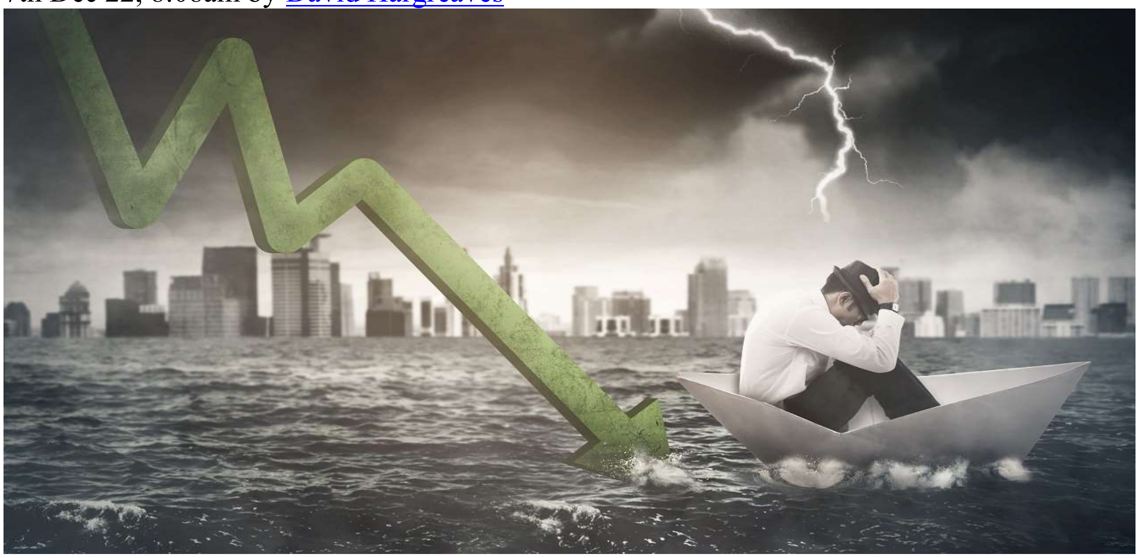
Kiwibank economists say the RBNZ is 'doggedly determined to deliver' OCR hikes and it is 'likely to be too much'; see bigger house price falls now, of 21%, taking prices back to 2020 levels

7th Dec 22, 8:08am by David Hargreaves



Source: 123rf.com. Copyright:

Kiwibank economists are saying the Reserve Bank (RBNZ) is planning to take the Official Cash Rate (OCR) too high.

"The RBNZ are hell-bent on forcing inflation back within its mandated 1-to-3% year-on-year target band. And fair enough, their credibility as an inflation-fighter is being tested," Kiwibank's chief economist Jarrod Kerr, senior economist Jeremy Couchman and economist Mary Jo Vergara say in **Kiwibank's latest Our Take publication**.

"They expect the OCR to hit 5.5% in order to achieve the required economic slowdown. We think a move beyond 5% is a step too far. What the RBNZ will do (hike to 5.5%), is beyond what we think the RBNZ should do. We place a much larger weight on the global slowdown, higher interest rates are effective, and Kiwi are feeling the pinch now," the economists say.

They describe the RBNZ as being "extreme" and say that "seemingly at odds with international developments", it has upped the ante.

"We find ourselves factoring in what the RBNZ is doggedly determined to deliver, and it is likely to be too much.

"We're worried about the impact on Kiwi households and businesses.

"The RBNZ's forecast recession could easily turn into another economic accident.

"First there was too much easing, and now there is too much tightening," the economists say.

They say the housing market appears to have borne the brunt of the tightening in credit conditions to date.

"Sales activity has fallen sharply, and the supply of listed housing has risen to surpass pre-covid levels.

"Across Aotearoa, house prices were down 11% year on year in October and have fallen 12% from the peak. Prices have fallen back to levels seen at the start of 2021.

"Unfortunately, house price declines have further to run.

"The RBNZ's desire to quickly hike the cash rate to 5.5%, with a 75bp move in February on the cards, has already seen mortgage rates take another leg higher.

"Higher mortgage rates will weigh on the market over summer. We are still expecting house prices to be 13% lower in the final quarter of 2022 compared to a year earlier.

"However, annual house price declines are expected to reach 15% in the first quarter of next year.

"The deeper fall now means our new forecast represents a 21% drop from peak to trough and take prices back to levels seen in late 2020."

On the economy in general, the Kiwibank economists say they are starting to see a softening in spending already.

"Our spending tracker showed a third of the categories we monitor dropped in the volume of transactions made over the September quarter; and all were concentrated within discretionary spending. We expect this to continue. Residential property investment is also under pressure. Construction has helped the economy power through the Covid lockdowns. But as residential construction quietens down, Kiwi economic activity will slow.

"The sheer weight of rising interest rates is set to push the economy into recession from the middle of next year. We are forecasting a three-quarter contraction in activity from the June quarter to leave the economy 0.7% smaller at the end of 2023."

The economists say their "central scenario" (core view), is that interest rates will hold near current levels into 2023, and then decline over the year ahead.

"We expect central bank tightening to run its course over the next six months. Markets will position for the next move, of course, being rate cuts. The persistence of inflation, and the need for central banks to see a sharp deceleration in price pressure, is likely to mean cash rates may hold for a while.

"We suspect the tide is already turning, and central banks will be in a position to ease monetary policy by the end of 2023.

"We see wholesale rates declining over the year ahead. The 2-year swap rate is likely to start 2023 over 5%, but end the year around 4.4-4.5% (that's a full 100bps off the recent highs).

Interest rate curves are likely to remain deeply inverted, with long-end rates factoring in much lower growth and inflation rates.

"We are then likely to see a sharp bull-steepening in interest rate curves as rate cuts are ultimately delivered."

They say, given the balance of risks, "with downside risks significantly outweighing upside risks", positioning for lower interest rates and a lower currency "makes sense".