All Signal, No Noise

MARKET ANALYSIS

MNI RBA Preview - December 2020

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Central Bank Watch - RBA

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MNI RBA Data Watch List

Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
CPI (Q)	% y/y	0.7	-0.3	↑	2.2	↓					-0.81
CPI Trimmed Mean (Q)	% y/y	1.2	1.2	→	1.7	↓					-1.40
Import Prices (Q)	% q/q	-3.5	-1.9	↓	-1.0	↓					-1.93
Consumer Inflation Exp	% y/y	3.5	3.3	↑	3.4	↑					0.05
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
AiG PMI	Index	56.3	53.5	↑	35.8	↑					1.34
GDP (Q)	% y/y	-6.3	1.6	↓	2.3	↓					-2.46
Building Approvals	% y/y	8.8	-13.5	↑	3.1	↑					1.04
Trade Balance	AUD m	5630	7826	↓	10823	↓					-0.23
Monetary Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Home Loans	% m/m	1.4	-0.8	↑	-2.1	↑					0.84
Private Sector Credit	% y/y	1.8	2.4	↓	3.5	↓					-1.22
Private Capital Expend (Q)	% q/q	-3.0	-6.4	↑	-2.0	↓					-0.43
Commodity Prices	% SDR	-0.3	-14.8	↑	-10.3	↑					1.96
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales	% m/m	-1.1	2.7	↓	8.5	↓					-0.29
Consumer Confidence	Index	107.66	79.53	↑	88.06	↑					1.45
Employment Change	k	178.8	119.2	↑	-607.4	↑					0.73
Wage Price Index (Q)	% q/q	0.1	0.2	↓	0.5	↓					-1.96
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Equity Market	Index	6517.8	6060.5	↑	5755.7	↑					0.60
AUD 10-Year Yield	%	0.90	0.98	↓	0.89	↑					0.44
AUD Yield Curve (3s-10s)	bps	78.5	71.9	↑	62.8	↑					1.70
AUD TWI	Index	134.04	129.16	↑	132.01	↑					1.07

Note: For quarterly data the 3m ago column will display the previous data point and the 6m ago column will display the data point prior to that.
Source: MNI, Bloomberg

MNI POV (Point Of View): A Quiet End To An Active Year

The RBA is set to leave its monetary policy settings unchanged at its final monetary policy decision of 2020, rounding off a year which has seen the Bank dip its feet into the waters of unconventional monetary policy for the first time.

Inflation and wages remain subdued, at best, and the Bank is set to re-affirm its pledge re: low for long interest rates alongside the ongoing bond purchase scheme, as well as its promise to do more, if deemed necessary. It is worth remembering that the Australian economy has avoided the worst-case scenario, with the latest monthly labour market report placing further weight behind that particular view. We should also stress that the continued re-opening of the state of Victoria is set to provide tailwinds to certain datasets in the coming months.

The RBA's purer QE scheme, adopted in November, is progressing pretty much as planned, with the 3-Year yield target being enforced via limited ACGB purchases, which will please the Bank. Still, we should remember that at least some of the Bank's focus falls on relative monetary policy settings/market dynamics, with Governor Lowe referring to international government bond yield spreads (with the U.S.A & Canada at the fore) in recent addresses. As we move forwards the RBA may struggle to contain widening pressures in the aforementioned yield spreads, given expectations for Australia's economic outperformance on the back its relative success in containing COVID-19, although the negative to flat net ACGB supply dynamic that will be apparent in a typical week of AOFM issuance (courtesy of the RBA's ACGB purchases) will limit the chances of any notable blowouts in yield spreads.

Furthermore, the Bank's bond purchases have re-fuelled growth in surplus E/S balances lodged at the RBA, which hit A$65bn at the start of last week, before tailing back off (which was at least partially aided by the settlement of an ACGB syndicated tap), although the metric remains some way shy of the record ~A$89bn lodged in April. The effective overnight cash rate continues to trade through target as a result of the more than abundant liquidity evident in the system, settling at 0.05% in recent weeks.

The Bank remains against the idea of a negative cash rate, and would only really open up to the possibility of such a move if the likes of the Fed and BoC went down that particular rabbit hole (both of those central banks have also stressed their reluctance re: the idea of sub-zero benchmark rates).

Ultimately, the RBA views its previously enacted/outlined policy easing as enough for now, which it hopes will provide a fertile enough round for the fiscal side of the coin to come to the fore, whether that be at federal or state government level. RBA Governor Lowe has even gone as far as outlining targets for state governments to hit re: infrastructure investment, blurring the lines between the sides of the policy sphere.

Looking to FX, the RBA's AUD TWI measure has recovered from its early November dip (which centred on the speculation and the actual enactment of the Bank's latest round of monetary easing), with the AUD/USD cross benefitting from the move higher in risk assets, which is of course linked to COVID vaccine-19 developments and, once again, Australia's relative outperformance re: COVID-19 mitigation. Elsewhere, the AUD/NZD cross has come under pressure in recent weeks, on the back of the aggressive unwind re: market pricing for the trough of the RBNZ's OCR. As ever, FX is all about relative matters, with the Bank's recent move to a purer form of QE at least somewhat based on relative monetary policy stances within the G10 FX sphere.

In sum, relative matters remain at the heart of the Bank's thought process, whether that be in terms of policy rates, FX levels or government bond yield spreads. The Bank will be faced with several challenges on that front, mostly stemming from Australia's relative success in dealing with COVID-19. Any gyrations within the FX and bond markets will likely remain well within the confines of the new normal established in recent years and shouldn't necessarily result in a knee-jerk reaction from the RBA, unless the momentum behind any such move is overwhelming. The Bank's focus on realised employment and inflation measures (which we have discussed previously) also points to a lower for longer policy outlook.

The decision will be followed up by Governor Lowe's latest appearance before the House of Representatives Standing Committee on Economics, which takes place on Wednesday. While we shouldn't expect any changes to the broad brushstrokes of the Bank's policy settings the lengthy Q&A may provide us with some insightful nuances, questions permitting.

RBA November 3 2020 Meeting Statement

At its meeting today, the Board decided on a package of further measures to support job creation and the recovery of the Australian economy from the pandemic. With Australia facing a period of high unemployment, the Reserve Bank is committed to doing what it can to support the creation of jobs. Encouragingly, the recent economic data have been a bit better than expected and the near-term outlook is better than it was three months ago. Even so, the recovery is still expected to be bumpy and drawn out and the outlook remains dependent on successful containment of the virus.

The elements of today's package are as follows:

- a reduction in the cash rate target to 0.1 per cent
- a reduction in the target for the yield on the 3-year Australian Government bond to around 0.1 per cent
- a reduction in the interest rate on new drawings under the Term Funding Facility to 0.1 per cent
- a reduction in the interest rate on Exchange Settlement balances to zero
- the purchase of $100 billion of government bonds of maturities of around 5 to 10 years over the next six months.

Under the program to purchase longer-dated bonds, the Bank will buy bonds issued by the Australian Government and by the states and territories, with an expected 80/20 split. These bonds will be bought in the secondary market through regular auctions, with the first auction to be held this Thursday for Australian Government securities. Further details of the auctions are provided in the accompanying market notice.

The Bank remains prepared to purchase bonds in whatever quantity is required to achieve the 3-year yield target. Any bonds purchased to support this target would be in addition to the $100 billion bond purchase program.

At today's meeting, the Board also considered an updated set of economic forecasts. The global economy has been recovering from the initial virus outbreaks, with the recovery most advanced in China. Even so, output in most countries remains well short of pre-pandemic levels and recent virus outbreaks pose a downside risk to the outlook, particularly in Europe.

In Australia, the economic recovery is under way and positive GDP growth is now expected in the September quarter, despite the restrictions in Victoria. It will, however, take some time to reach the pre-pandemic level of output. In the central scenario, GDP growth is expected to be around 6 per cent over the year to June 2021 and 4 per cent in 2022. The unemployment rate is expected to remain high, but to peak at a little below 8 per cent, rather than the 10 per cent expected previously. At the end of 2022, the unemployment rate is forecast to be around 6 per cent.

This extended period of high unemployment and excess capacity is expected to result in subdued increases in wages and prices over coming years. In underlying terms, inflation is forecast to be 1 per cent in 2021 and 1½ per cent in 2022. In the most recent quarter, year-ended CPI inflation was 0.7 per cent and, in underlying terms, inflation was 1¼ per cent.

The Board views addressing the high rate of unemployment as an important national priority. Today's policy package, together with the earlier measures by the RBA, will help in this effort. The RBA's response is complementary to the significant steps taken by the Australian Government, including in the recent budget, to support jobs and economic growth.

The combination of the RBA's bond purchases and lower interest rates across the yield curve will assist the recovery by: lowering financing costs for borrowers; contributing to a lower exchange rate than otherwise; and supporting asset prices and balance sheets. At the same time, the RBA's Term Funding Facility is contributing to low funding costs and supporting the supply of credit to the economy. To date, authorised deposit-taking institutions have drawn $83 billion under this facility and have access to a further $104 billion.

Given the outlook for both employment and inflation, monetary and fiscal support will be required for some time. For its part, the Board will not increase the cash rate until actual inflation is sustainably within the 2 to 3 per cent target range. For this to occur, wages growth will have to be materially higher than it is currently. This will require significant gains in employment and a return to a tight labour market. Given the outlook, the Board is not expecting to increase the cash rate for at least three years. The Board will keep the size of the bond purchase program under review, particularly in light of the evolving outlook for jobs and inflation. The Board is prepared to do more if necessary.

MNI Policy Team Preview: RBA To Stand Pat In Last 2020 Meet

By Lachlan Colquhoun

SYDNEY (MNI) - The Reserve Bank of Australia holds its final meeting of 2020 Tuesday, with no new policy moves expected after what has been an extraordinary year of activity for the central bank.

Although there seems little need for policy action in coming months, the RBA has stated it has room to ease further if needed. However, with Australia's economy recovering, a stronger than expected pick-up could prompt a review of the bank's forward guidance at some point in 2021.

While the RBA has given a clear indication that it is unlikely to increase rates for another three years, its economic forecasts have become more optimistic as Australia has brought the pandemic under control quicker than most and the economy has begun to recover.

The bank has specifically targeted a recovery in employment as its main priority, and the October unemployment rate stood at 7.0%, compared to just over 5% in the early months of 2020.

Total employment is on the increase as the participation rate rises, although the impact of the end of Government job subsidies which are soon set to taper off and end in April 2021 is unclear.

MORE QE IF NEEDED
If the RBA decides more easing is required next year its most likely next move is to increase the size of the QE program. Governor Philip Lowe has consistently ruled out zero or negative interest rates, although the bank could feel the pressure for more rate cuts if the U.S. Federal Reserve were to go move into negative territory.

Over the course of 2020 the RBA has cut official interest rates from 0.75% to a record low 0.1%, purchased more than AUD50 billion in Government securities as part of its yield control program targeting the benchmark three year bond, and more recently announced a AUD100 billion program of Quantitative Easing to purchase longer-dated government bonds.

The RBA has also implemented a AUD200 billion Term Funding Facility for commercial banks to access low cost funding at the cash rate, and reduced the interest rate on Exchange Settlement balances to zero.

Sell-Side Analyst Views

AMP Capital: The RBA is expected to make no changes to monetary policy at its board meeting on Tuesday, given its rate cut and quantitative easing announcement in November. The RBA is now in wait and see mode again and focussed on the implementation of its $100bn six-month bond buying program. The post meeting statement and Governor Lowe's parliamentary testimony on Wednesday may express more confidence regarding the outlook given recent positive vaccine news but is likely to remain dovish given the huge amount of spare capacity in the economy with the RBA still not expecting to meet its inflation and employment objectives over the next few years. Governor Lowe is likely to repeat that the RBA does not expect to raise rates for the next three years at least.

ANZ: No change in policy expected.

Barclays: The RBA has delivered material easing with a number of packages from March through November. With economic growth returning gradually, we do not expect the RBA to announce any further major policy changes before May 2021, unless there is a resurgence of COVID-19 cases in Australia.

CBA: At the RBA's Board Meeting for December we do not expect any further policy action to be takento what was announced in November.The Governor may refer to the strong growth in employment in the October labour force survey in his post meeting statement.

Citi: The RBA this week should note the improving domestic economy especially after strong October labor market data (note Citi Economics has upwardly revised their Australia 2020 GDP forecast) while reiterating the need for accommodative policy for an extended period. On the margin this should be AUD positive as it reflects that we have likely seen "peak dovishness" for the RBA after last month's rate cuts and LSAP expansion.

Goldman Sachs: Since November's meeting, the RBA made some modest upgrades to its macro forecasts, with Governor Lowe noting that interest rates were now at the lower bound and that the size of the QE purchases would be the incremental tool going forward. Governor Lowe also continued to characterize negative rates as 'extraordinary unlikely'.

- Looking forward, we expect the RBA to keep policy setting on hold at its December meeting and reiterate existing forward guidance. Governor Lowe is also due to speak before a Parliamentary committee on Wednesday. Given recent positive news around domestic virus trends and global vaccine developments, we would not be surprised if Governor Lowe sounds a bit more upbeat about the prospects for recovery in 2021.
- That said, Governor Lowe is likely to continue to highlight elevated uncertainty and risks to the outlook. Looking ahead, we expect the RBA to keep policy rates on hold at current settings for several years, including maintaining the YCC target until 2023 and the 0.1% cash rate until 2025. Given spare capacity in the labour market, we expect the RBA to renew another round of QE in 2021.

ING: Whatever the 3Q GDP outcome (ING forecasts +2.5% quarter-on-quarter vs. -7% in 2Q), it's still history and doesn't reflect current trends. And, having cut the Cash Rate by 15 basis points to 0.10% at the November meeting, it's hard to see the RBA moving the policy rate again in less than a month. Reinforcing this view further is the latest labour report for October with a 179,000-strong surge in employment, hinting at a faster economic recovery in the current quarter.

J.P.Morgan: Given the historic November meeting and the numerous RBA speeches over the past month it's likely this meeting is fairly uneventful. We expect the guidance to remain unchanged with the Bank continuing to tether the outlook for the cash rate to actual (rather than forecast) inflation. The policy Statement will need to be updated to include comments around the recently announced quantity-based QE scheme, but given that the modalities of the program are well-understood there is limited room for surprises. The RBA meeting is held the day before the release of Australia's 3Q GDP data, and although the Bank will not have the official number in hand, the available partial inputs will provide a fairly good indication of the magnitude of the recovery. Last month, RBA officials lowered their forecast for peak unemployment by about 2%-pts to 8%, which broadly aligns with our own view. The data released in the past month are consistent with that forecast tweak, so the language on this front should match the previous month's statement.

Morgan Stanley: We expect the RBA to leave its policy setting unchanged at the December meeting, with the cash rate, 3-year yield target and term funding facility rate at 0.1% and the rate of QE purchases unchanged. With a significant policy package at the previous meeting, alongside updated forecasts and several speeches over the past few weeks – the RBA's outlook has been well broadcasted. In the statement we would be watching for any acknowledgement of the recent run of stronger data, as well as any signs of discomfort around the rise in long-term yields and the AUD since the QE package was announced.

RBC: We expect little new information from the RBA's last meeting for 2020 with the new A$100bn QE recently launched. More interesting will be the Governor's appearance before the House as he answers a multitude of questions that will likely span C-19 vaccine prospects, further opening of state borders, QE program and the currency. As per convention, there is no meeting in Jan with Feb often presenting the opportunity for a reset amid a refreshed set of forecasts.

Societe Generale: We expect the RBA to maintain the policy stance that was introduced at the November meeting, including the near-zero policy rates (0.1% target for both cash rate and 3-year government bond yield), Term Funding Facility and A$100bn purchase of government bonds of maturities of 5-10 years (QE). Forward guidance of holding the cash rate for at least three years will also be the same as in the previous month. The final sentence of the policy statement, "The Board is prepared to do more (bond purchases) if necessary" should also remain intact and continue to suggest additional QE next year.

- Admittedly, we have been hearing quite a bit of positive news regarding the economic outlook. Australia continues to be successful in containing COVID-19, which is also boosting macroeconomic data such as employment and retail sales. Chances are growing that the actual economic performance in 2H20 could turn out to be better than the RBA's base scenario. In addition, positive news on COVID-19 vaccine developments by various pharmaceutical companies clearly raises hope for a swift normalisation of the global economy in 2021. But we believe that it is too early for this positive news to affect the basic policy stance of the RBA, including rather aggressive forward guidance to hold the policy rate for three years. Governor Lowe and Deputy Governor Debelle reiterated the RBA's forward guidance in recent public speeches. Debelle also made it clear that the RBA continues to expect an uneven recovery despite the news on vaccines.
- Meanwhile, one can still question whether there will be additional easing measures in the near future. Above all, the RBA policymakers' adverse stance on negative interest rates was confirmed by the recent Statement on Monetary Policy. But we maintain our base scenario that there will be additional bond purchases (QE) in the near future, especially when the initial amount of A$100bn is used up. Policymakers could still extend the QE programme to limit the upside in bond yields as well as Australian dollar exchange rates, even with positive news on the growth outlook.

TD Securities: We doubt there will be any surprises to digest in the RBA statement. The Bank will confirm it stands ready to provide additional easing if required. More interest in Lowe's parliamentary testimony. For GDP, see upside risks to the RBA's 1.75% q/q average increase in both Q3 & Q4 to meet the Bank's Dec'20 GDP forecast.

Westpac: The RBA cut its key rate targets to 0.10% – viewed as the effective lower bound – and adopted a more aggressive quantitative easing at its Nov meeting. Minutes and a subsequent speech from the Governor also outlined a significant pivot in the Board's approach: emphasising outcomes over forecast outcomes in its decision-making process; placing primary importance on the labour market; acknowledging the influences of policy developments abroad; and noting that quantities are now a key aspect of policy.

- The RBA is now back in 'watch and wait' mode. We are unlikely to see any additional moves given November's momentous changes but the Board will reiterate its changed approach and that it remains prepared to do more if needed.