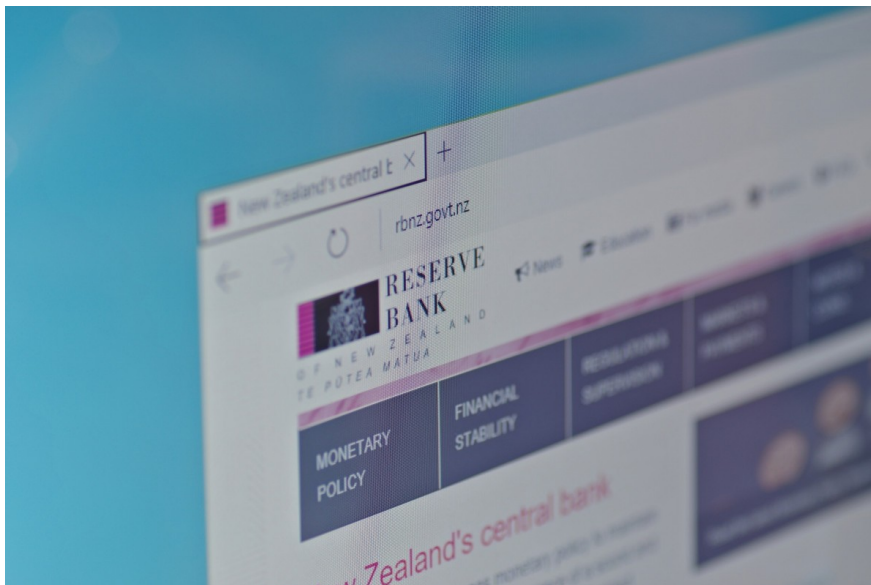


RBNZ Preview: 50bp hike, but the peak is close

We expect the Reserve Bank of New Zealand to hike rates by 50bp to 4.75% next week, in line with market pricing. Peaking inflation and a deteriorating housing market and activity suggest the RBNZ will not reach its projected 5.50% peak rate. A hawkish hike (unchanged projections) should lift NZD, but more NZD strength may soon rely only on external factors



Source: Shutterstock

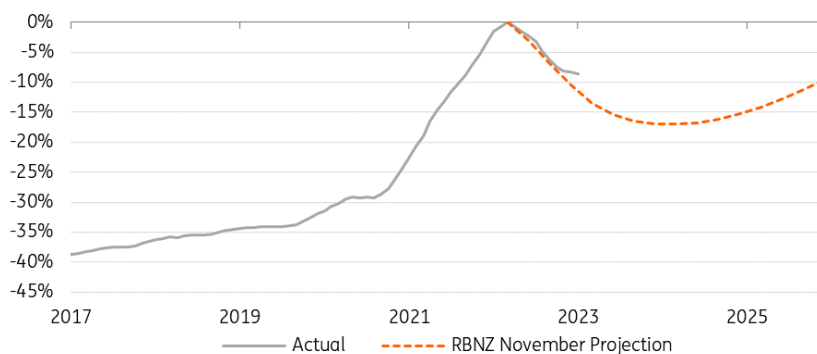
Some things have changed since the November meeting

On 22 February, the RBNZ will make its first policy announcement of the year. The most recent meeting, held in November, resulted in a 75bp rate increase (to 4.25%) and a significant upward revision to the Official Cash Rate (OCR) estimates, which indicated that rates would have peaked at 5.50%. At the time, the hawkish surprise seemed to be supported by robust CPI and wage figures as well as encouraging activity indicators.

The economic landscape in New Zealand has changed since then. Although the third-quarter GDP numbers were good, activity and consumer confidence surveys began to decline, wage growth

slowed, unemployment edged up, inflation did not accelerate further, and inflation expectations dropped. The housing market has continued to deteriorate in line with RBNZ forecasts, with prices falling by 9% since the March 2022 peak.

Change to New Zealand house price index from the peak in March 2022 (% change)



Source: ING, CoreLogic

A (hawkish) 50bp seems appropriate now

We believe that the most important input to the monetary policy decision right now is the growing evidence that inflation has peaked. The headline rate steadied at 7.2% in the fourth quarter of 2022, while the RBNZ had forecast another acceleration to 7.5%. Crucially, falling energy prices, wage growth, and inflation expectations point to disinflation beginning in the first quarter, whereas the RBNZ had predicted 7.5% for the first quarter and a slowdown to 6.90% only in the third quarter of 2023.

The less alarming inflation story argues against another 75bp move next week. Nonetheless, given the low frequency of RBNZ policy announcements, policymakers will want to take the chance to deliver a 50bp hike before hard economic data deteriorates materially.

Markets are fully pricing in a 50bp hike in February, so the references to future tightening will drive most market moves. Updated economic projections will shed some light in this sense. A revision lower in inflation forecasts will be necessary, but we suspect the RBNZ will resist the temptation to scale back peak rate projections, which may be left at 5.50% in an attempt to avert a bond rally similar to the one seen in the aftermath of the latest Fed and ECB meetings.

High chances that 5.50% won't be reached at all

Indeed, the deterioration in the property market has been in line with the RBNZ forecasts, but this does not mean that the Bank is willing to risk facing the repercussions of the estimated 19% house price contraction for the broader economy and financial stability should the disinflation story prove more benign.

With many indications that such improvement in the inflation picture will materialise earlier than previously expected, and the New Zealand economy already feeling the strains of tighter financial conditions, we think the chances that another 75bp of tightening (as per latest projections) will be delivered after 50bp next week have decreased meaningfully.

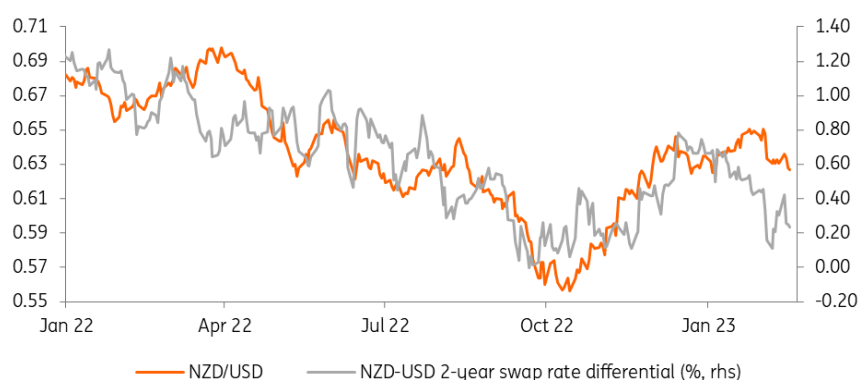
Markets have indeed started to cast doubts on the RBNZ projected rate path, with the peak rate pricing embedded into the OIS curve having declined to around 5.30% from 5.50% starting from mid/late January. Unchanged RBNZ rate forecasts next week see rate expectations staying at least supported in the near term, but we think data will ultimately provide enough evidence to trigger a dovish repricing.

Our base case is only one last 25bp hike in April, so a 5.0% peak rate. There are non-negligible risks of another 25bp in May, but we'd rule out a 5.50% peak rate unless the inflation picture changes dramatically. We think the RBNZ will see more value in stopping earlier and shift to a credible 'higher-for-longer' rhetoric, rather than pushing rates higher and inevitably face rate cut speculation. At the moment, markets are seeing a 60% probability of rates cuts starting already in November this year.

NZD could rise next week, but bullish domestic inputs will fade

The two-year NZD-USD swap rate has been on a steady downtrend in the past three months, having declined from the 75bp December levels to the current 25bp. This has been due to the combination of repricing higher in Fed rate expectations and contracting RBNZ peak rate pricing.

Rate differential and NZD/USD



Source: ING, Refinitiv

However, the rate differential continues to play a secondary role for NZD/USD compared to the relative equity performance and global risk sentiment, according to our short-term fair value model. This means that NZD/USD is not overvalued despite the deterioration in the short-term swap rate differential.

NZD/USD rose after each of the past three RBNZ announcements, and given markets are not fully pricing in the 5.50% projected peak rate, a hawkish 50bp hike may trigger a small NZD rally next week. But, as discussed above, we think the domestic push for a stronger NZD will run out of steam as data should endorse the disinflation story and the RBNZ should ultimately fall short of its expected tightening projections.

Our bullish view on NZD/USD for the remainder of the year is therefore primarily a function of global factors: improved risk sentiment, positive exposure to the China reopening story, a benign USD decline. We target 0.67-0.68 in the second half of 2023.

Author

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.