NAB CHANGE IN CASH RATE CALL 13 NOVEMBER 2019

NEXT RBA CUT DELAYED TO FEBRUARY 2020, WITH THE RISK OF FURTHER CUTS AND QE BY MID-2020 WITHOUT FISCAL STIMULUS

NAB Economics

We have pushed out our expected timing of the next cash rate cut by the RBA to February 2020, where we expect a further reduction of 25bps to a new low of 0.5%. It is at this level of the cash rate where the RBA has previously stated it would outline a 'package' of unconventional policies if further monetary easing is required to support growth, full employment and the return of inflation to target. The RBA Governor is speaking on "Unconventional Monetary Policy" on November 26th. To be clear, we think that the RBA should actually provide a further interest rate cut next month with private sector growth remaining weak and little evidence to date that prior easing or the tax rebates has done enough to offset the weakness in the economy. However, for now, the RBA appears to be in a holding pattern, while it assesses the impact of prior rate cuts and 'the gentle turning point'. We see an improvement in growth over time but not to a sufficiently strong rate of growth to prevent the unemployment rate beginning to rise. At the same time, the Government does not seem to be inclined to provide material fiscal stimulus in the near term, which increases the need for the RBA to ease further (including a further rate cut and unconventional policy) should our forecast of a deteriorating labour market materialise.

- We now expect the RBA to cut the cash rate by 25bps to 0.5% in February 2020 – and potentially announce a package of unconventional policy should there be a need to provide further stimulus to the economy going forward. Previously we had pencilled in a cut for December (the fourth this year) – and still consider this the best course of action – but the RBA has signalled it is in 'wait and see' mode.
- Growth looks to have remained weak in Q3, with our expectation for quarterly growth now 0.3% (1.5% y/y) – a small slowing from the previous two quarters. This deterioration comes despite the support provided by tax cuts which look to have provided little offset to the weakness in consumption with retail sales declining in Q3 – though it is likely too early to see the impact of recent rate cuts. In addition, NAB's internal modelling suggests that the services component of consumption was also weak in Q3. In the business sector, both business confidence and conditions have remained below average in the first month of Q4 – though encouragingly have not deteriorated further. The forward-looking indicators suggest little significant signs of a turnaround.
- Further out we have broadly maintained the shape of our growth forecasts. We expect growth of 1.6% this year, before a small improvement to 2.1% in 2020 and 2.4% in 2021. These below average rates of growth lead to a small rise in the unemployment rate. Inflation is expected to remain weak and only reach the bottom of the target band by the end of our forecast horizon. The key dynamics behind our assessment of the economy continue to be headwinds from a weak consumer and a significant downturn in housing construction. We have also lowered our business investment forecasts a touch. These weak outcomes in private domestic demand continue to be partly offset by strong public sector spending and growth in exports – preventing a more troublesome slowing of growth. Our global outlook remains broadly unchanged.
- While we think that fiscal policy could be used to effectively support the economy and the recent easing in monetary policy – this increasingly appears unlikely to occur in the required time frame. We think the government should act to bring forward infrastructure investment (where constraints allow) and that an earlier introduction of planned tax cuts could usefully bolster household income growth and spending. In addition, investment allowances to support and bring forward investment may help, as would lifting Newstart payment rates. The risk of fiscal policy remaining on the sidelines for too long, increases the chance that the RBA will ease further than otherwise (including both further rate cuts and the use of QE) though both of the latter see longer lags in boosting growth.
- As previously outlined we see the risk of a move to unconventional policy by mid-next year without material support from fiscal policy. We think that initially the RBA could flag a package of options at around a 0.5% cash rate and would begin to implement these as rates are cut further in this scenario. Initially, we think it is highly likely the RBA would shift to an explicit form of forward guidance and purchase government bonds. Other unconventional measures could include a broader range of asset purchases and increasing liquidity in the short-term money 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.

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