

Interest Rate Outlook

Tuesday, 3 March 2020

RBA Cash Rate Outlook

COVID-19 Pushes RBA Into Rate Action

- Fears over the COVID-19 outbreak have deepened and widened significantly, as cases outside of China rise dramatically.
- These fears resulted in further sharp falls in global share markets, sharp gains in global bond prices (i.e. declines in global bond yields) and declines in commodity prices. The outlook for economic growth in the world economy also darkened, as global-supply disruptions escalated and travel restrictions rose.
- The RBA has responded to the external shock from this virus by cutting the cash rate by 25 basis points to an all-time low of 0.50%. We expect a follow-up rate cut in April.
- COVID-19 is still evolving and it is difficult to ascertain how long lasting or deep its impact will be. The virus is causing considerable uncertainty and this uncertainty is impacting domestic spending.
- The coronavirus is having a significant effect on the Australian economy at present, especially in the education and tourism sectors.
- The RBA highlighted that GDP growth in the March quarter is likely to be “noticeably weaker” than earlier expected. There is a real prospect that activity will contract in the March quarter.
- We expect GDP data tomorrow for the December quarter of 2019 to reveal that the economy was sluggish even before the outbreak of the coronavirus.

The Reserve Bank (RBA) cut the cash rate by 25 basis points to a new record low of 0.50% today. This decision was not unexpected by us after recent developments with the COVID-19 outbreak and the response of asset markets to these developments.

Our long-held view has been for the RBA to cut the cash rate two times this year. Yesterday, we brought forward the timing of the RBA’s first rate cut for 2020 to today. Previously, we had flagged an April rate cut.

Last week, fears over COVID-19 widened and deepened as the number of confirmed cases outside of China rose, especially in Iran, Italy and South Korea. These fears resulted in sharp falls in global share markets, sharp gains in global bond prices (i.e. declines in global bond yields) and declines in commodity prices. The outlook for economic growth in the world economy also darkened, as global-supply disruptions escalated and travel restrictions broadened.

Hard data on the economic impact of COVID-19 is still sparse, but on the weekend Chinese data revealed the manufacturing purchasing managers’ index (PMI) fell to a record low in February.

Also on the weekend, unscheduled remarks from US Federal Reserve Chairman, Jerome Powell, suggested the US Federal Reserve would take action. These comments raised speculation there would also be coordinated action from major central banks around the world.

A rate cut today from the RBA then seemed inevitable given these recent developments. The rate cut's primary objective is to help assist the Australian economy to deal with the shocks associated with the virus.

A follow-up rate cut in April is likely with the RBA in its media statement suggesting it is ready to ease again. With the COVID-19 outbreak still evolving, the length and depth of its impact remains highly uncertain.

The coronavirus is having a significant effect on the Australian economy at present, especially in the education and tourism sectors. It is also creating uncertainty, which the RBA highlighted is affecting domestic spending. Indeed, the RBA added that GDP growth in the March quarter is likely to be "noticeably weaker" than earlier expected. There is a real prospect that activity will contract in the March quarter.

GDP data tomorrow for the December quarter of 2019 should reveal that the economy was sluggish even before the outbreak of the coronavirus. Economic activity should print well below trend. Add to that, unemployment above the rate of full employment, soggy wages growth and underlying inflation running under the band, it is clear that this external virus shock warranted the RBA deploying stimulus.

The key themes in today's RBA statement were devoted to the coronavirus. The RBA's other usual narratives around unemployment, wages, inflation and the housing market were little changed to the previous statement. The RBA noted though that the coronavirus will delay Australia's progress towards full employment and its inflation target.

Conclusion

We continue to anticipate a follow-up rate cut from the RBA in April, again of 25 basis points in size, taking the cash rate to 0.25%. We do not think the RBA's response will be limited to one rate cut. Financial markets are currently attached a probability of 70% to a rate cut in April.

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