

Tuesday, 7 July 2020

RBA Board Meeting Certainly Uncertain

- The Reserve Bank (RBA) Board met today. As widely expected, policy settings remained unchanged.
- In today's statement, the RBA used the word "uncertain" or "uncertainty" four times. It was used only once in the previous statement.
- On the domestic economy, the RBA reiterated that the downturn is so far not as severe as earlier expected, and moreover, that conditions have "stabilised recently". The RBA underscored that the nature and speed of economic recovery remains "highly uncertain".
- Indeed, in a note we published last week we likened the shape of the economic recovery to alphabet soup.
- Since the statement was published at 2:30pm AEST, the nascent economic recovery has become more uncertain and fragile after Victoria's State government returned metropolitan Melbourne and Mitchell Shire to full lockdown for six weeks.
- The lockdown in Victoria means growth will be softer in this current September quarter and could mean the recession lasts longer, given the size of the Victorian economy. There is the risk of spill-over effects to confidence to other parts of the country. There is also the risk of lockdown measures being imposed in other parts of the country.
- The long shadow the pandemic is casting is changing the way we work, learn and live. The RBA inserted a new sentence around these changes by explaining that the pandemic is prompting many firms to reconsider their business models, including the restructuring of operations.
- The RBA's reaffirms that fiscal and monetary stimulus is likely needed for some time. Moreover, the RBA repeated it stands ready to scale up bond purchases if needed.
- On the RBA's term funding facility, in the past month there has been a step up in its usage by banks, with \$15 billion total withdrawals to date versus \$6 billion from late March to early June.
- Of note, the RBA did not mention the currency. After hitting an 11-month high of 0.7063 on June 10, the AUD/USD exchange rate has pulled back and in much of the past month has stuck to a trading band within around 0.6775 - 0.7005.

The Reserve Bank (RBA) Board met today. As widely expected, policy settings remained unchanged. That is, the cash rate remained at a record low of 0.25% and the RBA continues to target a 3-year government bond yield of around 0.25% as part of its quantitative-easing program (one of its unconventional policy measures).

We gleaned the statement carefully for more colour on the RBA's thinking about the outlook.

On the global economy, the RBA added this month that "leading indicators have generally picked up recently, suggesting the worst of the global economic contraction has now passed". However, the RBA critically notes that the outlook remains uncertain, the recovery is expected to be "bumpy" and depends upon "containment of the virus". It suggests the RBA might be a bit more concerned than last month about the global outlook.

On the domestic economy, the RBA reiterated that the downturn is so far not as severe as earlier expected, and moreover, that conditions have "stabilised recently". The RBA highlights the decline in total hours worked in May was "considerably smaller" than in April and less than previously thought likely. The RBA also selects the "pick-up in retail spending".

Again, the RBA underscores that the nature and speed of economic recovery remains "highly uncertain". Indeed, in a note we published last week we likened the shape of the economic recovery to alphabet soup. There are the shapes of the letters L, U, V and W shapes, as well as our preferred shape of a back-to-front J, which incorporates our view that it will take an extended time for the economy to fully recover from this pandemic and unemployment to fall back down to 5%.

In today's statement, the RBA used the word "uncertain" or "uncertainty" four times compared to only once in its previous board-meeting statement on June 2.

Since the last board meeting and today's statement (released 2:30pm AEST), one could argue the nascent domestic recovery has become more uncertain and fragile. Metropolitan Melbourne and Mitchell Shire have been subsequently returned to a full lockdown for six weeks. Lockdowns had been imposed on selected Victorian hotspots earlier this month.

The full lockdown in metropolitan Melbourne and Mitchell Shire means economic activity will be softer in this current September quarter and could mean the recession lasts a little longer (running potentially into the third quarter), given the size of the Victorian economy. There is the risk of spill-over effects to confidence to other parts of the country. There is also the risk of lockdown measures being imposed in other parts of the country.

The pandemic will cast a long shadow and is changing the way we work, learn and live. The RBA inserted a new sentence around these changes by explaining that the pandemic is prompting many firms to reconsider their business models, including the restructuring of operations. Whilst the RBA did not make mention of geopolitical trade tensions, these tensions are also likely prompting changes to global supply chains for Australian businesses.

The RBA's final paragraph reaffirms that fiscal and monetary stimulus is likely needed for some time. The RBA also says it is prepared to scale up bond purchases if needed. On the term funding facility, in the past month there has been a step up in its usage by banks, with \$15 billion total withdrawals to date versus \$6 billion from late March to early June.

Of note, the RBA did not mention the currency. After hitting an 11-month high of 0.7063 on June 10, the AUD/USD exchange rate has pulled back and in much of the past month has stuck to a trading band within 0.6775-0.7005.

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