Economic Bulletin.

13 May 2020

Keeping the door open – Review of RBNZ Monetary Policy Statement.

- As expected, the RBNZ aggressively expanded its quantitative easing programme.
- The RBNZ was open to a negative OCR, just not yet.
- Guidance about the timing of a negative OCR pointed to early 2021, although no commitments were made.
- We remain very comfortable forecasting a negative OCR, although the November 2020 timing is looking less certain.
- The RBNZ's inflation and unemployment forecasts seem too optimistic to us.

Dominick Stephens, Chief Economist
+64 9 336 5671

Today's Monetary Policy Statement was very much what we were expecting from the RBNZ.

Expansion of QE.

The RBNZ expanded its Long Term Asset Purchase programme (LSAP) from $33bn to $60bn. The scope of the programme has been expanded to include inflation indexed bonds alongside the already-included NZ Government Bonds and local government debt.

The RBNZ also mentioned that, should more stimulus be required in the future, purchasing foreign bonds was a possibility. This would mainly work by lowering the exchange rate, and was mentioned in the RBNZ's playbook on alternative monetary policy, which it published late last year.

The Monetary Policy Committee has continued to delegate to staff decisions about the pace of purchases under the LSAP. We were disappointed to see no guidance about how staff are making those decisions. To date, the staff have bought bonds at a pace that would have exhausted their $33bn allowance in four months, rather than a year. The staff obviously had some goal in mind when they made that decision, and we think it would be more transparent if the central bank was to come clean about what that goal is.

RBNZ opens the door to a negative OCR, timing uncertain.

For us, the most interesting aspect of today's MPS was always going to be what the RBNZ said about the possibility of a negative OCR. We are forecasting that the OCR will be reduced to -0.5% in November this year. We are the only major bank forecasting a negative OCR.

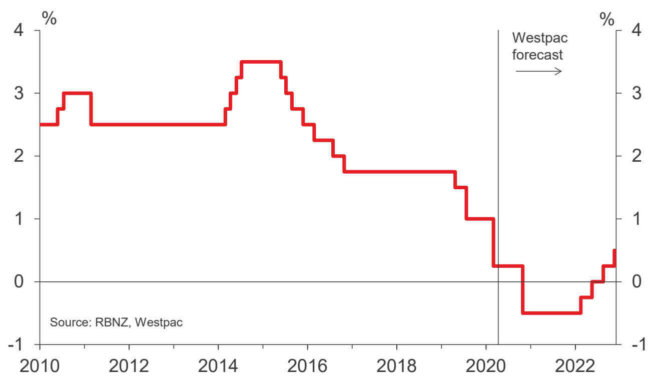
The RBNZ certainly made it clear that it would adopt a negative OCR in the future if the situation required it and it was operationally feasible. That settles one aspect of the debate, and financial market pricing moved further in the direction of a negative OCR in response to the these comments.

What we were looking for today was guidance as to the possible timing of a negative OCR. The key reason that the RBNZ has not already implemented a negative OCR is that the trading banks are not operationally ready – changes to their IT systems and legal documentation are required. Consequently, back in March the RBNZ said it would keep the OCR at 0.25% for a year. We were very keen to see what the RBNZ had to say about the timing today.

The RBNZ noted that a negative OCR is not currently possible, so it "reaffirmed its **forward guidance** that the OCR would remain at 0.25% until early-2021" (our emphasis). That is rather soft – it certainly wasn't a promise or a commitment. Forward guidance is routinely updated if the economic reality changes. The fact of having given this guidance certainly would not stand in the way of the RBNZ cutting the OCR below zero if the situation requires it later this year.

However, during the press conference the RBNZ revealed that it has asked the banks to prepare for a negative OCR "by the end of the year." That suggested that our forecast of a negative OCR late this year might be a bit of a stretch, and seemed to favour early next year. However, we will seek clarity around that comment and assess any further RBNZ communications before drawing any conclusions.

Westpac Official Cash Rate forecast



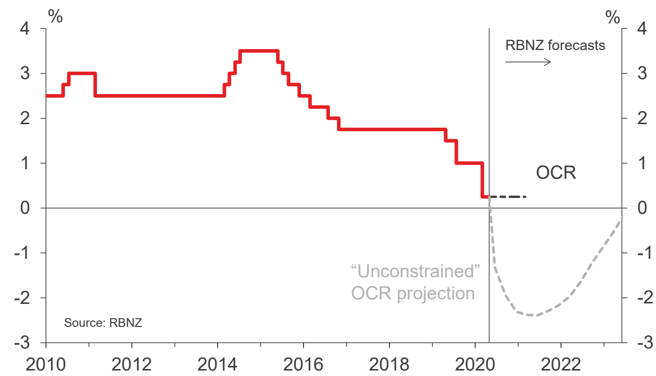
If you could do anything you wanted...

The RBNZ's OCR forecasts this time were unusual. First of all, the RBNZ's OCR forecast was 0.25% until March 2021, but no numbers were published beyond that. The forecast out to March was consistent with the guidance mentioned above. We think the lack of forecast beyond March 2021 reflects the fact that the RBNZ's models would be saying that a negative OCR is necessary, and the RBNZ is probably not ready to give that signal just yet.

The RBNZ did publish an "unconstrained OCR forecast." This is the level of the OCR that would be necessary to achieve the RBNZ's goals in a theoretical world in which the OCR could go as low as the RBNZ wanted. It is presumably what the RBNZ's models would spit out if the model wasn't "told" that a negative OCR is not possible right now.

The unconstrained OCR forecast was -2%. This does not mean the OCR will actually go to -2%. Instead, it emphasises that the RBNZ needs to provide much more stimulus than just an OCR of 0.25%. Quantitative easing might fill some of the gap between what is required and where the OCR actually is right now. But we think that a negative OCR will also have to be part of the mix in the future.

RBNZ Official Cash Rate projections



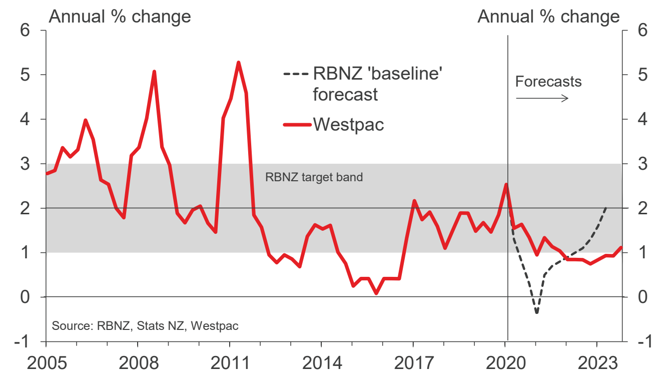
RBNZ forecast of inflation too optimistic.

The RBNZ's GDP forecasts are fairly similar to our own, except that the RBNZ expects a bigger dip-then-recovery during the lockdown period. However, the RBNZ is much more optimistic than we are about unemployment falling and inflation rising during the early-2020s. In other words, the RBNZ believes that the stimulus it has delivered to date, combined with $52bn of fiscal stimulus, will be enough to meet its targets within a reasonable time frame.

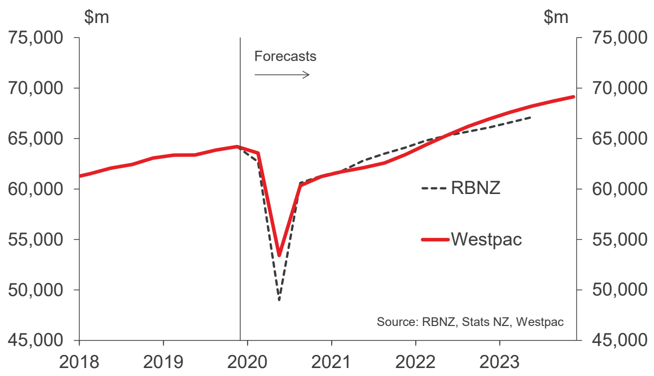
We disagree with that. We expect inflation to remain low for longer, and unemployment to remain high for longer.

If we are correct, the RBNZ will have to reassess its monetary policy stance. This is a key reason that we are comfortable forecasting a negative OCR even though the central bank itself is not forecasting such a move.

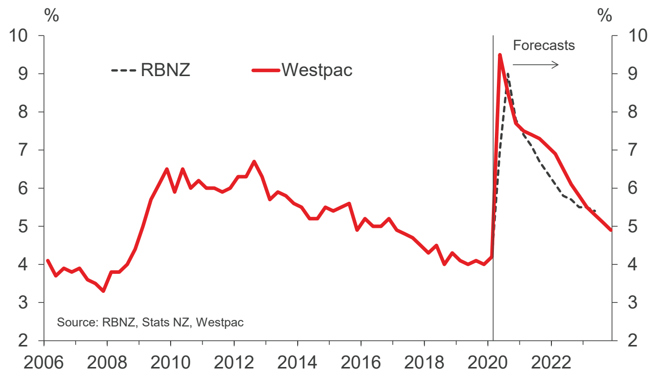
Comparison of Westpac and RBNZ inflation forecasts



Comparison of Westpac and RBNZ GDP forecasts



Comparison of Westpac and RBNZ unemployment forecasts



Contact the Westpac economics team.

Dominick Stephens, Chief Economist
+64 9 336 5671

Michael Gordon, Senior Economist
+64 9 336 5670

Satish Ranchhod, Senior Economist
+64 9 336 5668

Paul Clark, Industry Economist
+64 9 336 5656

Any questions email:
economics@westpac.co.nz

Past performance is not a reliable indicator of future performance. The forecasts given in this document are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Disclaimer.

Things you should know

Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141 ('Westpac').

Disclaimer

This material contains general commentary, and market colour. The material does not constitute investment advice. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Country disclosures

Australia: Westpac holds an Australian Financial Services Licence (No. 233714). This material is provided to you solely for your own use and in your capacity as a wholesale client of Westpac.

New Zealand: In New Zealand, Westpac Institutional Bank refers to the brand under which products and services are provided by either Westpac or Westpac New Zealand Limited ("WNZL"). Any product or service made available by WNZL does not represent an offer from Westpac or any of its subsidiaries (other than WNZL). Neither Westpac nor its other subsidiaries guarantee or otherwise support the performance of WNZL in respect of any such product. The current disclosure statements for the New Zealand branch of Westpac and WNZL can be obtained at the internet address www.westpac.co.nz. For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement. Download the Westpac NZ QFE Group Financial Advisers Act 2008 Disclosure Statement at www.westpac.co.nz.

China, Hong Kong, Singapore and India: This material has been prepared and issued for distribution in Singapore to institutional investors, accredited investors and expert investors (as defined in the applicable Singapore laws and regulations) only. Recipients in Singapore of this material should contact Westpac Singapore Branch in respect of any matters arising from, or in connection with, this material. Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking license and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activities. This material is intended only to "professional investors" as defined in the Securities and Futures Ordinance and any rules made under that Ordinance. Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking and Insurance Regulatory Commission (CBIRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

UK: The contents of this communication, which have been prepared by and are the sole responsibility of Westpac Banking Corporation London and Westpac Europe Limited. Westpac (a) has its principal place of business in the United Kingdom at Camomile Court, 23 Camomile Street, London EC3A 7LL, and is registered at Cardiff in the UK (as Branch No. BR00106), and (b) authorised and regulated by the Australian Prudential Regulation Authority in Australia. Westpac is authorised in the United Kingdom by the Prudential Regulation Authority. Westpac is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

This communication is being made only to and is directed at (a) persons who have professional experience in matters relating to investments who fall within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (b) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this communication or any of its contents. The investments to which this communication relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this communication or any of its contents. In the same way, the information contained in this communication is intended for "eligible counterparties" and "professional clients" as defined by the rules of the Financial Conduct Authority and is not intended for "retail clients". With this in mind, Westpac expressly prohibits you from passing on the information in this communication to any third party. In particular this communication and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction. This communication is made in compliance with the Market Abuse Regulation (Regulation(EU) 596/2014).

Investment Recommendations Disclosure

The material may contain investment recommendations, including information recommending an investment strategy. Reasonable steps have been taken to ensure that the material is presented in a clear, accurate and objective manner. Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts in interests associated with the provision of investment recommendations.

(i) Chinese Wall/Cell arrangements;

(ii) physical separation of various Business/Support Units;

(iii) and well defined wall/cell crossing procedures;

(iv) a "need to know" policy;

(v) documented and well defined procedures for dealing with conflicts of interest;

(vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

U.S: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission ("CFTC") as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC ('WCM'), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 ('the Exchange Act') and member of the Financial Industry Regulatory Authority ('FINRA'). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.