NAB CHANGE IN CASH RATE CALL 4 DECEMBER 2019

LITTLE SUPPORT FROM FISCAL POLICY TO SEE FURTHER CUTS IN FEBRUARY AND JUNE WITH A MOVE TO QE IN H2 2020 A REAL PROSPECT

NAB Economics

We have included an additional 25bp cut to the cash rate in our rate track. We now expect cuts in both February and June 2020 - taking the cash rate to 0.25%. At this point, we see an increased risk of a move to 'unconventional' policy in H2 2020 should the labour market deteriorate more significantly than we forecast, with low inflation posing little constraint to further easing. Previously, we had pencilled in only a further 25bp cut to the cash rate and hoped to see a material support from fiscal policy, which now looks unlikely in the required timeframe. Our forecasts of below-trend growth, a deterioration in the unemployment rate and inflation firmly below the RBA's target band are broadly unchanged, but clearly imply the need for policy makers to do more. Weak private-sector growth is likely to see employment growth slow and unemployment drift further above the NAIRU, cementing weak wages growth. Indeed, our forecasts for the household sector and business investment are notably weaker than the RBA's, although we remain more optimistic on public spending. Should the data turn out weaker than our forecasts, there is a real prospect the RBA moves to unconventional policy in H2 2020.

- We now expect two further 25bp cuts in the cash rate, with the first occurring in February and the second (and final before moving to QE) in June. Previously we had factored in only one further cut, but had hoped to see a material fiscal stimulus package to provide additional support. With our forecasts largely unchanged, we think monetary policy will have to continue to do the heavy lifting given that there has been little response to date on the fiscal front.
- In addition to stalling momentum in wages growth and continued below-target inflation in Q3, growth remained weak with the national accounts showing a modest growth 0.4% q/q. Again, private demand remained weak with dwelling investment falling further and consumption growth weakening. While exports and the public sector again provided an offset to this weakness (see our GDP note released today).
- Further out the shape of our forecasts remains unchanged. We expect year average growth of 1.6% this year and despite a small improvement, below trend growth of 2.1% and 2.4% in 2020 and 2021. We expect ongoing weakness, with household consumption growth remaining soft and dwelling investment continuing to fall in 2020 before levelling out in 2021. We expect modest growth in business investment with the drag from mining having faded but activity in the non-mining sector still weak. We see public spending as a key support to growth over the next two years, with the continued roll-out of the NDIS and a large infrastructure spending pipeline. In the near-term, exports will provide support with the last of the LNG mega-projects reaching capacity, before exports level off.
- With private sector growth remaining weak, we see slowing in employment growth and a small rise in the unemployment rate. With unemployment reaching 5.5% by end 2020 – and hovering well above the NAIRU – we see only a modest lift in inflation but for it to remain below the RBA's target band for a significant portion of the next 24 months. In addition, global inflation remains low and without a material deterioration in the exchange rate inflation will pose little constraint on monetary easing.
- Fiscal policy is still likely to be the more appropriate policy response. While spending on infrastructure work is already high, ensuring an ongoing pipeline that is 'shovel ready' and has moved through the design and approval processes will allow for continued support to growth. Similarly, we think there is a need for renewed focus on structural policy to lift productivity growth over the medium term, which would in turn provide support for wage growth. In the short-run a bring forward of mooted tax cuts or increases to Newstart payments would provide more support to households.
- Should the RBA move to unconventional policy in an attempt to provide further stimulus to the economy, these actions are likely to come in the form of outright secondary market purchases of government securities. It is likely that initially these purchases would include AGS but Governor Lowe has not ruled out purchases of semi-government securities. Intervention in money markets – though common for the RBA – is unlikely without a widening in spreads due to liquidity pressure. As is the purchase of RMBS securities or bank paper while the flow of credit remains healthy.

Contacts: Alan Oster – Chief Economist

AUTHORS

Alan Oster, Group Chief Economist
Ivan Colhoun, Global Head of Research
Kieran Davies, Market Economics
Gareth Spence, Senior 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