# Economic Note

RBNZ MPR Preview Sep 2020

18 September 2020

## And now we wait

- We expect the RBNZ to leave the OCR, forward guidance, and LSAP parameters all unchanged next week.
- Wholesale and retail interest rates are grinding lower, important given the RBNZ's laser-like focus on driving them down, and the economic picture is not materially different to prior RBNZ expectations.
- Markets will be most sensitive to any changes to forward guidance. We see a small risk that it is softened.

We expect next week's RBNZ Monetary Policy Review to be relatively uneventful. Most of the grunty policy updates were done in the August Monetary Policy Statement (MPS). And with the deployment of alternative policy tools including a negative OCR a story for early 2021, this meeting will really be about marking time. We continue to expect the OCR to be lowered from its current 0.25% to -0.5% in April 2021. A Funding for Lending programme is expected to be introduced at the same time, but we think it should come earlier. We released two notes this week that discuss the practical implications of a negative OCR (see here and here).

Key for market watchers will be whether the Bank sticks to its forward guidance that the OCR will be left where it is until March next year. The guidance was reiterated again in August: "the Official Cash Rate (OCR) is being held at 0.25 percent in accordance with the guidance issued on 16 March". We expect that this line will broadly be retained. But the risk, if any, is that the guidance could be softened a little. Markets are already toying with the idea. Pricing is now consistent with a better-than-even chance of the OCR being reduced to zero by February (18bps of cuts priced). Any softening in the Bank's forward guidance would see markets move to front-load OCR cuts even further.

The Bank is now busy consulting, investigating, and designing alternative monetary policy tools. Banks have been instructed to be ready for a negative OCR by the end of the year. Should all of this work turn up a package of tools that is both effective and operationally ready, and there is no material improvement in the economic outlook, there is a chance the Bank moves on additional policy easing before March of next year. In other words, we think the market is right to price a chance of earlier easing. Adding to the potential for an earlier move is the fact that the OCR announcement dates have shifted, with the next scheduled OCR announcement after the February MPS (February 24) not coming until April 14.

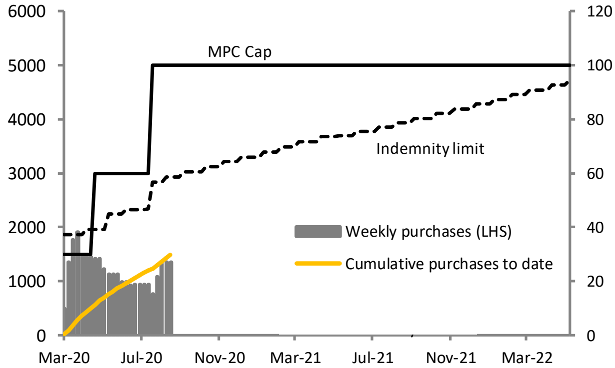
In recent communications the RBNZ has explicitly linked the prospect of a negative OCR with a Funding for Lending Programme (FLP) which would see the RBNZ directly fund banks at the prevailing OCR rate. We remain of the view that a FLP scheme should be put in place earlier than March. The *timely* success of such a scheme partly rests on banks having a long enough lead time to factor such a programme into their funding plans.

We don't expect any change to the parameters of the Bank's Large Scale Asset Purchase (LSAP) programme. In August, the Monetary Policy Committee (MPC) lifted the cap on such to $100bn and announced an intention to front-load weekly bond purchases. There hasn't been sufficient change to the economic and financial markets outlooks to

Mike Jones – Senior Economist mike.jones@asb.co.nz

warrant any deviation from this strategy. The $100b limit is plenty to be going on with for now. Cumulative purchases to date are only around $30b. And, in any case, the indemnity limit agreed with the Finance Minister remains the constraining factor for weekly bond purchases, not the MPC cap (see chart). Note that this indemnity constraint now kicks in slightly earlier following this week's small reduction in planned government bond issuance.

Overall, the local and global economic picture is not materially different to prior RBNZ expectations. Most importantly, given the Bank's laser-like focus on such, NZ wholesale and retail interest rates have continued to grind lower.



Source: ASB, RBNZ *Excludes LGFA, indemnity based on current bond programme

The August change in Alert Levels occurred literally the day of the August MPS so will only now have been factored into RBNZ forecasts. This won't be major – our estimates suggest only a mild GDP impact. What's more, this impact will likely have been more than offset by a stronger starting point for the economy. Q2 GDP growth "only" plunged 12.2% qoq, better than the Bank's -14.3% qoq forecast. Probably the biggest surprise for the Bank would have been the strength in the housing market. The RBNZ August MPS forecasts implied around a 9% fall in house prices over 2020. That's very unlikely to occur now, and will probably have the Bank nudging up its consumption and GDP forecasts a little.

Still, the persistence of the COVID-19 headwind remains a major unknown, with the risk of longer-lasting disruptions to economic activity than what the RBNZ have assumed. We thus expect the Bank to maintain its commitment to do more to support the economy, including lowering the OCR in 2021.


| **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 |
| Economist | Nat Keall | nathaniel.keall@asb.co.nz | (649) 301 5720 |
| Data & Publication Manager | Judith Pinto | judith.pinto@asb.co.nz | (649) 301 5660 |

**www.asb.co.nz/economics** **@ASBMarkets**