RBNZ Preview: Time to recalibrate hawkishness?

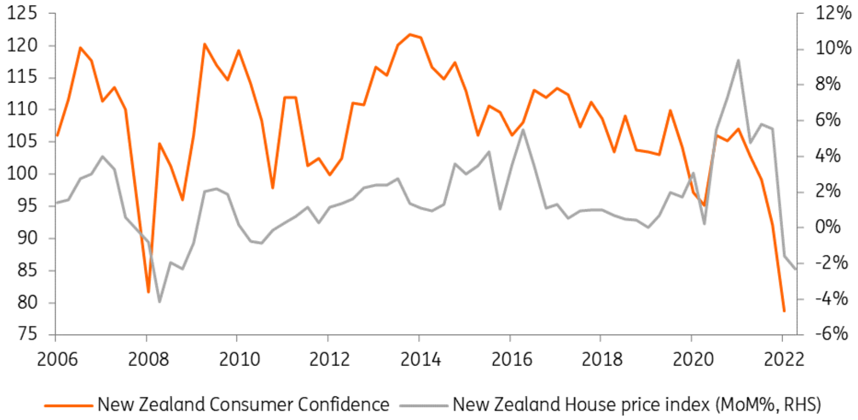
The Reserve Bank of New Zealand meets on Wednesday and another 50bp hike seems likely. But a trembling housing market and deteriorating economic picture suggest the RBNZ may have to recalibrate its hawkish message soon - probably not at this meeting, but potentially in August. And the rest of the world will likely take note. NZD to remain weak for now

Economic woes intensify

Since the last RBNZ meeting (25 May, 50bp hike), the data calendar in New Zealand has not included any inflation or employment figures (which are published quarterly), but a number of other relevant releases have pointed to a worsening overall picture for the country.

GDP data showed a surprise 0.2% quarterly contraction in 1Q22, consumer confidence fell to the lowest on record and business confidence is back at 2Q20 levels. Additionally, house prices have entered contraction territory, dropping 2.3% QoQ as of the end of June, the largest quarterly drop since 2009.

Signs of distress in the NZ economy



Source: RBNZ, Macrobond, ING

50bp hike likely, but what then?

As we approach the July RBNZ policy announcement on 13 July (no updated projections and no press conference), the rhetoric has been firmly centred on fighting inflation, and a third consecutive 50bp rate hike seems likely. Such a move was embedded in May's projections and is fully priced in by the market. However, the deteriorating economic picture and housing concerns may start to have an impact on the RBNZ's future hiking plans.

We can't exclude that the RBNZ will start to sound the alarm on the worsening outlook and open the way for an adjustment lower in its rate profile. Currently, the Bank's projections see an extended tightening path with a terminal rate around 4.0% in 2H23.

But while we think that the RBNZ will have to acknowledge a worsening outlook, re-calibrating the hawkish tone in July may be premature, especially given that the updated CPI numbers for 2Q will be published a few days after the meeting and there is a risk of hindering the efforts to tame inflation expectations too early. We think that a material softening of the hawkish tone would only be warranted by more serious concerns about the housing market and the possibility of a significantly larger drop in house prices beyond the 8% YoY already in the RBNZ projections for end-2022.

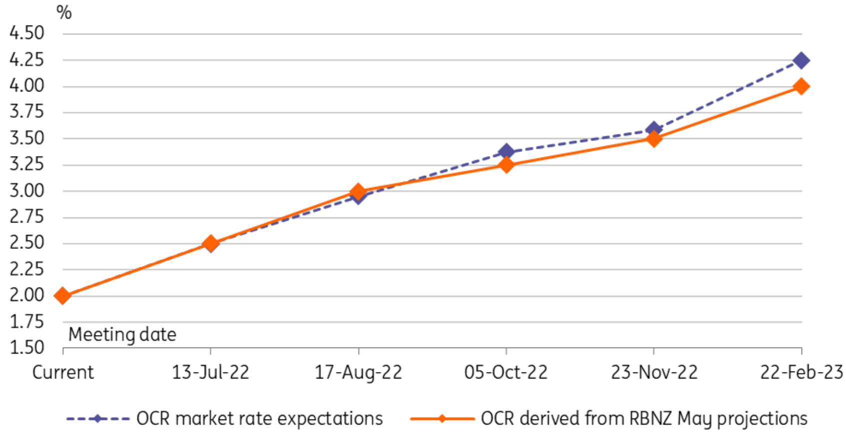
The August policy meeting is when there will be – in our view - a much higher risk of a shift in the policy message away from the ultra-hawkish tone, as the release of updated economic forecasts could lay the base for a lower projected rate path.

Market impact may be contained

Our base case is that the RBNZ will hike by 50bp, acknowledge some economic woes, but reiterate its commitment to bringing inflation down via further hikes. This may be received as only a slightly less hawkish message and may not particularly shake market expectations, which are aligned with the latest RBNZ rate projections.

Naturally, any clearer hint at a tightening pause on the back of economic/housing concerns will cause a dovish re-pricing across the curve.

Market expectations in line with RBNZ projections



Source: Refinitiv, RBNZ, ING

From an FX perspective, we doubt that the RBNZ rate announcement will have major implications for NZD/USD, which has been relatively detached from domestic policy dynamics and remains instead mostly driven by external drivers: global risk sentiment, commodity dynamics, Fed policy, China's outlook. We think that it is too early to call for those factors to turn tangibly positive for NZD/USD in the near term, when there is indeed a risk of 0.6000 being tested.

We have a more constructive view on high-beta currencies for 4Q22, when we think NZD/USD could climb back towards the 0.6400 area.

Lessons for the rest of world?

New Zealand is a small, very open economy, with some rather unique economic characteristics that would normally warn against comparing it with many other large economies. However, the market's focus on RBNZ policy has risen in recent times as the Bank, which 30 years ago pioneered inflation targeting, is now pioneering aggressive tightening (the first one to push rates above 2% in G10). As recent developments force it to seek a balance between booming inflation and a looming economic slowdown, the RBNZ's policy - and above all its impact on the economy and market - could continue to be seen as a benchmark for other large central banks.

In a way, the predominance of global factors over domestic ones (from the pandemic to the rise in global prices) seen over the past couple of years means that central banks are facing ever more similar issues, and looking at similar solutions. The housing market concerns are a case in point. Many other countries are looking at the housing market as a source of concern as mortgage rates rise. The risk of tightening too fast and triggering a major housing slump is non-negligible, and the RBNZ may start to embed this risk into its policy sooner than other central banks.

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