Economic Note

RBNZ June 2020 Official Cash Rate Preview

18 June 2020

Steady pedal to the metal

- We expect the RBNZ will leave its policy settings unchanged, while emphasising it still has further options.
- The short-term economic dip may not be as deep as the RBNZ expected, but long-term recovery will be gradual.
- The extent of RBNZ stimulus is not much more extreme than in 2009-11, despite the extent of the downturn.

The RBNZ has effectively made all the big policy decisions it is going to do for the time being. It has cut the OCR as low as it judges it can for now. It has expanded the ceiling size of its asset purchase programme to an amount that gives plenty of scope for continued asset purchases into early 2021. It has also relaxed its Loan to Value ratio restrictions on home loans and delayed its planned increase in bank capital requirements.

We expect the RBNZ will continue to stress that it will take further action as needed, including keeping alive the possibility of a negative OCR. But the RBNZ's current stimulus efforts, extreme as they seem from a headline perspective, are not that much more stimulatory than the response to the Global Financial Crisis. Monetary stimulus is likely to remain in place for longer than the RBNZ signalled back in its May Monetary Policy Statement.

The RBNZ is likely to sound more positive about the near-term outlook, given that recent events suggest NZ will not be in degrees of lockdown for as long as the RBNZ had assumed back in May. However, the RBNZ is likely to keep reminding that the global economy as a whole is far from out of the woods in the biggest global downturn since the Great Depression. Such comments would be similar to those recently made by the NZ Treasury, which also had forecast a more substantial economic impact from the lockdown than is likely to be the case in reality.

Same policy stance and guidance

The RBNZ has effectively put in place all the policy responses that will be operating for the time being. The Official Cash Rate (OCR) is at 0.25% with a commitment to keep it there into early 2021. The size of the RBNZ's asset purchase programme has been scaled up to $60 billion, with plenty of headroom within that limit to enable ongoing bond purchases into early next year.

We expect the RBNZ to continue to emphasise that it will do whatever it needs to, including leaving open the possibility of a negative OCR if that was necessary to ensure the economy gets enough stimulus. This channel of 'forward guidance', the conditioning financial markets to expect the OCR to remain low on an ongoing basis – spiced with some potential for an even lower OCR – is an effective way for the RBNZ to keep wholesale interest rates very low.

Seeing some light at the end of the tunnel

NZ is coming out of lockdown into a different world, and one that can be a bit discombobulating – Dan Carter has signed with the Blues, for example, bringing tears to eyepatches. Crucially, Level 1 means businesses reliant on people being in close proximity can now operate without any fetters other than people's desire to patronise them

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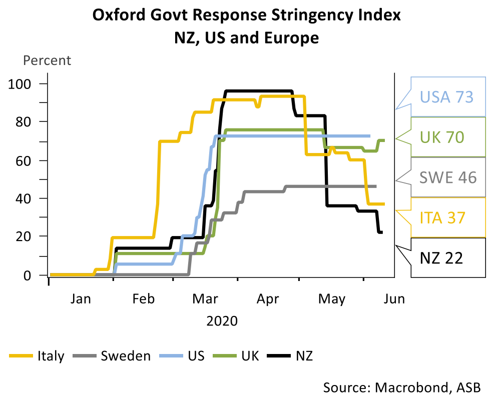
again. And, judging by the growing crowds and return of traffic jams, the desire to make up for lost time is there. The light at the end of the tunnel is more likely to be a car racing you for the last available car park, rather than a train.

The RBNZ is likely to note that the depth of the downturn in the first half of 2020 is now unlikely to be as severe as previously forecast, including the circa 22% decline expected in the June quarter alone. The RBNZ's baseline (and most upbeat) scenario had NZ remaining in Level 2 lockdown for 10 months. In the end NZ spent 18 days at Level 2 before moving to Level 1 for the time being at least – handshakes, hugs, and hospitality venues are back. Retail spending through credit and debit cards was back near pre-lockdown levels even under Level 2 restrictions, and electricity usage is back to normal levels. Q1 GDP printed at -1.6% qoq relative to the RBNZ's -2.4% expectation, although margins of error around Q2's expected decline make the whole of Q1 look like a small margin of error in comparison.

Not out of the woods yet

It is encouraging to see the NZ economy getting back to more normal commercial and social interactions, after one of the world's strictest lockdowns. But the border remains effectively closed: current quarantine capacity is around 250 arrivals a day, and is primarily taken up by returning New Zealanders (at least those that aren't doing fuel economy road trips). The hole torn in NZ's export earnings from the border closure will take a while to knit closed. Moreover, the world as a whole is still dealing with the presence of COVID-19, with 2020 set to feel the most significant downturn since the Great Depression.

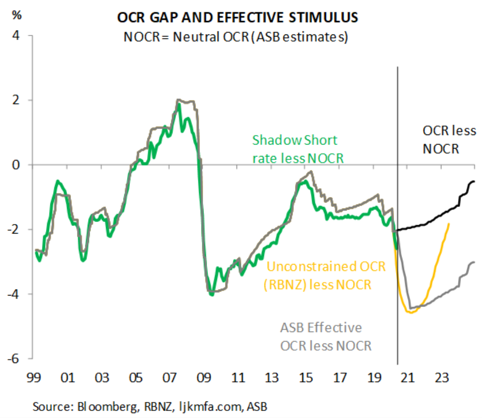


For that reason, strong policy support will need to remain in place for a considerable period, likely for longer than the RBNZ's May forecasts would suggest. We are mindful that the longer-term recovery could still be more gradual than the RBNZ has assumed, even if the short-term dip proves to be less severe than the RBNZ's recent forecast.

Current monetary stimulus not as big as it seems

The RBNZ's policy actions are extreme. Yet, the challenges of being close to the effective floor for interest rates before the crisis started means that there hasn't been much room for manoeuvring. The effective stimulus of monetary policy is currently not that much more substantial than the response to the Global Financial Crisis, despite the greater seriousness of the shock.

In recent research work we adjusted the OCR level to take account of the impact of the RBNZ's asset purchases. That gives an impressively-low sounding figure of a -0.5% OCR. But, when you adjust this 'effective' OCR for how it sits relative to estimates of the neutral (i.e. goldilocks) OCR, current monetary settings aren't that much lower relative to 'neutral' than they were in 2009 – 2011.



What this work reinforces is that borrowers and depositors will be living in a world of very low nominal interest rates for a long time.

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