29 October 2026

Outlook for Borrowers: Post-October MPR

- **The RBNZ unexpectedly held the OCR at 2.75%, with the Committee voting 4-3. The Bank maintained a clear tightening bias.**
- **BNZ expects a 25bp hike in December, with sequential increases taking the OCR to a 3.75% peak in May 2027.**
- **Shorter-dated NZ rates fell sharply after the decision. Markets imply an OCR near 3.90% by end-2027, down from about 4.0% beforehand.**
- **At around 4.0%, 2-year swaps sit about 20bp above our fair value estimate, so we see limited scope for a sustained rise. Use dips to top up cover.**
- **5-year swaps are around 4.30%, only about 15bp above our forecast for early 2027 but well above the level implied by our expected OCR path.**
- **A sustained fall in 5-year rates would need lower oil prices or softer global growth and inflation. Until then, layering in cover and using target-level orders can help capture dips.**

RBNZ Monetary Policy Review

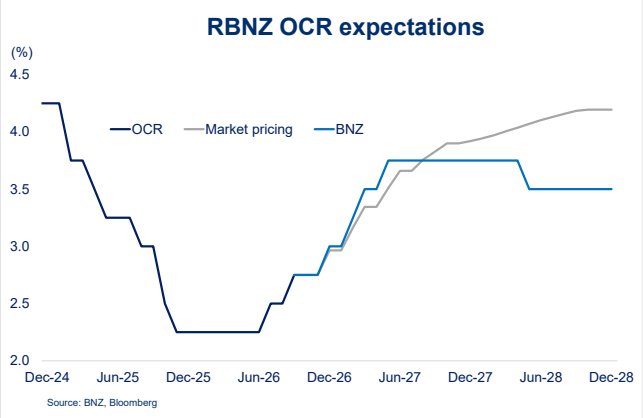
The RBNZ left the Official Cash Rate at 2.75% at Wednesday's Monetary Policy Review (MPR), contrary to our expectations and the roughly 95% probability of a hike implied by market pricing ahead of the announcement. The decision was reached by a vote of 4-3. The four-member majority preferred to pause and assess the impact of the two recent hikes ahead of December, while three members favoured an immediate 25bp increase. The Bank maintained a clear tightening bias - all Committee members agreed that further OCR increases are likely, depending on how the outlook evolves.

The Committee emphasised that incoming information ahead of the December MPS could meaningfully alter the appropriate policy stance in either direction. Further tightening would be warranted if domestic pricing pressures fail to moderate or broaden beyond normal cost pass-through, while more subdued pricing pressures could support another hold, particularly given weak domestic demand, contained wage growth and anchored inflation expectations. The Bank also noted the risk of an abrupt deterioration in the global economy.

As this was an MPR, the RBNZ did not publish updated projections or an OCR track. However, it indicated that annual CPI inflation would rise from 3.7% in Q3 to 4.4% in Q4, largely reflecting elevated fuel prices. The NZD trade-weighted index has fallen about 4% since the September MPS. The Bank noted that a weaker currency eases domestic financial conditions but could amplify indirect price effects and raise the risk of second-round impacts on price and wage setting.

We expect a 25bp increase at the 9 December MPS, with sequential hikes at each meeting, taking the OCR to a 3.75% peak in May 2027. Markets have pared back expectations but remain more aggressive than our forecast from the second half of next year. Swaps put the chance of a December hike at around 85%, suggesting the unexpected hold is viewed as a delay rather than an extended pause in the tightening cycle. The market-implied OCR for end-2027 is near 3.90%, down from about 4.0% before the announcement but still above the roughly 3.65% at the time of the September MPS.

Market prices a higher OCR peak than BNZ

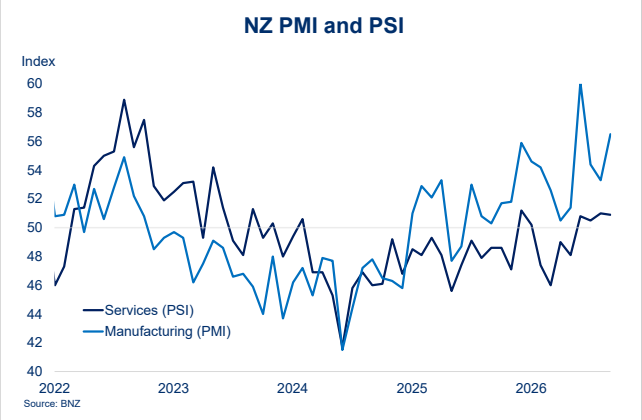


Economic Overview

The economy has been resilient despite headwinds from higher fuel costs and elevated geopolitical uncertainty. GDP rose 0.2% in the June quarter, beating the RBNZ's forecast of flat growth, and after revisions annual growth of 2.6% was well ahead of the 2.1% it had expected. Growth is uneven. Investment and exports, led by primary-sector production and tourism, have driven activity, while household spending was flat as higher fuel prices squeezed real disposable incomes. We forecast GDP growth of 0.5% in Q3 and 0.4% in Q4.

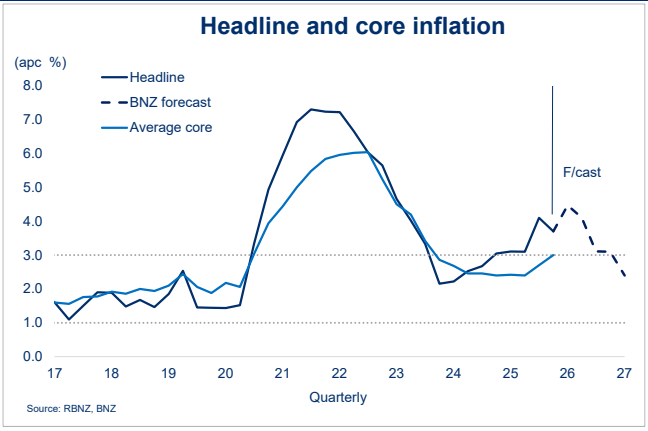
Business surveys point to momentum building into year-end. The manufacturing PMI rose to 56.5 in September. Setting aside June's exceptional 60.1, that is the strongest reading since 2021, with all sub-indices in expansion and employment back above 50. Meanwhile the services PMI was little changed at 50.9, its fourth consecutive month of expansion after two years of contraction. Services employment rose to its highest level since late 2023. Retail remains the weak spot, reflecting pressure on household budgets. The GDP-weighted composite index edged up to 51.6, consistent with our view of a gradual pick-up in growth through the second half of the year.

Manufacturing leads activity higher



The labour market remains soft, with unemployment at an 11-year high of 5.6% in the June quarter. Firmer Quarterly Survey of Business Opinion (QSBO) hiring intentions and stronger PMI employment readings suggest a turning point may be approaching. Any recovery is likely to be gradual, with spare capacity continuing to restrain wage pressures. We expect annual private-sector labour cost inflation to remain near 2%.

Inflation set to peak in Q4



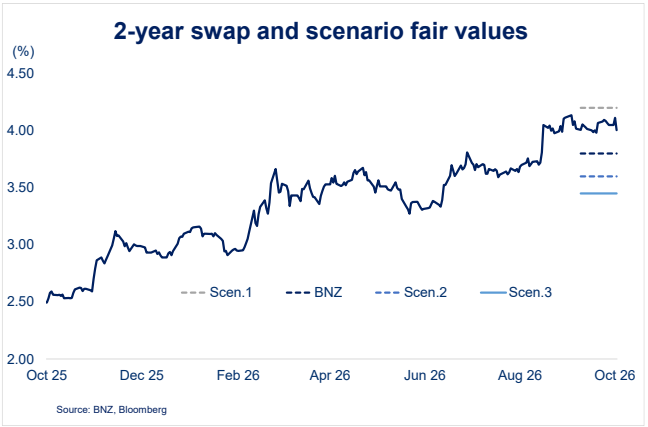
Annual CPI inflation eased to 3.7% in Q3 from 4.1% in Q2, slightly below market expectations (3.8%) and the RBNZ's September MPS projection (3.9%). However, the dip is likely to be temporary. The underlying detail was also less reassuring, with core measures clustered around 3%, the top of the 1–3% target band. We forecast annual inflation to peak at 4.5% in Q4, close to the RBNZ's updated 4.4% projection. The weaker currency could prolong imported inflation beyond the oil shock, increasing the risk that above-target inflation becomes embedded in expectations and pricing behaviour.

Key data ahead of the December MPS include Q3 labour market statistics in early November, the RBNZ's Survey of Expectations and monthly price and activity indicators. First-tier releases such as Q4 CPI and the QSBO are not due until January. The closely contested 7 November election adds uncertainty. Past elections have had no consistent impact on activity data, but a Labour-led government could reinstate an employment objective in the RBNZ's remit.

Short-Dated Wholesale Fixed Rates (1–3 years)

Two-year swap rates dropped as low as 3.97% after the decision, down 15bp from 4.12%, before settling near 4.0%. That is below the late-September cycle peak of 4.15% but still around 30bp above levels at the September MPS. That rise reflected a global repricing of policy-rate expectations on higher oil prices, amplified in NZ by the unwinding of received positions. Domestic factors had played a secondary role until the MPR, despite building underlying inflation pressures. The market-implied OCR peak remains above our 3.75% forecast.

2-year swap above BNZ central-scenario fair value



The chart above compares the 2-year swap with the fair values implied by our OCR scenarios, which are set out in the table below. At around 4.0%, the 2-year swap sits about 20bp above our central-scenario fair value of 3.80%, but below the 4.30% implied by our hawkish scenario, in which the OCR peaks at 4.25%. Fixing for two years only beats floating if the OCR peaks at around 4% or higher and stays there, which is more tightening than we expect. The analysis excludes swap-market supply-demand dynamics and term premia, and short-end pricing can stay elevated while global volatility persists. Even so, we see limited scope for a sustained move higher unless the RBNZ signals a peak above 4%.

NZD OCR scenario-implied swap rate fair value

Scenario	OCR peak	Peak timing	OCR Terminal	2Y scenario-implied fair value	5Y scenario-implied fair value
BNZ	3.75	May-27	3.50	3.80	3.80
Scen.1	4.25	Jun-27	4.25	4.20	4.40
Scen.2	3.50	Mar-27	3.25	3.60	3.55
Scen.3	3.25	Mar-27	3.25	3.45	3.50
Current	-	-	-	4.01	4.32

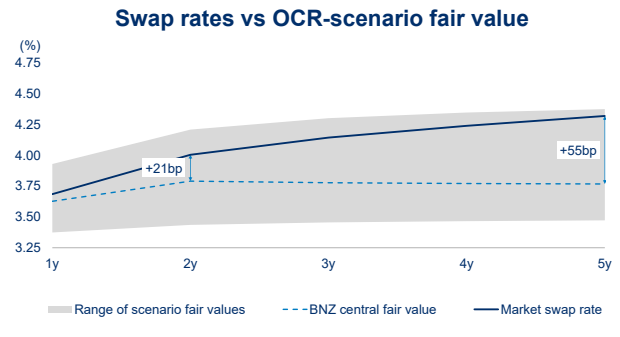
Fair value represents the fixed rate that would produce the same present value of interest payments as staying on floating under each OCR scenario. Floating rates are projected using the assumed OCR path plus a constant 25bp allowance for the bank-bill/OIS spread. The calculation excludes any term premium embedded in market fixed rates.

If the OCR peaks near 3.75% next year, as we forecast, short-end swap rates are likely close to their cycle highs. Volatility should stay elevated, and hedging demand and investment flows can push rates away from fair value, creating opportunities. For hedgers with flexibility, a move back towards our 3.80% fair value in the 2-year swap would offer an attractive level to top up short-dated cover.

Long-Dated Wholesale Fixed Rates (5–10 years)

Extending the analysis across the curve, the gap to fair value widens from around 20bp at two years to around 55bp at five (see chart below). Part of that gap reflects a higher market-implied OCR peak than we expect and would narrow if our forecast proves correct. The remainder is largely a term premium, the extra compensation investors require to hold longer-dated exposure, which is a normal feature of the curve and tends to rise with tenor. That premium provides protection against a longer period of uncertainty around inflation, global yields and where the OCR eventually settles.

Fixed rates sit further above fair value at longer tenors

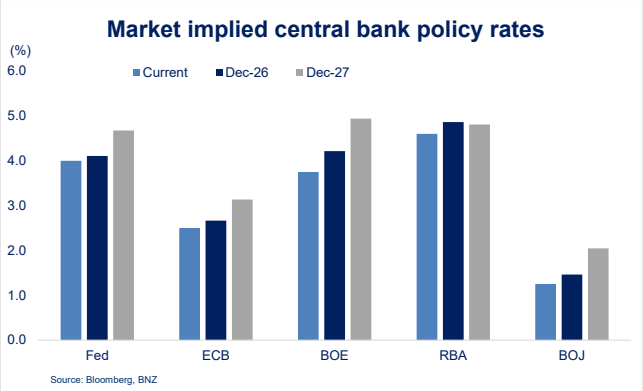


Source: Bloomberg, BNZ. Fair value: fixed rate equal to expected floating cost (OCR path + 25bp). Excludes term premium.

Long-dated NZ rates continue to take their lead from offshore markets. Global long-end government bond yields reached multi-decade highs in early October. The US 10-year Treasury yield peaked above 5.3%, its highest level in 24 years, before easing to around 5.0%, partly as short positions were unwound. The rise in global yields over the past three months has largely reflected a repricing of policy-rate expectations as central banks responded to renewed energy-driven inflation risks. Term premia have been volatile but, after trending higher in recent years, have contributed relatively little to the latest move.

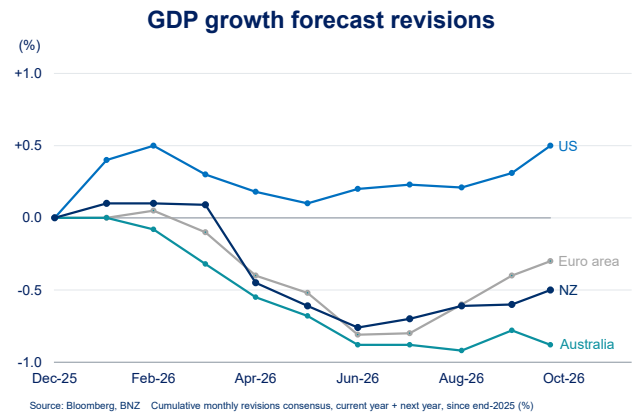
Higher yields are beginning to attract investor interest. Ten-year real yields across developed markets and the spread between nominal yields and consensus nominal growth are both around one standard deviation above their five-year averages. Neither measure reliably signals a peak in yields, but both suggest valuations are becoming more attractive. Improved auction participation and inflows into government bond funds also point to tentative signs of stronger demand, which could help absorb issuance and limit upward pressure on long-term rates.

A hawkish central bank outlook is already priced

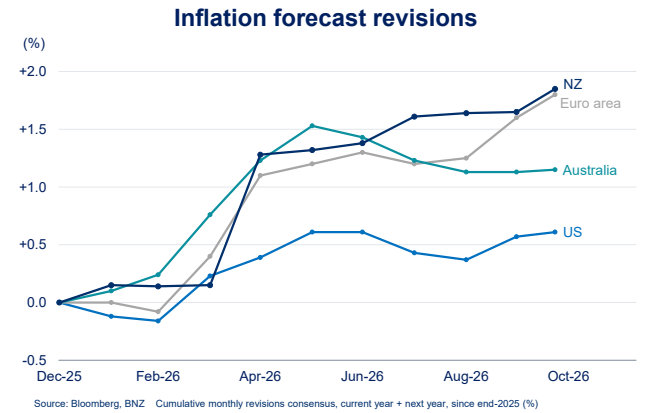


Markets already price a substantial amount of further tightening from major central banks, which raises the bar for another sustained rise in yields. However, that alone is unlikely to deliver a durable bond rally. Growth and inflation surprises have continued to skew to the upside, and consensus forecasts show little sign of retreating (see charts below), limiting the scope for central banks to turn less hawkish. A sustained decline in yields is more likely to require clearer evidence of softer growth, easing inflation pressures, or both.

Growth forecasts revised up in recent months

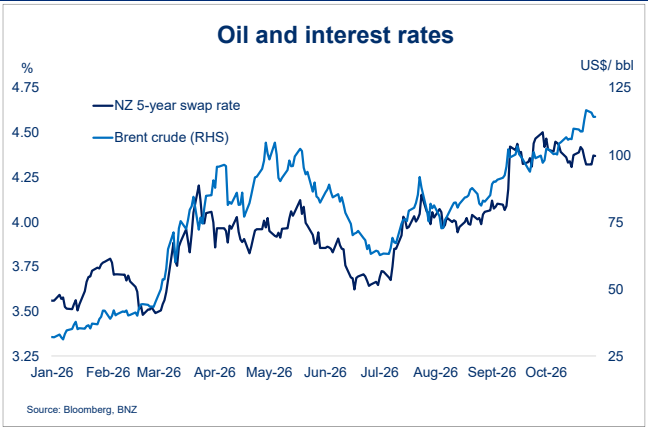


Inflation forecasts show little sign of easing



With NZ 10-year government bond yields trading close to US Treasuries, there is limited scope for NZ long-term rates to decouple from global moves. Oil is the key swing factor. NZ 5-year swaps have tracked oil prices closely through 2026 (see chart below). A lower geopolitical risk premium in oil, by easing inflation pressures, is the most likely near-term catalyst for a meaningful fall in long-term fixed rates. The OCR outlook still matters for the 5-year. The unexpected MPR hold pushed 5-year swap rates down around 5bp in the immediate aftermath.

Oil prices key driver of interest rates in 2026



We expect NZ 5-year rates to remain broadly range-bound, with a modest downward bias as the OCR peak comes into view. That would be consistent with most previous RBNZ tightening cycles, when 5-year rates peaked around or a few months before the OCR. The tightening already priced in NZ and offshore limits the scope for materially higher long-term rates, but the near-term outlook will remain driven by global growth, inflation and energy prices.

5-year near the cycle peak



At around 4.30%, 5-year swaps sit only about 15bp above our forecast for early next year, but well above the level implied by our expected OCR path. Most of that gap is a term premium, which we expect to persist while global yields remain elevated. We see 4.00–4.50% as the likely range. A sustained move below 4.00% would need a fall in oil prices or clearer evidence of softer growth and inflation, while a break higher would require a higher-than-expected OCR peak or a further leg up in global yields. Within that range, layering in hedge top-ups and using target-level orders can help borrowers capture dips without having to time the market precisely.

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