RBNZ Monetary Policy Review

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Keep calm and carry on

- The RBNZ left the OCR and QE cap unchanged today, as expected.
- The text of the Review emphasised that despite some positive near-term developments, "significant economic challenges remain" and risks remain skewed firmly to the downside.
- The RBNZ reminded markets that they have further tricks up their sleeve if required, and said "we will outline the outlook for the LSAP programme and our readiness to deploy alternative monetary policy tools in our August Statement". We continue to expect the RBNZ LSAP program to be further expanded to a cap of $90bn by August, in a pre-emptive move.

The view

As expected, the RBNZ left the OCR unchanged at 0.25% and the QE program unchanged at a cap of $60bn today.

The RBNZ reiterated several points from the May MPS Policy Assessment:

- "Significant economic challenges remain" and "the balance of economic risks remains to the downside".
- We are dealing with "severe global economic disruption".
- Fiscal policy is the main game in town but "monetary policy will continue to provide significant support".
- Retail interest rates have declined and, reading between the lines, are expected to continue to do so.

The earlier exit out of Level 2 lockdown was acknowledged and welcomed, as was a slightly larger fiscal package than the RBNZ had assumed in the May Statement. These developments plus our success containing COVID-19 locally ("for now") were seen as giving "cause for some confidence".

However, in a dose of bracing realism the RBNZ was at pains to point out that both in New Zealand and globally we can expect "lower economic activity, employment, and inflation". We've beaten back Covid-19, but there is a gaping hole in the economy where international tourism used to be, and that has unpleasant implications for the labour market. We may be in the best case scenario, but it's really not a great one.

The higher exchange rate got an explicit mention, but this was framed as a headwind for the economy, as opposed to a development the RBNZ was actively looking to lean against just yet. The RBNZ would no doubt prefer a lower exchange rate, but it's not clear that the NZD *should* be lower given how well placed New Zealand is relative to other countries. However, reiterating that foreign asset purchase remain an option at the table suggest there is less tolerance for further appreciation from here.

The RBNZ was keen to point out that it has plenty of ammunition left. In the August Statement we can look forward to an outline of the outlook for the LSAP (QE) program and "our readiness to deploy alternative monetary policy tools". We continue to expect the LSAP program cap to be extended from $60bn to $90bn in August. The RBNZ will not be bumping into its current limits by then, but will be keen to reassure markets that they won't any time soon. But they are not interested in frequent small tweaks: changes "need to be of sufficient magnitude to make a meaningful difference."

The Summary Record of Meeting acknowledged the bounce in the high-frequency data as New Zealand exited lockdown, but noted that "household and business confidence… weak," with considerable uncertainty surrounding the outlook for investment and consumption. That's certainly true, but it's clear that there is a large hole in the New Zealand economy where tourism used to be, and a deep recession is underway regardless of how the usual feedback loops play out.

The Committee sounded content as regards the impact of the LSAP program so far, in that financial markets "are functioning well and… the NZ government bond yield curve has flattened", as well as mortgage and deposit rates declining. That said, "the Committee agreed that it is not yet clear whether the monetary stimulus delivered to date is sufficient to meet its mandate." With such an unprecedented shock, it's difficult to disagree with that assessment. In particular, we concur that "the possible negative outcomes remain severe and larger than any near-term upside surprises."

It is in that light that one should interpret the fact that "staff are working towards ensuring a broader range of monetary policy tools would be deployable in coming months, including a term lending facility, reductions in the OCR, and foreign asset purchases, as well as reassessing the appropriate quantum of the current LSAP."

All hands on deck.

Market reaction

No change to the OCR as expected, but the tone of today's OCR Review was very dovish, reinforcing forward guidance and reiterating the easing would continue. The RBNZ also left the door open to more easing in the form of OCR cuts, an increase to the LSAP and other tools including foreign asset purchases, with more information forthcoming in August.

But although an inclination towards more easing was clear, the emphasis was on LSAP, rather than negative interest rates. This nuances the market reaction, with the market pricing in an expansion of LSAP, pushing curves lower and flatter. However, the threat of a lower OCR (or even negative next year) was not overplayed, keeping the short end well anchored.

Although the long end has been a bit unloved of late, and will struggle a bit into issuance next month, some comfort should come from the explicitly mention that "a change in the size of the [LSAP] programme would also need to be of sufficient magnitude to make a meaningful difference", which lends itself to another "big bang" announcement in August such as we are forecasting. We think this was as least as dovish as the Bank could have been.

Such a strongly worded comment also begs the question; will we see a tactical tilt in LSAP purchases toward the longer end, or see an increase in the pace this week? We might. We suspect that if the RBNZ goes down the path of foreign asset purchases, it would do so while also increasing NZGB purchases, which should contain the slope of the curve, issuance notwithstanding.

The message for the currency market seems clear though, with the Bank explicitly mentioning that "the appreciation of New Zealand's exchange rate has placed further pressure on export earnings", and keeping the option of foreign asset purchases on the table.

Text of Statement

Tēnā koutou katoa, welcome all.

The Monetary Policy Committee agreed to continue with the Large Scale Asset Purchase (LSAP) programme aimed at keeping interest rates low for the foreseeable future. The LSAP quantum remains set at $60 billion. The assets included are New Zealand Government Bonds, Local Government Funding Agency Bonds, and NZ Government Inflation-Indexed Bonds. The Committee is committed to reviewing this quantum at regular intervals, with a focus on achieving its remit. The Official Cash Rate (OCR) is being held at 0.25 percent in accordance with the guidance issued on 16 March.

New Zealand has contained the spread of COVID-19 locally for now, enabling a relaxation of social restrictions and an earlier resumption of domestic economic activity than assumed in our May Monetary Policy Statement. The Government's intended fiscal stimulus, announced in its May Budget, was also slightly larger than we assumed. These outcomes give cause for some confidence but significant economic challenges remain.

The severe global economic disruption caused by the COVID-19 pandemic is persisting, leading to lower economic activity, employment, and inflation abroad and in New Zealand. The negative economic impact on New Zealand is exacerbated by the required international border restrictions, as the vast majority of the world battles to contain the pandemic. The appreciation of New Zealand's exchange rate has placed further pressure on export earnings.

The main support for the economy in this environment is appropriately being provided through increased fiscal spending. However, monetary policy will continue to provide significant support.

As outlined in our May Statement, the balance of economic risks remains to the downside. The LSAP programme aims to continue to reduce the cost of borrowing. Retail interest rates have declined with lower wholesale borrowing costs. It remains in the best long-term interests of the banking sector to promptly maximise the effectiveness of our LSAP programme.

The Monetary Policy Committee is prepared to provide additional stimulus as necessary. As well as potentially expanding the LSAP programme, the Committee continues to prepare for the use of additional monetary policy tools as needed.

The Committee's decisions are guided by the Reserve Bank's mandate and its decision making principles on the use of alternative monetary policy instruments. We will outline the outlook for the LSAP programme and our readiness to deploy alternative monetary policy tools in our August Statement. We are committed to meeting our inflation and employment mandate.

Meitaki, thanks.

Record of Meeting– interim policy review June 2020

The Monetary Policy Committee agreed that global economic activity has been severely affected by the COVID-19 pandemic. Measures to mitigate the pandemic have resulted in a global economic downturn and severe disruption to international trade.

The global restrictions introduced to mitigate the spread of the virus have provoked a severe downturn in New Zealand as well. The full set of evidence is not yet available to determine how the pandemic is affecting the economy, but the Committee agreed that the June quarter data will show a substantial decline in economic activity. The economic risks remain to the downside despite some high-frequency data suggesting that demand has increased since the end of Alert Level 2 restrictions.

The Committee agreed that the extent of the continued job losses and reduced activity remains uncertain. It noted that much will depend on how willing households and businesses are to spend or invest in the current uncertain environment. Members noted that household and business confidence remain weak.

The Committee discussed the importance of fiscal and monetary policy support in lifting economic activity and employment. Members noted that announced fiscal policy measures are expected to support economic activity. The extent of recovery will depend in part on the impact of these policy measures and the speed with which they are implemented.

Members discussed the improvements in the outlook since the May Monetary Policy Statement. It was noted the move to Alert Level 1 arrived sooner than assumed in the Statement, bringing an earlier lift in retail spending and general activity. The Government's fiscal spending intentions outlined in its May Budget were also larger than assumed, implying more spending support than estimated in the Statement.

The Committee acknowledged that some trading-partner economies have begun to relax their restrictions on business activity, providing some confidence on the outlook for New Zealand's export demand.

However, members noted that these positives could be short-lived given the fragile nature of the global pandemic containment. The Committee agreed that current disruptions to supply chains and international travel – including tourism – will persist and constrain growth and employment. Members also noted that the exchange rate has appreciated since the May Statement, dampening the outlook for inflation and reducing returns for New Zealand exports.

The Committee discussed the effectiveness of the Large Scale Asset Purchase (LSAP) programme so far. Members noted that financial markets are functioning well and that the NZ government bond yield curve has flattened. The Committee noted that mortgage rates have declined since the May Statement, reducing the cost of borrowing for households and businesses. Members noted that these mortgage rate declines have been accompanied by similar declines in deposit rates.

However, the Committee agreed that it is not yet clear whether the monetary stimulus delivered to date is sufficient to meet its mandate.

Members discussed risks to the economic outlook. It was noted that risks remain skewed to the downside as outlined in the May Statement, despite the marginally stronger starting point for the New Zealand economy.

Due to worldwide uncertainty about the pandemic containment, the possible negative outcomes remain severe and larger than any near-term upside surprises. Added to these concerns was the challenge of phasing out various Government support schemes – in particular the wage subsidy – which could lead to further job losses. The Committee agreed that the labour market is severely disrupted, with data on wages, hours worked, participation, and utilisation all important for assessing aggregate demand and supply capacity.

The Committee noted that any potential easing in international border restrictions could provide a boost to the New Zealand tourism and education sectors, however it acknowledged this is highly dependent on the virus remained sufficiently contained in other parts of the world.

The Committee discussed the secondary objectives of monetary policy. Members noted that financial stability is being supported by the ongoing monetary stimulus. A prolonged downturn could undermine financial stability, so it is important that there is sufficient monetary stimulus to achieve the goals of monetary policy. The Committee noted that Reserve Bank staff will provide a more detailed briefing on financial stability for the August monetary policy decision.

The Committee discussed the range of available policy tools. It was noted that the existing LSAP programme is continuing to ease monetary conditions.

Members discussed the pros and cons of expanding the LSAP programme now. Members noted that any expansion would need to be driven by the economic outlook and assessment of the effectiveness of the programme. A change in the size of the programme would also need to be of sufficient magnitude to make a meaningful difference.

Members noted that staff are working towards ensuring a broader range of monetary policy tools would be deployable in coming months, including a term lending facility, reductions in the OCR, and foreign asset purchases, as well as reassessing the appropriate quantum of the current LSAP.

The Committee reached a consensus to continue monetary easing through the existing LSAP programme and to keep the OCR at 0.25 percent.

Attendees

Reserve Bank staff: Adrian Orr, Geoff Bascand, Christian Hawkesby, Yuong Ha

External: Bob Buckle, Peter Harris, Caroline Saunders

Observer: Tim Ng

Secretary: Gael Price

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