Weekly Economic Outlook

9 March 2020

Bracing for COVID-19 Impact

The spread of the coronavirus has dramatically picked up around the globe over the past week. Over 100 countries have now reported laboratory-confirmed cases of the infection, according to the World Health Organisation (WHO). With more than 100,000 confirmed cases and almost 3,500 deaths globally, it is fast becoming an outbreak of pandemic proportion.

Aside from the loss of life and disruption to families and communities, the outbreak is having a significant impact on markets and the economy. When the spread of the virus was predominately confined to China, the economic impact was focussed on supply-chain and travel related disruptions which were expected to be temporary. The dramatic increase in global cases has heightened the risk that the economic impact will be much further reaching, both in terms of sectors and countries.

Since G-7 finance ministers and central banks acknowledged the need for an aggressive policy response last week, ructions in global markets have only heightened. OPEC was expected to agree on a cut to oil production to stem the slide in oil prices, however, no consensus was able to be met. Following the breakdown of the deal, Saudi Arabia slashed its official selling price (OSP) and announced plans to raise crude production significantly, possibly signalling the start of a price war. Oil futures fell 10% on Friday and are down a further 20% today. WTI futures are currently US$32.8 per barrel at the time of writing.

The surprise 50 basis point cut by the Fed at its emergency meeting last week and the Reserve Bank (RBA)'s 25 basis point cut are not likely to be the last cuts of the easing cycle. Global bond yields have nose-dived as the virus has continued its spread. Interest rate markets are now pricing in a certain cut by the RBA's April meeting, which would move rates to their effective lower bound.

Meanwhile, the US dollar has fallen dramatically. The US had previously had a sizeable interest rate differential compared with its major global peers. As the coronavirus' economic impact becomes increasingly indiscriminate and global interest rate prospects converge, the US dollar's interest rate advantage has eroded, putting extra downward pressure on the currency. This effect has left the Australian dollar relatively little-affected against the US, despite a sharp decline and subsequent bounce in trading today. The Australian dollar is usually affected by prospects for global growth, especially in China. The slowdown to a virtual crawl in cases in China may also be playing a role. However, as the prospect for global growth deteriorates and commodity prices reflect the downturn in demand, downward pressure on the Australian dollar could return. There appears to be major support for the AUD at around US$0.6430, but if that gives, then it faces the prospect of falling to US$0.6300.

Reflecting some of these fears, the Australian share market has declined recently. The ASX 200 fell almost 10% last week and opened lower by more than 5% on Monday. The disruption to Australian economic growth is likely to be substantial. The impact of the travel ban and other likely containment measures is set to have a permanent effect on some key domestic sectors, including recreational activities (such as the postponement of large commercial and entertainment events), airfares and accommodation. Additionally, there is already evidence that key services exports have been impacted, mainly including tourism and education exports.

The looming hit to consumption, which was already on weak footing before the impact of the virus, suggests that economic growth is set to trend lower. We have revised lower our forecast for economic growth this year. The containment measures are forecast to result in negative growth of 0.3% in Q1, followed by a 0.3% fall in Q2. The largest revisions to growth are in discretionary consumer spending due to the expected measures to contain the virus. Services exports have also been revised lower. Our baseline scenario assumes the spread of the virus is contained in Q2, and a return to more normal activity levels thereafter. Our year-ended 2020 forecast for growth is 1.6%.

Nervousness in financial markets and increasing evidence of a major shock to the real economy will elicit a substantial policy response. The RBA has already indicated that it is willing to act further to support growth while the Commonwealth Government is expected to announce a stimulus programme to combat the economic impact of the coronavirus between $5-10 billion. The slowdown in new cases in China since mid-February shows that containment measures are effective and that the economic shock is one that can be recovered from. The depth of the decline and speed of the recovery all depend on how quickly the virus is contained.

This week is relatively quiet on the domestic data front. On Wednesday, a crucial snapshot into consumer confidence in March will be released, providing a signal of how consumers have reacted to the growing spread of the coronavirus. The Westpac-MI Consumer Sentiment Index was already running below average before the coronavirus' spread ramped up, amid low wages, high household debt and the bushfire emergency. Also on Wednesday, housing finance approvals for January are released. We forecast a 2.0% increase over the month following a 4.0% surge in December. The RBA had indicated that it was weighing the benefits of further policy easing with the possibility of stoking household credit too high. It is unlikely that these side-effects will stop the RBA from cutting interest rates again in April, however, the figures still bear close attention.

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Forecasts

		2020			2021	
End Period:	**Close (Mar 2)**	**Q2 (f)**	**Q3 (f)**	**Q4 (f)**	**Q1 (f)**	**Q2 (f)**
Aust. Interest Rates:						
RBA Cash Rate, %	0.50	0.25	0.25	0.25	0.25	0.25
90 Day BBSW, %	0.55	0.45	0.45	0.45	0.50	0.50
3 Year Swap, %	0.55	0.45	0.50	0.55	0.67	0.70
10 Year Bond, %	0.68	0.70	0.75	0.80	0.85	0.90
US Interest Rates:						
Fed Funds Rate, %	1.125	0.375	0.375	0.375	0.375	0.375
US 10 Year Bond, %	0.76	0.90	1.00	1.10	1.15	1.20
USD Exchange Rates:						
AUD-USD	0.6636	0.65	0.66	0.67	0.68	0.68
USD-JPY	105.39	106	105	105	106	107
EUR-USD	1.1284	1.10	1.11	1.12	1.13	1.14
GBP-USD	1.3048	1.30	1.30	1.30	1.31	1.31
NZD-USD	0.6350	0.63	0.64	0.65	0.65	0.65
AUD Exchange Rates:						
AUD-USD	0.6636	0.65	0.66	0.67	0.68	0.68
AUD-EUR	0.5882	0.59	0.59	0.60	0.60	0.60
AUD-JPY	69.88	68.9	69.3	70.4	72.1	72.8
AUD-GBP	0.5087	0.50	0.51	0.52	0.52	0.52
AUD-NZD	1.0432	1.03	1.03	1.03	1.05	1.05

	2018	**2019 (f)**	**2020 (f)**
GDP, %	2.1	2.2	1.6

AUD cross exchange rates have been rounded.

Financial forecasts are quarter end.

GDP, CPI, employment and wage growth forecasts are year end.

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