Economic Bulletin.

24 June 2020

Straight bat – RBNZ OCR Review, June 2020.

- There was no change to the stance of monetary policy.
- The RBNZ acknowledged the recent improvement in the economic outlook, but it was sceptical and thought the positives may be short-lived.
- The RBNZ also noted that the rising exchange rate would dampen inflation.
- All of this was bang in line with our expectations, and was no surprise to markets.
- The RBNZ is still open to using other monetary policy tools if necessary.
- We still expect that the RBNZ will eventually have to expand the LSAP to $100bn just to keep interest rates where they are.
- And we expect the RBNZ will need to cut the OCR to -0.5% next year.

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Today's OCR Review from the RBNZ was straightforward compared to the dramatic events that unfolded earlier this year.

The RBNZ opted not to make any change to the stance of monetary policy. It left the OCR at 0.25% and it left the quantum of the Large-Scale Asset Purchase programme at $60bn (more on exactly what that means below). This was exactly what we and the markets were expecting.

The RBNZ acknowledged that the country has gone to Covid Alert Level 1 sooner than expected, and that recent economic data has suggested the economic fallout may not be as severe as previously anticipated. However, the RBNZ was deeply sceptical of these improvements to the outlook. It worried that "these positives may be short-lived given the fragile nature" of global pandemic containment.

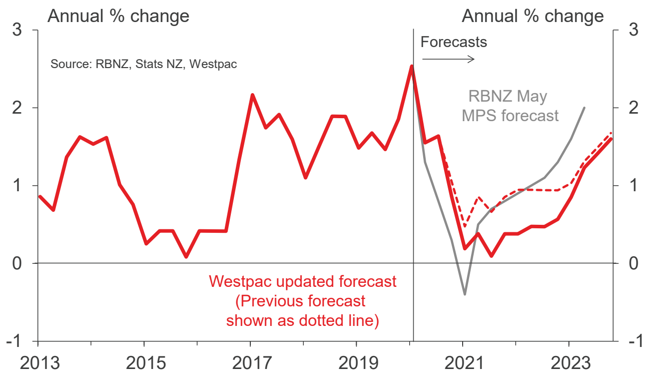
The RBNZ also acknowledged that retail and business interest rates have fallen recently. This was important, because it gives the RBNZ confidence that its LSAP has been effective.

However, the RBNZ also pointed out that the exchange rate had risen, which will suppress inflation and impinge on export earnings.

When we updated our own forecasts recently, we assessed the higher exchange rate to be roughly equal and opposite to the improved economic outlook for the purposes of monetary policy. In other words, we did not alter our medium-term inflation or monetary policy forecasts. There was nothing in today's document to indicate what the RBNZ thought about the balance between the less-bad economic outlook and the higher exchange rate. But the fact that they decided not to change anything suggests that their conclusion was similar to ours.

Interestingly, the Summary Record of Minutes showed that the Monetary Policy Committee discussed expanding the LSAP programme now. This confirms that the RBNZ's underlying disposition is still leaning towards looser monetary policy, and still sees the risks to inflation as being to the downside.

RBNZ and Westpac forecasts of inflation



The Summary Record also noted that RBNZ staff are "working towards ensuring a broader range of monetary policy tools would be deployable in coming months, including a term lending facility, reductions in the OCR, and foreign asset purchases." This reiterates that the RBNZ remains open to using any of these tools in the future. We remain of the view that the OCR will be reduced to -0.5% in April next year, because the RBNZ will run out of Government Bonds to buy if it relies solely on the LSAP.

The RBNZ has basically kicked the can down the road, with little detail in today's missive. Instead, the RBNZ said that it would outline the outlook for its LSAP and describe its readiness to deploy other monetary policy tools in the August Monetary Policy Statement.

Clarity on the meaning of a $60bn LSAP.

There has been some confusion in markets about exactly what a $60bn LSAP entails.

Back in May the RBNZ stated that it would purchase "a maximum of $60bn over the next 12 months." It was not clear whether this figure included the $10bn it had already purchased before it made that statement. Does the LSAP maximum refer only to future purchases, or is it a cumulative sum?

Today the RBNZ said only that the LSAP "quantum remains set at $60bn." After a discussion with the RBNZ, our understanding is that this means the cumulative total of bonds purchased from the start of the LSAP programme until May 2021 will be $60bn. The RBNZ has already purchased $17bn, so this leaves $43bn between now and May 2021.

Expressing the LSAP this way is going to make communication quite complex at upcoming Monetary Policy Statements. We think that the RBNZ is going to have to continue purchasing around $1bn of bonds per week if it is to keep interest rates low. At that pace, it will hit the $60bn cumulative cap by early April 2021. But if the RBNZ slows the pace of bond buying, interest rates will rise. So the RBNZ is going to have to expand the cap on the LSAP just to keep interest rates unchanged and the degree of monetary stimulus the same.

We think that a "non-expansionary expansion" of the LSAP will have to occur at the August MPS – the RBNZ will have to lift the maximum cap on the LSAP to $80bn just to reassure markets that it intends to continue buying bonds at about the current pace beyond April next year. Eventually, we expect that the bond programme will have to total $100bn in order to allow sufficient monetary stimulus for a sufficient length of time.

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