New Zealand Institute of Economic Research (Inc)
Media release

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NZIER's *Shadow Board* favours further QE over negative OCR

The significant changes in monetary policy implementation in recent weeks in response to the effects of the COVID-19 outbreak has led us to revamp the format of our Shadow Board reporting. The Reserve Bank of New Zealand (RBNZ) on 16 March 2020 announced it was undertaking an emergency 75 basis points cut in the OCR to take it to 0.25%. The central bank indicated in its accompanying statement it expected the OCR to remain at 0.25% "for at least the next 12 months".

The RBNZ subsequently introduced other monetary policy measures to support economic activity, including the introduction of Quantitative Easing (QE) through its $30 billion Large Scale Asset Purchases (LSAP) and $3 billion Local Government Funding Agency (LGFA) programmes. By buying these government bonds on the secondary market, it can influence longer-term interest rates lower, thus helping to encourage spending and investment.

In the wake of the announcement of these substantial stimulus measures, there has been increasing speculation that the RBNZ will further reduce the OCR to take it to negative territory. There is also an increased probability of growth in the government's QE programme in order to provide even more stimulus to the New Zealand to mitigate the effects of the COVID-19 outbreak. To reflect these fast-evolving times, we have overhauled the format of our Shadow Board reporting.

All decisions come with costs and benefits. Ahead of each announcement, we ask our Shadow Board members what % strength of policy preference they place on whether the RBNZ ***should:***

1) further reduce the OCR to take it to negative territory at the upcoming meeting
2) further reduce the OCR to take it to negative territory over the coming twelve months
3) expand its QE programme by buying even more bonds at the upcoming meeting, and
4) expand its QE programme over the coming twelve months.

A higher percentage would indicate the degree to which Shadow Board members feel the benefits of undertaking the policy action outweighs the costs.

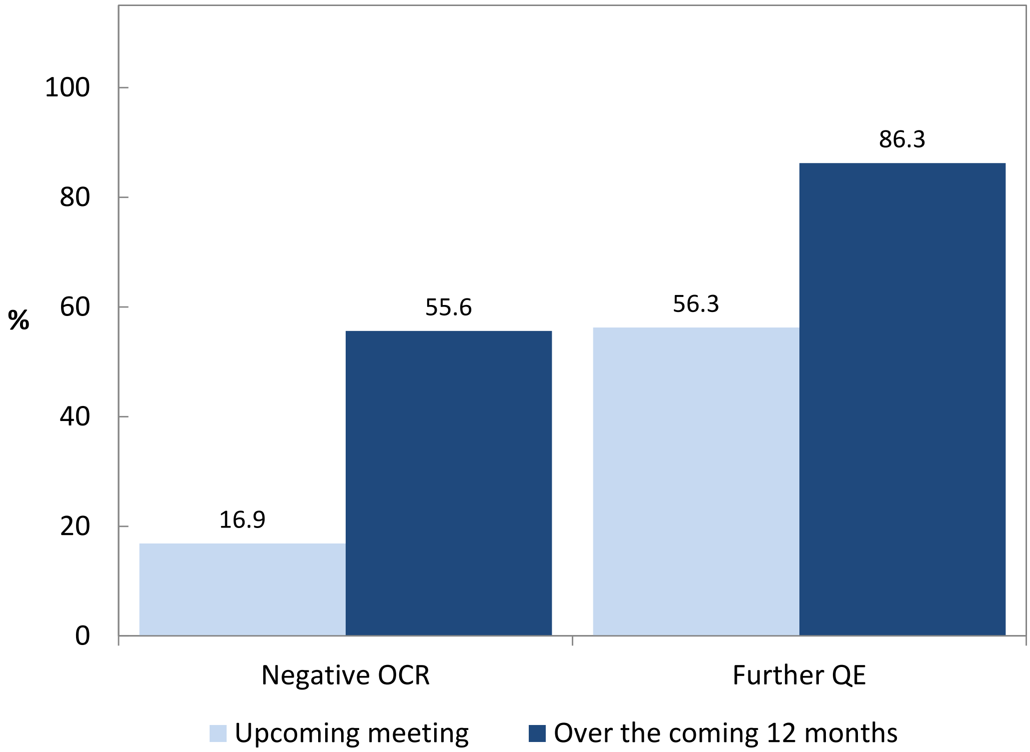
There has been a wide range of views on these four questions. On the issue of a negative OCR, the general view was that a negative OCR was not required at the upcoming May meeting, but Shadow Board members were divided on whether the OCR should be reduced further over the coming twelve months. Proponents of a negative OCR point to the need for monetary policy to also go hard and go early to head off the risk of a prolonged recession. Opponents of a negative OCR consider QE, as a support to stimulatory fiscal policy, to be a more effective way to support economic activity. Some also highlighted the damaging effects of negative interest rates on savers and bank profitability.

There were mixed views over whether the RBNZ should expand its QE programme at the May meeting, but the consensus was that the central bank should expand its programme over the coming year. Most saw it as a tool to support increased Government spending, with the purchase of Government bonds helping to maintain liquidity in the financial markets to keep it functioning.

These results indicate the Shadow Board considers it appropriate for the RBNZ to undertake more stimulatory monetary policy over the coming year.

Figure 1 Wide range of views over what the RBNZ should do

(% strength of policy preference on what the RBNZ should do for each monetary policy tool)



Source: NZIER *Monetary Policy Shadow Board*

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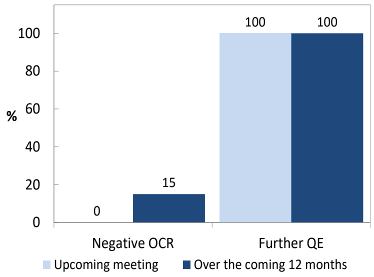
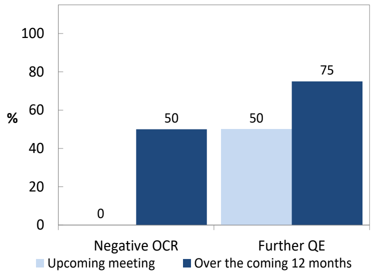
Figure 2 Individual participants' recommended rate settings – 8 May 2020

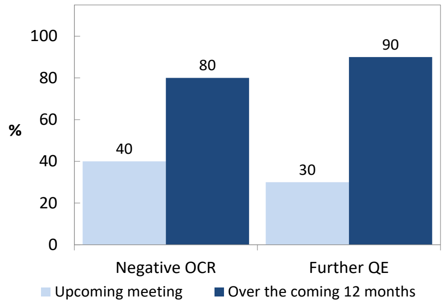
Stephen Toplis
Head of Research, BNZ



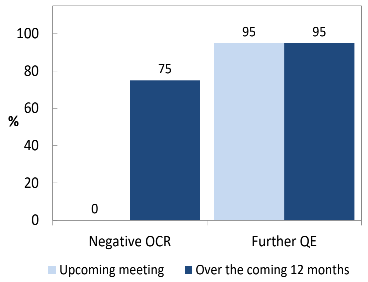
Viv Hall
Professor, VUW



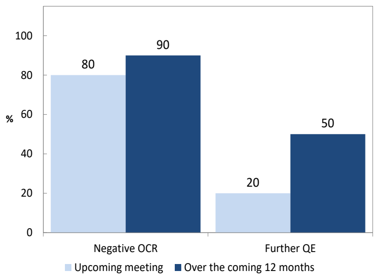
Ingrid Cronin-Knight
NZ Country Manager, MYOB



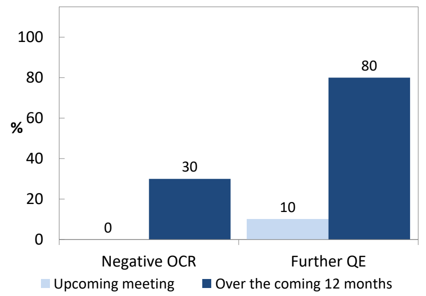
Dominick Stephens
Chief Economist, Westpac



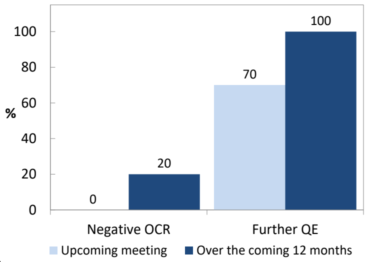
Prasanna Gai
Professor, University of Auckland



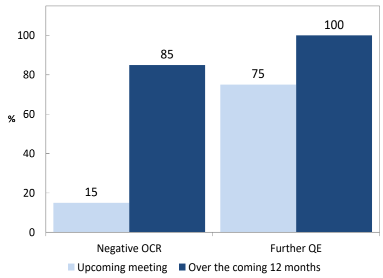
Kirk Hope
CEO, BusinessNZ



Jarrod Kerr
Chief Economist, Kiwibank



Kerry Gupwell
CEO, Boffa Miskell



Source: NZIER *Monetary Policy Shadow Board*

Table 1 Participant comments

Participant comments are optional.

Stephen Toplis	We do not think that allowing interest rates to go negative would be beneficial to the economy. QE is the preferred option. The RBNZ has to continue supporting the expanding Government debt programme.
Viv Hall	For the rest of 2020, primary focus should be on further expansionary fiscal policy, any further required QE, ensuring continued smooth functioning of financial markets/sufficient liquidity in the financial system, and clear forward guidance.
Dominick Stephens	Much more monetary stimulus is going to be needed. A negative OCR cannot be implemented until the trading banks' systems are ready, so the RBNZ should expand QE immediately. Over the coming 12 months the RBNZ should expand QE and adopt a negative OCR. Even if they do, our analysis suggests inflation will still drop below 1%. But at least with this monetary stimulus the RBNZ can avoid an even worse outcome.
Prasanna Gai	No comment.
Kirk Hope	No comment.
Jarrod Kerr	I'm not convinced negative interest rates work, or are worth the risk. Negative rates punish savers, and actually induce a greater level of saving (and not necessarily greater risk taking or expenditure). Savers realise they need a greater pool of savings to meet their retirement needs (as they lose savings rather than gain interest), or have to fight much harder to reach their goals (deposit on a house, for example). Negative rates also put an added burden onto the financial system, with increasing pressure on bank margins and lower (negative) returns on interest bearing assets. Furthermore, inflation expectations have followed negative rates (down) overseas. The RBNZ should remain focussed on lowering wholesale rates with QE and funding fiscal policy. The best policy to combat Covid-19 is fiscal, not monetary. Extraordinary Monetary Policy should remain focussed on ample liquidity in financial markets, and removing duration from the bond market.
Ingrid Cronin-Knight	We have just completed our latest MYOB Business Monitor survey of 1,000 SMEs, which was in market through the whole of March. Our key findings are: • Almost a fifth of SMEs said low interest rates were having a negative impact on their confidence (5th highest in the list of key concerns) • By the second half of March, 20% of SMEs said they planned to reduce prices this year, while 50% will keep them the same – reducing inflationary pressure from an SME perspective • At the same time, SME confidence had reached its lowest levels in the 10 year survey, with over 90% of SMEs interviewed in the second half of the month expecting the economy to decline this year. MYOB's view of these factors is that while more steps in the short term from the RBNZ to expand unconventional monetary policy may have the effect of further depressing SME confidence; over the longer term, increased stimulus is likely to be required for the NZ economy.
Kerry Gupwell	These are unprecedented times and my view is that the RBNZ should go hard and go early, just as we have done with the health response. It's now time (if not overtime) we step up the economic response, the health and well-being downsides of a prolonged recession or even a depression will be catastrophic.

About the NZIER *Monetary Policy Shadow Board*

NZIER's *Monetary Policy Shadow Board* is independent of the Reserve Bank of New Zealand. Individuals' views are their own, not those of their respective organisations. The next *Shadow Board* release will be Monday 22 June 2020, ahead of the RBNZ's *OCR Review*. Past releases are available from the NZIER website: www.nzier.org.nz

Shadow Board participants put a percentage preference on each policy action. Combined, the average of these preferences form a *Shadow Board* view ahead of each monetary policy decision.

The NZIER *Monetary Policy Shadow Board* aims to:

- encourage informed debate on each interest rate decision
- help inform how a Board structure might operate
- explore how Board members could use probabilities to express uncertainty.