Deutsche Bank
Markets Research

New Zealand

Foreign Exchange
FX Spot

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FX Daily

Kiwi after the RBNZ

RBNZ's tightening cycle well underway

The RBNZ struck a hawkish note in last week's monetary policy statement as it raised interest rates by 25 bps. Pointing to a 'continued acceleration' in construction, 'high' house price inflation, 'buoyant' consumer and business confidence, business investment and hiring intentions and 'strong' net migration, the Bank said that while headline inflation remains moderate, '[i]nflationary pressures are expected to increase.' Our New Zealand chief economist expects a further 50 bps of tightening this year and 75 bps in 2015. (The current forecast total of 125 bps of tightening in 2014 is 50 bps more than we were expecting in January when we entered our long AUD/NZD trade.)

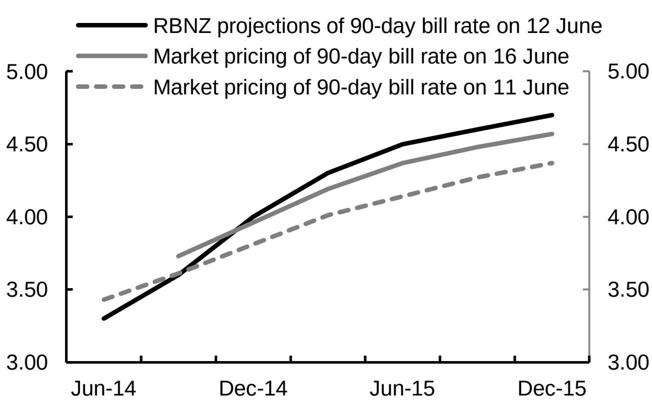
What would it mean for AUD/NZD if the rates market fully priced the RBNZ's projections?

In Thursday's statement the RBNZ projected that the 90-day bank bill rate will be 4.7% in December 2015. The rates market is currently pricing ~13 bps less than that (Figure 1). The recent relationship between AUD/NZD and the Australia-New Zealand fourth-bill rate differential suggests that a 10bp increase in the rate differential is correlated with a 0.7-cent fall in the exchange rate. That implies that if the market fully priced the RBNZ's projected rate for December 2015, AUD/NZD would fall a further 1 cent or so.

Closing our AUD/NZD long position

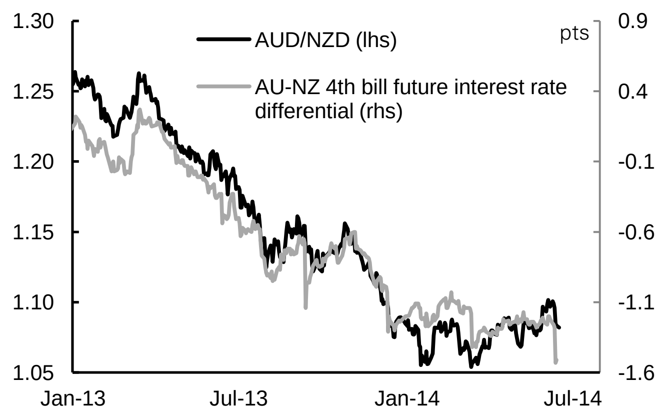
So with the RBNZ still hawkish and the RBA likely to be on hold through 2015 at least, the rate differential is unlikely to narrow from here. We therefore closed out our AUD/NZD long position in the *Dollar Bloc Weekly* on Friday for a small gain of 0.7% (ex-carry).

Figure 1: The rates market is yet to price all of the RBNZ's projected rate rises



Source: RBNZ, Bloomberg Finance LP, Deutsche Bank

Figure 2: AUD/NZD tends to track the rate differential



Source: Bloomberg Finance LP, Deutsche Bank