RBNZ delivers emergency 75bp OCR cut

- RBNZ delivered an emergency 75bp cut this morning, taking the OCR to 0.25% “for at least the next 12 months”.
- The RBNZ indicated that the next step, if required, will be large scale asset purchases rather than further OCR cuts – indeed, the forward guidance explicitly states that the OCR will remain at 0.25%.
- The 25 March meeting has been cancelled.
- We expect a move to unconventional policy as soon as practicable, since more stimulus is very likely to be needed. This clarification should calm the very unsettled bond market, driving the curve lower and flatter.
- The RBNZ has announced that the increase in bank capital requirements will be delayed by 12 months, with further delays possible down the track.
- A very large fiscal package is expected tomorrow. A broad, economy-wide fiscal response is now necessary.

Today the RBNZ cut the OCR 75bps to 0.25% in an out-of-cycle move, an unprecedented step. Immediate and sizeable action was needed, and it brings the RBNZ into the line with the actions of central banks overseas.

We are in uncharted territory economically. Not only exporters but also the domestic economy is experiencing a very significant blow – now amplified by the necessary containment measures that have now been put in place. We are in the midst of an unprecedented synchronised global demand slowdown, with financial market pressures starting to emerge.

The RBNZ said “The Committee also agreed that should further stimulus be required, a Large Scale Asset Purchase programme of New Zealand government bonds would be preferable to further OCR reductions”. However, “the Committee agreed that additional tools were not needed at this point.”

We think they will be; we expect a move to unconventional policy as soon as practicable. We consider 0.25% to be the effective lower bound for the OCR. In the current environment, the risks of financial market disruption and a credit squeeze are very real; these risks would be exacerbated by zero or negative interest rates and in our view it is just not worth the risk. However, it was actually operational constraints that drove the decision, rather than a strong judgement on where the effective lower bound sits: “Staff also advised that an OCR of 0.25 percent was currently the lower limit, given the operational readiness of the financial system for very low or negative interest rates."

The RBNZ has given unusually specific forward guidance in indicating the OCR would be held at 0.25% for “at least 12 months”. Asset purchases are the next cab off the rank. Assistant Governor Christian Hawkesby said the Bank is also ensuring there is sufficient liquidity in the financial system, through regular market operations.

In order to support stimulatory financial conditions and credit provision in particular, the RBNZ will also delay the implementation of its tougher capital requirements for banks by 12 months, to 1 July 2021, and down the track “will consider whether further delays are necessary.”
The spotlight is now firmly on fiscal policy to step up to the plate, with a very significant package expected tomorrow. Encouragingly, the RBNZ described the upcoming package as “broad scale”. Rather than targeted, sector-specific measures, an economy-wide support package is now required with jobs and business livelihoods hanging in the balance. We’re all in this together; no sector of the economy will be left untouched.

**Markets**

Markets will focus on five key points. First, the OCR is now at its effective lower bound, which is 0.25%. The RBNZ has said that the OCR will “remain at this level”, ruling out both hikes and cuts. Second, we have strong forward guidance “for at least the next 12 months”. Third, we no longer have a formal timetable for the next decision, with the 25 March meeting scrapped. Anything could happen any time. Fourth, we have crystal clarity that the next step is QE, and it will involve buying NZGBs. Last, we have a 12-month delay to the new capital requirements.

For interest rate markets, beyond the necessary downward adjustment to the entire term structure today that needs to happen on this cut, we expect the threat of QE to drive the NZGB curve lower and flatter, and to see swap spreads widen (in this case, going from negative back to positive as bond yields fall faster than, and through, corresponding swap yields). We see QE as inevitable in the near future and it will work hand in hand with fiscal policy, effectively negating the unhelpful impact further bond issuance would otherwise have had on the bond curve. We expect that QE will be targeted at the very long end of the government bond curve in a bid to lower term rates and restore market functioning. In short, it is pointless cutting the OCR if bond yields are in an uncontrolled upward spiral as they were into the end of last week. Further policy actions from the Fed (who will cut at this week’s FOMC meeting, if not earlier) and other central banks will also support longer bonds.

For the NZD – which had already reacted an hour or earlier (the 8am announcement was flagged at 7am) – this is arguably slightly good news, as it takes the RBNZ off the side-lines to firmly midfield, with strong support provided by fiscal policy. Because the majority of NZGBs are held offshore (52.9% of all lines, but much higher proportions of the longer lines), we would expect QE to result in some NZD selling as offshore sellers surrender bonds to the RBNZ – but that’s a story for down the track. We also note the RBNZ opined that “the New Zealand dollar exchange rate has also depreciated against our trading partners acting as a partial buffer for export earnings”. That’s code for “don’t expect us to stand in the way of NZD weakness”. However, some consistency is required – not all currencies can weaken at the same time and this is a global epidemic/economic slowdown – hence we expect the NZD to be under mild downward pressure as opposed to collapsing.
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