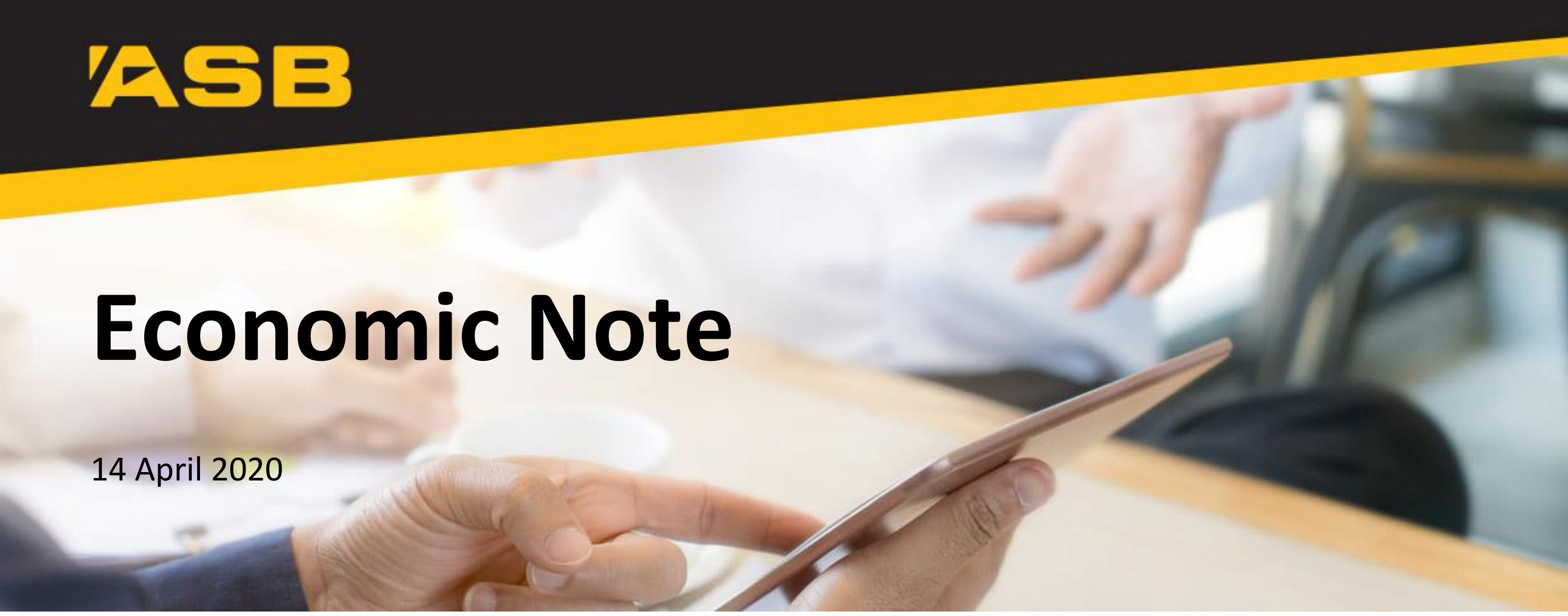


Economic Note

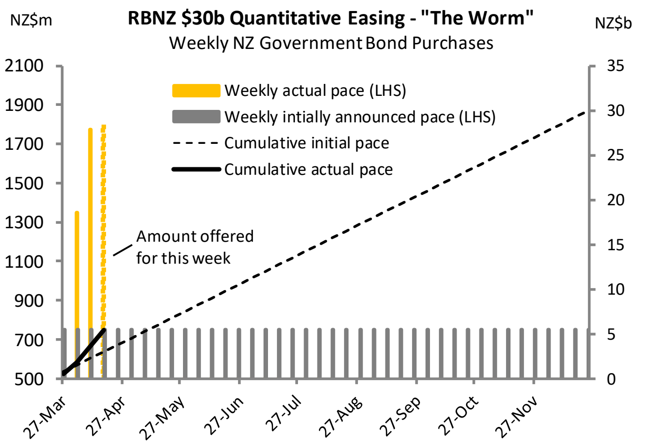
14 April 2020

RBNZ: QE upsize likely in May

- **RBNZ has been front-loading government bond purchases**.
- **We estimate the Bank is $1.4b ahead of the initially communicated run rate**.
- **Additional government debt issuance warrants a QE-upsize**.
- **We think the programme could lift from $33b, to $40-50b at the May meeting.**
- **Inflation-linked bonds to be added to the mix, but not corporate bonds.**

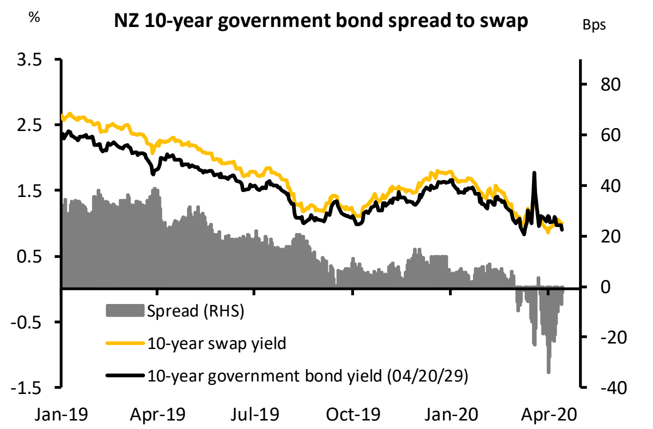
The RBNZ has made a strong quantitative easing (QE) debut, but we think it's going to have to go harder.

Recall the Bank initially announced a $30b, twelve-month programme of government bond purchases. A $750m per week cadence was the early plan, but with on-the-ground implementation decisions delegated to Bank staff. At that time, $30b amounted to about half of the entire nominal government bond market.



Source: RBNZ

Of course, since that announcement, the NZ government has upsized massively its debt issuance plans, effectively diluting the yield-moving power of the RBNZ's $30b QE programme. As we outlined in our note last week, this mix of more bond supply but the same amount of RBNZ buying saw government bond yields move well above swap rates – a historically unusual event (chart opposite).



Source: Bloomberg

Last week, the RBNZ hinted fairly strongly that it will go harder on the QE front, but that this is a decision for the Monetary Policy Committee, which makes its next formal announcement on 13 May. By then the Committee would have received the next full economic assessment from RBNZ staff.

But how big will they go? A couple of points on this.

First, they have moved already. Following the government's bond programme upsize, the Bank has been using its operational flexibility to buy bonds at a run-rate

Mike Jones – Senior Economist (649) 301 5661 mike.jones@asb.co.nz

well above what was initially outlined. As the chart above shows, just under $1.8b in government bonds were bought last week with a further $1.8b planned for this week. In the three weeks QE has been running, the cumulative bond buying "worm" is $1.4b ahead of the initial plan.

Second, by the end of June we estimate that the (nominal) government bond market will be around $15b larger – at around $75b – than what the RBNZ *thought* it would be at the time their $30b QE plan was hatched. The size of the market will also continue to grow beyond June. Last week, Assistant Governor Hawkesby confirmed the ideal state for the Bank is still to own 40-50% of the market. Indeed, this is a broadly similar ownership percentage to the RBNZ's QE-happy offshore counterparts.

Then there's the question of scope.

The Bank confirmed last week that it will add Local Government Funding Agency bonds to its QE mandate, to the tune of $3b (around 30% of the market). We also expect inflation-indexed government bonds to be added to the list in May. There's around $18b of 'linkers' on issue and, applying a similar RBNZ ownership percentage as LGFA bonds, we expect the Bank could purchases $5b or so of linkers.

At this stage we don't expect the Bank to start buying corporate bonds in the same way the likes of Fed are now doing in earnest. There are a few difficulties associated with doing so. For one thing, there is a dearth of highly-rated corporate bonds on issue in NZ. Buying corporate paper also raises the thorny issue of which corporates to buy, and which not to. Who gets the special treatment, in other words. Finally, for QE buying to actually benefit the borrowing entities (rather than simply the institution who is holding their paper) corporates need to be issuing new bonds, and they aren't at present.

We think the Bank's approach of buying government and LGFA bonds to (1) directly lower base interest rates and (2) splash cash around the system is the best approach. There should be indirect positive effects on corporate bond spreads in doing so. Assistant Governor Hawkesby toed a similar line in his interview with Bloomberg last week.

Based on all of the above, we think the total RBNZ QE programme could lift from the current $33b (including the $3b of LGFA bonds) to $45-50b in May.

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 Rural Economist	Nathan Penny	nathan.penny@asb.co.nz	(649) 448 8778
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

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