ANZ Research

RBNZ Monetary Policy Statement

12 August 2020

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Keeping the foot to the floor

- RBNZ today increased their quantitative easing (LSAP) programme to $100bn and extended its length from 12 to 22 months.
- As regards potential alternative policy options beyond the LSAP, the RBNZ expressed a preference for a lower or negative OCR and a 'Funding for Lending Programme', while leaving all options on the table.
- The OCR will remain unchanged at 0.25% until March 2021 but the odds of lower rates beyond that have risen.
- It is hard to imagine a more dovish set of policies and commentary today – yields and the NZD both fell in response.

QE programme

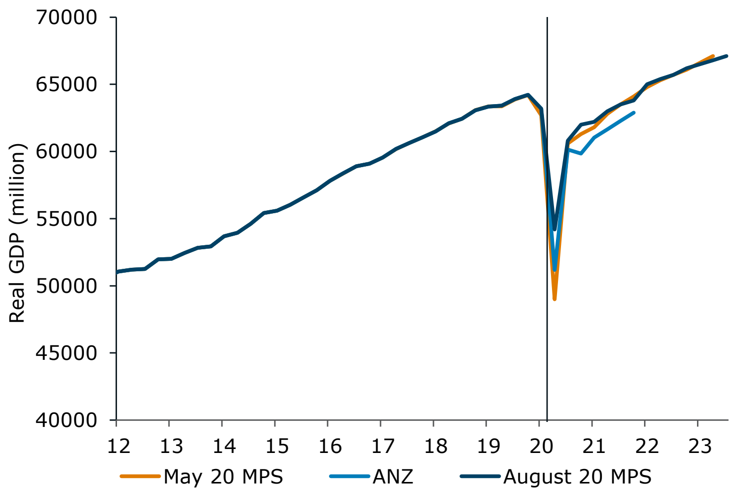
The RBNZ's Large-scale Asset Purchases (LSAP) programme was scaled up from $60bn to $100bn, even more than we were expecting. This was based on "updated staff advice that central bank purchases could absorb a larger proportion of the total market than previously thought without affecting market functioning." In addition, "Members noted and endorsed staff advice that a larger LSAP programme would mean purchases could be front-loaded in order to put more downward pressure on New Zealand wholesale interest rates."

Forecasts

Like everyone's, the RBNZ's freshly minted forecasts are out of date now that community transmission of COVID-19 has returned. Given this, we see little point diving into the details. However, for the record, the economic forecasts were upgraded a touch from May's MPS, largely reflecting an upgrade to Q2. The medium-term outlook was virtually unchanged, signalling a continued cautious view of the outlook.

The RBNZ reiterated that the OCR would remain unchanged at 0.25% until at least March 2021, but gave no forecasts after that. The unconstrained OCR track was broadly unchanged, with today's increase in the LSAP working against the recent appreciation of the TWI.

Figure 1. RBNZ GDP forecast May and August MPS



Source: RBNZ, Statistics NZ

Alternative tools

The RBNZ expressed a strong openness to provide more stimulus if necessary. All tools are still on the table, but the summary of meeting noted that "The Committee expressed a preference for considering a package of a negative OCR and a 'Funding for Lending Programme' in addition to the current QE programme." And, "The Committee instructed staff to prepare advice on the design of a package for deployment if deemed necessary, taking account of the operational readiness of the financial system." They also kept foreign asset purchases on the table, but it is down the list at this stage.

We've discussed a negative OCR at length, but the 'Funding for Lending' programme perhaps requires a bit more explanation. The two policies are very much seen as a complementary "package", with the RBNZ commenting that the "exact design of a negative OCR policy can help to ensure that it is effective. In addition, the policy may be more effective if combined with other monetary instruments." The Funding for Lending Programme would provide banks directly with "low-cost, secured, long-term funding", meaning funding costs would continue to decline with the OCR even if the cost of wholesale or deposit funding does not. Overseas, such programmes have tended to have conditions regarding lending growth attached, often to SMEs.

Bottom line

The job facing the RBNZ has only gotten bigger. QE is working well but requires a bit more ammunition, delivered today. However, QE will likely hit its limits before the economy is out of the woods. Next year, when the financial system is technically ready, we absolutely can't rule out the possibility of a negative OCR. The bad news delivered last night has ramped up uncertainty, but certainly done nothing to reduce the odds of further OCR cuts next year.

More broadly, today's Statement has significant implications for markets, with

- the new $100bn LSAP beating even our top-of-market call for $90bn,
- the time-frame extended from 12 months to 22 months (to June 2022),
- a preference for a negative OCR; an open mind on foreign asset purchases,
- front-loaded bond purchases, with an immediate increase in next week's LSAP schedule, signalling a move to a more tactical approach, and
- an indemnity that allows for the purchase of more bonds.

Short of cutting the OCR today, it's difficult to imagine a more dovish outcome than what we have seen. And if anyone thought this was a last-minute decision, it wasn't: the RBNZ letter to the Finance Minister asking for the indemnity to be upsized to 60% of outstandings was dated August 6th.

In our view, this speaks to the whole term structure of interest rates going lower, with the prospect of negative rates driving the short end lower, and the larger than expected LSAP driving the long end lower. Against the global backdrop of inflation fears, we expect NZGBs to outperform global peers, and for the NZD to be under significant pressure over coming weeks.

Market reaction

Interest rates moved lower on the news, but they had already drifted off ahead of the MPS in the wake of last night's news that COVID-19 was back in the community. NZGB 23s and 29s were both around 3 basis points lower, but we think that's just the start and we will see a further extension to the downside as the week and month progresses. The NZD moved 30-40bps lower immediately, but has since recovered part of the move. Given how dovish the tone was, we see a real risk that the NZD weakens further in coming weeks as the gravity of today sinks in.

Policy Assessment

Tēnā koutou katoa, welcome all.

The Monetary Policy Committee agreed to expand the Large Scale Asset Purchase (LSAP) programme up to $100 billion so as to further lower retail interest rates in order to achieve its remit. The eligible assets remain the same and the Official Cash Rate (OCR) is being held at 0.25 percent in accordance with the guidance issued on 16 March.

Reflecting a possible need for further monetary stimulus, the Committee also agreed that a package of additional monetary instruments must remain in active preparation. The deployment of such tools will depend on the outlook for inflation and employment. The package of further instruments includes a negative OCR supported by funding retail banks directly at near-OCR (a Funding for Lending Programme). Purchases of foreign assets also remain an option.

Over recent months New Zealand had contained the spread of COVID-19 locally, allowing a relaxation of social restrictions and a recovery in economic activity. Recent indicators highlight that the faster return to social norms and a higher proportion of employees working from home has seen output and employment recover sooner than projected in our May *Monetary Policy Statement*. Recent spending also reflected pent up demand resulting from the lockdown period.

However, the severe global economic disruption caused by the pandemic is persisting. Any significant change in the global and domestic economic outlook remains dependent on the containment of the virus, which is highly uncertain as evidenced today by the return to social restrictions in New Zealand. Such uncertainty is stifling household and business spending appetites, as highlighted in confidence surveys. Given the ongoing health uncertainty, there remains a downside risk to our baseline economic scenario.

International border restrictions will continue to significantly curtail migration and tourism, and lead to the activity outlook being uneven across industries and regions. Commodity prices for New Zealand's exports remain robust, but this has been partly offset by a rise in the New Zealand dollar exchange rate moderating the return to local export producers.

Ongoing support for domestic economic activity is being provided through significant government spending on business assistance and household income support. This will be supported by a rising level of government investment. However, there will be a transition of policies in the near-term, with the announced end of the Wage Subsidy likely to coincide with a decline in employment.

Monetary policy will continue to provide important economic support in the period ahead. Its effectiveness is evidenced by retail banks' lower funding costs and lending rates, which are benefiting businesses and households. It remains in the long-term interest of banks to fully pass on the benefits of lower funding costs to their customers.

The Monetary Policy Committee will provide additional stimulus as necessary to meet its remit.

Meitaki, thanks.

Adrian Orr
Governor

Summary record of meeting

The Monetary Policy Committee (MPC) discussed the outlook for inflation and employment, and whether current monetary conditions will achieve its policy remit. The ongoing economic effects of the COVID-19 pandemic were central to the discussion. Members agreed that significant uncertainty existed as to virus containment, and that this was dampening economic confidence globally.

The Committee noted that New Zealand had contained the local spread of the virus, thereby enabling the relaxation of social restrictions. Members agreed that recent domestic economic activity and employment had been stronger than expected in the May Monetary Policy Statement. They noted that this was largely due to the earlier than assumed relaxation of social restrictions, a higher proportion of people working from home, and the pent up demand that arose due to the lockdown period.

The Committee noted that the recovery in economic activity had been uneven across industries and regions, with ongoing international border restrictions severely curtailing migration and services' export earnings – such as tourism and foreign student education. The Committee noted that domestic economic activity remains below the level it was at prior to the COVID-19 outbreak, and that a sustainable recovery in investment and employment depends on both the degree to which the virus is contained effectively and on a reduction in uncertainty in the general economic environment. Members noted that fiscal policy continues to provide the primary support to the economy, as is appropriate given the pace and scale of the economic shock.

Members agreed that global uncertainty is significantly dampening consumer and business confidence to spend, invest, and employ over the near term. As a result the Committee agreed that the outlook for global economic activity remains weak. It also noted that a rise in the New Zealand dollar exchange rate has moderated local exporters' incomes.

Members discussed the balance of risks to the baseline economic scenario prepared for the August Statement. Members agreed that, given the primary economic risks are health-related, as evidenced by recent events, the economic risks remain to the downside. The Committee noted a risk that persistent low inflation and employment become embedded in people's expectations, creating the need for more monetary stimulus than otherwise.

The Committee discussed the current effectiveness of monetary policy. The Committee agreed that monetary policy remains effective and has a strong support role for the economy through improving cash-flow, increasing the incentive to invest, and keeping the exchange rate lower than otherwise. Members agreed that these transmission channels are important for the Committee to achieve its remit and would be important for enabling any necessary resource reallocation during a recovery.

Members noted that retail interest rates have declined consistent with the lower funding costs brought about by the recent monetary easing. The Committee also agreed that it remains in the best long-term interests of banks to continue to pass on the lower wholesale interest rates to their customers, and to maintain the supply of credit.

The Committee then discussed the appropriateness of current monetary settings for achieving its remit. The Committee agreed that, given the weak economic outlook, low inflation and employment, further monetary stimulus is needed to achieve its remit objectives.

The Committee discussed the monetary policy strategy having regard to the soundness and efficiency of the financial system, and to avoiding unnecessary instability in output, interest rates and the exchange rate.

Members weighed the risks associated with potential actions in pursuit of achieving the operational objectives of the remit against the risks and consequences of insufficient monetary stimulus. On balance, the Committee agreed that a deep and protracted economic downturn with high unemployment would pose a more serious risk to financial stability.

Members discussed the implications of alternative monetary policy tools for financial stability. The discussion covered the tools that are being considered, noted the lessons and experiences from other central banks, and considered the calibration of a package of monetary instruments. The Committee agreed that a lower or negative OCR, a Funding for Lending Programme, purchasing of foreign assets, and interest rate swaps all provided policy optionality.

The Committee noted staff advice that the design features of each tool could be selected to maximise effectiveness and reduce risks to financial stability. The Committee expressed a preference for considering a package of a negative OCR and a 'Funding for Lending Programme' in addition to the current Large Scale Asset Purchase (LSAP) programme. The Committee instructed staff to prepare advice on the design of a package for deployment if deemed necessary, taking account of the operational readiness of the financial system.

The Committee agreed that the most immediately available suitable tool is an expansion to the Large Scale Asset Purchase (LSAP) programme. The Committee discussed expanding the LSAP programme with the aim of adding more stimulus by lowering retail interest rates and the exchange rate.

Members noted the increase in New Zealand's sovereign debt issuance, which means that the market for bonds is now larger than previously. The Committee noted updated staff advice that central bank purchases could absorb a larger proportion of the total market than previously thought without affecting market functioning. Members noted and endorsed staff advice that a larger LSAP programme would mean purchases could be front-loaded in order to put more downward pressure on New Zealand wholesale interest rates.

The Committee agreed that an increased LSAP limit of up to $100 billion by June 2022 would enable the Bank to implement purchases to lower wholesale interest rates. Members agreed that the Bank should retain the flexibility to adjust the pace and composition of bond purchases as market conditions dictate.

The Committee also agreed that any future move to a lower or negative OCR, if complemented by a Funding for Lending Programme, could provide an effective way to deliver monetary stimulus in addition to the expanded LSAP if needed.

On Wednesday 12 August, the Committee reached a consensus to:

- expand the LSAP programme to purchase up to a maximum of $100b by June 2022;
- direct the Bank to actively prepare a package of additional monetary policy tools, to be deployed if and when the outlook for inflation and employment requires additional stimulus, taking into account operational readiness; and
- hold the OCR at 25 basis points in accordance with the guidance issued on 16 March.

Attendees

Reserve Bank members of MPC: Adrian Orr, Geoff Bascand, Christian Hawkesby, Yuong Ha

External MPC members: Bob Buckle, Peter Harris, Caroline Saunders

Treasury Observer: Caralee McLiesh

MPC Secretary: Gael Price

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