# MNI RBNZ Review – August 2020

**Meeting Date:** Wednesday, 12 August 2020

**Link To Announcement:** https://www.rbnz.govt.nz/news/2020/08/further-easing-in-monetary-policy-delivered

**Link To MPS:** https://www.rbnz.govt.nz/monetary-policy/monetary-policy-statement/mps-august-2020

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# MNI POV (Point Of View): Edging Towards Negative OCR

The Reserve Bank of New Zealand (RBNZ) showed its dovish face yesterday, as the Monetary Policy Committee left the Official Cash Rate unchanged at 0.25%, but boosted the size of the Large Scale Asset Purchase Program to NZD100bn, extending its duration by over a year, to June 2022. The upgrades to outdated economic projections from May MPS came as no surprise, but Governor Orr noted that risks to the outlook remain skewed to the downside. The RBNZ's rhetoric surrounding unconventional monetary policy options fitted well into the dovish tone of the announcement, as policymakers appeared to lean further towards deploying negative interest rates in the future.

Although the expansion of the LSAP scheme at some point was widely viewed as a necessary step, analysts had either expected the RBNZ to leave the LSAP settings unchanged this time, or to up the programme's size by a smaller margin, with the more aggressive forecasts seeing the increased size at NZD80-90bn. Changes to the LSAP scheme were accompanied by a pledge to front-load operations, with Assistant Governor Hawkesby noting that a longer duration of the programme is testament to the central bank's willingness to stay in this market for longer. In MNI RBNZ Preview we pointed to why New Zealand's central bank might want to tinker with its asset-purchase programme, but the magnitude of the RBNZ's action was somewhat surprising. The MPC yet again proved that it is willing to run ahead of the curve when market conditions warrant action.

The RBNZ used this Monetary Policy Statement to share its outlook on alternative monetary policy options. Policymakers assured that additional tools remain in active preparation and reiterated openness to negative interest rates, which could be supported by direct funding of retail banks (Funding-For-Lending). The MPC stated that such a package would be its preferred policy option, should there be a need to add further monetary stimulus beyond LSAP, suggesting that the probability of its future deployment has increased. Issues with lenders' operational preparedness for a negative OCR still have to be resolved, but these hurdles should be cleared at the end of the year at the latest.

The RBNZ mentioned that large scale foreign asset purchases are also on the menu, albeit as the least preferred item. With NZD trading roughly in line with its fundamental value, the RBNZ sees little reason to buy overseas assets. Although the appreciation in New Zealand's currency has been driven by fundamental factors, the RBNZ still took the opportunity to note that a strong NZD moderates the benefit to domestic exporters from firmer commodity prices. A reminder that the MPC is not entirely comfortable with a strong NZD was expected, but still worth a note.

The RBNZ had to update its forecasts from the May MPS, as actual macroeconomic data was better than policymakers expected, partly on the back of New Zealand's success in containing the spread of Covid-19 on its soil and effective fiscal efforts to shield the economy.

The language used by the RBNZ in the MPS and subsequent press conference reinforced the sense that Governor Orr and his MPC stand ready to add monetary stimulus. Orr noted that the RBNZ wants to "actively" bring NZGB yields lower and lifting next week's bond buying target served to bring that message home. In combination with Hawkesby's remarks on the willingness to pursue asset purchases for longer, this should have satisfied doves who sought further clarity on the Bank's attitude.

The MPC announced its decision just one day after New Zealand snapped its impressive run without a single new Covid-19 case. While some might think that this was a factor which helped tip the balance towards a more decisive monetary action, available evidence points to the contrary. The letter from RBNZ Governor to the Finance Minister, requesting indemnity to let the MPC increase the size and duration of LSAP was dated August 6, so the decision to boost the scheme was in the making before the confirmation of new coronavirus cases. During the press conference, policymakers clarified that the re-emergence of Covid-19 had no bearing on their decision.

One thing that the return of coronavirus did for the RBNZ was it poured cold water on any expectations that economic forecasts got any more credible. The outlook remains invariably cloudy and infection dynamics will not only affect New Zealand's economic recovery, but may also affect its electoral cycle. While the RBNZ will have to remain flexible, yesterday's meeting leaves no doubt that they will stand ready to act.

# RBNZ August Monetary Policy Review Announcement:

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.

**Summary Record of Meeting - August 2020 MPS**

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.


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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.

# Comparison Of Key Variables Under The Baseline Scenario In August vs. May MPS

*Key baseline scenario variables*

**August MPS**

| | | GDP growth Quarterly | CPI inflation Quarterly | CPI inflation Annual | TWI | OCR |
|---|---|---|---|---|---|---|
| 2018 | Mar | 0.7 | 0.5 | 1.1 | 74.9 | 1.8 |
| | Jun | 1.0 | 0.4 | 1.5 | 73.7 | 1.8 |
| | Sep | 0.5 | 0.9 | 1.9 | 72.4 | 1.8 |
| | Dec | 1.0 | 0.1 | 1.9 | 73.4 | 1.8 |
| 2019 | Mar | 0.4 | 0.1 | 1.5 | 74.0 | 1.8 |
| | Jun | 0.1 | 0.6 | 1.7 | 72.6 | 1.6 |
| | Sep | 0.8 | 0.7 | 1.5 | 72.0 | 1.2 |
| | Dec | 0.5 | 0.5 | 1.9 | 71.3 | 1.0 |
| 2020 | Mar | -1.6 | 0.8 | 2.5 | 70.9 | 0.9 |
| | Jun | -14.3 | -0.5 | 1.5 | 69.7 | 0.3 |
| | Sep | 12.2 | 1.1 | 1.8 | 72.3 | 0.3 |
| | Dec | 1.9 | 0.0 | 1.3 | 72.2 | 0.3 |
| 2021 | Mar | 0.4 | -0.2 | 0.4 | 72.2 | 0.3 |
| | Jun | 1.2 | 0.1 | 1.0 | 72.2 | |
| | Sep | 0.9 | 0.4 | 0.3 | 72.2 | |
| | Dec | 0.5 | 0.0 | 0.3 | 72.2 | |
| 2022 | Mar | 1.8 | 0.3 | 0.8 | 72.2 | |
| | Jun | 0.7 | 0.2 | 0.9 | 72.2 | |
| | Sep | 0.4 | 0.6 | 1.0 | 72.2 | |
| | Dec | 0.8 | 0.2 | 1.2 | 72.2 | |
| 2023 | Mar | 0.4 | 0.6 | 1.5 | 72.1 | |
| | Jun | 0.5 | 0.5 | 1.8 | 72.1 | |
| | Sep | 0.4 | 0.7 | 2.0 | 72.1 | |

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*Key variables under the baseline scenario*

**May MPS**

| | | GDP growth Quarterly | CPI inflation Quarterly | CPI inflation Annual | TWI | OCR |
|---|---|---|---|---|---|---|
| 2018 | Mar | 0.7 | 0.5 | 1.1 | 74.9 | 1.8 |
| | Jun | 0.9 | 0.4 | 1.5 | 73.7 | 1.8 |
| | Sep | 0.6 | 0.9 | 1.9 | 72.4 | 1.8 |
| | Dec | 1.0 | 0.1 | 1.9 | 73.4 | 1.8 |
| 2019 | Mar | 0.4 | 0.1 | 1.5 | 74.0 | 1.8 |
| | Jun | 0.0 | 0.6 | 1.7 | 72.6 | 1.6 |
| | Sep | 0.8 | 0.7 | 1.5 | 72.0 | 1.2 |
| | Dec | 0.5 | 0.5 | 1.9 | 71.3 | 1.0 |
| 2020 | Mar | -2.4 | 0.8 | 2.5 | 70.9 | 0.9 |
| | Jun | -21.8 | -0.7 | 1.3 | 68.5 | 0.3 |
| | Sep | 23.8 | 0.2 | 0.8 | 67.1 | 0.3 |
| | Dec | 1.1 | 0.0 | 0.3 | 66.3 | 0.3 |
| 2021 | Mar | 0.7 | 0.1 | -0.4 | 66.3 | 0.3 |
| | Jun | 1.7 | 0.2 | 0.5 | 66.4 | |
| | Sep | 1.0 | 0.4 | 0.7 | 66.6 | |
| | Dec | 1.0 | 0.1 | 0.8 | 66.7 | |
| 2022 | Mar | 1.1 | 0.2 | 0.9 | 66.8 | |
| | Jun | 0.7 | 0.3 | 1.0 | 66.9 | |
| | Sep | 0.6 | 0.6 | 1.1 | 67.2 | |
| | Dec | 0.7 | 0.3 | 1.3 | 67.2 | |
| 2023 | Mar | 0.7 | 0.5 | 1.6 | 67.2 | |
| | Jun | 0.7 | 0.7 | 2.0 | 67.1 | |

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Source: RBNZ

# Sell-Side Analyst Views

**ANZ**

- 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
- 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.
- 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." 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.
- 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.

**ASB**

- The RBNZ's Monetary Policy Committee (MPC) has given a clear signal to the market that it has a strong commitment to keeping NZ interest rates low and is amassing the firepower to back that commitment up. It has lifted the purchase ceiling on its Large Scale Asset Purchase (LSAP) programme to $100bn. In addition, the MPC has given the go-ahead for the RBNZ to prepare further tools to use: a negative OCR; direct funding for banks at an interest rate near the OCR, and; foreign asset purchases. All these measures will help allay market concerns over where to for interest rates after the previous LSAP programme expired next May. The OCR remained at 0.25% in line with the commitment to keep it at that level until early next year.
- The RBNZ appears largely satisfied with the progress towards lowering effective interest rates in the economy, though notes the risks are all skewed to a weaker than expected economic environment and the need for more monetary support. The RBNZ revised its GDP growth forecasts to be closer to our own, including a smaller decline in Q2 GDP – which will reflect the fact that events (up until this week) have evolved more favourably than the RBNZ assumed in May. The most recent COVID outbreak is an evolving event and it is too soon to say how much of an impact it will have on the economy, but it does reinforce the RBNZ's view about the risks to the economy.
- So, where to? If more stimulus is needed beyond the expanded LSAP programme, a negative OCR and direct lending to banks through the Funding for Lending Programme (FLP) look like they will be the first cabs off the rank. Of the two we see the FLP as likely to be more effective (and can be made conditional on lending outcomes). But we acknowledge that the RBNZ may not want to use the FLP without lowering the OCR in tandem.
- It is possible that the new tools do get used next year, though we expect the RBNZ will keep up with the LSAP purchases for now. The RBNZ's growth outlook still appears a little strong to us, and there is the added uncertainty of what happens with the latest COVID-19 outbreak. In any case, the message is clear: the bias for the OCR and interest rates in general is that they could fall further over the next year if the economy needs added monetary support.

**Barclays**

- The RBNZ today expanded its LSAP programme to as much as NZD100bn and extended the scheme to June 2022, while maintaining the OCR at 0.25%. This was much larger than expected by the market for this meeting. The bank remains ready to deploy further stimulus and favours a negative OCR over foreign asset purchases. We now expect the bank to cut the OCR to 0.1% in early 2021.

**ING**

- The Reserve Bank of New Zealand (RBNZ) expanded its large scale asset purchase (LSAP) programme at its latest monetary policy meeting today. The LSAP programme will now buy up to NZD100bn of assets, up from NZD60bn previously.
- Governor Orr also said that the RBNZ would actively prepare an additional set of stimulus tools to be used as necessary depending on growth and inflation and that this would include negative cash rates assisted with a funding-for-lending programme and the possibility of buying foreign assets.
- Not surprisingly, the additional QE and possibility of negative rates have weighed down on the NZD, which was no doubt what was intended.
- What happens next will depend in no small part on the evolution of new Covid-19 cases, following the discovery of a number of new community cases in the Auckland area, which has led to a renewed lockdown of the city.
- The message markets can take from New Zealand to the rest of the Asia-pacific region is: "Be on your guard. This is not over until it is over".

**J.P. Morgan**

- At today's decision the RBNZ left the OCR unchanged at 0.25%, and expanded its LSAP program from NZ$60bn to NZ$100bn. The magnitude of the expansion was larger than expected (JPM: NZ$85bn), as was the extension in life by more than a year to June 2022. The implied average run rate for purchases works out to be very similar to that under the previous parameters. But the statement suggests a willingness to front-load purchases within this envelope, and the staff raised its estimate of the RBNZ's sustainable ownership share of the market from 50% to 60%. The governor also directly stated in the press conference that the committee wants "to actively get bond yields lower".
- In arriving at the decision, the minutes suggest the committee favoured the immediate scalability of LSAPs to other options of negative rates, foreign asset purchases, and intervening in the swap market. All have been mooted in previous communications and meetings, but still have unanswered questions regarding implementation. They remain possibilities for the future, and the staff is still being directed to "actively prepare" a package of such additional tools, as they were for this meeting.
- The committee is also being more explicit about relative pricing of the two elements: "the package of further instruments includes a negative OCR supported by funding retail banks directly at near-OCR". We read this to mean the funding scheme would be priced above where the OCR settles. This is somewhat backward to how other central banks have thought about negative rates – i.e. make funding rates as low as possible while limiting the drag on banks from the reserve tax of a negative IOER, via tiering for example.
- But it would reflect New Zealand's somewhat different constraints. The strong political desire to insulate households from negative deposit rates would argue against pushing bank funding rates negative. And the RBNZ's primary objective has morphed into supporting the government's funding requirement. This makes cutting IOER a good idea, as it would create more room to deliver the LSAP program at very low yields without risking central bank losses/negative dividends to the government.
- With more meat on the bones of the negative rates structure, it becomes more credible. In the press conference, the governor stated local banks are making "significant progress" on the technical constraints, though December is still technically the deadline to be ready. We have an OCR cut to 0 in the forecast for November. Whatever the issue with negative rates, zero is not a problem given that the RBNZ has set IOER = OCR so both have the same lower bound, and the interbank rate has already traded at 0 anyway. The risk, therefore, remains skewed to the OCR moving before the RBNZ's current guidance (March), as soon as it is technically feasible. Relative to our view, the risk may be to the move occurring at the following meeting in February, but the cut itself is now likely to be bigger.

**KiwiBank**

- The RBNZ kept the cash rate at 0.25%, as everyone expected. The RBNZ also expanded the LSAP program to $100bn, as we expected. The extension of the LSAP program to June 2021 (an extra 13



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months) was a little more than market expectations of $80-90bn, but the natural next step in our view. In order to avoid any awkward limits, the RBNZ now has the remit to buy 60% of total outstanding Government bonds. The changes allow for the 100b size and front loading of purchases (without expanding the pool of assets to buy). The assertive changes were designed to keep the pedal to the metal, and flatten market interest rates.

- Beyond the inevitable LSAP extension, the focus turned to the RBNZ's positioning on "other" alternative measures. We have long argued that the next best option is a Bank Term Lending (funding for lending) programme. A term lending facility would be a sure-fire way to reduce all retail rates (deposit and lending). We were surprised, however, to see the idea of a "package" deal with a negative OCR. The MPS positioned a negative OCR alongside term lending to banks as a package to fight downside risks. At face value, a negative OCR (say -25bps or -50bps) could see a term (wholesale) funding rate for banks below 0% from the RBNZ. In such a world, retail rates would NOT fall negative, but closer to 0%. We could conceivably see retail deposit rates well below 1% (and closer to 0%), and mortgage rates closer to 1%.
- In the process to smashing interest rates expectations to, and now through, 0%, the Kiwi currency took a welcome hit. But the Kiwi dollar is still too strong. Commodity prices for Kiwi exports remain strong, but our exporters are reaping little benefit. Because of the recent uptrend in the Kiwi dollar. A lower exchange rate should help our exporters take advantage of the higher prices. If conditions deteriorate further and the level of the exchange rate becomes unjustified, the option of purchasing foreign assets may become a serious one. But we're not there yet. It is an option.
- Fiscal policy will continue to play an important role in supporting NZ's economic recovery. Next Thursday the Government's books will be opened ahead of the general election. The Government had set aside around $14bn from the Covid-19 recovery fund to tackle further Covid outbreaks. Like the one we are facing now. This morning the Minister of Finance, Grant Robertson, signalled that the Government is open to a regional wage subsidy for Auckland should the region go into an extended lockdown. The PREFU will take on a little more importance as a result.

**Westpac**

- The Reserve Bank today provided useful clarity to markets. It clarified that it intends to purchase bonds under the Large Scale Asset Purchase (LSAP) programme for much longer than the May 2021 date it had previously been explicit about. And the RBNZ clarified that if the economy requires more monetary stimulus than the LSAP alone can deliver, then its next tool would be a combination of a negative OCR and direct loans to banks.
- None of this surprised us. The RBNZ's announced policy now looks much closer to our long-held forecasts for monetary policy. Back in May we said that the LSAP would have to be extended in time, and in order to purchase bonds over such a long timeframe, the cap on the LSAP would have to be increased to $100bn. We have also long predicted that the OCR will fall to -0.5% in April 2021. The RBNZ did not go that far today, but they inched a little closer in that direction by saying that a negative OCR is a preferred policy option. Consequently, there was nothing in today's announcement that will materially change our monetary policy forecasts.
- The RBNZ's new, extended LSAP description is slightly more generous than the forecast we issued in our MPS preview last week. There might be some scope for us to lift our forecast of the pace of bond purchases in the near term, but it is marginal.
- Like us, financial markets already expected the RBNZ would extend the LSAP well beyond May 2021, so the market reaction to today's RBNZ announcement was limited.
- Recognising the possible need for further monetary policy firepower, today the RBNZ clarified its thinking on the next step beyond the LSAP. The RBNZ said its preference remains for a negative OCR. This would work in much the same way as a regular OCR cut, by reducing short-term wholesale rates, flowing through to lower lending and deposit rates for customers, and putting downward pressure on the exchange rate.
- The other alternative tool highlighted in the MPS was purchasing foreign assets instead of New Zealand Government bonds. However, the RBNZ doesn't appear to be convinced that this is the right tool for the current conditions, and it also carries a significantly higher level of risk for the public sector balance sheet, so this option seems less likely.
- Westpac has long been alone in forecasting that the OCR will drop to -0.5% in April 2021. Today's announcement was a major shot in the arm for our forecast. Financial markets have been loath to incorporate much chance of a negative OCR into fixed interest rates, but that could change following today's announcement. Indeed, forward pricing for the OCR in August 2021 has dropped from zero to -0.05%, indicating a decent chance that the OCR will be below zero at that point.

# MNI Policy Team Insights

**MNI REVIEW: RBNZ Ups Bond Buys; Prepares For Negative Rates**

- RBNZ Increases Asset Purchase Program to NZD100 Billion
- Central Bank Staff 'Express Preference' For Negative Rates As Part Of Future Option Pack

*By Lachlan Colquhoun*

SYDNEY (MNI) - The Reserve Bank of New Zealand boosted its Large Scale Asset Program to NZD100 billion and left its official rate at a record low 0.25% Wednesday, as policymakers accepted "considerable monetary stimulus remains necessary" to achieve their employment and inflation objectives.

Looking ahead, the RBNZ Monetary Policy Committee "expressed a preference" for a package of monetary policy measures including negative official interest rates will be used if needed, and noted that central bank staff are preparing for its implementation based on the readiness of the financial system.

The central banks' Monetary Policy Statement, releases alongside the policy decision, said the RBNZ had considered other alternative policy options and concluded its next moves, if necessary, would be a for a "lower or negative" Official Cash Rate and a "Funding for Lending Program" which would facilitate low interest lending by commercial banks.

The RBNZ wrote to commercial banks earlier in the year, asking them to be ready for a negative interest rate regime by the end of the year.

--FOREIGN BONDS

The RBNZ ruled out foreign asset purchases and the direct purchase of Government bonds as a next move, but said overseas purchases remained an option for future use if required.

Speaking after the policy announcement, RBNZ Governor Adrian Orr did not commit the bank to implement the negative rates program, saying it would be deployed "if deemed necessary."

"The precise degree of monetary stimulus needed is uncertain," the statement said.

Wednesday's decision was not a direct response to a short-term reintroduction of lockdown measures in parts of New Zealand this week.

Orr said that he had only been informed late Tuesday of new restrictions and the information had not changed the announcement which was decided on a baseline scenario that NZ avoided a widespread outbreak and was at Alert Level 1 or lower from early June 2020.

--BOND BUYS

Addressing the size o the RBNZ's bond purchase scheme, Assistant Governor Christian Hawkesby said the bank had assessed that increasing its purchases of government debt would mean the RBNZ held up to 60% of all debt on issue, a "very deliberate step" to maintain a secondary market.

The RBNZ said the primary goal of increasing the LSAP was to lower domestic lending rates, but also noted that the NZD had appreciated by 6% against the Trade Weighted Index since the last statement in May.

This was attributable to risk sentiment -- as New Zealand had contained the pandemic -- and rebounding prices for key export commodities.