NAB CHANGE IN CASH RATE CALL SEPTEMBER 2019

CASH RATE TO 0.5% BY FEB; MORE STIMULUS BY MID 2020 UNLESS THE GOVERNMENT STEPS IN

NAB Economics

We have changed our call on monetary policy. Previously we expected a cut in November to 0.75%, together with additional fiscal stimulus. We now expect a further cut to 0.5% in February, at which point the Reserve Bank would outline its plans on unconventional policy. Unless the government delivers a meaningful fiscal stimulus, a further cut to 0.25% by mid-2020 is likely, along with the adoption of non-conventional monetary policy measures.

- We have changed our view on the cash rate, factoring in an additional rate cut in February to take the cash rate to 0.5%, at which point the Reserve Bank has suggested it would signal its intentions on unconventional policy. We still expect the next cut to be in November, with our forecast of a more drawn-out easing of policy reflecting the cautious nature of Governor Lowe, where the Board has signalled an "accumulation of additional evidence" was required to cut rates again. That said, we are very aware the Bank could cut as soon as October if there was further weakness in the labour market revealed next week.
- The forecast of lower interest rates reflects increased downside risks to the domestic economy and greater uncertainty about the world economy. Growth continues to undershoot the Reserve Bank's forecasts, such that unemployment is likely to edge higher, with inflation stuck below the 2-3% target band. Public spending remains strong, but private demand has fallen over the past year for the first time since the global financial crisis. The NAB business survey points to continued weakness in private demand, while our internal data suggest that rate cuts and tax refunds have done little to boost consumer spending in July and August as was hoped. House prices have picked up in a number of cities, which should help limit further wealth effects on consumer spending, but leading indicators suggest that the sharp downturn under way in residential construction could be deeper than previously forecast.
- 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 slumped 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, we continue to see the need for additional fiscal stimulus, through new infrastructure investment, cash hand-outs and/or the pull-forward of tax cuts. Governor Lowe has repeatedly called for more help from fiscal policy, although to date the government is focused on the political objective of returning the budget to surplus, pointing only to possible tax concessions for business investment in the May 2020-21 Budget. Unless something meaningful is done on fiscal stimulus, we think the Reserve Bank could cut the cash rate further to 0.25% by mid-2020, simultaneously undertaking unconventional monetary policy. Governor Lowe has said that unconventional monetary policy would most likely involve buying government bonds, but we anticipate additional steps, such as long-dated repurchase agreements to lower bank funding costs, given the Bank has previously said a mix of policies is more effective based on international experience. The exact mix would likely be determined depending on economic and financial conditions when short-end rates move below 0.5%.

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