NAB CHANGE IN CASH RATE CALL 30 JANUARY 2020

RBA LIKELY TO STAY ON HOLD IN FEBRUARY - WITH LABOUR MARKET CONDITIONS BUYING TIME. BUT CUTS ARE STILL COMING

NAB Economics

The RBA will stay on hold in February, using the recent improvement in the unemployment rate to buy time – suggesting the bank will continue to react to the accumulation of evidence very gradually. It is important to note that the framework for monetary policy still suggests that rates should be lower. Inflationary pressure remains weak and recent headwinds – particularly for consumption and business investment - are likely to persist. Notwithstanding the recent dip in the unemployment rate, a large degree of spare capacity remains in the labour market with little progress having been made over the last year in reducing unemployment. Nonetheless, unless the RBA wishes to move against market expectations, the February cut appears off the table. Consequently, we have moved the timing of the next cut to April followed by a second cut around mid-year. Beyond that the risk of a move to 'unconventional' policy in H2 2020 will depend critically on whether the labour market deteriorates more significantly than we forecast. By April, the RBA will have confirmation of another quarter of weak consumer spending with further evidence that interest rate and tax cuts to date have not done enough to boost spending. We will review our GDP forecasts over the next week or so as more information comes in on the indirect effects of the bushfires and coronavirus on activity and ultimately the labour market.

- The stronger than expected December labour market data has provided time for the RBA to further assess the data flow. While the RBA staying on hold in February is expected by the market, we still think the RBA will regret not moving earlier this year – as was also the case in 2019 – as consumer spending trends remain very soft. The December NAB survey also suggests that private sector economic momentum, while it didn't collapse in late 2019, remains stalled.
- Ultimately the RBA's policy path will depend on where the economy and the labour market goes from here. We remain of the view that the economy – and consumer spending in particular - will continue to underperform and probably more than the RBA expects – albeit new RBA forecasts will be published later this week and will likely contain a softer near-term growth outlook.
- An early estimate of the short-term bushfire impact could well see average GDP growth in 2020 slow to around 1.5% or lower, with unemployment starting to rise to around 5.5% by H2 2020. While we will be assessing the indirect disruption effects of the fires over coming weeks it seems likely that Q1 GDP will be negative. We are quite worried that the January NAB Survey will further highlight that the indirect effects were larger than most expect. Internal data on income growth suggests that wages growth may have weakened in late 2019. Indeed, our analysis suggests household cash flows weakened further in late 2019. It is too early to assess the impact of the Coronavirus but clearly it will also not be a positive. Next week we will formally review our GDP forecasts ahead of the next NAB business survey release.
- The bushfire rebuild will add somewhat to growth in the out years but we do not see that as significant in 2020 – rather it is likely to be a 2021 issue. Also, the fiscal outlay on the fires (at $2billion over two years) is not likely to be a game changer in terms of the near term macroeconomic outlook. We still see scope for more support from a material fiscal package. That does not appear to be on the government's agenda. 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. Whether the RBA moves to unconventional policy will very much depend on whether the economy strengthens in H2 2020 and unemployment continues its recent gains. We fear that will not be the case. Beyond that, the shape of the 2020/21 Federal Budget will be important.
- While we can understand the RBA's position of taking more time to assess the outlook, that in our view is only sustainable for a short period. By April it will be clear that private sector growth continues to flat line, consumer spending remains soft and potentially that recent unemployment gains are not sustained. That combination means that further stimulus will be needed.

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