19 November, 2021

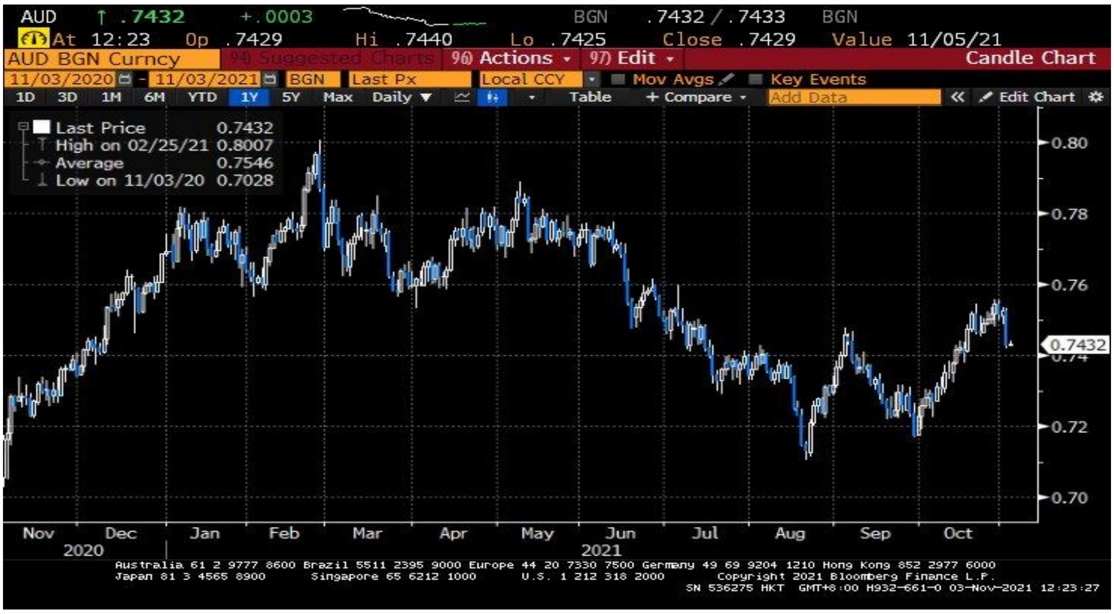
RBA abandon yield control, shifting to hawkish stance?

Following RBA's monthly board meeting on 2 Nov, the Reserve Bank of Australia announced the following:

- While the cash rate was left unchanged at a record-low 0.10%, it has stood since late 2020, but it decided to discontinue the target of 10 basis points for the April 2024 Australian Government bond.
- The bank continues its government securities purchase at the rate of A$ 4 billion ($3 billion) a week until at least mid-February 2022, and emphasized that the central forecast is for underlying inflation of around 2¼ per cent over 2021 and 2022 and 2½ per cent over 2023.
- The RBA has repeatedly said a hike is unlikely before 2024 as it wants actual inflation "sustainably" within the 2-3 per cent target range.
- However, the bank has omitted its previous projection that rates were unlikely to rise until 2024, reflecting the improvement in economy and a recent surprisingly high reading for inflation.
- The RBA also emphasized that Australia is different from other countries that inflation poses less threat to itself.

The RBA has surrendered to market forces and ceased trying to keep the yield on the benchmark April 2024 to just 10 basis points, abandons the yield control which launched since pandemic as one of the measures to assure the market that the central bank would not pose a rate hike before April 2024. Right after RBA announced that it discontinues the target of 10 basis points for the April 2024 Australian Government bond, the market has immediately interpreted that RBA has shifted from dovish to hawkish. However, we do not think that RBA really shifted to hawkish. First of all, RBA has not reduced the amount for its weekly bond purchases and has repeatedly emphasized "abandoning the target of 10 basis points for the April 2024 Australian Government bond" does not signal RBA would likely hike rate before April 2024. Most importantly, RBA has emphasized that Australia does not have an inflation problem and thus RBA does not need to rush to tighten its monetary policy. Therefore, the AUD/USD dropped substantially right after the meeting, which reflects the concern over RBA will lag behind other countries' central banks in tightening/ normalizing their monetary policies.

AUD/USD had a significant drop immediately after the RBA meeting



Source: Bloomberg

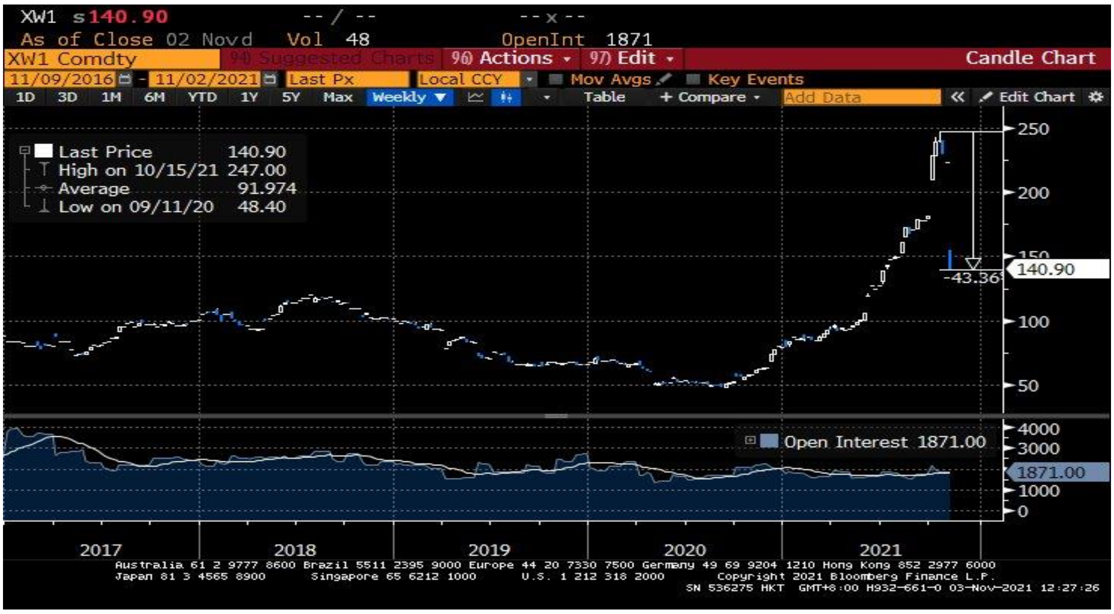
Another reason for the recent weakening of AUD amid the fall down of commodity prices, Australia is well known as a major exporter of commodities, which accounts a substantial proportion in its export. While over the economic recovery this year, the commodity prices have risen sharply since the end of last year, which has brought great support to Australia's exports as well as AUD. However, in light of recent changes in the commodity market, some commodity prices such as iron ore and coal had dropped significantly from their previous record high. Although it does not mean that the export of Australia will necessarily have a sharp decline in the coming one or two months, it will surely jeopardize the export growth of Australia and also the upward momentum of AUD.

Due to the still dovish policy stance from RBA and also the jeopardizing export outlook, we expect that AUD will further correct after the RBA meeting and may touch the low in September or even the low in August.

Iron ore price has fallen by more than 50% from the high in June this year

Source: Bloomberg

Coal prices had a 40% drop from October's high this year



Source: Bloomberg

Source: Bloomberg, Reuters, FT, MarketWatch, NewsTrend, CNBC

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