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BANCORP TREASURY SERVICES LIMITED

ECONOMIC ALERT

OCR — MARCH 2020

16 March 2020 | www.bancorptreasury.com

"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."

And …

"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."

Why …

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

And …

"Demand for New Zealand's goods and services will be constrained, as will domestic production."

But …

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

In conclusion …

"New Zealand's financial system remains sound and our major financial institutions are well capitalised and liquid."

Comment and Market Implications

In slashing the OCR to 0.25% this morning, the Reserve Bank of New Zealand's ("RBNZ") Monetary Policy Committee ("MPC") has lowered its interest rate benchmark as low as it practically can, given not all retail bank systems can accommodate negative interest rates.

It has also given clear forward guidance, that the OCR would stay at the level of 0.25% for at least the next 12 months and provided a clear framework that the purchase of Government bonds was the next tool to be used should additional stimulus be needed. By taking negative interest rates off the table, at least for now, borrowers have one less complication to deal with.

The unprecedented action is being mirrored by central banks across the globe, including in the US, with the Federal Reserve cutting its benchmark interest rate by a full percentage point to near zero this morning and promising to boost its bond holdings by at least USD700 billion.

The BKBM rates have set significantly lower this morning, although with the 3-month at 0.64%, there is a significant premium over the OCR. This spread suggests a fair bit of market disruption within financial and funding markets as financial institutions work to keep up with domestic and global events.

Banks have already responded, lowering both floating mortgage rates and deposit rates significantly.

The NZD is being whipped around by coronavirus headlines and policy responses; the NZD/USD already oscillating within a 150 point range this morning. However, with interest rates across the globe quickly being cut to zero (or below in some cases), the currency implications are somewhat neutralised. Risk aversion remains the dominant driver however, with the NZD low on the list of safe-haven destinations.

The RBNZ has acknowledged that there will be a severe impact to the local economy and that business failures and job losses should be expected. The Government is set to announce a fiscal package on Tuesday, another avenue for policy to help support businesses and consumers through these troubling times.

With developments moving fast, the key for businesses is in having certainty around funding and liquidity. Open communication with funders remains paramount, as does a good handle on financial exposures and revisiting underlying assumptions regularly.