Economic Update – First Impressions.

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RBNZ cuts by 75bp to 0.25%.

- The RBNZ cuts the OCR to 0.25% as the economic cost of the Covid-19 pandemic escalates.

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The rapid escalation of the Covid-19 pandemic has prompted the Reserve Bank into action. In an unscheduled review this morning, the RBNZ reduced the cash rate by 75 basis points to 0.25%, and committed to holding it at this level for at least the next 12 months.

This was, in the RBNZ's view, the largest rate cut that it could do right now. While the Governor's speech last week suggested that a negative OCR was their first preference for 'unconventional' policy measures, there were concerns about the financial system's operational readiness to handle very low or negative interest rates.

The RBNZ noted that if any further easing is required, it is most likely to be large-scale purchases of government bonds. We think that such a step will be announced before too long, potentially even before the May Monetary Policy Statement. And with the Government set to announce a major fiscal support package tomorrow, there will soon be substantially more bonds in the market to buy.

The RBNZ is also looking at ways to reduce the pressures on the banking system, to ensure that credit continues to flow to businesses. The planned increase in bank capital requirements will be delayed for a year – while the full increase was to be phased in over seven years, about a quarter of the increase was scheduled to occur in July this year. The RBNZ said that will identify other regulatory measures that can be deferred, with an announcement expected in the next few days.

Strong action was necessary to backstop the economy. The expected cost of the Covid-19 pandemic has escalated rapidly, culminating in the Government's announcement over the weekend that all arrivals into New Zealand will be required to self-isolate for 14 days (except those arriving from the Pacific Islands). While not an outright travel ban, it means that anything other than essential travel is essentially no longer viable. This will be a major economic disruption, most obviously for the tourism and travel sectors, but it will ripple through the economy more widely.

At this point a severe recession is inevitable. Policymakers can’t simply resort on stimulating demand, as the efforts to contain the spread of the virus actually require demand to be suppressed for a period of time. Instead, the focus will need to be on helping businesses and households tide themselves over during the containment period. The RBNZ is doing its part, and we’ll see the Government’s response tomorrow.

RBNZ statement:

The Official Cash Rate (OCR) is 0.25 percent, reduced from 1.0 percent, and will remain at this level for at least the next 12 months.

The negative economic implications of the COVID-19 virus continue to rise warranting further monetary stimulus.

Since the outbreak of the virus, global trade, travel, and business and consumer spending have been curtailed significantly. Increasingly, governments internationally have imposed a variety of restraints on people movement within and across national borders in order to mitigate the virus transmission.

Financial market pricing has responded to these events with declining global equity prices and increased interest rate spreads on traditionally riskier asset classes.

The negative impact on the New Zealand economy is, and will continue to be, significant. Demand for New Zealand's goods and services will be constrained, as will domestic production. Spending and investment will be subdued for an extended period while the responses to the COVID-19 virus evolve.

Several factors will continue to assist and support economic activity in New Zealand.

New Zealand's financial system remains sound and our major financial institutions are well capitalised and liquid. The Reserve Bank is also ensuring that the banking system continues to function normally.

The Government is operating an expansionary fiscal policy and has imminent intentions to increase its support with a fiscal package to provide both targeted and broad-based economic stimulus.

The New Zealand dollar exchange rate has also depreciated against our trading partners acting as a partial buffer for export earnings.

And, the Monetary Policy Committee agreed to provide further support with the OCR now at 0.25 percent. The Committee agreed unanimously to keep the OCR at this level for at least 12 months.

The Committee also agreed that should further stimulus be required, a Large Scale Asset Purchase programme of New Zealand government bonds would be preferable to further OCR reductions.

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