RBNZ Preview: Another outsized cut

Inflation seems to be under control and last week's poor labour market data backs up our view of a second consecutive 50bp cut by the Reserve Bank of New Zealand in February. There is some risk of a downward revision in the rate projections and we retain a bearish bias on the New Zealand dollar

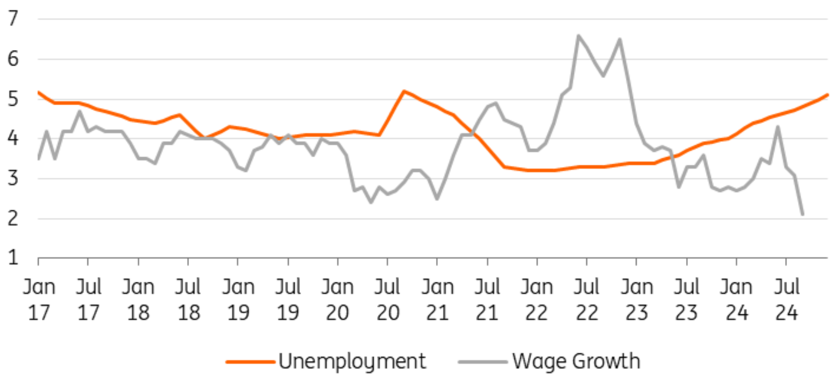
Adrian Orr, governor of New Zealand's Reserve Bank

Further easing is necessary, with leading indicators showing weakness

We expect the Reserve Bank of New Zealand to deliver a second consecutive 50bp cut to 3.75% on 19 February, broadly in line with consensus. Inflation over the past two quarters has stayed within the 1-3% range targeted by the central bank amid a backdrop of weak economic conditions. In 4Q24, non-tradable inflation slowed to 4.5% year-on-year, faster than the RBNZ had estimated at the November meeting (4.7%) when the Bank had already indicated another 50bp cut as the most likely scenario for February.

Every indicator released since the November MPC meeting has pointed to underlying weakness and a need for relaxing monetary policy. Business confidence marked a third month in decline while manufacturing PMI continued its 22-month streak of contraction. Consumers were a bit more confident on the back of previous monetary policy easing and slowing inflation, but this was largely limited to higher-income groups.

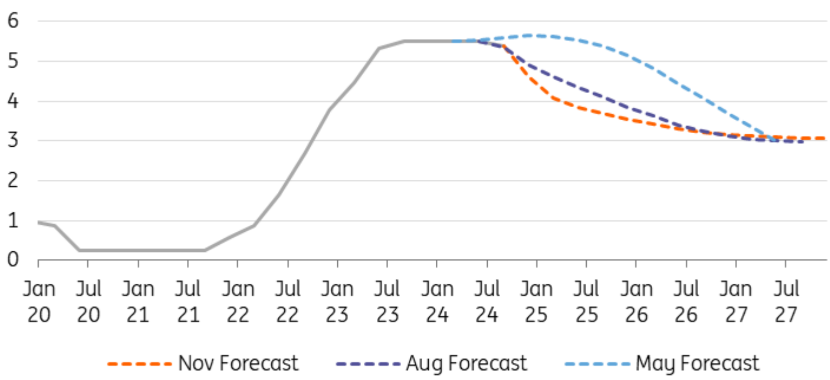
The unemployment rate isn't pretty



Source: ING, Macrobond

The most worrying indicator was the labour market data released last week. Nothing here is good. The unemployment rate rose to 5.1% and is almost at its Covid peak, while the number of job vacancies declined. This combination even saw the participation rate dip as people left the labour force entirely.

RBNZ has revised rate path projections lower - again



Source: Macrobond, RBNZ

NZD: RBNZ turning increasingly negative

The RBNZ has revised its rate cut projections lower multiple times as the economy has cooled faster than expected. This is in stark contrast to the country's nearest neighbour, Australia, which has not yet cut. Across the Tasman Sea, Australia has positive GDP growth and a steady unemployment rate. Sure, they have stickier inflation, but even that is just 0.2% higher than New Zealand.

Markets have put an 85% chance of the RBA cutting at its next meeting (here is our preview) as well as almost fully pricing in a 50bp move by the RBNZ (45bp in the price). We expect the projections to replicate a similar pattern where rates fall to a terminal 3% rate. However, there are risks of another dovish revision, and we think the balance of risks is tilted to the downside for NZD next week.

The Kiwi dollar is not set to receive the same kind of support destined for the euro and Scandinavian currencies if a Russia-Ukraine truce materialises in February. The US's aggressive protectionist stance targeting China means we retain our bearish bias on NZD/USD, at least through the summer. Explorations below 0.55 are a tangible possibility. By the end of the year, we could see some relative outperformance of NZD relative to AUD due to less structural (i.e. export) risk for New Zealand compared to Australia from a China slowdown.

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