

International Commentary — July 6, 2021

Reserve Bank of Australia TipToes Into Tapering

Summary

- In a closely watched monetary policy announcement, the Reserve Bank of Australia (RBA) made no changes to current monetary policy settings; however, did signal future modest steps toward less policy accommodation.
- To that point, the RBA retained the 2024 government bond as its yield target, while it also extended and tapered its asset purchase program. RBA policymakers also highlighted the domestic economic recovery is progressing quicker than expected and recent COVID-related restrictions should not have a material impact on the economy. However, modest tweaks to RBA guidance were offset by an extension of the current asset purchase program as well as indications that policy rates are likely to stay at current levels for longer than G10 peer central banks.
- As of now, we remain mildly constructive on the prospects for the Australian dollar. We believe the Australian currency can strengthen over the medium-to-longer-term; however, we view risks around our view as tilted toward somewhat less currency appreciation than we currently forecast.

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The Reserve Bank of Australia Tweaks Some Monetary Policy Parameters

The Reserve Bank of Australia's (RBA) July monetary policy announcement was more closely watched than usual, given the central bank had signaled ahead of time it would take the opportunity to reconsider its recent monetary policy approach. Although there was no change in current monetary policy settings, the RBA made some slight tweaks to its future monetary policy guidance, which represent an initial, albeit modest, step in the direction of less monetary policy accommodation.

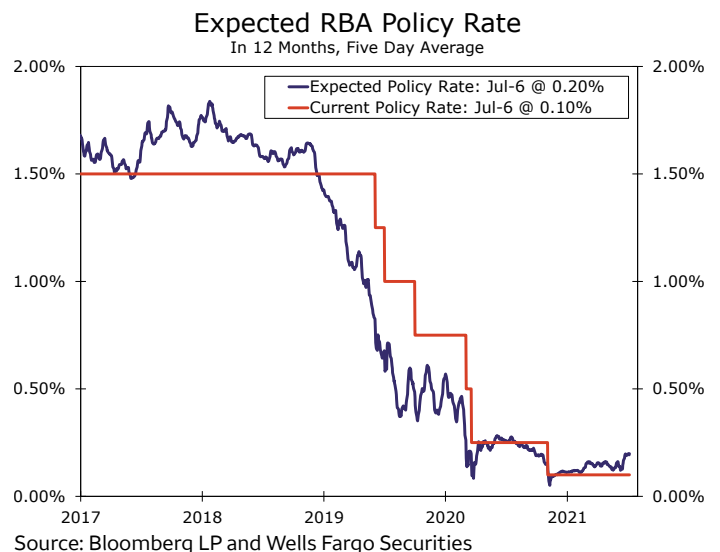
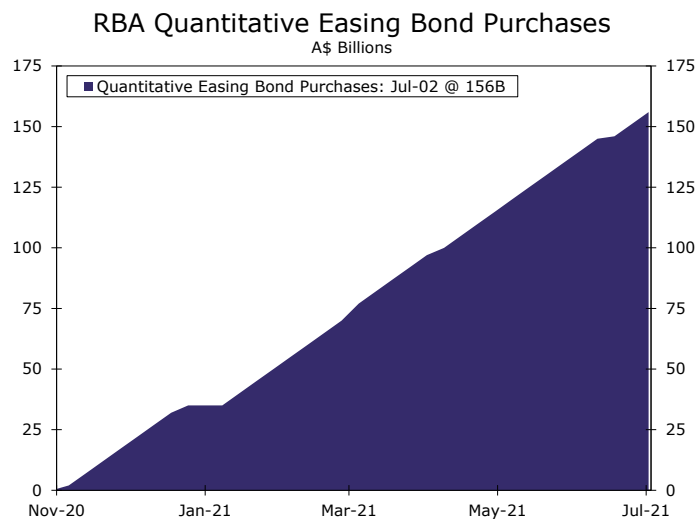
With respect to current policy settings, the RBA kept its Cash Rate at 0.10% and its target for three-year government bond yields also at 0.10%, while stating it would complete its current A\$200 billion quantitative easing program in September as scheduled. Note that the RBA has recently been purchasing bonds for its quantitative easing program at a pace of around A\$5 billion per week.

With respect to future policy guidance, the RBA:

- retained the April 2024 bond as the bond for the yield target for three-year government bonds. This is perhaps a very mild tilt in a less dovish direction. Extending the bond to a later maturity (for example November 2024) would have perhaps been a mild signal that rates could remain lower for an extended period.
- extended, and tapered, its bond purchase program. Following the completion of the current program in September, the central bank said it will purchase bonds at a moderately slower pace of at least A\$4 billion per week until at least mid-November, at which time it would conduct a further review.

Regarding the outlook, the central bank said the economic recovery is stronger than expected, while noting the recent COVID outbreaks and lockdowns pose a brief risk to activity. However, despite the stronger recovery, wage and price inflation has, and is expected, to remain subdued. The RBA's central scenario anticipates underlying CPI inflation of 1.5% in 2021 and 2% by mid-2023. The central bank also made note of a robust housing market, which it said it would monitor carefully.

Finally, the RBA said it will not increase the Cash Rate until actual inflation is sustainably within its 2%-3% target range, adding that in the RBA's central scenario this condition will not be met before 2024. That is a slight change in wording where the central bank had signaled that rates were unlikely to rise until at least 2024, although central bank governor Lowe was careful to emphasize the RBA was not hinting at rate increases in 2023.



Overall, despite some modestly less dovish tweaks in policy guidance (a tapering of bond purchases, a small change with respect to interest rate language), there is an offset in terms of further bond purchases beyond the current quantitative easing program, as well as indications that Australian policy interest rates are likely remain at the current low levels for longer than many other G10 central banks. We continue to forecast only moderate gains in the Australian dollar over time, and see the risks as tilted towards a more gradual pace of Australian dollar appreciation.

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