NAB CHANGE IN CASH RATE CALL 2 MARCH 2020

RBA TO CUT IN MARCH AND AGAIN IN APRIL

NAB Economics

We now expect the RBA to cut the cash rate tomorrow by 25bp and again in April, taking the cash rate to the RBA's self-imposed floor of 0.25% sooner than our original forecast of April and June cuts. We also see a risk of a 50bp cut tomorrow in an aggressive response to the unfolding growth shock resulting from the spread of coronavirus. The RBA should also signal its willingness to consider other measures should stress emerge in the financial system and markets (e.g. measures to support liquidity and ongoing access to credit markets). While we have long factored in further rate cuts given an underperforming economy, the coronavirus is having a large negative effect on China, which is Australia's largest trading partner, and also in the local economy, with the travel ban curbing tourism and education exports and spill-overs to local spending and disruptions to supply chains. The virus outbreak represents both a supply shock and a demand shock, likely significantly weighing on business and consumer sentiment. Lower interest rates can help cash flows, lower the exchange rate and potentially boost confidence, but easier fiscal policy will also be required, particularly when both the household sector and business investment are already weak. Measures to assist firms manage across cash flow impacts (such as delaying tax payments) would likely be helpful. We also expect the US Federal Reserve will cut rates by at least 25 bps this month.

- Since the RBA's previous board meeting the spread of coronavirus has worsened and markets have become increasingly concerned about the impact to the real economy and global growth. While little official data is available to confirm the magnitude of the impacts on global growth, partial data point to a collapse in activity in February and China's importance as a consumer and in global supply chains presents a significant risk to global trade and therefore growth in trade-exposed economies. The virus's rapid spread to other countries presents further risk with the likelihood of consumers and businesses unable to go about their usual activities in those countries as well.
- The RBA is also likely to react to policy action by other central banks, with the exchange rate also playing an important role in the transmission of easier policy.
- To date we have factored in the impact of the virus in the short-term, and see a small fall in GDP in Q1. Beyond that we have pencilled in a small recovery in growth, but for growth to remain below trend for the most part of the next two years (1.3% in 2020 and 2.7% in 2021). Consequently, this sees the unemployment rate drift higher, reaching around 5.5% by end 2020. Inflation risk remains low and poses no constraint to easier monetary policy. A key risk to our forecasts is that the impact of the coronavirus is both deeper and more protracted, this would necessarily see a downgrade to our outlook for growth, a sharper deterioration in the labour market and the need for unconventional policy as the RBA reaches the zero lower bound. That said, fiscal policy could also play a role, and in our opinion, should be used to support monetary policy in addressing the current virus outbreak.
- The US Federal Reserve is also likely to cut the fed funds rate this month by at least 25bps. The Fed Chair put out a statement last Friday indicating that the Fed was ready to use its tools to support the economy, foreshadowing the possibility of a rate cut this month. While a rate cut will not address the direct risks associated with the coronavirus, and related containment efforts and community reaction, the Fed will be keen to ensure that financial market disruption does not add to the damage. A theme of US Fed research has been that, with policy room limited, the best response to a shock is to act quickly and aggressively – so a 50bp cut is possible.
- We will update out rate track further out, alongside our usual update to our growth and labour market forecasts over the next week. Alongside this, we will revisit the magnitude and timing of expected unconventional policy. We will also provide an update to our US and Global forecasts.

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