ANZ Research

ANZ New Zealand Insight

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Buying time

Summary

- When the Official Cash Rate was cut 50bp to 1% this week, the RBNZ also quietly repriced a key standing facility. This repricing of the Bond Lending Facility (from 150bp under OCR to 100bp under OCR), prevented it trading at negative interest rates.
- This repricing buys the RBNZ some time, but a broader, communicated strategy for potential unconventional policy is needed.
- As the zero lower bound approaches, the RBNZ could choose to implement negative interest rates, lower long-term interest rates via government bond and swap rates purchases, and term lending facilities.
- But the RBNZ will need to navigate several challenges including risks to the central bank balance sheet, the consequences of a deterioration in bank profitability, and an impairment in market functioning.

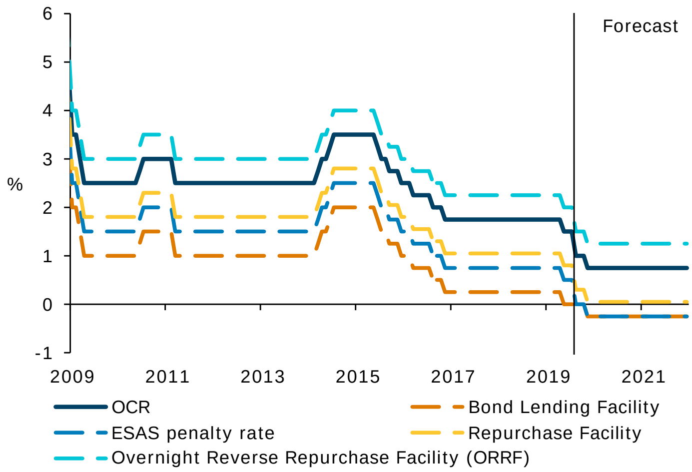
Running low on ammo

The RBNZ's OCR cut this week should have seen the first of its standing facilities (the Bond Lending Facility, priced at OCR less 150bp) attract a negative interest rate. But the RBNZ avoided this by repricing this facility in line with the ESAS penalty rate (OCR less 100bp, ie zero).

This repricing sees the RBNZ and the NZ banking system avoid a negative interest rate for now, but not if we see any more OCR reductions. We are forecasting a 25bp cut in November and see downside risk beyond that.

The ESAS penalty rate is less of a consideration at present as the RBNZ is not looking increasing the supply of liquidity in the banking system, but should unconventional policies like quantitative easing be adopted, we expect the RBNZ to consider repricing the suite of its standing facilities and adjust the credit tier system. Otherwise, with the banking system flooded with excess cash, market overnight interest rates would start trading closer to the ESAS penalty rate than the OCR.

Figure 1. The Official Cash Rate and pricing of RBNZ standing facilities (assuming no further change in pricing)



Source: RBNZ, ANZ Research

But the quick fix doesn't mean that New Zealand rates are currently immune to negative rates. Yesterday, the September 2025 inflation-indexed government bond traded at a yield of 0.00%, tantalisingly close to being the first New Zealand market rate to trade at a negative yield.

There are several unconventional policy options that the RBNZ could take if they conclude that rates need to fall further from here, summarised in table 1 (discussed in detail in our previous note). However, there are also several challenges that the RBNZ will need to navigate and address, including risks to the central bank balance sheet, the consequences of a deterioration in bank profitability, and an impairment in market functioning.

The effectiveness of monetary policy will also diminish as rates move lower from here. Although the RBNZ has claimed that monetary policy is just as effective at low interest rates, they also noted in the August MPS that recent transmission from the OCR to bank funding costs had been dampened by upward pressure on deposit rates (as banks try to retain deposit funding).

Bank funding cost pressures will only intensify as the OCR falls from here, so there is a risk that monetary policy effectiveness does diminish as the OCR approaches, and potentially goes through, 0%. That said, there are multiple channels through which monetary policy operates – the effects of further easing on the NZD, wholesale (rather than bank) lending rates, and inflation expectations channels are also important.

At the press conference, Governor Orr noted that the RBNZ was "well advanced" on unconventional policy work (in contrast to a recent OIA response which noted that the RBNZ was in the "very early stages").

Let's hope that a possible plan for unconventional monetary policy is shared publically soon, so that financial market participants and households can be confident of a smooth rollout of extra stimulus. And with the recent cut to 1%, and an even lower OCR widely expected, the clock is ticking.

Table 1: Unconventional policy options for the RBNZ

Policy	Description	Rationale
Negative interest rates	• Cut the OCR as low as -0.25%. • Reduce the ESAS penalty rates from 100bps to 50bps.	A slightly negative OCR rate, and retention of a tiering system, will mitigate costs to financial participants in the banking system. If the ESAS penalty rate is not reduced and asset purchases occur, the OCR cannot go negative.
Asset purchases and swap transactions	• Transact (receive) swaps. • Purchase NZ government bonds. • Purchase collateralised mortgages.	Asset purchases and swap transactions will lower long-term lending rates and risk premia, and free up liquidity for lending. Available assets for purchase are limited, so a range of securities need to be considered. The RBNZ will bear substantial financial risks.
Term lending facilities	• Introduce long-term cash facilities to inject balances into the banking system.	This helps to ensure liquidity in the banking system during a crisis, but may be less effective outside periods of crisis and market stress.

Source: ANZ Research, Prospects for unconventional monetary policy in New Zealand

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