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Mortgage rates move with official interest rates, but it takes time

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Home loan borrowers start to feel the initial impact of a rise or fall in official interest rates within a month, but the biggest impact on mortgage rates takes about six months.

This Reserve Bank Analytical Note shows that a 1% change in the Official Cash Rate (OCR) typically moves average two-year mortgage rates by 0.34% within one month.

- Read Monetary Policy Pass-Through to Mortgage Rates (PDF 1.5MB)

The pass-through from changes in monetary policy increases over time, with the peak impact on mortgage rates about 6 months after the change in the OCR. At that point about 0.80% (percentage points) of the initial 1% change in the OCR is typically passed through in higher or lower mortgage rates.

A rise or fall in the OCR does not change all mortgage rates to the same extent. Typically, moves in the official cash rate will have the biggest impact on shorter mortgage terms, for example terms of a year or less.

"Individual borrowers with mortgages on longer fixed terms may take months or years to roll off, delaying the impact on their monthly repayments," Severin Bernhard, James Graham, and Shaun Markham, the Analytical Note authors say.

The research also found preliminary evidence that some banks pass on more of the change in official interest rates than others. For instance, banks that rely less on deposits from local retail investors seem to have a stronger and faster pass-through than others.

Alternatively, small banks (in terms of total assets) also seem to pass on changes in the OCR more than large banks. As we get more data in future we will be able to re-visit these initial findings.

Household borrowing in the form of mortgages makes up around 43% of commercial bank balance sheets, a large part of all borrowing in New Zealand.

In order to understand the extent to which changes in the OCR pass through to mortgage borrowers in the short and medium-term, this paper explores the pass-through of the monetary policy rate to offered mortgage interest rates.

The Reserve Bank moves official interest rates up or down to influence lending by banks to households and businesses. Low interest rates tend to boost the economy by encouraging spending and investment, supporting jobs and inflation. Higher rates tend to slow the economy by encouraging saving and slowing investment, in turn keeping inflation in check.

This research does not account for potential changes in the terms borrowers choose. For example, if rates are low or falling, borrowers may borrow for shorter terms. If rates are high or rising, they may fix for longer terms.

More information:

- Monetary Policy Pass-Through to Mortgage Rates
- Mortgage debt by time to reprice - See Figure B1, P25, Monetary Policy Statement, August 2021

About our research programme

The Reserve Bank carries out a wide range of research about the ways changes in interest rates affect New Zealand. Each research paper is aimed at giving the bank (and other decision-makers) parts of the jigsaw puzzle, to help our understanding, rather than a complete picture all at once.

This research programme may or may not change our overall view of monetary policy- whether rates should be raised or cut and by how much. This research is about the impact of monetary policy on borrowing rates, not about the overall effectiveness of monetary policy in achieving our mandate. An earlier Analytical Note in 2019 showed that conventional monetary policy remains as effective as before the Global Financial Crisis, despite persistently low interest rates.

- Read the 2019 Analytical Note - Have the effects of monetary policy on inflation and economic activity in New Zealand changed over time?

The Reserve Bank's overarching aim is to promote the prosperity and well-being of all New Zealanders. With monetary policy, our core focus is to support maximum sustainable employment and low and stable inflation.

Monetary policy remains an effective, albeit blunt, tool to achieve these goals. It is important that we understand how changes in official interest rates and mortgage rates flow through the economy.

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Weir J 2021, *Mortgage rates move with official interest rates, but it takes time,* Reserve Bank of New Zealand, viewed 30 August 2021, <https://mailchi.mp/rbnz.govt.nz/news-release-reserve-bank-analytical-note-monetary-policy-pass-through-to-mortgage-rates-13800877?e=427f6f0c62>