Friday, 8 November 2019

RBA Statement on Monetary Policy

Another Trim to Growth Forecasts

- **Today's Statement on Monetary Policy confirmed that the Reserve Bank (RBA) has once again downgraded its near-term outlook for the economy. Further downside risks to the outlook suggest that the cash rate could be cut further. The RBA kept the cash rate at 0.75% on Tuesday, but left the door open for further easing should the economy fail to show meaningful signs of improvement.**
- **The downgrade in the growth forecast for 2019 had already been flagged in previous communications. The forecast for next year and for 2021 remained unchanged.**
- **The RBA expects GDP growth to be 2.25% in 2019 and 2.75% in 2020. It expects inflation to remain below its 2-3% target band until December 2021.**
- **On the labour market, the RBA appears to have conceded that the unemployment rate is likely to remain well above the level at full employment (which it estimates is 4.5%) for the remainder of the outlook. This spare capacity in the labour market means that it no longer expects a lift in wages in the near-term. It now expects the unemployment rate to remain steady at 5.2% until it begins to drift lower in mid-2021 before reaching 4.9% in December 2021.**
- **The Statement noted that the evident spare capacity in the economy and lack of progress in bringing inflation to its target range contribute to the case for further easing. The Board judged that there is not a case for "holding some stimulus in reserve to address potential future shocks". Its acknowledgement that further easing could begin to have less of an impact as rates approach the effective lower bound highlighted that the RBA has been at least contemplating unconventional monetary policies.**

A lot can happen in a year. One year ago the RBA was forecasting annual GDP growth of 3.25% and rate hikes were on the radar. Fast forward to today and the RBA now expects below-trend growth of 2.25% this year. One of the few things to have remained the same has been the US-China trade conflict. The fledgling trade war was flagged as a downside risk to global growth last year, and remains a headwind.

The downgrade in the RBA's 2019 GDP forecast was flagged on Tuesday when it kept the official cash rate at a record low 0.75%. Its other main forecasts were largely unchanged, with a small downgrade to its forecast for underlying inflation in 2021.

If the RBA's forecasts are correct, both headline and underlying inflation will remain below the 2-3% band until 2021. That would be 5 years of inflation below target. Consumer prices grew largely in line with expectations in the September quarter of 1.7% for the headline and 1.6% for underlying inflation. The RBA expects underlying inflation to dip to 1.5% in the December quarter before steadily rising to 2% by December 2021.

On the economy, the RBA highlighted its expectation that growth will improve from here. It expects the current main source of uncertainty –consumer spending– to gradually improve due to an increase in household disposable income and the wealth effect from the recent house price rebound in Sydney and Melbourne. Investment by the mining sector is expected to continue to support activity while public investment is forecast to continue to grow moderately. A key downside risk it highlights is residential construction investment, which has been falling sharply despite the pick-up in house prices.

Underpinning sluggish inflation has been a long period of tepid wages growth. The RBA noted in its Statement of Monetary Policy (SoMP) today that wages growth would be required in order for inflation to materially lift.

In order for wages to rise, there needs to be significant progress in tightening the labour market. On the labour market, the RBA appears to have conceded that the unemployment rate is likely to remain well above the level at full employment (which it estimates is 4.5%) for the remainder of the outlook. This spare capacity in the labour market means that it no longer expects a lift in wages in the near-term. It now expects the unemployment rate to remain steady at 5.2% until it begins to drift lower in mid-2021 before reaching 4.9% in December 2021.

The Statement noted that the evident spare capacity in the economy and lack of progress in bringing inflation to its target range contributed to the case for further easing. The Board judged that there is not a case for "holding some stimulus in reserve to address potential future shocks".

In considering monetary policy settings, the Board was mindful that rates were already very low and that each further cut brings closer the point at which other policy options might come into play. Its acknowledgement that further easing could begin to have less of an impact as rates approach the effective lower bound highlighted that the RBA has been contemplating unconventional monetary policies.

We continue to expect the RBA to cut rates one more time in February next year.

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The RBA's forecasts in full are detailed on the following page.

FORECASTS FROM THE RBA, November Statement on Monetary Policy

Table 5.1: Output Growth and Inflation Forecasts[(a)]

Per cent

	Year-ended					
	June 2019	Dec 2019	June 2020	Dec 2020	June 2021	Dec 2021
GDP growth	1.4	2¼	2½	2¾	3	3
(previous)	(1¾)	(2½)	(2¾)	(2¾)	(3)	(3)
Unemployment rate[(b)]	5.2	5¼	5¼	5¼	5	5
(previous)	(5.2)	(5¼)	(5¼)	(5¼)	(5)	(5)
CPI inflation	1.6	1¾	2	1¾	1¾	2
(previous)	(1.6)	(1¾)	(1¾)	(1¾)	(2)	(2)
Trimmed mean inflation	1.6	1½	1¾	1¾	1¾	2
(previous)	(1.6)	(1½)	(1¾)	(1¾)	(2)	(2)
	Year-average					
	2018/19	2019	2019/20	2020	2020/21	2021
GDP growth	2.0	1¾	2¼	2¾	2¾	3
(previous)	(2¼)	(2)	(2½)	(2¾)	(3)	(3)

(a) Technical assumptions set on 6 November include the cash rate moving in line with market pricing, TWI at 60, A$ at US$0.69 and Brent crude oil price at US$61 per barrel; shaded regions are historical data; figures in parentheses show the corresponding forecasts in the August 2019 Statement

(b) Average rate in the quarter

Sources: ABS; RBA

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