Tuesday, 1 June 2021

Reserve Bank Board Meeting

The Entrée to the Main Meal in July

- **Today's meeting was the entrée to the main meal in July. In July, the Reserve Bank (RBA) will decide whether to direct its yield-curve control (YCC) program from the April 2024 bond to November 2024 (the next maturity). The RBA will also decide whether to extend its quantitative easing (QE) program.**
- **We are anticipating YCC will be extended to November 2024 and another round of QE, with $100 billion in bond purchases, will be announced.**
- **It meant the focus today was on other hot topics – the labour market and house prices.**
- **On the jobs market, the RBA acknowledged in its board statement for the first time that there are reports of labour shortages. However, the RBA has stuck to its expectation of only a gradual and modest rise in wages growth.**
- **The RBA's forecasts for inflation remain unchanged and consistent with the view that they are unlikely to lift the cash rate before 2024. Time will tell.**

The Reserve Bank (RBA) delivered no surprises today, leaving policy settings unchanged. The RBA last month flagged that July would be the meeting it would consider the future of YCC and QE. So, today's meeting was really the entrée to the main meal in July.

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On the jobs market, the RBA acknowledged in its board statement for the first time that there are reports of labour shortages. Certainly, anecdotes and business surveys since late last year suggest businesses have found it hard to source labour and the right type of labour, exacerbated by international border closures.

Whilst the RBA has highlighted the reports of labour shortages, it also goes on to explain that despite the strong recovery in the economy and jobs, "inflation and wage pressures are subdued". The RBA underscores that the pick-up in inflation and wages growth is expected to be "only gradual and modest". These remarks suggesting that the cash rate will remain low for some time to come.

Indeed, the RBA has reiterated that it unlikely to increase the cash rate until 2024 at the earliest because this depends on inflation being sustainably within the 2 to 3 percent target range.

House prices continue to ramp up with the latest data published today showing very strong growth, underpinned by low mortgage rates, falling unemployment and a shortage of available housing stock. As such, we were eyeing the statement closely for any clues around the possibility of macroprudential tightening. The RBA inserted a new sentence to acknowledge "increased borrowing by investors", but the sentence around lending standards remained unchanged. The

RBA reiterated it "will be monitoring trends in housing borrowing carefully and it is important that lending standards are maintained". We anticipate the RBA will be watching riskier forms of borrowing, especially by investors. High loan-to-value ratio and interest-only borrowing will also be under the microscope. We would not rule out a tightening in macroprudential policy with the timing most likely to be next year.

On the outlook, the RBA's central scenario remains that the economy will grow 4¾ per cent over 2021. The RBA notes, however, an important ongoing source of uncertainty is the possibility of significant outbreaks of the virus.

Our eyes now turn to the July meeting. Last month, the RBA drew a line in the sand and said it will decide at the July meeting if it will direct its YCC program from the April 2024 bond to November 2024 (the next maturity). The YCC program is designed to keep the three-year government bond yield at around 0.10%. Our view for some time has been that the RBA will shift to the November 2024 bond.

Also at its July meeting, the RBA will consider the future of its QE program. The second round of QE, under which the RBA is purchasing $100 billion of longer-dated bonds, is due to conclude in September. We anticipate this program will be extended for a third round by another $100 billion. The RBA emphasised that "it continues to place a high priority on a return to full employment" when referring to the program. This language suggests the RBA intends to extend QE to ensure the unemployment rate keeps falling. Deputy Governor Guy Debelle has stated the unemployment rate consistent with full employment is around the "high 3s to low 4s". We are still a long way off this target.

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