MNI RBNZ Decision Preview – August 2020

Meeting Dates: Wednesday, 12 August

Statement Release Time: 14:00 NZST/03:00 BST

Link To Statement: https://www.rbnz.govt.nz/monetary-policy/official-cash-rate-decisions

Link To MPS: https://www.rbnz.govt.nz/monetary-policy/monetary-policy-statement

Press Conference: 15:00 NZST/04:00 BST

Link To Live Stream of Press Conference: https://www.rbnz.govt.nz/research-and-publications/webcasts

CONTENTS

mni Central Bank Watch - RBNZ

MNI RBNZ Data Watch List

Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
CPI (Q)	% y/y	1.5	2.5	↓	1.9	↓					-0.89
House Prices	% y/y	7.5	7.1	↑	4.4	↑					0.89
RBNZ Inflation Exp (Q)	% y/y	1.24	1.93	↓	1.80	↓					-2.34
Inflation Breakeven 10Yr	%	0.47	0.70	↓	1.09	↓					-0.94
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
ISM	Index	56.3	37.3	↑	48.7	↑					1.02
GDP (Q)	% m/m	-0.2	1.8	↓	2.4	↓					-2.19
Trade Balance	% m/m	426	726	↓	380	↑					-0.02
Exports	K	5070	5815	↓	5498	↓					-0.45
Monetary Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Credit Card Sending (Retail)	bps	1.2	-47.4	↑	0.1	↑					-0.05
House Sales	Index	7.1	-4.8	↑	12.3	↓					0.60
Terms of Trade (Q)	$bn	-0.7	2.7	↓	1.7	↓					-0.61
Commodity Prices	K	2.3	-1.1	↑	-1.4	↑					1.76
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales (Q)	% m/m	-0.7	0.0	↓	1.9	↓					-2.32
Consumer Confidence	Index	104.3	84.8	↑	122.7	↓					-0.28
Employment Change (Q)	K	-0.4	1.0	↓	0.2	↓					-1.48
Ave Hourly Earnings (Q)	% y/y	0.4	1.4	↓	0.1	↑					-1.03
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Equity Market	Index	11645	10532	↑	11717	↓					0.92
NZ 10-Year Yield	%	0.76	0.84	↓	1.39	↓					-1.05
NZ Yield Curve (2s-10s)	bps	48.0	71.0	↓	40.3	↑					-0.73
NZD TWI	Index	72.05	69.24	↑	71.63	↑					0.91

Note: For quarterly data the 3m ago column will display the previous data point and the 6m ago column will display the data point prior to that.
Source: MNI, Bloomberg

MNI POV (Point Of View): RBNZ To Outline Policy Menu, May Scale Up LSAP

The Reserve Bank of New Zealand (RBNZ) will most likely leave the OCR unchanged at 0.25%, but could lift the cap on its LSAP programme to arrest NZD appreciation and reinforce market confidence. Despite positive signals sent by the economic data, the case for continuing to support New Zealand's economic recovery remains strong. The RBNZ will also unveil more details on its unconventional policy options and will likely reiterate readiness to use those tools if needed.

All in all, the outlook remains skewed to the downside, as the coronavirus pandemic is set to weigh on global economic conditions for the foreseeable future. Admittedly, New Zealand remains a poster child of global efforts to contain the spread of Covid-19 and has just marked 100 days without any community transmission of the pathogen. An early exit from a strict, nationwide lockdown and sizeable fiscal stimulus helped give the ailing economy some relief. But with no clear end to the pandemic in sight and the looming reduction of fiscal support measures, the road ahead is a bumpy one.

Since the Monetary Policy Committee last met in June, the Finance Minister announced that the government will not spend the full NZD50bn devoted for fighting the coronavirus crisis before the September 19 general election and will set aside the remaining NZD14bn for a rainy day, such as the potential resurgence of Covid-19. On the one hand, this suggests that the government will be reluctant to extend stimulus measures. On the other hand, it may result in less need for new debt issuance, part of which the RBNZ would have to absorb to maintain the effectiveness of QE.

New Zealand's relative success in fighting the coronavirus outbreak and its economic fallout has been reflected in domestic economic data, which has generally topped expectations, including the projections from the May MPS. With the benefit of hindsight, the RBNZ's forecasts may have been overly pessimistic, which should warrant an upgrade to economic projections this time.

That being said, things have not been rosy all along on the data front. ANZ Consumer Confidence and final ANZ Business Confidence for the month of July set off an alarm bell, as both indices edged lower, which was interpreted as a signal that the post-lockdown enthusiasm was losing steam. Flash August ANZ Business Confidence vindicated these suspicions, showing further deterioration in sentiment. The MPC will have this evidence of weakening confidence in minds while taking the monetary policy decision.

Another important data signal seen in the direct lead-up to the RBNZ's decision was Q2 labour market report. Although headline figures were better than forecast, including an unexpected drop in the unemployment rate, the devil was in the detail. The data was skewed by the counting method, which did not include the beneficiaries of wage subsidies as unemployed, while StatsNZ noted that the jobless rate showed an ascending trend over the measurement period and rose to 4.9% when the government lifted lockdown restrictions. With the wage subsidy programme set to roll off at the end of the month, we may expect deterioration in labour market conditions – something the RBNZ has to consider under its dual mandate.

On the currency front, the NZD has appreciated in reaction to global monetary and fiscal efforts to stimulate economic recovery, albeit its rally has stalled over the past few weeks. Still, it sits comfortably above RBNZ projections from their May MPS in TWI terms. The RBNZ's communique suggested that policymakers are concerned about the impact of currency strength on exporter profitability, with a couple of the latest MNI Policy pieces (see the end of this document) noting as much. We may expect that the RBNZ will continue to try and cap NZD strengthening, albeit probably with jaw-boning rather than intervention in the FX market.

At the June Monetary Policy Review, the RBNZ told us that they "will outline the outlook for the LSAP programme and our readiness to deploy alternative monetary policy tools in our August Statement". How the RBNZ frames its messaging on available options will constitute an important element of the general overtone of this MPS. While unveiling the details such as the order of preference, the RBNZ will probably reaffirm that they have a wide policy smorgasbord at their disposal and will not hesitate to use them (including negative interest rates and foreign asset purchases) if economic conditions demand adding monetary support.

With the OCR at the RBNZ's self-imposed effective lower bound and banks still operationally unprepared for negative interest rates, a reduction to the main policy rate at this meeting seems exceedingly unlikely. The RBNZ's primary tool of choice is its LSAP programme. Should the MPC judge that the time has come to touch policy levers, it will likely ramp up the size of the programme, but the case for doing so is not overwhelming.

- **Base Case:** No change to the OCR or the LSAP programme or a modest increase in the size of the LSAP programme from the current NZD60bn. Reiteration of readiness to use unconventional monetary policy tools, including negative rates, with a greater sense of urgency.
- **Dovish Risks:** Very little chance of any change to the OCR, but lifting the LSAP cap as much as to NZD90bn remains on the table. Dovish rhetoric on the economic outlook, coupled with emphasis on readiness to deploy a wide range of unconventional monetary policy tools.
- **Hawkish Risks:** No change to the OCR or the LSAP programme, accompanied by language focusing on above-forecast data and more significant upgrades to economic forecasts. Any sense of comfort with the NZD would be hawkish.

RBNZ June Interim Monetary Policy Review

The Monetary Policy Committee agreed to continue with the Large Scale Asset Purchase (LSAP) programme aimed at keeping interest rates low for the foreseeable future. The LSAP quantum remains set at $60 billion. The assets included are New Zealand Government Bonds, Local Government Funding Agency Bonds, and NZ Government Inflation-Indexed Bonds. The Committee is committed to reviewing this quantum at regular intervals, with a focus on achieving its remit. The Official Cash Rate (OCR) is being held at 0.25 percent in accordance with the guidance issued on 16 March.

New Zealand has contained the spread of COVID-19 locally for now, enabling a relaxation of social restrictions and an earlier resumption of domestic economic activity than assumed in our May Monetary Policy Statement. The Government's intended fiscal stimulus, announced in its May Budget, was also slightly larger than we assumed. These outcomes give cause for some confidence but significant economic challenges remain.

The severe global economic disruption caused by the COVID-19 pandemic is persisting, leading to lower economic activity, employment, and inflation abroad and in New Zealand. The negative economic impact on New Zealand is exacerbated by the required international border restrictions, as the vast majority of the world battles to contain the pandemic. The appreciation of New Zealand's exchange rate has placed further pressure on export earnings.

The main support for the economy in this environment is appropriately being provided through increased fiscal spending. However, monetary policy will continue to provide significant support.

As outlined in our May Statement, the balance of economic risks remains to the downside. The LSAP programme aims to continue to reduce the cost of borrowing. Retail interest rates have declined with lower wholesale borrowing costs. It remains in the best long-term interests of the banking sector to promptly maximise the effectiveness of our LSAP programme.

The Monetary Policy Committee is prepared to provide additional stimulus as necessary. As well as potentially expanding the LSAP programme, the Committee continues to prepare for the use of additional monetary policy tools as needed.

The Committee's decisions are guided by the Reserve Bank's mandate and its decision making principles on the use of alternative monetary policy instruments. We will outline the outlook for the LSAP programme and our readiness to deploy alternative monetary policy tools in our August Statement. We are committed to meeting our inflation and employment mandate.

Record of Meeting – interim policy review June 2020

The Monetary Policy Committee agreed that global economic activity has been severely affected by the COVID-19 pandemic. Measures to mitigate the pandemic have resulted in a global economic downturn and severe disruption to international trade.

The global restrictions introduced to mitigate the spread of the virus have provoked a severe downturn in New Zealand as well. The full set of evidence is not yet available to determine how the pandemic is affecting the economy, but the Committee agreed that the June quarter data will show a substantial decline in economic activity. The economic risks remain to the downside despite some high-frequency data suggesting that demand has increased since the end of Alert Level 2 restrictions.

The Committee agreed that the extent of the continued job losses and reduced activity remains uncertain. It noted that much will depend on how willing households and businesses are to spend or invest in the current uncertain environment. Members noted that household and business confidence remain weak.

The Committee discussed the importance of fiscal and monetary policy support in lifting economic activity and employment. Members noted that announced fiscal policy measures are expected to support economic activity. The extent of recovery will depend in part on the impact of these policy measures and the speed with which they are implemented.

Business Address – MNI Market News, 5th Floor, 69 Leadenhall Street, London, EC3M 2DB

Members discussed the improvements in the outlook since the May Monetary Policy Statement. It was noted the move to Alert Level 1 arrived sooner than assumed in the Statement, bringing an earlier lift in retail spending and general activity. The Government's fiscal spending intentions outlined in its May Budget were also larger than assumed, implying more spending support than estimated in the Statement.

The Committee acknowledged that some trading-partner economies have begun to relax their restrictions on business activity, providing some confidence on the outlook for New Zealand's export demand.

However, members noted that these positives could be short-lived given the fragile nature of the global pandemic containment. The Committee agreed that current disruptions to supply chains and international travel – including tourism – will persist and constrain growth and employment. Members also noted that the exchange rate has appreciated since the May Statement, dampening the outlook for inflation and reducing returns for New Zealand exports.

The Committee discussed the effectiveness of the Large Scale Asset Purchase (LSAP) programme so far. Members noted that financial markets are functioning well and that the NZ government bond yield curve has flattened. The Committee noted that mortgage rates have declined since the May Statement, reducing the cost of borrowing for households and businesses. Members noted that these mortgage rate declines have been accompanied by similar declines in deposit rates.

However, the Committee agreed that it is not yet clear whether the monetary stimulus delivered to date is sufficient to meet its mandate.

Members discussed risks to the economic outlook. It was noted that risks remain skewed to the downside as outlined in the May Statement, despite the marginally stronger starting point for the New Zealand economy.

Due to worldwide uncertainty about the pandemic containment, the possible negative outcomes remain severe and larger than any near-term upside surprises. Added to these concerns was the challenge of phasing out various Government support schemes – in particular the wage subsidy – which could lead to further job losses. The Committee agreed that the labour market is severely disrupted, with data on wages, hours worked, participation, and utilisation all important for assessing aggregate demand and supply capacity.

The Committee noted that any potential easing in international border restrictions could provide a boost to the New Zealand tourism and education sectors, however it acknowledged this is highly dependent on the virus remained sufficiently contained in other parts of the world.

The Committee discussed the secondary objectives of monetary policy. Members noted that financial stability is being supported by the ongoing monetary stimulus. A prolonged downturn could undermine financial stability, so it is important that there is sufficient monetary stimulus to achieve the goals of monetary policy. The Committee noted that Reserve Bank staff will provide a more detailed briefing on financial stability for the August monetary policy decision.

The Committee discussed the range of available policy tools. It was noted that the existing LSAP programme is continuing to ease monetary conditions.

Members discussed the pros and cons of expanding the LSAP programme now. Members noted that any expansion would need to be driven by the economic outlook and assessment of the effectiveness of the programme. A change in the size of the programme would also need to be of sufficient magnitude to make a meaningful difference.

Members noted that 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, as well as reassessing the appropriate quantum of the current LSAP.

The Committee reached a consensus to continue monetary easing through the existing LSAP programme and to keep the OCR at 0.25 percent.

RBNZ May Monetary Policy Statement – Key Variables Under The Baseline Scenario

Key variables under the baseline scenario

		GDP growth Quarterly	CPI inflation Quarterly	CPI inflation Annual	TWI	OCR
2018	Mar	0.7	0.5	1.1	74.9	1.8
	Jun	0.9	0.4	1.5	73.7	1.8
	Sep	0.6	0.9	1.9	72.4	1.8
	Dec	1.0	0.1	1.9	73.4	1.8
2019	Mar	0.4	0.1	1.5	74.0	1.8
	Jun	0.0	0.6	1.7	72.6	1.6
	Sep	0.8	0.7	1.5	72.0	1.2
	Dec	0.5	0.5	1.9	71.3	1.0
2020	Mar	-2.4	0.8	2.5	70.9	0.9
	Jun	-21.8	-0.7	1.3	68.5	0.3
	Sep	23.8	0.2	0.8	67.1	0.3
	Dec	1.1	0.0	0.3	66.3	0.3
2021	Mar	0.7	0.1	-0.4	66.3	0.3
	Jun	1.7	0.2	0.5	66.4	
	Sep	1.0	0.4	0.7	66.6	
	Dec	1.0	0.1	0.8	66.7	
2022	Mar	1.1	0.2	0.9	66.8	
	Jun	0.7	0.3	1.0	66.9	
	Sep	0.6	0.6	1.1	67.2	
	Dec	0.7	0.3	1.3	67.2	
2023	Mar	0.7	0.5	1.6	67.2	
	Jun	0.7	0.7	2.0	67.1	

RESERVE BANK OF NEW ZEALAND/*MONETARY POLICY STATEMENT,* MAY 2020

Analyst Views - Summary

- Analysts are unanimous in expecting the RBNZ to leave the OCR unchanged at 0.25%, but differ in their forecasts with regards to the LSAP programme.
- Expectations vary from leaving the size of Large-Scale Asset Purchases at NZD60bn to expanding the programme to NZD90bn.
- Some expect the RBNZ to tinker with the length of the programme, as the MPC will consider the pace of asset purchases.
- Analysts widely expect further clarity on the RBNZ's alternative policy options, after the central bank promised to provide an update on its policy menu at this meeting.

Sell-Side Analyst Views

ANZ

- **The case for further significant monetary easing is clear with inflation set to plummet and unemployment heading towards double-digits**. **Expanding the Large-Scale Asset (LSAP) Programme (QE) remains the first choice** to deploy more stimulus at the August MPS, but **we also expect much more clarity on the "menu" of policy options**, detailing the criteria for when each tool might be considered, and stressing that choices will depend on circumstances.
- None of the policy options are straightforward, but **the RBNZ will want to keep its options open, and a negative OCR and foreign asset purchases will remain firmly on the table**. We don't currently expect they will deploy either, but they are non-trivial possibilities, and there is a risk that the RBNZ conveys more openness to their use than the market currently expects.
- The seemingly easy choice to increase QE next week is also not straightforward. Weighing up a number of considerations, **we expect QE to increase to $90bn, and that the length of the programme will be extended to 18 months**. This would make a meaningful difference, keep a sizeable free-float of bonds in the market, and push the QE "cliff" into the future, though not eliminate it. Our forecast includes an expectation that the RBNZ sticks with the approach of announcing a set programme size and time-frame for QE.
- However, we would see significant benefits to the RBNZ shifting to announcing a run rate or adopting a tactical approach to buying. While it's not our base case that the implementation strategy will change, now could be a good time to change tack.
- The implications for markets are potentially significant. **At a minimum we expect the overall tone of the MPS to be very dovish**, adding weight to our view that the NZGB curve will continue to move gradually lower and flatter. **While we expect the LSAP to be increased to $90bn, sending a very strong signal, we wouldn't automatically regard anything less as underwhelming.** If, for example, the RBNZ lifted QE to $75bn, moved to a constant run rate, and signalled that negative rates are their preferred next step, we would expect interest rates to rally.

ASB

- The RBNZ has already done plenty, and with the NZ economy and markets looking to have stabilised, a case can be made for the Bank not having to significantly change course. The OCR is already at its 0.25% operational low. Asset purchases have continued and the RBNZ has instituted a range of policy implementation measures and has backtracked/delayed earlier policy measures (including delaying bank capital increases, lowering the core funding ratio, dropping the loan-to value restrictions for housing lending) to provide more breathing space to the economy. Even with maintaining asset purchases at their current $970m weekly rate there is still plenty of headroom remaining under the existing $60b QE cap.
- This, and actions by the NZ Government and global central banks, are providing significant support to the economy. Wholesale and retail interest rates have fallen since May. Financial markets have calmed and are functioning better than they did in April/May. Moreover, some of the gloom over the NZ economic outlook has lifted. The pace of the recovery has clearly exceeded the (admittedly pessimistic) May MPS projections. This principally relates to NZ moving down to Alert Level 1 much earlier than RBNZ assumptions, thus allowing a quicker restart to economic activity.
- Nonetheless, **we still expect the RBNZ to reaffirm its determination to maintain highly stimulatory policy settings and provide more support if needed**. **The OCR will likely be held at 0.25% and the**

potential for OCR cuts over 2021 will be emphasised if operational hurdles are cleared and economic circumstances require it. Moreover, **the RBNZ is expected to signal its intent to continue with asset purchases** so as to provide interest rate relief to borrowers.

- **We expect that the Bank will take the opportunity in the August Monetary Policy Statement to tinker with the QE programme, and update us on its readiness to deploy alternative monetary policy tools**. The Bank told us both were under review in June. **We think to reassure markets, the QE cap could be lifted to $80b** as an interim step so as to allow the Bank to maintain the current pace of asset purchases for longer if need be. We also hope to see further details on the timing of the programme clarified. Nevertheless, **we don't expect the scope of QE to be expanded** and the indemnity with the Finance Minister (which is currently acting as more of a constraint on weekly purchases) will likely be left where it is. **We also expect the RBNZ to reassure markets that it has a number of other policy options available** that it will be prepared to exercise if needed.

Barclays

- Our economists **expect the RBNZ to stand pat (Wednesday) without adding more stimulus at this meeting, but the bank is likely to outline its outlook for the LSAP scheme and its readiness to deploy other policy tools**. However, we see little reason to ignore risks of an increase in the LSAP program or inclusion of foreign assets as eligible as the RBNZ tries to put pressure on the NZD. It has already voiced its concern about a stronger NZD creating further downside risks to the economy, and the NZD TWI has appreciated, in contrast to the RBNZ's path in the May MPS. The RBNZ is likely to revise forecasts in the August MPS, as its May forecasts appear bearish following the effective containment of COVID. Data remain weak, as Q2 CPI moderated to -0.5% q/q nsa last week, while the reduction in the Q2 unemployment rate (to 4%) was driven by a decline in the participation rate.

BNZ

- At Wednesday's Monetary Policy Statement (MPS), **the RBNZ is bound to acknowledge the better-than-anticipated local data** – and starkly so relative to its May MPS expectations. However, **the Bank will also surely reiterate the many risks it sees** on the broader horizon. Today's weakened ANZ business survey spoke to this. Hopes around a v-shaped global recovery have also clearly taken a knock, over recent months. So, there will be plenty to keep the Bank with a clear easing bias.
- There is the possibility **the RBNZ also uses this week's MPS to elaborate on its range of alternative monetary policy tools**. Things such as forward guidance (including forecasting "shadow rates", a la Krippner); a negative OCR; dealing in the swaps market (versus NZGB's); foreign asset purchases (as part of FX intervention), and; dedicated lending facilities (beyond those already underwritten as part of responses to COVID-19).
- Having said all this, and while noting the risk of a further easing in monetary policy in some way shape or form, **we think the RBNZ is likely to leave its policy settings unchanged** at this juncture In effect, this means its **Large Scale Asset Purchase (LSAP) programme maintained at a potential $60b, out to May 2021**. This is also taking the Bank at its recent word that it will keep its Official Cash Rate at 0.25% until at least March 2021.
- While the RBNZ has been busy (indirectly) soaking up much of the government bond issuance over recent months, it still has about $36b to go with its LSAP before testing the programme's $60b envelope. Even on the current strong run-rate this wouldn't occur until the June quarter of next year. Meanwhile, a key targeted outcome of the LSAP, interest rates, have remained low in the wholesale space, and have fallen with respect to retail lending and deposit rates. In this sense, the RBNZ will probably see the LSAP as having worked a treat, while querying what even-greater "stimulus" would reasonably achieve at this point.
- Of course, the Bank's LSAP programme is not exactly dictated by the size of the government's bond programme. However, the latter does have some bearing more generally. And the bond programme will, of course, be updated at next week's Pre-Election Economic and Fiscal Update (PREFU). There is potential for this to reduce – at least for the coming fiscal year. After all, the economy is looking as though it's running far better than May's Budget figured on. What's more, the $14b earmarked for a secondary wave of COVID-19 pain for the NZ economy might be done away with for the purposes of the PREFU (perhaps diverted to scenario analysis instead?). All things considered then, the RBNZ has time to wait on policy, including on the prescribed size and duration of its LSAP undertaking.

Goldman Sachs

- The RBNZ left the cash rate on hold at 0.25% and maintained the size of its Large Scale Asset Purchase programme (NZ$60bn) at the June meeting, in line with expectations. Despite flagging "a marginally stronger starting point for the NZ economy", "improvements in the outlook since the May MPS", and a "larger than assumed" fiscal stimulus, the attending statement and Minutes maintained a clear dovish bias. In particular the RBNZ continued to characterize risks as being skewed to the downside, flagged that the RBNZ staff are "working towards ensuring a broader range of monetary policy tools would be deployable in coming months", and expressed concerns about the appreciation of the NZD.

- Since the June meeting, high frequency indicators suggest that the NZ economy has continued to recover, and GDP growth in Q2 was likely well-above the RBNZ's May MPS forecast implies. Labour market conditions were also better than feared notwithstanding measurement issues (hours worked 'only' fell -10%qoq). These developments likely buy the RBNZ more time, and **we expect the Bank will leave policy settings including the OCR and LSAP limits unchanged, and upgrade its macro forecasts in the MPS.**
- That said, **we do expect the RBNZ to maintain a very dovish tone, highlighting downside risks** – particularly with respect to the global economy and 'second waves' of virus outbreaks. The RBNZ may also highlight the strength of the NZD (we note spot NZD TWI is ~8% above the RBNZ's May MPS forecast), and continue to flag the possibility of further easing measures – including foreign asset purchases – if necessary. However, ultimately we don't think the RBNZ will engage in foreign asset purchases given i) the NZD does not appear significantly overvalued relative to economic (and virus-driven) fundamentals, ii) the macro impact of a lower NZD is more muted today given border closures, and iii) the potential global political backlash from announcing a large easing programme designed to weaken the currency.

J. P. Morgan

- In June, the RBNZ's monetary policy committee directed the staff to develop new options for easing at the August meeting. Negative rates apparently still are technically infeasible for banks, so the most prominent of the remaining options flagged by the leadership are expanding the LSAP program, and buying foreign assets. There is some overlap between the two, and we have been expecting both (see here and the NZD section here for further discussion). The precise details depend on how the RBNZ weighs its objectives against balance sheet constraints.
- **We expect an expansion of the LSAP envelope from NZ$60bn (including LGFA) to NZ$85bn, including foreign asset purchases.** We do not expect many specific details on the latter (size, period of implementation, hedging etc) to be carved out. **The LSAP program life should also be extended from May to December**, alleviating capacity constraints in domestic bond purchases, given the supply growth assumed in the interim.

KiwiBank

- So now we turn to the RBNZ, and the LSAP QE program. Market participants need to see a commitment to extend the LSAP program into 2022. Even under the most optimistic assumptions, we are unlikely to be in a position to start tightening monetary policy from May 2021 – when the LSAP guidance currently ends at ~$60bn. Extending the LSAPs to May 2022 (or beyond if they want to get serious), pushes the program towards $100bn. **In order to ensure NZ Govt. bond yields remain low and flat, the LSAP must be increased. Failure to extend the program will cause unnecessary volatility in the long end of the curve (+10s).**
- The LSAP program is the focus for financial markets. But we will also get updated forecasts, and **the RBNZ's thoughts around other monetary policy measures** like bank lending facilities (the most effective in lowering retail rates), FX intervention (buying other Government's bonds to clip the Kiwi flyer), and negative rates (the most risky of strategies). We should also get some thoughts around yield curve control (rather than quantitative LSAPs).
- **We expect to see some positive upward revisions to growth, employment (but not inflation) forecasts.** The mixture of a much higher than forecast Kiwi currency (lower inflation and less support for exporters), and weaker trading partner growth will limit the 'upside' to the RBNZ's forecasts.

NZIER

- We are continuing to seek our Shadow Board members' views on whether the Official Cash Rate (OCR) should be negative and if the Reserve Bank should expand its quantitative easing (QE).
- Fewer Board members this quarter consider further monetary policy stimulus is appropriate, particularly when it comes to introducing a negative OCR. While there was support for an expansion of the Reserve Bank's Large-Scale Asset Purchases (LSAP) programme over the coming year, this stimulus was considered more appropriate beyond the upcoming meeting.

- Recent economic developments have been more positive than expected, with activity indicators such as heavy vehicle flows and retail spending pointing to a rebound in demand in the wake of the lockdown being lifted. The unprecedented amount of stimulus introduced by the Government and the Reserve Bank has helped to prop up confidence and support spending. However, members highlighted the uncertainty over the longer term once the stimulus measures, such as the wage subsidy scheme, come to an end.
- Some members considered introducing a negative OCR an ineffective way to stimulate demand, and all members felt expanding QE was more appropriate.

Westpac

- When the Reserve Bank releases its Monetary Policy Statement on Wednesday next week, **we expect that it will keep the overall stance of monetary policy unchanged**. There have been both positive and negative developments recently, and the overall balance has been roughly neutral so far as monetary policy is concerned.
- The RBNZ is currently holding the OCR at 0.25%, and is buying about $0.93bn worth of bonds per week in an effort to supress longer term interest rates. **We expect next Wednesday's primary message to be that both measures will continue for the foreseeable future**.
- **The RBNZ may simply to restate that it will buy $60bn of bonds by May 2021**. This would be simple, but it would provide no guidance to markets about what the RBNZ expects will happen after May 2021. **The alternative option is for the RBNZ to state that it intends to buy up to $70bn between the start of the LSAP and August 2021.** $70bn is sufficient for the RBNZ to continue buying roughly $900m of bonds per week for this extended period. In that sense, the two announcements would be equivalent – they both imply the same pace of bond buying for the foreseeable future. (The August 2021 date makes sense because it is one year from now, and previous LSAP announcements have referred to the year ahead.) If we had to choose, we would say that the $60bn by May 2021 is slightly more likely.
- **A subsidiary message will be that the Reserve Bank has options if more vigorous monetary stimulus is required in the future**, for example if COVID-19 returns to our shores. The Reserve Bank has said that it will provide more details on the possible options of dropping the OCR below zero, expanding the LSAP by buying foreign government bonds, or making direct loans to banks. This will be an articulation of possible future options, not a signal of impending action.
- Our own assessment is that the Reserve Bank will have to provide a great deal of monetary stimulus for an extended period to achieve its targets – probably more, and for longer, than the RBNZ itself currently expects. Consequently, over the coming year we expect to see the RBNZ progressively extend the timeframe of the Large Scale Asset Purchase Programme (LSAP), while also expanding the cap to an eventual $90bn. We also expect the RBNZ to lower the OCR to -0.5% in April next year. However, this is all something for future Monetary Policy Statements – next week we are expecting a very straight bat from the central bank.

MNI Policy Team Insights

MNI PREVIEW: RBNZ Eyes Bond Buys To Address Currency Strength

- No Rate Cut Expected, But Asset Purchases Could Be Increased

By Lachlan Colquhoun

SYDNEY (MNI) - The Reserve Bank of New Zealand is seen edging towards further easing at the August policy meeting, as policymakers look to address a surging currency that is making life hard for the country's exporters already struggling in the pandemic-hit global economy.

With interest rates currently at a record low 0.25% and bank officials asking financial institutions to be ready for potential negative rates by the end of the year if there is a need, any easing will likely come in the form of further asset purchases -- although as former RBNZ chief economist John McDermott told MNI last week, there is the potential for up to 20bps in rates cuts to 0.05%

Despite the potential for a modest trimming of rates, an extension of the RBNZ's current bond-buying scheme, the Large Scale Asset Purchase Program, is the most likely move, with many pointing to a potential increase from the current NZD60 billion to as much as NZD90 billion.

--FOREIGN BONDS

At the RBNZ's current rate of purchase, the LSAP is expected to run through until the spring of 2021, so there is no immediate need for an increase in bond buys.

That could give the RBNZ the opportunity to turn its bond buying focus towards foreign bonds, helping it directly address the issue of the stronger currency.

The Kiwi dollar has surged from USD56 cents in March to USD67 cents in recent days, an unwelcome rise which impacts NZ exports and economic competitiveness, as noted by the RBNZ at their last meeting.

--OUTLOOK

The latest inflation forecast data was expected to provide some indication of potential RBNZ action, but the result was equivocal in terms of suggesting policy moves.

The two-year inflation forecast rose from 1.24% to 1.43%, edging closer to the midway point in the RBNZ target of between 1% and 3%.

Second quarter unemployment figures had the jobless rate at 4%, although this was an average over a three-month period, with the monthly indications unsurprisingly suggesting a higher unemployment rate in June, closer to 5%. The Government's NZ$13 billion wage subsidy scheme ends this month which is expected to put many more people out of work.

MNI INTERVIEW: Kiwi Strength Could Prompt RBNZ Cut-McDermott

- RBNZ Could Cut To As Low As 0.05%
- Further Kiwi Appreciation Would Be Problematic

By Lachlan Colquhoun

MNI (Sydney) - The strength of the New Zealand dollar has put the central bank's "warning lights on amber," a former Reserve Bank of New Zealand assistant governor and chief economist told MNI, adding that it might have room to cut interest rates to as low as 0.05% should the kiwi continue to appreciate.

John McDermott, who was at the RBNZ for a decade until 2018 before moving into private consulting, said in an interview that the central bank has around "20 basis points up their sleeves if they really wanted to." Further interest rate cuts were a more likely response than additional unconventional policy measures, he said.

The NZD is at around US67 cents this week after hitting US57 cents in March.

--KIWI STRENGTH

At current levels, McDermott said he thought policy makers would be "scratching their heads and wondering" if the Kiwi unit was too high, but were unlikely to act. If it rose to US70 cents, however, "that could be a problem" for the NZ economic recovery, McDermott said.

The RBNZ's official cash rate is at a record low 0.25%, the same as official rates at the Reserve Bank of Australia, but McDermott said that because of the different corridor system used by both banks effective market rates were slightly higher in NZ.

"Normally 15 basis points is chicken feed, but right now with interest rates so low that could be a reason that people are moving to the NZD just for that extra bit," McDermott said.

--20 BASIS POINTS UP SLEEVE

The RBNZ still had some "conventional monetary policy room to move" in the event of a higher NZD, and the bank could do down as low as 0.05% or 0.10% without the technical issues posed by zero rates.

"So I'd say they have 20 basis points up their sleeve if they really wanted to use it."

The RBNZ has not ruled out additional unconventional monetary policy measures such as zero rates or the purchase of foreign assets, but McDermott said he believed the bank was currently in a "wait and see mood" and was recalibrating policy as it waits to see the strength of the economic recovery.

NZ has moved off stage four lockdowns and the domestic economy has re-opened. While McDermott said it was "roaring back" there are still pockets of weakness in export industries such as tourism, which remains closed to international visitors.

The full picture would not be known until GDP numbers were published in September, he said, but with the exception of export service industries like tourism and international education other indicators were showing a "very big rebound."