ASB

Economic Note

RBNZ June 2020 Official Cash Rate Review

24 June 2020

Steady on the tiller

- The RBNZ kept its policy settings the same, as expected: OCR at 0.25%, asset purchase ceiling at $60 billion.
- The RBNZ remains "prepared to provide additional stimulus as necessary".
- The near-term picture is more encouraging, but the longer-term risks remain skewed to a weaker outlook.

The RBNZ's OCR Review statement was pretty much in line with what we expected: no change to policy settings; a better near-term picture; but tempered by an outlook that is still highly uncertain with the risks still skewed to a weaker than anticipated economic outlook. The RBNZ forecasts will get updated in August. We remain more cautious than the RBNZ about the pace of longer-term recovery. We also expect monetary stimulus will endure for longer than the RBNZ's May forecasts implied.

Importantly, the RBNZ has continued to reiterate that it is prepared to do more stimulus if needed and is working on getting the monetary tool kit fleshed out. The statement had a dovish tinge to it through the Monetary Policy Committee's discussion of the merits of expanding its asset purchase programme.

No change to policy measures

As expected, all policy measures were left unchanged.

The size of the Large-Scale Asset Purchase (LSAP) programme remains the key policy lever for the moment, with the OCR unlikely to budge until March 2021 at the earliest given the RBNZ's commitment to its prior forward guidance.

The LSAP remains at $60b although it was interesting the MPC "discussed the pros and cons of expanding the LSAP programme now". We note the Bank still has over $40b of unused limit under the current LSAP cap so you could be forgiven for questioning the relevance of lifting it now. Still, the language is clearly a steer as to the risk profile and we suspect this is why financial markets read the Statement as marginally more dovish than expected. The NZD/USD fell around 20 points and swap yields are down around 1-2bps.

In terms of the outlook for monetary policy, it appears the Bank broadly shares our view that the recent burst in economic activity could be short-lived, not least because the roll back of some government support in coming months could see the jobless rate rise. The Bank also duly noted "the fragile nature of the global pandemic containment." We remain cautious about the pace of longer-term recovery (as discussed below).

It is for these reasons the Bank is "prepared to provide additional stimulus as necessary". Indeed, it was noted that the Bank is continuing to prepare the use of additional policy tools and that we will be updated as to the Bank's readiness on this front in the August *Statement*. Our view is that a negative OCR is still probably towards the back of the pack in terms of these additional tools, with an expansion in the LSAP and a term lending facility ranking higher.

Nick Tuffley – Chief Economist; Mike Jones – Senior Economist; Mark Smith – Senior Economist

Stronger short-term outlook, but concerns lie further ahead.

The RBNZ acknowledged that the short-term outlook was undoubtedly stronger than in the May MPS. NZ has moved to Alert Level 1 much sooner than the RBNZ had previously assumed (the May MPS had assumed that NZ would remain at Level 2 until early next year). This relaxation in social restrictions and the 'feel good' factor on tackling the outbreak has seen more buoyancy in the NZ data than many would have expected, likely coming as a pleasant surprise to the RBNZ. Added to that was a fiscal package in the 2020 Budget providing slightly more of a boost than the Bank had assumed. Moreover, recent falls in retail interest rates had reduced borrowing costs for households and businesses.

All this is small change compared to the impact of a global pandemic, with the RBNZ monetary policy committee warning these positives could be "short-lived", with "possible negative outcomes remaining severe and larger than any near-term upside surprises". Once again, the outlook remains highly uncertain and dependent on efforts to contain COVID-19. Any potential easing in international border restrictions could provide a boost to the beleaguered New Zealand tourism and education sectors (about 5% of NZ's GDP). However, the recent flaring up of COVID-19 cases globally highlights the risk that current disruptions to supply chains and international travel will remain for a while yet.

The RBNZ were also concerned that the phasing out of various Government support schemes – the wage subsidy scheme in particular which runs out in September– could lead to further job losses and further labour market disruption. The higher NZD was cited as an added concern, placing further pressure on export earnings. Hence the intent of the RBNZ to continue to provide significant monetary support.

The guarded tone of the RBNZ's policy assessment is consistent with our core economic view. We expect NZ's borders to remain shut for a while yet, for economic activity to be about 5% lower over 2020 and for the unemployment rate to end this year close to double the rate at which it started 2020. Interest rates are expected to remain very, very low for a long time yet.

ASB Economics & Research			**Phone**
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5957
Senior Economist	Jane Turner	jane.turner@asb.co.nz	(649) 301 5853
Senior Economist	Mike Jones	Mike.jones@asb.co.nz	(649) 301 5660
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Data & Publication Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

www.asb.co.nz/economics

@ASBMarkets