



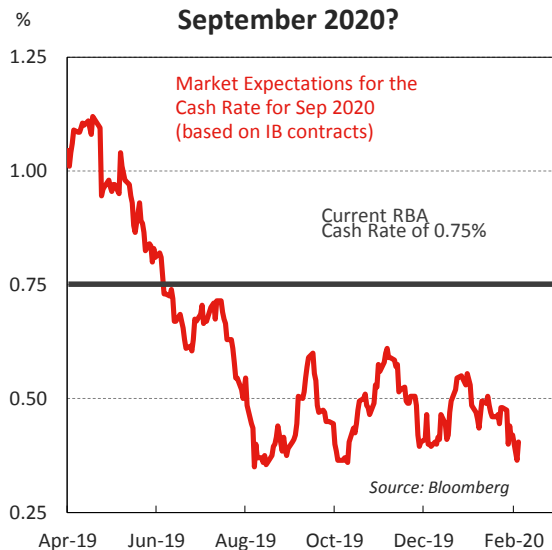
4 February 2020

RBA Cash Rate Outlook

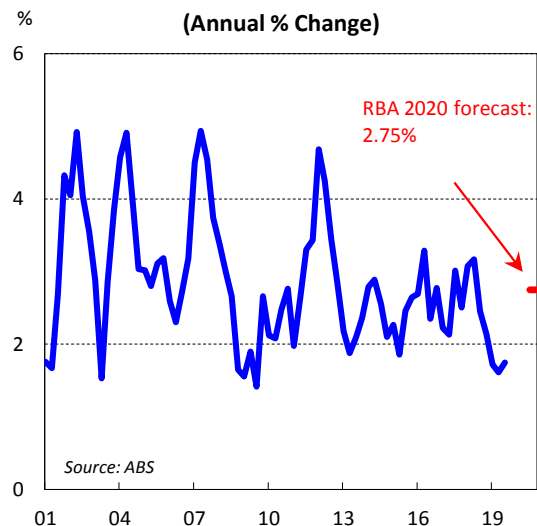
RBA Holds Fire

- 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.

Where Will The Cash Rate Be:
September 2020?



Australian Gross Domestic Product
(Annual % Change)



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 (2¼%) 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.

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

The Detail

The information contained in this report (“the Information”) is provided for, and is only to be used by, persons in Australia. The information may not comply with the laws of another jurisdiction. The Information is general in nature and does not take into account the particular investment objectives or financial situation of any potential reader. It does not constitute, and should not be relied on as, financial or investment advice or recommendations (expressed or implied) and is not an invitation to take up securities or other financial products or services. No decision should be made on the basis of the Information without first seeking expert financial advice. For persons with whom Bank of Melbourne has a contract to supply Information, the supply of the Information is made under that contract and Bank of Melbourne’s agreed terms of supply apply. Bank of Melbourne does not represent or guarantee that the Information is accurate or free from errors or omissions and Bank of Melbourne disclaims any duty of care in relation to the Information and liability for any reliance on investment decisions made using the Information. The Information is subject to change. Terms, conditions and any fees apply to Bank of Melbourne products and details are available. Bank of Melbourne or its officers, agents or employees (including persons involved in preparation of the Information) may have financial interests in the markets discussed in the Information. Bank of Melbourne owns copyright in the information unless otherwise indicated. The Information should not be reproduced, distributed, linked or transmitted without the written consent of Bank of Melbourne.

Any unauthorised use or dissemination is prohibited. Neither Bank of Melbourne- A Division of Westpac Banking Corporation ABN 33 007 457 141 AFSL 233714 ACL 233714, nor any of Westpac’s subsidiaries or affiliates shall be liable for the message if altered, changed or falsified.
