ANALYSIS

Savers 'collateral damage' as analyst sees mortgage rates falling below 3pc

PM By business reporter David Taylor

Updated Thu 3 Oct 2019, 2:51pm

PHOTO: Weaker global manufacturing may drive the RBA to adopt unconventional policies. (REUTERS: FABIAN BIMMER)

The global economy hasn't looked this weak since the global financial crisis.

"There are some things that are signalling potential recession," New York-based Silvercrest Asset Management chief strategist Patrick Chovanec said.

The US-China trade war is no longer some abstract geo-political issue.

Its sting is being felt by factories and manufacturing centres across the globe.

Manufacturing sectors in the US, Britain, Germany and Japan are now in their worst shape since the global financial crisis.

US money managers say it's now a major risk to the global economy, and indeed the Trump presidency.

"There are people who point to that manufacturing slowdown in the United States in 2016 and say it contributed to the unhappiness that contributed to the election of Donald Trump," Mr Chovanec said.

"Once again, if President Trump faces a slowdown in manufacturing it might have a political impact even if the rest of the economy doesn't go into recession."

The bottom line is factory managers face enormous uncertainty about how much to churn out, so they're being cautious and just churning out less.

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Key points:

- As the cash rate approaches zero, the RBA is running out of room to keep cutting and may need to resort to "unconventional" tools to stimulate the economy
- Other policies that drive down long-term interest rates could prove more effective at driving borrowing costs than RBA cuts
- As the global economy deteriorates, the chances of unconventional RBA policy increases

The economy is weak and heading downward

It's left manufacturing activity in Britain, Germany and Japan reeling.

It's also punching a big hole in global economic growth, with JP Morgan's economics team forecasting a roughly 45 per cent chance of another global recession.

"We would certainly need to see other parts of the US economy soften … and then you'd start to see that number drift towards 50 and perhaps above," JP Morgan chief economist Sally Auld said.

The Conversation's 2019-20 forecasting panel is predicting an economic growth rate as weak as any since the GFC.

Higher global risks mean lower interest rates

The Reserve Bank simply says the "risks are clearly to the downside".

The global economic malaise is one of the reasons the RBA cut the cash rate to a record low of 0.75 of a per cent.

But with the local economy slowing, and unemployment rising, JP Morgan's Sally Auld says it's only a matter of time before the Reserve Bank pulls out an entirely new economic weapon — quantitative easing, or money printing.

"The chances of quantitative easing are pretty high," Ms Auld told PM.

"From that perspective we should assume [the RBA] is pretty well-prepared and ready to pull that lever if they need to."

If the RBA does "pull that lever", many analysts say regardless of what the central bank does with the cash rate, the borrowing rate on mortgages is set to go lower still.

"If the RBA were to do that then that would suggest that perhaps there's further downside for mortgage rates," Ms Auld said said.

Australia joins low rate club

With the cash rate down to a fresh low of 1 per cent, Australia has entered what's been dubbed the "era of irrationality, impotence and inequality".

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Mortgage rates could fall without RBA pressure

The reason for lower mortgage rates is painfully simple; the overnight cash rate is just one method of lowering the cost of funding for commercial banks.

The RBA can do the same, and in some cases more effectively, by lowering longer-term interest rates (think 3, 5 or 10-year interest rate terms) throughout the economy by buying bonds — that's quantitative easing.

Shaw and Partners banking analyst Brett Le Mesurier explains it this way; "If those rates are going to fall then you would reasonably expect that home loan rates would fall further as well."

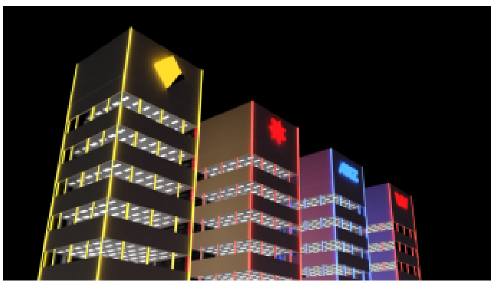
"In other words, it could be possible for [the RBA] to further reduce home loan rates without movement in cash rates."

Mr Le Mesurier has crunched the numbers and says if the cash rate falls to nothing and the RBA rolls out quantitative easing, mortgages rates could dive.

"CBA, for example, announced its standard variable owner occupier (principal and interest) rate of 4.8 per cent with a cash rate of 75 basis points.

"If it goes zero, I couldn't see that number falling below 4 per cent, but the actual rate paid by borrowers would be significantly less than that because the vast majority of people get discounts of a least 1 per cent.

Why banks are not passing on the full cut



"So an owner occupier (principal and interest) loan in a zero cash rate environment — with QE potentially already employed — would most likely be less than 3 per cent," Mr Le Mesurier told PM.

The RBA is about exhausted, the banks are not passing on much of a rate cut and the economy has just about stalled. Have we reached the end of the road with rate cuts?

Savers are collateral damage

And who is paying for this? Savers, of course.

"Unfortunately they're the collateral damage of all this," Mr Le Mesurier said

"For those who have prudently saved are now being penalised effectively for taking that action.

"The borrowers, who have arguably borrowed more than they should have in some cases, are now being rewarded for that," Mr Le Mesurier added.

Topics: business-economics-and-finance, economic-trends, markets, money-and-monetary-policy, australia

First posted Thu 3 Oct 2019, 8:16am

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