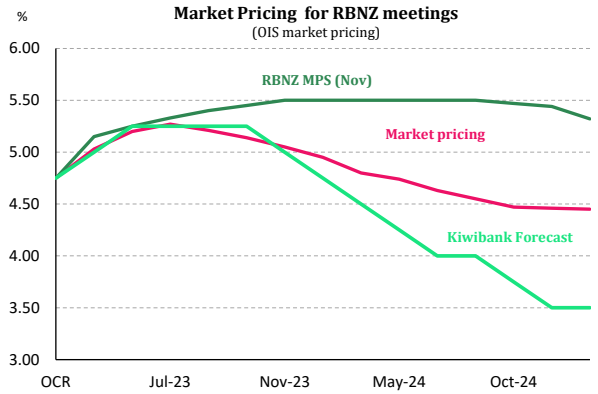
First View
Kiwibank economics.

Yet another interest rate rise. But the end is near.

- Mark your diaries: the RBNZ's Monetary Policy Review is out on Wed, 2pm. The RBNZ's decision should be relatively straight forward. We expect another 25bp hike, lifting the cash rate to 5%.
- The MPR is a stepping stone between the Feb and May MPS. And it is in May that we expect the RBNZ to "pivot". We expect the RBNZ to hike to 5.25%, not 5.5%. Although we think they "should" stop this Wednesday at 5%.
- Our charts of the week look at three possible pathways for the Kiwi dollar in the near-term. On balance, heightened uncertainty and strengthening prospects of a recession mean the risks are tilted toward a lower Kiwi dollar.

The RBNZ's decision this week should be relatively straight forward. All surveyed economists expect a rate hike, most think 25bps. Financial market traders have priced in a 25bp hike to 5%, with a terminal rate of around 5.25%. This week's policy decision is a "review", not a full blown statement with updated forecasts. It's a stepping stone between the MPS in February and May. The language is expected to focus mainly on the inflation fight. But we will be looking for any hints of an end to the tightening cycle.

Inflation is still running above 7% and will take some time, possibly a year, to return to the RBNZ's target range of 1-to-3%. Imported inflation (tradables) is likely to ease quite quickly. Global growth is losing momentum. And commodity prices may fall further this year. But domestically generated inflation (non-tradables) may prove to be frustratingly sticky. The impact of recent flooding and the cyclone is likely to be inflationary. The clean-up and rebuild effort is likely to come in well above $10bn. And the construction industry is already running at full capacity. We had seen some signs of a significant slowdown in construction activity, however. The pipeline of work, particularly in residential construction, was starting to evaporate before the weather events struck the North Island. Building consents peaked early in 2022, and continue to fall with a housing market in retreat. The monthly number of new homes consented in Feb was down 9% (seasonally adjusted). However, with thousands of



homes needing to be rebuilt, we may see consents tick higher in the impacted regions. The repair of damaged infrastructure will also see the construction pipeline swell in coming months.

Inflation may be running hot, but many households and businesses are feeling the strain from the rapid rise in interest rates. We have seen some clear evidence that rate hikes are working. Both business and consumer confidence have dropped into recessionary territory, and economic activity contracted in the final quarter of 2022. Business investment intentions are downbeat, and we have seen a sharp drop in employment intentions. Many projects that would have gone ahead this time last year, are no longer viable with today's interest rates. We are starting to hear more and more anecdotes of firms downsizing their workforce. It's the beginning of a softening in the labour force, with the unemployment rate likely to rise from near-record lows. The RBNZ is openly engineering a recession to combat inflation. And that involves a lift in unemployment.

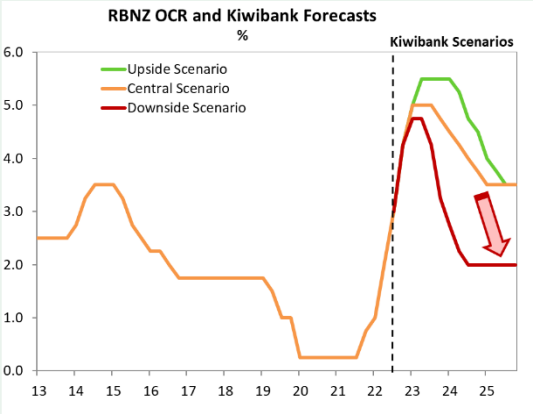
The RBNZ is likely to deliver a brief statement that illustrates the fight against inflation, and aims to keep interest rates elevated. The market pricing of the terminal cash rate at around 5.25% feels about right. But the rate cuts that follow are likely to be deemed "too early" by the RBNZ. According to Kiwi OIS pricing, the cash rate peaks at 5.27% in July – basically another hike in May. Thereafter, rates begin to fall. We have a full cut priced by year-end, back to 5%. By the end of 2024, the cash rate is expected to fall to 4.5%. We agree with this pricing, but the RBNZ will not. We think the RBNZ will try to guide pricing higher, by partially removing thoughts of imminent rate cuts. We think this week's

statement will try to provide a steady hand, and shut down thoughts of early rate cuts.

That said, we expect the RBNZ to "pivot" in May. We suspect the economic data will have turned enough to justify an end to the tightening cycle. All throughout, we have noted that a move beyond 5% will be a move too far. We think the cash rate should peak at 5%, not 5.5% as signalled by the RBNZ. The RBNZ risks delivering too much tightening, after doing too much easing during the heights of the Covid pandemic. What we think the RBNZ should do – stop tightening now – is less less than what we think the RBNZ will do. But that's hopefully changing. We now expect the RBNZ to hike to 5.25%, not 5.5%. Although we think they "should" stop this Wednesday at 5%.

Before we hear from the RBNZ, the RBA will first take the stage. In what would be an interesting contrast, the RBA is expected to hit pause. The Aussie cash rate is picked to be left unchanged at 3.60%, ending a run of 10 straight increases. Inflation in Australia is slowing. Last week's CPI print slowed by more than expected, down from 7.4%yoy to 6.8%. There are also clear signs that economic growth is weakening with modest household consumption. Slower inflation and economic growth afford the RBA with the option to pause and assess the 350bp of tightening. 350bp of tightening delivered in under a year is a lot. But compared to the RBNZ's 450bp of hikes so far, the RBA has done much less. The RBA was among the last (developed) central banks to start tightening. Now, they're among the first to stop (behind the Bank of Canada). The Aussie 2s10s govie bond curve looks straight out of a textbook, maintaining an upward slope. The Kiwi curve however remains inverted, with further rate rises signalled and expected. Only time will tell who gets it right and another set of bragging rights.

Charts of the week: Three possible futures for the Kiwi dollar.



The stresses in the global banking sector have roiled financial markets. It's meant that picking the levels and direction of currency in 10 minutes' time is a tough task – let almone in three months' time. So, we've taken a scenario-based approach in our latest FX Tactical. We've mapped out three possible futures for the Kiwi dollar – welcome to the multiverse.

Central scenario (60%) – As you were: Our central scenario is unchanged from our Dec publication. In our central scenario, the global disinflation process continues. Fears of bank contagion ensuing from the bank failures dissipate. The focus returns to central banks and the task at hand – bringing down inflation. With inflation still unacceptably elevated, central banks will remain on the front foot, but progress is pleasing. The tightening cycle is drawing to a close, and a soft landing still seems achievable. In our central scenario, we see the Kiwi dollar drifting around current levels, with some upside into the 0.6365 resistance level, and then potentially beyond that.

Downside scenario (30%) – March madness magnified: There are numerous downside risks, and they heavily outweigh the upside risks. Here and now, fears of bank failures and contagion risks are front and centre. A full-blown bank crisis is still unlikely, in our opinion, but the probability of such risk is clearly higher today than it was a month ago. An uncontrolled meltdown in capital markets may shut the door on foreign funding for Kiwi banks. Bank spreads would blow wider, and credit creation (the oil in the economic engine) would seize. If we see a sharper downturn, commodity currencies will get hit hard. In our downside scenario, the Kiwi dollar is much lower. We see downside here, well below 0.5910, and the Kiwi dollar could even head into the 0.55 level quite easily in the upcoming quarter(s).

Upside scenario (10%) – Re-acceleration required: Our upside scenario assumes the task of bringing inflation down from such lofty heights is increasingly difficult to achieve. Central banks will be forced to tighten even more than anticipated. More is needed to temper price growth expectations. But the more tightening, the greater the risks of a hard landing. In our upside scenario, the Kiwi flyer could drift higher, largely driven by rate differentials. The RBNZ is still on the hawkish side compared to other central banks.

See our latest note for more on the key themes of the NZ Dollar and other Kiwi crosses (NZDAUD, NZDGBP and NZEUR).

Financial Markets

The comments below were provided by Kiwibank traders. Trader comments may not reflect the view of the research team.

In rates, the focus shifts to the RBNZ:

"Last week, no news was good news for risk in markets, leading to higher global yields and a dampening of volatility. In the kiwi rates market, the focus shifted to this week's RBNZ meeting, with a 25bps hike now fully priced in and a terminal rate of around 5.25%. This led to higher swap rates and a flatter curve as cuts were pushed out of this year. The 2-year part of the curve was up 16bps over the week.

In the local market, we saw a return of primary issuance, with Contact Energy and CCHL both getting deals away last week. A notable technical change last week saw most bond indices significantly extend their duration due to the upcoming maturity of the NZGB23s and NZGB24s falling out of the WGBI.

On Friday US inflation data, the core PCE deflator, was slightly weaker than expected in February. This saw a rally in US treasuries and also spilled over to other markets.

Looking ahead, the RBNZ meeting will be the main focus for the kiwi rates market, it will be interesting to see if the Bank signals any change in their outlook. A 25bps hike seems quite likely but a unexpectedly hawkish or dovish statement could see the front end of the curve shift sharply." **Matthew Crowder, Treasury Dealer.**

In currencies, the NZD is treading water:

"Despite a relatively positive vibe for risk assets, including global equity markets, the NZ Dollar continued to tread water for much of last week. Not even some hopeful news of a softening in US PCE inflation data on Friday night could bring a breakout of recent trading levels. In a now narrowing range between 0.6150 and 0.63, the week ahead may perhaps bring some activity to the largely docile Kiwi price action of recent weeks. Whilst Wednesday's RBNZ MPR is largely expected to see the OCR lifted to the significant and psychological 5% level, investors will be trawling the shortened statement for any form of clue as to what may come next in the form of monetary policy. Clearly offshore financial stability events, and now softening local economic data (as commented on last week by RBNZ Chief Economist Paul Conway) will be on policy makers minds. However the balancing act of not declaring victory on inflation just yet will be closely watched.

Often the MPR comes and goes with little fanfare in wholesale markets given the pre-pricing of the event itself. That said, when markets become blasé about events, that is when even the smallest of surprises can create price action. Best not take your eye off this one before the Easter break. 0.61 - 0.6350 remain the current key broader levels to be watching.

Also this week, NZDAUD will be a currency pair to watch. With the RBA on Tuesday, and then RBNZ on Wednesday, there is certainly opportunity for some variance. The RBA have been seen a little more dovish (vs the RBNZ) of late, but they may still deliver a final hike to ensure that inflation is well and truly put to bed. Last week's below expectations February CPI print will provide some further food thought for the RBA and the market now prices no change to the cash rate at tomorrow's event. If they do deliver a 25bp hike, then this should put pressure on the downside of the recent month's range of 0.9250 – 0.9380." **Hamish Wilkinson, Senior Dealer – Financial Markets.**

Weekly Calendar

Key Data and Events

• The RBNZ's April Monetary Policy Review on Wednesday is the main event this week. The RBNZ is widely expected to deliver its 11th consecutive hike, raising the cash rate by 25bp (a downshift from Feb's 50bp hike) to 5%. A weaker economic starting point and the recent troubles in the global banking sector suggests a more cautious approach from the RBNZ (see front page for more detail). Also on the domestic data calendar is NZIER's survey of business opinion for the March quarter. The most recent reading (Dec-22 qtr) saw business confidence fall to an all-time low. It followed the RBNZ's supersized 75bp hike in Nov and stern warning to rein in spending. With the March quarter capturing Cyclone Gabrielle, NZIER's latest numbers could likely show another downbeat report.

• Before the RBNZ, we first hear from the RBA on Tuesday. In an interesting constrast, the RBA is expected to hit pause on rate hikes, leaving the cash rate unchanged at 3.6%. Slowing infation and signs of weaker growth should give it room to pause and assess the impact of the 350bp of tightening delivered in under 12 months. RBA Governor, Philip Lowe, is due to speak on the day following the policy announcement.

• Further afield, we round out the week with the monthly US employment report (out Friday). Almost 250k jobs are expected to have been added over the month of March. That's still a chunky increase, but slower than the blockbuster growth seen at the beginning of the year. Weather-related factors that drove the strong Jan and Feb job reports have begun to reverse. Despite slower hiring, the unemployment rate is picked to remain unchanged at 3.6% as workers are slow to return to the labour force.

Date		Economic Indicator	Last	Consensus
Mon, Apr 03	**AU**	Feb Building Approvals (% mom)	-27.6	10.0
	CH	Mar Caixin Manufacturing PMI	51.6	51.5
	JN	Mar Qtr BoJ Tankan Large Manufacturing Index	88.6	-
		Mar Qtr BoJ Tankan Large Non-Manufacturing Index	19	20
	EZ	ECB Speaker - Vujcic	-	-
Tue, Apr 04	**NZ**	Mar Qtr NZIER Business Opinion Survey (DTA net %)	-12.87	-
	AU	RBA Cash Rate Target (%)	3.60	3.60
	UK	BoE Speaker - Pill	-	-
	EZ	Feb PPI (% yoy)	15.0	-
	US	Feb Factory Orders (% mom)	-1.6	-0.5
		Feb Durable Goods Orders (% mom)	-1.0	-
Wed, Apr 05	**NZ**	RBNZ Monetary Policy Review (%)	4.75	5.00
	AU	RBA Speaker - Lowe	-	-
	GE	Feb Factory Orders (% mom)	1.0	0.7
		Feb Factory Orders WDA (% yoy)	-10.9	-
	US	Feb Trade Balance ($bn)	-68.3	-68.5
		Fed Speaker - Mester	-	-
Thu, Apr 06	**AU**	Feb Trade Balance ($mn)	11,688	11,719
		Financial Stability Review	-	-
	GE	Feb Industrial Production (% mom)	3.5	-0.4
	US	Fed Speaker - Bullard	-	-
Fri, Apr 07	**US**	Mar Change in Nonfarm Payrolls (000)	311	240
		Mar Unemployment Rate (%)	3.6	3.6

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