RBNZ Preview: We expect a hike, but pace of further tightening increasingly uncertain

The Reserve Bank of New Zealand should hike by 25bp on Wednesday. We don't think lingering restrictions in New Zealand will derail tightening plans again, but may warrant more gradual rate increases than previously signalled by the RBNZ. For now, we think the Bank will leave all options open and NZD should moderately benefit from the rate hike this week

Reserve Bank of New Zealand building

RBNZ unlikely to postpone hike again

The Reserve Bank of New Zealand announces monetary policy this Wednesday, and we expect it to deliver a 25 basis point rate hike. That appeared to be a well-telegraphed move also at the August meeting, but the announcement of a nationwide lockdown in New Zealand days before the RBNZ announcement convinced policymakers to keep rates unchanged instead.

Recent communication by the RBNZ, in particular via the comments of Assistant Governor Christian Hawkesby, conveyed two main points: a) the hike was simply postponed, and should be delivered in October; and b) the RBNZ should not opt for an aggressive 50bp increase for now.

The second point muted some speculation about a more aggressive hike – which had been fuelled by previous comments by Hawkesby – and now appears to be further endorsed by the inability of New Zealand to fully eradicate the new Covid-19 variant, and parts of the country (in particular, Auckland) still stuck in a lockdown.

Markets are pricing in an 80% probability of a rate hike this week, signalling how there is still some marginal speculation that the RBNZ will postpone its first hike again. In our view, there is too much evidence that the New Zealand economy is running hot – as shown in the table below – to keep rates at record lows.

New Zealand economic data

Indicator	Pe-pandemic: 4Q19	Latest read: 2Q21
GDP, nominal, NZD mln	81,398	⬆ 88,203
GDP growth (QoQ)	0.2%	⬆ 2.8%
Number of people employed ('000)	2,715	⬆ 2,780
Unemployment rate	4.0%	= 4.0%
Inflation (CPI YoY)	1.9%	⬆ 3.3%

Source: ING, Refinitiv

Inflation is above the 1-3% inflation target, and a very tight labour market suggests higher prices may be more persistent than in other developed economies. Incidentally, house prices have continued to rise despite the government's measures aimed at curbing speculative real estate investment. Data by CoreLogic show that housing inflation in New Zealand reached a new peak (27.8% year-on-year) in September. On this topic, we could see the RBNZ announce further tightening of the loan-to-value ratio (LVR) restrictions on mortgages, but we doubt this will be enough to deflate the NZ housing bubble unless the Bank starts raising the policy rate.

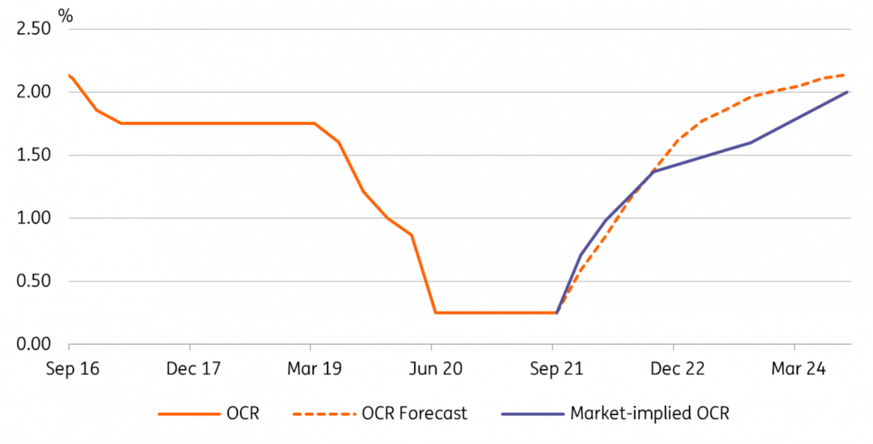
Pace of tightening increasingly uncertain, but RBNZ should leave all doors open

New Zealand's "zero cases" approach during the pandemic surely allowed the country's economy to stand out as an outperformer. Now, as Auckland enters yet another week of lockdown, many are starting to question whether the Government will be able to fully eradicate the new Covid strain, and opposition parties have started to suggest an easing of restrictions and the acceptance of a low-contagion rather than a zero-contagion status-quo.

The ability of the government to successfully move back to zero cases in the community or their decision to shift to less draconian restrictions clearly hold the keys for the economic outlook in New Zealand in the coming months. From a monetary policy perspective, this – and the economic damage already done by restrictions in August and September – has increased the uncertainty around the pace and timing of RBNZ tightening.

As shown in the chart below, current pricing implied in the OIS market shows markets are currently close to the RBNZ rate path published in August. Any signals that the RBNZ is turning less upbeat on the economic outlook may well prompt some shift lower in the curve, and ultimately weigh on NZD.

RBNZ pricing



Source: ING, Refinitiv

However, given the uncertainty on how long restrictions will remain in place in New Zealand and the lack of evidence around the economic impact of the recent lockdowns, we think RBNZ members will have little interest in radically changing their view on the economy just yet. We think they will leave the discussion about the timing of further hikes very open ended as they deliver the first hike this week.

Considering the market is not fully pricing in a rate hike this week (but around 80% of it) we think that the start of the tightening cycle in New Zealand – and the lack of a materially more pessimistic tone on the economic outlook – will be able to provide some moderate support to NZD after the rate announcement, although external factors are set to remain the main determinant of NZD moves in the near term.

Incoming data and contagion dynamics will be key to determine future moves by the RBNZ. For now, we are still pencilling in another 25bp hike in November, although this is becoming an increasingly close call.

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