futuro FINANCIAL SERVICES

futuro.com.au
(07) 3018 0400 info@futuro.com.au

4th November 2020

RBA ANNOUNCEMENT - NOVEMBER 2020

At its November meeting, the Reserve Bank of Australia (RBA) announced a package of stimulus measures, largely as expected by economists and market participants, as both the Governor and Deputy Governor of the RBA had well flagged their intentions in the lead up to the meeting. The RBA made it clear that whilst recent economic data looks better than previously expected, they remain very concerned regarding the medium-term outlook specifically regarding unemployment, and more so underemployment, and inflation remaining below their target.

The stimulus measures include both immediate action and quite explicit forward guidance regarding their intentions over the medium term. Whilst the measures have plenty of direct and indirect implications, the RBA's clear intentions are three-pronged:

1. To lower borrowing rates for the government (both Federal and State) and the financial system, specifically banks
2. To provide additional liquidity and encourage the financial system to lend (ie. credit growth)
3. To put a lid or cap on Australian dollar strength to ensure a rising currency doesn't hurt the economic recovery

This was their first significant policy change since March and also the first time the RBA has initiated traditional quantitative easing (QE). The measures include:

1. A reduction in the RBA Cash Rate from 0.25% to 0.10%, to encourage banks to lower their loan rates
2. A reduction in the 3-year Australian government bond yield target to 0.10% (which the RBA fixes through their market operations, i.e.. buying these bonds)
3. A reduction on new drawings under the Term Funding Facility to 0.10%, the rate at which banks can borrow from the RBA
4. A reduction in the interest rate on Exchange Settlement balances from 0.10% to 0%, the rate at which the financial system settles payments
5. The introduction of traditional QE (i.e.. money printing to fund government bond purchases), with their intention to buy $100 billion of bonds with 5-10-year maturities over the next 6 months, to lower medium to longer term borrowing costs

The RBA also gave fairly explicit forward guidance regarding their Cash Rate intentions. They will not be increasing the Cash Rate until actual inflation is sustainably within their target range of 2-3%, which means we need to see significantly higher wage growth from here. Considering the RBA's unemployment outlook, the 0.10% Cash Rate will be in place for at least 3 years, but probably closer to 4-5 years.

futuro
FINANCIAL SERVICES
futuro.com.au
(07) 3018 0400 info@futuro.com.au

The RBA also remained firm and clear that they have plenty of stimulus ammunition remaining.

What does this all mean for businesses, households, and markets?

(Please note – the section below may be construed as advice)

The clear intention is to both lower borrowing costs and encourage banks to lend to businesses and household to stoke investment which will ultimately lead to declining unemployment and asset price inflation (i.e.. higher equity markets and property prices). They also want to ensure the financial system is awash with liquidity to both provide comfort and support whilst also "encouraging" (forcing) participants to take more risks to help lower unemployment and support economic growth. They want governments to be able to run larger budget deficits without having to worry about their ability to borrow and borrowing costs. Lastly, they want to ensure the Australian dollar doesn't surge from here, given already upward pressure from commodity prices, so that the economy can be supported by an export-led recovery.

This is all positive for risk assets – equities, property, infrastructure, and riskier parts of the bond spectrum.

That doesn't mean you should take unchecked and unnecessary risks. But it does mean that:

1. More risk tolerant investors should retain their strategic positioning - i.e.. no need to de-risk
2. Less risk tolerant investors will need to re-visit their return targets / expectations as cash and bond yields are driven to zero (i.e. may need to take additional risk to meet these)

Chris Lioutas
M App Fin, B App Fin / B Com - Acctg