Friday, 6 November 2020

RBA Statement on Monetary Policy

RBA Forecasts a Stronger Recovery

The Reserve Bank (RBA) released its quarterly Statement on Monetary Policy earlier today. It provided insights on the RBA's thoughts around the outlook. This SoMP includes the full detail of its updated forecasts.

The RBA starts the statement by noting that economic developments, here and abroad, continue to be driven by the pandemic and the responses to it. In most countries, economic activity remains below pre-pandemic levels.

In Australia, the decline in activity was sharp and sudden. However, Australia's early success in bring infection rates down allowed restrictions on activity to be eased earlier than the RBA had anticipated.

The easing of restrictions, combined with the Budget's policy responses and the RBA's own policy changes, has led to RBA to lift its outlook for economic growth.

Given the high level of uncertainty surround outlook, the RBA continues to provide three sets of forecasts for the major economic variable. It has its baseline scenario, a plausible downside scenario and then an upside scenario.

The major forecasts, together with changes from the August Statement, are shown in the table over the page.

GDP Forecasts

The RBA's near-term baseline scenario is now more optimistic. In the August Statement, GDP was expected to decline 6% in the year to December 2020. The decline is now expected to be 4%.

Better growth in the near-term is predicated upon stronger household consumption and public demand. The Federal Budget outlined its spending measures in October and the RBA expects a further contribution to public demand from upcoming State government Budgets.

Household consumption is expected to be driven by personal tax cuts and a drawdown in savings built up during the June quarter.

The RBA is not expecting the economy to reach pre-pandemic levels of activity until the end of 2021. Slower population was mentioned a factor holding back the economy.

Beyond June 2021, the forecasts for GDP growth have been held steady. Growth of 5% is the baseline forecast for the year to December 2021 and 4% growth in the year to December 2022. These are more optimistic than out our forecasts which see GDP growth of 2.8% in the year to December 21 and 3.4% in the year to December 2022.

The plausible down-side scenario has economic activity still below pre-pandemic levels by the end of 2022 and is likely based on vaccine availability and international border restrictions.

Business Investment

The RBA expects a gradual recovery in non-mining business investment is expected to get underway in the first half of 2021 as the domestic recovery continues, led by investment in machinery & equipment.

Tax incentives introduced in the Federal Budget are expected to bring forward investment. These incentives, combined with reductions to interest rates, should ease the cash flow constraints that may have held back new investment.

The RBA notes that a sustainable pick-up in non-residential construction activity is not expected until late 2021 because of the typical long lags in the planning and approval of construction projects.

Mining investment is expected to be a little higher in the near term, led by work on iron ore and coal projects.

Unemployment

Under the previous baseline scenario in August, the unemployment rate had been anticipated to peak at around 10%. The peak has been pared back to a little under 8%. In September, the unemployment rate stood at 6.9%, so a deterioration in labour market conditions is expected in the near term.

There will be several cross-currents affecting the labour market in the near-term. The lifting of restrictions should assist employment, but the changes to JobKeeper seem likely to act in the opposition direction.

Labour market policies introduced in the Budget, such as the JobMaker Hiring Credit and subsidies for apprenticeships and traineeships, are expected to lift employment. Working in the opposite direction, in terms of measuring the unemployment rate, will be an expected increase in the participation rate as underlying labour market conditions improve.

Under the RBA's baseline forecast, the unemployment rate is forecast to sit at 6% in December 2022. The is well below full employment, hence the RBA's expectation that the cash rate will not rise for at least three years. It is also lower than our forecast. We expect an unemployment rate of 6.6% by December 2022.

Inflation

The RBA's outlook for underlying inflation in the baseline scenario is little changed from its August forecasts. The annual rate of inflation is expected to remain very subdued at 1.5% in the December quarter of 2022. This reflects the anticipated high level of spare capacity that remains in the economy.

Sitting behind the RBA's inflation forecast is its outlook for wages growth. It expects the underemployment to remain high for the next few years suggesting limited upward pressure on wages. Wage growth is expected to remain below 2% per annum over the next few years.

RBA Policy Outlook

Today's Statement made no departures from comments made at the time of Tuesday's easing.

The forecasts contained in the Statement are consistent with the notion that monetary policy will not be tightened until actual inflation is sustainably within the 2-3% target band and that the labour market is close to full employment. We expect this to be at least three years if not more.

The Governor has said that prior to any increase in the cash rate, the RBA's target for three-year bond yields would be lifted.

Australian Dollar

The Statement had little to say about the level of the Australian dollar (AUD) or its outlook. It did note that the AUD is a touch lower than historical relationships with the terms of trade and interest-rate differentials would suggest.

In a speech earlier in the week, the RBA Governor said that one of the aims of pushing the Australian yield curve lower was to keep the AUD lower than it might otherwise have been. Since rates were reduced this week the AUD has risen from US$0.7228 up to a six-week high of US$0.7289 earlier today.

Despite the RBA's best efforts, we expect the AUD to rise to $US0.7500 by the end of the year. It may well have moved higher if not for the RBA's action. Our forecast rise in the AUD reflects a weaker US dollar, as well as our trade links to China's V-shaped economic recovery.

Table 6.1: Output Growth and Inflation Baseline Forecasts[a],[b]
Per cent

	Year-ended					
	Jun 2020	Dec 2020	Jun 2021	Dec 2021	Jun 2022	Dec 2022
GDP growth	−6.3	−4	6	5	4	4
(previous)	(−6)	(−6)	(4)	(5)	(4)	(4)
Unemployment rate[c]	7.0	8	7½	6½	6½	6
(previous)	(7.0)	(10)	(9)	(8½)	(7½)	(7)
CPI inflation	−0.3	½	2¼	1	1¼	1½
(previous)	(−0.3)	(1¼)	(3)	(1)	(1¼)	(1½)
Trimmed mean inflation	1.2	1	1¼	1	1¼	1½
(previous)	(1.2)	(1)	(1¼)	(1)	(1¼)	(1½)
	Year-average					
	2019/20	2020	2020/21	2021	2021/22	2022
GDP growth	0	−4	−2	3	4	4
(previous)	(0)	(−4)	(−3)	(2)	(5)	(4)

(a) Forecast assumptions (August Statement in parenthesis): TWI at 60 (61), A$ at US$0.70 (US$0.72), Brent crude oil price at US$42/bbl (US$46/bbl); the cash rate remains around its current level and other elements of the Bank's monetary stimulus package are in line with the announcements made following the November Board meeting.
(b) Rounding varies: GDP growth to the nearest whole number; unemployment rate to the nearest half point; inflation rates to the nearest quarter point. Shaded regions are historical data and are shown to one decimal place. Figures in parentheses show the corresponding baseline scenario forecasts in the August 2020 Statement.
(c) Average rate in the quarter

Sources: ABS; RBA

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