

Monday, 29 June 2020

Counting Waves in Choppy Seas

Markets have been watching COVID-19 infection rates with renewed vigour over the past week. The sombre milestone of 10 million global confirmed cases was reached over the weekend, with a record number of new cases being added to the tally daily. It took more than four months for the first one million cases to be reached; the most recent one million cases came during the past week alone.

Investors are watching closely for a “second wave”. The reality is that new outbreaks in some parts of the US and China, as well as the continued growth in cases in developing nations such as Brazil and India look more like a turbulent swell rather than separate waves.

Concern over the growth outlook reached a fever pitch in late March, coinciding with a low in the Australian ASX 200, the US S&P 500 and the Australian dollar. Since those lows, sentiment rebounded strongly. Unprecedented stimulus from global governments and central banks helped, but underpinning investor confidence was a degree of latent optimism that the economic shock would be temporary, and that growth would return to normal in an orderly fashion once the pandemic was controlled. The hard economic data for April and May has been dismal, but the most timely indicators, such as confidence surveys and labour market reports, have suggested that the economy suffered most in April. Economic activity has since staged a tentative recovery as lockdowns have been gradually relaxed.

The increase in new cases in hotspots around the world, including locally in Victoria, highlight the difficulty containing COVID-19. New outbreaks come with the risks of new restrictions being imposed and a longer economic contraction. Investors now appear to be reassessing the consensus for the shape and the timing of the recovery.

The initial restrictions alone have left a crater in the economy which will take time to recover from. As the effects of the first rounds of stimulus are revealed and evaluated, the willingness of central banks and governments to provide further support is likely to be tested.

Officials at the US Federal Reserve have demonstrated their commitment to provide support, expanding the eligibility of its asset purchases to include a wider range of corporate bonds while warning of the likely bumpiness of the recovery ahead. Australia will face its own test in September when various forms of support, including JobKeeper, are due to end.

Coming up this week are further clues about how the Australian economic landscape is evolving heading into the September deadline. Deputy Governor of the Reserve Bank (RBA), Guy Debelle, is delivering a speech tomorrow entitled “The Reserve Bank’s policy actions and balance sheet”. In it, he may provide an indication of what new forms of stimulus could potentially look like and the RBA’s assessment of the economic situation to date.

CoreLogic house prices for June are released on Wednesday. Initial falls in house prices have been modest, as reduced interest rates, mortgage holidays and fiscal support have limited forced sales. Our forecast is for a 0.7% decline in prices following a 0.5% fall in May. Building approvals for May

are also released on the same day. We are forecasting a 10% decline in May following a more muted 1.8% decline in April. A fall in the pipeline is expected as COVID-19 delivers a blow to the residential construction sector which was already on weak footing before the pandemic.

Reduced housing turnover will lead to a fall in the demand for new borrowing by households, but these impulses have been tempered by an increase in the overall balance of credit due to loan repayment holidays and businesses drawing down on lines of credit to temporarily support cashflow. More information on this dynamic will be made available tomorrow when private sector credit data is released. We expect these forces to balance out, with a flat outturn in May following a flat outcome in April. Outstanding credit is likely to fall in the months ahead as aggregate demand continues to fall.

The Australian Bureau of Statistics (ABS) has introduced a range of new statistics to help monitor the economy during COVID-19. Part of this suite includes weekly payrolls data, released every fortnight. Payrolls data for the week ending June 13 will be released tomorrow, which will provide further details on the extent of any recovery in the labour market following the easing of restrictions earlier in the month. Official labour market statistics have suggested that the recovery is likely to be gradual and uneven.

Other initiatives recently launched by the ABS include preliminary estimates for trade and retail sales. The full complement of trade statistics is due to be released on Thursday. Preliminary data released last week suggests that the trade surplus likely widened in May, due to a sharper fall in imports compared with exports. We are forecasting the trade balance to widen to \$9.0 billion from \$8.8 billion in April. Meanwhile, retail trade statistics for May are set to show a record increase in turnover. Preliminary data suggests a 16.3% increase, following a record fall of 17.7% in April.

In the US, an important read on the economic recovery will be released on Wednesday night in the ISM manufacturing PMI for June. The minutes of the June FOMC will also be released, shedding some light on discussions around further stimulus, including yield curve control.

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Forecasts are detailed on the following page

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:	Close (June 26)	2020		2021		
		Q3 (f)	Q4 (f)	Q1 (f)	Q2 (f)	Q3 (f)
Aust. Interest Rates:						
RBA Cash Rate, %	0.25	0.25	0.25	0.25	0.25	0.25
90 Day BBSW, %	0.10	0.10	0.15	0.20	0.25	0.30
3 Year Swap, %	0.24	0.30	0.30	0.35	0.35	0.40
10 Year Bond, %	0.87	1.00	1.00	1.05	1.15	1.25
US Interest Rates:						
Fed Funds Rate, %	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond, %	0.69	0.75	0.75	0.80	0.85	0.90
USD Exchange Rates:						
AUD-USD	0.6865	0.70	0.72	0.73	0.74	0.75
USD-JPY	107.22	106	106	107	107	108
EUR-USD	1.1219	1.13	1.14	1.15	1.16	1.17
GBP-USD	1.2336	1.26	1.27	1.27	1.28	1.29
NZD-USD	0.6423	0.65	0.65	0.64	0.65	0.66
AUD Exchange Rates:						
AUD-USD	0.6865	0.70	0.72	0.73	0.74	0.75
AUD-EUR	0.6119	0.62	0.63	0.63	0.64	0.64
AUD-JPY	73.61	74.2	76.3	78.1	79.2	81.0
AUD-GBP	0.5565	0.56	0.57	0.57	0.58	0.58
AUD-NZD	1.0689	1.08	1.11	1.14	1.14	1.14

	2019	2020 (f)	2021 (f)
GDP, %	2.2	-4.0	3.0
CPI (Headline), %	1.8	0.2	2.3
CPI (Trimmed mean), %	1.6	1.0	1.8
Unemployment Rate, %	5.2	8.3	7.1
Wages Growth, %	2.2	1.8	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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The Detail

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