Tuesday, 7 April 2020

Cash Rate Outlook

RBA Puts Plan into Action

- **The Reserve Bank (RBA) board met today and reaffirmed their target for the cash rate and the 3-year government bond yield at around 0.25%. They also appear to have entered a period of assessment. These targets and the term funding facility are aimed at keeping funding costs low in the economy.**
- **The RBA noted that there was "considerable uncertainty" to the outlook, which suggests the RBA wants to wait to see how events and how economic developments will play out.**
- **Nonetheless, the RBA stated that "a very large economic contraction" was expected for the June quarter and that "the unemployment rate is expected to increase to its highest level for many years".**
- **In terms of the recent measures implemented by the RBA, the 3-year government bond yield target of "around 0.25%" has now been met; this yield is currently sitting at 0.25%, down from 0.49% prior to the announcement. To achieve this target, the RBA said it has purchased around $36 billion worth of securities so far (or just under 2% of GDP), including government bonds and semi-government bonds.**
- **The extensive measures already announced suggests that the RBA can wait and assess the effectiveness of these new policies. Moreover, the considerable uncertainty to the outlook, which depends on containment of COVID-19, also gives reason for the RBA to wait and see how developments unfold.**
- **The RBA has made it clear again that any raising of the cash rate target will not occur for some time and not 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". All of us, including the RBA, are waiting for containment of the virus, before expecting a recovery in the economy.**

After announcing a comprehensive package of measures on March 19, the Reserve Bank (RBA) mostly used today's announcement to provide an update on the implementation of these policies.

The RBA reaffirmed its target for the cash rate and the 3-year government bond yield at 0.25%, and it appears to have entered a period of assessment. These targets and the term funding facility are aimed at keeping funding costs low in the economy.

The RBA noted that there was "considerable uncertainty" to the outlook, adding to the sense that the RBA wants to wait to see how events and the economy will play out. Nonetheless, the RBA stated that "a very large economic contraction" was expected for the June quarter and that "the unemployment rate is expected to increase to its highest level for many years".

All of us, including the RBA, are waiting for containment of the virus, before expecting a recovery in the economy.

In terms of the new measures implemented by the RBA, the 3-year government bond yield target of "around 0.25%" has now been met; the yield currently is sitting at 0.25%, down from 0.49% prior to the announcement. In achieving this target, the RBA announced it has purchased around $36 billion worth of securities so far (or just under 2% of GDP), including government bonds and semi-government bonds.

The RBA also announced that the first drawings under the Term Funding Facility had been made yesterday, which is aimed to keep down funding costs and to provide an incentive to support credit to businesses, particularly small and medium-sized businesses.

There was also some discussion around the functioning in financial markets, which have undergone considerable stress over recent weeks. However, there were "signs that markets are working more effectively than they were a few weeks ago", which had been helped by the actions of central banks. The RBA noted it had injected substantial liquidity into the financial system. The RBA also pointed out that the functioning in the bond market had improved after some dislocations in recent weeks.

Outlook

The extensive measures already announced suggests that the RBA can wait and assess the effectiveness of these new policies. Moreover, the considerable uncertainty to the outlook, which depends on containment of COVID-19, also gives reason for the RBA to wait and see how developments unfold. Further action could also depend on the functioning of financial markets – if stresses continue in money and credit markets, additional liquidity measures may likely be deployed. In terms of whether further monetary policy stimulus could be deployed, the RBA appears to be waiting for greater clarity on how well COVID-19 will be contained. Nonetheless, the RBA has made it clear again that any raising of the cash rate target will not occur for some time, and not 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".

Janu Chan, Senior Economist
Ph: 02-8253-0898

Contact Listing

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

Senior Economist
Janu Chan
chanj@bankofmelbourne.com.au
(02) 8253 0898

Economist
Nelson Aston
nelson.aston@bankofmelbourne.com.au
(02) 8254 1316