# NAB CHANGE IN POLICY VIEW 9 MARCH 2020

## RBA TO SOON UNDERTAKE YIELD CURVE CONTROL, REINFORCING FISCAL STIMULUS

*NAB Economics*

**NAB now expects the RBA to soon adopt unconventional monetary policy given the rapid coronavirus-driven deterioration in both the local and global economies, where Australia's economy is likely to have contracted in Q1. The RBA cut the cash rate in March to 0.5% in response to the outbreak and we continue to expect a follow-up cut to 0.25% in April. This means conventional monetary policy will soon reach its limit given the RBA has said it is unwilling to take the cash rate below 0.25%. This places unconventional policy on the table and we now forecast "yield curve control" to commence by May or June. Yield curve control is a form of quantitative easing where the RBA announces target levels for government bond yields and buys bonds if yields fail to settle at those targets. The timing is very fluid, depending on the state of the outbreak, the economy and financial markets, and the RBA could announce its plans as early as April. Increased containment efforts in Australia and the rest of the world would likely speed the path to unconventional policy. The functioning of short-term wholesale money markets is also critical to the effectiveness of the low cash rate, although in this respect the RBA has already said it will ensure the financial system has sufficient liquidity. Importantly, monetary and fiscal policy are now working in tandem. The Commonwealth government should announce spending and tax measures later this week, aiming to minimise job losses by shoring up the cash flow of affected businesses. The press reports this fiscal stimulus could total $10bn, or around 0.5% of GDP. More significant measures could be considered in the May budget and a greater reliance on fiscal policy is warranted given the nature of the shock and with conventional monetary policy near exhaustion. The economy will recover as the outbreak comes under control, hopefully by the end of this year, if not sooner, but until then easier policy has a critical role in providing support until the crisis abates.**

- The coronavirus is having a large and immediate negative impact on the world and Australian economies. Aggressive containment efforts have likely seen the Chinese economy contract in Q1, while world equity prices have slumped as the virus has rapidly spread to other countries, with some central banks cutting interest rates. Australia's economy was underperforming prior to the outbreak and GDP now looks to have contracted in Q1 given: (1) the travel ban on Chinese tourists and students that now extends to South Korea; (2) spillovers to other parts of the domestic economy; and (3) supply chain disruptions from the reliance on Chinese-manufactured inputs. NAB will publish updated economic forecasts in The Forward View on Wednesday.
- The RBA cut the cash rate to 0.5% in March and we continue to anticipate a further cut to 0.25% in April. This is the RBA's self-imposed floor for the cash rate and the point at which the RBA has said it would consider buying government securities to lower risk-free interest rates. We had previously regarded quantitative easing as a clear risk for H2 2020 if the economy turned out weaker than expected. The current situation clearly overrides that risk and we are now incorporating unconventional policy into our forecasts given the fall-out from the coronavirus. We are forecasting unconventional policy to commence by May or June, but this could change depending on the path of the virus and the state of the economy. Indeed, it is possible that the RBA sketches its plans as soon as April given how quickly things are changing.
- In terms of unconventional policy, the RBA is indirectly signalling a preference for the BoJ's "yield curve control". This involves setting target levels for government bond yields and buying bonds if actual yields fail to settle at the targets. The targets are likely to depend on market conditions at the time, but likely aim at flattening the yield curve and ensuring yields would stay very low until the world and Australian economies sustainably recover from this shock. One advantage of yield curve control is that the RBA avoids having to announce the size and mix of planned purchases in advance and may buy fewer bonds than would otherwise be the case.
- Overseas experience suggests that unconventional policy is best tied to economic objectives for inflation and unemployment, but there is the possibility that the RBA links it to the duration of the virus outbreak given its previous reluctance to undertake QE. In terms of the effectiveness of QE, experience in other countries suggests that it can help: (1) lower interest rates more broadly; (2) reduce liquidity premiums on other assets; (3) reduce bank funding costs to encourage lending; (4) encourage investors to switch into longer-dated/riskier assets; (5) signal the future path of policy; and (6) lower the exchange rate.

# 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