NAB Monetary Policy Update 20 May 2025

RBA cuts by 25bp and moves to a more dovish stance

NAB Economics

Key points

- The RBA cut by 25bps to 3.85%
- Final sentence of the post meeting statement now focussed on both sides of the mandate
- Forecast revisions are modest but supportive of more comfort moving away from restrictive policy than the February outlook
- NAB now expects a 25bp rate cut in July, August and November for a terminal rate of 3.1%

Bottom Line

The RBA cut the cash rate by 25bp today, to 3.85%. This was in line with market pricing and the consensus view of economists, but a smaller cut than the NAB forecast (50bps cut). Nonetheless, the Governor did acknowledge that a 50bp cut was discussed by the Board today.

The Statement has evolved in a dovish direction since April, with the final sentence now acknowledging both sides of the RBA's dual mandate: *"The Board is focused on its mandate to deliver price stability and full employment and will do what it considers necessary to achieve that outcome."*

This is a marked change from April, where the final sentence was focused on inflation only*: "The Board is resolute in its determination to sustainably return inflation to target and will do what is necessary to achieve that outcome".*

Rhetoric on inflation now reflects greater comfort with the inflation forecast. Risks to inflation are described as *"more balanced",* a change from April, where it was noted that there were *"…risks on both sides and the Board is cautious about the outlook."*

Forecast changes in the quarterly SoMP were modest but generally consistent with a dovish bias. Core inflation was revised down slightly, the unemployment rate was revised higher and the 2025 GDP forecast was revised down. Weaker consumption outcomes were the main driver of the lower growth forecast.

These forecasts reflect the RBA's "Baseline Scenario", which assumes US-China tariffs remain around current levels, tariffs on other countries imposed by the US remain at 10%, with the stance of Chinese (and global) fiscal policy easing this year. The baseline scenario also assumes a cash rate of ~3.4% by December 2025.

The "Trade War" (downside) and "Trade Peace" (upside) scenarios are also based on a cash rate of 3.4% by year end. In the latter, inflation remains above 2.5% through the forecast horizon, while in the former, it slows to around 2% by December 2026. The assumptions underlying these scenarios embed a very large escalation/reversal in trade policy. Current market pricing expects a further 65bp of easing by year end, which seems a little on the low side for investors who see some risks of re-escalation in trade policy.

Overall, the Board assesses monetary policy after today's move to be *"…somewhat less restrictive".* This opens the door to further easing given 1) the modal forecast for below trend growth in 2025; 2) risks around a re-escalation of trade tensions; and 3) evidence of a growing acceptance that the outlook for the labour market is consistent with inflation near target.

NAB now expects the Bank to cut by 25bp in July, August and November, taking the cash rate to 3.1% by year end. We have pared the pace and depth of easing relative to our previous forecast in recognition that the headwinds from the global backdrop, while still material, have eased. Uncertainty remains elevated, and so it is possible that any re-escalation would weigh on both growth and inflation in Australia, and result in an assessment that stimulatory policy may be required.

RBA Forecasts

The RBA made only modest revisions to their forecast profile relative to the February SoMP but the direction of revisions was all consistent with a more accommodative path for policy than had been expected at the February SoMP. The baseline forecasts are conditioned on a policy rate that declines to 3.4% by year end and settles at 3.2% by mid 2026, US tariffs that remain at their current levels and Chinese authorities that mitigate the adverse impact of tariffs on economic activity to achieve robust 2025 growth of 4.8%. The RBA also noted that it now judges global trade developments to be disinflationary in net terms, in line with NAB's assessment.

- GDP growth has been revised lower to 2.1% over 2025 (from 2.4%). The downward revision is due to both weaker global growth and higher policy uncertainty, and partial data for Q1 that suggests a less pronounced pick up in consumption. NAB's forecasts are for modestly softer growth over 2025 (1.8%) but are aligned further out in expecting GDP growth near trend (Chart 2).
- The RBA now expects the unemployment rate to stabilise at 4.3% (from 4.2%). That is 'closer to balance' and the RBA notes 'considerable uncertainty around estimates of full employment'. The SoMP also noted that "*the observed decline in the rate of job-switching in the market sector might indicate less upwards pressure on wages growth and inflation than implied by the unemployment rate.*" We have highlighted similar themes in previous NAB research and remain comfortable that the labour market is nearer balance than the RBA had been assessing. NAB sees slight upside risk to the RBA's unemployment track (Chart 3)
- The trimmed mean inflation forecast now settles at 2.6% (from 2.7%). That small downward revision reflects the downward revision to GDP growth and a small downward revision to import prices. Importantly though, that is now assessed as 'around the midpoint' of the target range. The February outlook was characterised as 'a bit above.'

The SoMP includes scenarios of a much more material increase in tariff barriers on the downside, and a reversal of US import tariffs to 2024 levels and a quick and sharp decline in uncertainty on the upside.

Chart 1: GDP forecasts

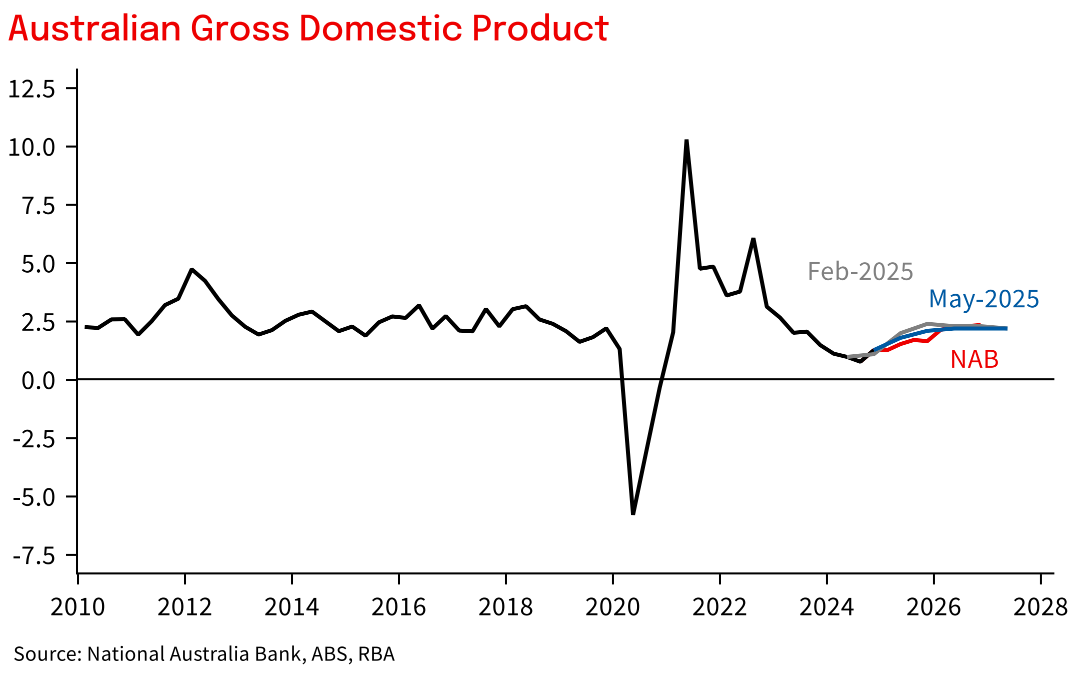


Chart 2: Unemployment forecasts

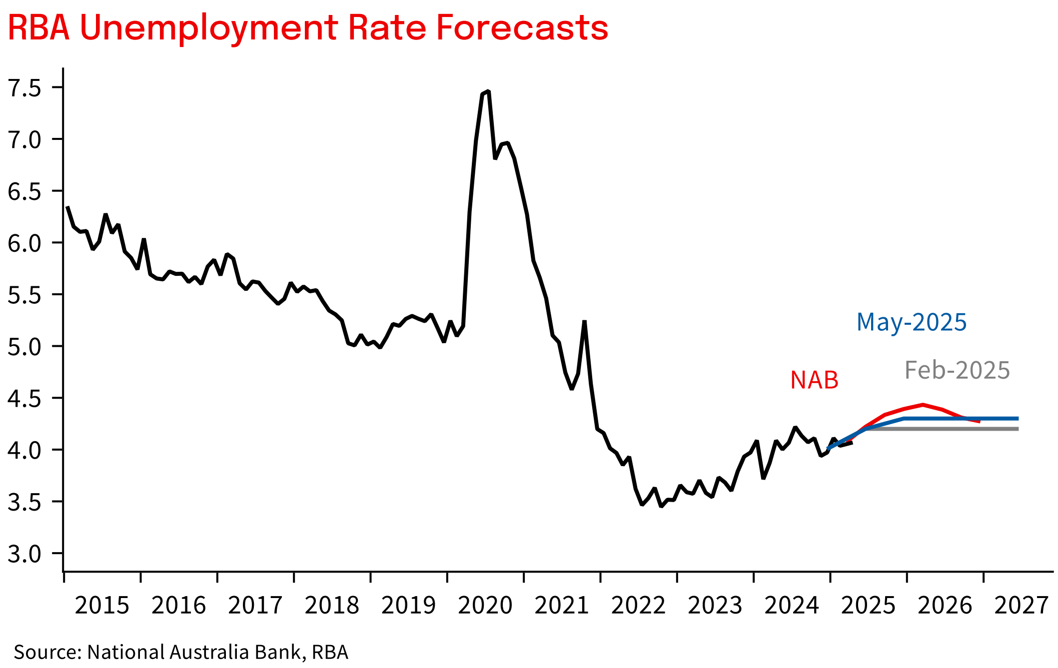
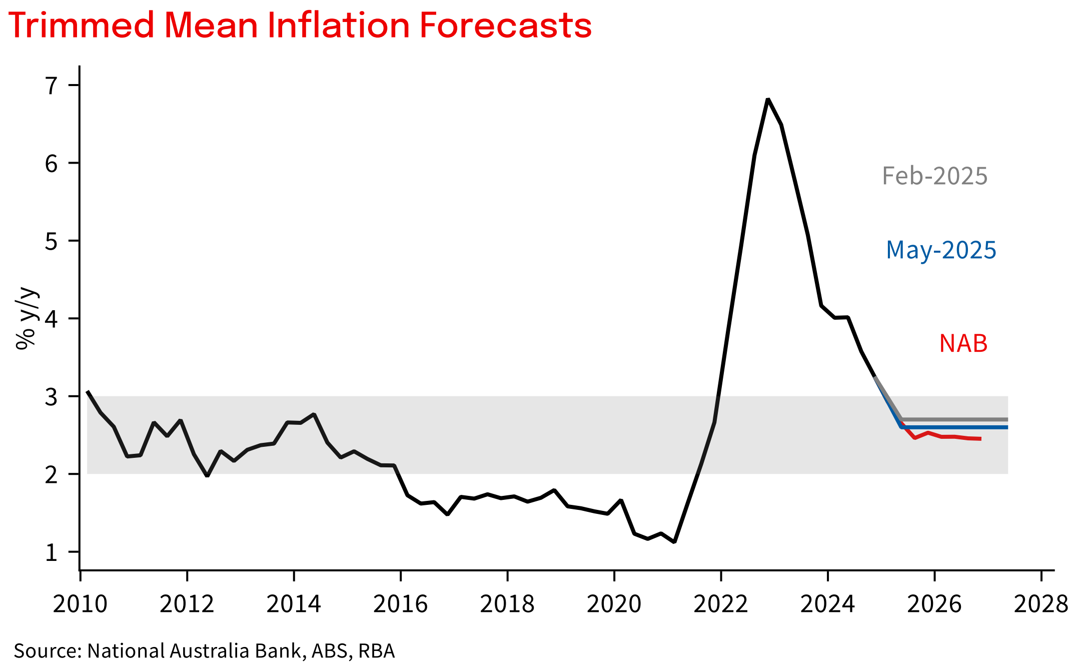


Chart 3: Underlying inflation forecasts



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