Reserve Bank of Australia Eases Monetary Policy on Coronavirus Concerns

- **The Reserve Bank of Australia (RBA) cuts the benchmark interest rate by 25 basis points to 0.50% as economic challenges accumulate.**

- **The RBA reaffirmed its readiness to ease monetary policy further if needed.**

Australian monetary authorities followed market pricing and eased monetary policy following today's monetary policy meeting. The RBA cut the benchmark cash rate by 25 bps to 0.50%; the cut follows rate reductions of 75 bps over the course of 2019 (chart 1). The RBA's decision to lower the rate today was justified by rising concerns regarding the impact of the Covid-19 outbreak.

The RBA's policymakers assess that the virus outbreak will delay Australia's progress toward reaching full employment and meeting the 2–3% y/y inflation target; hence looser monetary policy is justified. The RBA also indicated that it is prepared to ease monetary policy further if needed. While we expect the RBA to stay on hold over the coming months, we note that further rate cuts are possible if the virus outbreak worsens. We also highlight the fact that Governor Philip Lowe has previously indicated that the central bank would consider quantitative easing—i.e. purchasing of government bonds in the secondary market—in a situation where the cash rate had reached 0.25%.

According to Governor Lowe, the global economic outlook is clouded by the coronavirus outbreak. Domestically, the RBA assesses the virus outbreak to have a significant adverse impact on the education and travel sectors. Moreover, domestic spending is expected to be affected, yet significant uncertainties regarding the impact remain in place. In our view, the Australian economy faces several downside risks; externally, the US-China trade and technology dispute and the Covid-19 outbreak are the main sources of uncertainty. Domestically, the bushfires and the virus outbreak are set to weigh on growth temporarily, which will contribute to muted wage growth over the coming quarters. While low interests rates and the recovering residential real estate market will provide support to the Australian consumer, we expect the labour market to soften somewhat over the coming months. Moreover, the bushfires and the coronavirus outbreak are set to dent the already-fragile consumer confidence further, preventing a notable recovery in household outlays. We also point out that the rapidly spreading virus will significantly slow China's economic growth momentum, which will have an adverse impact on Australia. Indeed, China purchases almost 40% of Australia's total exports and over 80% of the shipments of the main export, iron ore. Against this background, we forecast Australia's output gains to average 1.9% y/y this year, roughly in line with the advance in 2019.

Muted inflationary pressures will allow the RBA to maintain accommodative monetary conditions in the foreseeable future. Australia's headline inflation remains below the RBA's 2–3% inflation target, with prices rising by 1.8% y/y in Q4 2019. Demand-driven price pressures will likely remain largely absent in the foreseeable future, with headline inflation hovering around the lower end of the RBA's target range through 2021.

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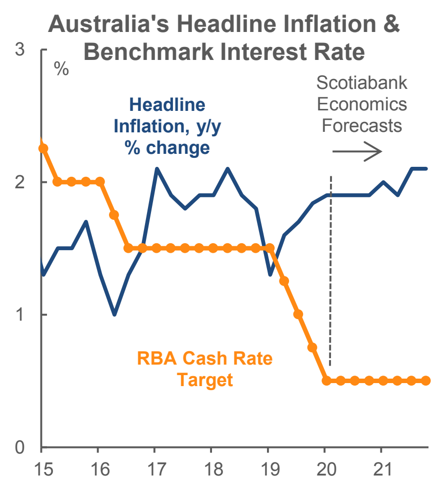
Chart 1



Sources: Scotiabank Economics, Bloomberg.