Tuesday, 20 October 2020

RBA Minutes of the October Meeting

The Stage is Set for an Easing

- **At its meeting on 6 October, the Reserve Bank of Australia (RBA) outlined possible options should it choose to ease monetary policy in the future.**
- **We expect the RBA to ease monetary policy on 3rd November.**
- **The RBA believes that an easing of monetary policy would have 'traction' or 'bite' now that a range of restrictions have been lifted. The fewer the restrictions, the greater the impact from lower interest rates.**
- **The RBA has shifted away from its focus on 'forecast' inflation and onto 'actual' inflation. Only when 'actual' inflation is sustainably in the RBA's 2-3% range will it consider lifting the cash rate. This suggests that the cash rate will be on hold for at least three years.**
- **Global interest rates affect exchange rates. Central banks are suppressing interest rates and are thus impacting currencies. A lower AUD would assist Australia's economic recovery but given the actions of other central banks, a lower AUD seems unlikely.**

The Reserve Bank Board met on 6th October, the same day the Federal Budget was released. At its meeting, the decision was taken not to change any of its current policy settings.

The cash rate remained at 0.25%, the target for 3-year government bond yields remained at 0.25% and it maintained its settings for lending to the banking sector.

The RBA board minutes made the following comment:

> *"The Board discussed the case for additional monetary easing to support jobs and the overall economy. As in previous meetings, members discussed the options of reducing the targets for the cash rate and the 3-year yield towards zero, without going negative, and buying government bonds further along the yield curve. These options would have the effect of further easing financial conditions in Australia."*

When the RBA does decide to adjust its policy settings, its options are clear. As the board noted, such change would ease financial conditions in Australia. So, given their desire to assist in the creation of jobs and to encourage economic recovery, why did they not ease?

Fundamental to the recovery will be a lift in confidence and an expectation that demand will grow. Part of the general policy framework is managing expectations. Given the high number of pre-Budget announcements, it was clear that the Federal Budget would be significantly stimulatory. It would lift consumer sentiment as we witnessed when the October figures were released.

Expectation had been shifted. Job done.

In this context, the RBA would be in a position to further boost confidence if it held back its decision to cut rates until its November meeting. We expect the RBA will cut its cash rate to 0.10% from 0.25% in November as well as lowering its target for 3-year government bond yields to 0.10% from 0.25%. Three-year yields are already at 0.13% in anticipation of the change. They may well also begin purchasing government bonds further along the yield curve.

A further issue facing the RBA board was the matter of 'traction'. Would a cut in interest rates actually work? The board minutes made the following comment.

> *"..as the economy opens up, members considered it reasonable to expect that further monetary easing would gain more traction than had been the case earlier. Members also considered the effect of lower interest rates on community confidence and on those people who rely on interest income."*

With the economy slowly opening up, there is scope for a reduction in interest rates to have more bite or traction and thus assist in recovery and job creation.

The board did spare a thought for those who rely on interest payments for income but part of the role of policy is to encourage investors to seek out higher yielding investment options.

The exchange rate plays an important role in a small open economy such as Australia. The RBA views the current exchange rate to be broadly in line with economic fundaments but did note the impact other central banks' activity of exchange rates.

> *"Members noted that the larger balance sheet expansions by other central banks relative to the Reserve Bank was contributing to lower sovereign yields in most other advanced economies than in Australia. Members discussed the implications of this for the Australian dollar exchange rate."*

Central banks around the globe have expanded their balance sheets as they have sought to put downward pressure on the bond yields. This, other things being equal, puts downward pressure on their currency and assists their exporters. But if all central banks change at the same rate, there would be no net change. This is not happening, and the more aggressive central banks are having a greater impact on their currency.

Hans Kunnen, Senior Economist
Ph: 02-8254-1316

Contact Listing

Chief Economist
Besa Deda
dedab@bankofmelbourne.com.au
(02) 8254 3251

Senior Economist
Hans Kunnen
hans.kunnen@bankofmelbourne.com.au
(02) 8253 0898

Economist
Felipe Pelaio
Felipe.pelaio@bankofmelbourne.com.au
(02) 8253 0898