

Monday, 19 October 2020

## The Race That Stops The Nation Nears

Melbourne Cup Day is approaching. For economists, November 3 will also be a day that includes the next Reserve Bank (RBA) board meeting.

We expect the Reserve Bank to deliver a package of stimulus measures. We expect three things. The RBA cash rate to be cut by 15 basis points to 0.10%; the target rate on the 3-year government bond yields be cut to 0.10% and finally, an expansion of quantitative easing to include buying a specified volume of government bonds with maturities beyond three years.

Last week, the RBA Governor took to the podium and appeared to confirm that more stimulus was on the way. Philip Lowe noted that “as the economy opens up...it is reasonable to expect that further monetary easing would get more traction than was the case earlier”.

Lowe also flagged that policy would remain in stimulus mode for even longer. He noted that the RBA will now focus on actual inflation rather than inflation forecasts in its decision making. This new emphasis suggests rates will stay lower for longer because actual inflation will take some years before it returns to the RBA’s target band of 2-3% per annum. Indeed, the cash rate will not be moving up for at least three years.

When the RBA board last met, market consensus was almost fully priced for more stimulus before the end of this year. Tomorrow’s minutes from this meeting will be looked over very closely.

When the board met, the accompanying statement indicated that the peak in the unemployment rate would be cut from 10% to 8% before year’s end. This suggests an upward revision to the upcoming RBA GDP growth forecasts. The Federal Budget stimulus earlier this month led us to upgrade our growth forecasts for 2021 to 2.8%, from 2.5% previously.

Tomorrow, weekly payroll jobs and wages data for the latest fortnight (ending October 3) will be published. This data will not be eyed as closely as usual because last Thursday the official labour force figures for September were published. After strong gains in August, employment took a step backwards in September with the loss of 29.5k jobs. The unemployment rate shifted up to 6.9% in September, from 6.8% in August.

The bulk of the job losses in September occurred in Victoria where lockdowns continue to put the brakes on economic activity. The good news is that restrictions have been eased in Victoria and further restrictions, including the reopening of cafes, restaurants, bars and retail should occur soon.

The hard lockdown in metropolitan Melbourne should show up in the preliminary retail sales data for September out this Wednesday. We expect that nationally, retail sales fell again in September due to rising unemployment and consumer confidence remaining fragile.

The pace of online sales growth pulled back in August but remained much faster than spending in bricks-and-mortar stores. As a share of retailing, online spending has lifted from 6.0% in January 2020 to 10.6% in August 2020.

Retailing in Australia has performed better than anticipated during the pandemic. Access to superannuation and income-support measures have helped underpin spending. These income-support measures are due to be wound back over coming months and will test the resilience of the consumer. The back dating of personal income tax cuts to 1 July 2020 will help provide a buffer when the cash arrives.

Prior to the pandemic, retailers were facing challenges. Some rents in shopping centres were increasingly being linked to turnover, with a lower base rent component. The pandemic has led to downward pressure on rents intensifying. The pandemic has also led retailers to try and adapt to economic conditions by pivoting their products, adapting their business operations and/or going online to support and drive revenues.

RBA Governor Lowe last week stressed that “confidence in the health situation and the future state of the economy” would be the most important determinant of consumer spending and the shape of the economic recovery.

The high-frequency measure of consumer sentiment published by Roy Morgan suggests consumers are still pessimistic about the outlook, but pessimism has waned over the past six weeks. An update on consumer sentiment for the week ending October 18 is due tomorrow. The most recent reading was 97.7, up from 90.2 at the end of August.

Consumption patterns will continue to change. There are four core consumption themes in addition to the flight to online and omni-channel. There is the shift to spending on essential and “value” goods, as consumers look for value or discounts and spending is more devoted to groceries and essentials. There is the shock to loyalty, as household incomes come under pressure. There are also shifts to health and “caring”, as well as the “homebody” economy, as people focus on health, eat in more, renovate their homes and work from home. We expect some unwinding of these effects when the pandemic has passed or a viable vaccine appears.

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**Forecasts**

End Period:	2020		2021			
	Close (Oct 9)	Q4 (f)	Q1 (f)	Q2 (f)	Q3 (f)	Q4 (f)
<b>Aust. Interest Rates:</b>						
RBA Cash Rate, %	0.25	0.10	0.10	0.10	0.10	0.10
90 Day BBSW, %	0.08	0.04	0.04	0.04	0.04	0.04
3 Year Swap, %	0.13	0.08	0.08	0.08	0.08	0.08
10 Year Bond, %	0.87	0.80	0.90	1.00	1.05	1.15
<b>US Interest Rates:</b>						
Fed Funds Rate, %	0.13	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond, %	0.79	0.60	0.65	0.75	0.75	0.85
<b>USD Exchange Rates:</b>						
AUD-USD	0.7165	0.75	0.76	0.76	0.78	0.80
USD-JPY	106.03	105	105	106	106	106
EUR-USD	1.1759	1.21	1.22	1.23	1.24	1.25
GBP-USD	1.2938	1.33	1.34	1.35	1.37	1.39
NZD-USD	0.6577	0.67	0.66	0.66	0.68	0.70
<b>AUD Exchange Rates:</b>						
AUD-USD	0.7165	0.75	0.76	0.76	0.78	0.80
AUD-EUR	0.6093	0.62	0.62	0.62	0.63	0.64
AUD-JPY	75.99	78.8	79.8	80.6	82.7	84.8
AUD-GBP	0.5539	0.56	0.57	0.56	0.57	0.58
AUD-NZD	1.0896	1.12	1.15	1.15	1.15	1.14

	2019	2020 (f)	2021 (f)
GDP, %	2.2	-3.5	2.8
CPI (Headline), %	1.8	0.4	2.2
CPI (Trimmed mean), %	1.6	0.8	1.7
Unemployment Rate, %	5.2	7.7	7.6
Wages Growth, %	2.2	1.9	1.6

AUD cross exchange rates have been rounded.

Financial forecasts are quarter end.

GDP, CPI, employment and wage growth forecasts are year end.

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