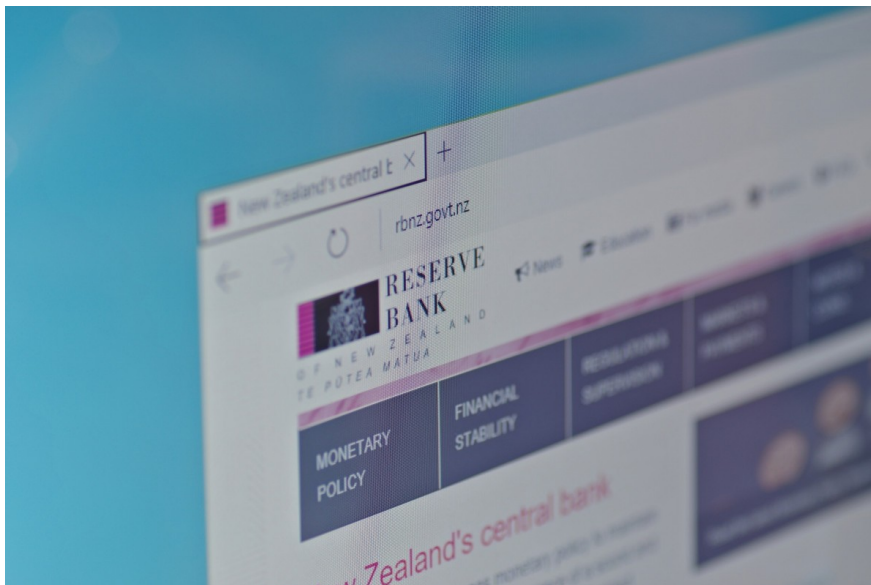


RBNZ preview: Fiscal spending argues for a hawkish 25bp hike

Last week, New Zealand's government announced large spending plans and a set of more encouraging economic forecasts. All this has radically changed the picture for the Reserve Bank, which should hike by 25bp to 5.50% this week and may revise its peak rate projections to 6.00% given new inflationary risks. NZD can keep outpacing AUD on policy divergence



Source: Shutterstock

Fiscal boost puts pressure for another hawkish surprise

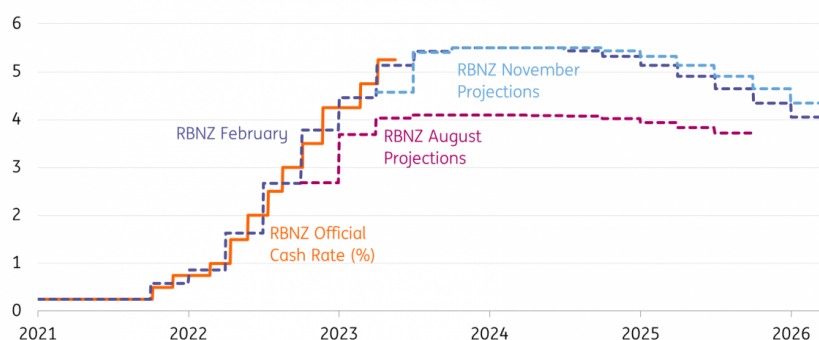
At the April meeting, the Reserve Bank of New Zealand hiked by 50bp, taking the official cash rate to 5.25%, and the latest rate projections suggest it should deliver one last 25bp hike this week. A 25bp hike is a consensus call and fully priced in, and most of the market reaction will however depend on forward looking language and the new rate projections. We had previously expected a drop in inflation to push the RBNZ towards confirming this was indeed the end of the hiking cycle, but the recent surprises in the New Zealand Treasury's budget are generating fresh inflationary risks.

The government announced last week it will boost spending to support an economy hit by high cost of living and recently by severe weather events. The new estimates for the fiscal 2023 budget deficits are at NZD6.63bn, considerably above the NZD3.63bn December forecast. Most importantly for the RBNZ, the Treasury sharply revised growth forecasts on the back of extra spending, and no longer expects a recession this year (which is instead the RBNZ base case).

An above-expectations fiscal boost and improved growth expectations inevitably put pressure on the RBNZ to signal a higher peak at this week's meeting. Markets are pricing in a peak at around 5.80%, but we think the RBNZ can deliver an extra bit of hawkishness and signal tightening until the 6.00% mark as it hikes by 25bp this week.

That would have positive implications for NZD in the near term. AUD/NZD has been on a descending pattern over the past week and we could see the 1.0485 December lows being tested on the back of RBA-RBNZ divergence. Still, our view remains that the RBNZ will be forced to start cutting rates as early as in the fourth quarter as inflation could prove less resilient than expected, the Fed starts its own easing cycle and global economic conditions deteriorate.

RBNZ rate projections



Source: RBNZ, ING

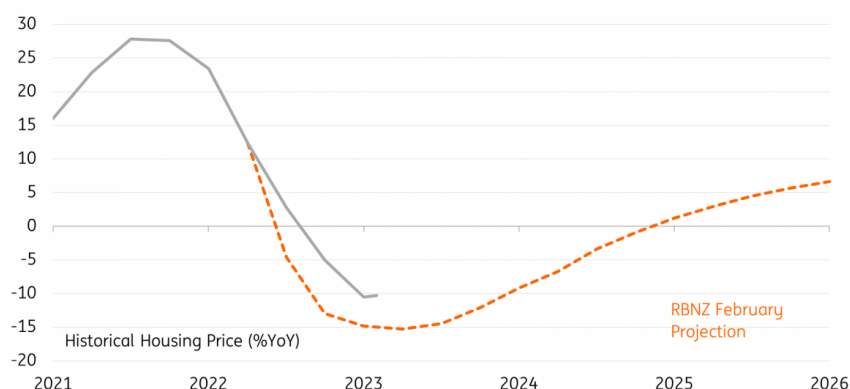
Migration, inflation and housing have sent mixed signals

New Zealand experienced a net migration gain of 65,400 in the first quarter. Of the arrivals, 42,254 are on work visa, which far exceeds the RBNZ's estimate of 6,600. One could argue that the large injection will help ease labour market pressures by increasing labour supply as New Zealand's jobs market had remained very tight – despite overall labour market participation at its highest since 1987, first quarter unemployment remained unchanged from December at 3.4%. However, the Reserve Bank recently pointed at migration to be inflationary on balance, and the government's focus on attracting skilled workers is probably behind this assessment.

Data wise, there have been no upside surprises for the latest headline inflation numbers. First quarter inflation fell well below the Reserve Bank's February forecast, dropping from 7.2% to 6.7%. The housing story in New Zealand is not that different from few months ago – activities remain subdued as households face tight lending conditions and high cost of living pressures. CoreLogic's latest data show annual housing consents down by 7.9%, and both sales number and prices are

down by 30.5% and 10.3% respectively compared to April 2022.

New Zealand house prices



Source: RBNZ, CoreLogic, ING

The housing market, however, has held up better than the Reserve Bank had anticipated. Compared to the previous month, average national prices dropped by 0.6%, which is smaller than the average level of 0.9% seen during the current downturn. We don't see the housing market stopping the RBNZ from its hawkish stance, especially with inflationary risks from fiscal stimulus on the upside.

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 www.ing.com.