Tuesday, 21 April 2020

RBA Minutes of the Meeting April 7

Surveying the Defences

- **The minutes of the Reserve Bank (RBA) meeting were released today, and included discussion around current and expected conditions in the economy and financial markets.**
- **The RBA provided some insights into their liaison with businesses.**
- **In their discussions with retailers, a larger shift in household spending had occurred through March, following a trend towards spending on grocery items and away from clothing and other services in February.**
- **Another theme in the discussion with businesses was deferrals and cancellations of business investment plans. The RBA highlighted weak demand for short-term rental accommodation, which would contribute to weakness in residential construction.**
- **The RBA suggests that GDP could "fall significantly in the June quarter and remain subdued in the September quarter". In a speech given this afternoon, the RBA Governor outlined its forecasts in greater detail.**
- **Given that the source of the current shock wasn't from the financial system itself, and that regulatory reforms had taken place after the GFC, the financial system was "well placed to mitigate the impact of the pandemic".**
- **The RBA has provided significant amounts of liquidity to the financial system, to the point where exchange settlement balances with the RBA have risen significantly. Consequently, there hasn't been much need for borrowing at the overnight cash rate, which has effectively fallen to 0.15% (below the RBA's cash rate target of 0.25%). High levels of liquidity have also been reflected in the 3-month bank bill swap rate (BBSW), also falling to levels below the cash rate. These low levels of rates are as a result of the RBA's actions aimed at keeping the cost of borrowing low across the economy.**
- **There were concerns raised with regards to the commercial property market, in particular within retail which was facing challenges before the COVID-19 outbreak. The RBA notes that "the risks in commercial property markets warranted close monitoring".**

At the Reserve Bank (RBA) board meeting on April 7, the central bank left its policy settings unchanged and reaffirmed the package of policy measures announced on March 19. These included keeping the cash rate at a record low of 0.25%, a target for the 3-year government bond yield of around 0.25% and a term funding facility to provide low-cost funds to banks.

The minutes of that meeting were released today, and included discussion around current and expected conditions in the economy and financial markets.

While most of the available economic data pre-dated the bulk of social distancing restrictions implemented in late March, the RBA provided some insights into their liaison with businesses.

In their discussions with retailers, a larger shift in household spending had occurred through March, following a trend towards spending in grocery stores and away from clothing and other services in February. Household spending was expected to be much weaker, reflecting the inability of consumers to spend on travel, dining out and some recreational services.

Another theme in the discussion with businesses was deferrals and cancellations of business investment plans. The RBA highlighted weak demand for short-term rental accommodation, which would contribute to weakness in residential construction.

These anecdotes are consistent with the expectation of a sharp economic contraction. The RBA suggests that GDP could "fall significantly in the June quarter and remain subdued in the September quarter".

Industries most affected by the current restrictions were real estate, hospitality and tourism, and many parts of retail. Less affected industries included healthcare, utilities and mining.

The Government's JobKeeper package was highlighted as being of significant support, but while it would "increase the number of people remaining employed, household incomes were expected to be much lower". The extensive government support would provide a safety net for households and provide a "cushion", but that "it was unlikely that these policies would provide a strong boost to spending" given the restrictions on non-essential activities.

There was discussion around the current crisis and the impact on financial stability. Given that source of the current shock wasn't from the financial system itself, and that regulatory reforms had taken place after the GFC, the financial system was "well placed to mitigate the impact of the pandemic".

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High levels of liquidity have also been reflected in the 3-month bank bill swap rate (BBSW), also falling to levels below the cash rate. These low levels of rates are as a result of the RBA's actions aimed at keeping the cost of borrowing low across the economy.With regards to the housing market, the RBA noted that there would be "very little turnover in the housing market" so it was "unclear how it would affect residential property prices".

Concerns were, however, more heightened in relation to the commercial property market, noting that conditions were deteriorating. The RBA singled out the retail property market, which was facing challenging conditions even before the COVID-19 outbreak. Retail commercial tenants were seeking significant rental relief. The RBA notes that "the risks in commercial property markets warranted close monitoring".

On the global economy, GDP was projected to contract by at least 10% in the US, Europe and China over a couple of quarters. Contractions in Asia were expected to be smaller, but still significant.

We are all looking forward to a recovery once economic activity can restart. The RBA notes that "a recovery was expected once the COVID-19 outbreak was contained, but members noted that the timing and speed of that recovery was highly uncertain and the possibility of renewed outbreaks presented an additional downside risk.”

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