Tuesday, 5 May 2020

# Cash Rate Outlook

## Slivers of Improvement?

- **The Reserve Bank (RBA) left policy settings unchanged at its meeting today. These include the target for the cash rate and the 3-year government bond yield at 0.25%.**
- **However, the RBA announced it was broadening the range of corporate debt securities that are eligible as collateral for domestic market operations. Investment grade securities are now eligible. The broadened criteria will enhance liquidity and improve functioning in credit markets.**
- **There was a small hint of improvement regarding the global outlook, recognising that "the containment measures have reduced infection rates in a number of countries. If this continues, a recovery in the global economy will start later this year…"**
- **There was also better news within financial markets, which were "working more effectively than they were a month ago", although the RBA added that conditions have not completely normalised.**
- **As discussed in a speech by Governor Lowe on April 21, the RBA outlined its forecasts. The baseline scenario is for output to fall around 10% over the first half of 2020, and by around 6% over the year. The RBA expects a rebound of 6% next year.**
- **The unemployment rate is expected to peak at 10% over the coming months, and the RBA added that it still expects the unemployment rate to remain above 7% at the end of next year. Further details around these forecasts and risks to the outlook will be outlined in the Statement on Monetary Policy to be released this Friday.**
- **The RBA noted the lift in annual headline CPI to sit within its 2 to 3% target, but does not expect it to stay there. The RBA continues to expect inflation to turn negative in the June quarter, reflecting oil prices, free childcare and "deferrals of various price increases".**
- **A range of scenarios in regards to the outlook were provided, highlighting the significant uncertainty in the current environment.**
- **The RBA has reiterated that the cash rate target will not increase until progress "is being made towards full employment and it is confident that inflation will be sustainably within the 2 to 3% target band". The RBA's forecasts suggest this will not happen for some time.**

The Reserve Bank (RBA) left policy settings unchanged at its meeting today. These include the target for the cash rate and the 3-year government bond yield at 0.25%.

However, the RBA announced it was broadening the range of corporate debt securities that are eligible as collateral for domestic market operations. Investment grade securities are now eligible, which include a minimum average credit rating of BBB- for long-term and A-3 for short-term. Previously, these were AAA for long-term and A-1 for short-term. The broadened criteria will enhance liquidity and improve functioning in credit markets.

There was a small hint of improvement regarding the global outlook, recognising that "the containment measures have reduced infection rates in a number of countries. If this continues, a recovery in the global economy will start later this year…"

There was also better news within financial markets, which were "working more effectively than they were a month ago", although the RBA added that conditions have not completely normalised.

Nonetheless, the RBA's accompanying statement continued to highlight uncertainty with regards to the outlook.

As discussed in a speech by Governor Lowe on April 21, the RBA outlined its forecasts. The baseline scenario is for output to fall around 10% over the first half of 2020, and by around 6% over the year. The RBA also expects a rebound of 6% next year.

The unemployment rate is expected to peak at 10% over coming months, and the RBA added that it still expects the unemployment rate to remain above 7% at the end of next year.

The RBA today also highlighted both key upside and downside risks, reflecting the uncertainty surrounding these forecasts. Indeed, the RBA board considered a range of scenarios in regards to the outlook. In one scenario, the RBA noted that "a stronger economic recovery is possible if there is further substantial progress in containing the coronavirus in the near term and there is a faster return to normal activity". However, the RBA also presents the scenario: "if the lifting of restrictions is delayed or the restrictions need to be reimposed or household and business confidence remains low, the outcomes would be even more challenging than those in the baseline scenario".

We expect to obtain further details around these forecasts and risks to the outlook in the Statement on Monetary Policy which will be released this Friday.

While the Australian economy was going through a "very difficult period", the RBA acknowledged the significant fiscal and monetary stimulus which was "supporting people's incomes, maintaining the important connections between businesses and their employees, underpinning the supply of credit to businesses and households, and keeping borrowing costs low".

On the inflation outlook, the RBA noted the lift in annual headline CPI to sit within its 2 to 3% target, but does not expect it to stay there. The RBA continues to expect inflation to turn negative in the June quarter, reflecting oil prices, free childcare and "deferrals of various price increases".

**Outlook**

The stabilising in new cases of COVID-19, and progress toward potentially lifting restrictions provide some hope that economic activity could improve sooner than we had expected.

However, the RBA has reiterated that the cash rate target will not increase until progress "is being made towards full employment and it is confident that inflation will be sustainably within the 2 to 3% target band".

Given the expectation for the unemployment rate to remain above 7% at the end of next year, well above the unemployment rate estimated at full-employment (estimated to be at 4.5%), any lift to the cash rate will not likely occur for some time. Moreover, inflation is expected to weaken to 1 to 1.5% in 2021, well below the RBA's target.

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