

Monday, 02 November 2020

The RBA is Set to Ease

Tomorrow, the Reserve Bank (RBA) Board meets to decide on the next steps for monetary policy in Australia.

We expect the Board to announce a further easing of monetary policy as the Australian economy continues to crawl its way out of the recession.

We expect the key policy rates - the cash rate; the three-year target bond rate; and the Term Funding Facility rate - to be cut from the current rate of 0.25% to 0.10%. In addition, we expect the Exchange Settlement Account rate will be lowered to 0.01%, potentially exposing financial institutions to negative interest rates in times of excess liquidity.

Additionally, we expect the RBA will introduce a bond-buying program for bonds of maturities beyond three years. The key uncertainty is whether the RBA announces a specific quantity of bonds it will buy as part of this program or whether it will leave it open ended. The market is betting for a fixed quantity of at least \$100 billion. We believe the RBA will be better off having greater flexibility and leaving its bond-buying program open ended but it may not want to disappoint financial market participants. These are uncharted waters, so either option cannot be fully ruled out.

Forward guidance is also likely to form part of the RBA's statement tomorrow. Indeed, the RBA is likely to reinforce a "low rates for longer" theme, including that the cash rate will not be raised for at least three years.

The intention of this package of measures is to lower lending rates in the economy and help bolster the economic recovery. The introduction of a bond-buying program for longer-dated maturities could also help in placing downward pressure on the Australian dollar, which would help boost the competitiveness of our export sector.

For those seeking further detail, the RBA will release its quarterly Statement of Monetary Policy on November 6. The Statement will provide colour around its policy decisions and print its updated economic forecasts. We anticipate growth forecasts will be adjusted. In a recent speech by the RBA Governor, he indicated the peak in the unemployment rate was 8%, down from 10%. It suggests changes to unemployment forecasts, as well as growth and inflation forecasts.

The US election will also take place on Tuesday (US time). The timing of the final result is unclear. Exit polls may provide an indication but official results usually occur from early Wednesday afternoon (Australian time). A result, if clear, is usually known by early evening on Wednesday.

Real Clear Politics - a US polling aggregator - indicates a victory for the Democrat candidate, Joe Biden (currently with 51.1% of intentions) over President Donald Trump (43.6%). Congressional elections will also take place, and polls predict a Democrat majority in the Senate and the House of Representatives.

In terms of key economic data, today we will see new figures on house prices, building approvals

and housing finance.

Monthly building approvals are always volatile but have been in a downward trend since late 2017. We are expecting a decline in the month of 3.0%. Housing finance picked up strongly after lockdowns ended in May. We expect some retracement in the September figures before picking up later in the year.

The Australian Bureau of Statistics (ABS) will release the September retail sales figures on Wednesday. We forecast a fall of 1.5% in nominal retailing, following a 4.0% decline in August. Despite the decline in September, we expect the volume of retail sales (i.e. adjusted for inflation) to have risen 6.0% in the September quarter. This result sits behind our tentative expectation that GDP rose in the September quarter. Private consumption, of which retail sales is a part, comprises a significant portion of GDP.

On Friday, data on the trade balance will be published. We anticipate a stronger surplus in September (\$5.2 billion) than in August (\$2.6 billion), stemming from a 4% increase in exports and a 4% decline in imports.

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Forecasts

End Period:	Close (Oct 30)	Q4 (f)	Q1 (f)	Q2 (f)	Q3 (f)	Q4 (f)
Aust. Interest Rates:						
RBA Cash Rate, %	0.25	0.10	0.10	0.10	0.10	0.10
90 Day BBSW, %	0.06	0.04	0.04	0.04	0.04	0.04
3 Year Swap, %	0.09	0.08	0.08	0.08	0.08	0.08
10 Year Bond, %	0.82	0.75	0.75	0.75	0.80	0.85
US Interest Rates:						
Fed Funds Rate, %	0.13	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond, %	0.82	0.70	0.65	0.65	0.70	0.75
USD Exchange Rates:						
AUD-USD	0.7029	0.75	0.76	0.76	0.78	0.80
USD-JPY	104.61	105	105	106	106	106
EUR-USD	1.1674	1.21	1.22	1.23	1.24	1.25
GBP-USD	1.2930	1.32	1.34	1.35	1.37	1.39
NZD-USD	0.6629	0.67	0.66	0.66	0.68	0.70
AUD Exchange Rates:						
AUD-USD	0.7029	0.75	0.76	0.76	0.78	0.80
AUD-EUR	0.6021	0.62	0.62	0.62	0.63	0.64
AUD-JPY	73.52	78.8	79.8	80.6	82.7	84.8
AUD-GBP	0.5437	0.57	0.57	0.56	0.57	0.58
AUD-NZD	1.0604	1.12	1.15	1.15	1.15	1.14

	2019	2020 (f)	2021 (f)
GDP, %	2.3	-3.5	2.8
CPI (Headline), %	1.8	0.3	1.9
CPI (Trimmed mean), %	1.6	0.6	1.7
Unemployment Rate, %	5.2	7.5	7.5
Wages Growth, %	2.2	0.9	1.0

AUD cross exchange rates have been rounded.

Financial forecasts are quarter end.

GDP, CPI, employment and wage growth forecasts are year end.

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