ANZ Research

RBNZ Announces Quantitative Easing

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Contact

David Croy
Strategist
Telephone: +64 4 576 1022
david.croy@anz.com

Sharon Zollner
Chief Economist
Telephone: +64 9 357 4094
Sharon.Zollner@anz.com

RBNZ announces quantitative easing

- This morning the RBNZ announced that it would conduct large-scale asset purchases of New Zealand Government bonds ('quantitative easing', or 'QE'), following similar moves by global central banks last week.
- The RBNZ will purchase $30bn of NZGBs with a range of maturities across the yield curve over the next 12 months, with purchases starting this week.
- **This package is huge. Our analysis** last week flagged the need for purchases of $15-20bn per annum, if not more, and this announcement is even larger with that. Our expectations were at the top end of market expectations, so we expect this package to have a significant impact.
- QE will help support the economy and soothe markets that have been dysfunctional. We believe this package will have an immediate and significant impact on the local bond market, especially with NZDM set to issue NZGBs at a $20bn annualised pace in Q2. There will be beneficial knock-ons across the credit spectrum.
- More QE, liquidity measures and market intervention may yet be needed. Of note, the RBNZ has said they will adjust the size and nature of the program as required. We also see a case for easing the counter-cyclical capital buffer to help facilitate the provision of credit.
- Next we expect another broad fiscal response; last week's package was only the first tranche. The RBNZ's move today paves the way for more government spending, by helping soak up the looming supply of bonds.

The RBNZ announced this morning that it will conduct large-scale asset purchases ('quantitative easing', or 'QE'), "to provide further support to the economy, build confidence, and keep interest rates on government bonds low". This follows similar moves by major central banks last week to introduce and expand bond-buying programmes dramatically. It follows on from the RBNZ's easing of the OCR last week, issuance of forward guidance, provision of significant additional liquidity, and freeing up of bank capital.

The RBNZ will purchase $30bn worth of NZGBs across the yield curve in the next 12 months, because "financial conditions have tightened unnecessarily over the past week." They have also said that they stand ready to "make adjustments and additions if needed." Given the size of the package, we think it will put to bed any questions about how effective it will be.

We expect the RBNZ to significantly front-load its bond purchases, potentially buying a third to a half of purchases planned for this year over the next 4-6 weeks. Front-loading purchases make sense given that markets are currently stressed; they will settle down once the RBNZ's presence in the market is felt. It is also consistent with moves by other central banks. In the US, the Fed will have purchased $197bn by the end of this week. This is relative to total purchases of "at least" $700bn, based on announced completed operations to date.

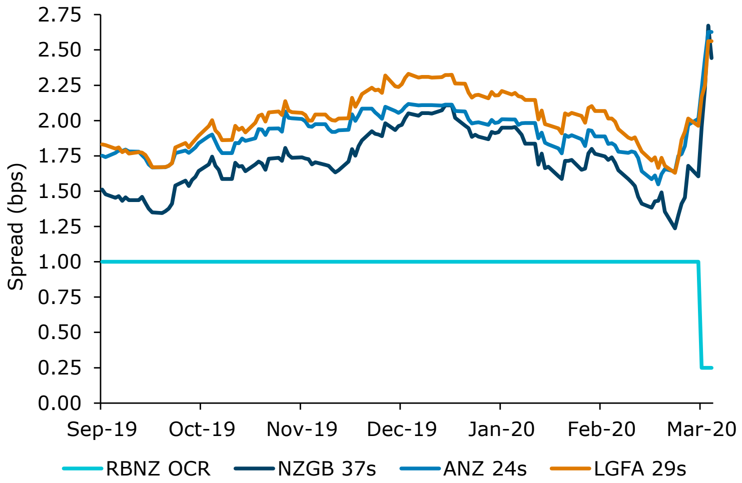
In terms of volume and timing, we think RBNZ purchasing should exceed NZDM primary issuance ($250m this week and $5bn over Q2) to ensure that yields move sharply lower – which is, after all, the intention of this policy. And If anyone doubts the potency of this policy, consider this: there are around

$80bn of NZGBs on issue, and if the RBNZ ended up buying them all, it would still have a smaller balance sheet than some of the major trading banks. In other words, the RBNZ's capacity to buy bonds (should this programme need to be expanded in future) is effectively absolute. Some in the market may be sceptical now, but if the RBNZ wants to have an impact, the Crown's starting position of enviably low debt is a huge advantage.

Today's announcement was urgently needed. Long-dated NZGB yields have risen to well above where they were before the COVID-19 crisis. It is not unusual for bond yield curves to steepen following rate cuts, especially with a significant increase in fiscal spending expected. But the market has been operating in a dysfunctional fashion, undermining the easing in monetary policy settings and putting widespread pressure on credit markets.

High-grade credit bonds such as the ANZ 24s and LGFA 29s have not gone as far as the ultra-long NZGB 37s (figure 1), thanks largely to their shorter durations. But NZGB 37s should be close to "risk-free", so it is deeply concerning that they have become one of the highest-yielding bonds in the market. The extreme steepening in the slope of the 10-20 year NZGB curve (83bps at Friday's close) is putting pressure on all other investments across the curve that are perceived to be riskier, leading to a widespread spike in borrowing costs. Today's actions by the RBNZ should stem that dynamic.

Figure 1. The OCR and yields on selected bonds



Source: Bloomberg, ANZ Research

We expect yield curves to go lower and flatter in response to this morning's announcement, in line with the broader monetary easing intended. In terms of impact, we think we will see NZGB yields gravitate towards Australian bond (ACGB) yields. Australia's cash rate is now in line with New Zealand's at 0.25%, and they have put a point target on their 3-year ACGB in line with their cash rate. The RBA are using "Yield Curve Control" (that is, purchasing bonds across the curve to target a yield, as opposed to signalling a quantity of bonds to be purchased and seeing what happens). This is a much more direct form of QE, but the intention is the same: lowering yields across the curve.

The 3-year NZGB closed at 0.66% on Friday, whereas the 3-year ACGB closed at 0.30%. The ACGB 10-year bond closed at 1.06% on Friday, with similar NZGBS closing at 1.46 and 1.75%. Something's got to give. We expect NZGB yields to move sharply lower from the open today.

QE is now an essential tool for central banks globally, with government spending set to balloon and action needed to soothe general nervousness in credit markets. We see increased NZDM issuance possibly in the realm of

$50bn cumulatively to June 2024, as a larger and broader fiscal response will be required from the Government. NZDM has announced today that they will not be adjusting the size of its debt programme until the Budget.

The next tender NZDM is conducting is for $250m of 25s on Thursday, which has been scheduled for a long time. With $500m of RBNZ bond purchases announced for this week, the RBNZ has sent a clear signal to the market that it intends to shift the supply/demand imbalance in the market.

Depending on how developments unfold, more QE may be required in time, perhaps buying other assets, or aimed at facilitating lending to certain segments. The RBNZ will be watching credit conditions closely and we see a case for the RBNZ to ease the counter-cyclical capital buffer in order to further free up banking system capital. We also expect to see continued liquidity provision and market intervention as needed. It’s crucial for the RBNZ to do everything it can to ensure that the financial system functions effectively and that credit can flow freely to where it is needed in these difficult and unprecedented times.

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