

## MNI RBNZ Preview – February 2023

**Meeting Date:** Wednesday, 22 February 2023

**Statement Release Time:** 14:00 NZDT/01:00 GMT

**Press Conference Time:** 15:00 NZDT/02:00 GMT

**Link To Statement:** <https://www.rbnz.govt.nz/monetary-policy/official-cash-rate-decisions>

**Link To MPS:** <https://www.rbnz.govt.nz/monetary-policy/monetary-policy-statement>

### CONTENTS

- **Page 1-2:** MNI POV (Point of View)
- **Page 3:** RBNZ-Dated OIS Pricing
- **Page 4-6:** RBNZ November Monetary Policy Review
- **Page 7:** RBNZ November Monetary Policy Statement – Key Forecast Variables
- **Page 8:** MNI RBNZ WATCH: 50bps Seen As Inflation Pressures, Jobs Ease
- **Page 9-12:** Sell-Side Analyst Views

### MNI POV (Point Of View): Another 50bp Amid Uncertainty

The RBNZ holds its first meeting since November on February 22 and it is going to be a difficult one. A step down to a 50bp hike is widely expected. The market almost has a full 50bp priced in but some commentators are calling for the discussion to be around a pause or 25bp given that a national state of emergency was declared on February 14 after Cyclone Gabrielle hit. But the RBNZ has a mandate to return inflation to between 1% and 3% and it printed well above that in Q4.

Despite the recent uncertainty surrounding the RBNZ's February meeting mentioned above, it is likely to hike rates 50bp to 4.75% after 75bp in November given the tentative peaking in inflation and labour market tightness, housing correction and lacklustre activity indicators. Most analysts surveyed by Bloomberg expect another 50bp but two still expect another 75bp while one 25bp and one a pause. Another 50bp would bring cumulative tightening to 450bp since the cycle began in October 2021 and in line with the Fed.

In November, the RBNZ said that it now sees neutral at around 3.6%, revised up from 2% previously because of the increase in inflation expectations. Thus, the effect of its policy tightening to date on demand and inflation has been less than it expected suggesting that it has more to do to return inflation to target. But given tightening to date and inflation and the labour market coming in softer than the November projections, another outsized 75bp in February doesn't seem justified.

Since a 50bp hike is widely expected, the focus is likely to be on the statement and the updated forecasts. The last projections had the cash rate peaking at 5.5% in Q3 2023 as the central bank expected to continue hiking into a recession. Following the lower-than-expected Q4 CPI reading and drop in Q1 inflation expectations, the RBNZ's inflation forecast is likely to be revised down. The higher-than-expected unemployment rate could drive an increase

in the bank's forecasts here. With a lower inflation path and higher unemployment, there is a strong possibility that the peak OCR is revised down closer to 5-5.25%.

Attention will also be on the discussion of the various options, if there was a step down from the November possibilities of 50, 75 or 100bp, and the recent natural disaster. If the OCR projections are revised down, then the February guidance is likely to signal that rates will remain elevated for a prolonged period rather than an imminent easing on the cards. The guidance is also likely to state that inflation remains too high and the labour market too tight but keep the RBNZ's options open, especially given the uncertainty created by recent weather events and how much tightening is already in the system and still feeding through to the economy. The central bank is unlikely to want to sound more dovish in case the market prices in more easing. It is likely to acknowledge the recent human tragedy but reiterate that demand remains too strong, and it has a responsibility to contain inflation.

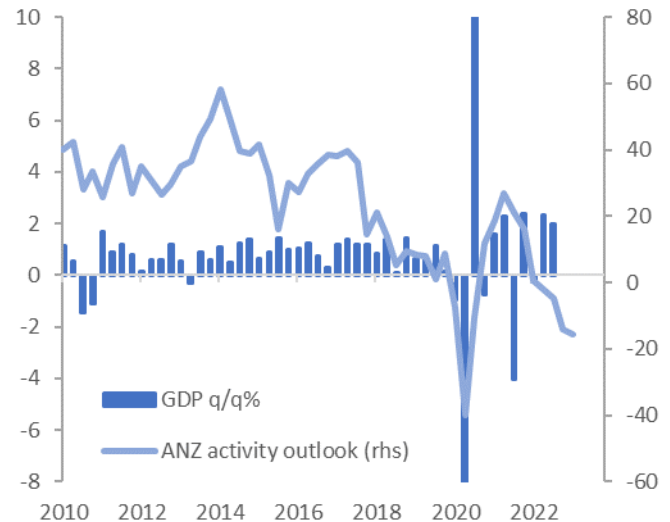
Q4 headline CPI inflation was stable at 7.2% y/y but below the RBNZ's forecast of 7.5%. The data suggest that inflation, including the important domestically-driven components, is rolling over. The unemployment rate unexpectedly rose 0.1pp to 3.4%. However, wage pressures deteriorated in Q4 with salaries and wages rising by an elevated 1.1% q/q for the third consecutive quarter and private average hourly earnings still above 8% y/y. The minimum wage is scheduled to rise 7.1% in April, but the RBNZ seems to have already included this in its Q2 wage forecasts. The aftermath of ex-Cyclone Gabrielle is likely to be inflationary, in the short term through food prices, rents and household goods, but also in the longer term through construction costs and insurance.

**Figure 1: Inflation pressures peaking**



Source: Source: MNI – Market News/Refinitiv

**Figure 2: Growth outlook lacklustre**



Source: MNI – Market News/Refinitiv

Post the 2011 Christchurch earthquake, the RBNZ cut rates 50bp but inflation was only 2% rather than over 7% and unemployment was a lot higher. This natural disaster is different as the economy is still overheating even if Q4 2022 was not as bad as expected. The RBNZ's focus is on the medium-term outlook and not the short-term and the impact of Cyclone Gabrielle on activity and inflation is likely to be transitory. It is also too early to ascertain the impact at this meeting. The government has also come out and said that the cost of this disaster will be in line with Christchurch and that rebuilding will boost activity and thus inflation. It also said that the central bank has the mandate to look through these events and its responsibility is to contain inflation. Despite the RBNZ's independence, it appears that they are giving the central bank the green light to go ahead as planned.

The RBNZ is widely expected to hike rates by a further 50bp on February 22 while possibly signalling that rates are likely to be higher for longer by revising down the terminal rate but pushing out the first cut. Given inflation remains so far above target and the labour market at capacity another hike in April is probable with another step down to 25bp possible given the cumulative tightening this cycle and the lags involved before it is felt in the economy. There should be a clearer picture by the end May meeting as to how much heat has come out of the economy and the economic impact of the recent floods and cyclone. The outcome of the May meeting is likely to depend on the Q1 CPI data released on April 20 and the wages and employment on May 3.

## RBNZ-Dated OIS Pricing

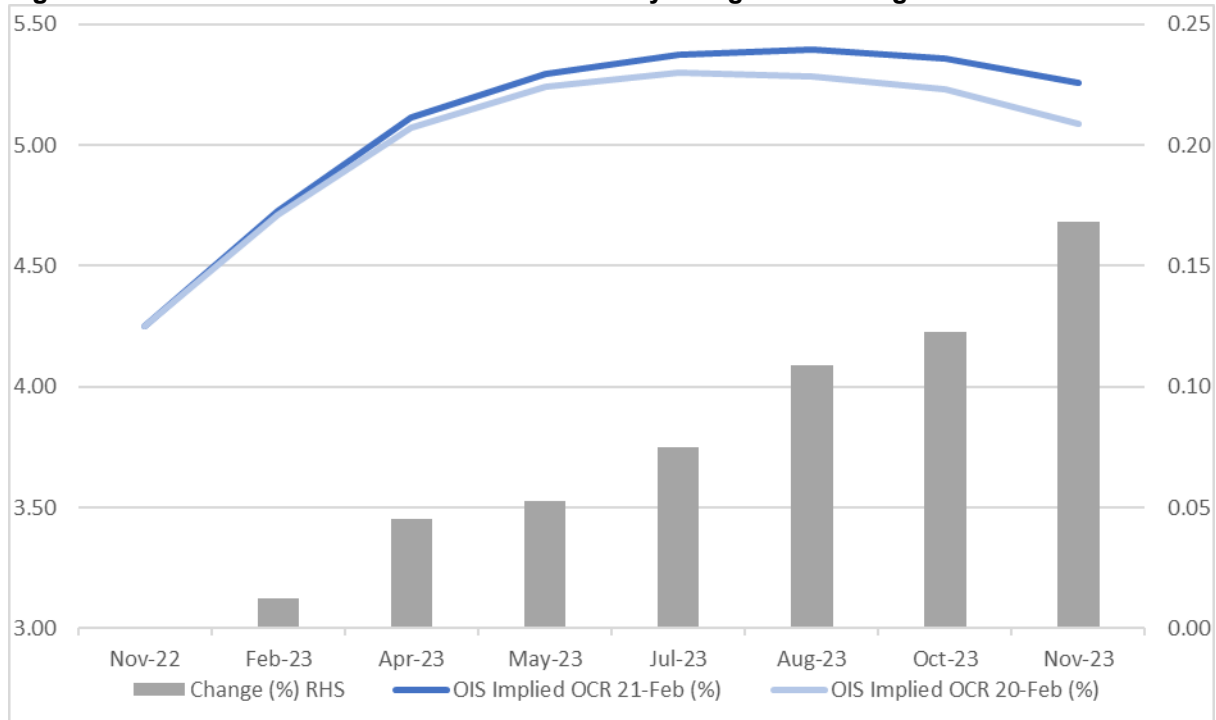
While the debate continues as to whether the RBNZ maintains its 75bp hiking pace, slows to a 50bp step, or surprises everyone with something less in lieu of the devastation of Cyclone Gabrielle, consensus appears to have settled on a scaled back 50bp hike at tomorrow's meeting with RBNZ-dated OIS pricing ~48bp of tightening.

Pricing had hovered just under 75bp until U.S. CPI data in mid-January signalled a likely scaled-down 25bp hike by the FOMC at its 1 February meeting. At that point, the market lowered February meeting tightening expectations to 62bp, the midpoint between 50bp and 75bp. Pricing stayed at that level until early last week when moderation in the RBNZ Survey of 2-year Inflation Expectations delivered a positive sentiment shift.

Tightening expectations reached their lowest level since the RBNZ's last rate decision early this week but have subsequently backed up following recent NZ Government communiques that have pushed back against a 'no hike' option for the RBNZ this week.

With the NZ Treasury also suggesting the post-Cyclone Gabrielle rebuild would add to both economic activity and inflationary pressures and may result in the RBNZ keeping rates higher for longer, terminal OCR expectations have also been marked considerably higher over the past 24 hours. The market is now pricing 5.40% for the Jul/Aug meeting, a 10bp rise from yesterday's close. Equally noteworthy has been the 17bp rise in pricing for the November meeting. Prior to the NZ Treasury's 'higher for longer' comments the market had priced in 20bp of policy easing by November. That has now been scaled back to around 14bp of easing, but with the rate at 5.26% priced versus yesterday's level of 5.09%.

**Fig 3: RBNZ-Dated OIS – Pre- and Post-NZ Treasury's 'Higher For Longer' Comments**



Source: Bloomberg / Market News

## RBNZ November Monetary Policy Review Announcement

The Committee agreed that the OCR needs to reach a higher level, and sooner than previously indicated, to ensure inflation returns to within its target range over the medium term. Core consumer price inflation is too high, employment is beyond its maximum sustainable level, and near-term inflation expectations have risen.

Global consumer price inflation is broad based and remains heightened. Food and energy prices, and persistent core inflation, have combined to create very high headline inflation in many countries. Central banks are tightening monetary conditions in an effort to slow spending and reduce inflation pressure. The ongoing slowdown in global growth will affect New Zealand through both financial and trade channels, and impact on people's confidence due to uncertainty.

In New Zealand, household spending remains resilient, especially considering the rise in debt servicing costs, the fall in house prices, and low levels of consumer confidence. Employment levels are high, and income growth and household savings are supporting spending. The rebound in tourism is also supporting domestic demand.

The productive capacity of the economy is being constrained by broad-based labour shortages, and wage pressures are evident. Aggregate demand continues to outstrip New Zealand's capacity to supply goods and services, with a range of indicators continuing to signify broad-based inflation pressure.

Committee members agreed that monetary conditions needed to continue to tighten further, so as to be confident there is sufficient restraint on spending to bring inflation back within its 1-3 percent per annum target range. The Committee remains resolute in achieving the Monetary Policy Remit.

### Summary record of meeting

The Monetary Policy Committee discussed developments affecting the outlook for inflation and employment in New Zealand. Inflation is currently too high and employment is beyond its maximum sustainable level. The Committee agreed it must continue to act decisively to return inflation to target and to fulfil its Remit.

The Committee discussed recent international economic developments. In many countries, elevated food and energy prices are contributing to high headline inflation, with high core inflation reflecting more broad based inflationary pressures. Most central banks have continued to tighten monetary conditions and to signal further interest rate increases in coming months. Financial market volatility remains high as central banks act to stem the rise in inflation in an environment of slowing and uncertain economic growth.

Expectations for global economic growth have declined further. For example, China's economy is facing headwinds emanating from the property sector, while measures to contain the spread of COVID-19 continue to cause production bottlenecks. The United States and Europe are, to varying degrees, experiencing the effects of high inflation, tighter financial conditions and associated economic uncertainty. The Committee agreed that the anticipated global growth slowdown will affect New Zealand through trade and financial channels, and increased economic uncertainty impacting on people's confidence.

The Committee observed that consumer price inflation in New Zealand in the September quarter was significantly stronger than expected. Measures of core inflation continued to rise and price pressures broadened. Survey measures and other high frequency data suggest that pricing pressure will be sustained over coming months. In addition, shorter term inflation expectations have increased as high inflation persists.

The Committee agreed that to achieve its Remit objectives, actual and expected inflation need to decline substantially. Members highlighted that the longer actual inflation remains above the target band, the more likely it is that higher inflation expectations become embedded.

The Committee discussed the labour market at length, given its importance in the current economic environment. Labour shortages remain a significant constraint on economic activity. Recent data highlight a material increase in employment, enabled by a strong lift in labour force participation to a record level. Measures of labour force utilisation are near record levels and firms continue to report severe difficulties finding labour.



High consumer price index (CPI) inflation and competition for workers are putting upward pressure on wages. The Committee observed that overall wage growth is not exceeding CPI inflation after accounting for productivity growth. While wage growth for people in the same job is generally not keeping pace with inflation, many people are changing jobs or increasing their hours worked to achieve real income growth. The Committee noted that public sector wage growth has lagged that in the private sector and agreed this lag represents an upside risk to wage pressure going forward.

The Committee observed the stronger than expected rebound in tourism since New Zealand's border reopened. Short-term visitor arrivals, international card spending data, and information gathered from recent business visits indicate that tourism spending will make a strong contribution to economic activity in coming months. However, some members noted that ongoing capacity constraints could, at some point, inhibit the tourism recovery and add to overall inflation pressures. In relation to New Zealand's goods exports, members observed that a lower New Zealand dollar is currently mitigating the impact of recent declines in international commodity prices.

The Committee discussed the recent Financial Stability Report and noted that the financial system remains resilient. In particular, members highlighted that recent stress tests demonstrate banks' resilience. The Committee was especially interested in the resilience of household balance sheets to scenarios of higher interest rates, reduced labour demand, and declining house prices. The Committee noted that while national house price indices have declined to mid-2021 levels, they are still above estimates of sustainable house prices and above levels that prevailed pre-COVID-19.

Household spending remains robust, especially considering the rise in debt servicing costs, the fall in house prices, and low levels of consumer confidence. Members observed that the large stock of household savings, in addition to income growth, may provide a buffer to support consumption now and in the future. However, members also noted that the ownership of savings is likely concentrated, leaving the majority of households exposed to high inflation and interest rates.

The Committee agreed that as debt servicing costs rise, spending decisions for many households will be increasingly constrained. These constraints would be most felt by recent home buyers with a high debt servicing commitment relative to their income. The Committee agreed that the impact of rising interest rates on households' spending and saving decisions is an important channel for monetary policy. In addition to constraining spending, higher interest rates also encourage saving and paying down of debt.

The Committee discussed domestic financial conditions, noting that wholesale interest rates have risen significantly since the August Statement, primarily due to higher-than-expected inflation in New Zealand and globally. Retail lending rates have also increased but remain lower than the levels wholesale rates might imply. Members observed that this reflects a combination of both the higher volume and the mix of current bank funding. Members noted that a gradual normalisation in bank funding conditions over the forecast period could result in sustained upward pressure on retail lending rates.

The Committee considered the economic projections. Members noted that a reduction in aggregate demand is projected to cause GDP in the New Zealand economy to temporarily contract by around 1% from 2023. Members noted that this reduction in aggregate demand was necessary to return inflation to target over the forecast period. Members agreed that the exact timing and extent of negative GDP growth was difficult to predict, but historical evidence suggests risks are skewed toward a likely short period of contraction. Members also agreed that the sooner supply and demand were better matched in the economy, the lower the overall cost of reducing inflation.

Members agreed that monetary policy primarily impacts on demand in the economy. However, any increase in the supply potential of the economy, such as through productivity improvements, would also assist in reducing inflation. However, members agreed that a significant increase in the economy's capacity to supply goods and services could not be relied on to reduce inflation pressures over the forecast horizon.

The Committee agreed that fiscal policy can also act to reduce demand in the economy. Members observed that in a higher inflation environment, a given level of government services would cost more to deliver. However, members noted that inflation would also lead to increased government revenues in nominal terms, potentially offsetting the rising cost of service delivery. On balance, members viewed the risks to inflation pressure from fiscal policies as skewed to the upside given the ongoing real demand for services.

The Committee received an update on the status of the Large Scale Asset Purchase (LSAP) portfolio and noted that sales of bonds in the LSAP portfolio to New Zealand Debt Management began in July. Members observed that the New Zealand government bond market continues to function normally under the current pace of LSAP sales and agreed to continue to evaluate this on an ongoing basis. The Committee agreed that the level of settlement cash balances is not a source of unexpected inflationary pressure and noted that overnight wholesale interest rates remain aligned to the OCR.

The Committee discussed the extent of additional monetary tightening required to achieve its Remit. Members agreed that the OCR needed to reach a level where the Committee could be confident it would reduce actual inflation to within the target range over the forecast horizon. Members agreed that this level had increased since the time of the August Statement due to the persistence of inflationary pressures resulting in a higher short-term nominal neutral interest rate.

The Committee discussed the size of the OCR increase to be delivered at this meeting. Increases of 50, 75 and 100 basis points were considered. The Committee discussed the relative merits of maintaining consistent increments in the OCR versus moving more quickly to reach the higher level of the OCR required. Members agreed that a larger increase in the OCR was appropriate, given the resilience of domestic spending, and the higher and more persistent actual and expected inflation outcomes.

The Committee gave consideration to an increase in the OCR of 75 or 100 basis points. On the balance of risks, the Committee agreed that a 75 basis point increase was appropriate at this meeting. Members highlighted that the cumulative tightening of monetary conditions delivered to date continues to pass through to the economy via the lagged transmission to effective retail interest rates.

On Wednesday 23 November, the Committee reached a consensus to increase the OCR from 3.5% to 4.25%.

## RBNZ November MPS – Key Forecast Variables

## Key forecast variables

		GDP growth Quarterly	CPI inflation Quarterly	CPI inflation Annual	Unemployment rate	TWI	OCR
2020	Mar	-1.1	0.8	2.5	4.2	70.9	0.9
	Jun	-10.4	-0.5	1.5	4.0	69.7	0.3
	Sep	13.7	0.7	1.4	5.3	72.0	0.3
	Dec	-0.4	0.5	1.4	4.9	72.9	0.3
2021	Mar	1.7	0.8	1.5	4.6	74.9	0.3
	Jun	2.3	1.3	3.3	3.9	74.7	0.3
	Sep	-3.9	2.2	4.9	3.3	74.4	0.3
	Dec	3.0	1.4	5.9	3.2	74.3	0.6
2022	Mar	-0.2	1.8	6.9	3.2	72.6	0.9
	Jun	1.7	1.7	7.3	3.3	72.1	1.6
	Sep	<b>0.8</b>	2.2	7.2	3.3	70.6	2.7
	Dec	<b>0.6</b>	<b>1.7</b>	<b>7.5</b>	<b>3.2</b>	<b>70.0</b>	<b>3.8</b>
2023	Mar	<b>0.4</b>	<b>1.8</b>	<b>7.5</b>	<b>3.6</b>	<b>70.0</b>	<b>4.6</b>
	Jun	<b>-0.5</b>	<b>1.1</b>	<b>6.9</b>	<b>3.9</b>	<b>70.0</b>	<b>5.4</b>
	Sep	<b>-0.3</b>	<b>1.3</b>	<b>6.0</b>	<b>4.4</b>	<b>70.0</b>	<b>5.5</b>
	Dec	<b>-0.1</b>	<b>0.7</b>	<b>5.0</b>	<b>4.8</b>	<b>70.0</b>	<b>5.5</b>
2024	Mar	<b>-0.1</b>	<b>0.7</b>	<b>3.8</b>	<b>5.0</b>	<b>70.0</b>	<b>5.5</b>
	Jun	<b>0.0</b>	<b>0.5</b>	<b>3.3</b>	<b>5.3</b>	<b>70.0</b>	<b>5.5</b>
	Sep	<b>0.0</b>	<b>0.9</b>	<b>2.9</b>	<b>5.4</b>	<b>70.0</b>	<b>5.4</b>
	Dec	<b>0.2</b>	<b>0.4</b>	<b>2.6</b>	<b>5.6</b>	<b>70.0</b>	<b>5.3</b>
2025	Mar	<b>0.3</b>	<b>0.5</b>	<b>2.4</b>	<b>5.7</b>	<b>70.0</b>	<b>5.1</b>
	Jun	<b>0.5</b>	<b>0.5</b>	<b>2.3</b>	<b>5.7</b>	<b>70.0</b>	<b>4.9</b>
	Sep	<b>0.7</b>	<b>0.7</b>	<b>2.0</b>	<b>5.7</b>	<b>70.0</b>	<b>4.6</b>
	Dec	<b>0.7</b>	<b>0.4</b>	<b>2.0</b>	<b>5.6</b>	<b>70.0</b>	<b>4.4</b>

Source: RBNZ

## MNI RBNZ WATCH: 50bps Seen As Inflation Pressures, Jobs Ease

By Robert Guy

(MNI) Perth - The Reserve Bank of New Zealand is expected to step down its tightening pace to 50bp amid better-than-expected price data and in the wake of Cyclone Gabrielle, although a hawkish tone will likely be maintained as inflation remains well above its 1-3% target.

Markets had leaned towards another 75bp rise since the RBNZ's last meeting in November, but the devastation wrought by Cyclone Gabrielle is viewed as firming the odds of a smaller hike, with overnight indexed swaps largely pricing in a 50bp increase to 4.75%. That would be the 10th consecutive hike and propel the Official Cash Rate to its highest since early 2009. (See [MNI RBNZ WATCH: Another 125bp Coming; Brace For Recession](#))

A small number of economists expect a 75bp move, to underline the RBNZ's resolute stand on reining in elevated inflation, while one economist has argued for a pause due to the cyclone. (See [VIEW: KiwiBank: The RBNZ Should Pause](#))

Wednesday's meeting will be accompanied by the latest Monetary Policy Statement, with the RBNZ's forecast peak rate to be in sharp focus as inflation, while still too high, has been lower than expected. The [November MPS](#) forecast a peak rate of 5.5%, but OIS pricing points to 5.25%.

While the RBNZ considered 75bps and 100bps at the November meeting, price pressures have not been as strong as predicted. The Consumer Price Index rose at a 7.2% y/y pace in Q4, falling shy of the RBNZ's 7.5% forecast. Non-tradables inflation, a gauge of domestic price pressures, printed at 6.6% y/y, steady on the prior quarter.

### INFLATION EXPECTATIONS

The RBNZ's [own measures of inflation expectations](#) for Q1 were mixed. The two-year measure dropped to 3.3% from 3.62% in Q4, though the one-year measure edged up to 5.11% from 5.08%. It's worth remembering the November MPS featured research on the neutral rate, with the short term nominal neutral rate calculated as the real neutral rate - estimated at zero percent - plus an "approximation" of inflation expectations using an average of several measures of one- and two-year inflation expectations. This would suggest the current rate of 4.35% is contractionary.

The labour market appears to be no longer tightening. The unemployment rate rose to 3.4% in Q4 from 3.3% in Q3, while the under-utilisation rate climbed to 9.4% from 9.1%. Job ads have also fallen.

Cumulative tightening of 400bps since October 2021 continues to weigh on the housing market, with the Real Estate of New Zealand's [Home Price Index](#) falling 13.9% y/y in January. Consumer spending has been resilient, shown by the jump in credit card transactions in January, though consumer and business confidence has weakened. The RBNZ has forecast four quarters of contraction starting in the June quarter.

RBNZ Governor Adrian Orr will provide additional insight into the bank's thinking when he appears before a parliamentary committee on Thursday.



## Sell-Side Analyst Views

**ANZ (+50bp):** We expect the RBNZ will raise the Official Cash Rate (OCR) 50bp to 4.75% at its Monetary Policy Statement (MPS) next Wednesday. In terms of alternatives, a 75bp hike is more likely than +25bp, in our view.

- On balance, local data since the November MPS have pointed towards inflation pressures not being quite as bad as the RBNZ assumed. But inflation pressures are far too strong, and we are certainly not expecting the RBNZ to go 'soft'.
- A hawkish tone is likely, along with only a marginally lower OCR track, if it's lowered at all. And it's no small beer for the RBNZ to deliver a double hike when they've already raised 400bp, house prices are down 15% and still falling, and business and consumer confidence are on the floor.
- The RBNZ's preferred measures of inflation expectations from its own survey fell in Q4 (2-year from 3.62% to 3.3%, and 5-year a smidge to 2.36%). Inflation expectations feed directly into the RBNZ's estimate of the short-term neutral OCR.
- The minimum wage will rise 7.1% on 1 April. While the RBNZ might have preferred a smaller lift, it's in line with broader wages and thus probably doesn't represent much in the way of additional impetus.
- Recent and ongoing weather events will clearly be negative for GDP in the short run, due to significant disruption over a large area. Our early assessment is that it presents upside risk to the eventual peak in the OCR. But with the impacts so uncertain we don't expect it to play into the immediate RBNZ decision or have a large impact on the forecasts at this stage.

**ASB (+50bp):** At February's Monetary Policy Statement release, we expect the RBNZ will now lift the OCR by 50bp and signal that more tightening is likely. The underlying environment is not far from what the RBNZ envisaged, so a marked change in stance is unlikely.

- The balance of events does suggest medium-term inflation pressures and labour market tightness will ease slightly faster now, flagging the potential for the RBNZ's OCR forecast to be nudged down to a peak around 5.25% from 5.5%. Financial market pricing has moved back to clearly favour 50bp over 75bp for February, and an eventual OCR peak around 5.3%.
- There are finally some signs that inflation pressures are close to peaking. Beyond February, the RBNZ's stance will increasingly depend on whether it starts to put some weight on the signs that monetary policy is finally starting to get some tangible results.
- The messaging for the April decision looks like it will be harder to manage. We expect a further 50bp increase in April, though it is possible the RBNZ moves to smaller 25bp steps as the RBNZ starts thinking about fine-tuning the end of the tightening cycle. At some point the RBNZ will need to signal it is pausing. It's hard to do that without creating a market stampede to price in OCR cuts that undermines the tightening the RBNZ will want to keep in place.
- The possible economic impacts of late January flooding and mid-February's devastating Cyclone Gabrielle will be discussed. It is important to remember that the RBNZ's prime focus is on medium-term inflation. The weather events are triggering disruption, boosting demand, and hampering supply. All up that is inflationary, though mainly in the short term. We expect the RBNZ will look through the inflationary impacts of the storms.

**Barclays (+50bp):** Given the MPC's continued hawkish tone at the November meeting and still-high inflation in Q4 22, we continue to expect the bank to raise the OCR by 50bp at the February meeting.

**BNY Mellon:** The Reserve Bank of New Zealand's rate decision next week will probably reinforce Wellington's status as the domicile likely to have the highest terminal rate outlook in the developed world. If the RBNZ is to follow through on its pledge to reach a higher level "sooner than previously indicated", then another 75bp hike should not be off the table.

- At this point, what seems to matter most is the labour shortage plaguing the New Zealand economy. Rates-based slowing of the economy aside – which does not appear to be having strong enough an impact – the RBNZ expects a "return of low but positive net immigration" to help ease labour shortages. Considering the pace of recovery in the services sector in particular, the RBNZ is unlikely to be optimistic that a supply-based easing in labour shortages can come soon enough.

**BNZ (+50bp):** In a formal sense, we have moved from a 75 call to a 50 call but our conviction is not strong. We have long said market pricing on the day could be the deciding factor for the Reserve Bank given the line-ball nature of the decision. Current market pricing is headed toward 50.

- We remain in the camp that says the Reserve Bank should now be moderating the pace of increase. Indeed, with the long lags between monetary policy setting and the economic reaction function, it is conceivable the Bank has already done enough. In particular, it is worth noting that a significant proportion of past tightening is still to hit mortgage holders' cash flows. It will, in due course.
- We recognise that financial markets are very keen to price in a near-term reduction in rates. The RBNZ will not want to encourage that sentiment so will be "forced" to keep tightening. We think the best approach for the Bank would be to raise the cash rate 50 basis points to 4.75%, signal 25 to 50 basis points further thereafter and then move to a data watching framework accompanied by a strong warning that it expects interest rates to stay elevated for an extended period of time.

#### **Citi (+50bp):**

- Initial damage from the Christchurch earthquake was estimated at \$NZ15bn or about 8% of GDP by Treasury with GDP around 1.5% lower in 2011 than it would have been otherwise. This is a rough starting point to assess the damage from Cyclone Gabrielle and suggests that Q1 GDP is likely to be smaller. Government and insurance-based recovery and rebuilding expenditure is likely to provide a boost to subsequent quarterly activity.
- The cyclone comes at a time when inflation pressures are acute. The loss of supply lines due to infrastructure and road closures is likely to add to short-term pressure on food prices and in the medium term on construction materials and labour and possibly some durable items from the need to replace damaged household goods. We expect some short-term reduction in dairy exports but little measurable influence on medium-term inbound tourism.
- The RBNZ is still likely to increase the OCR, but will need to communicate carefully accompanying policy rhetoric. The RBNZ unexpectedly cut the OCR by 50bps to 2.50% following the Christchurch earthquake rather than keep it steady. This was to "lessen the economic impact of the earthquake and guard against the risk of this impact becoming especially severe". Precedent in responding to a natural disaster with a change in policy would suggest that the RBNZ now possibly keep the OCR unchanged on February 23 rather than increase it as expected by the market and previously communicated by the RBNZ. We suspect that such an outcome will be discussed by the MPC, but that in the end, the need to stop the economy overheating will force a decision to increase the OCR by 50bps to 4.75%. That said, the RBNZ will likely need to moderate hawkish rhetoric at a time of human suffering and acknowledge the short-term impact.

**Goldman Sachs (+50bp):** We expect the RBNZ to slow the pace of hikes to 50bp in line with consensus and market pricing (c.53bp of hikes priced), although we highlight the significant uncertainty.

- Since November, news on inflation and the labour market has generally erred on the softer side of the RBNZ's expectations, although in levels terms inflation remains elevated and the labour market very tight. Global inflationary pressures also continue to ease. On balance, we think these developments give the RBNZ some room to ease the pace of hikes, alongside an easing in the pace of tightening by many global central bank peers.
- We expect the RBNZ to lower its peak inflation forecasts in the MPS in light of recent data – accompanied by a slightly lower peak OCR path to around 5-5.25% – and to downgrade near-term GDP growth in light of recent weather events, although from our perspective it is too early to quantify the damages. We expect to hear more about the RBNZ's deliberations around this in the MPS, which could also impact the guidance on the future rate path. Our own forecast is for another 25bp hike in April, to a terminal rate of 5%.
- As a precedent, we note that following the 2011 Christchurch earthquake (of which the cost was likely orders of magnitude larger than the current weather events), the RBNZ cut the OCR by 50bp. However, we don't think this is a good analogue given inflation was much more contained back then (headline inflation averaging 2.0%yoy in the four quarters prior to the earthquake vs 7.2%yoy today) while unemployment was also higher (6% vs 3.4% today). As a result, we see the bar for a significant dovish pivot from the RBNZ to be much higher today compared to 2011, although uncertainty remains.

**ING (+50bp):** We expect the Reserve Bank of New Zealand to hike rates by 50bp to 4.75% next week, in line with market pricing. Peaking inflation and a deteriorating housing market and activity suggest the RBNZ will not reach its projected 5.50% peak rate. A hawkish hike (unchanged projections) should lift NZD.

- We believe that the most important input to the monetary policy decision right now is the growing evidence that inflation has peaked. Crucially, falling energy prices, wage growth, and inflation expectations point to disinflation beginning in the first quarter. The less alarming inflation story argues against another 75bp move next week.

- Nonetheless, given the low frequency of RBNZ policy announcements, policymakers will want to take the chance to deliver a 50bp hike before hard economic data deteriorates materially.
- Markets are fully pricing in a 50bp hike in February, so the references to future tightening will drive most market moves. Updated economic projections will shed some light in this sense. A revision lower in inflation forecasts will be necessary, but we suspect the RBNZ will resist the temptation to scale back peak rate projections, which may be left at 5.50% in an attempt to avert a bond rally.
- Our base case is only one last 25bp hike in April, so a 5.0% peak rate. There are nonnegligible risks of another 25bp in May, but we'd rule out a 5.50% peak rate unless the inflation picture changes dramatically. We think the RBNZ will see more value in stopping earlier and shift to a credible 'higher-for-longer' rhetoric, rather than pushing rates higher and inevitably face rate cut speculation. At the moment, markets are seeing a 60% probability of rates cuts starting already in November this year.

**J.P. Morgan (+50bp):** We expect the RBNZ to hike 50bp to 4.75% at this week's meeting. After the labour market and CPI reports, consensus has also changed to assume a 50bp move; markets are pricing the decision as quite balanced between +50 and +75bp. The November meeting was very hawkish, flagging further hikes into the teeth of a forecast 18-month recession starting in 2Q. RBNZ guidance has mostly acted as a spot signaling and policy device, rather than a forward commitment device, so we don't view the hike into recession path as being locked in.

- The message in November seemed at least partly intended to preserve prior tightening over the long break to February, so that mortgage refixings over the summer would crystallize earlier hikes
- Consumption has been slowing consistently since early 2021, but now there are also signs of traction in the data the committee cares about (inflation and the labour market particularly), so the tone can now be more agnostic on how much further work is required.
- We expect the guidance that "monetary conditions needed to continue to tighten further" will be tweaked to be more backward-looking, explaining the decision to hike on the day, rather than locking in future moves. Vigilance would be conveyed by maintaining the clause that "the committee remains resolute in achieving the monetary policy remit". We suspect the OCR forecasts will maintain some prospect of future hikes.

**Kiwibank (+50bp):** The RBNZ should pause next week, as we deal with the devastating impact of Cyclone Gabrielle. The RBNZ can come back in April and resume tightening if required.

- Talk of a 50bp, or even 75bp, hike should be sidelined. The comms effort in explaining such a move in the middle of a crisis would be difficult to say the least. And it's not warranted.
- The need to tighten aggressively from here has evaporated. Inflation is peaking at lower levels. And global inflation pressures are abating. The balance of risks are tilted to the downside. We think the RBNZ should pause next week. Current circumstances warrant caution.
- But what we think they should do is not what they will likely do. What we expect the RBNZ will do, however, is deliver a 25bp or 50bp hike. We believe a 75bp hike is well and truly off the table. RBNZ officials are concerned about the path of inflation. And they may want to keep their foot firmly on the brake. But we expect to see a more moderate path for interest rates. We expect a peak of 5%, down from 5.5%.

**Natwest (+50bp):** We expect the RBNZ to hike the OCR by 50bp next week. Cyclone Gabrielle complicates RBNZ's hawkish stance and at this point it's hard to understand the impact on output. However, the economy remains resilient with most of the data indicating strong momentum.

- A new Monetary Policy Statement with a fresh set of forecasts will be released next week. On balance, we expect RBNZ to maintain a hawkish stance despite the uncertainty related to cyclone Gabrielle.
- Market pricing is for another 100bp hike for the next 6 months.
- China's faster than expected re-opening is positive for growth. As per RBNZ's estimate, the output gap is still positive despite the policy rate increasing above the neutral rate and most of the other factors point towards an economy still running hot.

**NZIER (+50bp):** Shadow Board members recommend that the Reserve Bank continue increasing the Official Cash Rate (OCR). The broad view was a 50 basis-points increase in the OCR at the Reserve Bank's February meeting, given inflation pressures in the New Zealand economy remain strong. Only one member recommended a smaller increase of 25 basis points. Some members also noted that while inflation and interest rates in New Zealand are approaching their peaks, the Reserve Bank should commit to controlling inflation.

- Regarding where the OCR should be in a year, the Shadow Board recommends the Reserve Bank takes a more measured approach, with the core views ranging from 4.00 percent to 5.50 percent. Some members pointed out that inflation in New Zealand is reaching its turning point, similar to other countries. However,



they also suggested the Reserve Bank should carefully consider the potential for a further rise in cost pressures, particularly in construction, due to the recent extreme weather events in the North Island.

**RBC (+50bp):** This is the RBNZ's first meeting for 2023 and occurs against the backdrop of immense natural disasters in the last few weeks. The near-term impact will be inflationary and the longer term rebuild will add to activity. Having bucked the global trend in late 2022 and sticking to a very hawkish tune, we expect the RBNZ to join the step down in the pace of tightening and deliver a 50bp hike after a string of outsized 75bp moves. Key will be the OCR track which showed terminal at 5.5% in Q3-23 and hovering there for around 12 months before around 100bp of cuts from mid- 24 to end-25.

**Scotiabank:** Markets are priced for a 50bps hike on Tuesday evening (eastern time as always). At its last decision way back in November, the RBNZ hiked by 75bps to 4.25%, said it had considered a 100bps hike as an alternative, and indicated that further tightening was required.

- Since then, Q4 inflation surprised a little higher than expected at 1.4% q/q non-annualized (1.3% consensus) which kept the year-over-year rate at 7.2%. Q4 job growth fell a little shy of expectations at 0.2% q/q non-annualized but remained solid, while wage growth remains fairly high.
- The fly in the ointment is whether Cyclone Gabrielle could dial back the size of the hike or suspend hikes. That might appear to be unlikely given that central banks tend to look through natural disasters because their negative effects on growth and positive effects on inflation are typically transitory.

**TD Securities (+50bp):** We expect the RBNZ to hike the official cash rate (OCR) by 50bps at its February meeting to 4.75%. After a historic 75bps hike at the November meeting, the subsequent inflation and labour market outcomes undershooting RBNZ forecasts support a return to RBNZ hiking in 50bps clips. The downshift would also be consistent with global central banks stepping down the pace of hikes. New economic projections will accompany the Board's decision with most focus on whether the Bank retains a 5.5% OCR peak by May.

- We believe that recent developments, especially on inflation and the labour front, have markedly reduced the odds of another 75bps hike, with OIS strip no longer pricing any chance of a 75bps hike either. Most of the data we think the RBNZ is monitoring and have universally come in softer than the Bank's forecasts in November.
- Inflation in Q4 slowed more than expected, with actual outcomes undershooting the RBNZ's Nov MPS forecasts. The cooling in inflation momentum could shift the Bank's focus away from the pace of hikes to the terminal rate. Labour market tightness should progressively ease in the months ahead as broad-based labour shortages are filled by the return of migrant workers.
- The Bank's OCR peak of 5.50% by May implied RBNZ hikes of 75bps in Feb'23 followed by 25bps hikes in April and May. The Bank's OCR path foreshadowed a step-down in the pace of hikes back in Nov.
- If the Bank retains a 5.50% May'23 peak it implies a follow-up 50bps hike in April followed by a 25bps hike in May. In the alternative scenario, the Bank pushes out the 5.50% peak to July, which implies a stepdown in the pace of hikes to 25bps in Apr with follow up 25bps hikes in May and July.

**Westpac (+50bp):** We expect the Reserve Bank to lift the Official Cash Rate by 50 basis points to 4.75% next week. While still a large increase, it's less than the 75 basis point move that the RBNZ seemed to have in mind at its November Monetary Policy Statement. Inflation pressures have remained strong, but not quite to the degree that the RBNZ was bracing for. We expect the OCR to rise further to a peak of 5.25% this year. Borrowers will continue to roll onto higher interest rates for some time to come, even if the OCR is reduced over 2024 as we're forecasting.

- We still expect the RBNZ's projections to show the cash rate rising further in the next few months, then holding at its peak for some time to come. The RBNZ will want to dissuade the market from pricing in rate cuts too soon, which would risk restimulating the economy before the inflation battle has been won.
- On the flipside, the inflation figures themselves haven't quite lived up to the RBNZ's very strong forecasts. The surprise was mostly domestically-driven prices, which tend to be both more persistent and more closely related to the stance of monetary policy. Similarly, wage growth was on the lower side of forecasts.
- The economic impact of this year's flooding and Cyclone Gabrielle is hard to pin down at the moment. This should be a 'look through' event for the RBNZ – but it will require even more patience before we see some hard evidence that inflation is heading back towards the target range.
- We expect the RBNZ's projections to show a further lift in the OCR to a peak of around 5.25% this year, again down slightly from the 5.5% that was signalled in the November projections. At this point, the RBNZ's task is largely around locking in its successes. For that reason, we think the RBNZ will continue to signal that an easing in monetary policy is some way off.