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Risks to Growth Abound

Data released last week jolted some optimism out of the Australian economic outlook. Labour market data showed the unemployment rate rising back to 5.3% in January, after falling in the previous two months. Confirming the spare capacity in the labour market, wages growth remained sluggish in Q4. From this weak footing, it will be a challenge for economic growth to return to the Reserve Bank (RBA)'s forecast of trend this year.

Firstly, the coronavirus presents an acute problem for Australian economic growth. Not only does China account for an overwhelming proportion of Australian commodities exports (not limited to iron ore; seafood, meat and other commodities end up in China as well), but many of our services exports rely on Chinese activity. Containment measures to slow the spread of the virus are likely to have a significant impact on the education and tourism sectors. Unlike with goods exports, it is unlikely that these losses will be recouped in later quarters due to “catch up” demand. The longer travel bans and other containment measures are in place, the greater the risks of a longer-lasting impact to the Australian services sector through reputational and sentiment damage.

A second major risk to the Australian economic recovery is the cautious consumer. High household debt and low wages growth has put downward pressure on disposable incomes. An already low savings rate means that consumers' appetite for spending remains low. Rising house prices should encourage some additional spending through the wealth effect, however, we expect only a gradual pick-up in consumption.

Further clues about how the economy performed in Q4 –before the major impact of the coronavirus and bushfires was felt– will be released this week. Construction work done for Q4 will be released on Wednesday, before private business capital expenditure for Q4 is released on Thursday. We forecast a 0.6% decline in construction work done in Q4, with some disruption due to bushfire smoke likely to have occurred.

Private business capital expenditure is forecast to fall 0.2%, consolidating around the flat trend experienced throughout 2019. The release will also update businesses' expected capital investment for the 2019-20 financial year, as well as their initial estimate for investment in the 2020-21 financial year. Our forecast is for a modest increase in investment expectations for 2019-20 of 2% to \$119 billion. We expect year-ahead investment expectations for 2020-21 to be \$94 billion, up slightly from investment expectations set a year earlier. The early estimates for capital expenditure in the coming year can vary significantly from later estimates, which tend to be closer to realised investment.

Private credit extended to the economy in January will be released on Friday. It will be closely watched by the RBA who has said that it was balancing the benefits of monetary policy easing with the risks of unabated credit growth brought on by low rates. We forecast a 0.2% increase in private sector credit over the month.

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Forecasts

End Period:	2020					2021
	Close (Feb 21)	Q1 (f)	Q2 (f)	Q3 (f)	Q4 (f)	Q1 (f)
Aust. Interest Rates:						
RBA Cash Rate, %	0.75	0.75	0.50	0.25	0.25	0.25
90 Day BBSW, %	0.91	0.85	0.70	0.45	0.45	0.50
3 Year Swap, %	0.65	0.70	0.60	0.50	0.55	0.60
10 Year Bond, %	0.94	1.00	0.95	0.90	0.80	0.80
US Interest Rates:						
Fed Funds Rate, %	1.625	1.625	1.375	1.125	0.875	0.875
US 10 Year Bond, %	1.52	1.60	1.50	1.45	1.40	1.45
USD Exchange Rates:						
AUD-USD	0.6627	0.67	0.66	0.67	0.67	0.68
USD-JPY	111.61	107	106	105	105	106
EUR-USD	1.0847	1.09	1.10	1.11	1.12	1.13
GBP-USD	1.2964	1.30	1.30	1.30	1.30	1.31
NZD-USD	0.6349	0.64	0.66	0.66	0.66	0.66
AUD Exchange Rates:						
AUD-USD	0.6627	0.67	0.66	0.67	0.67	0.68
AUD-EUR	0.6108	0.61	0.60	0.60	0.60	0.60
AUD-JPY	73.94	71.7	70.0	70.4	70.4	72.1
AUD-GBP	0.5113	0.52	0.51	0.52	0.52	0.52
AUD-NZD	1.0440	1.05	1.00	1.02	1.02	1.03

	2018	2019 (f)	2020 (f)
GDP, %	2.1	2.1	1.9
CPI (Headline), %	1.8	1.8	1.8
CPI (Trimmed mean), %	1.8	1.6	1.9
Unemployment Rate, %	5.0	5.2	5.4
Wages Growth, %	2.3	2.3	2.3

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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