Macro | FX Research and Strategy

Global

FX Flash

AUD - RBA Utilizes Cash Target, Moves to Yield Target

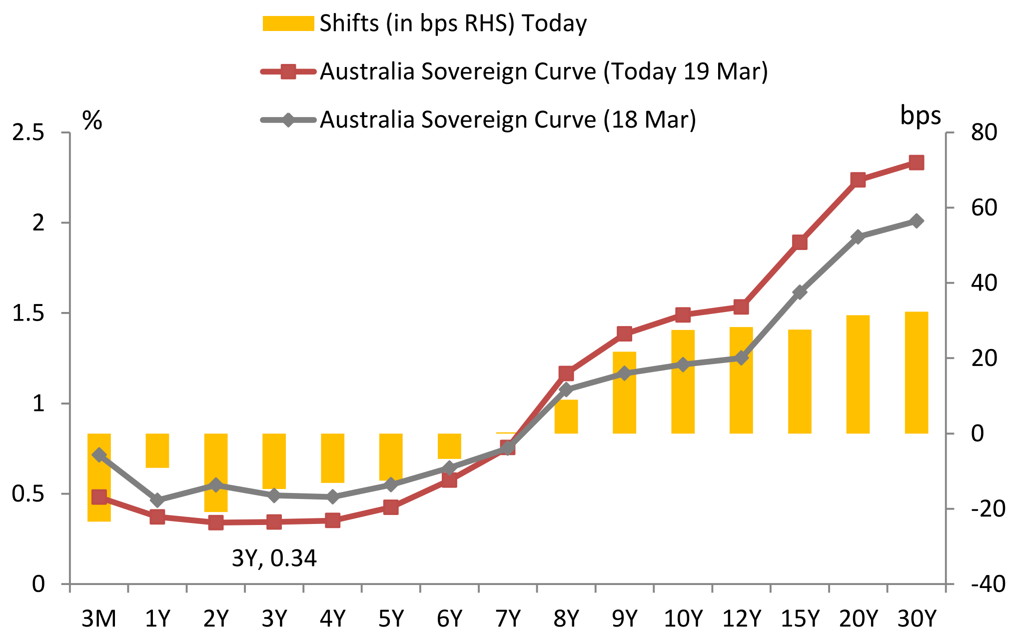
RBA Cuts Cash Target to 0.25%, Adopts YCC

RBA cut cash target rate by a final 25bps to 0.25% (effective lower bound) and adopted yield curve control with a target for the 3Y Australian government Securities (AGS) yield at around 0.25% with purchases made in the secondary market. RBA would declare its purchase intention at 11.15 am each day and will also purchase semi-government securities to "address market dislocations". The front end of the curve slid in response to this announcement but the far end of the curve rose. The 3Y yield slipped to 0.34%, down 14bps.

This should not be a surprise as RBA Lowe had mentioned back in his speech last Nov that undertaking a QE program would be with the intention of lowering risk-free interest rates along the yield curve. Buying 3Y government bonds, transmission mechanism to all asset prices and interest rates in the economy would be better enhanced.

AUDUSD had seen a precipitous decline since RBA hinted of more policy measures on Mon (16th Mar), falling around 8% from levels around 0.61 to levels around 0.57. The move lower was exacerbated by the rush for USD liquidity throughout much of the past week. **In our daily notes here and here, we had warned that AUD weakness could be frontloaded ahead of the QE announcement although bears could still be largely in control** as the COVID-19 pandemic is still evolving.

RBA Effectively Takes Control of The Front End of the Curve



Source: Bloomberg, Maybank FX Research & Strategy

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SEE PAGE 7 FOR IMPORTANT DISCLOSURES

What did RBA do Today?

- Cut cash target rate to 0.25% (effective lower bound).
- Target for the yield on 3Y AGS around 0.25% by conducting regular auctions starting tomorrow. Prepared to buy semi-government securities from secondary market.
- Support for SMEs. Term funding facility for the banking system with particular support for credit to SMEs.
    - A 3Y funding facility to authorized deposit-taking institutions (ADIs) at a fixed rate of 0.25%. ADIs can obtain initial funding of up to 3% of their existing outstanding credit and access to additional funding if they increase lending to businesses, especially SMEs. This facility is for at least $90bn.
    - Government developed a complementary program to aid the non-bank financial sector, small lenders and the securitization market, implemented by the AOFM.
- Exchange settlement balances with RBA will be remunerated at 10bps. This is an adjustment to the corridor system. Balances that banks hold with RBA overnight in Exchange Settlement accounts earn an interest 25bps below cash rate. With the cash rate at 0.25%, the original corridor would mean that interests on Exchange Settlement balances would have been zero but RBA has adjusted to 10bps.

What has RBA Done this Month?

- RBA has cut cash target rate on 3rd Mar from 0.75% to 0.50%.
- In reaction to the increasing liquidity strains, RBA has been ramping up open market operations with a record of A$12.7bn of liquidity injected via repos this morning, A$10.7bn done yesterday, topping the amount of A$8.826bn on Tue and A$9mn last Fri. The RBA has also assured that 1M and 3M repo operations will continue daily.

Elsewhere, APRA expects banks to utilize some of their current large buffers to lend and assures that the regulator would not be "concerned if they do not meet additional benchmarks announced in 2016 during the period of disruption caused by the pandemic". This comes as PM Scott Morrison announced that the government to deny entry to all non-Australians arrivals from Fri. More economic measures to follow in coming days.

Why Choose Yield Curve Control?

The choice of using yield curve control (vs. other unconventional monetary policy tools) is something that RBA Debelle hinted recently as they prefer to target price rather than volume.

Keeping the yield on 3Y AGS (Australian Government Securities) to be around 0.25% is a targeted approach as it can directly influence the front end of the curve and short-term financing rates for banks and corporates. By directly announcing a desired yield target instead of volume, there is a clear signaling effect on price. In addition, RBA can purchase whichever amount of bonds they require, depending on market conditions, in order to keep the 3Y at 0.25%. The central bank is thus, not bound to a fixed amount of bond purchase that could result in undesired implications on forward guidance (and possibly credibility) should they choose to unwind or increase the amount. The yield target would simply be removed before the cash target is raised.

Along with the commencement of the yield curve control and the 25bps rate cut, RBA released a statement underpinning their decision today. Key to their move today is the fact that "functioning of major government bond markets have been impaired", which has disrupted other markets given their important role as a financial benchmark. The USD liquidity run has affected overseas markets including Australia. Also, RBA noted that the policy package today "complements the fiscal response from governments in Australia". The central bank stressed that its priority is to support "jobs, incomes and businesses".

RBA Lowe Speech

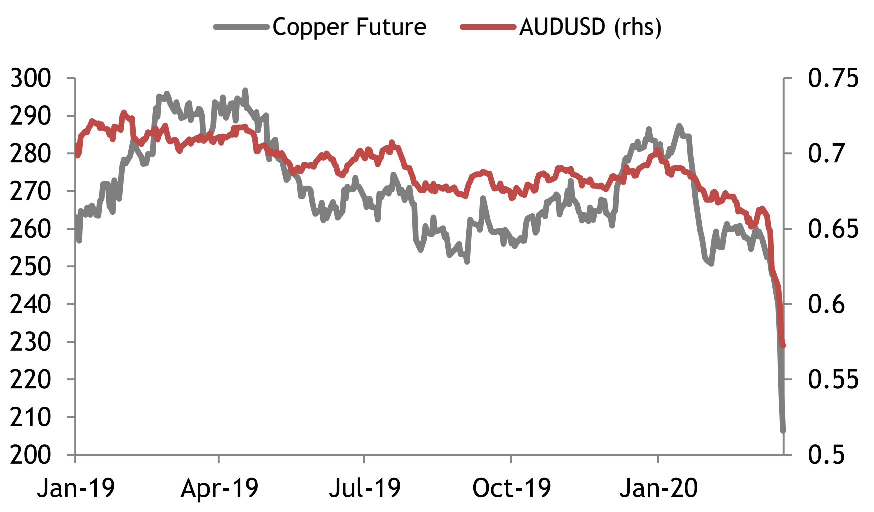
At his speech, there were a few key takeaways including his expectations for joblessness to rise, that "nothing is off the table" and that housing transactions could be scant for months.

With regards to the yield curve control, RBA Lowe stressed on the fact that quantity is not the aim of the game and price (3Y yield at 0.25%) is what they target. 3Y yield has been hovering around 0.40% and the target at 0.25% is a materially accommodative move. Last seen, 3Y remains at 0.34%, the RBA expects to take some time for 3Y to head towards 0.25%. There will also be buying across the yield curve. Cash rate is expected to be at 0.25% (equivalent to 3Y yield target) for years. Lowe assured at the QnA that RBA will still step in if "liquidity dries up"

The term-funding facility is aimed at encouraging ADIs to lend to businesses as they can borrow from RBA an amount that is equivalent to 3% of their existing outstanding credit to businesses and households. This facility will end in Sep. In addition, for every extra dollar lent to large business, lenders can have access to an additional dollar of funding from the RBA. Every extra dollar lent to SMEs, ADIs have access to an additional five dollars. These funds can be drawn upon up until the end of Mar. That said, there is no extra borrowing allowance for additional housing loans. Funding will last for three years at a fixed rate of 0.25% (below the funding costs for most banks). We are a tad disappointed that the RBA has not offered co-share risks (maximizing its role as a lender of last resort) with the lenders which could have given lenders more confidence to grant credits to businesses. That said, "nothing is off the table".

The AUD reaction

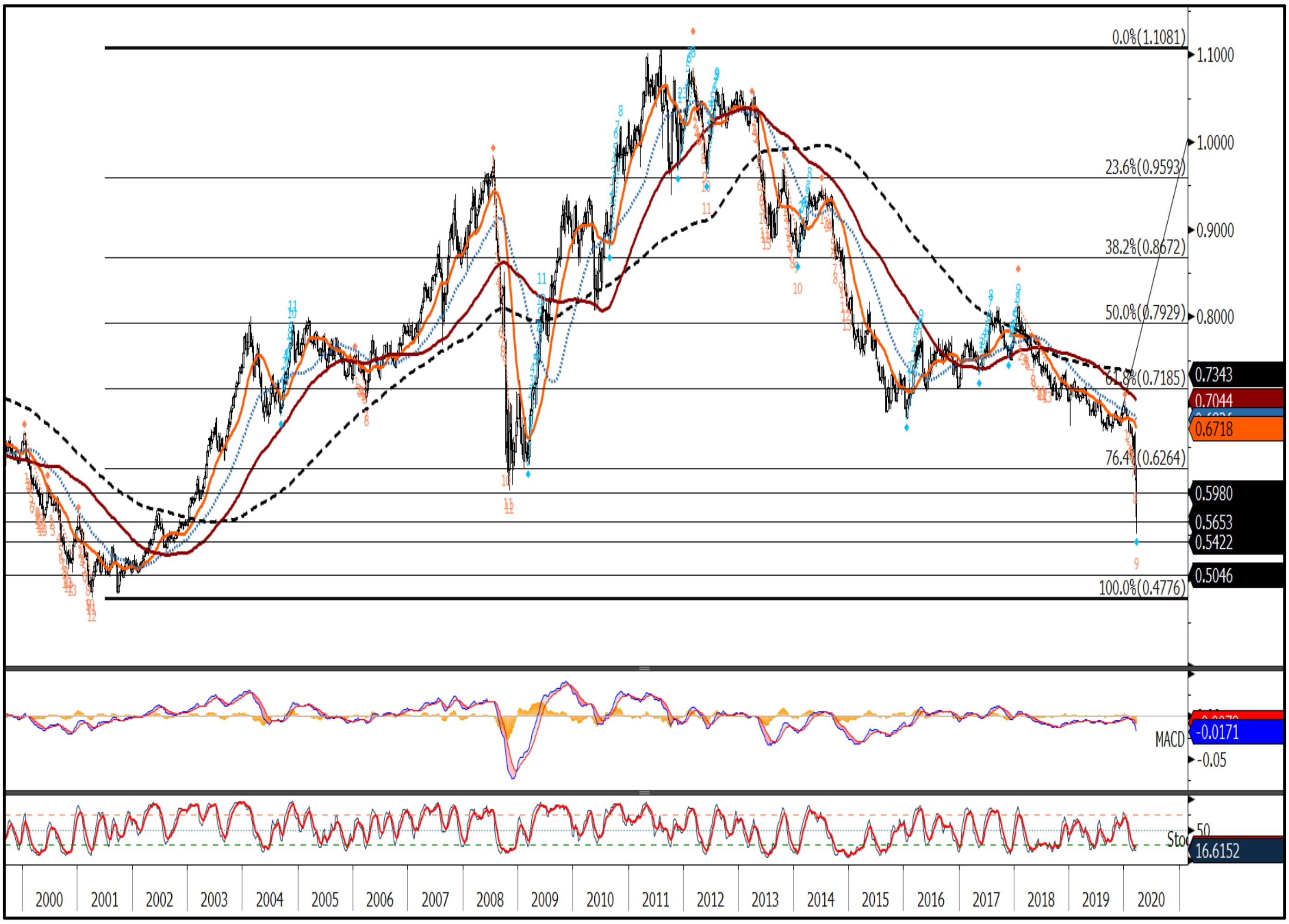
AUD Takes A Hit With Copper



Source: Maybank FX Research & Strategy, Bloomberg

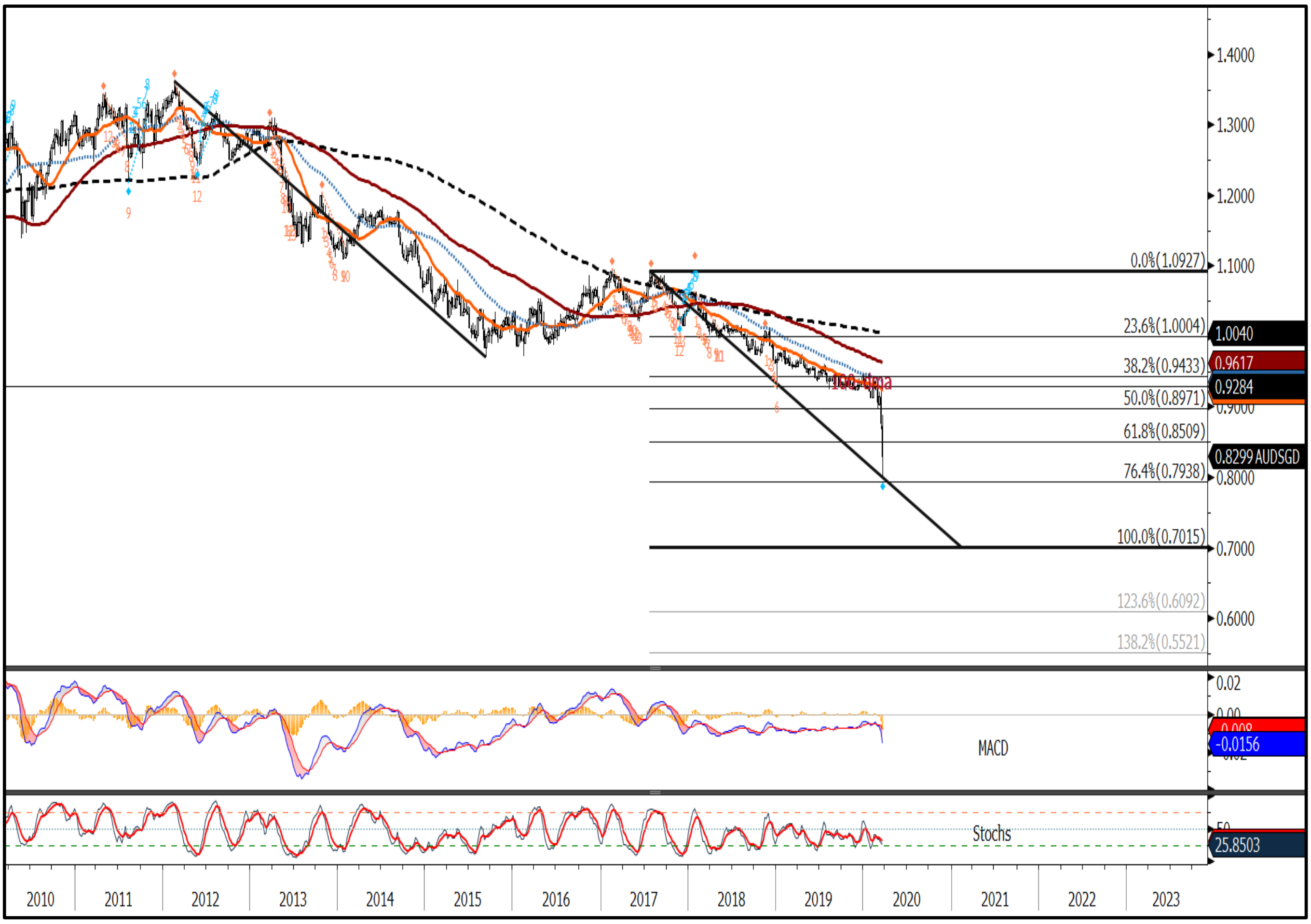
AUDUSD seemed to have found a tentative floor upon the announcement. Price touched a low of 0.5510 and rebounded towards 0.58-figure before tapering off towards 0.57 as we write. As we have warned in our GM daily recently (here and here), AUD weakness could be frontloaded ahead of the RBA announcement. That said, rebounds could still be reined in. Australia braces for tourism and services industries to take a severe blow as PM Morrison closes its borders to non-Australians. Investment and consumer sentiment look set to deteriorate at home even as Feb labour numbers look resilient for now. Jobless rate printed 5.1% for the month. The fall in global activity is best seen in the copper futures and prices of copper have come off along with the AUDUSD. AUDUSD is proven to be still rather sensitive to global headwinds and market development such as the USD funding squeeze. RBA Lowe said there has not been intervention in the FX market but the central bank would intervene if necessary. We see significant downsides to our forecast at this point but positions might be stretched and some reversion in USD strength could help in unwinding of AUD shorts.

AUDUSD (Weekly) - How To Catch A falling Knife?



AUDUSD is last seen around 0.57 and is still offered. Stochastics look stretched even though downside bias remains. 0.5653 is a next support level (May 2000 low) before 0.5420 and then at 0.5050 (Dec 2001 low), before 0.4776 (record low in 2001). 0.6260 is a resistance level (23.6% fibo retracement of the 2001-2011 rally), before the next at 0.6730.

AUDSGD (Weekly) - Historic Lows



Source: Bloomberg, Maybank FX Research & Strategy

AUDSGD has broken below historic low, last seen at 0.8294. This cross is still biased to the downside with next support at 0.7940 before the next at 0.75 (round figure) before 0.7015. A fresh record low was made today at 0.7991. Rebounds to meet 0.85 before 0.8970.

AUDMYR (Weekly) – Bearish but Stretched

Source: Bloomberg, Maybank FX Research & Strategy

AUDMYR dropped to a 2009 low of 2.4206 today on the precipitous AUD decline. Momentum is bearish but stochastics show signs of rising from oversold condition. Resistance at 2.5320 before 2.6480. Next support at 2.3400 before 2.2590 and then at 2.1530.

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