QE hui

- We expect the RBNZ to leave the OCR unchanged at 0.25% next Wednesday.
- We expect an approximate doubling of its quantitative easing (QE) programme from $33bn of purchases to $60bn, if not more, with additional purchases oriented towards NZGBs. To have more impact, the RBNZ may also choose to give more explicit guidance on where they would like to see the yield curve.
- We are unconvincing that lower or negative rates will be on the cards any time soon, though the RBNZ may not choose to continue to rule it out. We would not be surprised to see a tweak to their forward guidance to keep their options open. The market will be keenly watching this.
- The RBNZ is likely pleased with the success of its efforts to ease monetary conditions and facilitate the fiscal expansion so far. But there is more trouble ahead for the economy and the RBNZ can – and should – do more. We think QE will remain the tool of choice to up the ante, and in our view it is the right one.

Key points

Much has happened since the RBNZ cut the OCR 75bps to 0.25% on 16 March. At that time, they committed to leaving the OCR unchanged at 0.25% for “at least 12 months”, and launched quantitative easing (QE) shortly afterward. Next Wednesday, the RBNZ will release its Monetary Policy Statement. We expect the RBNZ to leave the OCR unchanged at 0.25%. But economic conditions have deteriorated and fiscal policy has stepped up, and accordingly we think the RBNZ will signal an approximate doubling of the QE programme from $33bn to $60bn, if not more.

We expect that additional purchases will be oriented towards Government bonds (NZGBs). It is possible that more LGFA bonds could be purchased or inflation-linked bonds added to the programme, but this would not be substantial relative to any increase in NZGBs. So far, the RBNZ has focused on purchasing longer-end bonds, and that has been very effective at flattening the yield curve. But more stimulus is required, with a difficult outlook ahead for the economy, and the RBNZ will need to ramp up its purchases to ease financial conditions further.

Although QE has been effective, bond markets have still been volatile and there could be a case for the RBNZ to adjust its forward guidance to help yields settle at lower levels. To do this, they could choose to give more explicit guidance on where they would like to see the yield curve.

We do not expect the OCR to be cut closer to zero next week. When the OCR was cut to 0.25% in March, the RBNZ noted that it was operational constraints that were behind the forward guidance that they intended to keep the OCR at 0.25% (not lower), rather than a strong judgement on where the effective lower bound for the OCR sits: “Staff... 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”.

We are assuming that advice has not changed. However, a tweak in the forward guidance could be used to signal openness to a future cut to close to or even below zero once the financial system is operationally ready. This possibility would help maintain downward pressure on interest rates at the short end, even if the timing of when it might be feasible is unknown.
The hurdles for negative rates

Technical constraints aside, a few other ducks would need to line up to make negative rates likely, in our view.

- The ground would have to be laid in terms of socialising the idea. Negative rates are pretty rough on savers, confusing for the public, and face specific technical issues in a New Zealand context. We have not yet seen the promised research paper on the topic, but that would be a good start.

- Negative rates here would become more likely in our view if we saw them in countries such as the US and Australia who have so far eschewed them.

- Quantitative easing would in some sense have to be seen to be tapped out, or at least inadequate. This could be either because the economic situation takes a severe turn for the worse, or QE starts to hit its limits or lose its efficacy at keeping long yields down, with the economy still in dire straits. Even then, there would be other options that we think would be effective and considerably less risky than negative rates, such as yield curve guidance.

- Global credit markets would need to be in decent shape. They remain highly vulnerable to a change in sentiment and abrupt reassessment and repricing of risk. New Zealand banks are an important conduit for the required funding for our net debtor nation. Negative interest rates severely damage bank profitability and therefore might mean that the cost of raising funds in a severely risk-off environment is higher than otherwise.

Timing is also key. Negative rates are, in one sense, simply a more extreme version of ‘low’ – they would further reduce financing costs for businesses and put downward pressure on the exchange rate. But they also have a punitive aspect; they are the ‘big stick’ to encourage lending by effectively ‘taxing’ banks’ unused cash parked at the central bank. In that context, the idea is that they can stimulate credit (and thereby activity) in an environment where firms are keen to borrow to expand and employ, but banks are ‘over-cautious’. We are still far off the point where firms are seeking credit for expansion, but demand for working capital is currently strong as banks help customers through the lockdown revenue hit.

Regular readers will know we are not enamoured of the concept of negative interest rates, particularly for long periods. Negative rates inflate asset prices and encourage excessive risk taking and leverage, not all of it for economically productive purposes. And although they are aimed at stimulating credit growth, they severely impact the health of the banking sector and therefore may impair the free flow of credit over the longer run.

But nonetheless we may get to a point where taking these risks is seen as justified. COVID-19 is an unprecedented economic shock and many previously taboo policy prescriptions are being rolled out globally, with the long-term consequences shelved as a problem for another day. We think we are a long way from that point here in New Zealand, though.

Quantitative easing is working well

In the meantime, the Reserve Bank’s quantitative easing programme has been very successful, seeing 10-year yields once more hovering near new lows – and sitting lower than in Australia (figure 1). The QE programme has been equivalent to roughly another 200bp of conventional easing in a shadow short rate framework.1

---

1 In broad terms, the shadow short rate is the OCR in a world without lower bounds that would have resulted in the yield curve that QE and forward guidance has achieved. It’s a way of measuring the overall policy stance including unconventional measures like QE. But one cannot transact at the shadow short rate, so it is not strictly equivalent stimulus. See www.ljkmfa.com.
So far, the RBNZ has spent $9.4bn of the $33bn headroom they were granted by the Government in March ($30bn of NZGBs) and April ($3bn LFGA). To ensure no doubt in the market’s mind that they will continue to succeed even as bond issuance ramps up massively, we expect the RBNZ to roughly double the size of its programme to $60bn. We expect the extra $27bn to be oriented towards NZGBs.

We see purchases of NZGBs roughly keeping pace with expected government bond issuance over the next 15 months. Indeed, the Treasury has said that it intends to issue $17bn of bonds in the current quarter, and we expect next year’s bond programme (for the year ending June 2021) to be $45bn. With government bond issuance focussed on nominal bonds rather than inflation-linked bonds (linkers), we think the expansion in QE will be largely (if not solely) aimed at nominal bonds. However, we would not rule out token purchases of linkers (perhaps $2-3bn). Similarly, we may see the volume of QE aimed at LGFA increased slightly, but our base assumption is that the programme will remain primarily aimed at NZGBs.

Further down the track, the RBNZ could run into limits regarding the share of government bonds it is comfortable buying. It’s not a hard and fast rule, but the market took note of Assistant Governor Hawkesby’s comment in a Bloomberg news interview when he said that overseas, other central banks holdings “do sit in that broad range of 40 to 50% as a limit.” With the amount of bonds on issue set to rise to just over $120bn by mid-2021, this could be an issue eventually. However, at that point, the RBNZ could loosen that constraint, or get more flexible in terms of its purchases, perhaps including linkers (inflation-indexed bonds), more quasi-government bonds, and potentially even corporate bonds in its purchase programme. But for now, “conventional” quantitative easing focussed primarily on nominal NZGBs is doing the job admirably, that job being twofold: flattening the yield curve and supporting fiscal policy by absorbing sharply higher bond issuance.

Forecasts
The Reserve Bank’s economic forecasts will have wide confidence intervals and a short shelf life, like everyone else’s best guesstimates at present. However, they will provide a useful benchmark against which to gauge economic data as it comes in. Given the uncertainty, some scenario analysis would be particularly useful. We won’t speculate too much here about what the Reserve Bank’s central forecasts will be. We’re confident their forecasts will show an economy facing an enormous negative shock and a strong need for policy stimulus. There’s not great value in nuance at this point.
Encouragingly, it has recently become more likely that New Zealand will successfully maintain COVID-19 cases at the extremely low levels that can give firms confidence that a return to lockdown can be avoided. Our own growth forecasts assume as much and we remain comfortable with them, but the recent dramatic fall in new cases does pave the way to a gradual re-opening of the economy, diminishing one particularly large source of downside risk and uncertainty: a prolonged or oscillating lockdown situation. But despite the public health situation looking better, plenty of big economic questions remain, including:

- whether a trans-Tasman bubble could give a glimmer of hope to our battered tourism industry;
- the global economic outlook, including New Zealand’s commodity prices;
- whether central banks can keep a lid on global financial market stresses;
- the extent to which firms will be able to hang onto their staff; and
- how ugly it might get for residential and commercial property.

Conclusion

Monetary conditions in New Zealand have been eased substantially since the COVID-19 crisis began. The Official Cash Rate has been eased 75bp, and the aggressive QE programme is keeping long rates low. Various backstops have also been put in place to ensure the free flow of credit should stresses emerge. The Reserve Bank has been very proactive – and it is working, and will cushion the blow to some degree. Fiscal policy is by necessity (and quite appropriately) the main game in town, and we expect more initiatives are on the way, with the Budget out next week.

Overall, we think the RBNZ will be quietly pleased with what they have managed to achieve so far. But the full brunt of the economic impact is yet to be seen and a larger monetary response is required. Looking further ahead, the scars of this crisis will take a long time to heal, and the RBNZ will need to be prepared to provide support well into the eventual recovery.
Important notice

This document is intended for ANZ’s Institutional, Markets and Private Banking clients. It should not be forwarded, copied or distributed. The information in this document is general in nature, and does not constitute personal financial product advice or take into account your objectives, financial situation or needs.

This document may be restricted by law in certain jurisdictions. Persons who receive this document must inform themselves about and observe all relevant restrictions.

Disclaimer for all jurisdictions: This document is prepared and distributed in your country/region by either: Australia and New Zealand Banking Group Limited (ABN11 005 357 522) (ANZ); or its relevant subsidiary or branch (each, an Affiliate), as appropriate or as set out below.

This document is distributed on the basis that it is only for the information of the specified recipient or permitted user of the relevant website (recipients).

This document is solely for informational purposes and nothing contained within is intended to be an invitation, solicitation or offer by ANZ to sell, or buy, receive or provide any product or service, or to participate in a particular trading strategy.

Distribution of this document to you is only as may be permissible by the laws of your jurisdiction, and is not directed to or intended for distribution or use by recipients resident or located in jurisdictions where its use or distribution would be contrary to those laws or regulations, or in jurisdictions where ANZ would be subject to additional licensing or registration requirements. Further, the products and services mentioned in this document may not be available in all countries.

ANZ in no way provides any financial, legal, taxation or investment advice to you in connection with any product or service discussed in this document. Before making any investment decision, recipients should seek independent financial, legal, tax and other relevant advice having regard to their particular circumstances.

Whilst care has been taken in the preparation of this document and the information contained within is believed to be accurate, ANZ does not represent or warrant the accuracy or completeness of the information in this document. Further, ANZ does not accept any responsibility to inform you of any matter that subsequently comes to its notice, which may affect the accuracy of the information in this document.

Preparation of this document and the opinions expressed in it may involve material elements of subjective judgement and analysis. Unless specifically stated otherwise: they are current on the date of this document and are subject to change without notice; and, all price information is indicative only. Any opinions expressed in this document are subject to change at any time without notice.

ANZ does not guarantee the performance of any product mentioned in this document. All investments entail a risk and may result in both profits and losses. Past performance is not necessarily an indicator of future performance. The products and services described in this document may not be suitable for all investors, and transacting in these products or services may be considered risky.

ANZ expressly disclaims any responsibility and shall not be liable for any loss, damage, claim, liability, proceedings, cost or expense (Liability) arising directly or indirectly and whether in tort (including negligence), contract, equity or otherwise out of or in connection with this document to the extent permissible under relevant law. Please note, the contents of this document have not been reviewed by any regulatory body or authority in any jurisdiction.

ANZ and its Affiliates may have an interest in the subject matter of this document. They may receive fees from customers for dealing in the products or services described in this document, and their staff and introducers of business may share in such fees or remuneration that may be influenced by total sales, at all times received and/or apportioned in accordance with local regulatory requirements. Further, they or their customers may have or have had interests or long or short positions in the products or services described in this document, and may at any time make purchases and/or sales in them as principal or agent, as well as act (or have acted) as a market maker in such products. This document is published in accordance with ANZ’s policies on conflicts of interest and ANZ maintains appropriate information barriers to control the flow of information between businesses within it and its Affiliates.

Your ANZ point of contact can assist with any questions about this document including for further information on these disclosures of interest.

Country/region specific information: Unless stated otherwise, this document is distributed by Australia and New Zealand Banking Group Limited (ANZ).

Australia. ANZ holds an Australian Financial Services licence no. 234527. For a copy of ANZ’s Financial Services Guide please click here or request from your ANZ point of contact.

Brazil, Brunei, India, Japan, Kuwait, Malaysia, Switzerland, Taiwan. This document is distributed in each of these jurisdictions by ANZ on a cross-border basis.

Cambodia. This document is distributed in Cambodia by ANZ Royal Bank (Cambodia) Limited (ANZ Royal Bank). The recipient acknowledges that although ANZ Royal Bank is a subsidiary of ANZ, it is a separate entity to ANZ and the obligations of ANZ Royal Bank do not constitute deposits or other liabilities of ANZ and ANZ is not required to meet the obligations of ANZ Royal Bank.

European Economic Area (EEA): United Kingdom. ANZ is authorised in the United Kingdom by the Prudential Regulation Authority (PRA) and is subject to regulation by the Financial Conduct Authority (FCA) and limited regulation by the PRA. Details about the extent of our regulation by the PRA are available from us on request. This document is distributed in the United Kingdom by Australia and New Zealand Banking Group Limited ANZ solely for the information of persons who would come within the FCA definition of “eligible counterparty” or “professional client”. It is not intended for and must not be distributed to any person who would come within the FCA definition of “retail client”. Nothing here excludes or restricts any duty or liability to a customer which ANZ may have under the UK Financial Services and Markets Act 2000 or under the regulatory system as defined in the Rules of the Prudential Regulation Authority (PRA) and the FCA. ANZ is authorised in the United Kingdom by the PRA and is subject to regulation by the FCA and limited regulation by the PRA. Details about the extent of our regulation by the PRA are available from us on request.

Fiji. For Fiji regulatory purposes, this document and any views and recommendations are not to be deemed as investment advice. Fiji investors must seek licensed professional advice should they wish to make any investment in relation to this document.

Hong Kong. This publication is issued or distributed in Hong Kong by the Hong Kong branch of ANZ, which is registered at the Hong Kong Monetary Authority to conduct Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) regulated activities. The contents of this publication have not been reviewed by any regulatory authority in Hong Kong.

India. If this document is received in India, only you (the specified recipient) may print it provided that before doing so, you specify on it your name and place of printing.
**Important notice**

**Myanmar.** This publication is intended to be general and part of ANZ's customer service and marketing activities when implementing its functions as a licensed bank. This publication is not Securities Investment Advice (as that term is defined in the Myanmar Securities Transaction Law 2013).

**New Zealand.** This document is intended to be of a general nature, does not take into account your financial situation or goals, and is not a personalised adviser service under the Financial Advisers Act 2008 (FAA).

**Oman.** ANZ neither has a registered business presence nor a representative office in Oman and does not undertake banking business or provide financial services in Oman. Consequently ANZ is not regulated by either the Central Bank of Oman or Oman’s Capital Market Authority. The information contained in this document is for discussion purposes only and neither constitutes an offer of securities in Oman as contemplated by the Commercial Companies Law of Oman (Royal Decree 4/74) or the Capital Market Law of Oman (Royal Decree 80/98), nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market Law (issued vide CMA Decision 1/2009). ANZ does not solicit business in Oman and the only circumstances in which ANZ sends information or material describing financial products or financial services to recipients in Oman, is where such information or material has been requested from ANZ and the recipient understands, acknowledges and agrees that this document has not been approved by the CBO, the CMA or any other regulatory body or authority in Oman. ANZ does not market, offer, sell or distribute any financial or investment products or services in Oman and no subscription to any securities, products or financial services may or will be consummated within Oman. Nothing contained in this document is intended to constitute Omani investment, legal, tax, accounting or other professional advice.

**People’s Republic of China (PRC).** This document may be distributed by either ANZ or Australia and New Zealand Bank (China) Comm Ltd (ANZ China). Recipients must comply with all applicable laws and regulations of PRC, including any prohibitions on speculative transactions and CNY/CNH arbitrage trading. If this document is distributed by ANZ or an Affiliate (other than ANZ China), the following statement and the text below is applicable: No action has been taken by ANZ or any affiliate which would permit a public offering of any products or services of such an entity or distribution or re-distribution of this document in the PRC. Accordingly, the products and services of such entities are not being offered or sold within the PRC by means of this document or any other document. This document makes no offer, solicitation or other document, is not an offer or sale, and no subscription to any securities, products or services described in this document is being made, re-distributed or published in the PRC, except under circumstances that will result in compliance with any applicable laws and regulations. If and when the material accompanying this document relates to the products and/or services of ANZ China, the following statement and the text below is applicable: This document is distributed by ANZ China in the Mainland of the PRC.

**Qatar.** This document has not been, and will not be:
- lodged or registered with, or reviewed or approved by, the Qatar Central Bank (QCB), the Qatar Financial Centre (QFC) Authority, QFC Regulatory Authority or any other authority in the State of Qatar (Qatar); or
- authorised or licensed for distribution in Qatar, and the information contained in this document does not, and is not intended to, constitute a public offer or other invitation in respect of securities of the QFC. The QFC or the QFC does not make or authorise the offer or distribution of these products or services described in this document, and it will not be:
  - registered with the QCB, QFC Authority, QFC Regulatory Authority or any other governmental authority in Qatar; or
  - authorised or licensed for offering, marketing, issue or sale, directly or indirectly, in Qatar.

Accordingly, the financial products or services described in this document are not being, and will not be, offered, issued or sold in Qatar, and this document is not being, and will not be, distributed in Qatar. The offering, marketing, issue and sale of the financial products or services described in this document and distribution of this document is being made in, and is subject to the laws, regulations and rules of jurisdictions outside of Qatar and the QFC. Recipients of this document must abide by this restriction and not distribute this document in breach of this restriction. This document is being issued/sent to a limited number of institutional and/or sophisticated investors (i) upon their request and confirmation that they understand the statements above; and (ii) on the condition that it will not be provided to any person other than the original recipient, and is not for general circulation and may not be reproduced or used for any other purpose.

**Singapore.** This document is distributed in Singapore by the Singapore branch of ANZ solely for the information of “accredited investors”, “expert investors” or (as the case may be) “institutional investors” (each term as defined in the Securities and Futures Act Cap. 289 of Singapore). ANZ is licensed in Singapore under the Banking Act Cap. 19 of Singapore and is exempted from holding a financial adviser’s licence by the Singapore Financial Advisory Council (SFA) under the SFA Act (Chapter 323) and SFA Regulation 11001 of the SFA.

**United Arab Emirates (UAE).** This document is distributed in the UAE or the Dubai International Financial Centre (DIFC) (as applicable) by ANZ. This document does not, and is not intended to constitute: (a) an offer of securities anywhere in the UAE; (b) the carrying on or engagement in banking, financial and/or investment consultation business in the UAE under the rules and regulations made by the Central Bank of the UAE, the Emirates Securities and Commodities Authority or the UAE Ministry of Economy; (c) an offer of securities within the meaning of the Dubai International Financial Centre Markets Law (DIFCLM) No. 12 of 2004; and (d) a financial promotion, as defined under the DIFCLM No. 1 of 200. ANZ DIFC Branch is regulated by the Dubai Financial Services Authority (DFSA) ANZ DIFC Branch is regulated by the Dubai Financial Services Authority (DFSA). The financial products or services described in this document are only available to persons who qualify as “Professional Clients” or “Market Counterparty” in accordance with the provisions of the DFSA rules. In addition, ANZ has a representative office (ANZ Representative Office) in Abu Dhabi regulated by the Central Bank of the UAE. The ANZ Representative Office is not permitted by the Central Bank of the UAE to provide any banking services to clients in the UAE.

**United States.** Except where this is a FX- related document, this document is distributed in the United States by ANZ Securities, Inc. (ANZ SI) which is a member of the Financial Regulatory Authority (FINRA) (www.finra.org) and registered with the SEC. ANZSI's address is 277 Park Avenue, 31st Floor, New York, NY 10172, USA (Tel: +1 212 801 9160 Fax: +1 212 801 9163). ANZSI accepts responsibility for its content. Information on any securities referred to in this document may be obtained from ANZSI upon request. This document or material is intended for institutional use only – not retail. If you are an institutional customer wishing to effect transactions in any securities referred to in this document you must contact ANZSI, not its affiliates. ANZSI is authorised as a broker-dealer only for institutional customers, not for US Persons (as “US person” is defined in Regulation S under the US Securities Act of 1933, as amended) who are individuals. If you have registered to use this website or have otherwise received this document and are a US Person who is an individual: to avoid loss, you should cease to use this website by unsubscribing or should notify the sender and you should not act on the contents of this document in any way. Non-U.S. analysts: Non-U.S. analysts may not be associated persons of ANZSI and therefore may not be subject to FINRA Rule 2242 restrictions on communications with the subject company, public appearances and trading securities held by the analysts. Wherever this is an FX- related document, it is distributed in the United States by ANZ's New York Branch, which is also located at 277 Park Avenue, 31st Floor, New York, NY 10172, USA (Tel: +1 212 801 9160 Fax: +1 212 801 9163).

**Vietnam.** This document is distributed in Vietnam by ANZ or ANZ Bank (Vietnam) Limited, a subsidiary of ANZ.

This document has been prepared by ANZ Bank New Zealand Limited, Level 26, 23-29 Albert Street, Auckland 1010, New Zealand, Ph 64-9-357 4094, e-mail nzeconomics@anz.com, http://www.anz.co.nz

NZ RBNZ MPS Preview | 6 May 2020 6