Tuesday, 2 February 2021

Reserve Bank Board Meeting

Rates on Hold Until 2024. More QE.

- **First things first. The Reserve Bank (RBA) has reiterated that it will not increase the cash rate until actual inflation is sustainably within the 2 to 3% per annum target range. It does not expect this to happen until 2024 at the earliest.**
- **As expected, the RBA has adjusted its forecasts for economic growth and the unemployment rate. It now expects the economy to reach its pre-pandemic level of output by June of this year, earlier than previously anticipated.**
- **The RBA plans to extend its current $100 billion bond-purchasing program (which ends in April) with a further $100 billion of purchases at the rate of around $5 billion per week. At that rate, the new QE program will last until September.**
- **The RBA will also keep its 3-year government bond yield target at 0.10%, the same as the cash rate target. The RBA noted that this yield target has not required any bond purchases since early December. The market appears to accept 0.10% as the appropriate rate for the 3-year bond yield.**
- **The RBA rightly notes the pick-up in home lending and the rise in housing prices underway. The RBA sees these as positive developments. Higher housing prices strengthen household balance sheets and lift confidence.**
- **The recovery is bumpy and uneven and will continue down that path. Sections of the economy remain in difficulty and at present the hopes for an extension of JobKeeper, even on a targeted basis, seems low. But it's still eight weeks until JobKeeper ends. New policy may be developed and / or economic recovery may be more rapid than expected.**

First things first. The Reserve Bank (RBA) has reiterated that it will not increase the cash rate until actual inflation is sustainably within the 2 to 3% per annum target range. It does not expect this to happen until 2024 at the earliest. Low official rates are here for quite a while.

As expected, the RBA has adjusted its forecasts for economic growth and the unemployment rate. It now expects the economy to reach its pre-pandemic level of output by June of this year, which is earlier than previously anticipated. It expects the unemployment rate to be around 6.0% at the end of 2020 (down from 6.5%).

Despite this brighter outlook, the cash rate remains on hold because inflation is below the RBA's target range and because the relatively high rate of unemployment suggests that growth in wages will remain muted.

The RBA has announced that it will extend its bond purchasing program (otherwise known as quantitative easing or QE). In November last year, the RBA began buying bonds in the 5-10 year maturity range. It did this to keep borrowing rates low and to defuse upward pressure on the Australian dollar (AUD).

The RBA plans to extend its current $100 billion bond purchasing program (which was due to end in April) with a further $100 billion of purchases at the rate of around $5 billion per week. At that rate, the new QE program will last until September. The AUD dipped from 76.62 US cents to 76.19 US cents on the announcement.

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Australian interest rates are at historically low levels and will remain so despite the upbeat commentary from the RBA and its positively upgraded forecasts for economic activity.

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One conundrum the RBA, and all of us face, is what happens when JobKeeper end on 28th March? Retail spending has been firm, but can this continue if there is a set-back in the unemployment rate? Will households use their recently accumulated saving to continue spending or will the economy sag? There are no clear answers.

On the positive side, the RBA notes the planned roll-out of vaccines and the potential for international and other borders to open. These will support employment and spending.

On the downside, poor health outcomes and delays with the vaccination program would hold back recovery.

The RBA continues to stress that the recovery is bumpy and uneven and will continue down that path. Sections of the economy remain in difficulty and at present the hopes for an extension of JobKeeper, even on a targeted basis, seems low. But it's still eight weeks until JobKeeper ends. New policy may be developed and / or economic recovery may be more rapid than expected.

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