Reserve Bank of Australia Expands QE

CONTACTS

Tuuli McCully, Head of Asia-Pacific Economics
65.6305.8313 (Singapore)
Scotiabank Economics
tuuli.mccully@scotiabank.com

- **The Australian central bank doubles its bond buying program to support the economy's recovery and to provide clear guidance that monetary conditions will remain accommodative for an extended period of time.**

Following today's monetary policy meeting, the Reserve Bank of Australia (RBA) announced an extension to its bond buying program; the move was not anticipated by the analyst consensus. The RBA will buy an additional AUD100 bn of bonds issued by the Australian Government as well as by the states and territories after its current program of AUD100 bn—introduced in November 2020—is completed in mid-April. The pace of the purchases will be kept at the current level of AUD5 bn a week. Meanwhile, the RBA left the benchmark cash rate and the target yield on the 3-year Australian Government bond unchanged at 0.10%; they were lowered to their current level last November (chart 1).

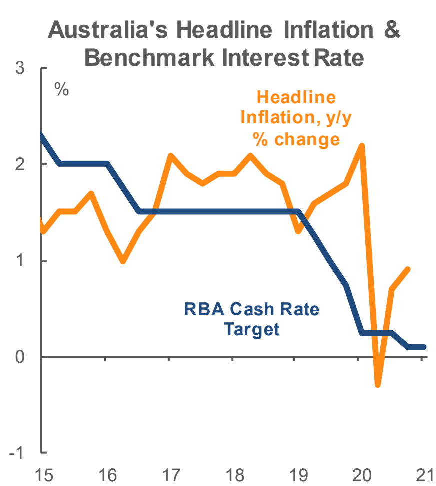
RBA Governor Philip Lowe justified the decision by the economy's need for continued monetary policy stimulus. While the outlook has improved in recent months, the RBA sees the economic recovery as bumpy, uneven and dependent on the evolution of the virus situation as well as on significant fiscal and monetary support. As the extension to its quantitative easing program was announced well ahead of the expiry of the current one, the RBA evidently wanted to provide clear guidance regarding its commitment to ultra-accommodative monetary conditions. Indeed, Governor Lowe pledged to maintain the benchmark interest rate at the current level until inflation has reached the RBA's 2–3% y/y inflation target in a sustainable manner. For demand-driven inflationary pressures to emerge, the labour market needs to tighten significantly and to prompt "materially higher" wage growth. The RBA's policymakers see such conditions occurring in 2024 "at the earliest".

In our view, inflationary pressures will remain muted in Australia over the coming quarters due to significant spare capacity in the economy, high unemployment and low wage gains. We expect headline inflation to close 2021 at 1.3% y/y, up only slightly from the 0.9% y/y gain in December 2020 (chart 1, again). The RBA expects inflation to remain below the 2% mark over the next couple of years.

Labour market developments will play a key role in Australia's inflation outlook. Employment gains have been encouraging in recent months, yet near-term prospects remain uncertain. The unemployment rate dropped to 6.6% in December from the July peak of 7.5%. The RBA forecasts the jobless rate to decline to around 6% by the end of this year. Nevertheless, we note that the Australian labour market may face renewed weakness after the government's "JobKeeper" program expires at the end of March 2021.

Against the backdrop of significant slack in the Australian economy and muted inflationary pressures, we expect Australia's monetary conditions to remain accommodative for an extended period of time. Nevertheless, as the economy is on a recovery path with the COVID-19 situation largely under control, we do not expect the RBA to unveil any additional monetary easing over the coming quarters.

Chart 1



Sources: Scotiabank Economics, Bloomberg.