

New Zealand Economic Watch

RBNZ preview: all about the time to target

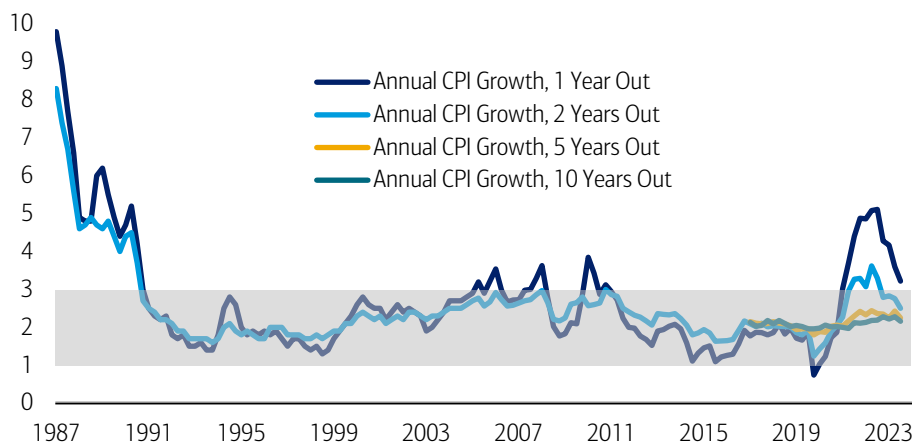
Rates in restrictive territory for how long?

The Reserve Bank of New Zealand meets on Feb 28 and is set to keep the official cash rate (OCR) unchanged at 5.5%, in our view. Recent economic data has printed either in line or slightly softer relative to the RBNZ's expectations so we would not expect major changes to guidance through the forecasts. Economic growth and inflation will be marked-to-market and the OCR track will likely reflect high rates for longer.

The RBNZ's communication remains hawkish and this is unlikely to change until the Bank is ready to abandon its restrictive setting. We think the Bank could ease as soon as in 2Q, but risk is for a delay if inflation remains persistent. Encouragingly, the RBNZ measures of inflation expectations have eased further increasing confidence on traction from sustained high rates. Governor Orr highlighted the RBNZ's medium-term focus on the inflation target does not prescribe a specific 'time-to-target', though the aim is to get inflation back to the 2% midpoint in reasonable time to mitigate the risks from inflation expectations becoming unanchored.

Exhibit 1: Inflation expectations coming down

The RBNZ will watch these measures very closely



Source: RBNZ, Macrobond

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High-beta NZD to outperform

We are constructive on NZDUSD against a backdrop of high-beta G10 FX outperformance. 3m option skew has moved in favour of calls as puts have cheapened (Exhibit 6). Recent moves in volatility-adjusted 3m risk reversals are supportive of NZD moves higher (Exhibit 7).

Tempering this view, any rates market convergence toward our economists' view should weigh on the currency and a long position in AUD looks more insulated from these macroeconomic risks against this backdrop.

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Could the RBNZ surprise with a hike?

The Reserve Bank of New Zealand meets on February 28 and we expect rates unchanged at 5.5%. Rates have been on hold since May 2023 and economic data has clearly reflected traction from a sustained period of tight monetary policy.

We do not think current economic conditions argue for further tightening though the Bank could choose to strengthen its hawkish stance by extending the high for longer period in the OCR track that currently sees a peak for the cash rate at 5.69% in June 2024 and slightly lower rates towards 3.55% by the end of 2026. That said, with a single inflation targeting mandate now in place the RBNZ could become less patient on the speed of return to the midpoint of the target should data show signs of a reacceleration in inflation.

The RBNZ will provide an update to their economic forecasts in the Monetary Policy Statement (MPS). Actual economic data particularly for growth has consistently surprised to the downside (Exhibit 2 & Exhibit 3). In addition, while inflation remains above target, a decline in tradables has contributed to further progress towards the target relative to the RBNZ's expectations. Yet, while lower than the RBNZ's assumption in the November MPS, headline inflation has only eased to 4.7% in the December quarter. This is still well above the target. See: [New Zealand Economic Watch: CPI review: Food for thought 24 January 2024](#).

Exhibit 2: Economic data has mostly surprised to the downside

Except unemployment

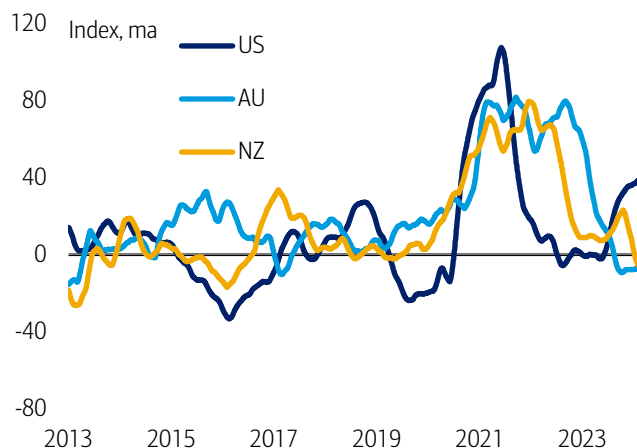
	Actuals	RBNZ forecast
CPI headline (yoy)	4.7%	5.0%
CPI tradables (qoq)	-0.2	0.7%
CPI non-tradables (qoq)	0.8%	0.9%
GDP (yoy)	-0.6%	0.6%
Unemployment rate	4.0%	4.2%

Source: RBNZ, StatsNZ, Data for 4Q except GDP which is 3Q.

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Exhibit 3: Economic data Surprises

Data has weakened in NZ



Source: Citi, Macrobond

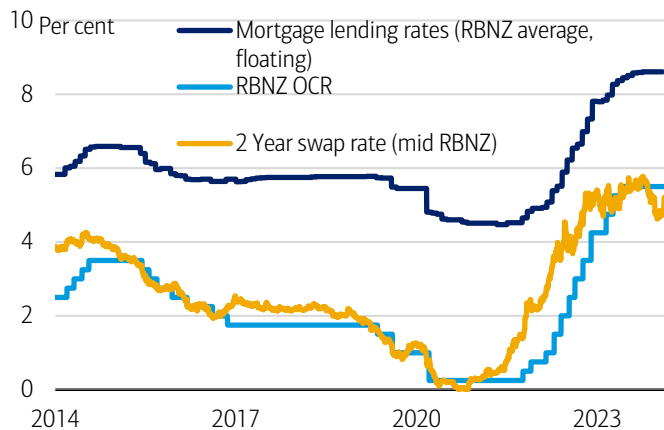
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At a recent speech, Governor Orr highlighted monetary policy should be set such that “future inflation can be reasonably expected to reach 2% over the medium term”. This would allow the Bank to look through volatility in the economic data. We note fiscal policy has made GDP data quite volatile of late given ongoing repair work that followed major climate events early in the year. The RBNZ's long term focus is on the balance between supply and demand and core inflation pressures.

We think the RBNZ will focus on the direction of inflation and remain alert to signs of reflation to set policy. Inflation has continued to trend lower as policy remains restrictive (Exhibit 4). A cautious approach to easing across global central banks could be mirrored in New Zealand. Hence, we see risk for a delayed easing cycle relative to our view that the RBNZ could ease as soon as May. Notably, monthly price indexes for January suggested sticky rents remain elevated and food prices are on the rise (Exhibit 5).

Exhibit 4: Mortgage rates at the highest level since the GFC

Constraining activity

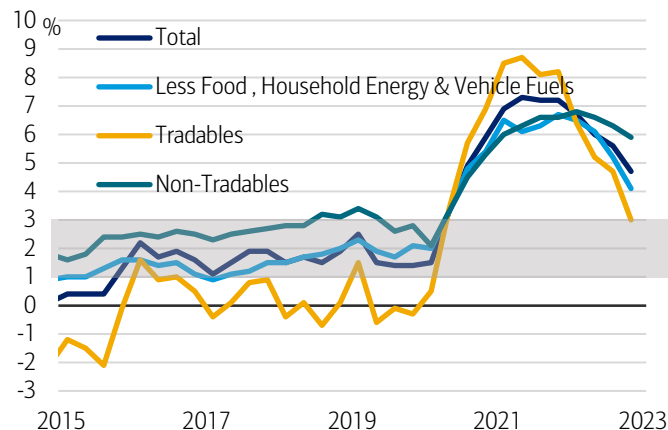


Source: RBNZ, Macrobond

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Exhibit 5: Inflation is clearly moving towards target

But domestic prices remain sticky.

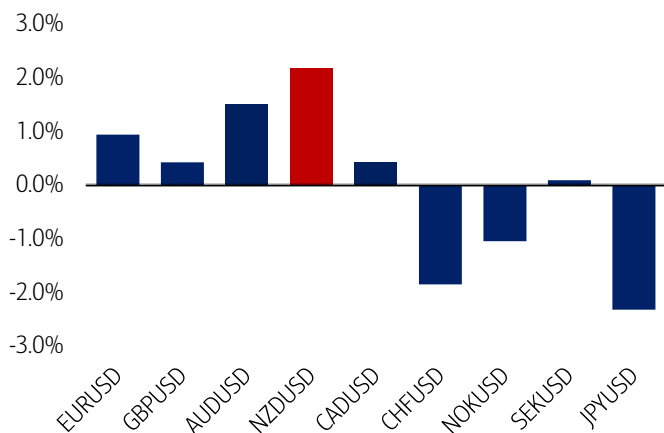


Source: Macrobond, StatsNZ

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Exhibit 6: 3m option skew has moved for AUD calls vs USD in 2024

Year-to-date change in 3m skews for USD/G10 pairs

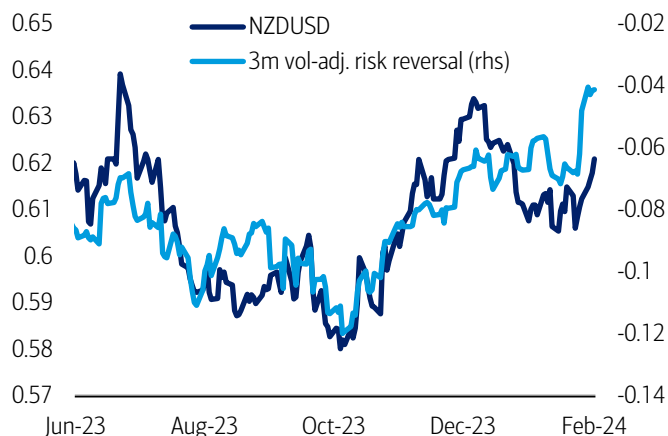


Source: BofA Global Research, Bloomberg

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Exhibit 7: 3m vol-adjusted risk reversal = NZD to rally

High beta NZD to outperform in low vol/ short USD environment

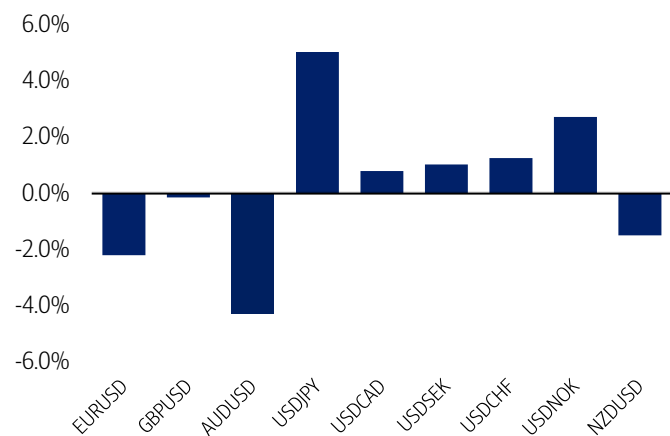


Source: BofA Global Research, Bloomberg

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Exhibit 8: NZDUSD has weakened by too much vs our midyear forecast

Current spot vs BofA Q2 forecast

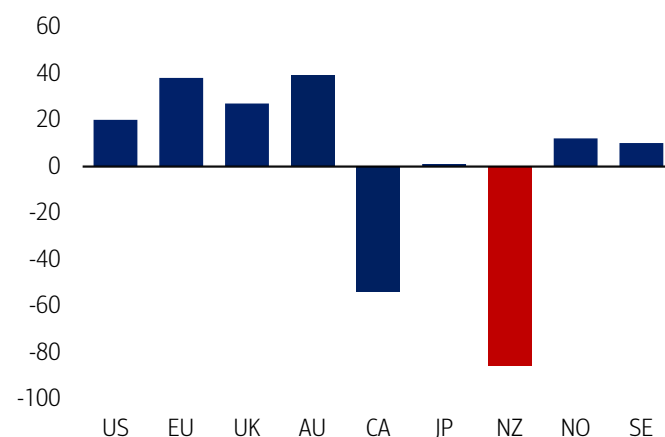


Source: BofA Global Research, Bloomberg

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Exhibit 9: Rates market converging to BofA policy rate forecasts for the RBA and BoC should support AUDCAD

BofA 2024 year-end G10 policy rate forecast – current market pricing



Source: BofA Global Research, Bloomberg. Positive values mean market is pricing in more rate cuts than BofA; negative values mean market is pricing less rate cuts than BofA.

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