RBNZ preview: Quietly monitoring house prices

The Reserve Bank of New Zealand should simply reiterate that prolonged stimulus remains necessary on 14 April, and the impact on NZD, which seems to be pricing in most negatives should be limited. Housing demand appears to be weakening after some government measures but their effectiveness will be key in keeping rate expectations capped

Luxury apartments in Auckland waterfront, New Zealand

Source: Shutterstock

Central bank likely to stick to its recent stance

The Reserve Bank of New Zealand's meeting on 14 April should be a rather uneventful one. The policy message will likely be very similar to the February meeting.

Back then, the central bank stressed how the improvement in global and domestic conditions was not changing the fact that prolonged monetary stimulus was necessary to sustainably reach inflation (1-3%) and employment goals.

Since then, the Bank has received only one important data input, which probably endorsed the need to maintain a dovish tone: GDP unexpectedly dropped 0.9% year-on-year (-1.0% QoQ) in 4Q20, falling short of central bank expectations of 0.3% YoY growth as was specified in February forecasts.

However, that isn't enough to suggest that the Bank will step in with even more stimulus than it is currently providing. Negative rates appear out of the question (if nothing else, because of housing-bubble concerns), and more quantitative easing seems unlikely considering that total purchases under the Large Scale Asset Purchase Programme's (LSAP) are still far from reaching the NZD 100bn ceiling.

The Bank will release new economic projections at the next policy meeting, scheduled for 26 May.

Housing remains the key factor to watch

Despite the central bank fiercely defending its independence and its inflation-and-employment remit after the government asked to consider house prices when setting policy, the size of the housing bubble in New Zealand has become too large to believe it won't impact monetary policy.

Some tax-related government measures announced at the end of March aimed at curbing surging housing prices are expected to take some burden off the central bank, and the market has subsequently reacted by scaling back expectations for policy normalisation in 2021-2022.

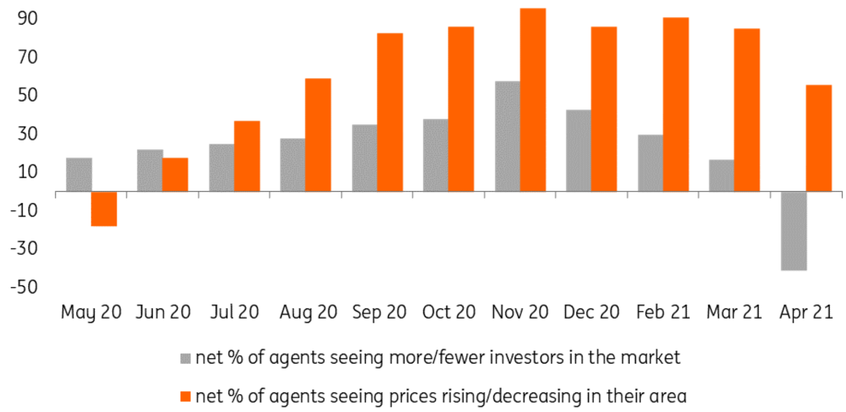
> *To keep the RBNZ rate expectations capped, markets will likely require evidence in the coming months that the government's measures are effectively curbing house prices*

But to keep the RBNZ rate expectations capped, markets will likely require evidence in the coming months that the government's measures are effectively curbing house prices. We may have to wait until May to have enough data to gauge the effect on the housing market, but a survey of real estate agents conducted by the Real Estate Institute of New Zealand (REINZ) published on 07 April already provide some interesting hints.

As shown in the chart below, for the first time in a year, the majority of agents are seeing fewer rather than more investors in the housing market. The survey also showed a majority of agents reporting fewer people turning up at auctions and empty houses, and also fewer offshore inquiries. While those are early encouraging signs that government measures are hindering investor demand for housing, a sizeable majority of respondents still saw house prices rising in their area.

All this suggests it may still take time to see the impact on housing prices, and that that will most likely be a key determinant of where rate expectations go, as the RBNZ will inevitably (though implicitly) need to keep a close eye on that market.

Early signs of slowing housing demand



Source: REINZ

Limited impact on the undervalued NZD

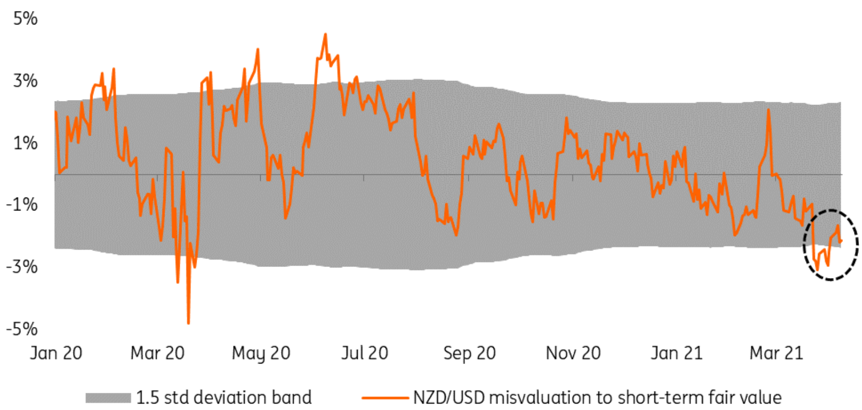
We think there is a significant probability that the April central bank meeting will be a non-event for NZD.

With rate expectations already low and unlikely to drop further (considering the unlikeliness of negative rates), the dragging impact of monetary policy on NZD is likely to be quite limited from now on.

It appears that most short-term negatives are already priced in when it comes to NZD/USD. Our short-term fair value model (calculated using short-term rate spread, the shape of the yield curve, equity performance, commodity prices and global risk appetite as factors) indicates that the pair is undervalued by 2.1% (as shown in the chart below).

This mis-valuation is close to the bottom of its 1.5 standard deviation band.

NZD/USD remains undervalued in the short-term



Source: ING, Refinitiv

Incidentally, data published by CFTC showed that NZD has returned to a much more balanced speculative positioning (net-longs amount to 11% of open interest), suggesting limited scope for long-squeezing events.

Considering the relevance of the reopening of international travel for the tourism-centred New Zealand economy, NZD will be extremely sensitive (also considering its pro-cyclical nature) to the speed of the Covid-19 vaccine roll-out across major economies.

> We continue to see NZD/USD make a move above 0.75 by this fall in line with our expectation for the global reflationary narrative to gather pace and the USD to enter a new downtrend.

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