New Zealand’s central bank to hold steady despite coronavirus

The Reserve Bank of New Zealand is unlikely to cut rates at the coming meeting, despite easing elsewhere in the Asia Pacific region

RBNZ Governor, Adrian Orr

No change expected

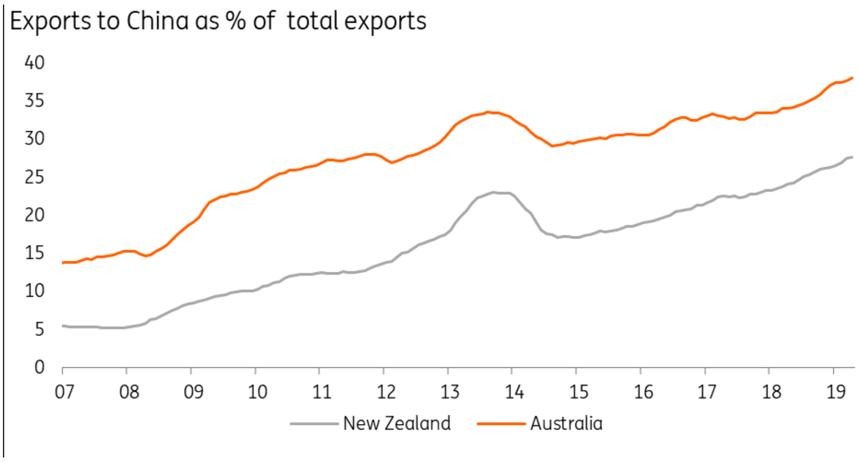
The Reserve Bank of New Zealand will probably leave its policy "cash rate" unchanged at 1.0% when it meets on 12 February. The central bank last cut rates in August 2019, when it cut by an unexpectedly large 50 basis points. Since then, it has stood on the sidelines.

New Zealand's macroeconomic conditions remain reasonable. 4Q19 inflation came in at 1.9%YoY, a whisker below the target midpoint of 2.0% removing one of the biggest arguments for easing policy rates. The activity side has been reasonable too. GDP growth of 2.3%YoY driven by a 0.7% QoQ increase in 4Q19 is very respectable and high-frequency indicators for activity have remained broadly supportive since.

The looming decision comes as other central banks in the region have been cutting rates - including the Philippines, and the Bank of Thailand citing coronavirus as motivation.

New Zealand is also less exposed to the likely downswing in demand from China stemming from the outbreak of the coronavirus than its larger neighbour, Australia. So whilst the Reserve Bank of Australia (RBA) may still need to ease its 0.75% cash rate further this year, after deciding to leave it unchanged at this month's meeting, we suspect the RBNZ has less reason to follow them with lower rates if they do.

New Zealand less exposed than Australia to Chinese demand

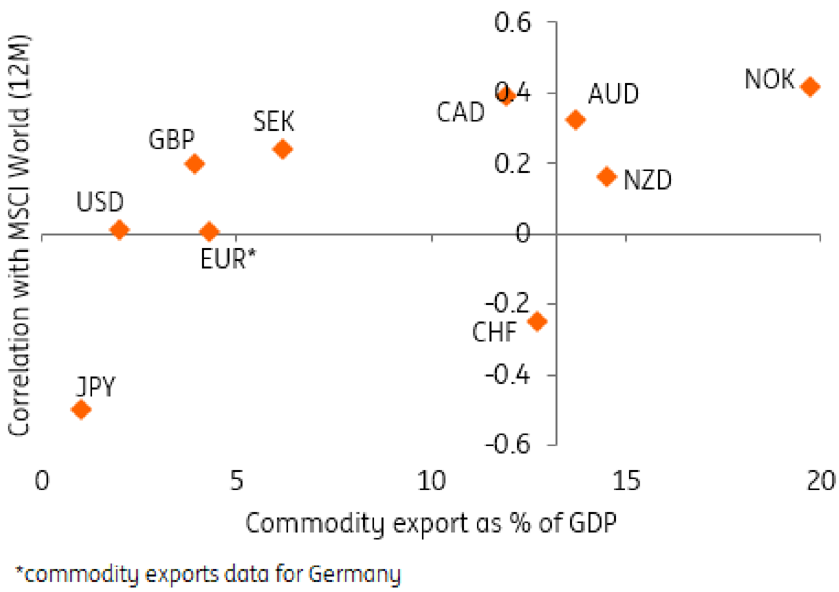


Source: Bloomberg, ING

NZD looks better than AUD

The Kiwi dollar is back to the 0.64 area vs USD and all the advancements since December have now been erased. The currency naturally presents a high correlation to risk and New Zealand is highly dependent on commodity exports (mostly to China), which puts NZD in the undesirable top-right quadrant in our chart that tracks FX vulnerability to the coronavirus story.

AUD highly vulnerable to Coronavirus



Source: ING, Bloomberg

The developments of the virus remain unpredictable, which translate into high uncertainty around the near-term moves in NZD/USD. However, considering that both AUD and NZD bear the brunt of the deteriorating Chinese sentiment. We note that the outlook for AUD/NZD still appears tilted to the downside.

Australia is about to face the economic consequences of the devastating bushfires and we remain quite firmly of the view that the RBA will step in with some easing in the next months.

On top of that, the underperformance in metals and iron ore in particular (it is Australia's biggest export, most of it to China) adds to the vulnerability of the economic outlook to the recent developments. New Zealand exports (mostly dairy products) appear less exposed. All this, along with our view the RBNZ will not move for the rest of the year, help reinforce our feeling that AUD/NZD will still head down, possibly reaching 1.02 in the near future.

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