All Signal, No Noise

MARKET ANALYSIS

MNI RBA Preview - September 2020

Meeting Date: Tuesday September 1 2020

Statement Release Time: 05:30 BST/14:30 AEST

Link To Statement Page: https://www.rba.gov.au/monetary-policy/int-rate-decisions/2020/

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Central Bank Watch - RBA

Monday, August 31, 2020

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	-0.3	2.2	↓	1.8	↓					-2.33
CPI Trimmed Mean (Q)	% y/y	1.2	1.8	↓	1.6	↓					-1.98
Import Prices (Q)	% q/q	-1.9	-1.0	↓	0.7	↓					-1.69
Consumer Inflation Exp	% y/y	3.3	3.4	↓	4.0	↓					-0.85
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
AiG PMI	Index	53.5	35.8	↑	45.4	↑					0.58
GDP (Q)	% y/y	1.4	2.2	↓	1.8	↓					-1.16
Building Approvals	% y/y	-15.8	2.3	↓	8.4	↓					-1.52
Trade Balance	AUD m	8202	10631	↓	4927	↑					0.69
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	2.4	3.5	↓	2.5	↓					-0.93
Private Capital Expend (Q)	% q/q	-5.9	-2.1	↓	-2.7	↓					-1.96
Commodity Prices	% SDR	-12.0	-11.2	↓	-4.1	↓					-1.06
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	2.7	8.5	↓	-0.8	↑					0.39
Consumer Confidence	Index	79.53	88.06	↓	95.52	↓					-1.21
Employment Change	k	114.7	-607.4	↑	11.6	↑					0.66
Wage Price Index (Q)	% q/q	0.2	0.5	↓	0.5	↓					-2.36
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Equity Market	Index	6060.5	5755.7	↑	6441.2	↓					-0.29
AUD 10-Year Yield	%	0.98	0.89	↑	0.82	↑					1.51
AUD Yield Curve (3s-10s)	bps	71.9	62.8	↑	31.7	↑					1.22
AUD TWI	Index	125.78	129.48	↓	134.91	↓					-1.17

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

Business Address – MNI Market News, 5th Floor, 69 Leadenhall Street, London, EC3M 2DB

MNI POV (Point Of View): Over To You, Fiscal

No changes are expected at the Reserve Bank of Australia's (RBA) August monetary policy decision, with the Bank expected to reaffirm its low for long, with a willingness to do more, if required, style of forward guidance.

This should be a relatively straight forward meeting, given last month's release of updated economic forecasts from the RBA and (relatively limited) return to the ACGB purchasing stage, as the Bank looks to promote re-convergence to its 3-Year yield target. Deviations from target have been by no means drastic, but the RBA needs to keep an eye on the steepness of the 3-4 Year section of the curve, in order to preserve a state of smooth market functioning.

Q2 GDP partial data released thus far has pointed to the worst case being averted, but the second wave of local COVID-19 cases, mostly located in the state of Victoria, clouds the short-term outlook and may very well limit the immediate domestic rebound. It should be noted that the new case count in the state has already moderated from the recent highs, with a broader roadmap for the state's move away from lockdown restrictions set to be outlined this weekend, although regional policymakers remain extremely cautious.

The Bank continues to point the finger at fiscal policy, with Governor Lowe recently doubling down, as he made a formal request for states to commit another A$40bn to major infrastructure projects over a two-year period. While Lowe's focus on fiscal loosening is nothing new, it is fair to say that the magnitude caught most, including the state Premiers, off guard. This gives the Bank some scope to tweak its rhetoric surrounding fiscal policy at this week's decision, but any such alteration would likely fall inline with rhetoric already deployed by the Governor.

Still, Lowe's move is understandable, with the Bank possessing relatively limited firepower after its March splurge, while the economy faces problems that are perhaps better addressed by fiscal, rather than monetary policy.

E/S surplus balances remain elevated by historical standards, albeit someway shy of the record highs witnessed in early April, which is understandable given the pullback in RBA ACGB purchases and drawdown in outstanding repo.

On the currency front, the latest round of US$ weakness has allowed the A$ to register fresh cycle highs, at least based on the RBA's TWI. We don't expect any overt references to the level of the A$ in the RBA's statement that accompanies its decision, any such reference should be reserved for the minutes. The RBA's A$ TWI measure only sits a touch above the level seen at its August meeting. The Bank is seemingly at ease with the recent rally in the A$, and officials have made several references to the relative nature of exchange rates in recent rounds of communique. This view was perhaps best expressed in the minutes of the Bank's August decision, as it noted that "The Australian dollar had also appreciated against the US dollar to be a little above where it had started the year. The Australian dollar had been broadly in line with its fundamental determinants, such as commodity prices and interest rate differentials, which had returned to their levels at the start of the year."

Ultimately the Bank remains hesitant to implement further easing measures, but still outlined the next steps that it could take down that road in the August meeting minutes.

The RBA continues to adopt a glass half full approach, even with the second round COVID-19 outbreak and Sino-Aussie relations providing clear sources of risk.

Wednesday's Q2 GDP release will provide the first real marker regarding the accuracy of the Bank's economic projections (albeit with collection of the data that underlies the release proving somewhat difficult). Still, the release shouldn't provide anything more than a look in the rear view, with participants keen to assess what comes next, as opposed to what has already passed.

RBA AUGUST 4 2020 MEETING STATEMENT

At its meeting today, the Board decided to maintain the current policy settings, including the targets for the cash rate and the yield on 3-year Australian Government bonds of 25 basis points.

The global economy is experiencing a severe contraction as countries seek to contain the coronavirus. Even though the worst of this contraction has now passed, the outlook remains highly uncertain. The recovery is expected to be only gradual and its shape is dependent on containment of the virus. While infection rates have declined in some countries, they are still very high and rising in others. International trade remains weak, although there has been a strong recovery in industrial activity in China over recent months.

Globally, conditions in financial markets remain accommodative. Volatility has declined and there have been large raisings of both debt and equity. The prices of many assets have risen substantially despite the high level of uncertainty about the economic outlook. Bond yields remain at historically low levels.

The Bank's mid-March package of support for the Australian economy is working as expected. There is a very high level of liquidity in the Australian financial system and borrowing rates are at historical lows. Authorised deposit-taking institutions are continuing to draw on the Term Funding Facility, with total drawings to date of around $29 billion. Further use of this facility is expected over coming months.

Government bond markets are functioning normally alongside a significant increase in issuance. The yield on 3-year Australian Government Securities (AGS) has been consistent with the target of around 25 basis points. The yield has, however, been a little higher than 25 basis points over recent weeks. Given this, tomorrow the Bank will purchase AGS in the secondary market to ensure that the yield on 3-year bonds remains consistent with the target. Further purchases will be undertaken as necessary. The yield target will remain in place until progress is being made towards the goals for full employment and inflation.

The Australian economy is going through a very difficult period and is experiencing the biggest contraction since the 1930s. As difficult as this is, the downturn is not as severe as earlier expected and a recovery is now underway in most of Australia. This recovery is, however, likely to be both uneven and bumpy, with the coronavirus outbreak in Victoria having a major effect on the Victorian economy. Given the uncertainties about the overall outlook, the Board considered a range of scenarios at its meeting. In the baseline scenario, output falls by 6 per cent over 2020 and then grows by 5 per cent over the following year. In this scenario, the unemployment rate rises to around 10 per cent later in 2020 due to further job losses in Victoria and more people elsewhere in Australia looking for jobs. Over the following couple of years, the unemployment rate is expected to decline gradually to around 7 per cent.

The Board also considered other scenarios. A stronger recovery is possible if progress is made in containing the virus in the near future. This progress would support an improvement in confidence and a less cautious approach by households and businesses to their spending. On the other hand, if Australia and other countries were to experience further widespread lockdowns, the recovery in both output and the labour market would be delayed. Details on these scenarios will be provided in the Statement on Monetary Policy on 7 August.

In each of the scenarios considered by the Board, inflation remains below 2 per cent over the next couple of years. In the most recent quarter, CPI inflation fell to –0.3 per cent in year-ended terms, reflecting lower oil prices and the effects of various policy measures, including the decisions to make child care and some pre-school free for a period. Inflation is expected to return to positive territory in the current quarter. Beyond that, given the ongoing spare capacity in the economy, inflation is expected to average between 1 and 1½ per cent over the next couple of years.

As Australians deal with the coronavirus, the economy is being supported by the substantial, coordinated and unprecedented easing of fiscal and monetary policy. The Australian Government's recent announcement that various income support measures will be extended is a welcome development and will support aggregate demand. It is likely that fiscal and monetary stimulus will be required for some time given the outlook for the economy and the labour market.

The Board is committed to do what it can to support jobs, incomes and businesses in Australia. Its actions are keeping funding costs low and assisting with the supply of credit to households and businesses. This accommodative approach will be maintained as long as it is required. The Board will not increase the cash rate target until progress is being made towards full employment and it is confident that inflation will be sustainably within the 2–3 per cent target band.

MNI POLICY TEAM PREVIEW: RBA SET TO HOLD, EYE DEVELOPMENTS

By Lachlan Colquhoun

SYDNEY (MNI) - The Reserve Bank of Australia will likely leave monetary policy unchanged Tuesday, looking through downside risks to the economy to take stock of earlier decisions that are seeming to have the desired effect on the economy.

Policymakers are expected to leave official interest rates on hold at a record low 0.25% for a sixth straight month and continue to target a yield of 25 basis points on the benchmark 3-year government bond, with the main focus of watchers likely to be on the accompanying statement rather than the likely decision.

In the last two months, Melbourne, Australia's second city, has been hit with a resurgence of Covid-19 infections which will have an impact on the strength of Australia's nascent recovery. Ongoing internal and external order closures are also hampering economic activity.

--OUTLOOK

The RBA estimates GDP fell by 7% in the first half of 2020 -- official data will be published Wednesday -- and, with the recovery slowed by the renewed disruptions in Melbourne, the bank's baseline scenario now sees a contraction of 6% over the whole year, which will not be fully recovered until some point in 2022 after a 5% expansion in 2021.

Unemployment, which reached 7.5% in July, is forecast to rise to almost 10% over the next six months and gradually decline to around 7% by December 2022.

The RBA last cut rates by 50 basis points at an out of cycle meeting in March when it also announced a bond buying program with a target of a 0.25% on the benchmark Australian three-year government bond.

It also introduced a A$90 billion Term Funding Facility (TFF) designed to facilitate low cost lending by commercial banks to smaller businesses.

Since then the RBA has been consistent in its messaging that while the economic contraction is Australia is severe, it is not as severe as originally expected.

The bank has said that it believes its policies are being transmitted as designed, and are complementing the Federal Government's AUD259 billion fiscal stimulus package.

ANALYSTS' KEY COMMENTS

AMP Capital:

- The RBA is expected to leave monetary policy on hold for the sixth month in a row. Having provided massive monetary stimulus back in March the RBA is still in "watch and wait" mode, and the policy focus remains largely on fiscal policy. Given the uncertainty around the pace of recovery and the risks flowing from Melbourne's lockdown, the RBA is likely to reiterate its dovish forward guidance on rates and note that it stands ready to do more if needed.
- Ultimately, we think it will ease further sometime in the next six months as its own forecasts have the attainment of full employment and the sustainable achievement of the inflation target as being more than two years away. In terms what it might do if it eases further it has all but ruled out negative interest rates, foreign exchange intervention and the direct monetary financing of government spending, but sees still lower but positive interest rates and the purchase of more government bonds as possible options. A rate cut to 0.1% would hardly be worth the effort which leaves more QE as the main tool for any further easing. Maybe the RBA should also move more explicitly to inflation average targeting like the Fed. Meanwhile, rate hikes are at least three years away.

ANZ:

- No change expected from the RBA in its September meeting.

Bank of America:

- We expect no changes to the cash rate or unconventional package of policies. Strong forward guidance that rates are likely to be low for a long time is expected to be confirmed.
- Case numbers are now falling sharply in Victoria where a draconian lockdown remains in place and remain in single digits in NSW so national economic reopening by 4Q remains on track.
- RBA Governor Lowe made a formal request to the states in the National Cabinet forum to double spending on crisis support via infrastructure by AUD40bn or 2% of GDP over two years. It is uncertain how much compulsion the states will have to increase spending in the near term considering the long lead time for major works projects. Rating concerns should be state-specific as S&P said "balance sheets have plenty of room to accommodate additional infrastructure investment." Moody's said the same in July.
- Some states have already ramped up spending, but there is still scope to increase investment as the pipeline for work to be done has fallen in recent years outside of Queensland. They can look to do more in light of the call from the RBA, but consumption tax revenues are down with the notable hit from the Victoria shutdown. The latter points to government spending expected to shift from income support to capital investment, as income support is due to be scaled back in 4Q20 and 1Q21. There should be tax cut and investment subsidies in the 6 October Budget to support this shift in fiscal orientation. Business confidence across the states has not rebound despite the reopening suggesting private sector spending will likely remain weak for some time.
- In our view, a broader increase in virus cases that could prompt more lockdowns across other states or a global shock to global financial markets could see the RBA taking further action.
- There is a high degree of uncertainty around the outlook for both the global and domestic economies as the limits to policy support have become more evident. While Australia's fiscal position remains strong as is the RBA's ability to increase the scope of its unconventional tools, another shock in the global economy would find most global central banks and government with very limited scope to provide further stimulus.
- As spare capacity remains significant, inflationary pressures should remain subdued for some time. However, we see risk for higher inflation beyond 2021. This is due to changes to the supply chain and international trade combined with accommodative policy and an expected rebound in aggregate demand.

Barclays:

- We continue to expect no change from the RBA to its policy package. The tone will likely remain dovish amid uncertainties, especially regarding the Victoria lockdown, even as COVID cases seem to be declining from an earlier peak.

CBA:

- We do not expect the RBA to take any policy action at their September meeting and see the cash rate remaining at 0.25% for the next three-years at least. The main shift from the RBA has been in forecasting a slower recovery in 2021.We will be watching closely to see how their view on the economic outlook changes as Q2 becomes clearer ahead of GDP.

Goldman Sachs:

- The RBA left the targets for the cash rate and the 3-year government bond yield unchanged at 0.25% at its August Board Meeting, in line with expectations. The RBA's forward guidance was unchanged, although it did observe that the 3-year yield had "been a little higher than 25bp" and guide that it would "purchase AGS in the secondary market".
- In the subsequent Statement on Monetary Policy and Parliamentary Testimony, the RBA provided extensive guidance around its assessment of the economic outlook and possible future policy adjustments.
- On the latter, Governor Lowe noted the RBA "could make some adjustments" but didn't think they would "get much traction" and continued to highlight the importance of ongoing fiscal support. That said, Governor Lowe did signal that any further easing would likely involve lowering the cash rate target to 10bp and expanding purchases of longer duration bonds, rather than adopting negative rates.
- Looking forward, we expect the RBA to keep policy setting unchanged in September, with little change in forward guidance. At the margin, trends in both the virus & macro data have been fairly positive since August's meeting, albeit still soft in absolute terms. Our base case remains for the RBA to remain on hold for the foreseeable future, with a ~25% chance of further incremental easing if the recovery proves slower than expected.

ING:

- We expect it to be - in line with market expectations - a relatively unremarkable event. The Bank is likely in a good spot in terms of the monetary stimulus that has already been deployed to assist the fiscal efforts against the pandemic shock. The fall-out of the lockdown in Victoria will likely be in focus and Governor Lowe may once again highlight the serious economic damage for the whole country. The lack of hard data to back any policy shift suggest a wait-and-see approach should prevail.

J.P.Morgan:

- The RBA surprised at last month's policy decision by announcing a resumption of QE purchases, after three months off. 3Y bond yields had been deviating marginally, but consistently, from the target, and bad news on the virus and economic outcomes in Melbourne was enough to see the Board take action. Previously, decisions on QE purchase activity were made outside of policy meetings, and seemed to be in the domain of the markets team. In our view last month's decision to resume purchases was instructive, in that it shows that the Board views delivery on the 3Y yield target as an essential component of the monetary policy stance, and market dysfunction is not required to warrant action.
- We similarly view future easing as more likely to come via use of the balance sheet (i.e., increases in QE pace/quantity) first, rather than changes to yield targets. The cash rate target, 3Y yield target, repo rate, and IOER have all been pegged at levels that incentivize the market to enforce lower yields further out the curve. These rates should therefore be viewed as a package - there is not much point changing one, without changing all. We don't expect any new actions from this meeting, with most of the commentary dedicated to an assessment of how the recovery is tracking in the midst of a second-wave outbreak.

NAB:

- The Reserve Bank meets on Tuesday, where it is universally expected to keep monetary policy and its policy guidance unchanged. In recent communications, the RBA has emphasised that it judged its package of monetary stimulus as appropriate, where cheaper borrowing rates would help support the recovery. That said, the RBA stressed it remains willing to do more "if circumstances warrant". The RBA has also highlighted the important and continuing role for fiscal policy, which is best able to support the economy through the pandemic-driven collapse in demand. We expect the RBA to echo similar thoughts in its September post-meeting statement.

Nomura:

- We expect no material change to the tone or policy guidance from the RBA at its regular monthly policy meeting. We expect it to repeat that the worst of the global contraction has likely passed and that market conditions remain supportive but that the outlook remains highly uncertain. AUD was not mentioned in the prior meeting press release, and we are curious about whether the further modest rise in AUD has attracted the attention of the RBA, although we would not expect any material expression of concern. We believe that the RBA's views on the local growth and inflation outlook will be largely unchanged and expect to see a repeat of its message that ongoing fiscal support is still required; indeed, we are keen to see if this (latter) language is "dialed up" at this meeting. We expect the current 0.25% target for the cash rate and YCC program to remain unchanged for an extended period, but continue to think that, if the policy stance is to be altered from this point, it would still be in the direction of more accommodation, not less. We do not think the Fed Chair's Jackson Hole communication will greatly impact RBA thinking at this meeting, but see it as supporting our belief that the policymakers continue to favour more easing, rather than less.

RBC:

- The step up in Victoria restrictions, increasing optimism on the C-19 vaccine front, and mixed domestic data are the key developments since the board last met in early August and will likely dominate discussion. Further thoughts on their brief foray back into bond purchases may also be discussed and we look for any additional colour on the firmer currency. The key message that the RBA stands ready to lend further support as needed will remain but another reminder that fiscal policy needs to do more would not be surprising.

Societe Generale:

- We expect the RBA to maintain its wait-and-see stance and announce no additional policy actions at its meeting in September. The Statement on Monetary Policy released on 6 August clarifies that the RBA is currently not in favour of policy options such as foreign exchange intervention, negative interest rates or direct central bank (i.e. monetary) financing of government budget deficits. The RBA is likely to repeat its cautious stance in the upcoming policy meeting, although it will probably continue to add the qualification that it is committed to do what it can to support jobs, incomes and businesses in Australia. In other words, the RBA should continue to suggest that it would adopt additional policy tools if the economic outlook were to worsen further.
- The RBA is expected to maintain its economic outlook while at the same time highlighting the deterioration in the COVID-19 situation both domestically and abroad. Stage 4 restrictions have been maintained in Victoria as the number of daily deaths continues to increase. The pace of increase in the global number of COVID-19 cases is not slowing, and there are signs of a second wave spreading through some major European countries as well as South Korea. Nevertheless, the strong macroeconomic data substantiates the underlying recovery momentum. We note continued gains in jobs and retail sales in July despite the second wave of infections in Victoria. The impressive recovery in China led by industrial production and infrastructure investment should support Australia's commodities exports. We also watch the number of new confirmed COVID-19 cases in Australia to have reached a peak. We conclude that the pandemic has not worsened enough to change the RBA's economic outlook and policy stance.

TD Securities:

- The RBA Meeting should pass without any major surprises. The Bank is likely to assert that uncertainties remain high especially in light of the Covid developments in Victoria. The RBA noted the downturn is not as severe as earlier expected and a recovery is underway in most of Australia. We expect the RBA to indicate this still remains the case.

Westpac:

Business Address – MNI Market News, 5th Floor, 69 Leadenhall Street, London, EC3M 2DB

- The RBA is expected to keep policy settings unchanged at its September meeting. The Bank is providing support to the economy through a range of stimulus policies and will continue to do so for the foreseeable future. The key elements have been: 1) lowering the cash rate to 0.25%; 2) targeting the 3 year government bond rate at 0.25%; 3) market operations, as needed, to provide ample liquidity to the banking system; 4) a Term Funding Facility for the banking system providing 3 year funding at 0.25%; and 5) Setting the rate paid on Exchange Settlement balances at the RBA at 10bps.
- Persistently poor economic outcomes - growth well below trend, high unemployment, and inflation below the bank's 2-3% target - mean the RBA will need to maintain these policies for an extended period and may come under pressure to do more in the future. For now though the bank is of the view that monetary policy is doing "what it can".