NAB MONETARY POLICY UPDATE 3 NOVEMBER 2020

THE RBA EASES FURTHER, LOWERING THE CASH RATE, 3-YEAR YIELD TARGET AND UNDERTAKING A FORMAL $100BN QE PROGRAM.

NAB Economics

The RBA eased policy further in November, as was widely expected. The cash rate target, 3-year yield target and lending rate on new drawings under the term funding facility were all cut by 15bps to 0.1%, while the balance paid on ES balances held at the RBA was cut to 0%. In addition, the Bank announced a QE program of $100bn of bond purchases – both AGS and semis - over the next 6 months, while leaving the door open to further QE should the labour market require additional support. The RBA did not provide explicit guidance on a target for the unemployment rate but did reiterate that it will need a tight labour market to see a material increase in inflation to within the target band before increasing rates.

These actions will see the structure of interest rates pushed even lower across the economy and some downward pressure on the exchange rate. Low rates have played an important role in supporting the economy and will continue to do so as the recovery unfolds. However, these actions will likely only have a marginal impact – particularly at the short-end with rates already well below what could be considered neutral. We expect rates to remain low for an extended period – in line with the RBA guidance of unchanged rates for at least the next three years. We see fiscal policy continuing to play a key role in stimulating the economy and expect that the government will need to do more.

- The RBA cut the cash rate target, the 3-year yield target and the rate for new lending to banks under the Term Funding Facility (TFF) to 0.1%. The rate paid on exchange settlement balances (deposits held with banks at the RBA) was cut to 0% (from 0.1%). Therefore, it is likely the cash rate will trade somewhere below the 0.1% target given turnover in the cash market and the degree of excess liquidity.
- The RBA announced a formal bond buying program (QE) of $100bn over the next 6 months. These purchases will be comprised of 80% of commonwealth bonds (AGS) between the 5-10 year tenors and 20% of semi-government securities. This equates to $5bn purchases a week ($4bn of AGS and $1bn of Semis). This is slightly more aggressive than our expectation for around $140bn of purchases over a year or so, with the RBA leaving the door open to further expansions of this part of the package, dependent on labour market outcomes.
- The overall goal of these actions is to lower yields across the curve and push borrowing rates across the economy lower. The short-end of the curve is likely still more important for business and consumer interest rates while the lower rate of the TFF will also help to keep bank lending rates low. The impact of the new QE program will likely come through the exchange rate channel, with lower yields weighing on the currency. A lower exchange rate would provide further support to the economy through more competitive exports and lower import competition.
- The RBA has upgraded its near-term forecasts for growth and unemployment. The post meeting statement provided a high-level update of the RBA's key forecasts, where details will be released in Friday's November Statement on Monetary Policy (SoMP). The RBA expects a positive outcome in the September quarter for GDP and has revised up its near-term forecasts for growth following the control of the Victorian outbreak. The RBA now expects GDP growth of 6% in the year to June 21 (NAB: 5.3%), and 4% to June 2021 (NAB: 3.2%). More importantly, the outlook for the unemployment rate has improved and is expected to peak at a little under 8%, instead of 10%, and recover to 6% by end of 2022. Nevertheless, the RBA continues to forecast a slow recovery in jobs and the outlook remains highly uncertain. On inflation, the RBA left its core inflation outlook unchanged, with inflation reaching 1½% at the end of 2022.
- Regardless of the forecast upgrade, the outlook remains highly uncertain with a full recovery not projected for some time. The RBA has stressed it sees unemployment as a "national priority" and developments in the labour market will be key to the policy outlook. In our view, an improvement in the unemployment rate will likely lag the recovery in activity, which will also see a protracted recovery in wage growth (and eventually domestic inflation). There are a number of risks around this outlook including the future spread of the virus, household and business confidence, the timing of a vaccine and the full opening of international borders.
- For details on the QE program please see: https://www.rba.gov.au/mkt-operations/announcements/rba-purchases-of-government-securities-2020-11.html

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