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focus

Down, Up, Down... Riding the Interest Rate Rollercoaster

The New Zealand economy has been on a turbulent journey over the past few years, with interest rates falling, rising, and now falling again. Since August, with inflation now looking under control, the Reserve Bank of New Zealand (RBNZ) has cut rates, with further reductions expected in 2025. Interest rate changes impact everyone—businesses, borrowers, savers, and investors.

FORSYTH BARR

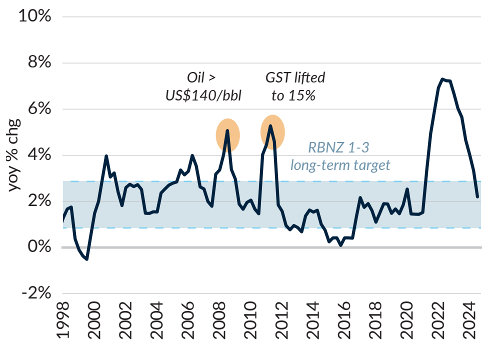
...Consumer spending surged, but global supply chains...couldn't keep up...

A wild ride for interest rates

Interest rates have been on a rollercoaster ride over the past few years. Before 2019, central banks, including the RBNZ, were grappling with low inflation and sluggish growth following the Global Financial Crisis (GFC). Interest rates sat at very low levels in an effort to stimulate economic activity and fight off deflation. When COVID struck, rates were cut even further—close to zero, and even lower in some countries.

This policy, however, had unintended consequences. Consumer spending surged, but global supply chains, constrained by restrictive COVID policies, couldn't keep up. Demand exceeded supply and prices rose. The war in Ukraine exacerbated the situation, driving up commodity prices like oil, contributing to worldwide inflation.

NZ INFLATION RATE (% YOY)



Source: Refinitiv, Forsyth Barr analysis

Initially, many believed these price increases were temporary. However, inflation persisted and became more widespread, forcing central banks into action to curb inflation. In New Zealand, the Official Cash Rate (OCR) skyrocketed from 0.25% in late 2021 to 5.5% by mid-2023.

Engineering a recession

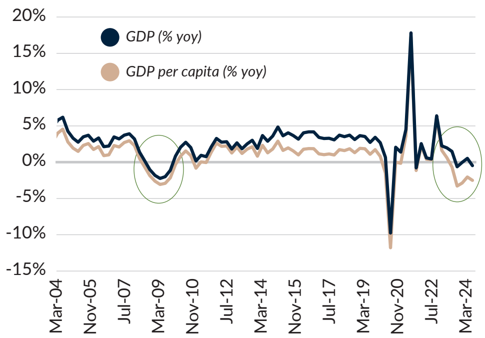
Two years ago, RBNZ Governor Adrian Orr admitted that the central bank was deliberately engineering a recession to tackle high inflation. In New Zealand, a recession typically refers to two consecutive periods of negative economic growth; the economy has been fluctuating in and out of recession over the past two years. This was a necessary step to bring inflation pressure under control, but it has been painful for both households and businesses.

The combination of high inflation and low economic growth has been especially challenging. Consumer spending and business investment—key drivers of the economy—have significantly declined. Per capita GDP has dropped even more sharply than during the GFC, and economic growth is expected to remain weak until mid-2025.

However, this difficult strategy has achieved its goal. Sluggish domestic growth, along with the return of more stable supply chains after the pandemic, has lowered inflation through 2024. There is hope that lower interest rates will now help stimulate the economy, providing much-needed relief to consumers and businesses in 2025.

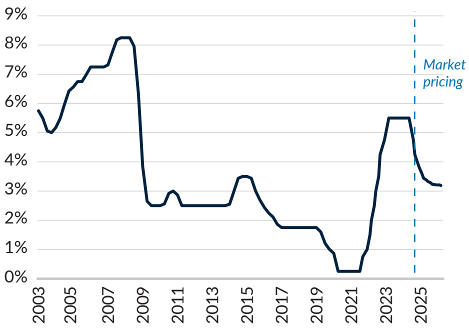
...Mortgage rates have been declining in recent months...

NZ GDP GROWTH AND GDP GROWTH PER CAPITA (% YOY)



Source: StatisticsNZ, Forsyth Barr analysis

RBNZ OFFICIAL CASH RATE AND MARKET PRICING (%)



Source: Refinitiv, Forsyth Barr analysis

More rate cuts on the horizon

The RBNZ has signalled further OCR reductions, with a 50 bps cut in February anticipated, taking the OCR down to 3.75%. While a lot could change over the year ahead, rates are broadly projected to decline further, with the consensus view being the OCR will fall to around 3%–3.5% by late 2025. The actual trajectory will, however, depend on the economy aligning with expectations. Uncertainties persist, including the extent of domestic inflationary pressures, how quickly the NZ economy will pick-up again, and geopolitical risks simmering in the background—complicating the outlook.

Two sides of every coin

The RBNZ's recent rate cuts have had mixed effects, depending on whether you're borrowing, saving, running a business, or investing.

For borrowers, lower interest rates offer relief. Mortgage rates have been declining in recent months, alongside the OCR. Over half of all mortgage debt is either on a floating rate or fixed for less than six months. As a result, many mortgage holders should begin to feel the benefits of lower rates relatively quickly. This could, hopefully, lead to a bit more disposable income for those with debt.

...Falling interest rates mean lower returns on deposits and savings accounts...

For businesses, lower interest rates make it easier to take out loans for expansion, buy equipment, and invest in growth, leading to more hiring, higher wages, and an overall boost to the economy. Greater spending from consumers should support companies' revenue.

Savers, however, face challenges. Falling interest rates mean lower returns on deposits and savings accounts. Retirees and others who rely on interest income will need to explore new strategies to make their money work harder, potentially moving away from traditional savings towards higher-yield investments.

Navigating change

Overall, while rate cuts are great for stimulating spending, they come with trade-offs. Borrowers and businesses benefit from cheaper money, but savers and investors need to adapt to a low-interest environment. As interest rates change, it's worth keeping in mind how best to position yourself to take advantage of the shifting environment.

If at any time you want to discuss investment options and opportunities, your Forsyth Barr Investment Adviser is available to provide you advice and assistance.

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