

# AUSTRALIAN MARKETS WEEKLY

*RBA to soon undertake yield curve control, reinforcing fiscal stimulus*



## In this issue

RBA to soon adopt yield curve control 2

Calendar of economic releases 3

Forecasts 4

## Analysis – RBA to soon undertake yield curve control, reinforcing fiscal stimulus

- NAB continues to expect the RBA to cut the cash rate to 0.25% in April and is now forecasting that the RBA adopts unconventional policy by May or June to help the economy deal with fall-out from the coronavirus outbreak.
- NAB expects the RBA to implement "yield curve control". This is a form of quantitative easing, where the central bank sets target levels for government bond yields and buys bonds if yields fail to settle at the targets.
- The economy will recover as the outbreak comes under control, hopefully by the end of this year, if not sooner, but until then both easier monetary and fiscal policy have a critical role in providing support until the crisis abates.

## The week ahead – AU fiscal stimulus & NAB business survey; RBNZ speech; COVID-19

- **Australia.** The Commonwealth is set to announce its stimulus package this week to counteract the economic impact of COVID-19. Reports suggest the measures include: (1) wages subsidies to prevent job losses; (2) cash injections and tax breaks to help businesses' cash flow; and (3) an investment allowance to encourage capital expenditure. On Tuesday the February NAB business survey will provide an early gauge of COVID-19 impacts on business conditions. Home loan data on Wednesday should see a further rise in owner-occupier loan approvals. Deputy Governor Debelle speaks on Wednesday.
- **NZ.** Wednesday's electronic card transactions and Friday's PMI will give early clues to COVID-19 impacts. RBNZ Governor Orr's Tuesday speech on unconventional policy tools is linked to a long-signalled policy paper on this issue, rather than a direct response to the recent economic and financial turmoil.
- **International.** In China, the focus remains on the pace of recovery in production. In the US, confidence measures will be important to track for COVID-19 impacts. Thursday's ECB meeting has markets pricing another 10bp cut to the deposit rate to 0.6%, likely with TLTROs to enhance the availability of bank finance. Markets will also look for fiscal support, especially from Germany. Wednesday's UK budget was intended to be expansionary even before the COVID-19 outbreak. Wednesday's January GDP, industrial production and trade reports will be worth a look to gauge the health of the economy prior to COVID-19.

## Key markets over the past week

	Last	% chg week		Last	bp/% chg week
AUD	0.6518	-0.3	RBA cash	0.50	-25
AUD/CNY	4.52	-0.6	3y swap	0.55	0
AUD/JPY	66.9	-5.5	ASX 200	5,829	-8.8
AUD/EUR	0.572	-2.7	Iron ore	84	-2.7
AUD/NZD	1.042	-0.2	Brent oil	32.3	-37.8

Source: Bloomberg

## RBA to soon adopt yield curve control

- **NAB continues to expect the RBA to cut the cash rate to 0.25% in April and is now forecasting that the RBA adopts unconventional policy by May or June to help the economy deal with fall-out from the coronavirus outbreak.**
- **NAB expects the RBA to implement “yield curve control”. This is a form of quantitative easing, where the central bank sets target levels for government bond yields and buys bonds if yields fail to settle at the targets.**
- **The economy will recover as the outbreak comes under control, hopefully by the end of this year, if not sooner, but until then both easier monetary and fiscal policy have 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 now expects the RBA to soon adopt unconventional monetary policy given this rapid virus-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 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;

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.

Alan Oster, Ivan Colhoun, Kieran Davies, Gareth Spence

# CALENDAR OF ECONOMIC RELEASES

Country	Economic Indicator	Period	Forecast	Consensus	Actual	Previous	GMT	AEDT
<b>Monday 09 March 2020</b>								
GE	Industrial Production WDA YoY	Jan		--		-6.8	7.00	18.00
CA	Housing Starts	Feb		--		213.224	12.15	23.15
<b>Tuesday 10 March 2020</b>								
NZ	ANZ Truckometer Heavy MoM	Feb		--		4.8	21.00	8.00
AU	NAB Business Conditions	Feb		--		3	0.30	11.30
NZ	RBNZ's Governor Orr speaks on unconventional						1.00	12.00
CH	PPI YoY	Feb		-0.3		0.1	1.30	12.30
CH	CPI YoY	Feb		5.2		5.4	1.30	12.30
CH	Money Supply M2 YoY	Feb		8.5		8.4		
CH	New Yuan Loans CNY	Feb		1100		3340		
US	NFIB Small Business Optimism	Feb		103.4		104.3	10.00	21.00
EC	GDP SA QoQ	4Q F		--		0.1	10.00	21.00
EC	GDP SA YoY	4Q F		--		0.9	10.00	21.00
<b>Wednesday 11 March 2020</b>								
NZ	Electronic card transactions	Q4	-0.3	--		0.3	21.45	8.45
AU	RBA's Debelle speaks on Investment						22.00	9.00
AU	Westpac Consumer Conf Index	Mar		--		95.5	23.30	10.30
UK	Monthly GDP (MoM)	Jan		--		0.3	9.30	20.30
US	CPI YoY	Feb		2.2		2.5	12.30	23.30
<b>Thursday 12 March 2020</b>								
JN	PPI YoY	Feb		1		1.7	23.50	10.50
AU	Consumer Inflation Expectation	Mar		--		4	0.00	11.00
EC	Industrial Production WDA YoY	Jan		--		-4.1	10.00	21.00
US	PPI Final Demand YoY	Feb		1.7		2.1	12.30	23.30
EC	ECB Deposit Facility Rate	Mar 12		-0.6		-0.5	12.45	23.45
EC	ECB Main Refinancing Rate	Mar 12		0		0	12.45	23.45
EC	ECB Marginal Lending Facility	Mar 12		0.25		0.25	12.45	23.45
<b>Friday 13 March 2020</b>								
NZ	BusinessNZ Manufacturing PMI	Feb		--		49.6	21.30	8.30
NZ	Food Prices MoM	Feb	-0.7	--		2.1	21.45	8.45
GE	CPI YoY	Feb F		--		1.7	7.00	18.00
US	U. of Mich. Sentiment	Mar P		95.5		101	14.00	1.00
<b>Upcoming Central Bank Interest Rate Announcements</b>								
Europe, ECB		Mar 12	-0.50	-0.60		-0.50		
Japan, BoJ		Mar 19	-0.10	-0.10		-0.10		
US, Federal Reserve		Mar 18	0.75/1	0.75/1		1/1.25		
New Zealand, RBNZ		Mar 25	0.75	0.75		1.00		
UK, BOE		Mar 26	0.75	0.75		0.75		
Australia, RBA		Apr 7	0.25	0.50		0.50		

GMT: Greenwich Mean Time; AEDT: Australian Eastern Daylight Time

# FORECASTS

Exchange Rate Forecasts						
	9-Mar	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
<b>Majors</b>						
AUD/USD	0.654	0.68	0.69	0.70	0.70	0.71
NZD/USD	0.63	0.64	0.65	0.66	0.66	0.66
USD/JPY	102.6	109	109	109	109	109
EUR/USD	1.14	1.08	1.10	1.12	1.13	1.14
GBP/USD	1.31	1.30	1.31	1.32	1.33	1.35
USD/CNY	6.94	7.10	7.05	7.00	7.00	6.95
USD/CAD	1.36	1.30	1.29	1.28	1.27	1.27
USD/CHF	0.92	0.99	0.97	0.96	0.96	0.95

Australian Cross Rates						
	9-Mar	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
AUD/NZD	1.04	1.06	1.06	1.06	1.06	1.08
AUD/JPY	67.1	74	75	76	76	77
AUD/EUR	0.57	0.63	0.63	0.63	0.62	0.62
AUD/GBP	0.50	0.52	0.53	0.53	0.53	0.53
AUD/CNY	4.54	4.83	4.86	4.90	4.90	4.93
AUD/CAD	0.89	0.88	0.89	0.90	0.89	0.90
AUD/CHF	0.60	0.67	0.67	0.67	0.67	0.67

Interest Rate Forecasts						
	9-Mar	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
<b>Australian Rates</b>						
RBA cash rate	0.50	0.25	0.25	0.25	0.25	0.25
3 month bill rate	0.55	0.40	0.40	0.40	0.40	0.40
3 Year Swap Rate	0.55	0.50	0.45	0.35	0.45	0.55
10 Year Swap Rate	0.84	1.02	1.02	0.92	1.02	1.12
<b>Offshore Policy Rates</b>						
US Fed funds	1.25	1.50	1.50	1.50	1.50	1.50
ECB deposit rate	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
BoE repo rate	0.75	0.75	0.75	0.75	0.75	0.75
BoJ excess reserves rate	-0.10	-0.30	-0.30	-0.30	-0.30	-0.30
RBNZ OCR	1.00	1.00	1.00	1.00	1.00	1.00
China 1yr lending rate	4.35	4.10	4.10	4.10	4.10	4.10
China Reserve Ratio	12.5	12.0	12.0	12.0	12.0	12.0
<b>10-year Bond Yields</b>						
Australia	0.61	0.90	0.90	0.80	0.90	1.00
United States	0.51	1.80	1.80	1.80	1.90	2.00
New Zealand	0.84	1.05	1.10	1.30	1.45	1.70

Sources: NAB Global Markets Research; Bloomberg; ABS

Global GDP				
	2018	2019	2020	2021
Australia	2.7	1.7	1.3	2.7
United States	2.9	2.3	1.8	1.9
Eurozone	1.9	1.2	1.0	1.4
United Kingdom	1.3	1.4	1.0	1.4
Japan	0.3	1.1	0.4	1.0
China	6.6	6.1	5.5	5.8
India	7.4	5.1	6.2	7.1
New Zealand	3.2	2.2	1.7	2.3
World	3.6	3.0	3.0	3.5

Commodity prices (\$US)						
	9-Mar	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
Brent oil	32.4	58	60	62	62	62
Gold	1672	1540	1560	1580	1580	1590
Iron ore	na	76	72	68	71	69
Hard coking coal*	161	152	150	148	151	147
Thermal coal	66	68	65	70	70	66
Copper	5589	5725	5750	5850	5900	5950
Aus LNG**	9	10	11	11	11	11

\* FOB quarterly contract prices (thermal coal is JFY contract)

\*\* Implied Australian LNG export prices

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