Friday, 8 May 2020

RBA Statement on Monetary Policy
Scenario Planning

- **The impact of COVID-19 on the global and domestic economy has presented a dramatic change to the outlook over the past few months. Economic growth forecasts have been rapidly revised down and a deep contraction is widely expected. Reserve Bank (RBA) Governor Lowe previously outlined the RBA's forecasts in a recent speech.Today we received further detail into those forecasts in the RBA's quarterly Statement on Monetary Policy.**
- **As flagged by Governor Lowe, the RBA is expecting a 10% contraction in GDP from peak to trough. GDP is expected to contract 6% over the year 2020, and to rebound by 6% over 2021.**
- **Headline inflation is expected to decline 1% in the year to the June quarter, and underlying inflation is expected to remain well below 2% through to June 2022.**
- **The unemployment rate is expected to peak at 10% by the June quarter of this year. It is expected to remain above 6% until June 2022, the end of the RBA's forecast period.**
- **A unique feature of the RBA's forecasts published today was the different scenarios the RBA presented for the outlook. It highlights the significant uncertainty surrounding forecasts, particularly around what the recovery would look like.**
- **In the base-line scenario, it assumes that the current domestic containment measures remain in place for most of the June quarter, and most restrictions will be lifted by the end of the September quarter. Large public events and gatherings are expected to be limited for longer, and international border closures are expected to remain in place until the end of the year.**
- **The containment of the virus in Australia and the easing of some restrictions suggests that risks are tilted towards measures being unwound sooner rather than later. Today, the Prime Minister outlined a three-phase plan to reopen the economy by July. Nonetheless, there remains some risk of infections rising and some restrictions needing to be reimposed.**
- **The RBA raised some concern over the more long-lasting damage from the sharp economic downturn. This would be as a result of not only the time needed for employment to be restored, and for businesses to re-establish, but also how the crisis affects the mindset of consumers and businesses. Businesses generally delay rehiring workers until uncertainty has passed and changes in the structure of the economy can make finding suitable workers more difficult. The longer shutdown measures are in place, the greater the risk of some of these longer-term consequences.**

The impact of COVID-19 on the global and domestic economy has presented a dramatic change to the outlook over the past few months. Economic growth forecasts have been rapidly revised down and a deep contraction is widely expected. Reserve Bank (RBA) Governor Lowe previously outlined the RBA's forecasts in a recent speech.Today we received further detail into those forecasts in the RBA's quarterly Statement on Monetary Policy.

As flagged by Governor Lowe, the RBA is expecting a 10% contraction in GDP from peak to trough, and the decline in the June quarter is expected to be the largest in the history of the quarterly national accounts. GDP is expected to contract 6% over the year 2020, and to rebound by 6% over 2021.

The unemployment rate is expected to peak at 10% by June of this year, and will remain above 6% by June 2022, which is the end of the RBA's forecast period.

Headline inflation is expected to decline 1% in the year to the June quarter, and underlying inflation is expected to remain at well below 2% through to June 2022.

In these forecasts, the RBA is expecting a sharp decline in household consumption of around 15% in the June quarter, mostly reflecting social-distancing measures and reduced spending on international travel. Dwelling investment and business investment are also expected to contract, and a particularly sharp fall is expected in non-mining machinery & equipment as firms look to preserve cash.

A unique feature of the RBA's forecasts published today was the different scenarios presented by the RBA for the outlook. It highlights the significant uncertainty surrounding forecasts, particularly around what a recovery would look like. Notably, the scenarios suggests that risks both lie towards the upside and downside.

In the base-line scenario, the RBA expects a recovery in GDP in the second half of 2020, led by consumption. This scenario assumes that the current domestic containment measures remain in place for most of the June quarter, and most restrictions will be lifted by the end of the September quarter. Large public events and gatherings are expected to be limited for longer, and international border closures are expected to remain in place until the end of the year.

The RBA also presents two other scenarios. One of which, a faster recovery could occur, if "further gains in controlling the virus were achieved in the near term and most containment measures were phased out over coming months". This scenario would entail confidence in the ongoing management of health outcomes.

The third scenario involves a slower recovery, in which the lifting of restrictions is delayed, restrictions would need to be reimposed or household or business confidence remains low.

The containment of the virus in Australia and the easing of some restrictions suggests that risks are tilted towards measures being unwound sooner rather than later. Today, the Prime Minister outlined a three-phase plan to reopen the economy by July. Nonetheless, there remains some risk of infections rising and some restrictions needing to be reimposed.

Further, the RBA raised some concern over the more long-lasting damage from the sharp economic downturn. This would be as a result of not only the time needed for employment to be restored, and for businesses to re-establish, but also how the crisis affects the mindset of consumers and businesses. The longer shutdown measures are in place, the greater the risk of some of these longer-term consequences.

The severity of the downturn, the likelihood for the unemployment rate to remain elevated and underlying inflation remaining below target supports the view that the very easy monetary policy settings currently in place will remain for some time.

Labour market

The SoMP contains a gloomy outlook for the labour market. In its baseline scenario, the RBA estimates that hours worked will decline by 20% in the June quarter, and employment is expected to fall by 8%. The outsized fall in hours worked compared with employment is a reflection of the RBA's expectation that some workers will retain their jobs but be working significantly fewer hours. The Federal Government's JobKeeper wage subsidy plays a key role in limiting the forecast drop in employment to 8%.

Nonetheless, the unemployment rate is forecast to rise to 10%, which would be the highest it has been since 1994. The RBA notes that the unemployment rate could rise to less than 10% if there is a material decline in the participation rate, as dismissed workers decide against actively looking for work. The participation rate tends to fall during periods of extreme labour market weakness, discouraging potential workers from even trying to find a job. Addtionally, the JobSeeker payment (formerly called Newstart) has temporarily suspended the requirement for participants to be actively seeking work.

Data from a new weekly series produced by the Australian Bureau of Statistics (ABS) suggests that the labour market has deteriorated significantly since social-distancing measures were introduced in mid-March. Statistics derived from the ATO's Single Touch Payrolls (STP) system show that employment declined 7.5% between the week ending March 14 and the week ending April 18.

Experience from other sharp economic contractions is that the labour market can take considerable time to recover to its former level. This slow recovery is because businesses generally delay rehiring workers until uncertainty has passed and changes in the structure of the economy can make finding suitable workers more difficult.

The RBA expects the recovery in the labour market to be quicker than the experience during other downturns. This is partly owing to the contraction coming from an external health-shock rather than emanating from within the economy itself and partly because the JobKeeper scheme will preserve some employer-employee relationships. However, it expects the recovery to be gradual and that it could still take several years.

The RBA forecasts the unemployment rate to recover by roughly 1 percentage point per year once restrictions are lifted. This would leave the unemployment rate at 6½% in June 2022, above 5.2% before the health crisis and the estimated rate at full employment of 4.5%.

Housing market

Housing conditions are expected to deteriorate. The RBA noted that house price growth moderated in April and that turnover has declined dramatically following the ban on in-person auctions and restrictions on open homes. Information from its liaison program showed that rental conditions have deteriorated markedly since mid-March. The number of houses being offered for rent at a discount increased in April, amid increased listing due to short-term rentals being offered for longer-term leases.

Reduced population growth is expected to further limit the demand for new housing over the coming months.

The decline in housing market conditions is expected to prolong the downturn in dwelling investment. The RBA now expects dwelling construction to trough early in 2021, compared with the previous forecast of a recovery in the middle of this year.

The RBA's forecasts in full are detailed below:

Table 6.1: Output Growth and Inflation Baseline Forecasts[(a),(b)]

Per cent

	Year-ended					
	Dec 2019	June 2020	Dec 2020	June 2021	Dec 2021	June 2022
GDP growth	2.2	−8	−6	7	6	5
(previous)	(2)	(2)	(2¾)	(3)	(3)	(3)
Unemployment rate[(c)]	5.2	10	9	8½	7½	6½
(previous)	(5.2)	(5¼)	(5)	(5)	(4¾)	(4¾)
CPI inflation	1.8	−1	¼	2¾	1¼	1½
(previous)	(1.8)	(1¾)	(1¾)	(1¾)	(2)	(2)
Trimmed mean inflation	1.6	1½	1¼	1¼	1¼	1½
(previous)	(1.6)	(1¾)	(1¾)	(1¾)	(2)	(2)
	Year-average					
	2019	**2019/20**	**2020**	**2020/21**	**2021**	**2021/22**
GDP growth	1.8	−1	−5	−3	4	6
(previous)	(1¾)	(2)	(2¼)	(2¾)	(3)	(3)

(a) The cash rate is assumed to remain at its current level, with other elements of the Bank's monetary stimulus package, including the 0.25 per cent target for the 3-year government bond yield, assumed to remain consistent with current settings. Other technical assumptions include the TWI at 57, A$ at US$0.64 and Brent crude oil price at US$35 per barrel; shaded regions are historical data; figures in parentheses show the corresponding forecasts in the February 2020 *Statement on Monetary Policy*.

(b) Rounding varies: Activity to the nearest whole number; unemployment to the nearest half point; wages and prices to the nearest quarter point

(c) Average rate in the quarter

Sources: ABS; RBA

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