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RBNZ's huge dovish surprise spells trouble for Kiwi dollar

The Reserve Bank of New Zealand surprised with a 4-3 split vote for a hold. While a December hike remains on the cards, the signal was dovish, leaving markets' tightening expectations vulnerable. That points to further downside risks for NZD vs commodity currency peers, despite potential near-term relief in the undervalued NZD/USD



The Kiwi dollar has been hit hard from the RBNZ's surprise hold

The New Zealand dollar is trading around 1.4% lower after the Reserve Bank of New Zealand shocked markets with a split 4-3 vote to hold rates at 2.75% today. Markets were pricing around 23bp, and we joined the overwhelming majority of economists in calling for a 25bp hike. The RBNZ appeared to signal that a December hike is the baseline, but clearly stressed the uncertainty around that view and the possibility of a prolonged hold.

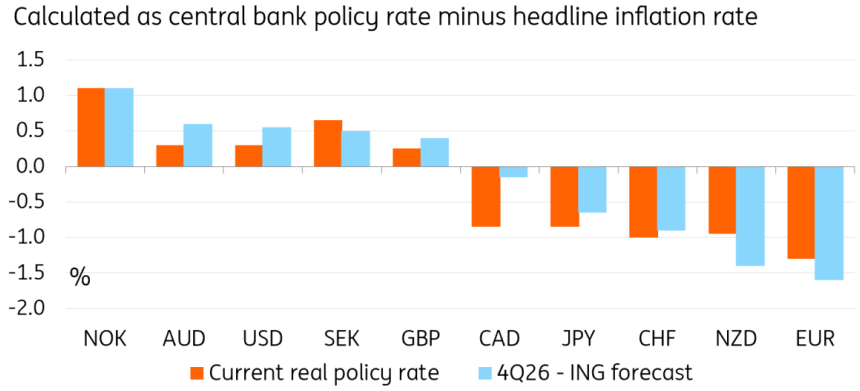
Doves stand firm despite inflation risks

One key argument we made for a hike in our preview was that inflation looks set to break above 4.0% in 4Q26. The RBNZ now puts its central expectation at 4.4%, even higher than consensus. Assuming a December hike to 3.0%, that would leave the real policy rate at -1.4% in the fourth quarter.

Three committee members agreed with that view, but the dovish front, crucially including Governor Anna Breman, has proved much firmer than many had thought. We also deduce that it does not see a high risk of inflationary effects from a weaker currency, despite the trade-weighted exchange rate now being at its lowest since the global financial crisis.

The doves' argument today was that inflation was lower than expected in the third quarter and medium-term inflation expectations have remained anchored. Most importantly, they are placing greater emphasis on downside risks to growth, especially household consumption and investments.

Real policy rate set to tank in 4Q



Source: ING, Macrobond

December hike likely, but pricing looks vulnerable

We are expecting a December hike. As the RBNZ itself admits, inflation should accelerate above 4.0% in the fourth quarter, and we see no evidence that resilient growth momentum is facing enough downside risks to justify another hold. We then expect at least one more hike in 1Q27.

Markets are pricing 22bp for December, 60bp by March and 100bp by August 2027. Beyond December, that pricing looks too aggressive and hard to reconcile with a central bank that is accepting a sharply negative real policy rate for multiple months.

We see that pricing as more vulnerable to domestic factors, such as weaker data, and external inputs, such as lower oil prices, than at many other central banks.

We have lost confidence in NZD outperformance

All the above has forced a rethink of our NZD view. Before this morning, we thought a hawkish RBNZ would provide a floor for the currency, particularly against comparable commodity currency peers like AUD. We have completely lost that conviction. We now see dovish repricing

risks and the negative real rate holding back NZD in a risk-sentiment recovery if it is led by lower energy prices.

Our short-term fair value model suggests the NZD/USD sell-off has been too large relative to the move in short-term rate differentials. But we wouldn't trust any relief rally to have very long legs unless it is driven by idiosyncratic USD losses. Our year-end target remains 0.570, although we now see some downside risks rather than the upside risks we saw before this RBNZ meeting.

The NZD outlook looks materially less attractive in the crosses in particular. We have flipped our view on AUD/NZD, especially after a hotter-than-expected Australian CPI print overnight. We see a break above 1.260 as imminent.

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