ANZ Research

RBNZ MPR Preview

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Hold the door

Key points

- We expect a dovish tone at next Wednesday's Monetary Policy Review, reiterating that a lower OCR and bank "funding for lending" program are next up.
- In our view the RBNZ is unlikely to change its forward guidance that the OCR will be left unchanged until March.
- We also expect the RBNZ to continue its evolution towards a more tactical approach to its weekly LSAP purchases, given recent curve steepening.

RBNZ to hold the door open to a negative OCR

The New Zealand economy is in the eye of the storm as regards the impacts of COVID-19. "Lockdown Lite" has certainly been tough on the Auckland hospitality sector and the national events industry, but will have nothing like the impact on the aggregate economy of the initial lockdown, which contributed to the 12.2% fall in GDP in the June quarter. The economy that the Finance Minister described in March as an "oven", slow to warm after being switched off, turned out to be a microwave. Activity rebounded quickly as the elimination of COVID set the scene for a rapid near-normalisation of activity over June and July.

However, massive, front-loaded fiscal stimulus had an enormous amount to do with that, and has masked the underlying state of affairs. The tsunami of support spending by the Government is clearly unsustainable. The COVID-19 Relief Payment (the higher benefit for the newly unemployed) and the generous initial round of wage subsidies are now starting to roll off, but it's still very early days. In addition, the extreme seasonality of tourism means that the bulk of the hit to national income on that front is also yet to be felt. The usual influx of tourists simply won't arrive this summer. Net migration has also plummeted (to -26 people in July), but there's always a lag of up to six months before the economic impact of net migration really becomes noticeable.

The Reserve Bank is aware of all of this. Its August Monetary Policy Statement forecast annual average GDP growth of -6.1%, an unemployment rate of 8%, and CPI inflation of just 0.4% in March next year. No wonder they sounded so focused on delivering maximum stimulus. We expect that they will hit a similar tone this time.

Since the August MPS,

- Q2 GDP fell a bit less (-12.2%) than they expected (-14.3%), but this is neither here nor there.
- The trade-weighted exchange rate is bang on their Q3 assumption.
- The housing market has shown a surprising degree of resilience. The RBNZ expected price falls in the June, September and December quarters (-8.9% y/y by March 2021). They'll be revising that up.
- The preliminary Business Outlook for September suggested firms are of assuming that the return COVID-19 to our communities will not derail things any further.

Though the data-flow has certainly not been one way, the RBNZ will have their eyes firmly on the medium term, where their forecasts will still be telling them times are going to be very rough, with unemployment too high, and inflation too low.

The RBNZ has made it clear that if further monetary stimulus is deemed necessary next year, a lower, potentially negative, Official Cash Rate is the next cab off the rank. It would be accompanied by a bank "funding for lending" scheme to protect the flow of credit and enable retail deposit and lending rates to move lower than otherwise.

The RBNZ is unlikely to have much more to say on that subject, given it is only just kicking off research into how a scheme would look, including consultations with banks and others. There are also no published forecasts at a Review.

Rather, the main interest for markets will be twofold: any change to forward guidance regarding the timing of OCR cuts, and any hints of changes to the implementation of the Bank's Large Scale Asset Purchase programme (QE).

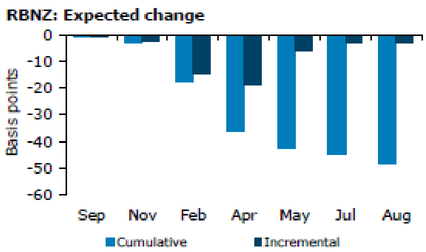
The RBNZ back in March made a commitment to keep the OCR unchanged for 12 months. That is a slightly awkward time-frame, as the commitment was made at an emergency inter-meeting cut. The deadline falls between a Monetary Policy Statement on 24 February, and a Monetary Policy Review in mid-April. The market has therefore started pondering whether "close enough" might be "good enough", putting February in play, despite the RBNZ's frequent reiteration of its guidance.

In a macroeconomic sense, a few weeks is neither here nor there. However, in a strategic sense, it matters. The RBNZ will be concerned that breaching their word, no matter how trivially, would undermine the power of forward guidance going forward. As the recovery evolves, convincing the market that they won't raise the OCR for a period come hell or higher inflation will be important for keeping long-term interest rates low. The RBNZ has taken a "least regrets" approach to policymaking in recent times – we believe they will conclude that they would regret damaging their credibility more than they'd regret a few weeks of delay.

In any case, the RBNZ will be able to deliver much of the easing in advance by simply clearly signalling that it's coming, by including it in their published forecasts at the next Monetary Policy Statement in November. Everything but very short-term rates will adjust immediately. The OIS market is already pricing 36bp of cuts by April (figure 1).

Figure 1. Current market pricing for OCR cuts

New Zealand	**Rate**	***Change***
Current Rate	*0.25*	***from current***
Wed 23 Sep 20	0.24	*-0.01*
Wed 11 Nov 20	0.22	*-0.03*
Wed 24 Feb 21	0.07	*-0.18*
Wed 14 Apr 21	-0.11	*-0.36*
Wed 26 May 21	-0.17	*-0.42*
Wed 14 Jul 21	-0.20	*-0.45*
Wed 18 Aug 21	-0.23	*-0.48*



Source: Bloomberg, ANZ Research

A potential counter-argument is that the RBNZ could get more bang for its buck on the exchange rate front via the element of surprise. But breaching your frequently reiterated commitment isn't the right kind of "surprise". If the RBNZ decides to go for shock value, cutting 75bp rather than 50bp is a more likely strategy, in our view.

We expect the RBNZ will expand the size of the LSAP programme again in time, but there is no urgency to do so. We anticipate an increase to $120bn in November, to stave off any impression that the programme is going to run out of headroom any time soon. But it will, eventually, which is why the RBNZ has laid out a path for what comes next. However, the details regarding the funding for lending programme remain some time off and we don't expect they'll have anything more to say about it at this Review.

In August the RBNZ adopted a tactical approach to QE implementation, with the MPC granting RBNZ staff the ability to adjust the pace of weekly LSAP purchases. This flexibility has been exercised, but not to the degree we would have expected given the steeper curve, reduction in cash in the banking system and strength of the NZD. At this regular six-weekly check-in, with the NZGB curve now a lot steeper than it was a month ago, we would not be surprised if the MPC asked RBNZ staffers to be more liberal in their application of tactical flexibility. Reminding markets of their flexibility in the Review might help push down long-end yields a bit, but in practice, actions speak louder than words.

We expect the RBNZ to also remind the market that it is open-minded about foreign asset purchases. This has been a constant since the May easing, alongside the commitment to leave the OCR on hold for at least 12-months, and they're unlikely to drop it now. We don't ever expect this to be a core part of the policy mix, but the domestic bond market is small and that limits QE in the traditional sense, and a lower NZD would help the economy. So it's less about buying foreign assets to target a particular level of the NZD and more about being ready to do so for practical reasons, knowing that at the margin it would likely negatively impact the exchange rate.

Looking forward, we continue to expect the Reserve Bank to cut the OCR by 50bp to -0.25% in April. The odds are skewed to more rather than less – a negative OCR looks a done deal. We remain sceptical about the risks associated with it in a New Zealand context. A well-designed funding for lending programme can certainly ameliorate many of the immediate risks to credit supply and ensure the easing is in fact stimulatory. Bigger questions around the long-term consequences of artificially elevated asset prices and risk-mispricing would remain, but the RBNZ will conclude that these can be addressed down the track if required.

Market implications

This Policy Review is something of a placeholder, but at the margin the RBNZ might hope to put a little downward pressure on the long end of the curve via a dovish tone and a reminder that it now has the ability to take a more tactical approach to its weekly bond purchases.

For the short end, any weakening of the commitment to keep the OCR unchanged until March would certainly cause a flurry of excitement, but this is not our expectation. With pricing for February OIS consistent with an OCR of 7bp, another reiteration of previous guidance may cause some minor drama.

As regards the currency, the RBNZ has sounded a somewhat resigned tone regarding its resilience, and indeed it's now officially no surprise, as they assumed as much in August. But reiterating that foreign purchases are possible and that a negative OCR is likely on the way will help keep a lid on things to some extent.

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