Economics

International Commentary — February 2, 2021

RBA Lets the Doves Fly

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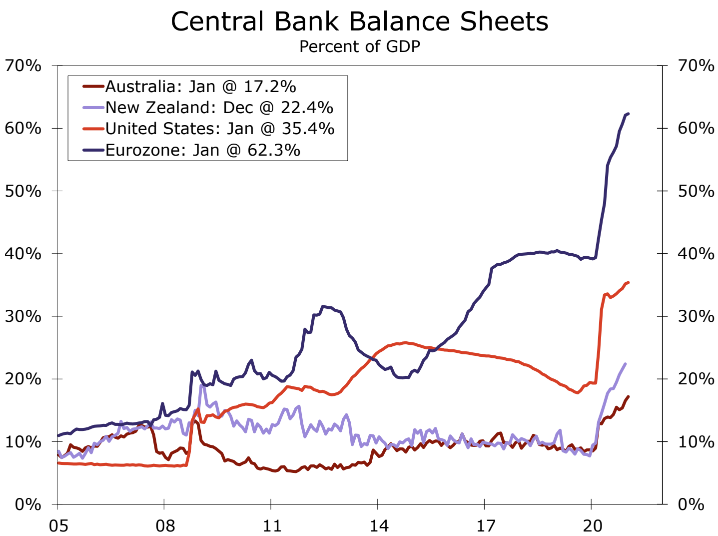
Summary

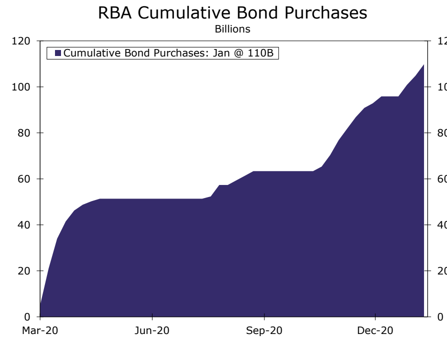
- The Reserve Bank of Australia's (RBA) latest monetary policy announcement was notably more dovish that expected in the areas of quantitative easing, interest rate guidance and the exchange rate.
- While there had been some expectations that the central bank's asset purchases could be extended, the 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.



Source: Bloomberg LP and Wells Fargo Securities

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).

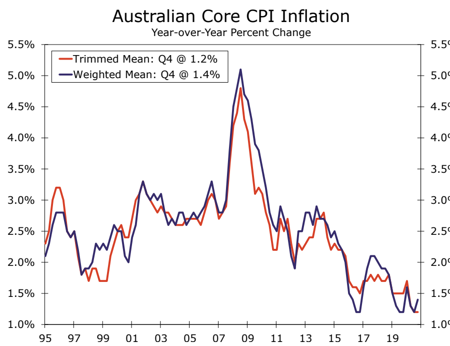


Source: Bloomberg LP and Wells Fargo Securities

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.



Source: Bloomberg LP and Wells Fargo Securities

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.

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