

International Commentary — February 2, 2021

RBA Lets the Doves Fly

Summary

- The Reserve Bank of Australia's (RBA) latest monetary policy announcement was notably more dovish than expected in the areas of quantitative easing, interest rate guidance and the exchange rate.
- While there had been some expectations that the central bank's asset purchases could be extended, the announced increase was toward the aggressive end of expectations. The pledge to keep interest rates low for multiple years was also a dovish surprise.
- The aggressive monetary easing is a double-edged sword for the Australian dollar. The direct effect is negative for the currency, though to the extent accommodative monetary policy supports the growth outlook it could cushion the extent of currency downside. As a result, we see only modest downside risk to our current Australian dollar outlook from today's monetary policy announcement.

Economist(s)

Nick Bennenbroek

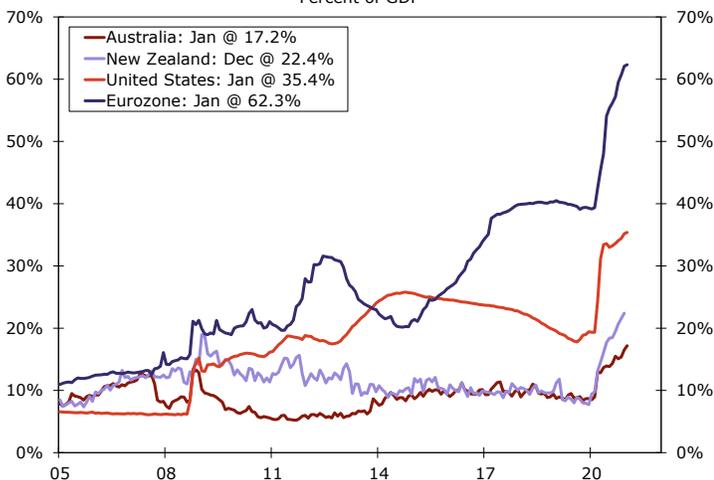
International Economist | Wells Fargo Securities, LLC
 nicholas.bennenbroek@wellsfargo.com | 212-214-5636

Jen Licis

Economic Analyst | Wells Fargo Securities, LLC
 jennifer.licis@wellsfargo.com | 704-410-1309

Central Bank Balance Sheets

Percent of GDP



Source: Bloomberg LP and Wells Fargo Securities

All estimates/forecasts are as of 2/2/2021 unless otherwise stated. 2/2/2021 12:17:05 EST. Please see page 3 for rating definitions, important disclosures and required analyst certifications. Wells Fargo Securities, LLC does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of the report and investors should consider this report as only a single factor in making their investment decision.

This report is available on Bloomberg WFRE

Dovish Central Bank Doubles Down on Quantitative Easing

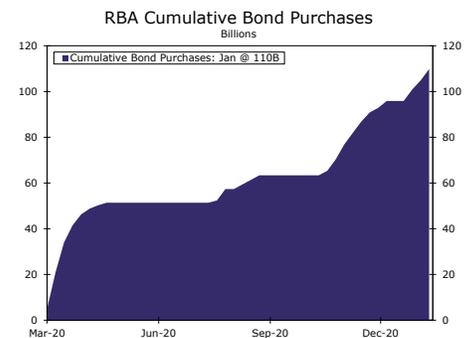
In the context of what we perceived as a very dovish monetary policy announcement from the Reserve Bank of Australia (RBA) today, the most notable action was the decision to double the size of its bond purchase program, which entails the purchases of bonds issued by the Australian Government as well as states and territories. The RBA had previously announced an A\$100 billion purchase in November, which was due to be completed in mid-April. Those bond purchases are in addition to the central bank's previous purchases aimed at keeping three-year government bond yields close to the central bank's target rate. Thus, while the central bank said it has currently bought a cumulative A\$52 billion against its A\$100 billion quantitative easing program, total cumulative purchases across all programs has already reached around A\$110 billion (see chart at right).

With today's announcement, the RBA has doubled the size of its quantitative easing program by saying it will purchase an additional \$100 billion of bonds once the current program concludes in April. Those additional purchases will be made at the current pace of around A\$5 billion per week. Certainly, we believe the central bank has scope to continue along the quantitative easing path. In terms of balance sheet expansion and compared to some of its international peers, the size of the RBA's balance sheet remains relatively modest at around 17% of GDP (see chart on front page).

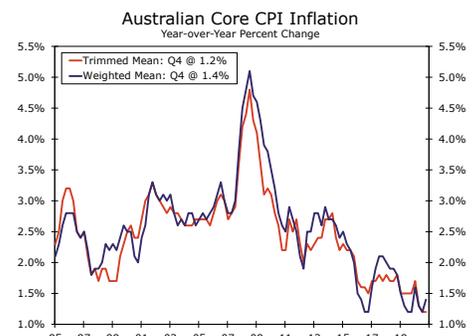
RBA Interest Rates Going Nowhere Fast

It wasn't just the quantitative easing action that attracted attention from today's announcement. In fact, it was *inaction* with respect to policy interest rates that garnered some attention. The Reserve Bank said the outlook for the global economy has improved in recent months, while with respect to the Australian economic outlook the central bank's central scenario anticipates GDP growth of around 3.5% over 2021 and 2022. That said, the economy will operate with spare capacity for some time, and underlying inflation is projected at only around 1.25% to 1.50% over the next couple of years. In fact, the RBA said it would not increase its policy rate until actual inflation is sustainably within its 2%-3% target range, which would require a significant improvement in the labor market and materially faster wage growth. The central bank does not expect a rate increase to happen until 2024 at the earliest. The pledge to keep interest rates low until at least 2024, we believe, was more dovish than markets would have anticipated. Finally, the RBA made passing reference to the currency, although its language was not especially dovish. The central bank said the exchange rate has appreciated and is at the upper end of the range of recent years. The RBA also said that currently monetary policy settings are contributing to a lower exchange rate than otherwise.

Today's relatively aggressive easing and dovish accompanying statement is, in our view, a bit of a double-edged sword for the Australian dollar. On the one hand, the pledge of additional liquidity and the fact that interest rates will remain low for longer should be a significant negative for the Australian currency. However, to the extent that accommodative monetary policy supports the economic growth outlook, that might help to limit the extent of currency downside. As a result, we see only modest downside risk to our current Australian dollar outlook from today's monetary policy announcement. Indeed, we note the Australian dollar is down only around 0.5% versus the greenback today, although we suspect favorable global market sentiment is also helping to limit the extent of today's Australian dollar weakness.



Source: Bloomberg LP and Wells Fargo Securities



Source: Bloomberg LP and Wells Fargo Securities

Subscription Information

To subscribe please visit: www.wellsfargo.com/economicsemail

The 2021 Annual Economic Outlook: *Aftershocks and Divergence in the Post-Pandemic Economy* is available at wellsfargo.com/economicoutlook

Via The Bloomberg Professional Services at WFRE

And for those with permission at www.wellsfargoresearch.com

Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	International Economist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	(212) 214-2029	azhar.iqbal@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	International Economist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economist	(704) 410-1681	shannon.seery@wellsfargo.com
Jen Licis	Economic Analyst	(704) 410-1309	jennifer.licis@wellsfargo.com
Hop Mathews	Economic Analyst	(704) 383-5312	hop.mathews@wellsfargo.com
Nicole Cervi	Economic Analyst	(704) 410-3059	nicole.cervi@wellsfargo.com
Sara Cotsakis	Economic Analyst	(704) 410-1437	sara.cotsakis@wellsfargo.com
Coren Burton	Administrative Assistant	(704) 410-6010	coren.burton@wellsfargo.com

Required Disclosures

This report is produced by the Economics Group of Wells Fargo Securities, LLC, a U.S. broker-dealer registered with the U.S. Securities and Exchange Commission, the Financial Industry Regulatory Authority, and the Securities Investor Protection Corp. Wells Fargo Securities, LLC, distributes this report directly and through affiliates including, but not limited to, Wells Fargo & Company, Wells Fargo Bank N.A., Wells Fargo Clearing Services, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Europe S.A., Wells Fargo Securities Canada, Ltd., Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. Wells Fargo Securities, LLC is registered with the Commodity Futures Trading Commission as a futures commission merchant and is a member in good standing of the National Futures Association. Wells Fargo Bank, N.A. is registered with the Commodity Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. Wells Fargo Securities, LLC and Wells Fargo Bank, N.A. are generally engaged in the trading of futures and derivative products, any of which may be discussed within this report.

The information in this report has been obtained or derived from sources believed by Wells Fargo Securities, LLC to be reliable, but Wells Fargo Securities, LLC does not guarantee its accuracy or completeness, nor does Wells Fargo Securities, LLC assume any liability for any loss that may result from the reliance by any person upon any such information or upon any opinions set forth herein. Such information and opinions are subject to change without notice, are for general information only and are not intended as an offer or solicitation with respect to the purchase or sale of any security or other financial product or as personalized investment advice. Wells Fargo Securities, LLC is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company. © 2021 Wells Fargo Securities, LLC

Important Information for Non-U.S. Recipients

For recipients in the United Kingdom, this report is distributed by Wells Fargo Securities International Limited ("WFSIL"). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Conduct Authority. For the purposes of Section 21 of the UK Financial Services and Markets Act 2000 ("the Act"), the content of this report has been approved by WFSIL, an authorized person under the Act. WFSIL does not deal with retail clients as defined in the Directive 2014/65/EU ("MiFID2"). The FCA rules made under the Financial Services and Markets Act 2000 for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. For recipients in the EEA, this report is distributed by WFSIL or Wells Fargo Securities Europe S.A. ("WFSE"). WFSE is a French incorporated investment firm authorized and regulated by the Autorité de contrôle prudentiel et de résolution and the Autorité des marchés financiers. WFSE does not deal with retail clients as defined in the Directive 2014/65/EU ("MiFID2"). This report is not intended for, and should not be relied upon by, retail clients.

SECURITIES: NOT FDIC-INSURED - MAY LOSE VALUE - NO BANK GUARANTEE