relative to our trading partners have put downward pressure on the New Zealand dollar exchange rate, despite the recent increases in prices for our export commodities. Increased global trade policy uncertainty is another factor likely reducing the value of the New Zealand dollar. All else equal, the lower New Zealand dollar exchange rate is expected to result in slightly higher tradables inflation in New Zealand relative to what was assumed at the time of the November *Statement*.

Inflation is expected to increase in the near term due to temporary factors, but remain in the MPC's 1 to 3 percent target range

Annual headline CPI inflation remained at 2.2 percent in the December 2024 quarter. Headline inflation was slightly higher than the 2.1 percent assumed in the November *Statement*. Annual tradables inflation was less negative than expected, while annual non-tradables inflation decreased by slightly more than expected.

Measures of annual core inflation declined further in the December 2024 quarter. Core inflation measures have declined steadily since 2023, consistent with slower inflation across a broad range of items. Despite these declines, the average of annual core inflation measures remains above headline inflation (figure 2.8). This indicates that headline inflation is being lowered in part by components that tend to experience more volatile price movements. Nonetheless, declines in core inflation measures imply that the underlying trend in inflation is converging towards the 2 percent target mid-point for CPI inflation. This trend is particularly evident in available quarterly measures of core inflation.

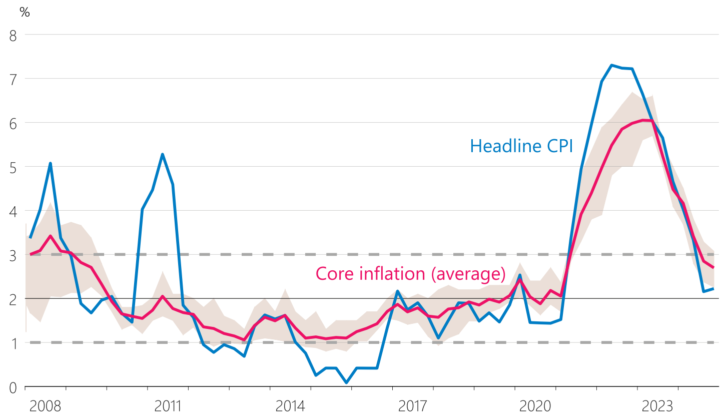
Survey measures indicate that firms expect inflation to remain near the 2 percent target mid-point. Businesses' inflation expectations have remained near 2 percent at all time horizons (figure 2.9). Households' expectations, which tend to be higher than those of firms, have also declined in recent years to be more consistent with a low-inflation environment, although increased slightly in the latest quarter.

Annual tradables inflation remained negative in the December 2024 quarter, albeit to a lesser extent than in the previous quarter. Annual tradables inflation was -1.1 percent in the December 2024 quarter, which is well below its 2002–2019 average of 0.5 percent. The decline in tradables prices over the past year reflected declines in petrol prices, but there has also been a broad-based easing in inflation for our other imported goods and services.

Figure 2.8

Headline and core inflation measures

(annual)



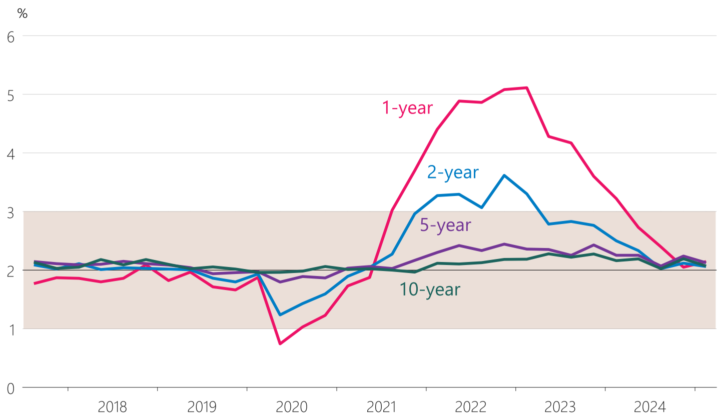
Source: Stats NZ, RBNZ.

Note: The dashed lines represent the MPC's 1 to 3 percent target range for inflation over the medium term. The shaded area shows the range of core inflation measures. The core inflation measures include the sectoral factor model, factor model, trimmed mean (30%), weighted median, and CPI excluding food and energy.

Figure 2.9

Business inflation expectations

(annual, years ahead)



Source: RBNZ's Survey of Expectations (Business).

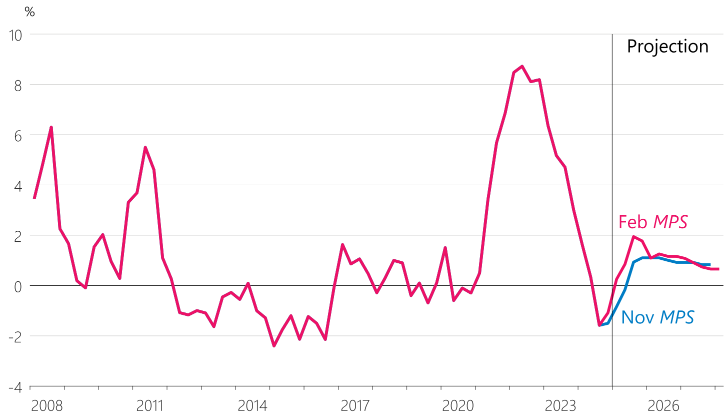
Note: The shaded area represents the MPC's 1 to 3 percent target range for inflation over the medium term.

Tradables inflation was higher than the -1.5 percent assumed in the November *Statement*. Annual tradables inflation is expected to increase in the near term, consistent with the increases in petrol prices over recent months, before returning to around pre-COVID-19 levels (figure 2.10).

Annual non-tradables inflation continued to decline, to 4.5 percent in the December 2024 quarter (figure 2.11)**.** This was slightly lower than 4.7 percent expected at the time of the November *Statement*. While non-tradables inflation remains elevated, it has become less broad-based over time as capacity pressures have declined and price-setting behaviour has adapted to a low-inflation environment. Box B discusses recent trends in different components of non-tradables inflation.

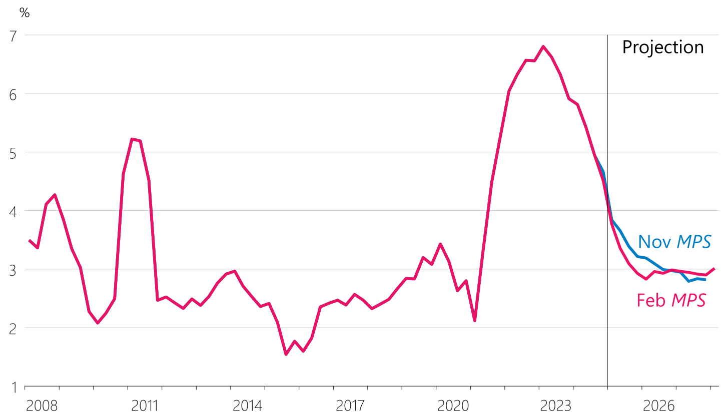
Annual non-tradables inflation is assumed to continue to decline over the next year. Current spare capacity in the economy is expected to flow through to lower cost pressures and non-tradables inflation over time. Non-tradables inflation is expected to decline slightly more quickly than at the time of the November *Statement*, mainly due to slightly weaker capacity pressures. Administered and policy-affected price changes are expected to continue to add volatility to some components of non-tradables inflation over the coming year.

Figure 2.10
Tradables inflation
(annual)



Source: Stats NZ, RBNZ estimates.

Figure 2.11
Non-tradables inflation
(annual)



Source: Stats NZ, RBNZ estimates.

Box B

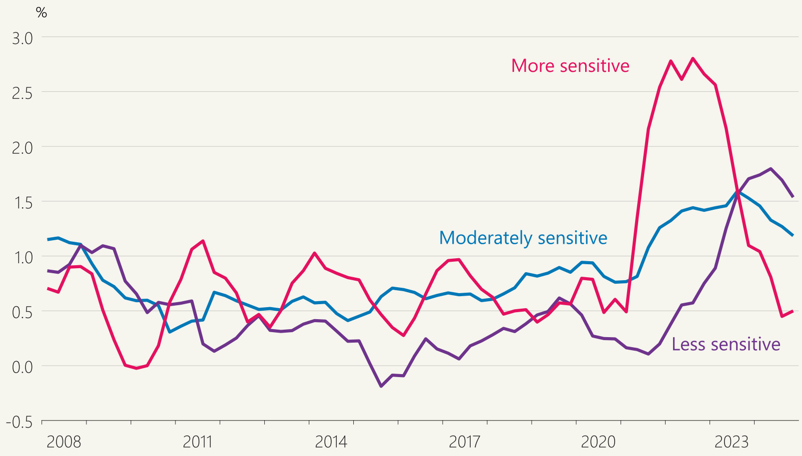
Trends in non-tradables inflation components

Recent trends in the non-tradables components of inflation are consistent with easing inflationary pressure, although headline inflation will continue to be affected by relative price shifts. Inflation rates have eased across a wide range of non-tradables components. However, inflation rates for some components have declined more quickly than others.

Inflation rates for non-tradables components that tend to be more sensitive to monetary policy have declined quickly since early 2023, and are now at levels similar to 2019 (figure B.1)**.** Easing inflation for these components is consistent with the decline in the output gap seen from the middle of 2022. Inflation rates for some items in this category, such as dwelling construction costs and domestic accommodation, are now below their long-run average levels.

As expected, inflation in non-tradables categories that are less and moderately sensitive to monetary policy are declining with more of a lag. For example, we estimate rental inflation in the CPI as being moderately sensitive to monetary policy. While rental inflation in the CPI has eased, it remains at an elevated level. However, rental inflation for new tenancies has fallen sharply since early 2024, consistent with weak economic activity and falling net immigration. This indicates that CPI rental inflation – which relies on rents for all properties, not just new tenancies – will continue to ease. Inflation in some other moderately sensitive items, such as restaurant meals and takeaway foods, has eased substantially. Inflation in some other moderately sensitive items – particularly local authority rate inflation – remains elevated.

Figure B.1
Non-tradables inflation by monetary policy sensitivity
(quarterly, 4-quarter moving average)



Source: Stats NZ, RBNZ estimates.

Note: Non-tradable sub-groups are ordered by most negative to most positive estimated response to an unanticipated OCR increase. 'More sensitive' groups represent the top third of these groups by sensitivity. 'Moderately sensitive' groups represent the middle third by sensitivity, and 'Less sensitive' groups represent the lowest third by sensitivity. Based on Åstebøl and Patel (forthcoming), 'Local Projections Estimates of Monetary Policy Pass-Through to GDP and Non-Tradables Inflation', *Analytical Note*, Reserve Bank of New Zealand.

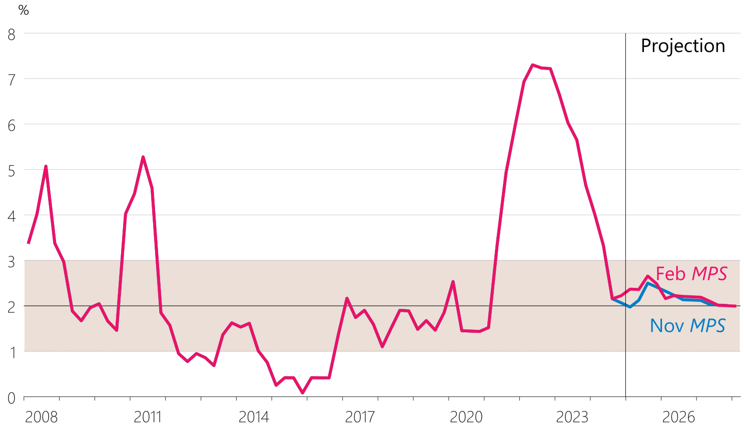
Inflation rates for insurance, energy, and administered goods and services have eased slightly, but remain high. Inflation rates for these items tend to have a slow responsiveness to monetary policy. Even though inflation in these groups is less sensitive, we expect their inflation rates to ease over the medium term. This reflects that some sector-specific drivers of higher inflation are assumed to wane, and that lower overall inflation and cost growth will feed into lower average inflation rates over time.

Annual headline inflation is forecast to remain in the 1 to 3 percent target range, and remain near the target mid-point from 2026 (figure 2.12)**.** Recent increases in petrol prices are assumed to lead to higher near-term headline inflation than expected in the November *Statement*. Annual CPI inflation is assumed to increase to a peak of 2.7 percent in the year to the September 2025 quarter. However, underlying inflationary pressures are assumed to continue to ease, and headline inflation is forecast to remain near the 2 percent mid-point once the effect of recent increases in petrol prices on inflation wanes.

Figure 2.12

CPI inflation

(annual)



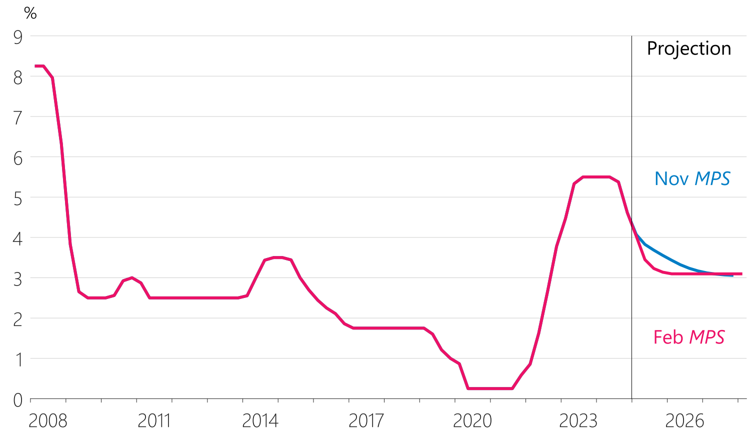
Source: Stats NZ, RBNZ estimates.

Note: The shaded area represents the MPC's 1 to 3 percent target range for inflation over the medium term.

Monetary policy outlook

Conditional on the central economic outlook, we assume that the OCR can continue to be lowered towards its neutral level over time (figure 2.13)**.** Inflationary pressures are assumed to ease further over the medium term, as a result of spare capacity in the economy and wage- and price-setters adapting to a low-inflation environment. We assume that the near-term increase in headline inflation does not significantly affect wage- and price-setting behaviour.

Figure 2.13
OCR
(quarterly average)



Source: RBNZ estimates.

Chapter 03

Global economy and financial markets

Lake Wānaka. Photo: Paul Conway

Chapter 3.
Global economy and financial markets

Key points

Global growth remains below trend and uncertainty regarding the outlook has increased. Consensus forecasts from Bloomberg for growth in New Zealand's major trading partners are largely unchanged since the November *Statement,* with global growth expected to decline slightly in 2025. These forecasts were made prior to the trade policy developments in recent weeks. Despite subdued global growth, prices for some of New Zealand's key commodity exports have increased, reflecting reduced global supply (see chapter 4.2). Uncertainty regarding the global economic outlook has increased recently as a consequence of escalating trade tensions (see chapter 4.1).

Disinflation among New Zealand's key trading partners has slowed. Inflation in advanced economies has increased slightly, mainly because of higher fuel and energy prices. However, headline inflation rates remain close to target levels and services inflation in advanced economies continues to gradually decline. Global labour market conditions have been relatively steady in recent months.

Market participants' expectations for policy rates have begun to diverge across advanced economies, while long-term government bond yields have increased. Differences in the expected pace of monetary policy easing across economies, implied by financial market pricing, reflect both differences in macroeconomic developments and likely exposure to increasing global trade tensions. In the US, increased uncertainty and expectations of larger fiscal deficits have increased longer-term government bond yields through an increase in the term premium. This has placed upward pressure on long-term sovereign yields across advanced economies. Increased global uncertainty and higher interest rates in the US compared to other economies have resulted in an appreciation of the US dollar exchange rate.

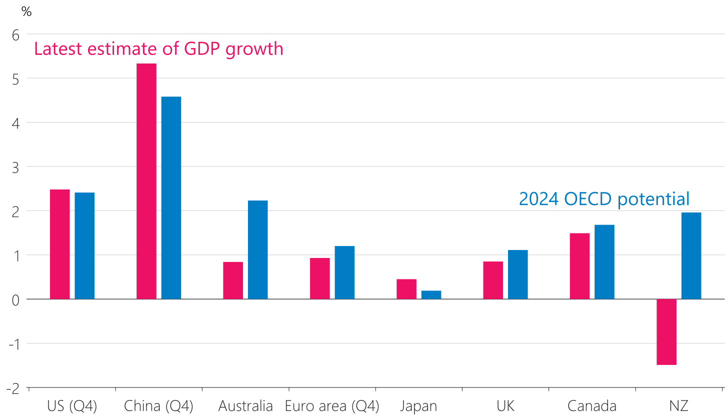
In New Zealand, financial conditions have become less restrictive since the November *Statement*. Wholesale interest rates, such as interest rate swaps, have decreased across most tenors, with shorter-term rates falling by more than longer-term rates. The New Zealand dollar has depreciated on a trade-weighted basis, partly because of US factors. Shorter-term mortgage and term deposit rates have decreased, while longer-term rates in New Zealand have moved slightly higher. This broadly reflects changes in the shape of the New Zealand swap curve.

Global economic conditions

Global growth remains below trend

Restrictive monetary policy settings in most of our key trading partners continue to reduce economic growth and inflationary pressure. GDP growth in many of these economies is close to, or below, potential growth (figure 3.1). However, economic growth was relatively strong in the US and China in the December 2024 quarter. In the US, growth was driven by stronger household consumption and employment growth, while in China it was supported by recent policy stimulus and robust export growth.

Figure 3.1
GDP growth compared to 2024 OECD potential growth estimates
(annual)



Source: Haver Analytics, OECD.

Note: GDP growth data are for the September 2024 quarter unless otherwise specified.

Consensus forecasts for trading-partner growth are for a marginal decline over 2025. Trade-weighted annual GDP growth in New Zealand's key trading partners is expected to decline from 2.8 percent in 2024 to 2.7 percent in both 2025 and 2026. Growth is expected to slow in China, the US, and high-income Asian economies. Partially offsetting some of this weakness is stronger growth in advanced economies excluding the US, and in emerging Asian economies. Overall, growth expectations are broadly unchanged from the time of the November *Statement*, despite heightened uncertainty regarding global trade. These Consensus forecasts for global growth only incorporate developments as of 31 January and, therefore, do not capture recent global trade developments.

Economic growth in the US is expected to slow this year, but by less than at the time of the November *Statement*. Restrictive monetary policy and slower labour force growth are expected to reduce momentum in the US economy. GDP is forecast to grow by 2.2 percent in 2025, down from 2.8 percent in 2024, but higher than the 2.1 percent growth expected at the time of the November *Statement*.

The US economic outlook is significantly more uncertain than usual. Higher tariffs on US imports are expected to weaken economic activity, particularly if other countries retaliate or if the tariffs lead to increased uncertainty and lower confidence among US businesses and households.

Average GDP growth in China is expected to slow from 5 percent in 2024 to 4.5 percent in 2025. Policy stimulus and strong export demand contributed to an increase in GDP growth in the December 2024 quarter. However, recent data on retail sales and business activity suggest that this rate of growth is unlikely to continue into 2025. Economic activity continues to be negatively affected by a weak property market and declining home prices, which are keeping confidence and consumer spending growth low. While fiscal and monetary policy settings are expected to loosen further in coming quarters, recent tariff increases on China by the US are likely to weaken export growth from strong levels in 2024.

Disinflation in advanced economies has slowed

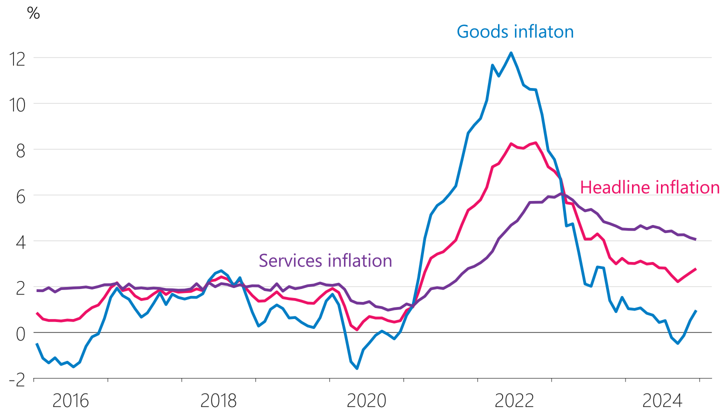
Headline inflation in advanced economies has increased slightly since the November *Statement*, but remains close to central bank targets. Advanced economy annual inflation increased to 2.8 percent in December 2024 (figure 3.2). Higher goods inflation accounted for the increase, which has largely been due to higher fuel and energy prices. Annual services inflation has continued to decline slowly but remains elevated at around 4 percent in aggregate across advanced economies. Core inflation measures have remained broadly stable since the November *Statement*.

US inflation is expected to remain above target this year. Core Personal Consumption Expenditure (PCE) prices, which exclude food and energy, are expected to increase by 2.5 percent in 2025. This is below the inflation rate of 2.8 percent in 2024, but 0.2 percentage points higher than expected at the time of the November *Statement*. This reflects the expected impact of more stimulatory fiscal policy, which will boost demand in the economy, and higher tariffs on US imports, which will increase import prices. Outside of the US, forecasts for inflation in New Zealand's major trading partners in 2025 are broadly unchanged since the November *Statement*.

Figure 3.2

Advanced economy aggregate CPI inflation

(annual)

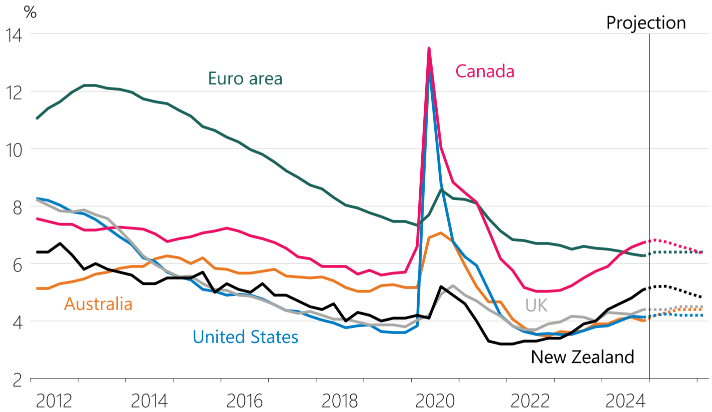


Source: Haver Analytics, OECD, RBNZ estimates.

Note: Aggregate uses OECD goods and services categorisations, including the US, UK, Australia, euro area, Japan, and Canada and is weighted by share of nominal GDP in US dollars.

Figure 3.3

Advanced economy unemployment rates



Source: Haver Analytics, Bloomberg, RBNZ estimates.

Note: Dotted lines show RBNZ forecasts for New Zealand and consensus forecasts from Bloomberg for other countries.

Labour market conditions have remained robust

Unemployment rates are relatively low in most advanced economies, and broadly unchanged from the November *Statement* (figure 3.3)**.** Meanwhile, job vacancies have remained largely stable at similar levels as before the COVID-19 pandemic. Global labour markets have generally eased since the very tight levels in 2022, in response to previous monetary tightening. In 2025, labour markets are expected to remain broadly stable as monetary policy easing supports demand for workers across economies.

Recent data suggest the US labour market is strengthening. Since around the middle of last year, employment growth has been increasing at a faster pace, and on a 3-month average basis is now at its highest growth rate since March 2023. The unemployment rate has fallen slightly over recent months, job vacancies have started to increase, and wage growth appears to be picking up following a steady decline from elevated levels in 2022.

Global financial conditions

Market expectations for central bank policy rates have diverged

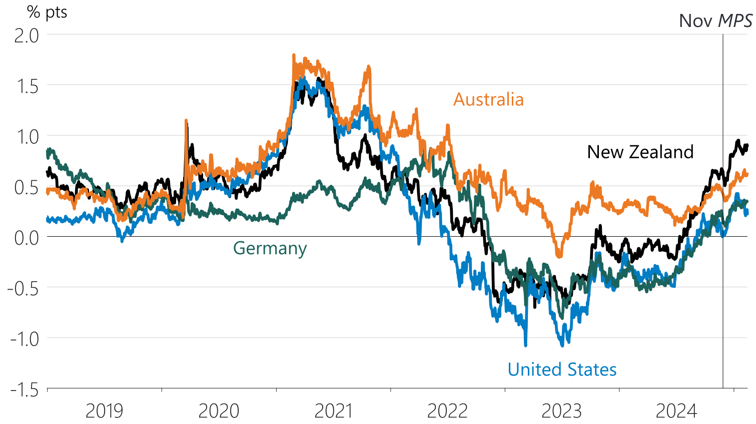
The pace of policy easing in advanced economies continues to diverge in line with differences in domestic macroeconomic conditions. Monetary policy settings in Canada, the euro area, and Australia are likely to return to broadly neutral over 2025, in line with reduced inflationary pressures in these economies. In contrast, the Bank of England and the Federal Reserve are expected to maintain their restrictive policy stances this year, as inflation is expected to remain above their respective targets throughout this year. Short-term bond yields have largely followed changes in near-term policy rate expectations in each economy.

Long-term government bond yields have increased, causing yield curves to steepen across advanced economies (figure 3.4)**.** Increased economic uncertainty (figure 4.3), alongside expectations of a larger fiscal deficit in the US, have led investors to demand a higher return on longer-term US government bonds relative to short-term bonds (the term premium). For example, the difference between the US 10-year and 2-year Treasury yield has increased by around 20 basis points since the November *Statement*. Advanced economy term premia are highly correlated with those in the US. As such, most of these economies have experienced a similar steepening, including New Zealand.

The US dollar has continued to strengthen

The US dollar has appreciated significantly in recent months in response to proposed tariffs and diverging monetary policy expectations. Financial market participants' expectations for US interest rates have increased relative to most other advanced economies, supporting the US dollar. The US dollar has risen 1.1 percent on a trade-weighted basis since the November *Statement,* and around 5.5 percent since September 2024 (figure 3.5). The US dollar has moved with changes in market participants' perceptions of the likely size of US tariffs. Higher tariffs tend to lead to an appreciation in the currency of the imposing economy, as their importers' demand for foreign currency falls.

Figure 3.4
10-year government bond yields minus 2-year yields



Source: Bloomberg.

Figure 3.5
US dollar trade-weighted index (DXY)

Source: Bloomberg.

US equity prices have increased slightly despite periods of policy uncertainty. Higher yields on US Treasury bonds, which are considered by financial market participants to be credit-risk-free assets, have put downwards pressure on US equity prices. However, equity prices have been supported by increasing financial market participants' expectations of future company earnings and greater risk appetite among investors. The additional return investors receive for holding US equities over risk-free assets (the equity risk premium) has now fallen to its lowest level since before the stock market crash in 2000 to 2002. The S&P 500 index is 1.7 percent higher and global equity prices are 1.6 percent higher than at the time of the November *Statement* (figure 3.6). European equities have been particularly strong while Chinese equities have remained weak.

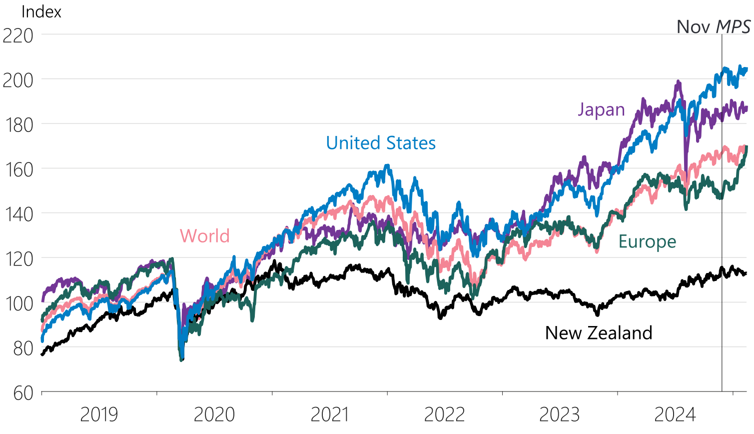
Domestic financial conditions

Domestic financial conditions have become less restrictive since the November *Statement*, influenced by both domestic and global factors. Consistent with global trends, shorter-term wholesale interest rates in New Zealand have fallen by more than longer-term rates. This has been reflected in changes in domestic mortgage and term deposit rates. The NZ dollar has depreciated on a trade-weighted basis in recent months. This follows a widening in the difference between interest rates in New Zealand and some of its major trading partners, and increased uncertainty about global trade. New Zealand is regarded by financial market participants as being subject to higher risk in an uncertain global environment compared to our major trading partners, which is why global uncertainty is causing our currency to depreciate.

Figure 3.6

Global equity prices

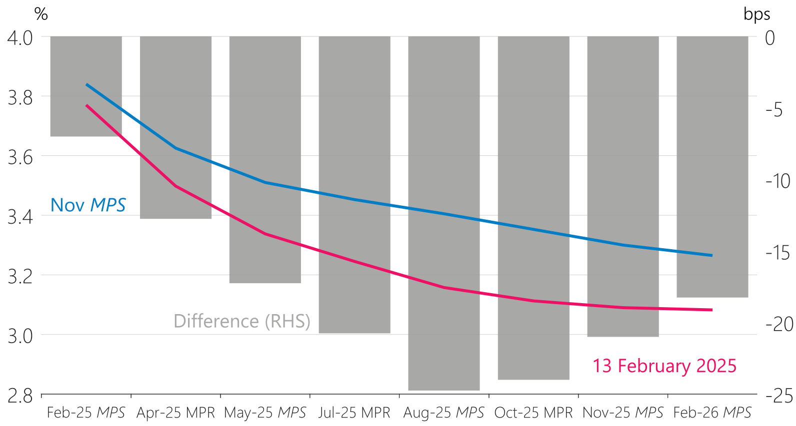
(index=100 on 1 March 2020)



Source: Bloomberg.

Figure 3.7

Financial market participants' expectations for the OCR



Source: Bloomberg.

Note: The blue line shows market expectations for the OCR immediately before the November *Statement*. Each data point represents market expectations of the level of the OCR at a given point in the future, as measured by overnight indexed swap pricing.

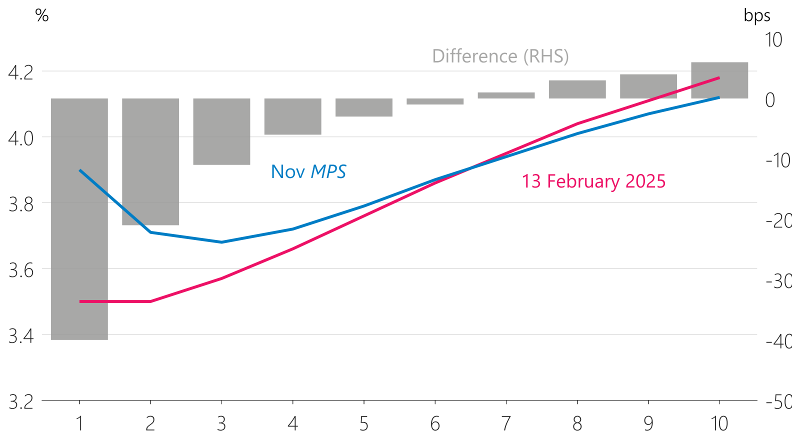
Near-term expectations for the OCR have decreased

Market participants expect further cuts to the OCR over the next year, and slightly larger cuts than at the time of the November *Statement* (figure 3.7).[4] Following the November *Statement*, market participants priced in a high chance of a 50 basis point OCR reduction in February 2025. This expectation was reinforced by data releases showing weak economic activity in New Zealand.

4 Market participants' expectations for the OCR can be inferred from prices for overnight indexed swap (OIS) contracts.

The reduction in market participants' expectations for the OCR has pushed shorter-term interest rate swaps lower since the November *Statement* (figure 3.8)**.**[5] In contrast, longer-term swap rates, which are influenced by global factors such as economic conditions in the US, as well as domestic factors, are broadly unchanged since the November *Statement*. This means the New Zealand interest rate swap curve has steepened — similar to steepening in the yield curves in the US and other advanced economies.

Figure 3.8
New Zealand interest rate swaps
(terms in years)



Source: LSEG.

The New Zealand dollar has depreciated

The New Zealand dollar exchange rate has depreciated by around 3 percent on a trade-weighted basis since the November *Statement* (figure 3.9)**.** As outlined above, the potential economic impacts of policies proposed by the US administration have contributed to the US dollar appreciation against a basket of global currencies. Several of New Zealand's other key trading partners, such as China, closely tie the value of their currencies to the US dollar. As such, a stronger US dollar has contributed to a weaker trade-weighted New Zealand dollar. Furthermore, interest rates in New Zealand have fallen by more than those of some of our key trading partners, making the New Zealand dollar relatively less attractive for investors.

Figure 3.9
New Zealand dollar trade-weighted index
(nominal)

Source: RBNZ.

5 Interest rate swap rates are wholesale interest rates often used as a benchmark by financial institutions in setting other interest rates in the economy. They can provide a guide to market participants' expectations for the policy rate over specific horizons. They involve the exchange of fixed and floating interest rate payments between two parties over a specified period. The level of interest rate swaps will be approximately equal to market expectations for average short-term market interest rates over the swap tenor.

Short-term mortgages remain popular

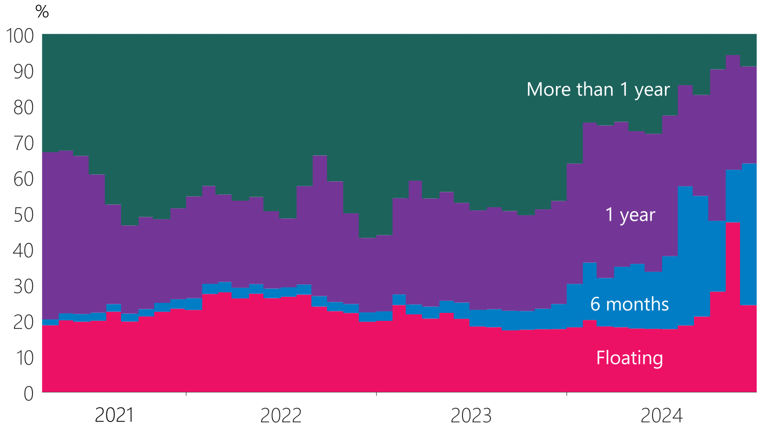
The trend towards short-term mortgage fixing, that began at the start of 2024, has intensified. In recent months, around 90 percent of new mortgage flows have been directed towards terms of one year and less, with the 6-month term the most popular (figure 3.10). This trend has increased the frequency at which mortgage rate repricing takes place, and hence the speed at which changes in mortgage rates influence household cashflows.

Shorter-term mortgage and term deposit rates have fallen and longer-term rates have increased slightly since the November *Statement* (figure 3.11)**.** This broadly reflects the change in the New Zealand swap rate curve. Shorter-term mortgage and term deposit rates remain slightly higher than longer-term rates. Since the November *Statement*, the popular 6-month mortgage and term deposit rates have fallen by around 35 basis points and 40 basis points, respectively.

The average yield on the stock of mortgages has recently started to decline and is expected to fall further over the next year. Most mortgage holders who have recently rolled off fixed-rate mortgages, or who have switched from floating to fixed, have done so at lower rates than they had previously been paying. A lower average yield on the stock of mortgages reduces the average monthly mortgage repayment paid by households, increasing disposable income and supporting household consumption.

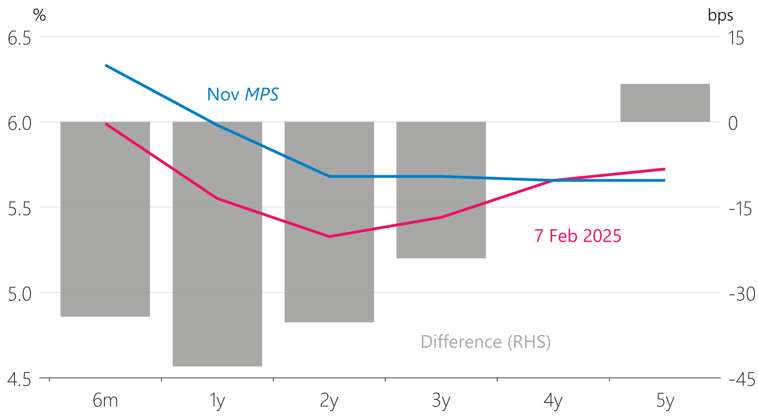
Falling interest rates since mid-2024 have been accompanied by increasing bank funding spreads. In particular, the relative cost of deposit funding has increased materially as wholesale rates have fallen faster than deposit rates. Despite this, mortgage rates have declined broadly in line with swap rates, putting downward pressure on bank margins.

Figure 3.10
Proportion of new mortgage lending volume by tenor



Source: RBNZ.

Figure 3.11
New Zealand mortgage rates
(terms in years)



Source: interest.co.nz.

Note: The 6-month to 3-year mortgage rates shown are the average of the latest advertised fixed-term rates on offer from ANZ, ASB, BNZ, and Westpac for mortgages with a loan-to-value ratio of less than 80 percent. The 4- and 5-year mortgage rates are the average of the latest advertised fixed-term rates on offer from ASB, BNZ, and Westpac.

Chapter 04

Special topics

Abel Tasman National Park. Photo: Magnus Åstebøl

Chapter 4.
Special topics

Before the publication of each *Statement*, RBNZ staff provide analyses of some topical issues to the Monetary Policy Committee.

Topics for the February *Statement* included:

1. The implications of global tariffs for the New Zealand economy
2. Outlook for some of New Zealand's key commodity exports

Special topics in the past 12 months

Topic	Date/publication
Trends in production sectors of the New Zealand economy	November 2024 *Statement* (Chapter 4)
Summary of recent business visits	November 2024 *Statement* (Chapter 4)
Real interest rates and their effect on the economy	November 2024 *Statement* (Chapter 4)
Price-setting behaviour in a low-inflation environment	August 2024 *Statement* (Chapter 4)
Comparing macroeconomic conditions in economies at different stages of monetary policy easing	August 2024 *Statement* (Chapter 4)
Non-tradables inflation in New Zealand	May 2024 *Statement* (Chapter 4)
Recent trends in New Zealand's exporting sector	May 2024 *Statement* (Chapter 4)
The effect of higher shipping costs on inflation and the OCR	February 2024 *Statement* (Chapter 4)
The effect of the Government's proposed policies on monetary policy	February 2024 *Statement* (Chapter 4)

1 The implications of global tariffs for the New Zealand economy

Summary

- **The US has announced and, in some cases, implemented a range of new tariffs.** Higher tariffs have come into effect on US imports from China. Higher tariffs on imports from Canada and Mexico are currently on hold, subject to ongoing negotiations. Targeted countries have threatened to impose retaliatory tariffs against the US, and China has implemented higher tariffs on some US products. It is currently uncertain whether these and other tariffs will be implemented and how long they would remain in place. However, uncertainty about future trade policies is already impacting the global economy and there is a risk that these policies initiate a broader increase in the level of global tariffs.
- **Tariffs are a tax imposed by a particular country on their imports of products from a 'tariff-targeted' country.** Tariffs increase the prices paid by consumers and businesses in the tariff-imposing country, and have the potential to lower export prices for the tariff-targeted country. The tariff is paid by the importer who has the option of passing it on to domestic consumers. This means that who ultimately bears the burden of the tariff depends on the relative price changes for importing and exporting companies and on the extent to which importing or exporting companies absorb the change in price in their margins.
- **There will be a larger negative impact on economic growth and more inflationary pressure in the country imposing tariffs when it is harder for consumers and businesses to switch to non-tariffed substitutes.** Similarly, there will be a larger negative impact on economic growth in the tariff-targeted country if it is harder to divert its products to non-tariff-imposing countries.
- **Higher global tariffs may result in:**
  - lower global economic growth;
  - increased inflationary pressure in tariff-imposing countries;
  - a decrease in export prices in tariff-targeted countries; and
  - trade diversion towards non-tariffed countries.
- **New Zealand would be directly affected if higher tariffs are imposed on our exports and indirectly affected via the effects of tariffs on our trading partners.** The indirect effects for New Zealand are likely to be larger than the direct effects. For example, tariffs between the US and China may reduce GDP growth in these economies, contributing to lower demand for New Zealand's exports, even if tariffs are not directly imposed on our products.
- **Global trade policies can also affect the New Zealand economy via financial market and uncertainty channels.** Domestic and global uncertainty can negatively affect economic activity in New Zealand, primarily by weakening business investment.[6] Heightened global uncertainty also tends to lead to the New Zealand dollar exchange rate depreciating, which increases the cost of our imports, and increases export revenues.
- **Tariffs are a combination of supply and demand side disruptions for global economies, with complex effects.** Increased uncertainty and any future trade policy shocks are likely to reduce growth in New Zealand, but the effect on inflation in New Zealand is currently uncertain.

6 See Rice, et al. (2018), 'Measuring uncertainty and its impact on the New Zealand economy', *Analytical Note*, Reserve Bank of New Zealand.

US trade policies are changing

The US has announced and, in some cases, implemented a range of new tariffs on imports. Tariffs on US imports from China increased by 10 percentage points on 4 February 2025. Tariffs of 25 percent on most imports from Canada and Mexico were due to come into effect on the same day but were delayed by 30 days subject to ongoing negotiations. Remarks made by the US administration also indicate that higher tariff rates on other trading partners, such as the European Union (EU), are under consideration. It is uncertain whether these and other tariffs will be implemented, and for what period. There is a risk that these changes may initiate a broader and sustained increase in the level of global tariffs.

Countries targeted by the US administration's announcements have indicated that they would impose retaliatory trade policies. Both China and the EU retaliated against tariff increases during President Trump's first term. In December 2024, China banned exports of critical minerals with military applications to the US. On 10 February 2025, China implemented a limited retaliation to the increased US tariffs, focusing largely on energy products and machinery. Government officials from Mexico and Canada have also voiced the possibility of retaliation.

Economic effects of tariffs

Tariffs are a tax imposed by a particular country on their imports of products from a 'tariff-targeted' country. Tariffs increase the prices paid by consumers and businesses in the tariff-imposing country, and have the potential to lower export prices for the tariff-targeted country. Although the importer pays the tariff, who ultimately bears the cost of the tariff depends on the extent to which importing and exporting companies absorb the cost through lower profit margins. This will depend on the price sensitivities of the countries trading the tariffed product. If price sensitivity varies significantly across countries trading the tariffed product, the less price-sensitive country will typically bear the brunt of initial price changes.

Trade volumes will be less sensitive to price changes if the product:

- is an essential input for the importing country;
- is significantly different to other products;
- uses specialised infrastructure or expertise;
- is subject to long-term contracts; or
- is not produced or demanded elsewhere.

The effects of tariffs on economic growth and inflation depend on the relative size of affected trade flows and how economic activity and trade patterns adapt. In general, there will be a larger negative effect on economic growth and greater inflationary pressure when it is harder for consumers and businesses in the tariff-imposing country to switch to non-tariffed substitutes. Similarly, the negative effect on economic growth in the targeted country will be larger when it is harder for exporters in the tariff-targeted country to divert their exports to alternative destinations.

External research suggests that a scenario of escalating global tariffs could remove up to 1 percentage point off our measure of trading-partner GDP growth. Table 4.1 summarises the likely economic impacts of tariffs on countries that impose and are targeted by tariffs.

Table 4.1

Possible effect of tariffs on the tariff-imposing country and the tariff-targeted country

Impact on	Tariff-imposing country	Tariff-targeted country
Prices	**Increase in import prices paid.** This increase in import prices is likely to be higher if demand for imports is not very price-sensitive. These higher prices may be passed on to domestic consumers, or absorbed by importers' profit margins.	**Decrease in export prices received.** This decrease in export prices is likely to be larger if export supply is not very price-sensitive. These lower prices may be passed on to domestic consumers, or other export destinations.
Trade volume and composition	**Decrease in import volumes** from the targeted country due to higher relative prices being paid. Imports may shift to non-tariffed products or countries, or to domestic production.	**Decrease in export volumes** to the tariff-imposing country due to lower relative prices being received. Exports may be redirected to non-tariffed products or countries, or to domestic consumption.
Exchange rate	**Appreciates** due to a decreased supply of currency as import volumes decline. This decreases the relative price of imports, offsetting some impact from the tariffs.	**Depreciates** relative to the tariff-imposing country due to a decreased demand for currency from the tariff-imposing country.
Economic activity	**Decrease in economic activity** and productivity as any gains to protected industries (which now face less global competition) are offset by higher prices for tariffed inputs for domestic production.	**Decrease in economic activity** and productivity if exporters are unable to find alternative markets.
Labour markets	**Decrease in employment** as any gains to protected industries are offset by declines in other parts of the economy. Real wages may also decrease.	**Decrease in employment** in exporting and related sectors. Real wages may also decrease.

Countries that are not directly targeted by tariffs may benefit from trade diversion. Exports from these non-tariffed countries may increase to the tariff-imposing country as their non-tariffed exports are now more competitive. Imports from the tariff-targeted country may become cheaper as these countries find alternative markets. These flows may be accompanied by increased investment and productive capacity in non-tariffed countries, as well as potentially increasing involvement in global supply chains.

Indirect effects from lower global growth may negatively affect non-tariffed countries. Tariffs are likely to reduce growth in both imposing and targeted economies. Lower global growth may offset any benefits to non-tariffed countries from trade diversion.

The net impact on non-tariffed countries' inflation is uncertain. Cheaper imports from the tariff-targeted country could be offset by more expensive imports from the tariff-imposing country, which now face higher production costs domestically. Weaker global economic growth could also reduce the cost of imports. These impacts are more ambiguous when the targeted country retaliates and faces their own potential inflationary pressures. Disruptions to global supply chains may also reduce global productivity, increasing the price of imports.

Transmission to New Zealand

Global economic developments affect New Zealand through trade, financial market, and uncertainty channels. Higher global tariffs could lead to lower global output, and higher inflation for countries introducing tariffs. The potential impact on export demand and import prices for non-tariffed countries is more ambiguous. Tariffs can also have a significant effect on exchange rates, interest rates, asset prices, and supply chains.

Increased uncertainty about global trade policies can also influence spending decisions by firms and households, who may choose to defer spending plans until uncertainty reduces. Table 4.2 provides an overview of the likely directional effects that higher levels of global tariffs may have on the New Zealand economy.

Table 4.2

Possible effect of tariffs on the New Zealand economy

Channels		Effect on the New Zealand (NZ) economy	Effect on NZ growth	Effect on NZ inflation
Trade[7]	Trade diversion that increases imports into NZ.	NZ may receive cheaper imports as tariff targeted exports are redirected towards NZ. This could increase domestic production (e.g. cheaper inputs and capital goods) or reduce domestic production (e.g. crowding out local businesses).	↔	↓
	Trade diversion that increases demand for NZ exports.	NZ could experience an increase in exports to tariff-imposing countries if we are not subject to tariffs directly, as we would be a relatively cheaper trading partner compared to tariff-targeted countries.	↑	↑
	Indirect effects via growth in our trading partners.	Demand for NZ exports may decline if growth slows in our trading partners.	↓	↓
	Supply chain disruptions and efficiency.	Supply chain fragmentation could reduce global resilience to shocks and increase import costs as countries adapt to tariffs. These disrupted supply chains may lower global productivity growth and lead to higher import costs in the medium term.	↓	↑
Financial	Exchange rate.	Higher global uncertainty tends to cause a depreciation in the New Zealand dollar.	↑	↑
	Interest rates.	In the shorter term, there may be upward pressure on interest rates in countries imposing tariffs. Over the longer term, there is likely to be downward pressure on global real interest rates due to declining productivity.	↔	↔
	Asset prices.	Slower global growth and higher uncertainty will weigh on asset prices.	↓	↓
Uncertainty	Trade policy uncertainty that reduces business and consumer confidence.	Higher uncertainty may result in New Zealand businesses and households delaying or reducing investment and consumer spending.	↓	↓

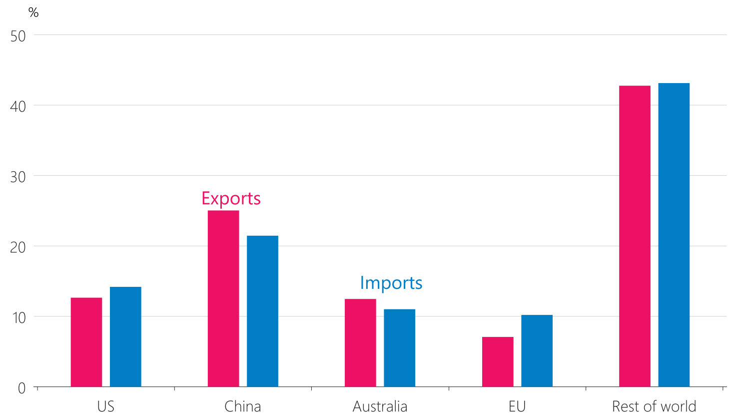
7 There may be second or third round effects if the import and export composition of our key trading partners are significantly impacted by trade policies — although the balance and scale of these effects is highly uncertain.

New Zealand's international trade is exposed to global tariffs both directly and indirectly through our trading partners. New Zealand would be affected directly by tariffs if another country imposed tariffs on us, or a universal tariff on all countries. However, New Zealand could be indirectly exposed to tariffs placed on, or by, our key trading partners. A large share of New Zealand's goods exports goes to the US and China, between which trade tensions have risen (figure 4.1). The overall impact on New Zealand's export sector will depend on how higher tariffs affect GDP growth in China and the US, and if demand for New Zealand exports increases due to substitution away from other countries' products.

Reduced US–China trade could result in China exporting goods to New Zealand at a lower cost. On the other hand, tariffs are also likely to be inflationary for the US and any retaliating countries, with a potential pass-through to higher global prices for products that New Zealand imports. There will be a complex interplay of trade redirection between tariff-imposing, tariff-targeted, and non-tariffed countries, with uncertain relative price effects.

Developments in trade policy affect New Zealand through financial market channels. Exchange rates can be directly affected by actual or expected tariffs. In addition, the New Zealand dollar exchange rate tends to depreciate when global uncertainty increases, and global investor risk appetite worsens. Recent global trade policy developments have contributed to a depreciation in the New Zealand dollar on a trade-weighted basis. All else equal, this will result in higher import costs (see chapter 5).

Figure 4.1
New Zealand goods exports and imports by location
(share of 2024 export value)

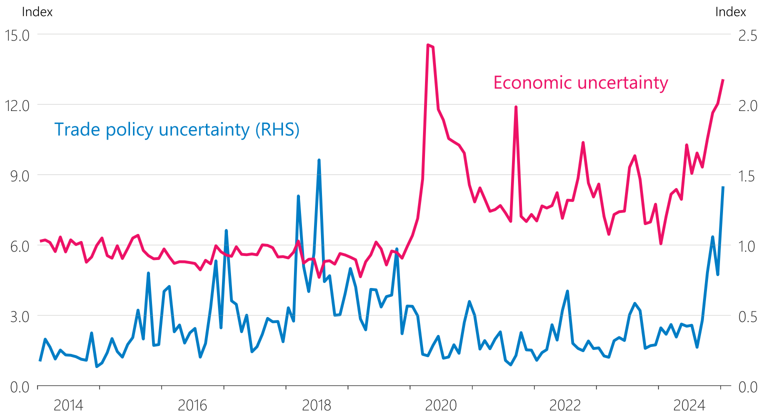


Source: Haver Analytics.

Trade policies affect the New Zealand economy via the uncertainty channel. Some measures of domestic and US trade and economic policy uncertainty have increased since the 2024 US election (figures 4.2 and 4.3). Higher domestic and US uncertainty can reduce economic activity in New Zealand, primarily through weakening business investment. The uncertainty channel transmits relatively quickly, and heightened uncertainty is likely to reduce domestic demand in New Zealand even if global tariff increases end up being relatively small or temporary.

Overall, these trade policy shocks are likely to reduce growth in the New Zealand economy, but the effect on inflation in New Zealand is highly uncertain. Tariffs are a combination of supply and demand side disruptions for global economies, with complex effects. The ultimate effects will depend on the nature of potential and applied tariffs, how other countries respond, and how tariffs transmit through various channels to the New Zealand economy. We will monitor key data releases, such as overseas merchandise trade and international prices, for emerging evidence of trade diversion, and both domestic and international uncertainty indices.

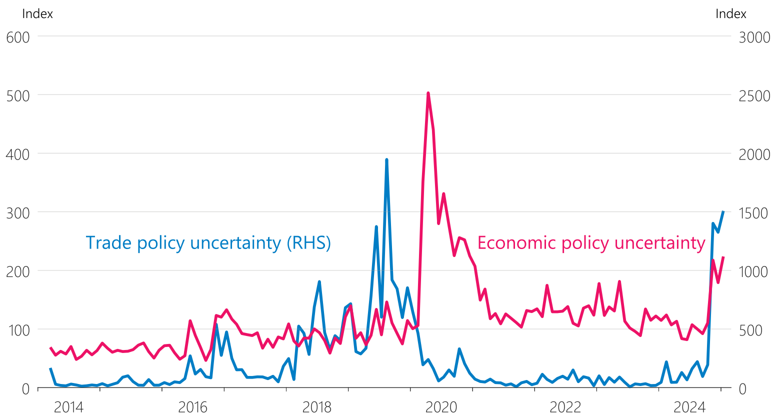
Figure 4.2
New Zealand uncertainty measures



Source: Sense Partners.

Note: Sense Partners tracks trade policy uncertainty and economic uncertainty using the share of New Zealand media articles that discuss trade and the economy.

Figure 4.3
United States uncertainty measures



Source: Haver Analytics.

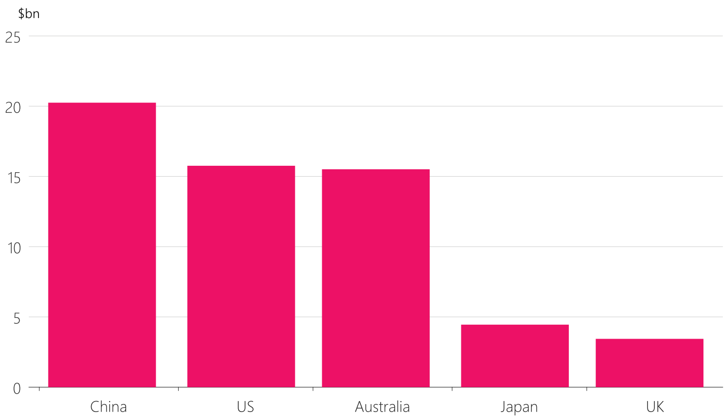
2 Outlook for some of New Zealand's key commodity exports

New Zealand's export sector is an important part of our economy, making up about 25 percent of GDP. Our top export destinations for goods and services in the year ended September 2024 were China, the US, Australia, Japan, and the UK (figure 4.4). Our top goods and services exports were dairy, travel, meat products, wood, and fruits and nuts (figure 4.5).

New Zealand's exports grew at a moderate pace, consistent with below trend global growth over 2024. Export volumes grew 2.5 percent in the year to the September 2024 quarter, while export prices were relatively unchanged. There are downside risks for New Zealand export volumes given the weaker global macroeconomic outlook (see chapter 3) and heightened trade tensions (see chapter 4.1).

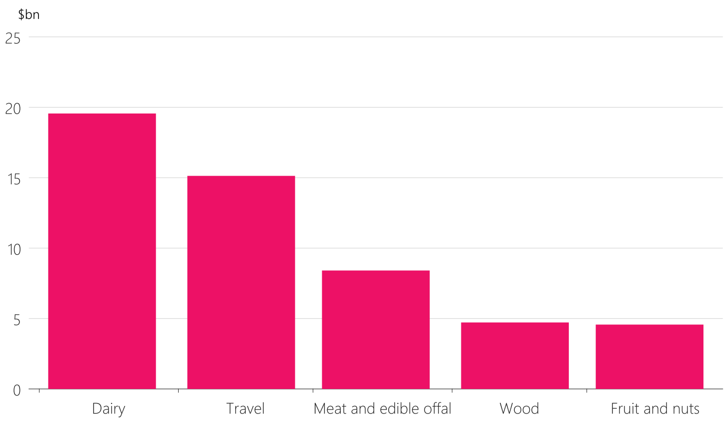
We expect the value of New Zealand's exports to increase in early 2025. Commodity prices increased over 2024, as shown by the ANZ World Commodity Price Index (figure 4.6). We expect commodity prices to remain at elevated levels over 2025, contributing to higher export values.

Figure 4.4
Top five New Zealand export destinations
(year to the September 2024 quarter)



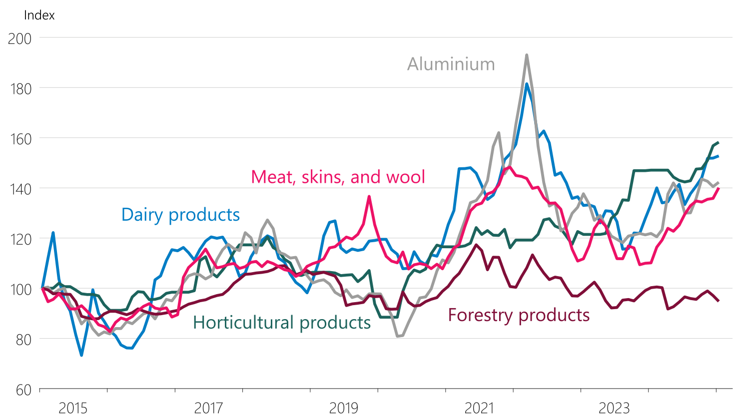
Source: Stats NZ.

Figure 4.5
Top five New Zealand exports by product
(year to the September 2024 quarter)



Source: Stats NZ.

Figure 4.6
ANZ World Commodity Price Index
(index = 100 in January 2015)



Source: ANZ.

Supply and demand factors have contributed to higher commodity prices since the start of 2024

Global prices for beef and dairy products — New Zealand's two largest export commodities — increased over 2024. Higher global commodity prices for beef and dairy were due to both resilient demand and constrained global supply.

Livestock disease in the US and Europe reduced the supply of beef and dairy over 2024. In the US, livestock were affected by avian flu, while in Europe livestock were affected by bluetongue disease. These diseases contributed to a reduction in milk supply and beef production. This reduction in supply resulted in the US and Europe needing to import more dairy and beef products to meet resilient domestic demand, contributing to upward pressure on prices. Additionally, foot and mouth disease was confirmed in German livestock in January 2025. This may impact supply over the near term, as some countries have imposed export restrictions on Germany's dairy and meat products.

Livestock numbers declined over 2024 in the US, China, and Europe, further contributing to reduced beef and dairy supply. An oversupply of raw milk in the domestic Chinese market and weak Chinese demand have contributed to suppressed domestic prices over the past couple of years and a subsequent reduction in Chinese dairy herds. Structural changes such as environmental regulation and an ageing farmer population in Europe have contributed to declining livestock numbers affecting both European beef and dairy supply. US livestock numbers have been declining since 2019, reflecting the cattle cycle — a recurring pattern where herd sizes expand when prices are high and shrink when costs increase or profits fall. US livestock numbers were expected to begin increasing in 2024. However, adverse weather conditions have delayed this.

Demand for beef and dairy products was relatively resilient over 2024 despite subdued global GDP growth, supporting prices. In the last quarter of 2024, China's restocking of milk powder inventories supported their demand for dairy products. This contributed to upward pressure on global dairy prices and an increase in demand for New Zealand dairy exports. In comparison, forestry exports have experienced weak prices over this same period due to weak demand from China's construction industry.

Supply factors will continue to influence global commodity prices in 2025

Global beef supply is likely to decline in 2025 for the first time since 2020. This is due to declining livestock numbers in four of the world's largest beef producers: the US, China, Europe, and Brazil. New Zealand cattle numbers are also projected to decline over 2025. Global demand for beef is expected to remain robust over 2025, further supporting prices. Falling supply and robust demand mean that global beef prices may increase further over 2025.

Global dairy product supply may also be partially constrained in 2025. Disease outbreaks in the US and Europe may contribute to a decrease in milk yields over the near term. China's Ministry of Agriculture and Rural Affairs forecasts Chinese milk production to continue to decline in the first half of 2025. However, supply constraints will be balanced against expected dairy production growth in other countries, such as New Zealand and Australia.

Financial market participants expect global dairy prices to remain resilient in 2025. However, there is downside risk to demand once China finishes restocking their inventories, which could result in downward pressure on dairy prices. Overall, resilient demand and near-term supply constraints suggest that global dairy prices are likely to remain elevated over the near term. The outlook for the medium term is more uncertain.

Our forecasts assume an elevated global commodity price outlook for 2025

Our forecasts assume that global prices for New Zealand's goods exports increase over 2025, supported by higher beef and dairy prices. Higher global prices will support incomes for dairy and beef exporters, and this is further supported by the recent depreciation in the New Zealand dollar exchange rate. The lower exchange rate means that exporters receive higher prices in New Zealand dollar terms for a given level of global prices.

Beef and dairy prices will be affected by weather conditions, geopolitical tensions, further disease outbreaks, and trade restrictions. For example, China is currently investigating beef imports, including from New Zealand. The Dairy Companies Association of New Zealand has also joined Australia and the US dairy industry to address concerns over Canada's subsidised dairy exports. The US approach to international trade is also uncertain.

Chapter 05

Economic projections

Hump Ridge Track. Photo: Luisa Gaspar

Chapter 5. Economic projections

This chapter summarises the economic projections that MPC members considered when making their policy assessment. The projections were finalised on 13 February 2025.

Economic activity and the labour market have been weak, and we estimate that the output gap is significantly negative. Annual headline inflation is now close to 2 percent. Non-tradables inflation has continued to decrease, and will soon return to a level consistent with sustainably achieving the mid-point of the MPC's 1 to 3 percent target band.

We assume that the negative output gap puts further downward pressure on non-tradables inflation over the next year. Lower interest rates are expected to contribute to a recovery in aggregate demand, reducing the negative output gap across the projection. This implies a period of economic growth above the potential growth rate. We assume that price-setting behaviour continues to adapt to a low-inflation environment over the medium term, easing persistent domestic inflationary pressure. As price-setting behaviour adapts, the OCR declines to around the middle of our estimated band of long-term neutral rates.

Headline inflation is projected to increase within the target band in 2025, before returning near the target mid-point in 2026. The increase in headline inflation is due to price increases in tradables components, such as petrol, which do not typically result in persistent inflationary pressure. Since monetary policy operates with a lag, we generally 'look through' temporary shocks to inflation, to achieve low and stable inflation in the medium term (consistent with the MPC's *Remit*).

We assume that offshore trade policy announcements will affect the New Zealand economy via the uncertainty and financial markets channels. Elevated uncertainty related to global trade policies is assumed to lead to businesses delaying, altering, or cancelling some investment plans. These projections do not assume specific effects of trade policies on New Zealand's exports or imports. The projections do include the market response so far as captured in global interest rates and the value of the New Zealand dollar exchange rate. The effect of trade policies on New Zealand exports and imports will depend on a range of factors, including their design, size, breadth, duration, and the extent of retaliation and trade diversion (see chapter 4.1).

The New Zealand labour market has continued to weaken. The unemployment rate increased to 5.1 percent in the December 2024 quarter, and employment has declined. Due to usual lags between activity and the labour market, the unemployment rate is expected to continue to increase to a peak of 5.2 percent in early 2025 before gradually decreasing.

These projections rely on a set of key assumptions about the global and domestic factors influencing the economy. There is significant uncertainty about these assumptions.

Table 5.1
Key projection assumptions

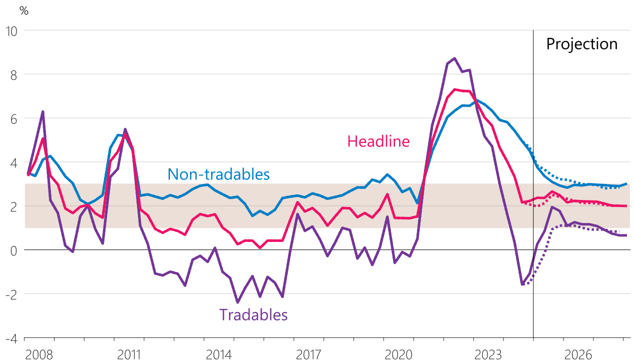
Key factors	
Global factors	• Global growth remains below potential and there is increased uncertainty around the growth outlook. As a result, the global economy is likely to continue constraining New Zealand's economic activity over the coming year. • The New Zealand dollar trade-weighted index (TWI) has depreciated about 3 percent since the November *Statement,* primarily due to increased global uncertainty. The weaker New Zealand dollar exchange rate puts upward pressure on tradables inflation in New Zealand. The New Zealand dollar TWI is assumed to remain at 67.5 over the projection.
Domestic capacity pressures	• The output gap is assumed to have a lower starting point (-1.7 percent of potential GDP in the December 2024 quarter) than in the November projection. We estimate the starting point of the output gap using the output gap indicator suite (figure 6.2). • We assume the output gap begins to recover in 2025 in response to lower interest rates. • The decline in the output gap since mid-2022 has been mainly in response to tighter monetary policy, slower growth in government spending, and headwinds from slowing growth in our trading partners. Likewise, less restrictive monetary policy is expected to result in a recovery in the output gap. Sectors of the economy that are typically more sensitive to monetary policy have tended to be weaker over the past two years, and are expected to lead the recovery in economic growth (see chapter 4.1 of the November *Statement*).
Economic growth	
Potential output	• We use the output gap indicator suite, which is largely independent of recent GDP data, to estimate the starting point output gap. The output gap is the difference between published GDP data and estimated potential GDP. Therefore, GDP revisions require us to adjust our estimate of recent potential GDP growth to match our independent output gap estimate. • GDP growth in the two years to early 2024 was revised significantly higher in the most recent GDP data release (see box A in chapter 2). Therefore, we have revised our estimate of potential growth higher over this period. The higher growth rate of potential GDP implies labour productivity did not decline by as much over the past few years as previously measured. However, labour productivity growth has still been weak and is assumed to remain so over the projection. • The rapid decline in GDP during 2024 means that our estimate of the output gap decreases from above +1 percent of potential GDP at the beginning of 2024 to -1.7 percent by the end of 2024 (figure 6.5).
Production	• Available data suggest modest GDP growth resumed in the December 2024 quarter. We assume a period of above-potential growth will begin in 2025, as the output gap begins to close in response to lower interest rates and higher international prices for dairy and meat products increase export earnings.
Consumption	• Consumption declined in the September 2024 quarter. We assume a moderate growth rate for consumption across the forecast, as interest rates decrease and house prices gradually increase.

Economic growth (continued)	
Residential investment	• Residential investment has been falling for two years, as restrictive interest rates have reduced housing demand and made development projects less viable. • Residential investment was revised down by Stats NZ over the past two years, and fell significantly in the most recent quarter. Real residential investment is now about 10 percent below its pre-COVID-19 level, which is similar to the decrease in residential building consents over this period. • Surveys of construction sector confidence have improved significantly in recent months, and we expect construction activity to increase across the forecast period in response to lower interest rates and increasing house prices.
Business investment	• Business investment was also revised down over the past two years, and fell significantly in the September 2024 quarter. We assume business investment will fall further in the near term in response to the negative output gap and significant economic and trade policy uncertainty (see chapter 4.1). In the medium term, we expect business investment to grow as the output gap closes.
Government	• Government consumption and investment were revised significantly higher over the past two years in the recent GDP release. Government spending was the largest contributor to the upward revision to expenditure GDP, but was partially offset by downward revisions to residential investment and business investment. • Our forecast for government spending is based on the *Half Year Economic and Fiscal Update (HYEFU)* 2024, published in December. *HYEFU* 2024 showed a relatively flat forecast for real government consumption, whereas *Budget* 2024 had forecast declines. The higher revised starting point and updated government consumption forecast imply higher total government spending in the medium term than assumed in the November *Statement*. • Government expenditure is still assumed to decline as a share of the economy over the medium term, reducing inflationary pressure, but to a lesser extent then previously.
Exports and imports	• Over the medium term, goods export volumes are assumed to grow at a similar pace to the rest of the economy. Prices for dairy and meat have been supported by weak global supply and resilient demand (see chapter 4.2). Given the weaker New Zealand dollar exchange rate, goods export revenues are assumed to be higher than in the November *Statement*. • Services exports are assumed to continue to recover toward pre-COVID-19 levels, causing total export growth to be slightly faster than overall economic growth. It is assumed that the weaker New Zealand dollar exchange rate leads to slightly higher volumes of services exports, all else equal. • Import volumes are assumed to evolve in line with their historical relationships with other components of GDP. Nominal import prices are assumed to remain around current levels in foreign currency terms.
Inventories	• Since early 2023, there has been a significant decrease in inventories, which had built up during the COVID-19 period. The drawdown in inventories has meant less production has taken place, given the level of demand. As the economy begins to recover, we expect inventories growth to return to more normal levels.

Labour market	
Employment and wages	• The New Zealand labour market has continued to weaken. The unemployment rate increased to 5.1 percent in the December 2024 quarter. Employment has decreased. • As the labour market tends to lag developments in the broader economy, employment growth is expected to remain subdued over the next year. • Same-job wage growth has declined. With weak labour market conditions, and headline inflation remaining within the target band, we expect wage growth to decline to around its pre-COVID-19 average of about 2 percent per year over the medium term. • The unemployment rate is expected to continue to increase slightly to a peak of 5.2 percent in early 2025, before declining. The slightly higher unemployment rate projection relative to the November *Statement* is consistent with a more negative output gap projection.
Migration	• Net immigration has continued to decline — although remains positive — with higher departures and lower arrival numbers. We expect working-age net immigration to remain low over the next year, before increasing gradually to around 6,500 per quarter by the end of the projection. The tight Australian labour market is encouraging New Zealand workers to leave for more attractive job opportunities in Australia. However, as labour market conditions in New Zealand improve from the second half of 2025, we expect net immigration to gradually increase. • Migration is assumed to have a minimal effect on inflationary pressure in our forecast, as we assume the additional supply of workers and increased demand for goods and services have broadly offsetting effects on inflation.
Inflation	
Headline	• Annual headline CPI inflation remained at 2.2 percent in the December 2024 quarter, near the target mid-point. • In 2024, negative tradables inflation contributed significantly to lower headline inflation. Recently, tradables prices have begun to increase, which is expected to contribute to headline inflation increasing within the target band during 2025. However, significant spare capacity in the economy is expected to continue to put downward pressure on non-tradables inflation, and headline inflation is expected to return near the target mid-point in early 2026.
Non-tradables	• Non-tradables inflation is projected to continue to decline due to the negative output gap and price-setting behaviour adapting to a low-inflation environment. We project annual non-tradables inflation will reach a level consistent with the mid-point of the MPC's 1 to 3 percent target band by the end of 2025. • Administered and policy-affected price changes are having a significant influence on non-tradables inflation at present, and this is likely to continue in 2025. On net, these changes are making a large positive contribution to annual non-tradables inflation.
Tradables	• Annual tradables inflation decreased rapidly in 2024, but has begun to increase recently. Fuel prices have increased since the November *Statement,* and a weaker New Zealand dollar exchange rate is expected to put upward pressure on tradables inflation over the next year. • After higher import costs have passed through, annual tradables inflation is assumed to decrease to around pre-COVID-19 average levels.

Charts

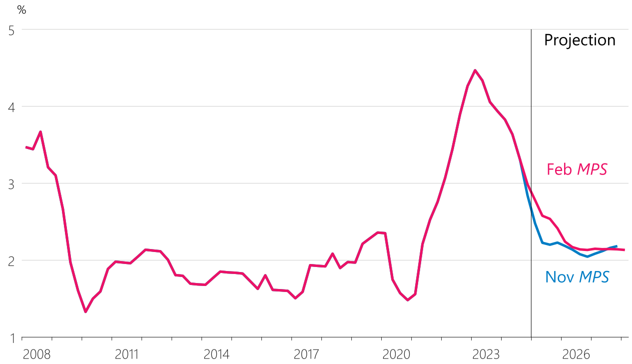
Figure 5.1
Inflation components
(annual)



Source: Stats NZ, RBNZ estimates.

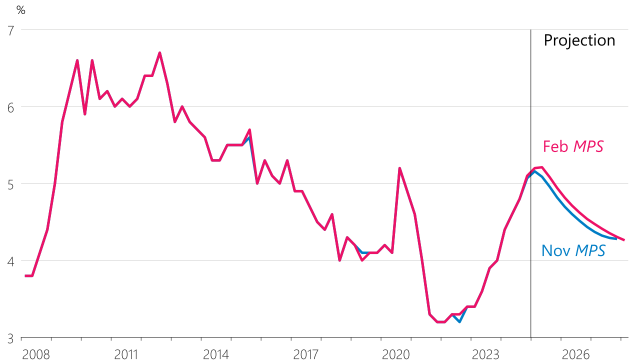
Note: Dotted lines show the projections from the November *Statement*. The shaded area represents the MPC's 1 to 3 percent target range for annual CPI inflation over the medium term.

Figure 5.2
Private sector LCI wage inflation
(annual)



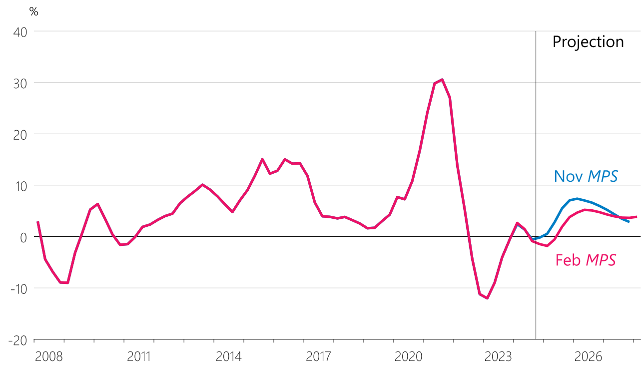
Source: Stats NZ, RBNZ estimates.

Figure 5.3
Unemployment rate
(unemployed people as a share of the labour force, seasonally adjusted)



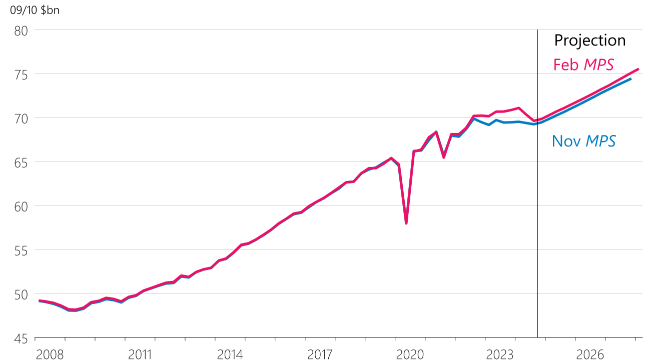
Source: Stats NZ, RBNZ estimates.

Figure 5.4
House price growth
(annual)



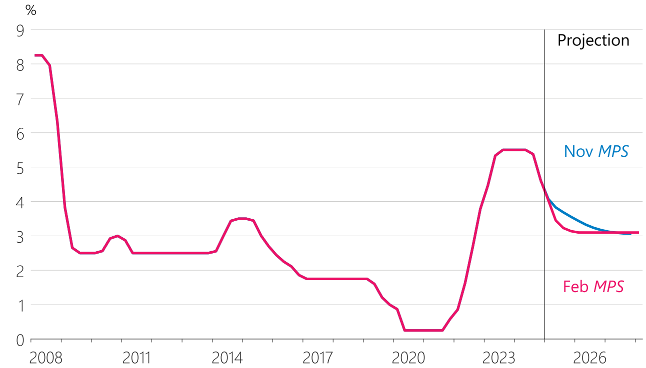
Source: CoreLogic, RBNZ estimates.

Figure 5.5
Production GDP
(quarterly, seasonally adjusted)



Source: Stats NZ, RBNZ estimates.

Figure 5.6
OCR
(quarterly average)



Source: RBNZ estimates.

Chapter 06

Appendices

Huka Falls. Photo: Michelle Laux

Chapter 6. Appendices

Appendix 1: Statistical tables

Table 6.1
Key forecast variables

		GDP growth Quarterly	CPI inflation Quarterly	CPI inflation Annual	Unemployment rate	TWI	OCR
2023	Mar	-0.1	1.2	6.7	3.4	71.3	4.5
	Jun	0.7	1.1	6.0	3.6	71.0	5.3
	Sep	0.0	1.8	5.6	3.9	70.6	5.5
	Dec	0.3	0.5	4.7	4.0	70.8	5.5
2024	Mar	0.3	0.6	4.0	4.4	71.6	5.5
	Jun	-1.1	0.4	3.3	4.6	71.4	5.5
	Sep	-1.0	0.6	2.2	4.8	70.9	5.4
	Dec	**0.3**	0.5	2.2	5.1	69.5	4.6
2025	Mar	**0.6**	**0.8**	**2.4**	**5.2**	**67.7**	**4.0**
	Jun	**0.6**	**0.4**	**2.4**	**5.2**	**67.5**	**3.4**
	Sep	**0.5**	**0.9**	**2.7**	**5.1**	**67.5**	**3.2**
	Dec	**0.6**	**0.4**	**2.5**	**4.9**	**67.5**	**3.1**
2026	Mar	**0.6**	**0.5**	**2.2**	**4.8**	**67.5**	**3.1**
	Jun	**0.6**	**0.5**	**2.2**	**4.7**	**67.5**	**3.1**
	Sep	**0.6**	**0.9**	**2.2**	**4.6**	**67.5**	**3.1**
	Dec	**0.6**	**0.4**	**2.2**	**4.5**	**67.5**	**3.1**
2027	Mar	**0.6**	**0.4**	**2.2**	**4.5**	**67.5**	**3.1**
	Jun	**0.6**	**0.4**	**2.1**	**4.4**	**67.5**	**3.1**
	Sep	**0.7**	**0.8**	**2.0**	**4.4**	**67.5**	**3.1**
	Dec	**0.6**	**0.4**	**2.0**	**4.3**	**67.5**	**3.1**
2028	Mar	**0.6**	**0.4**	**2.0**	**4.3**	**67.5**	**3.1**

Table 6.2

Measures of inflation and inflation expectations

	2023			2024				2025
	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar
Inflation (annual rates)								
CPI	6.0	5.6	4.7	4.0	3.3	2.2	2.2	
CPI non-tradables	6.6	6.3	5.9	5.8	5.4	4.9	4.5	
CPI tradables	5.2	4.7	3.0	1.6	0.3	-1.6	-1.1	
Sectoral factor model estimate of core inflation	5.8	5.3	4.6	4.2	3.5	3.3	3.1	
CPI trimmed mean (30% measure)	6.0	5.5	5.0	4.5	3.8	2.7	2.5	
CPI weighted median	6.6	5.0	4.4	4.4	3.5	2.8	2.6	
GDP deflator (expenditure)	5.3	6.5	3.5	3.8	2.9	2.7		
Inflation expectations								
RBNZ Survey of Expectations — inflation 1 year ahead	4.3	4.2	3.6	3.2	2.7	2.4	2.0	2.1
RBNZ Survey of Expectations — inflation 2 years ahead	2.8	2.8	2.8	2.5	2.3	2.0	2.1	2.1
RBNZ Survey of Expectations — inflation 5 years ahead	2.4	2.3	2.4	2.3	2.3	2.1	2.2	2.1
RBNZ Survey of Expectations — inflation 10 years ahead	2.3	2.2	2.3	2.2	2.2	2.0	2.2	2.1

Table 6.3

Measures of labour market conditions

(seasonally adjusted, changes expressed in annual percent terms, unless specified otherwise)

	2023			2024			
	Jun	Sep	Dec	Mar	Jun	Sep	Dec
Household Labour Force Survey							
Unemployment rate	3.6	3.9	4.0	4.4	4.6	4.8	5.1
Underutilisation rate	9.9	10.4	10.7	11.2	11.8	11.6	12.1
Labour force participation rate	72.4	72.0	71.9	71.5	71.6	71.1	71.0
Employment rate (% of working-age population)	69.8	69.2	69.0	68.4	68.3	67.7	67.4
Employment growth	4.4	3.0	2.8	1.0	0.1	-0.6	-1.1
Average weekly hours worked	33.5	33.6	33.7	33.8	33.2	33.3	33.2
Number unemployed (thousand people)	110	119	123	134	143	148	156
Number employed (million people)	2.93	2.94	2.95	2.93	2.94	2.92	2.92
Labour force (million people)	3.04	3.06	3.07	3.07	3.08	3.07	3.07
Extended labour force (million people)	3.14	3.15	3.16	3.17	3.18	3.17	3.17
Working-age population (million people, age 15+ years)	4.21	4.24	4.27	4.29	4.30	4.31	4.33
Quarterly Employment Survey — QES							
Filled jobs growth	6.5	6.1	4.3	3.5	-0.2	-1.3	-0.9
Average hourly earnings growth (private sector, ordinary time)	7.7	7.1	6.6	4.8	4.0	3.2	4.0
Other data sources							
Labour Cost Index growth, adjusted (private sector, ordinary and overtime)	4.3	4.1	3.9	3.8	3.6	3.3	3.0
Labour Cost Index growth, unadjusted (private sector, ordinary time)	6.1	5.7	5.7	5.2	4.8	4.5	3.9
Estimated net working-age immigration (thousands, quarterly)	33.4	23.7	12.8	7.0	4.9	1.4	1.0
Change in All Vacancies Index*	-21.6	-27.9	-27.6	-27.3	-33.4	-31.4	-27.3

Note: The All Vacancies Index is produced by MBIE as part of the monthly Jobs Online report, which shows changes in job vacancies advertised by businesses on internet job boards. The unadjusted Labour Cost Index (LCI) is an analytical index that reflects quality change in addition to price change (whereas the official LCI measures price changes only). For definitions of underutilisation, the extended labour force, and related concepts, see Stats NZ (2016) 'Introducting underutilisation in the labour market'.

* The All Vacancies Index is a non-seasonally adjusted series.

Table 6.4

Composition of real GDP growth

(annual average percent change, seasonally adjusted, March years, unless specified otherwise)

	Actuals							Projection			
March year	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
Final consumption expenditure											
Private	4.8	4.5	2.4	0.2	6.4	3.3	1.0	**0.2**	**1.9**	**2.1**	**2.4**
Public authority	3.8	3.3	5.5	7.0	8.0	2.6	2.0	**-1.4**	**0.0**	**0.0**	**0.0**
Total	**4.6**	**4.3**	**3.1**	**1.8**	**6.8**	**3.2**	**1.3**	-0.2	1.4	1.6	1.9
Gross fixed capital formation											
Residential	-1.8	-0.1	2.7	2.2	2.5	-2.0	-5.6	**-9.3**	**2.9**	**10.4**	**9.9**
Other	9.8	7.0	2.8	-2.3	11.3	5.0	-0.5	**-4.6**	**-2.2**	**6.6**	**5.1**
Total	**6.6**	**5.2**	**2.8**	**-1.2**	**9.1**	**3.3**	**-1.6**	-5.6	-1.1	7.4	6.2
Final domestic expenditure	5.0	4.5	3.0	1.1	7.3	3.2	0.6	**-1.5**	**0.9**	**2.8**	**2.8**
Changes in inventories*	0.2	-0.2	-0.2	-0.3	0.6	0.3	-1.6	**0.3**	**0.7**	**0.1**	**0.0**
Gross national expenditure	**5.5**	**4.3**	**2.7**	**-0.1**	**8.5**	**3.8**	**-0.9**	-1.1	1.5	3.0	2.8
Exports of goods and services	3.8	3.3	0.2	-17.9	2.5	5.6	8.3	**2.1**	**2.9**	**2.7**	**2.6**
Imports of goods and services	7.8	4.8	1.4	-15.7	17.1	4.5	-1.2	**0.5**	**1.6**	**4.7**	**3.7**
Expenditure on GDP	**4.3**	**3.9**	**2.4**	**0.2**	**4.6**	**3.9**	**1.3**	-0.7	1.8	2.3	2.5
GDP (production)	3.4	3.5	2.3	-0.3	4.6	3.5	1.4	**-1.2**	**1.8**	**2.4**	**2.5**
GDP (production, March qtr to March qtr)	3.5	3.5	0.7	4.7	0.5	3.0	1.3	**-1.2**	**2.4**	**2.4**	**2.6**

* Percentage point contribution to the growth rate of GDP.

Table 6.5

Summary of economic projections

(annual percent change, March years, unless specified otherwise)

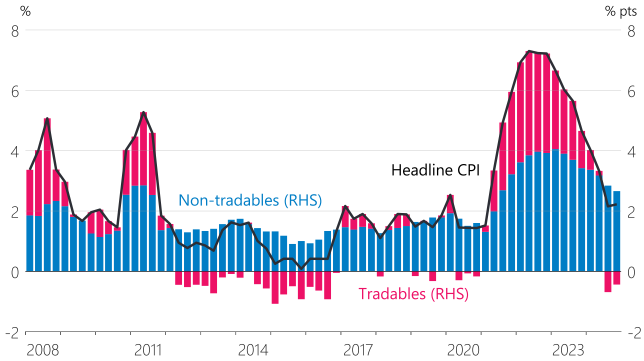
	Actuals							Projection			
March year	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
Price measures											
CPI	1.1	2.0	2.4	1.6	3.1	4.5	3.8	**2.8**	**2.2**	**2.1**	**2.1**
Labour costs	1.9	2.0	2.4	1.6	3.1	4.5	3.8	**2.8**	**2.2**	**2.1**	**2.1**
Export prices (in New Zealand dollars)	3.4	1.3	7.0	-6.0	20.8	1.1	-2.1	**7.4**	**3.0**	**1.8**	**1.9**
Import prices (in New Zealand dollars)	1.6	4.1	2.5	-2.4	18.9	8.2	-3.7	**3.6**	**-0.5**	**0.4**	**1.0**
Monetary conditions											
OCR (year average)	1.8	1.8	1.2	0.3	0.5	3.1	5.5	**4.9**	**3.2**	**3.1**	**3.1**
TWI (year average)	75.6	73.4	71.7	72.4	74.0	71.2	71.0	**69.9**	**67.5**	**67.5**	**67.5**
Output											
GDP (production, annual average % change)	3.4	3.5	2.3	-0.3	4.6	3.5	1.4	**-1.2**	**1.8**	**2.4**	**2.5**
Potential output (annual average % change)	3.2	3.1	2.6	0.0	1.9	3.3	2.7	**1.7**	**1.4**	**1.8**	**2.2**
Output gap (% of potential GDP, year average)	0.4	0.8	0.5	0.1	2.8	2.9	1.6	**-1.2**	**-0.8**	**-0.2**	**0.1**
Labour market											
Total employment (seasonally adjusted)	2.9	1.5	2.6	0.2	2.5	3.1	1.0	**-0.6**	**1.5**	**2.0**	**1.8**
Unemployment rate (March qtr, seasonally adjusted)	4.4	4.2	4.2	4.6	3.2	3.4	4.4	**5.2**	**4.8**	**4.5**	**4.3**
Trend labour productivity	0.6	0.7	0.8	0.8	0.6	0.4	0.2	**0.2**	**0.3**	**0.3**	**0.5**
Key balances											
Current account balance (% of GDP)	-3.1	-3.9	-1.7	-2.7	-6.8	-8.6	-6.6	**-5.4**	**-3.3**	**-3.3**	**-3.4**
Terms of trade (SNA measure, annual average % change)	4.5	-2.1	2.0	-1.0	0.4	-5.1	-1.3	**2.8**	**4.2**	**2.0**	**0.9**
Household saving rate (% of disposable income)	-2.0	-1.3	1.4	7.6	2.4	-3.0	-1.8	**-2.3**	**-1.2**	**-0.1**	**1.0**
World economy											
Trading-partner GDP (annual average % change)	4.0	3.5	1.7	-0.4	6.2	2.9	3.1	**2.9**	**2.7**	**2.8**	**2.8**
Trading-partner CPI (TWI-weighted)	1.8	1.4	2.4	0.8	4.1	4.8	2.2	**1.9**	**2.1**	**2.1**	**2.2**

Appendix 2: Chart pack

Figure 6.1

Composition of CPI inflation

(annual)

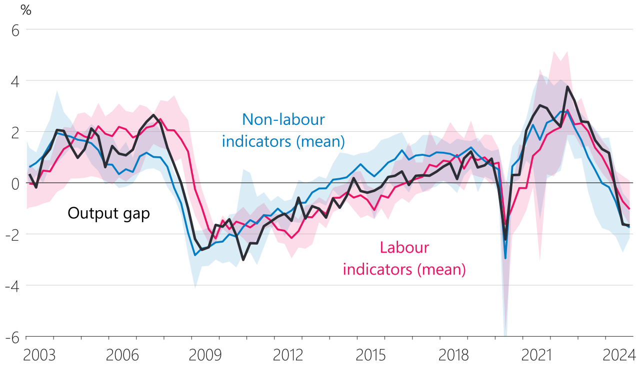


Source: Stats NZ.

Figure 6.2

Output gap and output gap indicators

(share of potential)



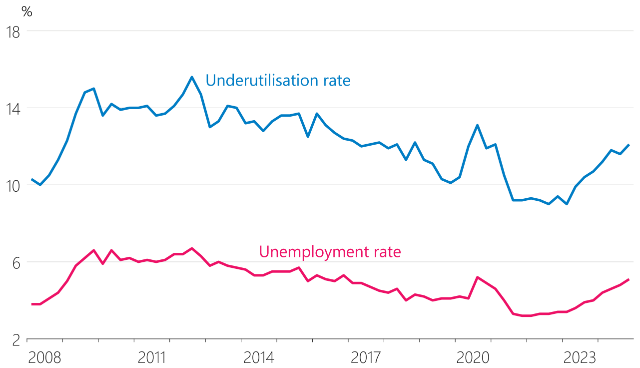
Source: NZIER, MBIE, Stats NZ, RBNZ estimates.

Note: The output gap indicators based on information from labour market surveys are shown separately from the other indicators. For each group of indicators, the shaded area shows the range of values and the line shows the mean value. The output gap estimate in the final quarter is based on our near-term GDP estimate.

Figure 6.3

Unemployment and underutilisation rates

(seasonally adjusted)

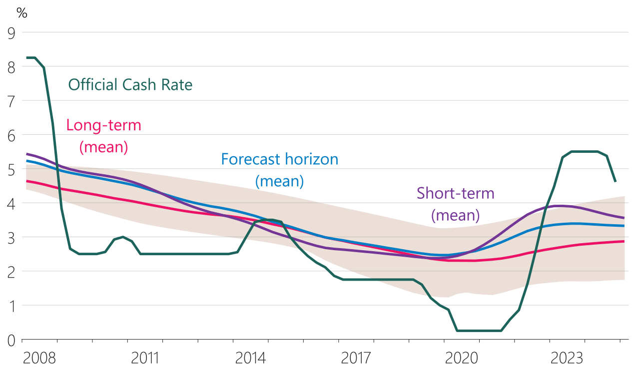


Source: Stats NZ.

Figure 6.4

OCR and nominal neutral OCR indicator suite

(quarterly average)



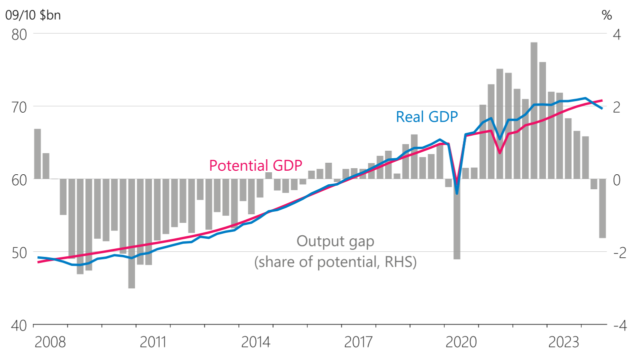
Source: RBNZ estimates.

Note: The shaded area indicates the range between the maximum and minimum values from our suite of long-run nominal neutral OCR indicators. See Castaing et al. (2024), 'Estimates of New Zealand's nominal neutral interest rate', *Bulletin*, Reserve Bank of New Zealand.

Figure 6.5

GDP and potential GDP

(seasonally adjusted)

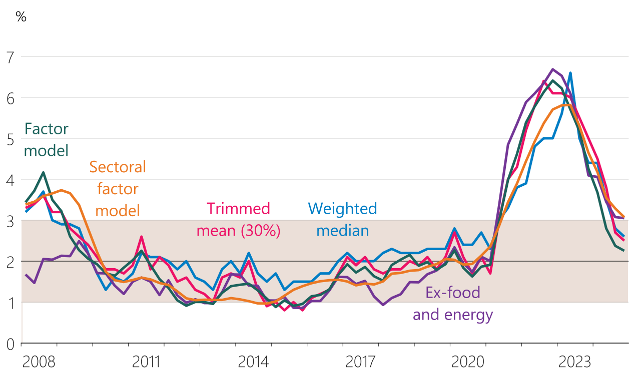


Source: Stats NZ, RBNZ estimates.

Figure 6.6

Measures of core inflation

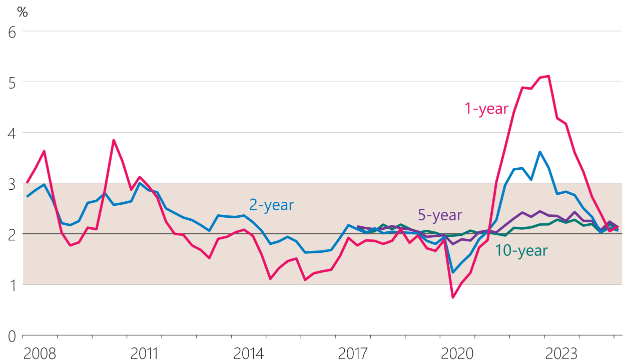
(annual)



Source: Stats NZ, RBNZ estimates.

Note: Core inflation measures exclude the GST increase in 2010. The shaded area represents the MPC's 1 to 3 percent target range for annual CPI inflation over the medium term.

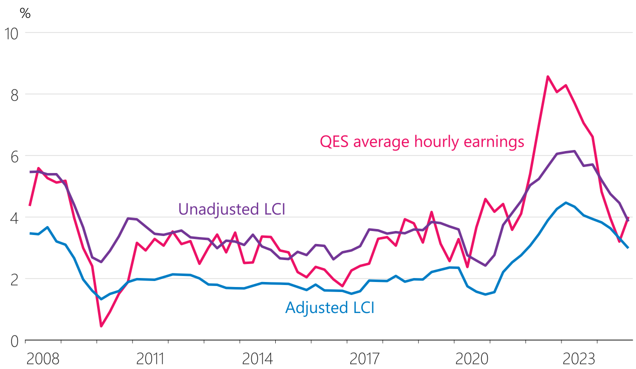
Figure 6.7
Inflation expectations
(annual, years ahead)



Source: RBNZ *Survey of Expectations (Business).*

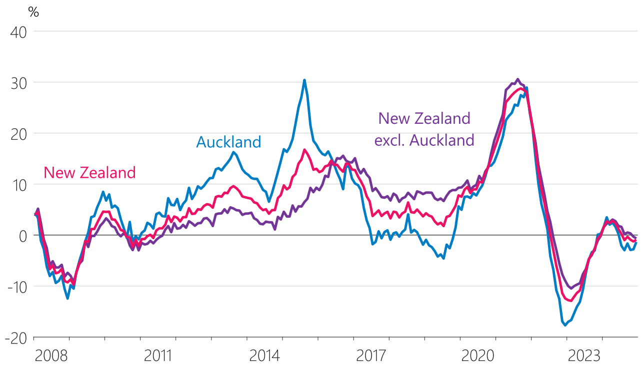
Note: The shaded area represents the MPC's 1 to 3 percent target range for annual CPI inflation over the medium term.

Figure 6.8
Private sector wage growth
(annual)



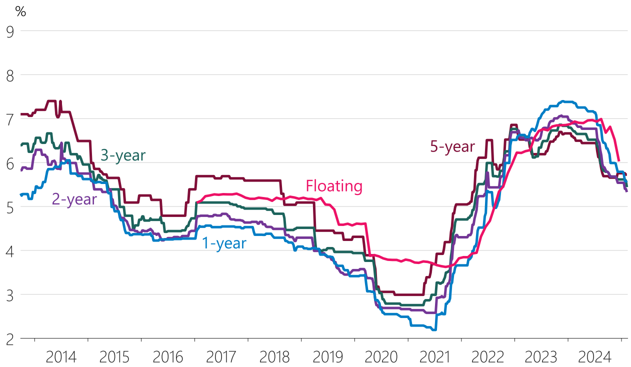
Source: Stats NZ.

Figure 6.9
House price inflation
(annual)



Source: REINZ.

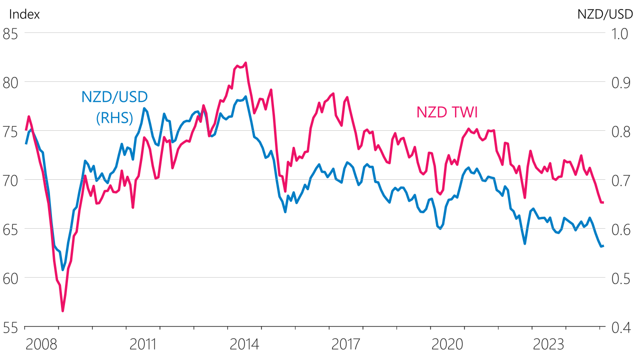
Figure 6.10
Mortgage interest rates



Source: interest.co.nz, RBNZ estimates.

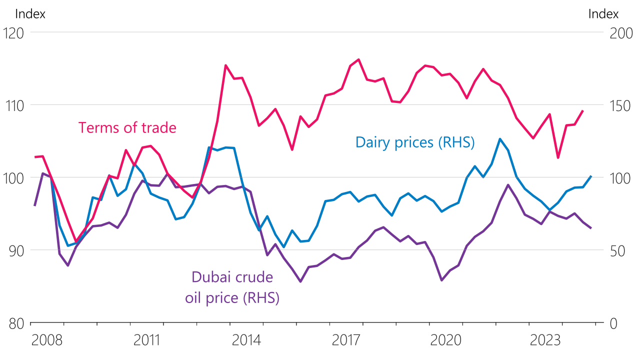
Note: The rates shown for the fixed terms are the average of the advertised rates from ANZ, ASB, BNZ, and Westpac, shown as weekly data. The floating rate represents the monthly yield on floating housing debt from the RBNZ *Income Statement* survey.

Figure 6.11
New Zealand dollar exchange rates
(monthly average)



Source: NZFMA, RBNZ.

Figure 6.12
Terms of trade, dairy, and oil price indices
(index = 100 in the September 2008 quarter, quarterly average)



Source: Stats NZ, Global Dairy Trade, LSEG, RBNZ estimates.

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