

Economic Note

RBNZ OCR Update

4 March 2020

OCR cuts coming soon

- Given the swiftly-changing COVID-19 situation, we expect the RBNZ to now respond with OCR cuts.
- Fiscal policy will be the best targeted response, but the likelihood of a prolonged economic impact warrants monetary support as well.
- We have pencilled in 25bp cuts for each of March and May, though the outlook will remain fluid.

Summary

Yesterday afternoon, after the Reserve Bank of Australia's 25bp cash rate cut, we changed our OCR forecast to predict imminent OCR cuts. Until very recently, central banks had sounded reluctant to respond – that bar has quickly dropped considerably. The US Federal Reserve's decision this morning to cut the Federal Funds rate by 50bp between scheduled meetings has strongly reinforced that view of a low threshold for the RBNZ to act.

We have pencilled in 25bp cuts for each of the March and May meetings, taking the OCR to a fresh low of 0.5%. What we'd warn at this point is the range of outcomes remains wide, and this forecast should be viewed as an indicative bookmark. We'll be doing work on a range of potential outcomes as a guide for helping to understand the impacts of several possible outcomes.

Fiscal policy remains the most effective response to the emerging pressures the economy is facing. It can be directed with more precision at the individuals, businesses and industries that are most affected. But, given the growing risk that the economic impact is with us for much of 2020, **it increasingly makes sense for monetary policy to do its bit to help.** Monetary policy also has the advantage of being a quicker lever to pull than some fiscal levers.

The inevitable questions from here on the OCR front are: when will the RBNZ cut, by what sized chunks, and to what end point? Experience from the Global Financial Crisis (GFC), a time of extreme uncertainty, says **the best answer right now is no-one knows** so remain flexible and nimble if interest rates and exchange rates matter to you.

An intra-meeting OCR cut (as the Fed did this morning) is always a possibility – and did occur in NZ after the 9/11 terror attacks. It will pay to keep watch, particularly around 9am and 2pm. We do see an intra-meeting cut as having a risk of fuelling the air of uncertainty rather than helping calm it. Likewise for a large 50bp cut: the combination of the Fed's large and intra-day meeting cut did not calm financial markets, and the initial response to last year's 50bp cut from the RBNZ was also initially greeted with a "what do they know that we don't" reaction. Having said that, the GFC had us picking moves of up to 150bp! But, the RBNZ now has far less ammo. **In our view, moving in gradual and measured steps at scheduled meetings will have the greatest impact on shoring up domestic confidence.**

And where is the low point for OCR? Essentially, anywhere between 1% and fractionally negative, depending on how prolonged the virus outbreak is, and the extent to which behavioural changes make a mark on the NZ economy.

Final word: calm and measured responses by policy-makers, businesses and households are what will make a difference to how NZ navigates through this latest challenge.

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