Preparations and readiness for negative interest rates

Information supplied to the Epidemic Response Committee for an appearance by the Reserve Bank of New Zealand

The Reserve Bank has been undertaking a programme of work on **unconventional monetary policy tools**, including negative interest rates, for some time. Since late 2019, this work included ensuring that the Reserve Bank's systems can operate with negative interest rates, and understanding the banking system's operational preparedness for negative interest rates. The Monetary Policy Committee (MPC) considered this work when deciding the most effective way to deliver monetary stimulus.

Reserve Bank systems and capability:

The Reserve Bank has the operational and legal ability to implement negative interest rates. After a multi-year project, the Reserve Bank launched a new **future-proofed payment settlement system** in February 2020. The new system is fully capable of operating with negative interest rates and negative yielding securities. The Reserve Bank also amended the systems' terms and conditions to ensure it could apply negative interest rates to both credit and debit balances. This functionality was achieved before the COVID-19 crisis.

The banking system's capability:

Over the second half of 2019, the Reserve Bank engaged with registered banks regarding their ability to operate negative interest rates. This first involved engaging with the Reserve Bank's counterparties in its open market operations in financial markets. More broadly, bank supervisors raised the issue of preparedness for negative interest rates at banking sector workshops in December 2019. In late January 2020, the Reserve Bank's Head of Supervision sent a letter to banks' chief executives formally requesting they report on the status of their systems and capability. The responses raised a number of material constraints and concerns regarding operationalising negative interest rates. These included:

- technical system issues (including front, middle and back office IT systems);
- required changes to loan documentation;
- tax and accounting considerations; and
- market conventions for settling negative interest rate transactions.

Some of the issues affected the entire banking system, while others were limited to particular banks. The majority of banks reported further testing was required, and advised it was being undertaken. The Reserve Bank is engaging with the banks and expects them to be taking steps to be operationally prepared for negative interest rates.

The Monetary Policy Committee's actions:

The Monetary Policy Committee (MPC) held an extraordinary meeting on 15 March 2020. As explained in the **Record of Meeting**, the Committee discussed the effectiveness of a monetary policy response given the nature of the economic shock and agreed that a significant easing in monetary policy was required in order to achieve the goals of price stability and maximum sustainable employment.

At the extraordinary meeting, the Committee was briefed by staff on additional monetary tools, and which were likely best suited to providing additional stimulus, noting that the **principles for using alternative monetary policy** recognise the best tool depends on the particular circumstances. Bank staff indicated that Large Scale Asset Purchases (LSAP) of New Zealand Government bonds were the next best monetary tool available to the Committee.

The LSAP has been successful in offsetting the rise in government bond yields that was observed in the lead-up to the decision to implement it. In addition, LSAPs have stabilised financial markets by providing liquidity and surety at a time when it was needed. These effects would not have been achieved with a negative OCR.

More information

Alternative Monetary Policy in New Zealand

Alternative Monetary Policy – Principles and Tools

Large Scale Asset Purchases

Extraordinary OCR Review – 15 March 2020 – Media Statement and Record of Meeting

Speech: Navigating at Low Altitude: Monetary Policy with Very Low Interest Rates.

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