ANZ Research

RBNZ Monetary Policy Statement

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Putting it all on the table

- RBNZ today increased their quantitative easing budget to $60bn, as expected.
- The OCR was unchanged, and forward guidance remains that it will be unchanged for 12 months. There was no forecast of the OCR after that.
- On the prospect of taking the OCR negative after that, the RBNZ noted that they are asking banks to prepare for the possibility.
- Risks are skewed towards QE being expanded in time, and we would not rule out OCR cuts into negative territory next year, though that would be a risky move, in our view.

Today the RBNZ announced an increase in their quantitative easing (QE) program from $33bn to $60bn, in line with market expectations. They also reiterated that the OCR would remain unchanged at 0.25% until at least March 2021. However, that was where their OCR forecast stopped, with the RBNZ wanting to leave open the option of negative rates but not wanting to commit to it at this stage. We think this is wise, as negative rates are a risky proposition in the New Zealand context, but keeping open the threat of them will help dampen short interest rates in the meantime, maximising monetary stimulus.

Whether they will need to be deployed when that time comes will depend crucially on the outlook and scope for recovery into next year. In the meantime, "Members agreed that the LSAP programme can be scaled as needed in future," and said, "there are policy tools available that have not yet been used."

Regarding negative interest rates, the RBNZ revealed in March that it was actually operational constraints that drove the forward guidance that the OCR would be unchanged at 0.25% for 12 months, rather than a strong judgement on how low the OCR can usefully go. That remains the case, with the RBNZ noting that "discussions with financial institutions about preparing for a negative OCR are ongoing."

In the meantime, though, it's all about quantitative easing, and this tool is working well, with the bond yield curve moving progressively lower and flatter to date and credit spreads narrower (and we expect those trends to continue). The size of the QE package has been increased to $60bn, as we expected. Given the RBNZ has spent around $10bn already, an upgrade was warranted. Most importantly, the increase gives the RBNZ the scope to buy approximately the same volume of NZGBs as the Treasury are expected to issue between now and the end of Fiscal 2020/21 (ie mid next year).

The RBNZ emphasised the role of fiscal policy, "Members noted that the main thing needed to support the economy is fiscal stimulus, given that fiscal policy is best placed to directly support households and businesses. The role of monetary policy is to support the economy by ensuring that interest rates remain low, which will complement the effects of fiscal measures."

That is, the Reserve Bank is doing its bit, but now all eyes turn to arguably the bigger event of the week, tomorrow's Budget. That'll include a whopping debt issuance profile that'll provide the RBNZ with plenty of bonds to buy.

The nuances of the macroeconomic forecasts are less important at this juncture. "The sharp contraction in activity is expected to reduce inflation and employment below the Bank's objectives for several years." 'Nuff said.

But the RBNZ did outline three alternative scenarios to demonstrate some of the possible paths the economy might take. Their baseline scenario sees GDP contract 2.4% in Q1 and 21.8% in Q2, which is very similar to our own outlook, but their assumed rebound is a touch stronger than ours. They see GDP 8½% lower this year as we do. That said, uncertainty around both our outlooks is extreme. Interestingly, the RBNZ's baseline forecasts assume almost the full $52 billion provisioned by the Government to respond to the COVID-19 shock will be used. A Budget package lower than $30 billion tomorrow could represent a mild downside risk to their baseline outlook.

The forecast OCR track is truncated, merely showing the forward guidance that the OCR will be left unchanged at 0.25% until March 2021. But there it stops. To indicate desired stimulus, the RBNZ instead published a forecast of the "unconstrained" OCR, ie where they think the OCR "should" be to achieve the RBNZ's objectives, if only it were possible. A range of tools, QE in particular, can then be used to achieve that degree of stimulus in practice. In short, this is a non-technical explanation of the shadow short rate we have talked about before. It shows current stimulus as equivalent to -2% on the OCR in terms of how it is impacting the yield curve. Maximum stimulus is -2.4% in March 2021 before increasing to -0.2% at the end of the projection (June 2023). It is important to note that the negative sign here does not mean that this stimulus necessarily has to be brought about by negative rates. QE is important too. The RBNZ estimates that we are already at the equivalent of -2% with the actual OCR at +0.25%. As the bond curve goes lower and flatter in response to today's announcement as we expect, more stimulus could be generated than currently assumed – and that wouldn't be a bad thing.

The RBNZ's forecasts showed scenarios in which the economic impacts might be worse and more stimulus might be required. However, there are upside risks too, with the RBNZ's baseline assuming Alert Level 2 for ten months and no trans-Tasman bubble. The Reserve Bank also noted the risk of upward pressure on some prices due to shortages but did not consider this risk "material" in the scheme of things. We concur.

We see risks as skewed towards the RBNZ needing to do more in time, particularly on the QE front. However, much will depend what will happen from here and we will wait a little longer to see how conditions unfold, the outlook for fiscal policy and how markets react before calling more stimulus at this stage. We continue to see QE as the weapon of choice for now.

Bottom line

The Reserve Bank has a big job on its hands. The tools it has employed so far are working well but require a bit more ammunition. The Minister of Finance would not have hesitated before signing off on the larger QE budget that will smooth the path of raising the funds to pay for the enormous fiscal stimulus that will be required over the next year or two.

Although COVID-19 is firmly on the retreat in New Zealand, it is wreaking economic devastation abroad. And the balance sheet damage done in the last couple of months in New Zealand is huge. It's going to be a long slog out, and both fiscal and monetary policy will need to do their bit to help the economy recover. A ramping up of both the size and breadth of the QE program is certainly possible, with purchases of foreign assets to dampen the exchange rate potentially on the cards. And next year, when the financial system is technically ready, we can't rule out the possibility of negative interest rates, though we are highly dubious that they would be effective in stimulating economic activity. In the meantime, even the possibility will help keep interest rates low, and that all helps.

Markets

In our view, today's policy announcements will see the NZGB curve continue to go lower and flatter. Not only did the market deliver at the upper end of market expectations with respect to the volume of QE, but they have also left the possibility of a negative OCR on the table. However, as they maintained the March forward guidance stating that the OCR would remain on hold for at least 12 months, the short end obviously has some adjusting to do.

This makes OIS expectations somewhat binary until around March 2021, but for the long end the signal is clear: the RBNZ is of a mind to do more, not less, and the NZGB curve needs to go lower yet to reflect that. The 10-year NZGB is already well below US and Australian equivalents, and this should see yields go lower yet, with the 0.25% OCR the first potential target. The inclusion of linkers in the QE programme will assist too, although we will need to see what volume the RBNZ intends to buy each week. Our feeling is that it is likely to be relatively small.

Today's action will also weigh on the Kiwi. Although we did not see an OCR cut today, negative rates are on the table, as are foreign bond purchases: "The Committee agreed that it will stand ready to deploy further tools as needed, should the need for stimulus continue to increase. Tools available include further reductions in the OCR; a term lending facility; and adding other asset classes, such as foreign assets, to the LSAP programme."

Buying foreign bonds could happen either because the RBNZ runs out of NZ bonds to buy (ie starts to approach the limit of its appetite for the proportion of NZGBs it owns, which they have informally said to be 40-50% of outstandings) and/or because they want the NZD lower. The RBNZ's tone certainly differs dramatically from that of the RBA, who have scaled back their bond purchases, and the Fed's, with many of the Federal Reserve District Presidents overtly unenthusiastic about negative rates.

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