

2 March 2020

## Virus Panic as Data Deluge Looms

Over the weekend the Federal Reserve signalled that it could be about to act. In the face of a plunging stock market amid escalating concerns over the spread of COVID-19, Federal Reserve Chairman Jerome Powell made an unusual, unscheduled statement. Powell said he would “act as appropriate to support the economy.”

Powell’s remarks had an immediate impact on markets. The Dow Jones, which was trading lower by about 900 points at the time and heading for its fourth 1000+ point drop of the week, recovered 600 points. Interest rate markets are now pricing in a 75% chance of a 50 basis point cut at the Federal Reserve Open Market Committee (FOMC) meeting on March 18. The market pricing for a 25 basis point interest rate cut at tomorrow’s Reserve Bank (RBA) Board meeting has risen from 18% on Friday to 120% at the time of writing.

We have long held the view that the RBA would cut rates two times this year. Underpinning our forecast has been the three major challenges faced by the RBA: underlying inflation below the RBA’s target (including soggy wages growth), unemployment running above the full employment rate and economic activity running below trend. The impact on the Australian economy from COVID-19 will make these challenges even more prominent.

Given the additional risks posed by COVID-19, as well as the increased likelihood of a co-ordinated easing of policy by central banks globally, we have moved our forecast for the timing of these cuts forward. We now expect a 25 basis point cut at tomorrow’s meeting, bringing the cash rate to 0.50%, as well as a follow-up cut in April, which would bring the cash rate to its effective-lower-bound of 0.25%. After that, the RBA will need to deploy unconventional monetary policy to stimulate economic activity. We expect that policy to take the form of quantitative easing (QE) beginning mid-year and to involve the RBA purchasing Commonwealth Government bonds.

We are also revising down our near-term view for AUD/USD. We now expect AUD/USD to end the March quarter at 0.6300. Our end-year forecast of 0.6700 remains unchanged and is predicated on world growth recovering from the worst of the virus’s impacts before the end of 2020.

Tomorrow’s RBA monetary policy decision is not the only marquee event this week. On Wednesday, GDP data for the fourth quarter will be released. We expect it to show that activity improved slightly from the third quarter, but that the underlying momentum of the economy remains weak. Sluggish consumer spending and tepid business investment is expected to persist. We forecast growth of 0.5% over the quarter and 2.1% over the year.

Before GDP is released, data for balance of payments and government finances will be released tomorrow for the fourth quarter. These estimates feed into GDP so will provide a further guide for what to expect. We expect that net exports continued to add to growth in the fourth quarter, with a forecasted 0.2 percentage point contribution, matching the outcome in the third quarter. Australia has recorded record back-to-back current account surpluses in recent quarters. We forecast a further surplus in the fourth quarter of a \$2.5 billion in the current account. For public demand, a 0.8% increase is forecast over the quarter, down from 1.7% in the third quarter.

Consumption associated with the NBN and NDIS rollout has been boosting government expenditure.

Earlier today, we received data for company profits & inventories for the fourth quarter, and dwelling prices in February. Gross company operating profits fell 3.5% over the quarter while inventories rose 0.3%. The data suggests inventories will make a contribution of 0.2 percentage points to GDP growth in the fourth quarter. CoreLogic dwelling prices posted another robust improvement in February. The 8-capital city combined price index rose 1.2%, its 8<sup>th</sup> consecutive monthly increase.

Data for the month of January will also be released for building approvals, retail sales and the trade balance this week. Dwelling approvals are expected to have remained flat, holding on to the significant gains registered at the end of 2019. Trade data released Thursday are expected to reveal a \$5.4 billion trade surplus. Commodity exports have remained firm, but the surplus is still expected to be lower than June's record high of \$8.1 billion. Retail sales data will be released on Friday, and expected to show a 0.5% decline, further unwinding November's Black-Friday boost.

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| <b>Movements Over Past Week</b>     |                  |                  |               |                 |
|-------------------------------------|------------------|------------------|---------------|-----------------|
| <b>Financial Market Variables</b>   | <b>21-Feb-20</b> | <b>28-Feb-20</b> | <b>Change</b> | <b>% Change</b> |
| ASX 200 Index                       | 7,139.0          | 6,441.2          | -697.8        | -9.8            |
| US S&P 500 Index                    | 3,337.8          | 2,954.2          | -383.5        | -11.5           |
| US Dow Jones                        | 28,992.4         | 25,409.4         | -3583.1       | -12.4           |
| AUD/USD                             | 0.6627           | 0.6515           | -0.0112       | -1.7            |
| LMEX Base Metal Prices              | 2,660.5          | 2,606.9          | -53.6         | -2.0            |
| Gold Price                          | 1,643.4          | 1,585.7          | -57.7         | -3.5            |
| Oil Price (West Texas Intermediate) | 53.4             | 44.8             | -8.6          | -16.1           |
| Australian 3-Year Swap Rate         | 0.65             | 0.47             | -0.18         | -28.1           |
| Australian 2-Year Bond Yield        | 0.67             | 0.55             | -0.13         | -18.8           |
| Australian 10-Year Bond Yield       | 0.94             | 0.82             | -0.12         | -12.8           |
| US 2-Year Bond Yield                | 1.35             | 0.91             | -0.44         | -32.6           |
| US 10-Year Bond Yield               | 1.47             | 1.15             | -0.32         | -21.9           |

**Forecasts**

| End Period:                  | Close (Feb 28) | Q1 (f) | Q2 (f) | Q3 (f)       | Q4 (f) | Q1 (f) |
|------------------------------|----------------|--------|--------|--------------|--------|--------|
| <b>Aust. Interest Rates:</b> |                |        |        |              |        |        |
| RBA Cash Rate, %             | 0.75           | 0.50   | 0.25   | 0.25         | 0.25   | 0.25   |
| 90 Day BBSW, %               | 0.81           |        |        |              |        |        |
| 3 Year Swap, %               | 0.47           |        |        | Under review |        |        |
| 10 Year Bond, %              | 0.82           |        |        |              |        |        |
| <b>US Interest Rates:</b>    |                |        |        |              |        |        |
| Fed Funds Rate, %            | 1.625          | 1.125  | 0.875  | 0.875        | 0.875  | 0.875  |
| US 10 Year Bond, %           | 1.15           |        |        | Under review |        |        |
| <b>USD Exchange Rates:</b>   |                |        |        |              |        |        |
| AUD-USD                      | 0.6515         |        |        |              |        |        |
| USD-JPY                      | 107.89         |        |        |              |        |        |
| EUR-USD                      | 1.1026         |        |        |              |        |        |
| GBP-USD                      | 1.2823         |        |        |              |        |        |
| NZD-USD                      | 0.6246         |        |        |              |        |        |
| <b>AUD Exchange Rates:</b>   |                |        |        |              |        |        |
| AUD-USD                      | 0.6515         |        |        | Under review |        |        |
| AUD-EUR                      | 0.5905         |        |        |              |        |        |
| AUD-JPY                      | 70.37          |        |        |              |        |        |
| AUD-GBP                      | 0.5080         |        |        |              |        |        |
| AUD-NZD                      | 1.0416         |        |        |              |        |        |

|                       | 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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