

Global markets force Australian central bank to scrap major plank of monetary policy

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The Reserve Bank of Australia (RBA) made a significant change to its monetary policy yesterday, abandoning so-called yield curve targeting. Its governor, Philip Lowe, sought to present the move as a response to the achievement of the central bank's inflation target earlier than expected.

In fact, the decision signified the failure of the RBA's efforts to maintain the yield on an Australian government bond maturing in April 2024 at 0.1 percent in the face of powerful global market forces that ripped through the bond market last week.

After the headline rate of Australian inflation hit 3 percent and the underlying inflation rate moved above 2 percent, there was a major sell-off of short-term bonds, reflecting investors' opinion that Australia was joining the worldwide rise in inflation.

The sell-off was part of a global movement, with short-term bond markets experiencing "unprecedented volatility" according to George Saravelos, Deutsche Bank's head of global currency research, in remarks cited by the *Financial Times*.

Saravelos said the moves in bond markets had been exacerbated by investors being forced to abandon bets that had gone sour, because markets had moved against them due to rising inflation. The situation was "the closest we can get to a distressed market."

The sell-off in the Australian market, Saravelos said, was the most severe since 1996. As a result, bond prices fell last week and the yield on the targeted bonds rose eight-fold from 0.1 percent to 0.8 percent (the price of bonds and their yield has an inverse relationship).

Last week the RBA was faced with a situation where in order to maintain its yield target it would have had to buy up every one of the available bonds in the market.

In the event, the bank decided to stand aside and basically scrap the policy. Lowe told a webinar yesterday he took the decision using his "discretionary" powers,

with the RBA board rubber-stamping the shift.

In yesterday's statement on monetary policy, Lowe said the RBA board was confronted with three options: to continue the existing policy, lift the target yield or discontinue it altogether.

It decided to take the third option on the basis that the targeting policy, introduced in March 2020, was an "appropriate tool during an exceptional period, but not one to be used on an ongoing basis."

Lowe sought to put the best face on a bad situation. "The decision to discontinue the yield target reflects the improvement in the economy and the earlier than expected progress towards the inflation target," he said.

That did not cut much ice. The *Australian Financial Review* noted: "Lowe is not the first leading public figure to make a virtue out of the disintegration of a strategy that proved unworkable in the face of market forces."

While it abandoned yield targeting, the RBA said it would continue its policy of quantitative easing—purchasing government bonds at the rate of \$4 billion a week at least until February 2022—and maintain its base interest rate at 0.1 percent. Like those of its counterparts internationally, both RBA policies have provided major support for corporations and financial markets.

But the rise in inflation is putting these measures under pressure.

Seeking to reassure the markets, Lowe insisted the decision to end yield targeting did not "reflect a view that the cash rate will be increased before 2024." But that was no cast iron guarantee. There was "genuine uncertainty as to the timing of future adjustments to the cash rate," he said.

It was "still entirely possible that the rate will remain at its current level until 2024." It was "also possible that an earlier move will be appropriate." It was "plausible that a lift in the cash rate could be appropriate in 2023," but

Lowe ruled out any increase next year.

“I recognise that that some other central banks are raising rates, but our situation is different,” Lowe said.

This wheeling out of the old line of Australian exceptionalism stood in marked contrast to what had just taken place—the RBA had been battered around the head by the operation of global markets and suddenly forced to abandon a key plank of its policies.

On the economic outlook, Lowe said the Australian economy was “well placed to resume its expansion.” Gross domestic product was expected to record a solid gain for the current December quarter. The RBA’s scenario is for economic growth of 5.5 percent for 2022 and for around 2.5 percent in 2023.

Yet Lowe acknowledged that it was “also possible that we experience yet another setback that throws the economy off course.” The source of such a shock could be a new strain of the COVID-19 virus or a decline in vaccine effectiveness.

Financial conditions in Australia, Lowe said, remain “highly accommodative,” with lending rates at record lows. The RBA was “committed to maintaining highly supportive monetary conditions.”

The maintenance of this support to corporations and the financial markets, which is also fuelling record housing price rises, depends on the suppression of wages, even as inflation starts to rise.

“While inflation has picked up, it remains low in underlying terms. Inflation pressures are also less than they are in many other countries, not least because of the only modest wages growth in Australia.”

This remark points to the crucial role of the trade union apparatuses in suppressing the growing demands among workers for higher wages under the impact of inflation. This helps the RBA continue with its cheap money policies that have enabled the siphoning of wealth to the upper echelons of society and the continued fabulous enrichment of the billionaires.



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