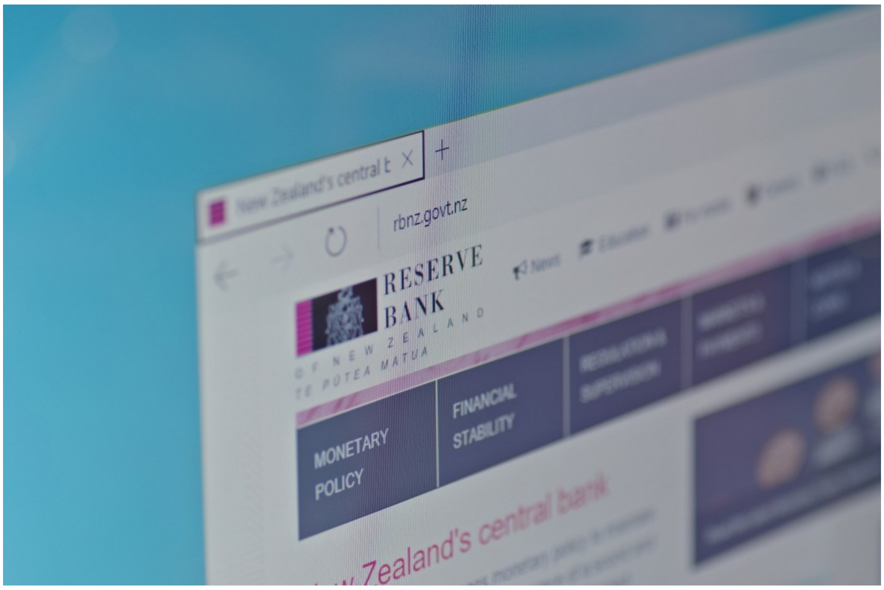
RBNZ: Hawkish hold leaves room for two hikes this year

The Reserve Bank of New Zealand surprisingly left rates unchanged today, citing the recently announced lockdown as the main reason. Still, the rate-path projections were even more hawkish than market pricing, and we still expect two rate hikes by the end of the year. In turn, NZD should benefit from an attractive carry once sentiment improves.



Source: Shutterstock

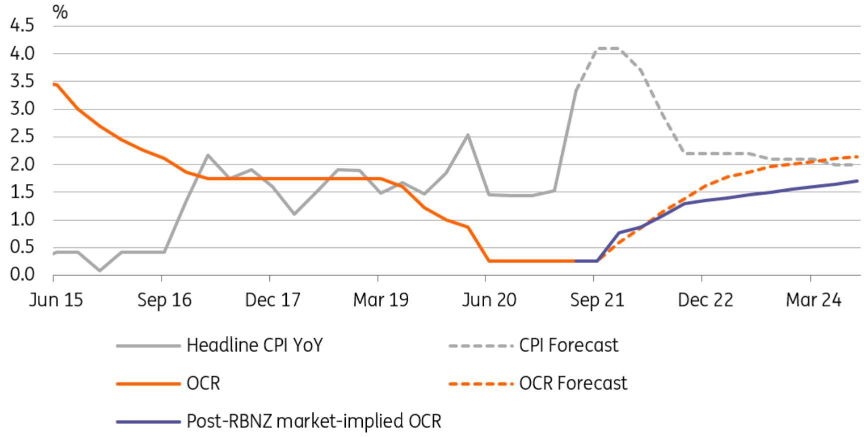
As hawkish as you can get without hiking

The RBNZ held rates unchanged at 0.25% today, but the policy statement and the projections included in the Monetary Policy Statement fell on the hawkish side of the spectrum. Policymakers clearly indicated the recently announced lockdown in New Zealand as the reason why they have refrained from hiking rates already this month.

Away from a reiteration of how the global and domestic Covid-19 situation continues to pose some risks to the economic recovery – and by extension to the timing of the tightening process – the RBNZ's assessment of the economy was very upbeat, as the Bank acknowledged how the epidemic fall-out has been contained, and how a tight labour market is driving wages higher.

Where the RBNZ sounded even more hawkish was in their updated quarterly forecasts. Along with expectations that headline inflation will remain above the 2-3% target band until the first quarter of 2022 and above the 2% mid-point until 2024, the rate-path projections were more hawkish than what the market was pricing before and after the rate announcement.

RBNZ projections even more hawkish than market pricing



Source: RBNZ, Refinitiv, ING

We still expect two hikes in 2021

Considering the RBNZ's hawkish tone, we have not changed our view that the RBNZ will raise rates by a total of 50bp by the year-end: we expect back-to-back hikes at the 6 October and 24 November meetings. We expect to see three more hikes in 2022, which would bring the OCR to 1.50% by the end of 2022.

Indeed, there is a risk that a further worsening in the epidemic situation and more lockdowns drives the RBNZ policy stance more on the cautious side, but we think that an economy that is by and large at or above its pre-pandemic level, above-target inflation, tight labour market and high housing inflation are all pointing to the need for the RBNZ to raise interest rates sooner than later.

Incidentally, the New Zealand government's ultra-strict approach when dealing with the pandemic – a mix of short lockdowns and closed borders – have proven quite successful in limiting contagion and the economic impact so far. We see no reason why this should no longer be the case in the coming months, where we should also see some improvements on the vaccination side.

NZD still set to benefit from attractive carry in the longer run

The Kiwi dollar has been under pressure lately due to a combination of a worsening global risk environment, the re-rating of China's growth expectations and more recently the lockdown announcement in New Zealand that prompted some unwinding of rate expectations.

Indeed, today's hold from the RBNZ has left the NZD quite vulnerable in the short-run to external headwinds, but in the longer-term we expect the RBNZ tightening cycle to fuel a sustained rebound in the currency. This view is, however, highly dependent on some improvement in the global risk appetite and a revamp in interest for carry trades, which would allow NZD to benefit from the what we expect to be the most attractive rate profile in G10 in the next year.

Tracking the epidemic developments remains a complicated task, but we could start seeing a more supportive risk environment already this fall, when the RBNZ will start hiking, in our view. Our current 0.74 year-end estimate for NZD/USD looks less realistic after the recent deterioration in market sentiment, but a move to the 0.72 region in 4Q21 may still be on the cards.

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