NAB CHANGE IN CASH RATE CALL 20 SEPTEMBER 2019

RBA TO CUT IN OCTOBER AND AGAIN IN DECEMBER, TAKING THE CASH RATE TO 0.5% BY YEAR'S END

NAB Economics

We have changed the timing of our previous rate call, bringing forward the next cut to October, with a follow-up to occur in December. Previously we expected a 25bp cut at each of the November and February board meetings in combination with some indication of likely unconventional policies going forward should more stimulus be needed. However, it appears that the impact of income tax cuts has been muted, or at least failed to offset growing weakness in the household sector. Furthermore, we previously anticipated some further support from fiscal policy but now believe this is unlikely in the near term. With monetary policy involving longer lags, we think the urgency to lower rates sooner has increased. Longer term, we still think that unless there is meaningful fiscal stimulus the RBA is likely to cut to 0.25% and adopt unconventional policy by mid-2020.

- We have brought forward our expectation for each of the next two predicted rate cuts by a meeting; that is, we now expect a 25bp cut in October and December (previously November and February). Previously, the board had signalled an easing bias noting an "accumulation of evidence" was required to cut rates further if needed. Importantly, the minutes from the September meeting note dropped this reference, with the RBA emphasising that more support can be provided to the labour market. While predicting month to month timing is difficult, in our view, the risks around the timing of reductions in the cash rate from here will be more dependent on prevailing financial conditions.
- Domestically, growth has remained weak with annual growth in GDP slowing to its slowest rate since the global financial crisis. Perhaps more worryingly, the composition of this growth shows that activity in the private sector is very weak, with ongoing weak consumption growth, a sizeable decline in dwelling investment, and weak business investment. While strong public-sector spending has been a significant support to growth over the past year, as have exports of commodities, this pattern of growth suggests unemployment is likely to edge higher.
- Our current forecasts look for this divergence to continue, with dwelling investment declining further and consumption growth remaining modest. Exports are expected to continue to grow this year before levelling off, while public-sector spending should be strong. We recently tempered our optimistic outlook for business investment, where positive spill-overs from infrastructure spending should be countered by weakening confidence in combination with weak consumer demand. Consequently, we see the unemployment rate deteriorating over the next year to reach 5.5%, well above the recent RBA full employment estimate of 4.5%.
- Internationally, the escalation in the trade war between the US and China has seen a fall in global trade and manufacturing production that has dragged on world growth. Business confidence has fallen and firms could defer investment in the face of increased uncertainty, which would be an additional drag on growth. Central banks have started to respond with easier policy, which places additional pressure on the Reserve Bank to cut rates further given an appreciating exchange rate would undo some of the benefit of lower interest rates locally.
- Importantly, with rates reaching very low levels the focus will turn to available 'unconventional' policy tools should more support be needed. We think that initially the RBA could flag a package of options at around 0.5% and would begin to implement these as rates tracked lower. Initially, we think it is highly likely the RBA would shift to an explicit form of forward guidance and purchase government bonds. An expansion of this could include a broader range of asset purchases and increasing liquidity in the short-end of the market. Long-dated repurchase agreements to banks are another option. The choice of instruments and size of the package is likely to reflect both economic conditions and financial market circumstances at the time of implementation.

AUTHORS

Alan Oster, Group Chief Economist

Ivan Colhoun, Global Head of Research

Kieran Davies, Market Economics

Gareth Spence, Senior Economist

Contacts: Alan Oster – Chief Economist

Group Economics

Alan Oster
Group Chief Economist
+(61 3) 8634 2927

Jacqui Brand
Executive Assistant
+(61 3) 8634 2181

Dean Pearson
Head of Behavioural & Industry Economics
+(61 3) 8634 2331

John Sharma
Economist
+(61 3) 8634 4514

Australian Economics and Commodities

Gareth Spence
Senior Economist
+(61 0) 436 606 175

Phin Ziebell
Economist – Australia
+(61 0) 475 940 662

Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 3837

Steven Wu
Economist – Behavioural & Industry Economics
+(61 3) 9208 2929

International Economics

Tony Kelly
Senior Economist
+(61 3) 9208 5049

Gerard Burg
Senior Economist – International
+(61 3) 8634 2788

Global Markets Research

Ivan Colhoun
Global Head of Research
+(61 2) 9237 1836