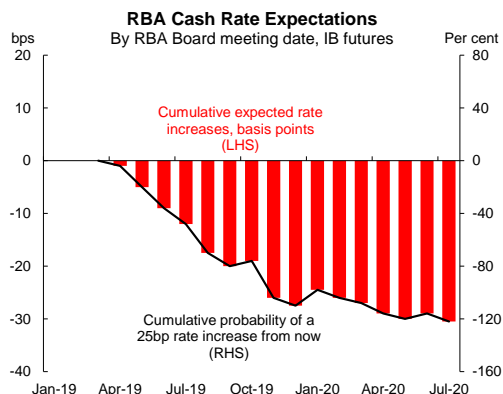


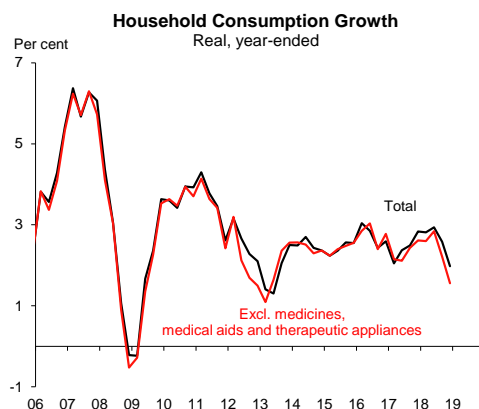
6 March 2019 Australia

ECONOMICS

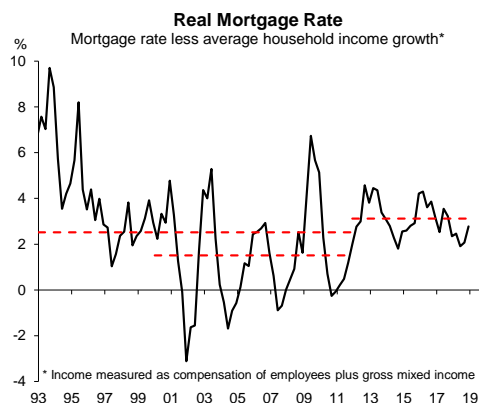
Markets have priced 30bps of cuts so we see this being extended



Consumer spending growth is weak



Real mortgage rates have possibly already been too high in hindsight in recent years



Source: ABS, Bloomberg, Macquarie Macro Strategy

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RBA to Cut What's the downside?

We now expect the RBA to cut the cash rate by 50bps to 1% this year rather than keep the stance of policy unchanged indefinitely. Markets have 30bps of cuts priced in and one 25bp cut fully priced by late this year.

Picking the timing of rate cuts is a little tricky. If the Bank sticks with *Statement* months to change policy then May or August is our best bet for the initial easing. A May cut may be too soon if the Bank feels it wants more clarity on the dataflow (particularly the labour market) and it would be just prior to the federal election, though we aren't sure that would be a relevant issue for the Bank.

The main catalyst for the change of view is that **we cannot see what the downside risks are to easing policy further**. Take the path of least regret.

Importantly, **we are strongly not of the view that central banks should “keep their powder dry”** in case growth turns out to be weaker down the track. If additional policy support is necessary then it should be provided – best to provide it early than have to take more drastic action if growth actually turns down sharply. In the event of a sharper downturn, Australia retains ample fiscal ammunition to respond and unconventional policy tools – including QE – are also available (which the Bank has recently emphasised).

We also do not support the view that cutting the cash rate from here would provide little economic support. Cash rate cuts would be substantially passed through to actual lending rates (including those on existing loans) in our view. If they aren't, the Bank can cut by more. The Australian dollar would also be lower.

We don't see downside risks from cutting

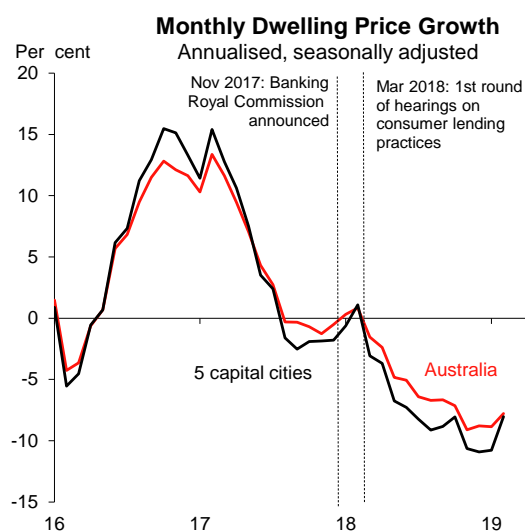
In addition to seeing little downside risks to cutting, we see several reasons for easing monetary policy.

- Growth risks:** growth has slowed noticeably, both in Australia and globally (see [Q1 Air Pocket](#)). There is **little risk that easier policy will lead to growth that is “too strong”**, even if there is some near-term loosening of the fiscal purse strings. The greater risk appears to be growth that is too low to achieve the Bank's dual mandate. Consumer spending growth has slowed sharply and faces further headwinds from falling housing prices. **The Bank could get away with being patient on the rates outlook when global growth was above trend last year – that is no longer the case.**
- Inflation undershoot:** inflation has undershot the 2-3% target for three years and we and the Bank don't expect it to return to target for another ~18 months. The global experience suggests too-high inflation is a *much* lower risk than the opposite. The **risk of inflation expectations becoming unanchored if actual inflation surprises to the upside is very low**. The opposite is a higher risk.
- Spare capacity remains:** the unemployment rate remains noticeably above 'full employment' in our view. We agree with Governor Lowe's recent comment that Australia “can have an unemployment rate close to 4½ per cent without wage growth causing problems for inflation”. In the near-term, a higher unemployment rate looks to be a greater risk than a lower one (see [The RBA's reaction function](#)).

4. **Housing-related risks have changed since 2016:** the risk of a significant and unwelcome resurgence of housing price growth and investor borrowing activity amid lower interest rates (like in 2016) appears low in our view. To be sure, lower lending rates would likely support housing demand and sentiment versus the counterfactual. But the lending and regulatory landscape has changed and recent falls in housing prices have been a timely reminder that housing is not a one-way bet. **More than seven years of little real wage growth is also likely to have resulted in many households reassess their ability and appetite to take on significantly more debt.**
5. **No risk to credibility:** if the economy and inflation turn out much stronger than expected heading into 2020, then the cash rate can be increased if necessary. This is a low probability outcome in our view and would be a welcome situation to be in for the RBA. Importantly, we find it unlikely that the Bank would lose any credibility from taking this path of least regret.

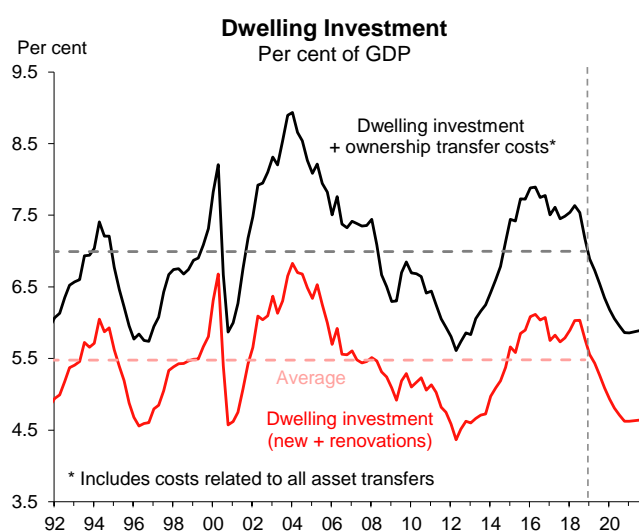
So where's the downside to cutting?

Fig 1 Dwelling prices continue to fall at a solid clip despite tentative signs of some moderation in the rate of decline



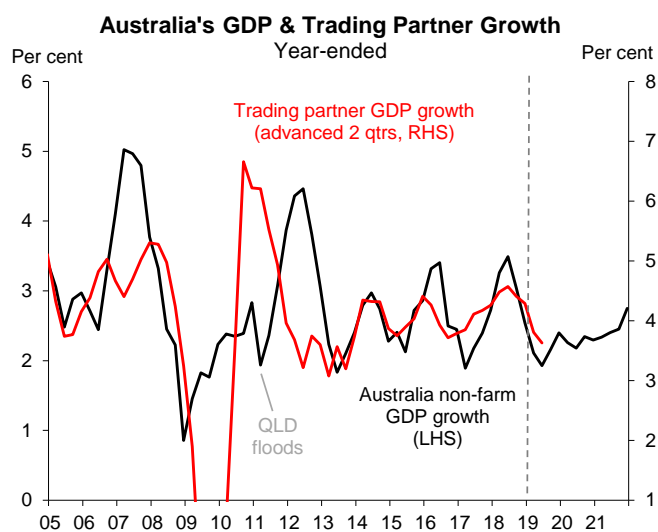
Source: CoreLogic RPData, Macquarie Macro Strategy

Fig 2 Weaker dwelling construction and related activity will be a noticeable drag on growth



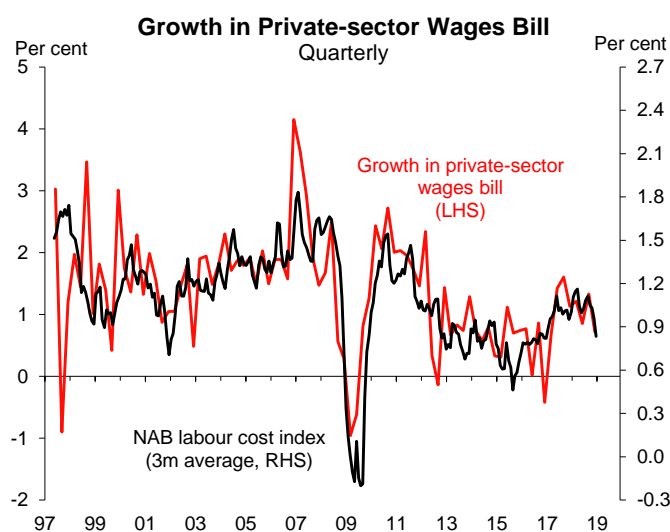
Source: ABS, NAB, Macquarie Macro Strategy

Fig 3 The comfort of above-trend global growth is no longer a reality for the RBA



Source: ABS, Macrobond, Macquarie Macro Strategy

Fig 4 Household income growth has improved but surveys point to near-term headwinds



Source: ABS, Macquarie Macro Strategy

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