Interest Rate Outlook

Tuesday, 1 September 2020

RBA Board Meeting

Term Funding Facility Extends & Enhances

- **The Reserve Bank (RBA) Board met today. There were no changes to the cash rate and quantitative easing. However, the RBA's term-funding facility (TFF) available to authorised deposit-taking institutions (ADIs) was extended and expanded.**
- **Under the expanded TFF, ADIs will have access to extra funding, equivalent to 2% of their outstanding credit, at a fixed rate of 25 basis points for 3 years. ADIs will be able to draw on this extra funding until the end of June 2021, encouraging low lending rates in the economy and helping boost confidence among ADIs around ongoing access to cheap funding.**
- **The RBA repeated its now familiar mantra that it will not increase the cash rate target and the yield target will remain in place until progress is made towards its goals of full employment and inflation.**
- **With both key variables – the unemployment and inflation rates – a long way from target and likely to stay that way for some time, further stimulus from the RBA and government cannot be ruled out.**
- **The RBA's central forecast is for the unemployment to rise to around 10% later this year, before it gradually declines to be 7% in two years' time. Inflation is expected to average 1-1.5% over the next couple of years.**
- **Further stimulus from the RBA could take the form of cutting the cash rate from 0.25% to 0.10% and/or cutting the 3-year bond yield target from 0.25% to 0.10%. Forward guidance could also take a more dovish tilt.**
- **Encouragingly, today the RBA added that "a recovery is now under way in most of Australia". The RBA predicts this recovery will be "both uneven and bumpy", which echoes rhetoric of recent speeches from RBA officials, including the Governor.**
- **The RBA expects the outbreak in Victoria to have a major effect on the Victorian economy. Together with subdued economic activity, the RBA expects it to be some months before a meaningful recovery in the labour market is under way.**

The Reserve Bank (RBA) Board met today. There were no changes to the cash rate or quantitative easing. That is, the cash rate remained at a record low of 0.25% and the RBA continues to target the 3-year government bond yield at around 0.25% as part of its quantitative-easing program (one of its unconventional policy measures).

However, the RBA's term-funding facility (TFF) available to authorised deposit-taking institutions (ADIs) has been extended and expanded. The TFF formed part of the package of stimulus measures deployed by the RBA on March 19 to combat the effects of the pandemic on the economy. The TFF enables ADIs to access cheaper funding. This cheaper funding spurs lower lending rates in the economy, helping to underpin economic activity. This is also achieved by giving ADIs greater confidence about ongoing access to low-cost funding.

The initial allowance of TFF (with an initial allowance of 3% of outstanding credit) was due to expire at the end September. Under the expanded TFF, ADIs will have access to extra funding, equivalent to 2% of their outstanding credit, at a fixed rate of 25 basis points for three years. ADIs will be able to draw on this extra funding up until the end of June 2021.

Today's change brings the total amount available under the TFF to around $200 billion.

ADIs have stepped up their drawings from this facility, which has likely contributed to the RBA's decision to expand the facility. The RBA reports in today's statement that ADIs have drawn $52 billion under the TFF compared with last July's board meeting statement of $29 billion.

The RBA, over the past month, also stepped up its purchases of Australian government securities (AGS) in order to achieve its 3-year bond yield target of around 25 basis points (or 0.25%). The RBA reiterated that the yield target will remain in place until progress is made towards its goals of full employment and inflation. The RBA also repeated its now familiar mantra that it will not increase the cash rate target until progress is being made towards its goals for full employment and inflation.

The virus outbreak in Victoria and subdued economic activity more broadly in the economy leaves the RBA anticipating it will be some months before a meaningful recovery in the labour market is under way. The RBA's central forecast is for the unemployment to rise to around 10% later this year, before it gradually declines to be 7% in two years' time. An unemployment rate of 7% in two years' time is still elevated given the rate of unemployment consistent with full employment has been estimated by the RBA to be around 4.5%.

For inflation, the RBA targets 2-3% per annum over the cycle and the RBA today reiterated that it expected inflation to average 1-1.5% over the next couple of years.

With both key variables – the unemployment and inflation rates – a long way from target and likely to stay that way for some time, further stimulus from the RBA and government cannot be ruled out. Indeed, the RBA statement is slightly more forceful in its language when referring to the need for fiscal and monetary support to be applied to the economy for some time.

Further stimulus from the RBA could take the form of cutting the cash rate from 0.25% to 0.10% and/or cutting the 3-year bond yield target from 0.25% to 0.10%. Forward guidance could also take a more dovish tilt.

On the economic outlook, the RBA repeated this month that the future path of recovery in the global economy is highly dependent on containment of the virus. The RBA notes that an "uneven" economic recovery globally is under way after a severe contraction in the first half of this year. On China, the RBA notes economic growth has been "relatively strong".

Encouragingly, today the RBA added that "a recovery is now under way in most of Australia". The RBA predicts this recovery will be "both uneven and bumpy", which echoes rhetoric of recent speeches from RBA officials, including the Governor. The RBA expects the coronavirus outbreak in Victoria to have a major effect on the Victorian economy.

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