Can the RBNZ really curb the Kiwi $?

The RBNZ was as dovish as it could be without cutting rates and the threat of negative rates was reiterated. Still, NZD continues to show limited reactiveness to such threat and the Bank may have to effectively cut (or directly intervene in the market) to prompt a currency correction. Otherwise, the reflation/weak-USD story should keep NZD/USD supported

A firmly dovish message

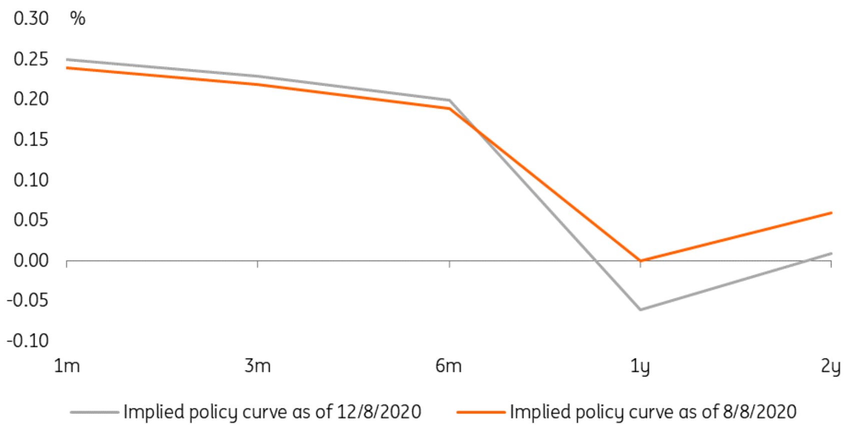
With most developed central banks taking stock of their stimulus efforts and pausing, the Reserve Bank of New Zealand delivered on expectations of adding monetary stimulus in its rate announcement overnight. Our economist Rob Carnell reviews the policy decision here, and the official statement is available here.

In summary, the RBNZ boosted its asset purchases programme from NZD60bn to NZD100bn. As New Zealand approaches a period of higher bond issuance to finance its Covid-19 relief measures, the move appeared mostly on the cards. Accordingly, the negative reaction of NZD immediately after the announcement was hardly only a function of the increased QE.

The statement highlights how – depending on "the outlook for inflation and employment" – the bank is ready (and effectively preparing for) further stimulus measures, which would take the shape of negative rates. The Bank added that "purchase of foreign assets also remains an option".

The reiteration of the negative rates threat was likely the key driver of the NZD negative reaction.

RBNZ rate expectations haven't materially shifted



Source: ING, Bloomberg

Negative rates threat is still not enough to dampen NZD

It is to note, however, how NZD has quickly regained all losses during the day. A look at the market pricing of the OCR, the RBNZ meeting does not appear to have prompted a clear shift in the direction of more rate cut expectations, as shown in the chart above. This might be an indication that investors are still not convinced Governor Orr will ultimately take the road of negative rates and this may explain NZD resilience.

All this may be suggesting that – if the RBNZ is indeed concerned for a strong NZD as we reckon they are – only the threat of more rate cuts may still not be enough to curb more NZD appreciation. More specifically, the Bank may keep failing to be a key driver of the currency moves, which continues to be mostly a function of reflation hopes and largely benefiting from USD weakness.

At this stage, it appears that the RBNZ may have to deliver on its threat and effectively cut rates in order to prompt a sizeable downward correction in NZD. Still, curbing the currency strength may not be enough of a reason to jump into the often risky negative rates territory. An alternative path could be direct FX interventions: this was mentioned in the statement but the Governor appears to have little appetite for this option for now.

NZD has not lost attractiveness yet

We see the RBNZ's dovish tone as unlikely to be a substantial obstacle to more upside to NZD unless the Bank effectively decides to jump into negative rates (which appeared to be only marginally priced in). The resurgence of Covid-19 fears in Auckland this week also may have limited ability to dampen the NZD: the AUD did not particularly suffer the strict lockdown imposed in Victoria lately after the massive flare-up in Covid cases, and this could be the case for NZD too if another health emergency in NZ were to emerge.

As we see the combination of the reflation story and USD weakness to cement in the near future, NZD/USD continues to look like a buy on dips rather than an overvaluation story. The recent drop in NZD positioning to 4% of net shorts also indicates the NZD is not overbought in the speculative market.

We have recently updated our FX forecasts ("FX Talking: 'Opportunistic reflation' sinks the dollar"), and have reiterated our view for a gentle upward-sloping trend for NZD/USD for the rest of the year, targeting 0.68 in 4Q.

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