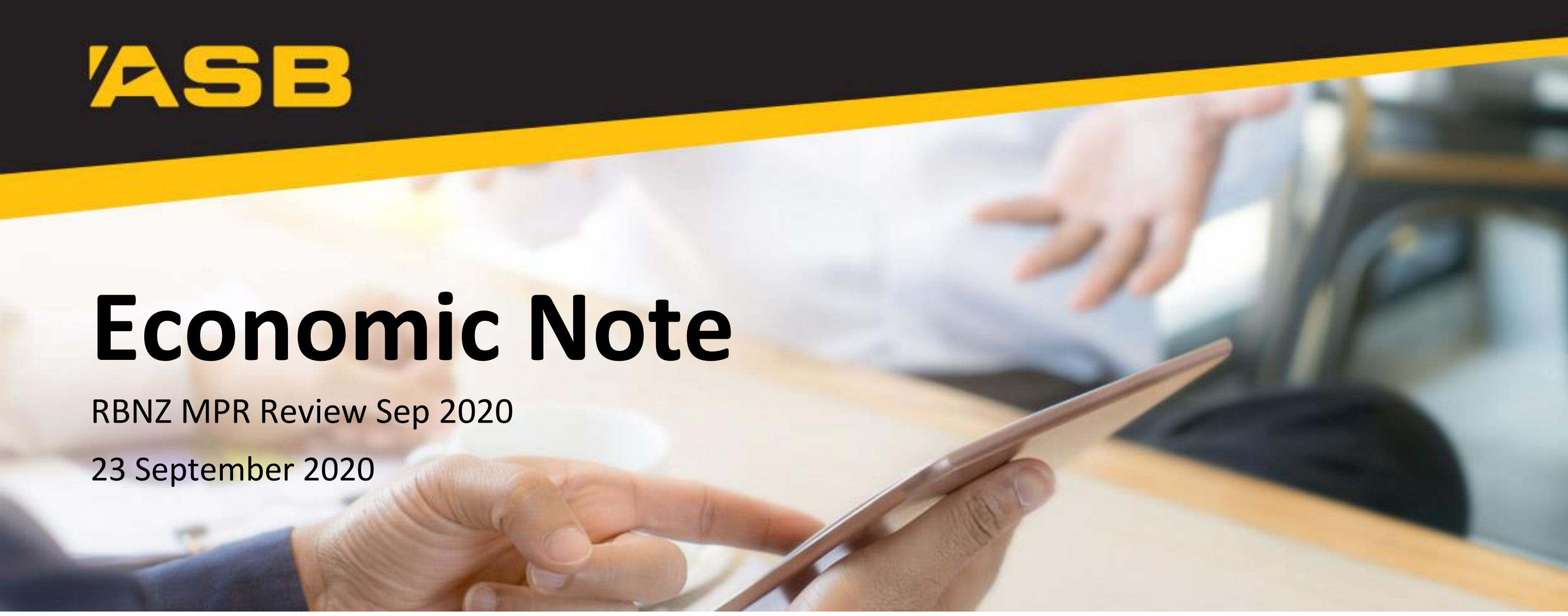

Economic Note

RBNZ MPR Review Sep 2020

23 September 2020

RBNZ signals further interest rate relief for borrowers

- As expected, the RBNZ maintained current settings and kept its easing bias.
- However, the RBNZ also cited that progress had been made on developing alternative monetary policy instruments, flagging that a Funding for Lending Programme will be introduced by the end of the year.
- We expect the RBNZ to sequence policy easing, with a funding for lending programme to be introduced later this year before the OCR is lowered in early 2021. Prior to this we expect the RBNZ to maintain a strong pace of asset purchases to push yields lower. Such moves are designed to further lower borrowing costs in the economy.

Something old, something new from the RBNZ

There was much in the September MPR assessment that was little changed on the August MPS. **For one, current policy settings were retained**, with the RBNZ holding the OCR steady at 0.25% and maintaining the size of its Large-Scale Asset Purchase Programme (LSAP) at $100 billion. Moreover, it stuck to its forward guidance to leave the OCR on hold at 0.25% until early next year.

Second, the RBNZ assessment of the economic outlook was sombre. The RBNZ remains concerned over the global outlook, and the risks of the recovery stalling. While there were a few glimmers of positivity, the policy assessment pointed to subdued levels of economic activity, with the Summary Record of Meeting citing the "unprecedented contraction" in Q2 economic activity and the potentially longer-lasting headwinds posed by COVID. Fiscal policy support measures had been effective in cushioning the economy, but with the income support measures rolling off, fiscal tailwinds were receding.

Third, the RBNZ view is that monetary policy will need to provide significant economic support for a considerable period. International border restrictions are likely to significantly curtail migration and tourism, and lead to the activity outlook being uneven across industries and regions. The weak global backdrop and soft domestic conditions will likely result in rising NZ unemployment and firm closures. The RBNZ reiterated that the economic outlook remained highly uncertain and dependent on the course of the virus. However, the balance of risks remained skewed to the downside, with the MPC concerned that a severe and prolonged economic downturn would make it difficult to achieve its inflation and employment objectives. We concur.

Fourth, the RBNZ maintained the same additional options for providing policy stimulus. These included the same 'Big 3' that were cited in August, including a Funding for Lending Programme (FLP), a negative OCR, and purchases of foreign assets. The policy assessment also reiterated that these instruments would be mutually supportive in bolstering economic activity.

What was different this time around, however, was the comments on the progress being made on the Bank's ability to deploy additional monetary instruments. First, the RBNZ was explicit in noting that these alternative instruments could be deployed independently, rather than as a package of measures. Second, it was noted that the FLP would be ready before the end of this calendar year, an explicit signal to banks to get things ready now. It seems the RBNZ

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has done a lot more thinking on policy implementation, including the sequencing of additional monetary instruments. As we had asserted earlier (see here and here) the RBNZ should look at introducing the FLP *prior* to cutting the OCR. As the RBNZ noted today, having an FLP in place earlier would provide certainty to enable financial institutions to plan their funding needs and would help speed up the transmission of the programme by allowing banks to replace funding as it matured over time. This should help provide interest rate relief to borrowers *sooner*.

The RBNZ was a little more direct on its language on a negative OCR, with the banking system deemed to be "on track to be operationally prepared for negative interest rates by year end". We think that the RBNZ will stick to its March 16 guidance on not cutting the OCR until early 2021. Beyond that, however, the direction is risk is clear.

Our take

In addition to its LSAP programme, the RBNZ clearly wishes to add more policy stimulus and is not prepared to wait until early next year to do so. It is clear that they wish to lower borrowing costs in the economy and do it swiftly; hence the signal to go with an FLP as soon as is practically possible. Given it is nearly October, the RBNZ pledge to have the programme ready by the end of the year suggests they are not mucking around.

When might this be? **The intention to implement FLP before year-end may mean it is ready to implement the scheme at the November 11th Monetary Policy statement release. But if the scheme is not ready by then, it is still likely the RBNZ would want to get it implemented before Christmas** rather than waiting until next year. It was helpful that the RBNZ has pledged to provide details on the design of the programme prior to them being deployed. However, to get more bang for its policy buck, the sooner these details are provided the better. As we noted recently, the RBNZ will need to get the design details right to ensure the scheme maximises its effectiveness.

We still expect the RBNZ will cut the OCR in early 2021 and have pencilled in an April OCR cut. In our view, risks to the economic outlook are still tilted to the downside and the RBNZ will want to provide as much stimulus as possible to support the economy that it going through a severe downturn. The adoption of an effective FLP would reduce the urgency for the RBNZ to reduce the OCR, but it would not negate it altogether.

Table 1: Side-by-side Statement comparison

September MPR	**August MPS**
QE, OCR Decision and forward guidance	*QE, OCR Decision and forward guidance*
The Monetary Policy Committee agreed to continue with the Large Scale Asset Purchase (LSAP) Programme up to $100 billion. This action is necessary to further lower household and business borrowing rates in order to achieve the Committee's inflation and employment remit. The Official Cash Rate (OCR) is being held at 0.25 percent in accordance with the guidance issued on 16 March. Members agreed that monetary policy will need to provide significant economic support for a long time to come to meet the inflation and employment remit and promote financial stability. They also agreed they are prepared to provide additional stimulus.	The Monetary Policy Committee agreed to expand the Large Scale Asset Purchase (LSAP) programme up to $100 billion so as to further lower retail interest rates in order to achieve its remit. The eligible assets remain the same and the Official Cash Rate (OCR) is being held at 0.25 percent in accordance with the guidance issued on 16 March. Monetary policy will continue to provide important economic support in the period ahead. Its effectiveness is evidenced by retail banks' lower funding costs and lending rates, which are benefiting businesses and households. It remains in the long-term interest of banks to fully pass on the benefits of lower funding costs to their customers. The Monetary Policy Committee will provide additional stimulus as necessary to meet its remit.
Additional RBNZ tools	*Additional RBNZ tools*
Reflecting the possible need for further monetary stimulus, the Committee noted the progress being made on the Bank's ability to deploy additional monetary instruments. The instruments include a Funding for Lending Programme (FLP), a negative OCR, and purchases of foreign assets. The Committee agreed that these instruments can be mutually supportive in bolstering economic activity. <u>Members also agreed that the alternative instruments can be deployed independently and noted that the FLP would be ready before the end of this calendar year.</u>	Reflecting a possible need for further monetary stimulus, the Committee also agreed that a package of additional monetary instruments must remain in active preparation. The deployment of such tools will depend on the outlook for inflation and employment. The package of further instruments includes a negative OCR supported by funding retail banks directly at near-OCR (a Funding for Lending Programme). Purchases of foreign assets also remain an option.
Fiscal Policy	*Fiscal Policy*
Ongoing support for domestic economic activity is being provided through significant government spending on business assistance and household income support. This will be accompanied by a rising level of government investment. However, the removal of temporary support policies has commenced. For example, the Wage Subsidy scheme is now closed to new entrants.	Ongoing support for domestic economic activity is being provided through significant government spending on business assistance and household income support. This will be supported by a rising level of government investment. However, there will be a transition of policies in the near-term, with the announced end of the Wage Subsidy likely to coincide with a decline in employment.
NZ Economic Activity/labour market	*NZ Economic Activity/labour market*
Economic information available since the August *Monetary Policy Statement*, both international and domestic, has confirmed the level of economic activity remains significantly below that experienced prior to the COVID-19 economic disruption. The ongoing virus-led activity restrictions – most notably in Auckland – had also continued to dampen economic activity, and business and consumer confidence. In line with the weak underlying international and domestic economic conditions, the Committee expects a rise in unemployment and an increase in firm closures, as resource reallocation continues.	Over recent months New Zealand had contained the spread of COVID-19 locally, allowing a relaxation of social restrictions and a recovery in economic activity. Recent indicators highlight that the faster return to social norms and a higher proportion of employees working from home has seen output and employment recover sooner than projected in our May Monetary Policy Statement. Recent spending also reflected pent up demand resulting from the lockdown period. International border restrictions will continue to significantly curtail migration and tourism, and lead to the activity outlook being uneven across industries and regions.

Global Outlook/exports	Global Outlook/exports
Any significant change in the global and domestic economic outlook remain dependent on the containment of the virus, which is highly uncertain. International border restrictions will continue to significantly curtail migration and tourism, and lead to the activity outlook being uneven across industries and regions.	However, the severe global economic disruption caused by the pandemic is persisting. Any significant change in the global and domestic economic outlook remains dependent on the containment of the virus, which is highly uncertain as evidenced today by the return to social restrictions in New Zealand.
Exchange rate/commodity prices	*Exchange rate/commodity prices*
Commodity prices for New Zealand's exports remain robust, but this has been partly offset by the New Zealand dollar exchange rate moderating the return to local export producers.	Commodity prices for New Zealand's exports remain robust, but this has been partly offset by a rise in the New Zealand dollar exchange rate moderating the return to local export producers.

Source: RBNZ, ASB

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