

RBA Sees Unemployment at 4.75% Next Year Amid Virus Concerns (1)
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By Michael Heath

(Bloomberg) -- Australia's central bank expects renewed hiring strength to lower unemployment to 4.75% next year, underscoring its decision to stand pat on interest rates, while acknowledging uncertainty over fallout from the coronavirus. In its quarterly update of forecasts, the Reserve Bank saw a near-term hit to growth from the devastating wildfires and viral epidemic. But it expects a rapid rebound spurred by a combination of low-rate fueled household spending, a turnaround in mining and fire-related reconstruction.

"Monetary policy is very likely to remain accommodative for some time," it said in Sydney Friday. "The forecasts imply progress towards the inflation target and full employment, but that progress is expected to be only gradual." The estimates are based on market pricing for a rate cut around mid-year.

The RBA reiterated Governor Philip Lowe's comments Wednesday that the current balance in the economy favored a policy pause, but this could change in the event of a weakening in the labor market and inflation moving away from target. It acknowledged that coronavirus is "a significant near-term risk" to the outlook for China and Australia's other key trading partners.

The currency ticked down to 67.23 U.S. cents after the release from 67.29 just prior, and was trading at 67.20 cents at 12:03 p.m. Traders are pricing in a less than 50% chance of a rate cut this half, before climbing to 55% in July and higher thereafter.

Australia's linkages to China are broad and deep: it's the biggest buyer of Australian iron ore and Chinese tourists and students lead those sectors, taking more than one-third of exports from Down Under.

The RBA is basing its expectations of a quick rebound from the virus on the SARS epidemic of 2003. But it is clear that this will require rapid containment of the outbreak.

The bank's unemployment outlook is premised on the participation rate holding steady, implying an end to the swelling labor force that absorbed a wave of hiring in the past three years. But even then, the jobless rate is short of estimated full employment at 4.5%, and the bank forecasts little change in wages growth, with inflation only reaching the bottom

of the 2%-3% target at the end of next year.

The stronger economic growth outlook also requires an upswing in household spending that has been in the doldrums for a prolonged period. The RBA sees consumption growth accelerating to 2% at the end of this year from 1.2% in June and then climbing to 2.6% by the end of next year.

The forecast reflects the “ongoing improvement in housing market activity and moderate growth in household income,” the RBA said, acknowledging that household spending remains an “important source of uncertainty for the domestic growth forecasts.”

The bank is however gaining confidence that dwelling investment will turn around and start adding rather than subtracting from growth.

For a small, open economy like Australia’s, the international outlook is very important and the bank acknowledges that risks are to the downside.

“There will be near-term spillover effects to Australia” from coronavirus, it said, citing tourists, students and commodity prices. The bank also highlighted that the U.S.-China phase one trade deal is quite limited and could see a future escalation.

That said, Australia’s flexible exchange rate has long been an important shock absorber and would be expected to depreciate again if the risks come to pass.

To contact the reporter on this story:

Michael Heath in Sydney at mheath1@bloomberg.net

To contact the editors responsible for this story:

Paul Jackson at pjackson53@bloomberg.net

Victoria Batchelor