

Monday, 3 February 2020

## Coronavirus fears grow

The new coronavirus outbreak has led to nearly 15,000 confirmed cases so far and a human toll of more than 300. Wuhan and 15 other cities in the Hubei province are in lock down. Many other Chinese areas have also put in travel and transport restrictions. The World Health Organisation (WHO) declared the new coronavirus outbreak as a public health emergency of international concern last week, prompting many countries to reduce or shut down travel linkages with China. The coronavirus is still evolving rapidly, making it very challenging to quantify and forecast its full effects. However, it is clear it will dent China's growth forecasts in this quarter and perhaps for longer, depending on how the disease transpires. If we assume the outbreak is controlled in Q1 with few new cases thereafter, Chinese GDP annual growth in Q1 could drop to be as low as 3.5-4%. Growth should then recover and normalise in Q2. However, the risks lie to the downside, as the impact of the coronavirus could extend into Q2.

Consumption is one of the areas to be hit the hardest in China, especially in tourism, travel, accommodation, transport and retailing. The Chinese government is likely to step up and ease policy further to support growth amid this vulnerable backdrop.

The spread of the coronavirus has caused risk aversion to rise among global investors and has encouraged demand for safe-haven assets, like global bonds. These pressures will likely continue until the virus is brought under control. Downside risks to the world growth outlook will also persist against such a backdrop, given China is the world's second largest economy.

Turning to data at home and it is a data-packed week this week. Dwelling prices and building approvals were released earlier today. This data showed the upturn in dwelling prices was continuing, although the monthly growth rates have lost some momentum. Housing prices across the combined capital cities lifted by 0.9% in January and by 5.2% on a year ago, which is the fastest annual rate since November 2017. The housing upturn is being led by Sydney and Melbourne.

Today's data also revealed that the housing recovery is broadening; the lift in dwelling prices since July 2019 has led to early signs of a recovery in building approvals, which in time will also lead to a recovery in residential construction. Building approvals are very volatile but trend data tries to smooth this volatility. And in trend terms, building approvals have risen for four straight months (September-December 2019).

Tomorrow, the Reserve Bank (RBA) board meets. We expect the RBA to leave the cash rate on hold at 0.75% tomorrow. Interest-rate markets are also widely priced for such a decision. However, we expect the RBA to maintain an easing bias and cut the cash rate in April. By this time, incoming data should convince the RBA it needs to do more easing. For now, the RBA is likely to want to keep its powder dry, especially as the two latest jobs report were strong.

On Thursday, the international trade balance and retailing data are published.

We expect the trade surplus to widen by \$0.9 billion in December to \$6.7 billion, driven by strong growth in export receipts.

For retailing, the Bureau of Statistics will publish nominal retail sales for December and real retail sales (i.e. retail sales adjusted for inflation) for the December quarter.

Retail sales jumped sharply in November; indeed retailing rose by 0.9%, which was its fastest monthly pace in 2 years. But much of the strength was related to 'Black-Friday' sales. In December, data should reveal an unwind of this retailing effect. Further, the worsening bushfire conditions in South-East Australia during December are likely to have contributed to a decline in retail sales in the month. We anticipate retail sales fell 0.2% in December. In real terms, we are forecasting a slight improvement, after Q3's contraction of 0.1% in the quarter and 0.2% year-on-year. Consumer spending continues to be a major source of uncertainty for the RBA and this data should help some extra light.

Finally, on Friday we have the RBA's quarterly Statement on Monetary Policy (SoMP) and the RBA Governor's semi-annual testimony to Parliament. Since the last SoMP, the Australian economy has had to deal with bushfires and now the new coronavirus. We anticipate the bushfires shaved 0.1 percentage points off GDP growth in Q4 2019 and in Q1 2020 via mostly the tourism, agriculture and retailing channels. The coronavirus is still evolving and so not yet fully quantifiable.

The SoMP will be gleaned closely. One change that should pop out easily is changes to the RBA's growth forecasts. We expect the RBA to downgrade its 2020 growth forecasts from 2.8% to 2.6%. Our own GDP forecast is weaker at 2.1%. We expect the RBA growth forecast for 2021 of 3.1% to remain largely unchanged. At this time, the RBA is likely to consider any coronavirus and bushfire effect as transitory on the economic outlook. However, the coronavirus is evolving, so this could well change in future. The most direct effect of the coronavirus is likely to come via the impact on Australia's service exports, which includes tourism and education. This sector has been an important source of growth in recent years.

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**Forecasts**

End Period:	2020					2021
	Close (Jan 31)	Q1 (f)	Q2 (f)	Q3 (f)	Q4 (f)	Q1 (f)
<b>Aust. Interest Rates:</b>						
RBA Cash Rate, %	0.75	0.75	0.50	0.25	0.25	0.25
90 Day BBSW, %	0.88	0.95	0.70	0.45	0.45	0.50
3 Year Swap, %	0.63	0.70	0.60	0.50	0.55	0.60
10 Year Bond, %	0.95	1.05	0.95	0.90	0.80	0.80
<b>US Interest Rates:</b>						
Fed Funds Rate, %	1.625	1.625	1.375	1.125	0.875	0.875
US 10 Year Bond, %	1.51	1.65	1.50	1.45	1.40	1.45
<b>USD Exchange Rates:</b>						
AUD-USD	0.6692	0.68	0.66	0.67	0.67	0.68
USD-JPY	108.35	107	106	105	105	106
EUR-USD	1.1093	1.09	1.10	1.11	1.12	1.13
GBP-USD	1.3206	1.33	1.32	1.32	1.31	1.31
NZD-USD	0.6464	0.66	0.66	0.66	0.66	0.66
<b>AUD Exchange Rates:</b>						
AUD-USD	0.6692	0.68	0.66	0.67	0.67	0.68
AUD-EUR	0.6030	0.62	0.60	0.60	0.60	0.60
AUD-JPY	72.51	72.8	70.0	70.4	70.4	72.1
AUD-GBP	0.5068	0.51	0.50	0.51	0.51	0.52
AUD-NZD	1.0348	1.03	1.00	1.02	1.02	1.03

	2018	2019 (f)	2020 (f)
GDP, %	2.1	2.1	2.1
CPI (Headline), %	1.8	1.8	1.7
CPI (Trimmed mean), %	1.8	1.5	1.9
Unemployment Rate, %	5.0	5.2	5.5
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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