CIO comment
RBA cuts again and moves to unconventional policy

The Reserve Bank of Australia (RBA) today cut its policy rate by 25bp to 0.25% (following its decision to cut 25bp on March 4 to 0.5%). With Governor Lowe previously communicating that 0.25% is viewed by the RBA as its effective lower bound, this almost certainly brings to an end traditional policy rate reductions.

The RBA has also, today, broadened its use on non-traditional monetary policy tools. For the first time in its history, the RBA has engaged in explicit 'yield curve control', with a goal to push bond yields across the curve, and other borrowing rates, lower toward the cash rate. By targeting a three-year bond yield of 0.25% (compared with yesterday's close of 0.50%), the RBA is signalling that it expects to keep the cash rate unchanged for around three years. The RBA will outwork this by buying government and semi-government bonds in the secondary market (as we have seen from the US Federal Reserve and European Central Bank in recent years). Importantly, the RBA also announced a greater than $90 billion term funding facility focused on bank lending to small and medium-sized enterprises. Under this three-year facility, banks will have access to funding at 0.25% to lend to business (equivalent to 3% of their existing credit to the economy). The RBA has left open the option to increase the size of this facility.

The RBA's policy announcements today are broadly seeking to achieve three key outcomes. Firstly, to reduce the cash rate to its lowest possible rate, and secondly, to clearly set expectations that the cash rate will not be raised for an extended period of time, potentially more than three years. Both decisions are targeted to support lending and investment markets in the economy. The RBA's willingness to buy bonds is also targeting the proper functioning, and appropriate levels of liquidity, in bond and credit markets. Thirdly, the RBA is attempting to provide emergency credit via banks to Australian businesses to support them through what is potentially going to be a sharp downturn in the economy through Q2 and Q3 this year. Further announcements by the Government are anticipated to augment the RBA's term lending facility.

Key to the outlook for Australia and the world, both for markets and economic growth, is to see a return of liquidity and the proper functioning of short term commercial paper and credit markets. Moreover, easing cash flow pressures and borrowing costs for small and medium-sized (and global businesses), confronted by one of the most rapid and sharp curtailment of economic activity in history (due to the covid-19 outbreak) will be critical to minimising the extent unemployment rises, the length of any recession, and the time taken to recover from it.

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