Data snapshot

Friday, 7 August 2020

RBA Statement on Monetary Policy

RBA Forecasts a Slower Recovery

The Reserve Bank released its quarterly Statement on Monetary Policy earlier today, which 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 the economic contraction over the first half of this year was smaller than anticipated three months ago. But adds the pace of recovery is expected to be slower than previously forecast. Uncertainty and deficiency in demand have dragged on growth by more than previously thought.

The RBA expects the measures taken to address the current outbreak in Victoria to further delay the economic recovery. Indeed, the most recently announced containment measures are expected by the RBA to subtract at least 2 percentage points from national growth in the September quarter, relative to the counterfactual where the renewed outbreak had not occurred.

GDP Forecasts

The heightened level of uncertainty that marks the economy means the RBA has considered the outlook again in terms of three scenarios. In the baseline scenario, the Australian economy is expected to shrink by about 6% over 2020, before growing by around 5% over 2021 and 4% over 2022. The RBA'S forecast for 2020 is unchanged from its previous SoMP, while the forecast for 2021 has been cut by 1 percentage point. The inclusion of a forecast for 2022 is new.

Notably, these forecasts still leave the level of output at the end of 2022 below where output would have been had the pandemic not occurred, underscoring the long road to recovery.

Business Investment

The RBA expects business investment to decline significantly this year. In surveys and liaison, many firms have reported to the RBA that they have already deferred or cancelled discretionary investment spending. These decisions have generally not been mandated by health-related activity restrictions. Rather, firms have reacted to actual and anticipated declines in demand and the heightened uncertainty about the future, and have scaled back spending in an effort to preserve liquidity. The RBA expects business investment to be slow to recover. Businesses will likely wait to see demand recover before committing to expand capacity.

Unemployment

Under the baseline scenario, the unemployment rate is also expected to peak at around 10% by the end of this year. The timing is later than previously anticipated by the RBA at the time of the last SoMP in May. The unemployment rate is then expected to drop to 8.5% in December 2021 and 7% in December 2022. The rate of unemployment consistent with full employment in the economy is 4.5%, so by the end of 2022, policymakers are expecting considerable slack in the labour market to exist.

Inflation

The annual rate of headline inflation in the baseline scenario is forecast at 1.25% for December 2020, 1.00% for December 2021 and 1.50% for December 2022. Trimmed-mean (or underlying) inflation is expected to increase gradually, reaching around 1.50% by the end of 2022. By the end of 2022, headline and underlying inflation will be growing at annual rates well below the RBA's inflation target band of 2-3% per annum over time.

RBA Policy Outlook

With both unemployment and inflation remaining a way off from the RBA's targets through to the end of December 2022, the RBA will not be hiking the cash rate any time soon. Low interest rates will characterise the economic landscape for time to come.

Earlier this year, on March 19, the RBA delivered a package of policy measures. Further stimulus was not ruled out in the SoMP today. The SoMP said the board has not ruled out adjusting this package in the future if circumstances warrant.

The cash rate is currently sitting at a record low of 0.25%. We think there is a growing risk the RBA could consider cutting to 0.10% if economic conditions warrant further easing. The RBA could also cut their target on the 3-year government bond yield from around 0.25% to 0.10% to further lower lending rates. Or it could target yields on longer-dated bond maturities.

Whatever the next move is, we do not expect it will be an adoption of negative interest rates. The RBA Governor recently made it clear that negative interest rates in Australia are "extraordinarily unlikely". Today's SoMP made no departures from this explicit message.

Australian Dollar

The RBA indicated that the Australian dollar is now in a range that is broadly consistent with its fundamental determinants. It suggests the RBA is not uncomfortable with the AUD's recent appreciation. The AUD/USD has risen from a 17½ low of 0.5510 on March 23 to a 14-month high of 0.7243 during trade today. We would not rule out the AUD stretching to be near 80 US cents within the next 9 months.

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