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Tuesday, 17 August 2021

RBA Board Meeting Minutes

RBA Looks Through Delta Disruption

- **The Reserve Bank (RBA) surprised the market, and us, at its August 3 meeting. Despite the drastic deterioration in the near-term outlook on the back of the lengthy lockdown in NSW, the central bank opted to stick to its plan of tapering bond purchases from September.**
- **The minutes released earlier today provide more colour on the RBA's decision. Effectively, the RBA is looking through the near-term disruption. Their forecasts are suggesting the NSW lockdown will have little lasting impact on the economy.**
- **However, it is an evolving situation. There is a fairly big caveat over the near-term forecasts. It is noted the delta variant has introduced a "high degree of uncertainty to the outlook for the second half of 2021" and that activity is expected to decline in the September quarter.**
- **We expect the national economy will contract by 2.6% in the September quarter with a rebound of 2.6% in the December quarter. This will take growth over 2021 to 2.4%, which is a pace below trend. We expect a big bounce in 2022 with 5% growth.**
- **The RBA said its surprise decision to push ahead with tapering in September reflects the lags of monetary policy, noting fiscal policy is best placed to respond to lockdowns.**
- **Members judged that additional bond purchases would have their maximum effect in 2022 when the economy would be rebounding strongly, and only a marginal effect at present when the support is most required.**
- **But, the Board left the door open to adjust policy "in response to further bad news on the health front" that would lead to a "more significant setback to the economic recovery".**
- **Based on these comments, it seems there needs to be a material deterioration in the outlook for 2022 to trigger for an increase in bond purchases.**
- **Separately, the RBA stuck to its view that its "central scenario" is that the cash rate won't increase until 2024. As outlined, we anticipate a strong rebound in 2022. And so, we still expect the RBA will lift the cash rate in the first half of 2023, despite the near-term setbacks.**

The RBA surprised the market, and us, at its August 3 meeting. Despite the drastic deterioration in the near-term outlook on the back of the lengthy lockdown in NSW, the central bank opted to stick to its plan of tapering bond purchases from September. Other policy settings were left unchanged as expected.

The minutes released earlier today provide more colour on the RBA's decision and some additional insight into how they expect the NSW lockdown will impact the economy.

Economic activity

The RBA leads with a fairly big caveat over its forecasts, highlighting the delta variant has introduced a "high degree of uncertainty to the outlook for the second half of 2021". It is noted that activity is expected to decline in the September quarter. And that the high degree of transmissibility of the delta variant could mean the reopening will be more gradual than in 2020.

More broadly, the RBA continued to emphasise once restrictions are eased, the economy is set to rebound rapidly, consistent with our expectations. The RBA notes the underlying momentum in the economy prior to the outbreaks, strong balance sheets, substantial fiscal support and progress in the vaccine rollout as key reasons for this.

The major uncertainty is how health outcomes will evolve, and subsequently, when will lockdowns end.

We expect the national economy will contract by 2.6% in the September quarter with a rebound of 2.6% in the December quarter. This will take growth over 2021 to 2.4%, which is below the trend pace. This is based on the assumption the NSW lockdown lasts until the end of October and bakes in a six-week lockdown in Victoria. But we expect a strong rebound in 2022 with 5% growth.

Our numbers are notably weaker than the RBA's forecast of 4% growth in 2021. However, the RBA's forecasts were formulated before the recent lockdowns in Victoria, ACT and NT and before the health outcomes deteriorated further in NSW. The RBA's forecasts assume the NSW lockdown runs until September.

Labour market

The RBA expects some of recent improvement in the labour market will temporarily reverse in the September quarter. Employment is expected to decline in the quarter. Restrictions are expected to result in a substantial decline in hours worked, as we have previously flagged.

The RBA notes it expects some increase in the unemployment rate, but a decline in the participation rate will help to limit the uptick. In addition, fiscal support and the elevated level of job vacancies will also help to minimise job losses. However, a longer lockdown will mean more job losses.

We expect the unemployment rate is likely to rise in the next few months to the high 5s before declining to be at 5.0% at the end of December 2021. We then expect the rate to fall to 4.1% at the end of 2022. These forecasts are broadly consistent with the RBA's projections over the same period.

Inflation

The minutes note that underlying inflation is likely to remain subdued over the coming quarters, alongside the decline in activity in the September quarter and the absence of broad-based inflationary pressures.

The RBA does concede, however, that beyond the near-term, wages and inflation are expected to pick up at a slightly faster rate than they previously anticipated because of the stronger-than-expected growth in employment in the lead up to the recent outbreaks.

Monetary policy

The key focus at the August meeting was whether the RBA would respond to the deterioration in the near-term outlook by adjusting bond purchases under its quantitative easing program. Market economists widely expected the tapering of quantitative easing announced at the July meeting would be deferred.

The RBA said its surprise decision to push ahead with tapering in September reflects the lagged impact of monetary policy, noting fiscal policy is best placed to respond to “temporary, localised reduction in incomes”. Members judged that any additional bond purchases would have their maximum effect in 2022 when the economy would be rebounding strongly, and only a marginal effect at present when the support is most required.

However, the Board left the door open to increase purchases “in response to further bad news on the health front” that would lead to a “more significant setback to the economic recovery”.

Based on these comments, it seems there needs to be a material deterioration in the outlook for 2022 to trigger an increase in bond purchases.

Separately, the RBA stuck to its view that its “central scenario” is that the cash rate won’t increase until 2024.

As outlined, we expect a strong rebound in 2022. And so, we still expect the RBA will lift the cash rate in the first half of 2023, despite the near-term setbacks.

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