

Australia/New Zealand Watch

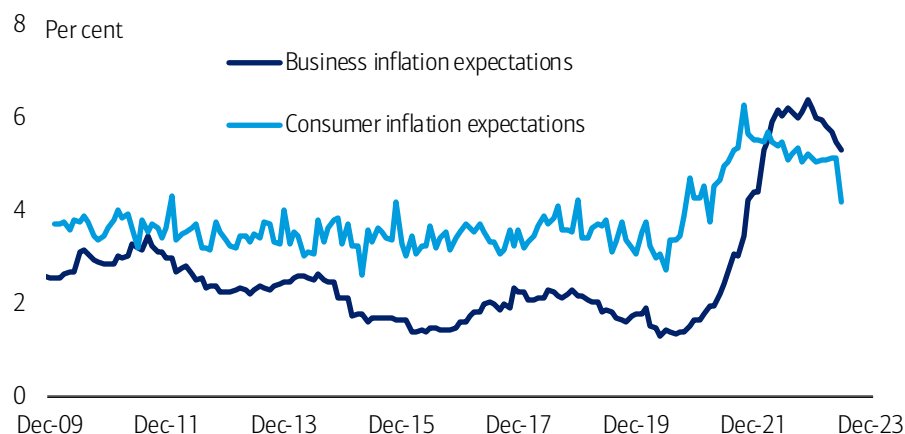
RNBZ review: High rates gain traction

RBNZ keeps rates on hold at 5.5%

The Reserve Bank of New Zealand (RBNZ) has maintained the Official Cash Rate (OCR) at 5.50%, in line with our expectations. The Statement provides a confirmation that the level of interest rates is constraining spending and inflation pressure, and the Committee agrees that “the OCR will need to remain at a restrictive level for the foreseeable future” to ensure inflation returns to target while supporting growth and the labour market. Weaker global conditions and softer tradable inflation are supporting an ongoing decline in CPI from its peak and expectations for inflation have already fallen (Exhibit 1). However, domestic inflation pressures remain sticky.

Exhibit 1: Inflation expectations decline

For both business and consumers



Source: Macrobond, ANZ Roy Morgan

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On hold in August, but watching non-tradables CPI

With house prices having stabilised, the labour market showing signs of a turn and a firm conviction from the RBNZ that higher rates will continue to place downward pressure on growth and inflation, we expect rates to remain on hold at the next meeting on August 16th. The Bank will provide a full update of its views and forecasts in the Monetary Policy Statement as well as the OCR track that remained unchanged in May.

We get 2Q CPI on July 19th and we see a 1% qoq rise that takes the annual rate to 6% from 6.7% yoy. While food prices have softened alongside commodity prices, non-tradables inflation would be key as 1Q recorded the largest increase since the series began. Labour market data for 2Q will also be released on 2 August, ahead of the next RBNZ meeting. Labour shortages have started to ease as migration increases and surveyed measures report that finding labour and has become easier and employment growth is set to moderate.

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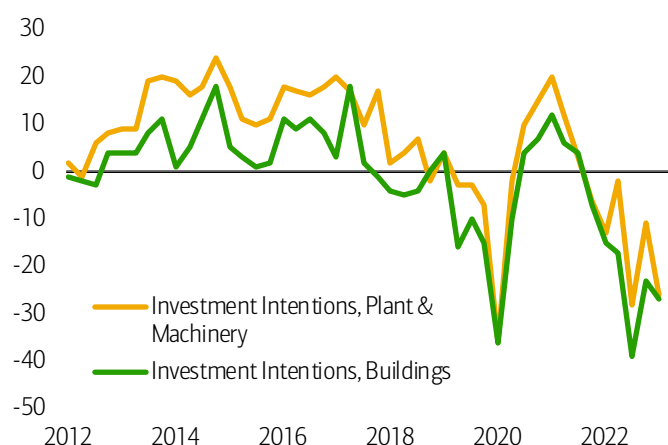
All softer except domestic prices

Economic conditions have weakened of late with 1Q CPI recording a 0.1% decline vs a soft 0.3% rise expected by the RBNZ. While near term economic conditions will be supported by weather disaster repairs, growth is expected to continue to weaken as household spending softens and residential building work slows. Notably, despite a general election due in October, fiscal support is expected to decline.

While inflation has been lower than expected by the RBNZ, this has been due to a large decline in tradables, such as petrol prices and airfares while non tradables recorded the highest value since the start of this series in 1999 in 1Q. This reflects strong demand and the tight labour market. Higher prices for construction, household utilities, restaurant meals and ready-to-eat food accounted for much of this annual increase. Surveyed measures of investment intentions have declined (Exhibit 2), particularly in the building sector that has been a main driver of domestic inflation.

Exhibit 2: Business investment is set to decline

Based on surveyed measures

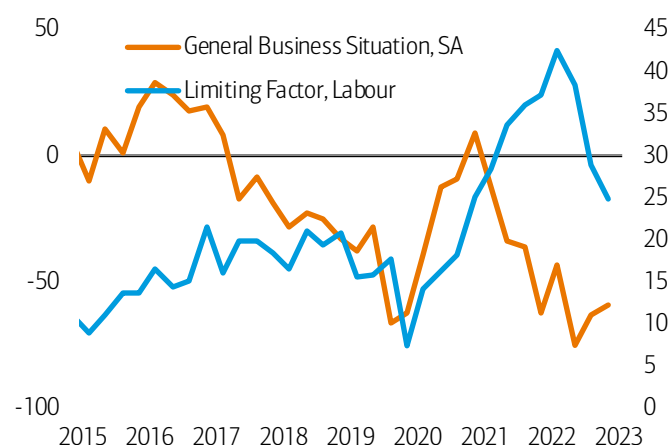


Source: Macrobond, ANZ Roy Morgan

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Exhibit 3: Labour shortages ease

As migration rises



Source: Macrobond, ANZ Roy Morgan

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Notably, the labour market outlook remains a key uncertainty for the outlook as is the impact of higher migration and population growth returning to more normal levels. There are signs of easing labour shortages (Exhibit 3), but employment remains “above its maximum sustainable level” with unemployment at 3.4% in 1Q. We expect employment growth to soften in 2Q and unemployment to rise albeit at a slow pace. Uncertainty is around the impact of higher population growth in participation as well as how fast aggregate demand declines as rates continue to gain traction. Notably, wage inflation (excluding changing jobs and promotions) remains below CPI, but broader measures of wage inflation are strong and will most likely lag the decline in inflation.

NZ rates: round trip

Kiwi rates have fully participated in the global sell-off despite the notable differences between NZ and its peers in the peripheral dollar bloc like Australia and Canada. Even after this week’s relief rally, NZ 2y interest-rate swaps (IRS) are almost at the same level they were on the eve of the last rate decision before a RBNZ pause saw yields fall to 5.14%. Given liquidity concerns, we prefer to express our view through FX and see AUDNZD as attractively priced at this level, in line with our FX strategists’ forecasts for year-end.

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