

New Zealand: Kiwi Gets a Lift as RBNZ's Carries Forward Plan to Raise Rates

The Reserve Bank of New Zealand kept the official cash rate unchanged at 2.50% this morning. Once again, it was not so much the rate decision itself (since it was widely expected that rates would be kept on hold) but the tone of the statement which moved markets. The highlight this morning was that the RBNZ said it will raise the benchmark interest rate sooner than it previously indicated, easing away from the October 29 pledge (to keep rates unchanged until the second half of 2010).

In the statement, RBNZ Governor Alan Bollard said that "In New Zealand, the economy continues to recover, reflecting improved world growth, higher export commodity prices, increased government spending and housing strength". Nevertheless, he acknowledged that "there remains considerable uncertainty about the durability of the expansion".

The New Zealand economy grew 0.1% in the second quarter, the first expansion after six quarters. The Bank expects that the economy will expand 1.9% in the first quarter of 2010 from a year earlier, better than the 1.3% pace predicted back in September. The bank added that annual growth will accelerate to 4.2% by the first quarter of 2011.

On Tuesday, Finance Minister Bill English had said that the economy is improving and may grow faster than forecast in his May budget (where the government had forecast the economy to contract 1.7% in the year ending March 31 amid rising unemployment and a slump in the housing market). English will be releasing fresh forecasts on December 15. He added though, that "The picture is patchy" and the government is yet to see business confidence convert into investment and jobs. English also said that a major challenge for the economy is the rising jobless rate. Unemployment was at a nine-year high of 6.5% in 3Q; and the Bank expects the rate will increase to 6.6% by the first quarter of next year before trending lower to 6.3% a year later.

On rates, as mentioned in the previous flash note on New Zealand, in terms of its "communications" with markets, the RBNZ has so far reiterated that rates will not be raised until the latter part of 2010. Looking back at the September statement, the RBNZ had concluded by saying that it expects to "keep the OCR at or below the current level through until the latter part of 2010". Then in October, the words "or below" were omitted, signaling its move away from any traces of an easing bias; whereby the statement left off with "we see no urgency to begin withdrawing monetary policy stimulus, and we expect to keep the OCR at the current level until the second half of 2010".

	End 4Q09	End 1Q10	End 2Q10
Overnight Cash Rate	2.50	2.50	2.75
NZD/USD	0.720	0.725	0.740
Source: UOB			

And this morning, Bollard ended off the December statement saying that “If the economy continues to recover, conditions may support beginning to remove monetary stimulus around the middle of 2010.” We had expected that at some point, the RBNZ will probably indicate the need to “normalize” rates. And it seems that we were right to think that it was going to take a “gradual” approach in terms of setting up markets for a rate hike, preferring to prepare markets well before it lays the groundwork for any rate hikes. Thus, we have not changed our view that the RBNZ will begin taking on a hawkish gear some time in the second quarter next year.

Nevertheless, the changes in the wording and tone this morning were seen lifting the Kiwi. From where it left off in the overnight session at 0.7185, NZD/USD has since climbed and is now trading above the 0.7200-figure – the first time this week. Typically moving in line with the Australian currency, we expect support from the AUD/USD as well, which has also gained from this morning’s figures showing that Australian employment rose by 31,200 in November from the previous month and the jobless rate fell to 5.7% from 5.8% in October.

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