

Monday, 27 April 2020

The Great Global Hibernation

It is becoming increasingly clear just how deep the global economic contraction currently underway is.

Last week, a range of PMI readings, which measure economic activity around the world, pointed to a marked deterioration. In Europe, the UK and the US, PMIs all fell to record lows. Services have undoubtedly been hit the hardest, including restaurants, bars and non-essentials, which have been shuttered to contain the spread of COVID-19. However, manufacturing activity has also weakened sharply.

In Australia, data releases which capture the economic impact of social distancing measures have been few. So far, consumer and business confidence measures have had record falls this month.

Nonetheless, the ABS is releasing a range of additional material to assist us in gauging how COVID-19 is affecting us.

Last week, data assessing the payrolls from the Australian Taxation Office suggest a sharp fall in employment over a few weeks. If a similar scale of job losses were applied to the monthly labour force statistics, it would imply a job loss of at least half a million over a month.

In a speech last Tuesday, RBA Governor Lowe was rather forthcoming in outlining the RBA's forecasts for the period ahead. Lowe said that over the first half of this year, Australia was likely to experience the biggest contraction in national output and income since the 1930s.

The RBA also expects the unemployment rate to reach 10% by June – that would suggest just over 600k jobs lost over the three months to June.

To understand just how mind-boggling these estimates are, we *added* a net total of 252k jobs, over the entire year of 2019. This followed a gain of 289k over 2018.

In addition to the warning of how significant the decline in economic activity we are currently experiencing is, Governor Lowe added that “we keep in mind that this period will pass, and that a bridge has been built to get us to the other side. With the help of that bridge, we will recover and the economy will grow strongly again.”

No doubt, there is significant uncertainty about when a recovery will occur. But every day that passes with new cases staying at low levels gives greater hope that the other side will come sooner.

Any recovery is however likely to be slow, as some kind of restrictions are likely to be in place for a time. Additionally, confidence will take time to be restored, particularly if there remains uncertainty about the prevalence of the virus in the community.

This week on Friday, the AiG will release its performance of manufacturing index which will be the first of the AiG indicators to assess economic activity in April. It will also be one of the early indicators that will capture the full force of the lockdown measures over the whole of the month. The main data release will be CPI to be released on Wednesday. Inflation is likely to have

remained low in the March quarter, with the annual rate in trimmed mean (or underlying) inflation expected to remain below the RBA's 2 to 3% target band. Indeed, inflation is likely to weaken further given the sharp drop-off in demand and the collapse in the oil price. The RBA Governor has said that that annual headline inflation will likely turn negative in June. If the RBA is correct, it would be the first time there has been an annual decline in consumer prices since the early 1960s.

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Forecasts

Please note that due to the unprecedented nature of the coronavirus's impact on the economy and the rapid change of developments, there is greater than usual variability attached to these forecasts.

| End Period: | 2020 | | | | 2021 | |
|------------------------------|----------------|--------|--------|--------|--------|--------|
| | Close (Apr 24) | Q2 (f) | Q3 (f) | Q4 (f) | Q1 (f) | Q2 (f) |
| Aust. Interest Rates: | | | | | | |
| RBA Cash Rate, % | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 |
| 90 Day BBSW, % | 0.12 | 0.15 | 0.20 | 0.25 | 0.30 | 0.35 |
| 3 Year Swap, % | 0.32 | 0.35 | 0.35 | 0.40 | 0.40 | 0.45 |
| 10 Year Bond, % | 0.88 | 0.75 | 0.75 | 0.80 | 0.85 | 0.95 |
| US Interest Rates: | | | | | | |
| Fed Funds Rate, % | 0.125 | 0.125 | 0.125 | 0.125 | 0.125 | 0.125 |
| US 10 Year Bond, % | 0.60 | 0.60 | 0.65 | 0.70 | 0.75 | 0.80 |
| USD Exchange Rates: | | | | | | |
| AUD-USD | 0.6371 | 0.62 | 0.64 | 0.66 | 0.68 | 0.68 |
| USD-JPY | 107.51 | 107 | 105 | 106 | 107 | 107 |
| EUR-USD | 1.0823 | 1.07 | 1.06 | 1.06 | 1.07 | 1.08 |
| GBP-USD | 1.2367 | 1.22 | 1.23 | 1.24 | 1.25 | 1.25 |
| NZD-USD | 0.6017 | 0.60 | 0.62 | 0.64 | 0.65 | 0.65 |
| AUD Exchange Rates: | | | | | | |
| AUD-USD | 0.6371 | 0.62 | 0.64 | 0.66 | 0.68 | 0.68 |
| AUD-EUR | 0.5904 | 0.58 | 0.60 | 0.62 | 0.64 | 0.63 |
| AUD-JPY | 68.71 | 66.3 | 67.2 | 70.0 | 72.8 | 72.8 |
| AUD-GBP | 0.5166 | 0.51 | 0.52 | 0.53 | 0.54 | 0.54 |
| AUD-NZD | 1.0607 | 1.03 | 1.03 | 1.03 | 1.05 | 1.05 |

| | 2018 | 2019 (f) | 2020 (f) |
|-----------------------|------|----------|----------|
| GDP, % | 2.2 | 2.2 | -5.0 |
| CPI (Headline), % | 1.8 | 1.8 | 0.1 |
| CPI (Trimmed mean), % | 1.8 | 1.6 | 0.8 |
| Unemployment Rate, % | 5.0 | 5.2 | 7.8 |
| Wages Growth, % | 2.3 | 2.2 | 1.8 |

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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