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RBA Board Meeting Minutes

Laying Out QE Options

- **The Reserve Bank (RBA) left policy settings unchanged at its 7 December meeting. The minutes reiterated the economy was rebounding strongly. Omicron was flagged as a new source of uncertainty, but the new variant was not expected to derail the recovery.**
- **The focus is now on quantitative easing (QE) which will be reviewed at the February meeting. Last week, Governor Lowe said three options were on the table: (1) tapering purchases further and concluding the program in May, (2) tapering purchases further and reviewing the program again in May, or (3) ceasing purchases altogether in February.**
- **The minutes stated the first option is "consistent with the Bank's November forecasts for employment and inflation". The third option would be selected if "better-than-expected progress towards the Board's goals was made". The second option would be appropriate if "progress was slower than expected, or if the outlook became more uncertain".**
- **The labour market has recovered faster than the RBA expected, increasing the likelihood that the RBA opts to cease purchases in February. However, the fresh wave of COVID-19 infections has clouded the outlook. The minutes left the door option to pursue a different option altogether "if there was another serious economic setback".**
- **Separately, the recent shift from the Fed to accelerate the withdrawal of policy support gives the RBA more flexibility to speed up the tapering of bond purchases.**
- **On the cash rate, the RBA repeated it is "prepared to be patient". Markets have shrugged off renewed virus concerns and are fully priced for the first rate hike in July 2022. Much will depend on the state of the labour market and inflation. And, of course, how the fresh uncertainties over the pandemic play out.**

The Reserve Bank (RBA) left policy settings unchanged at its 7 December meeting, as widely expected.

The minutes from the meeting, released earlier today, reiterated the economy was rebounding strongly from the Delta lockdowns, underpinned by substantial government support and high vaccination rates. Omicron was flagged as a new source of uncertainty, but the new variant was not expected to derail the recovery. Encouragingly, it was noted that the RBA's liaison suggested "firms' investment intentions were at, or above, average levels for most industries", consistent with the solid outlook for business investment.

The focus is now on the future of the QE program, which will be reviewed at the next meeting in February. The RBA first tapered bond purchases from $5 billion to $4 billion per week in September. The RBA has previously laid out the criteria for decision. Namely, progress towards the central bank's goals for employment and inflation, the actions of other central banks and the functioning of the Australian bond market.

In a speech last week, Governor Lowe said three options were on the table:

(1) tapering purchases further and concluding the program in May,

(2) tapering purchases further and reviewing the program again in May, or

(3) ceasing purchases altogether in February.

The minutes today shed more light on the RBA's thinking on each of the options. The minutes stated first option is "consistent with the Bank's November forecasts for employment and inflation". The third option would be selected if "better-than-expected progress towards the Board's goals was made". The second option would be appropriate if "progress was slower than expected, or if the outlook became more uncertain".

So far, the recovery looks to be playing out faster than the RBA expected, increasing the likelihood that the RBA opts for option three (ceasing purchases in February). Notably, the labour market is bouncing back faster than the RBA forecast in its November Statement on Monetary Policy. The blockbuster November jobs data saw the unemployment rate drop to 4.6 per cent, back near its lowest level in more than a decade. The RBA forecast the unemployment rate to reach 4¾ per cent by the end of 2021.

However, the fresh wave of COVID-19 infections in the past couple of weeks has clouded the outlook, adding weight to option two (tapering in February and reviewing again in May).

The minutes also left the door option to pursue a different option altogether "if there was another serious economic setback".

Separately, the recent shift from the Fed to accelerate the withdrawal of policy support gives the RBA more flexibility to speed up the tapering of bond purchases. Earlier this month, the US Federal Reserve announced it will taper its QE program faster, bringing forward the end of the program to March. Fed officials are also now expecting three rate hikes in 2022, compared with one previously.

The RBA's decision on bond purchases at the February meeting will hinge on the flow of information over the coming months. By this time, there will be a clearer picture of the risk posed by the Omicron variant. Plus, there will be data on the December quarter CPI and how the labour market performs over December and January.

Turning to the cash rate, the RBA repeated it is "prepared to be patient". There is a wide range of opinions on when the RBA will start raising rates. On one hand, the economy is primed to bounce back quickly from the Delta lockdowns. Indeed, we have already made good progress on that front; a sharp rebound in consumption is underway and all the jobs lost during the Delta lockdowns have been recovered. But on the other hand, the pandemic continues to cast considerable uncertainty over the outlook.

Markets have shrugged off renewed virus concerns and are fully priced for the first rate hike in July 2022. Much will depend on the state of the labour market and inflation. And, of course, how the fresh uncertainties over the pandemic play out.

Matthew Bunny, Economist
Ph: (02) 8254 0023

Contact Listing

Chief Economist
Besa Deda
dedab@stgeorge.com.au
(02) 8254 3251

Economist
Matthew Bunny
matthew.bunny@stgeorge.com.au
(02) 8254 0023

Senior Economist
Jarek Kowcza
jarek.kowcza@stgeorge.com.au
0481 476 436

Associate Economist
Jameson Coombs
jameson.coombs@stgeorge.com.au
0401 102 789