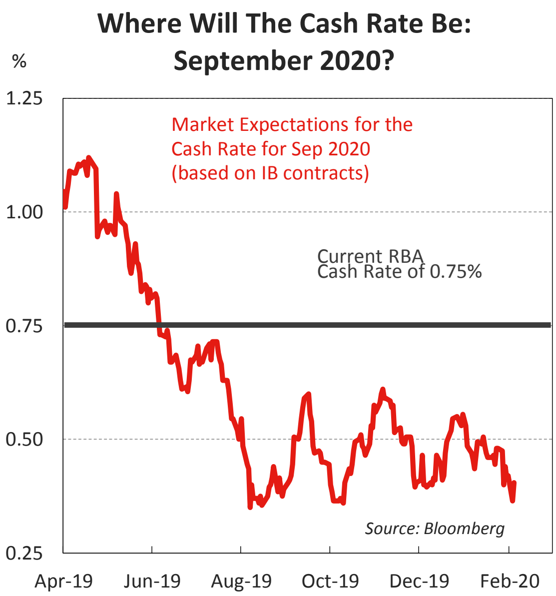
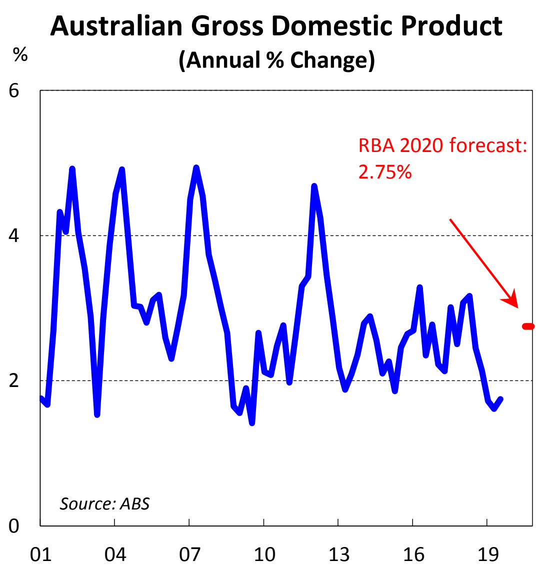
4 February 2020

RBA Cash Rate Outlook

RBA Holds Fire

- **The RBA returned from its summer break with a renewed sense of optimism. The RBA left the cash rate unchanged at 0.75%, having last cut rates in October 2019. The cash rate was cut three times in 2019.**
- **Today's statement was noticeably more upbeat. The statement contains clues suggesting that the RBA will be retaining its optimistic forecast for economic growth when it delivers its Statement on Monetary Policy (SoMP) on Friday.**
- **The RBA expects growth to reach trend (2¾%) this year and pick up to 3.0% growth in 2021. Our view is that growth is likely to be significantly below that, especially in light of the recent bushfires and coronavirus outbreak.**
- **The statement made the case that monetary policy easing to date has been working. It highlighted the positive effect of the lower exchange rate and pointed out the recent pick up in labour market outcomes. However, it acknowledged that more easing may be required**
- **It would be a challenge to achieve the RBA's forecasts of economic growth and underlying inflation this year without further easing. Economic growth is weak, and the outlook for consumer spending is soggy amid low wages growth and high household debt. We continue to expect two more cuts to the cash rate later this year.**





The Reserve Bank (RBA) decided to keep rates on hold today. Economic data domestically since the start of 2020 has been more positive. The RBA left the cash rate unchanged at 0.75%, having last cut rates in October. The cash rate was cut three times in 2019.

Previous statements have characterised the Australian economy as being at a gentle turning point. Today's statement was much more confident. The statement contains clues suggesting that the RBA will be upgrading its forecast for economic growth when it delivers its Statement on Monetary Policy (SoMP) on Friday. The RBA expects growth to reach trend (2¾%) this year and pick up to 3.0% growth in 2021. Our view is that growth is likely to be significantly below that, especially in light of the recent bushfires and coronavirus outbreak. We expect further easing will be required this year in order to support the RBA's objectives.

It appears that the RBA's upward revision to its growth forecast for 2020 is a result of an earlier recovery in residential construction investment than previously anticipated. Construction investment has been subdued since the housing market downturn that began in 2017, although building approvals appear to have turned a corner recently. House prices continue to recover strongly, and the increases have spread from Melbourne and Sydney to other capital cities.

Other factors that the RBA notes as supporting the economy are the low level of interest rates, the 2019-20 low-to-middle-income tax offset, house price growth, ongoing spending on infrastructure and a pickup in the mining sector.

The statement was noticeably more upbeat on the global economy, highlighting that "signs that the slowdown in global growth that started in 2018 is coming to an end." The statement made mention of the recent bushfires and coronavirus as contributing to uncertainty, however, it assessed that it was too early to determine the scale of the impact.

Despite the upbeat tone in today's statement, not all signs are pointing to lift-off for the domestic economy. The most recent GDP report for the September quarter showed annual growth at just 1.7%, a meagre 0.1 percentage point increase from 1.6% in the June quarter. Persistently low wages growth and high household debt have had a particularly dampening impact on household consumption. The RBA noted that wages growth is "subdued and is expected to remain at around its current rate for some time yet." The unemployment rate fell to 5.1% in December, but it remains above the level estimated at full employment of 4.5%.

Matching the more upbeat tone on growth, the statement realigned the RBA's assessment of the path of inflation. After previously forecasting inflation of "just below 2%" in 2020, the RBA said that "the central scenario is for CPI inflation to be around 2 per cent in the near term, and fluctuate around that rate over the next couple of years."

Finally, the RBA made the case that monetary policy easing to date has been working. It highlighted the positive effect of the lower exchange rate and pointed out the recent pick up in labour market outcomes. However, it acknowledged that more easing may be required, stating that "will continue to monitor developments carefully" and "remains prepared to ease monetary policy further if needed to support sustainable growth in the economy, full employment and the achievement of the inflation target over time."

Given the downside risks to the economy, and the lack of momentum in growth, we expect further easing will be required. We expect two more cuts will be required for the RBA's objectives to be achieved. The timing of these cuts is expected to be in April and August.

Nelson Aston, Economist
Ph: 02-8254-1316

Contact Listing

Chief Economist
Besa Deda
dedab@bankofmelbourne.com.au
(02) 8254 3251

Senior Economist
Janu Chan
chanj@bankofmelbourne.com.au
(02) 8253 0898

Economist
Nelson Aston
nelson.aston@bankofmelbourne.com.au
(02) 8254 1316