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Economics Group

Special Commentary

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RBA Readies for More Action

Executive Summary

- The Reserve Bank of Australia's (RBA) monetary policy rhetoric has become more dovish over the past several weeks, opening the door to further easing. RBA Governor Philip Lowe and Assistant Governor Christopher Kent have hinted at the possibility of further interest rate cuts or bond purchases in support of its employment and inflation goals. In addition, the RBA's October minutes showed policymakers expected further monetary easing could gain traction as the economy re-opens from COVID lockdown measures.
- After a resurgence in COVID cases across Victoria, the spread of the virus appears to have slowed, allowing the government to make progress toward the re-opening of its states and borders. Despite these efforts, the nature of the recovery still remains uncertain and is likely to remain uneven.
- Indeed, that uncertain and uneven nature of recovery is reflected in some economic figures. The Australian economy is recovering, but still has some way to go before it recoups the full losses from the first half of this year. The labor market is a notable weak spot, as the lockdown in Victoria weighed heavily on employment and hours worked in the state, while trends in retail sales and confidence surveys are mixed.
- We now expect the RBA to announce further monetary policy easing at its November 3 meeting, by cutting its Cash Rate and three-year yield target 15 bps to 0.10%, as well as announcing further quantitative easing measures. Specifically, we look for increased bond purchases of around A$75B (or ~3.8% of GDP).

We now expect further monetary policy easing from the RBA.

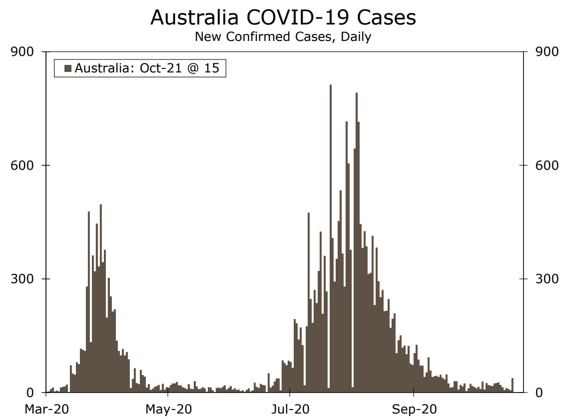
RBA Comments Signal Further Monetary Easing

The Reserve Bank of Australia has repeatedly indicated it expects fiscal and monetary stimulus will be required for some time to support economic recovery, and more recently has said it will consider how additional easing could support employment as the economy re-opens. Indeed, the latest comments from the central bank have been more dovish in tone. RBA Governor Lowe signaled that the central bank board is willing to consider further easing, including purchases of longer-dated bonds, to support employment, incomes and businesses in Australia. He said the RBA wants to see more than just "progress towards full employment" and views addressing high unemployment as a priority. Meanwhile, RBA Assistant Governor Kent said that it is possible for short-term rates to fall below zero and more broadly noted there was room for further compression in short-term rates. We also view the RBA's October monetary policy minutes as generally dovish, as those minutes said further monetary easing would likely gain more traction than had been the case earlier. It also reiterated that addressing the high unemployment rate remains an important national priority.

Since March, the RBA has adopted several measures aimed at supporting economic recovery and countering the negative economic effects of COVID. The RBA reduced its Cash Rate close to zero, at just 0.25%. The central bank's other measures also included initially establishing an A$90B Term Funding Facility (TFF) in March for banks to access three-year funding, a facility that was recently expanded to A$200B and extended through June 2021. Additionally, the RBA began targeting a yield on the three-year Australian government bond of around 0.25% through purchases of government bonds in the secondary market. So far the RBA has purchased A$63.3B of bonds in support of that objective.

Separately, the Australian government has also acted to support the economy. Most recently it released its federal budget which includes wage subsidies to protect jobs, as well as other temporary incentives for businesses. The underlying cash deficit is expected to rise to a record A$214B, or around 11% of GDP, in 2020-2021. However, the budget position is expected to improve to a deficit of $67B by 2023-2024.

Figure 1



Source: Bloomberg LP and Wells Fargo Securities

The nature of the Australian recovery is likely to be uneven.

After the second wave of COVID cases in Victoria, resulting in new lockdown measures, the spread of the virus appears to now be receding (Figure 1). Victoria announced an easing of its lockdown restrictions this week. Among the measure announced, Victoria indicated people can now travel up to 25km from their home or workplace, increased the limits on the number of people allowed to gather in restaurants and cafes, and said additional changes to retail, hospitality and personal services will be made from November 1. Australia has also made some progress toward the re-opening of its borders, allowing New Zealanders into the state of New South Wales and the Northern Territory without having to quarantine. Although progress has been made on the health front and the recovery appears to be underway, the nature of the recovery remains uncertain and is likely to be uneven. Indeed, the uncertain and uneven nature of the recovery is most evident in the Australian labor market.

The pandemic and resulting lockdowns weighed heavily on employment, particularly in the hospitality industry. In September, Australian employment fell—although by less than expected—due in part to the Stage 4 restrictions in Victoria weighing on the recovery. Employment in Victoria fell by 36,000, after dropping by 37,000 the previous month. Nationally, employment declined by 29,500 after three months of positive gains, while the nationwide unemployment rate increased to 6.9%. The details of the report indicated full-time jobs and part-time jobs fell by 20,100 and 9,400, respectively.

The somewhat uneven recovery has also been evident in the retail sector. Australian retail sales fell 1.5% month-over-month in September from the month earlier, preliminary data indicated, following a 4% month-over-month decline in August. The September details showed food retailing, household goods and other retailing contributed to the fall, while every state and territory—expect for the Northern Territory—also saw sales drop in September. Meanwhile, confidence surveys have been mixed. September business conditions rose six points to 0, driven by an increase in all three subcomponents, while business confidence rose four points to -4, well above the low in March, but still below last year's average. Consumers are becoming more optimistic or hopeful, however, as October consumer confidence increased 11.2 points to 105.0, the highest increase since July 2018.

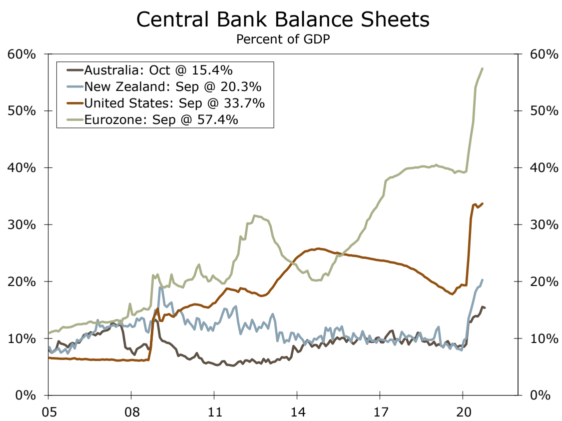
Time for a Change in Policy View

Given the recent economic developments in addition to RBA's more dovish tone over the past several weeks, we now expect the central bank to announce further monetary policy easing at its November 3 meeting. The fact that November will also see the publication of a quarterly Statement on Monetary Policy, which will include the RBA's latest updated economic forecasts, will also offer the central bank the opportunity to elaborate on its rationale for any policy action. Specifically, **we look for the RBA to cut its Cash Rate and three-year yield target 15 bps to 0.10%, as well as announce further quantitative easing measures** by expanding its bond purchase program. **We expect increased bond purchases of around A$75B (or ~3.8% of GDP) to be announced**, including purchases of government bonds in the five- and 10-year maturity range.

We look for the RBA to cut its Cash Rate and three-year yield target, as well as announce further QE measures.

In our view, the central bank has plenty of scope to expand its bond purchase program, given that the central bank currently holds only around 6% of total outstanding Australian (central and state) government bonds. More broadly, the size of the RBA's balance sheet is relatively modest, at around 15% of GDP currently. Other central banks have already seen larger balance sheet expansions in comparison to the Reserve Bank of Australia, including the European Central Bank, the Federal Reserve, and even the Reserve Bank of New Zealand (Figure 2).

Figure 2



Source: Bloomberg LP and Wells Fargo Securities

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