Tuesday, 7 September 2021

RBA Board Meeting

RBA to Taper as Planned Despite Setbacks

- **The Reserve Bank (RBA) has again shrugged off pressure to defer the tapering of its quantitative easing plan. However, in a nod to the hit to the economy from the Delta outbreak, the central bank has said it will hold the purchase rate steady at $4 billion a week until February next year. Other policy settings were left unchanged.**
- **The RBA announced that bond purchases would be pared back from $5 billion per week to $4 billion per week at its July meeting, and stuck with those plans at the August meeting.**
- **Ahead of this meeting, there was widespread speculation over whether the RBA would reverse its decision to taper from September, or in other words, continue purchasing bonds at $5 billion per week. Given the unexpected and drastic deterioration in the economic outlook, such a policy change would be reasonable. But the RBA did not go down this path.**
- **Today's statement also dropped the reference to the Board's "flexible approach to the rate of bond purchases". The RBA appears to be setting the bar higher for tinkering with bond purchases.**
- **The RBA is relatively upbeat on the outlook, noting Delta will "delay, but not derail, the recovery". In the RBA's central scenario, the economy is growing again in the December quarter and will be "back around its pre-Delta path in the second half of next year".**
- **However, as we have forecast, the RBA notes the recovery is likely to be slower than in the past.**
- **On the cash rate, the RBA stuck to its long-held line that its "central scenario" is that conditions to lift the cash rate will not be met before 2024.**
- **At this stage, we still expect the RBA will need to lift the cash rate in 2023, consistent with a strong rebound in 2022. However, there are larger-than-usual risks around the medium-term outlook and further setbacks on the health front could push out the first rate hike.**

The RBA has again shrugged off pressure to defer the tapering of its quantitative easing plan. However, in a nod to the hit to the economy from the Delta outbreak, the central bank has said it will hold the purchase rate steady at $4 billion a week until February next year. Other policy settings were left unchanged.

The RBA announced that bond purchases would be pared back from $5 billion per week to $4 billion per week at its July meeting, and stuck with those plans at the August meeting.

However, the near-term outlook has deteriorated significantly since the tapering decision was

announced. In the Statement on Monetary Policy (SOMP) released in early August, the RBA stated it expected GDP to decline by “at least one per cent” in the September quarter, with 4% growth over 2021. We now expect the economy will contract by 4% in the September quarter and that growth in 2021 will end up at 0%.

Ahead of this meeting, there was widespread speculation over whether the RBA would reverse its decision to taper from September, or in other words, continue purchasing bonds at $5 billion per week. Given the unexpected and drastic deterioration in the outlook, such a policy change would be reasonable. But the RBA did not go down this path.

The RBA did, however, provide more certainty over the future path of bond purchases, acknowledging the interruption to the recovery from Delta. The RBA committed to hold purchases at $4 billion per week until at least mid-February 2022. Previously, the RBA was set to review purchases in November 2021, and before the health situation deteriorated, we expected a further reduction in purchases at this time.

In the minutes from the last meeting, the RBA outlined two reasons to press ahead with tapering in September. First, the RBA noted that fiscal policy is better placed to respond to the localised and temporary losses of income which result from lockdowns. And second, that because of lags in monetary policy, any additional support from the RBA now would be felt most next year, when the economy is expected to be rebounding strongly.

Today’s statement also dropped the reference to the Board’s “flexible approach to the rate of bond purchases”. Instead, the statement notes that bond purchases will be “reviewed in light of economic conditions and the health situation, and their implications for the expected progress towards full employment and the inflation target.” The RBA appears to be setting the bar higher for tinkering with bond purchases.

The Governor’s statement provides some colour on how the RBA expects Delta will impact the economy. The RBA’s sentiment is summed by the phrase that Delta will “delay, but not derail, the recovery”.

As we have forecast, the RBA notes the recovery is likely to be slower than in the past, flagging “much will depend on the health situation and the easing of restrictions on activity”. However, in the RBA’s central scenario, the economy is growing again in the December quarter and will be “back around its pre-Delta path in the second half of next year”.

The RBA also highlighted the uneven impact of lockdowns, explaining some areas are “facing very difficult conditions while others are continuing to grow strongly”. As was the case in the past, we know sectors like hospitality and tourism are hit particularly hard by lockdowns.

As we explained in our Weekly Economic Outlook on 6 September, the shift to learning to live with the virus will likely mean we are reopening with high case numbers. This could mean consumer spending won’t bounce back as quickly as it has in the past. Plus, businesses are feeling the pinch from another round of lengthy lockdowns, and government support is less generous than previous measures.

On the cash rate, the RBA stuck to its long-held line that its “central scenario” is that conditions to lift the cash rate will not be met before 2024.

At this stage, we still expect the RBA will need to lift the cash rate in 2023, consistent with the strong rebound we anticipate in 2022. However, there are larger-than-usual risks around the medium-term outlook.

The health situation continues to evolve, and the recovery depends critically on the vaccine

rollout. Further setbacks would on this front could weigh on the economy and subsequently push out when the RBA increases interest rates.

Matthew Bunny, Economist
Ph: (02) 8254 0023

Contact Listing

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

Economist
Matthew Bunny
matthew.bunny@bankofmelbourne.com.au
(02) 8254 0023

Senior Economist
Jarek Kowcza
jarek.kowcza@bankofmelbourne.com.au
0481 476 436

Economist
Sonali Patel
sonali.patel@bankofmelbourne.com.au
(02) 8254 0030

The Detail

The information contained in this report ("the Information") is provided for, and is only to be used by, persons in Australia. The information may not comply with the laws of another jurisdiction. The Information is general in nature and does not take into account the particular investment objectives or financial situation of any potential reader. It does not constitute, and should not be relied on as, financial or investment advice or recommendations (expressed or implied) and is not an invitation to take up securities or other financial products or services. No decision should be made on the basis of the Information without first seeking expert financial advice. For persons with whom Bank of Melbourne has a contract to supply Information, the supply of the Information is made under that contract and Bank of Melbourne's agreed terms of supply apply. Bank of Melbourne does not represent or guarantee that the Information is accurate or free from errors or omissions and Bank of Melbourne disclaims any duty of care in relation to the Information and liability for any reliance on investment decisions made using the Information. The Information is subject to change. Terms, conditions and any fees apply to Bank of Melbourne products and details are available. Bank of Melbourne or its officers, agents or employees (including persons involved in preparation of the Information) may have financial interests in the markets discussed in the Information. Bank of Melbourne owns copyright in the information unless otherwise indicated. The Information should not be reproduced, distributed, linked or transmitted without the written consent of Bank of Melbourne.

Any unauthorised use or dissemination is prohibited. Neither Bank of Melbourne- A Division of Westpac Banking Corporation ABN 33 007 457 141 AFSL 233714 ACL 233714, nor any of Westpac's subsidiaries or affiliates shall be liable for the message if altered, changed or falsified.