6 July 2021

Global Markets Research

Research Alert

RBA: Erring on the side of caution

- **Reserve Bank of Australia left benchmark rate unchanged as expected**
- **Did not roll over 3Y yield target to next maturity bonds**
- **Expect quick economic rebound after every outbreak.**

Background

The RBA had in the previous months, foreshadowed that it would make adjustments to its policy setting on 6 July. The cash rate was left unchanged at 0.1% as expected while the key changes are:

- Retain the April 2024 bond as the target bond for its 3Y yield target as opposed to extending it to the next maturity i.e., November 2024 bond. The target rate is maintained at 0.1%.
- Continue its current AUD100b QE program after its original expiry in early September. The weekly purchase is scaled down from AUD5b to AUD4b until at least mid-November, after which a further review will be conducted.

RBA maintained accommodative stance, said inflation subdued

RBA acknowledged the near-term uncertainty of the recent Covid-19 outbreaks and related lockdowns in Australia but offered a less pessimistic view. It foresees the economy to bounce back after virus containment and easing of restrictions.

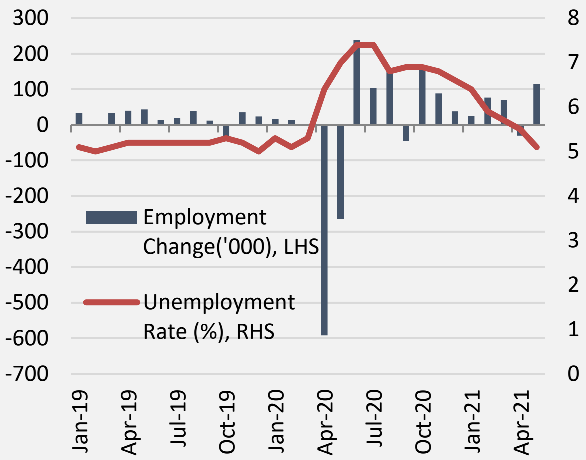
It offered a favourable assessment of the labour market, citing its faster than expected recovery and the record high participation rate, but said that inflation remained subdued. The forecasts for underlying CPI were unchanged at 1.5% in 2021 and 2% by mid-2023. It also gave a firmer view over the short-term inflation outlook, expecting CPI to temporarily climbed to 3.5% y/y in 2Q, compared to the previous estimate of "above 3%". RBA also kept the same language regarding the booming housing market, vowing to monitor housing borrowing carefully.

It maintained its accommodative stance by reinforcing the commitment to achieve full employment and inflation target. The cash rate will not be increased until "actual inflation is sustainably within the 2 to 3% target range". Its "central scenario" is that "this condition will not be met before 2024", a more specific language versus last statement's "unlikely to be until 2024 at the earliest".

Optimistic but conservative

We think the overall statement was a conservative one, instead of a definite reduction of the whole asset purchase program, the RBA had opted for an extension and only chose to pare down the weekly buying. It also made it clearer that it would not raise rate by 2024, based on a slight but firmer change in its forward guidance languages. The economic assessment was cautiously optimistic in our view, given its confidence that the economy could bounce up relatively quickly should it faces sporadic outbreaks. This is also supported by the fact that it did not roll over the 3Y

Figure 1: Australia's jobless rate has returned to pre-pandemic levels



Source: Bloomberg

Figure 2: RBA's key pandemic response

- Cut cash rate twice to 0.25% (3 Mar 20) and then 0.1% (19 Mar 20)
- Target 3Y Australian government bond yield at 0.25% (19 Mar 20) and then 0.1%. (3 Nov 20)
- Launch QE1, AUD 100b QE (3 Nov 2020 – Apr 21)
- Launch QE2, AUD100b (2 Feb 2021 – Sep-21)
- Set up term funding facility (19 Mar 20)
- Set up emergency FX swap line of USD60b to support USD funding

Source: RBA

yield target to the next maturity bonds, indicating that the yield curve control measure will not extend beyond April 2024.

The Australia economy has continued to fare well after last year's multi-month hard lockdown. Spending was supported by the elevated saving rates and is expected to remain so through 2021. (Household savings went as high as 22.0% at the height of the pandemic before trending down to near 12% as at March 2021, still a historically high level when compared to the 5-year average of 5.3% in the pre-Covid era). The external sector is supported by firmer global demand with China remaining a solid importer of Australian commodities. Looking ahead, we expect the government to impose "snap lockdowns" to swiftly contain any future sporadic outbreaks, as seen recently in Brisbane and Perth. These short-term restrictions would have less profound or minimal economic impact, although the presence of the super infectious Covid variants still put the economy at risk of longer period of hard lockdowns such as those just ended in Melbourne (21 June) and ongoing one in Sydney (19 July).

AUD Outlook

We see the RBA's stance slightly weighing against any AUD strength. Recently, the AUD has been vulnerable to USD correction. Another factor is Covid-19 containment and stance. Australia's more conservative stance (compared to other majors) towards outbreaks may limit against AUD outperformance.

However, AUD has been slightly supported by a more hawkish Reserve Bank of New Zealand. At the same time, strong commodity prices may also insulate the AUD against significant losses.

In our May FX outlook, we indicated a 3-4% weakness for AUD/USD over a 12-month period. Our end-June 2022 forecast for AUD/USD is at 0.76.

Figure 3: Inflation and wage growth continued to lag

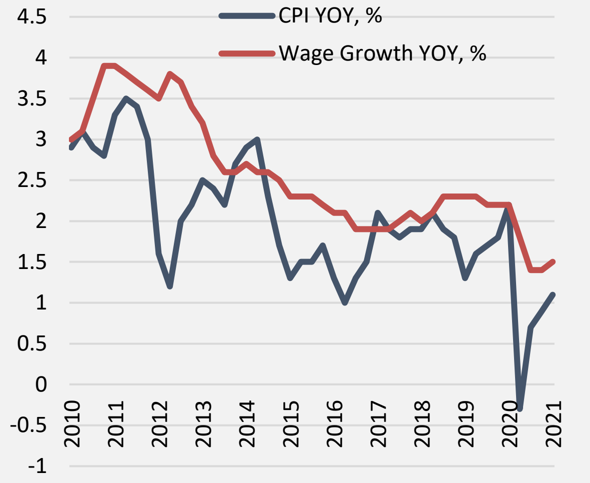
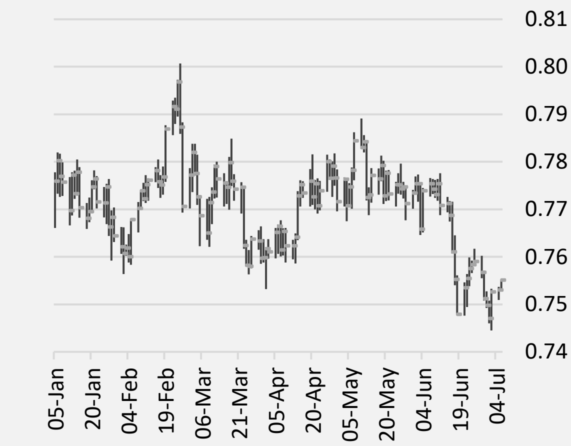


Figure 4: AUD/USD



Source: Bloomberg

Hong Leong Bank Berhad
Fixed Income & Economic Research, Global Markets
Level 8, Hong Leong Tower
6, Jalan Damanlela
Bukit Damansara
50490 Kuala Lumpur
Tel: 603-2081 1221
Fax: 603-2081 8936
Email: HLMarkets@hlbb.hongleong.com.my