

21 March 2020

Minister of Finance
The Beehive
Wellington

Dear Hon. Grant Robertson,

In accordance with the *Memorandum of Understanding between the Minister of Finance and the Reserve Bank of New Zealand regarding the use of alternative monetary policy tools* dated 21 March 2020, I am writing to request that the Crown provide the Reserve Bank (the 'Bank') with an indemnity for the purchase of up to a maximum of \$30 billion New Zealand Government debt on the secondary market over the next 18 months, financed by central bank money. Within that limit and 18 month timeframe the speed and scale of purchases will be up to the Bank to determine. I propose that the replacement of bonds that have matured would not count towards the limit. I request that the Crown indemnify the Bank from any losses arising out of or in connection with these purchases.

This Government bond purchase programme (the 'Programme') will help the Bank meet the economic objectives as specified in the remit and section 8 of the Reserve Bank of New Zealand Act (1989) (the 'Act'), namely (a) achieving and maintaining stability in the general level of prices over the medium term; and (b) supporting maximum sustainable employment.

The current and expected impact of the COVID-19 outbreak on the global and domestic economies compromises the Bank's ability to meet the economic objectives using its conventional monetary policy tool (a positive Official Cash Rate (OCR)). As such, the MPC believes alternative monetary policy tools are urgently required.

I propose that this Programme remain in place until the MPC is confident that it can sustainably achieve its inflation and employment objectives in the medium term without using the Programme. The purchase of New Zealand Government bonds in the secondary market would cease once the economic conditions and outlook warrant a tightening in monetary policy, but I propose that the Programme remain in place until the bonds held in the Programme mature or the Bank and Treasury agree to end the Programme. The Bank would be able to replace bonds within the Programme that had matured.

The Programme would be designed to minimise distortions in the Government bond market. The Bank would closely monitor the effect of its Government bond purchases on the functioning of financial and credit markets and on financial stability risks, and adapt its purchase operations when necessary. To help achieve this, the Bank would work with the Treasury's Capital Markets unit when planning operations under the Programme.

It is important that the Government's debt management policy remains independent, and is not implemented in a way that purposely contradicts the aims of monetary policy. We recommend that both parties agree to act in a coordinated manner and in a way that does not intentionally undermine the objectives of debt management in the case of the Treasury and alternative monetary policy tools in the case of the Bank.

To ensure that the financial risks associated with this Programme would be managed appropriately, the operations conducted under the Programme would conform to a risk control framework that would be agreed with the Treasury as soon as practicable. This framework would ensure that the financial risks from this Programme are identified and measured. Work on this framework has commenced.

The key financial risk relates to interest rate risk. This would be influenced by the future path of the OCR (i.e. the interest rate the Bank would pay on the central bank money issued to purchase Government bonds) and changes in the term premium, which would influence the Bank's return on Government bonds. The Bank would monitor these factors as part of its risk control framework. If conditions were to change so that potential losses expected rose materially above the level estimated at the start of the Programme, the Bank would inform you.

The risk control framework would also set out the decision rights and authorities within the Bank for implementing the Programme. The MPC would be responsible for determining the overall scale of purchases under the Programme, I (as Governor) am responsible for the operation of the Programme (although can delegate some responsibilities), and the Reserve Bank Board of Directors would act as an advisory board on the conduct of the Programme, and would also be responsible for overseeing the MPC and its individual members.

I propose that the Bank would report to the Treasury monthly on the transactions undertaken as part of the Programme. Information on the scale of operations, and the associated gains or losses, would be published in the Bank's annual report. The Bank would also seek to provide more frequent public reporting on the transactions under the Programme, provided that information could be provided in a way that did not compromise the efficacy of the Programme.

I look forward to receiving your reply.

Yours sincerely

A handwritten signature in blue ink, consisting of a series of loops and a long horizontal stroke at the end, representing the name Adrian Orr.

Adrian Orr
Governor, Reserve Bank of New Zealand