# NAB CHANGE IN CASH RATE CALL MARCH 2019

## TWO RATE CUTS IN 2019

*NAB Group Economics*

- **We now think that the RBA will make two rate cuts in 2019. Growth appears to have lost significant momentum, placing at risk further improvement in the labour market at a time when inflation poses little constraint on policy and financial stability risks have abated. We have pencilled in one 25bp cut to 1.25% in July and a further 25bp cut to 1% in November.**
- **We see the timing of a rate cut as very data dependent; any deterioration in the labour market would lead to cuts and this could happen earlier than the financial market currently anticipates.**
- **If, as we expect, the loss of momentum in private-sector activity seen in H2 2018 continues, then there is unlikely to be much improvement in the labour market despite its resilience to date. This view is reinforced by the forward indicators in the NAB Business Survey pointing to continuing (if not further) weakening. That is especially so for private consumption and the residential construction cycle.**
- **This means the RBA outlook for a further fall in unemployment to gradually lift wages and ultimately inflation is increasingly in doubt. We therefore expect the RBA to provide some further support to the economy in the form of lower interest rates.**
- **Determining the timing of such moves is much more difficult, but we are forecasting two 25bp cuts in July and November. In this respect, we note that the RBA is independent and the political cycle should and will be irrelevant to the timing of a rate cut.**
- **With monetary policy being forward looking, we think the RBA will act this year on a "no regrets" basis to boost economic activity and to offset a likely (on our forecasts) increase in unemployment in 2020. It is possible that further policy adjustment will be required in 2020.**

Last month we removed our expectation for any increase in the cash rate over the next 18 months. Even when judged against the RBA's relatively positive outlook for growth and relatively good labour market outcomes, there seemed little case for a near-term increase in the cash rate given inflation remained a little below target. In shifting our view, we noted that, if anything, there was a significant chance of a near-term interest rate cut, particularly should building downside risks materialise.

The Q4 national accounts confirmed that the downturn in the residential construction sector is likely to be as sharp as we had previously forecast and similar in magnitude to the early 1990s recession. It also confirmed that consumption growth has remained weak, alongside only modest growth in household income. The NAB Monthly Business Survey showed that the business sector lost significant momentum through the second half of 2018, with low business confidence suggesting little expected improvement. Indeed forward indicators in the Survey all suggested that firms believe that the loss of momentum will continue. The only part of the Survey that had maintained strong momentum is employment, but we see this as very much related to previously strong conditions in H1 2018. The key question then is: will employment continue to hold up? We fear not, given job advertisements have declined modestly for a number of months, suggesting that employment growth will ease.

While we have only made modest downward revisions to our previous growth forecasts of 2.4% this year and 2.2% next year, we now expect little if any improvement in the near term in the unemployment rate, with an eventual increase later in the forecast horizon. Wage growth is predicted to lift to around 2½ -2¾% by the end 2020 - not seen to be enough to see inflation rise to the middle of the RBA target band.

There remains some downside risks to our growth forecasts - and consequently labour market and inflation forecasts - if there turn out to be significant 'wealth effects' from the fall in house prices or if business investment should turn out materially weaker, as the Business Survey has begun to suggest as a risk.

What developments would allow the RBA to continue to keep interest rates on hold? Chiefly, if the unemployment rate remained low – or declined further – in spite of ongoing weak consumption growth and the downturn in housing construction. That seems unlikely to us. Substantial fiscal stimulus in the upcoming Budget would also be helpful, as would a sustained reduction in short-end funding pressures faced by lenders.

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