ECONOMIC BULLETIN

Hawks, doves, and kiwis.

5 Feb 2026 | **Westpac Economics Team** | **westpac.co.nz/economics** | economics@westpac.co.nz
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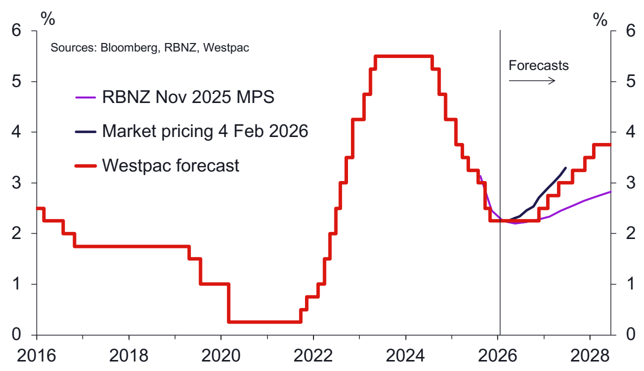
Overview.

With monetary policy settings now clearly stimulatory and key export commodity prices remaining at high levels, the New Zealand economy has shown positive signs of recovery in recent months. At the same time, headline inflation has picked up and the earlier decline in core inflation has been arrested. Against that backdrop, the monetary policy debate now has shifted away from its 2025 theme of whether more support might be needed. Rather, the debate as 2026 begins is about for how long the current level of support will be required and when the RBNZ should transition the OCR towards a neutral level.

In this note we present some of the arguments that those with a 'hawkish' persuasion might advance for an early rollback of stimulus, together with the arguments that a 'dove' might use to justify retaining the current policy stance for an extended period. As usual, in this note we don't try to judge the relative worth of these arguments. We will consider these and other arguments as we put together our first *Economic Overview* for this year, which we'll publish in mid-February.

Official Cash Rate forecasts

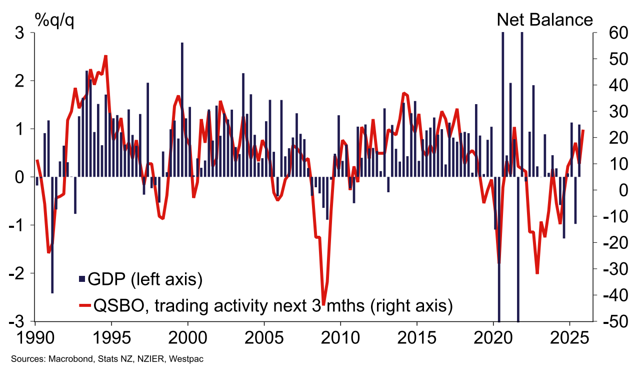


The Hawk's Eye View.

The case for OCR cuts below 3% has evaporated. It's appropriate to reverse those and then reassess.

- Running into mid-2025 the view was an OCR in the low 3s would be sufficient to stabilise the output gap while maintaining inflation close to 2%.
- Concerns increased that the economy was not responding adequately around mid-2025, and that was compounded by the very weak Q2 GDP print.
- Subsequent data showed that earlier weak data was misleading and that the economy had developed economic momentum from Q3 2025.
- It appears that interest rates in the 3.5-4.0% range were sufficient to generate above trend economic growth. Lags mean more stimulus was in the pipeline.
- With hindsight, the insurance cuts below 3% now look unnecessary and are adding stimulus to an already expansionary position.
- The last 75bp of cuts should now be reversed over 2026 and the situation then reassessed.

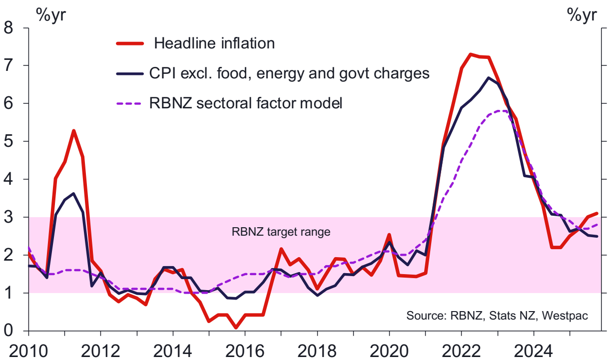
GDP and QSBO activity expectations



A cyclical upswing in the economy has begun at a time when inflation is above the top of the target band.

- Annual CPI inflation ended 2025 at 3.1%, above the top of the RBNZ's target band. This is firmer than the RBNZ had expected when deciding to pursue stimulatory settings.
- While high inflation in administered prices has helped drive this outcome, the earlier decline in core measures has been arrested. Persistently high headline inflation poses an ongoing risk to inflation expectations.
- Core inflation measures sit in the top quarter of the target range allowing little room for manoeuvre.
- With the economy now recovering, the output gap could close quickly leaving the risk of inflation not significantly falling and perhaps becoming embedded into inflation expectations.

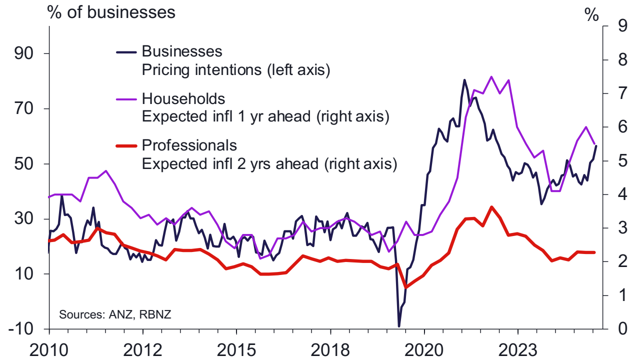
Headline and core inflation



Now the economy is picking up, there is a risk that firms will aim to restore margins squeezed in recent years. Stimulatory conditions are not appropriate in this situation.

- Pricing intentions are high and rising.
- Cost indicators remain strong and firms indicate profitability concerns and a desire to restore margins.
- Some sectors are seeing early signs of pricing increases. An example is construction where rising consents are seeing increased construction costs and pipeline input pressures even though the level of activity remains cyclically weak.
- Disinflation to 2% requires pricing pressures to remain restrained in cyclical sectors. These early signs of pricing pressure suggest that inflation won't fall too far if demand picks up.

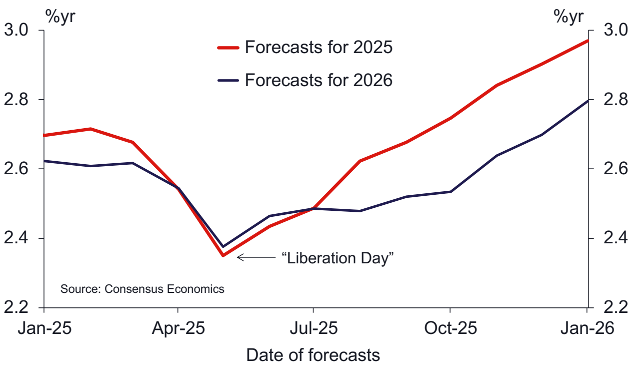
Inflation expectations and pricing intentions



The global economy is outperforming expectations and providing an unexpected tailwind to NZ growth.

- Consensus forecasts have been revised sharply upwards in recent months, defying concerns of downside risks from geopolitics and US tariffs.
- Stimulatory fiscal policy, AI-related investment, easy global financial conditions from record narrow credit spreads and the lagged impact of global monetary easing are supporting growth.
- US monetary policy could inappropriately ease in 2026 as the US administration exerts control over the Federal Reserve.
- Tariff concerns have taken a back seat as firms have adjusted to the new environment. Trade patterns have changed while aggregate demand remains strong.
- NZ export commodity markets remain strong despite supply overhangs in some areas. NZ exporters are set for a third strong year.

Forecasts of trading partner GDP growth have lifted

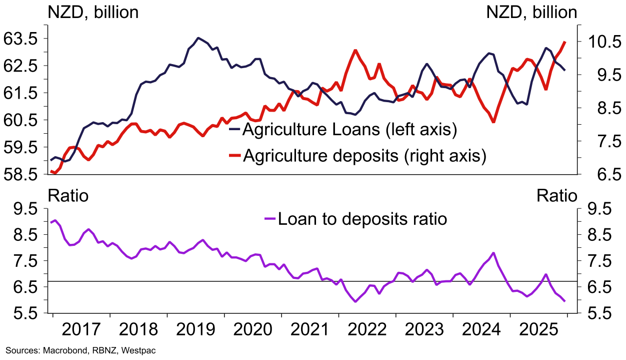


A wave of primary sector investment and spending is about to be unleashed.

- The sector is increasingly expecting a third consecutive strong year of returns.
- The exchange rate remains supportive in an environment of high prices.

- A significant cash injection is coming to Fonterra farmers from the Lactalis sale. Indications are that a lot of required on farm investment will occur.
- Agriculture sector balance sheets are very strong and well placed for increased spending. The debt-to-deposit ratio is at a 9-year low. The sector is awash with cash.

Agriculture loan and deposit trends

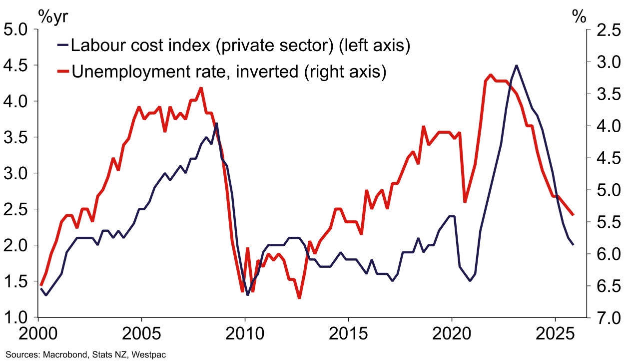


The Dove's Tale.

The improvement in labour market remains tentative, which means that a self-sustaining economic recovery is still not assured.

- While spending and activity appear to be growing, and surveys point to improving hiring intentions, job advertising levels remain very low and employment has lifted only modestly.
- Increased employment is required to ensure that a virtuous cycle of income and spending growth develops, so that GDP growth becomes self-sustaining as the growth impulse from monetary easing and high commodity prices begins to fade.
- Moreover, assuming employment does begin to grow strongly, increased job availability will likely be met with higher labour force participation, as occurred in the December quarter. As a result, the unemployment rate could remain above 4.0-4.5% well into 2027.
- Wage growth has already slowed to levels consistent with 2% inflation and is unlikely to rise this year given ongoing slack in the labour market.

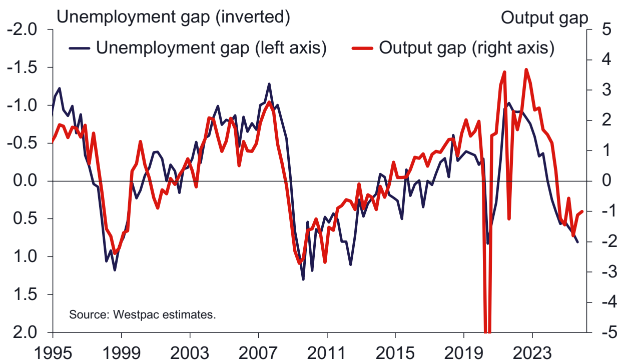
Unemployment rate and wage growth



Even though growth has resumed, the negative output gap is currently large and it will be some time until this is eliminated by above-trend growth.

- The economy ended 2025 with a negative output gap of around 1.5% to 2.0% of GDP. It seems unlikely that this spare capacity will be eliminated before the end of this year at the earliest.
- While this spare capacity exists, there should be little imminent upward pressure on medium term inflation pressures. Hence there is no urgency to raise interest rates.

Output gap and unemployment gap



While the global economy outperformed expectations in 2025, there remains substantial downside risks to growth this year.

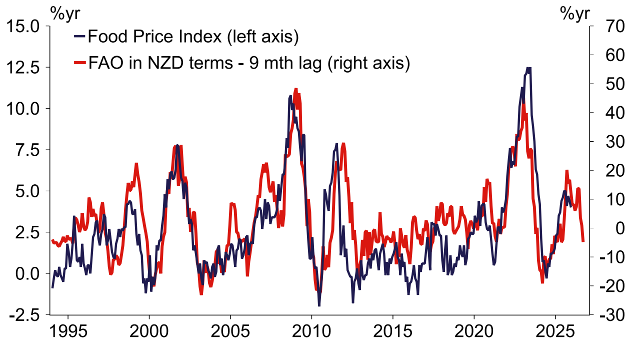
- Rapid growth in investment in AI has been a key economic driver in many countries in 2025, more than offsetting the negative impact of US tariffs.
- The AI boom does not come without risks. These include financial risks as it remains to be seen whether AI investments generate the returns investors are expecting.
- In the meantime, there are ongoing geopolitical risks, including those associated with the erratic behaviour of the US Administration. These risks could manifest through tightening financial conditions or new challenges to global trade.

Although headline inflation has been firmer than expected recently, it is still expected to drop within the RBNZ's target band this year.

- Inflation is set to drop back over 2026 as earlier large increases in food and fuel prices drop out of the annual calculations.
- With lingering spare capacity (including in the labour market), inflation is unlikely to rise over 3% this year. That gives the RBNZ scope to keep the OCR at stimulatory levels for some time yet.
- If the benchmark is for inflation to move "towards" 2% then current forecasts looks well in line with meeting that benchmark through 2026. Food prices, in particular, are unlikely to rise to the same extent they

did in 2026. Meanwhile, persistent items such as rents should remain very low in 2026.

Global and local food prices

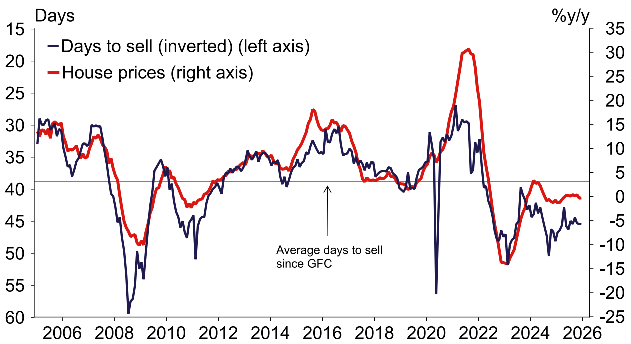


Sources: Macrobond, FAO, RBNZ, Stats NZ, Westpac

The economic recovery is unlikely to generate strong momentum without strong housing price growth. And there's no sign of that.

- At the nationwide level, house prices have continued to track sideways. Growth in some regional centres has been offset by falling prices in some of the major urban centres (especially Auckland and Wellington).
- Demand for housing remains moderate and supply high. Increased construction implies a supply overhang will remain for quite some time.
- The RBNZ has rarely been able to sustain a tightening cycle when house prices were not rising in real terms:
- The absence of wealth effects gives the RBNZ the room to wait for longer before removing stimulus.

House prices and median days to sell

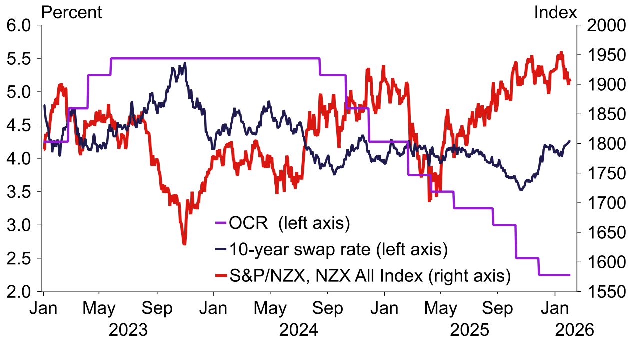


Sources: Macrobond, REINZ, Westpac

While the OCR is relatively low, long-term interest rates are relatively high and the exchange rate has begun to strengthen. Hence some aspects of financial conditions are not stimulatory.

- Long rates have not fallen with the OCR.
- The trade-weighted exchange rate is up almost 4% relative to RBNZ projections.
- The NZ equity market is still trading at similar levels to a year ago, suggesting that financial conditions are not easing on that score.

NZ OCR, 10-year swap and NZX equity index



Sources: Macrobond, RBNZ, S&P Global, Westpac

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