

RBA starts QE – AUD plummets

RBA Governor Lowe has described a series of measures to complement the government's fiscal stimulus and calm the financial system. This is a start, but probably not the end of measures the RBA will eventually have to undertake



A wide raft of measures

Australia's central bank, the Reserve Bank of Australia (RBA) has extended its support to the economy and financial system today. In a statement to the media, RBA Governor, Philip Lowe announced the following measures:

- Cash rate target would be reduced further to 0.25% from 0.50%.
- Cash rate will remain at this level or lower until progress is made towards full employment and inflation sustainably within its target 2-3% band (forward guidance).
- The 3Y Government bond yield would be targeted at around 0.25% through asset purchase in the secondary market (Quantitative Easing) across the yield curve and in government bonds and semi-government securities.
- Introduction of a term funding facility aimed at supporting SMEs. This is a 3Y facility for deposit-taking institutions at a fixed rate of 0.25% equivalent in size to 3% of outstanding credit, and at least AUD 90 billion.
- Increase of exchange settlement balances at the RBA to be remunerated at 10bp instead of

zero as currently.

- Addition to the 1 and 3-month repo operations until further notice, and additional six-month operations at least weekly until no longer necessary.

Market response mixed

Australian longer dated (10Y) bond yields spiked higher on the announcement, which was probably not the intended outcome, even if the 3Y government bond yield declined slightly. We anticipate finessing of the policy goals later to deliver a decline in yields across the curve, though a slight steepening would not be unwelcome for the banking sector.

The Australian dollar has fallen sharply on the announcement, in line with previous announcements of QE around the world. The 0.5569 current level is its weakest since 2002 and takes the AUD down close to parity with the NZD.

As with most central banks, we don't consider this the end for the RBA, but more likely the beginning in a series of measures to provide support for the government's fiscal policy, and to help maintain the functioning of the Australian financial system. The RBA will want to see longer dated bond yields come down too, so any further finessing of the policy package may move more in that direction.

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