

# AUSTRALIAN MARKETS WEEKLY

## The RBA's thoughts on Australian QE



### In this issue

The RBA's thoughts on unconventional monetary policy and Australian QE	2
Calendar of economic releases	4
Forecasts	5

### Analysis – RBA sees Australian QE as unlikely in the near term; unconventional policy most likely to take the form of buying government bonds, but not clear that this will have much additional effect on yields outside of a crisis

- Considerable insight into the RBA's current thinking on unconventional monetary policy (including QE) was contained in the latest Semi-Annual Testimony to Parliament. Former RBA Deputy Governor Stephen Grenville also argues today in the Australian Financial Review that there is no place for QE in Australia outside of a crisis.
- The RBA suggests it is unlikely to deploy unconventional monetary policy until interest rates are much closer to zero, something the Bank sees as possible, but not likely on the basis of their current economic forecasts. That said, the Governor did countenance Australian interest rates hitting zero if central banks around the world all reduced their policy rates to zero, something markets price as much more possible in recent months (see Chart of the week).
- It still seems likely that further interest rate reductions – and additional fiscal policy support – are likely to be deployed before the RBA turns to unconventional policy. However, the Governor did note that non-conventional measures could be deployed in a situation where growth noticeably underperforms expectations, not necessarily requiring a crisis.
- Measures to support consumer spending and improve wages growth are arguably more appropriate to the economy's current circumstance.
- The suggestion by the Governor that interest rates are likely to remain very low for an extended period effectively works as qualitative forward guidance. This likely would have much of the effect of Quantitative Easing (i.e. purchasing government bonds), absent pressure on bank funding costs.

### The week ahead – Jackson Hole symposium on the 'Challenges for monetary policy'

- **Global:** The biggest event on the international calendar comes at the end of the week with the invitation-only Jackson Hole Symposium on "Challenges for monetary policy", which runs from Thursday to Saturday. The opening address will be delivered by Fed Chair Powell. Coincidentally, G7 leaders are meeting in Biarritz, France, on 24-26 August, where the market will be on alert for any views/news on geopolitics and trade tensions.
- **Local:** Governor Lowe's speech at Jackson Hole on Saturday is likely to provide some update on the RBA's policy outlook, although the topic of the address has yet to be released. That speech is expected to eclipse the RBA minutes on Tuesday, which will likely repeat the RBA's messages from the Statement on Monetary Policy. The NAB Cashless Retail Sales index is released on Wednesday and will be the first sign of whether the tax offsets have boosted spending in July (more likely to affect August).

To contact NAB's market experts, please click on one of the following links:

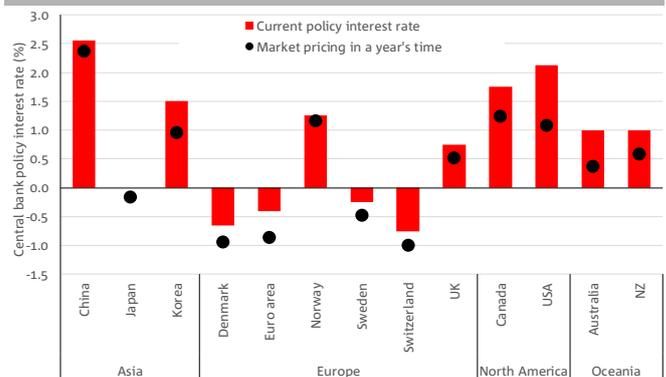
- [Ask the Economists](#)
- [Ask the FX Strategists](#)
- [Ask the Interest Rate Strategists](#)

### Key markets over the past week

	Last	% chg week	Last	bp/% chg week
AUD	0.6784	0.5	RBA cash	1.00 0
AUD/CNY	4.78	-0.6	3y swap	0.73 4
AUD/JPY	72.2	1.6	ASX 200	6,406 -2.7
AUD/EUR	0.612	1.6	Iron ore	87 -4.3
AUD/NZD	1.056	0.8	WTI oil	55.2 0.5

Source: Bloomberg

### Chart of the week: Significant rate cuts anticipated



## The RBA's thoughts on unconventional monetary policy and Australian QE

The Semi-Annual Testimony to Parliament by the RBA Governor and senior officials of the Bank contained a good deal of information on how the RBA is thinking about unconventional monetary policy and QE in an Australian context<sup>1</sup>.

These comments received relatively little coverage and so the main points are worth reiterating here, along with some additional perspective on the RBA's growth forecasts. The key points on the RBA's unconventional policy thinking in our opinion revealed in the Semi-Annual Testimony were:

- The RBA is still hopeful that it won't have to deploy unconventional monetary policy, seeing this as "unlikely, but it is possible". This view is primarily based on the RBA's latest forecasts, which envisage a strengthening economy, a marginal-medium-term reduction in unemployment and the eventual return of inflation to target;
- Many would note that the RBA has made similar such forecasts for some time, with varying success (growth and unemployment until the past year have been generally better than expected, while inflation has continued to run below forecast and target for an extended period). While like other central banks, the RBA sees near-term downside risks to growth due to global trade and technology uncertainties, the Bank's latest forecasts see the medium-term outlook as more balanced than it has been for some time! This reflects the earlier-than-expected stabilisation of the established housing market, the positive effects of interest rate reductions and tax cuts on household cash flow and a more positive outlook for mining investment. NAB remains a little more cautious on the domestic consumption outlook than the RBA's scenario;
- A scenario where all of the major central banks took interest rates to zero, was described as one that would see the RBA consider that policy also. This outcome (zero rates) would also be possible should growth in the economy fall considerably short of the RBA's central scenario. In this circumstance, "lower interest rates would be an option, as I hope fiscal measures would be as well";
- The RBA has been studying the types of non-conventional policies used overseas for contingency purposes. The Bank repeated that often a combination of unconventional responses works best;
- The Governor noted that purchases of government bonds were the most likely non-conventional policy response to be deployed in Australia, with the aim of this policy being to lower the risk-free rate (NAB: and so lower other general borrowing rates in Australia);

- Conventional monetary policy is currently still working, with unconventional monetary policy responses unlikely before the cash rate was very close to zero. (In other fora, the RBA has noted that the UK and the US did not deploy non-conventional policies before rates were very close to zero). The RBA notes that alternative monetary policies could be deployed should the economy underperform materially the RBA's central scenario: i.e., if "growth is very weak – it stays in the one per cent range for a longer period of time – the unemployment rate starts rising, wages growth doesn't pick up and inflation's falling short, then we'll need to look at all monetary options, fiscal options and structural options"; and
- The circumstances confronting the Bank would likely be important in determining what particular non-conventional policy response is deployed. For example, a market dislocation, funding or credit crisis would likely call for a different response than a continuation of slow growth.

### Former RBA Deputy Governor Stephen Grenville does not see a place for QE in Australia outside of a crisis

Former RBA Deputy Governor Stephen Grenville has added his thoughts to the debate, writing in today's Australian Financial Review that quantitative easing has proven to have only limited uses – and that none of them apply to Australia outside of a crisis<sup>2</sup>. (Note: Dr Grenville appears on a panel on Wednesday in Sydney entitled "QE in Australia; What would it look like?".)

The key points Grenville makes are:

- Like the RBA's current view, the economic and market circumstances under which QE needs to be deployed are important in determining the form of the policy response;
- The Fed's purchases of Mortgage-Backed Securities (MBS) in QE1 were very successful in unfreezing the MBS market;
- The effectiveness of QE2 and QE3, which mainly involved the purchases of government bonds, is less clear and hard to distinguish from the impact of forward guidance in lowering bond yields;
- Referencing former Fed Chairman Ben Bernanke speaking on the 10<sup>th</sup> anniversary of QE, QE is an emergency measure and should only be used when conventional policies are unavailable. If more stimulus is needed, other policies – such as fiscal policy – should do more.

### NAB View

Reading both these pieces is instructive and allows us to make the following observations:

- Conventional monetary policy (ie. interest rate reductions) is likely to continue to be the primary monetary policy response for another three to four moves – which would of course take the official cash

<sup>1</sup> See pages 25-27 of

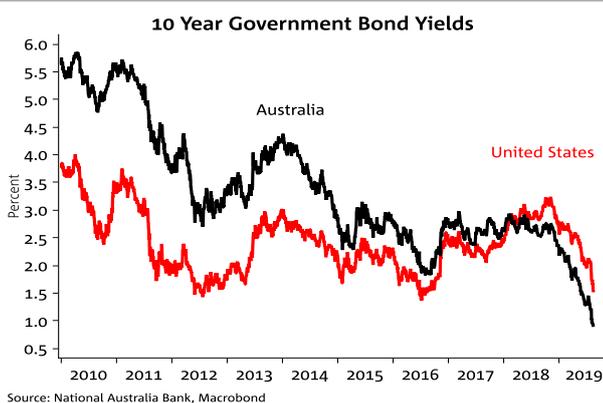
[https://parlinfo.aph.gov.au/parlInfo/download/committees/commrep/eea5d0b8-72e9-4b5e-acf8-52ed46888ced/toc\\_pdf/Standing%20Committee%20on%20Economics\\_2019\\_08\\_09\\_7100.pdf;fileType=application%2Fpdf](https://parlinfo.aph.gov.au/parlInfo/download/committees/commrep/eea5d0b8-72e9-4b5e-acf8-52ed46888ced/toc_pdf/Standing%20Committee%20on%20Economics_2019_08_09_7100.pdf;fileType=application%2Fpdf).

<sup>2</sup> <https://www.afr.com/policy/economy/there-is-no-case-for-australian-qe-20190818-p52i8t>.

rate to 0-0.25% – outside of an unforeseen crisis/market dislocation;

- The RBA, like NAB, anticipates that further fiscal policy support would likely also be delivered in an environment of ongoing slow growth that led to higher unemployment;
- The Governor notes that non-conventional monetary policy could be deployed outside of some form of crisis, such as in an environment where growth materially underperforms the RBA’s forecasts. In such a case, it would be reasonable to expect other policies to also be implemented, especially fiscal policy. Other forms of non-conventional policy could be expected should pressures on bank funding costs emerge;
- We suspect the RBA Governor’s judgment that it is reasonable to expect that interest rates are likely to remain very low for an extended period of time, acts similarly to forward guidance, even though the Governor has pushed back against this suggestion. This – along with substantial falls in global bond yields – is already having the effect of sharply lowering the risk-free rate in Australia. In so doing, like former Deputy Governor Grenville, we wonder whether QE in the form of buying Australian government bonds would have a significant further effect on the risk-free rate (and hence other borrowing rates) in current circumstances, with the yield curve already flatter and yields much lower than when QE was announced in the US. That assessment would likely change if pressure emerged on bank funding costs, for whatever reason. If that happened, purchases of government bonds, mortgage backed securities, or other measures to alleviate bank-funding pressures could also be introduced;

**Chart 2: Bond yields price low growth, rates & inflation**



- In the near term, given the low level of inflation globally, the ongoing drag on inflation from the housing and rental components of the CPI basket, and the lags associated with monetary policy, it’s hard to see either interest rate reductions or unconventional monetary policy having any significant or rapid success in returning inflation to target. Indeed, in the current circumstances, policy measures to support consumer spending and/or raise wages growth, would seem to be more appropriate.

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## CALENDAR OF ECONOMIC RELEASES

Country	Economic Indicator	Period	Forecast	Consensus	Actual	Previous	GMT	AEST
<b>Monday, 19 August 2019</b>								
NZ	Performance Services Index	Jul		--		52.7	22.30	8.30
EC	CPI Core YoY	Jul F		0.9		0.9	9.00	19.00
EC	CPI MoM	Jul		-0.4		0.2	9.00	19.00
EC	CPI YoY	Jul F		1.1		1.3	9.00	19.00
<b>Tuesday, 20 August 2019</b>								
AU	RBA Minutes	Aug		--		--	1.30	11.30
US	Fed Quarles Discusses Community Development			--		--	22.00	8.00
<b>Wednesday, 21 August 2019</b>								
NZ	Dairy Auction Avg. Winning Price MT	Aug 20	-2	--		-2.6		early am
AU	Westpac Leading Index MoM	Jul		--		-0.08	0.30	10.30
AU	NAB Cashless Sales Index	Jul		--		--	1.30	11.30
NZ	Credit Card Spending YoY	Jul		--		6.6	3.00	13.00
CA	CPI NSA MoM	Jul		0.1		-0.2	12.30	22.30
CA	CPI YoY	Jul		1.6		2	12.30	22.30
CA	CPI Core- Common YoY%	Jul		1.8		1.8	12.30	22.30
US	FOMC Meeting Minutes	Jul 31		--		--	18.00	4.00
<b>Thursday, 22 August 2019</b>								
US	Annual Federal Reserve Policy Symposium in Jackson Hole 22 - 24 Aug							
JN	Jibun Bank Japan PMI Mfg	Aug P		--		49.4	0.30	10.30
JN	All Industry Activity Index MoM	Jun		-0.8		0.3	4.30	14.30
GE	Markit Germany Services PMI	Aug P		54		54.5	7.30	17.30
GE	Markit/BME Germany Manufacturing PMI	Aug P		43		43.2	7.30	17.30
EC	Markit Eurozone Manufacturing PMI	Aug P		46.5		46.5	8.00	18.00
EC	ECB Minutes	Aug					11.30	21.30
US	Markit US Services PMI	Aug P		52.8		53	13.45	23.45
US	Markit US Manufacturing PMI	Aug P		50.5		50.4	13.45	23.45
EC	Consumer Confidence	Aug A		-6.8		-6.6	14.00	0.00
<b>Friday, 23 August 2019</b>								
NZ	Retail Sales Ex Inflation QoQ	2Q	0.2	0.2		0.7	22.45	8.45
JN	Natl CPI YoY	Jul		0.6		0.7	23.30	9.30
JN	Natl CPI Ex Fresh Food YoY	Jul		0.6		0.6	23.30	9.30
CA	Retail Sales MoM	Jun		-0.3		-0.1	12.30	22.30
CA	Retail Sales Ex Auto MoM	Jun		-0.2		-0.3	12.30	22.30
US	New Home Sales	Jul		640		646	14.00	0.00
<b>Upcoming Central Bank Interest Rate Announcements</b>								
Australia, RBA		Sep 3	1.00	1.00		1.00		
Europe, ECB		Sep 12	-0.5	-0.5		-0.40		
Japan, BoJ		Sep 19	-0.10	-0.10		-0.10		
US, Federal Reserve		Sep 18	1.75/2	1.75/2		2/2.25		
UK, BOE		Sep 19	0.75	0.75		0.75		
New Zealand, RBNZ		Sep 25	1.00	1.00		1.00		

GMT: Greenwich Mean Time; AEST: Australian Eastern Standard Time

# FORECASTS

Economic Forecasts																				
	Annual % change				Quarterly % change															
	2018	2019	2020	2021	2018				2019				2020				2021			
Australia Forecasts	2018	2019	2020	2021	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Household Consumption	2.6	1.5	2.0	2.4	0.4	0.8	0.3	0.4	0.3	0.3	0.4	0.6	0.4	0.5	0.7	0.5	0.6	0.6	0.6	0.6
Underlying Business Investment	0.9	0.3	3.0	2.0	0.6	-1.0	-2.1	0.0	0.6	0.8	0.4	1.2	0.6	0.6	0.9	0.4	0.6	0.4	0.2	0.5
Residential Construction	4.7	-8.2	-8.1	-1.4	4.1	1.7	0.7	-2.9	-2.5	-3.3	-3.0	-2.2	-2.0	-1.7	-1.8	-0.8	-0.2	0.5	0.2	0.8
Underlying Public Spending	5.0	5.4	4.5	4.1	1.4	0.4	2.5	1.6	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.0	1.0	1.0	1.0
Net Exports (a)	0.7	0.8	-0.1	-0.2	0.5	0.2	0.3	-0.2	0.2	0.1	0.2	0.2	0.1	0.0	-0.1	0.0	-0.1	0.0	-0.1	0.0
Inventories (a)	0.1	-0.2	-0.1	0.0	-0.1	0.2	-0.3	0.2	-0.1	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic Demand (q/q %)	--	--	--	--	0.9	0.6	0.5	0.4	0.1	0.3	0.4	0.6	0.5	0.5	0.6	0.6	0.7	0.7	0.7	0.7
Dom Demand (y/y %)	2.9	1.4	2.1	2.6	3.4	3.2	2.8	2.4	1.6	1.3	1.2	1.4	1.8	2.0	2.3	2.3	2.5	2.6	2.6	2.8
Real GDP (q/q %)	--	--	--	--	1.0	0.9	0.3	0.2	0.4	0.4	0.5	0.7	0.5	0.5	0.6	0.5	0.6	0.6	0.6	0.7
Real GDP (y/y %)	2.8	1.6	2.2	2.3	3.1	3.1	2.8	2.4	1.8	1.3	1.5	2.0	2.1	2.3	2.4	2.2	2.3	2.3	2.3	2.5
CPI headline (q/q %)	--	--	--	--	0.4	0.4	0.4	0.5	0.0	0.6	0.4	0.6	0.4	0.4	0.5	0.7	0.5	0.5	0.6	0.7
CPI headline (y/y %)	1.9	1.5	1.8	2.2	1.9	2.1	1.9	1.8	1.3	1.6	1.6	1.6	2.0	1.7	1.8	1.9	2.0	2.2	2.3	2.3
CPI underlying (q/q %)	--	--	--	--	0.5	0.5	0.3	0.4	0.2	0.4	0.3	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.5
CPI underlying (y/y %)	1.8	1.4	1.5	1.9	1.9	1.7	1.7	1.7	1.4	1.4	1.3	1.3	1.5	1.5	1.5	1.6	1.8	1.9	2.0	2.0
Private wages (q/q %)	--	--	--	--	0.5	0.6	0.6	0.5	0.5	0.6	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Private wages (y/y %)	2.1	2.3	2.5	2.8	1.9	2.1	2.2	2.3	2.4	2.3	2.3	2.4	2.5	2.5	2.6	2.6	2.7	2.7	2.8	2.8
Unemployment Rate (%)	5.3	5.2	5.4	5.5	5.5	5.5	5.1	5.0	5.1	5.2	5.2	5.3	5.3	5.3	5.4	5.5	5.5	5.5	5.5	5.5
Terms of trade	1.8	4.1	-7.6	1.8	3.2	-1.2	1.1	2.9	3.1	2.7	-4.4	-4.7	-2.6	-0.6	0.9	-0.2	1.2	0.6	-0.1	-0.1
Current Account (% GDP)	-2.0	-0.6	-2.1	-1.9	-2.2	-2.5	-2.1	-1.3	-0.6	0.2	-0.6	-1.5	-2.0	-2.2	-2.1	-2.1	-1.9	-1.8	-1.9	-2.0

Source: NAB Group Economics; (a) Contributions to GDP growth

Exchange Rate Forecasts						
	19-Aug	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20
<b>Majors</b>						
AUD/USD	0.678	0.67	0.65	0.66	0.67	0.69
NZD/USD	0.64	0.64	0.62	0.62	0.63	0.65
USD/JPY	106.4	105	104	104	105	106
EUR/USD	1.11	1.10	1.12	1.11	1.13	1.14
GBP/USD	1.22	1.17	1.20	1.18	1.20	1.22
USD/CNY	7.04	7.25	7.40	7.40	7.30	7.20
USD/CAD	1.33	1.33	1.36	1.38	1.38	1.36
USD/CHF	0.98	0.96	0.97	0.95	0.96	0.96

Australian Cross Rates						
	19-Aug	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20
AUD/NZD	1.06	1.05	1.05	1.06	1.06	1.06
AUD/JPY	72.2	70	68	69	70	73
AUD/EUR	0.61	0.61	0.58	0.59	0.59	0.61
AUD/GBP	0.56	0.57	0.54	0.56	0.56	0.57
AUD/CNY	4.78	4.86	4.81	4.88	4.89	4.97
AUD/CAD	0.90	0.89	0.88	0.91	0.92	0.94
AUD/CHF	0.66	0.64	0.63	0.63	0.64	0.66

Interest Rate Forecasts						
	19-Aug	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20
<b>Australian Rates</b>						
RBA cash rate	1.00	1.00	0.75	0.75	0.75	0.75
3 month bill rate	0.97	1.10	0.85	0.85	0.85	0.85
3 Year Swap Rate	0.72	0.80	0.80	1.10	1.20	1.30
10 Year Swap Rate	1.09	1.38	1.38	1.53	1.63	1.73
<b>Offshore Policy Rates</b>						
US Fed funds	2.25	2.00	1.75	1.75	1.75	1.75
ECB deposit rate	-0.40	-0.60	-0.60	-0.60	-0.60	-0.60
BoE repo rate	0.75	0.75	0.75	0.75	0.75	0.75
BoJ excess reserves rate	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
RBNZ OCR	1.00	1.00	0.75	0.75	0.75	0.75
China 1yr lending rate	4.35	4.10	4.10	4.10	4.10	4.10
China Reserve Ratio	13.5	13.00	12.50	12.00	12.00	12.00
<b>10-year Bond Yields</b>						
Australia	0.92	1.20	1.20	1.35	1.45	1.55
United States	1.55	1.90	1.90	2.00	2.10	2.20
New Zealand	1.04	1.25	1.25	1.35	1.45	1.55

Sources: NAB Global Markets Research; Bloomberg; ABS

Global GDP				
	2018	2019	2020	2021
Australia	2.8	1.6	2.2	2.3
United States	2.9	2.2	1.7	1.8
Eurozone	1.9	1.1	1.2	1.4
United Kingdom	1.4	1.2	1.2	1.5
Japan	0.8	1.2	0.3	0.9
China	6.6	6.3	6.0	5.8
India	6.8	6.3	7.0	7.1
New Zealand	2.9	2.4	2.6	2.5
World	3.6	3.1	3.3	3.5

Commodity prices (\$US)					
	19-Aug	Sep-19	Dec-19	Mar-20	Jun-20
Brent oil	58.9	68	70	70	75
Gold	1511	1456	1450	1483	1518
Iron ore	92	79	76	72	68
Hard coking coal*	157	178	170	165	160
Thermal coal	66	85	90	93	90
Copper	5720	6400	6300	6225	6150
Aus LNG**	9	12	12	12	12

\* FOB quarterly contract prices (thermal coal is JFY contract)

\*\* Implied Australian LNG export prices

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