Weekly Economic Outlook

Bank of Melbourne

Monday, 4 May 2020

Old Habits Die Hard

With a major event like COVID-19 affecting the world, there has been much reflection on the many ways in which the world has changed.

For the economy and society, there have been calls to rethink the way we distribute income to look after the less fortunate and support those in hard times. The Australian Government has pushed aside the idea of achieving a budget surplus so it can provide stimulus to support the economy.

It could be an opportunity for authorities to address some long-running challenges including productivity growth and reforming the tax system. Reserve Bank (RBA) Governor Lowe has called for a review of how consumption and land is being taxed. There are reports that the NSW and Victorian Governments are looking at reforming stamp duty and land tax – the former is one of the country's most inefficient and distortive taxes.

Given the concern about the disruption to supply chains, there is also the question of whether production of vital goods and services should occur domestically.

Unfortunately, there are some small reminders of how the world has not changed. For example, US President Trump's recent comment suggesting the imposition of tariffs on China to retaliate over COVID-19. The issues facing the economy prior to the crisis have not gone away. Global tensions, particularly between the US and China, were long-running, even before COVID-19 spread across the world. It was the dominant theme denting financial market sentiment for over a year. Rather than unifying the world, it would seem likely that COVID-19 is instead exacerbating those tensions.

It would, therefore, not be surprising if the renewed jitters affecting financial market sentiment late last week continues. The US S&P500 index is still up 26.5% from its recent low hit on March 23. In Australia, the ASX200 is 14.9% from its recent low, so a further retracement lower is possible.

Weaker risk appetite is also reflected in the AUD. The Australian dollar has dropped swiftly since April 30 after reaching a 7-week high of 65.70 US cents on April 30 and now sits at around 63.90 US cents at the time of writing.

Although new COVID-19 cases are declining and countries are starting to look to ease restrictions, some long-running economic issues remain unresolved. Moreover, there is the uncertainty over whether countries can re-open their economies without a renewed escalation of cases of COVID-19.

The domestic economy was also not in great shape prior to the crisis. Economic growth was running below trend. Slow wage growth and high household debt was squeezing consumer spending. While assistance from the government, the Reserve Bank (RBA) and the banks have alleviated the strains on households significantly, unemployment is likely to stay higher than pre-crisis levels for some time. An even slower pace of wage growth along with high unemployment suggests that these issues will become a bigger problem, particularly when some of the stimulus measures fade.

In the short-term, however, some aspects of economic activity may not be as dire as previously feared. Last week, house prices were relatively resilient in April, although sales volumes indicated that turnover was down over 60% on a year ago. This week, we will see the first partial economic data releases to assess the impact of COVID-19 on the domestic economy. Building approvals, retail sales, and trade data for March will be released today, Wednesday, and Thursday, respectively.

In the Australian Bureau of Statistics' (ABS) expanded coverage to gauge the impact of COVID-19, a preliminary release of retail sales revealed the sharpest increase in retail spending in the history of the series. While much of the increase can be attributed to panic-related stockpiling, it highlights how much of a cushion is being provided by policymakers. However, we expect that the fall in incomes is still likely to dent overall household spending in coming months.

Tuesday will reveal an update on the employment situation in a new fortnightly payrolls release by the ABS in conjunction with the Australian Taxation Office. The first release showed employment dropped sharply in a short space of time.

Finally, the RBA will meet on Tuesday and deliver its quarterly Statement on Monetary Policy on Friday. These events might seem less relevant given the RBA has already delivered significant policy measures, and brought interest rates down to their effective lower bond. RBA Governor Lowe has also outlined the RBA's views surrounding the economic outlook in a speech on April 21. However, the upcoming releases provide the opportunity to glean some further detail behind the RBA's thinking on the outlook, particularly in the Statement on Monetary Policy.

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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.

			2020			2021
End Period:	**Close (May 1)**	**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, %	0.10	0.15	0.20	0.25	0.30	0.35
3 Year Swap, %	0.28	0.35	0.35	0.40	0.40	0.45
10 Year Bond, %	0.87	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, %	0.64	0.60	0.65	0.70	0.75	0.80
USD Exchange Rates:						
AUD-USD	0.6418	0.62	0.64	0.66	0.68	0.68
USD-JPY	106.91	107	105	106	107	107
EUR-USD	1.0981	1.07	1.06	1.06	1.07	1.08
GBP-USD	1.2506	1.22	1.23	1.24	1.25	1.25
NZD-USD	0.6063	0.60	0.61	0.61	0.63	0.64
AUD Exchange Rates:						
AUD-USD	0.6418	0.62	0.64	0.66	0.68	0.68
AUD-EUR	0.5845	0.58	0.60	0.62	0.64	0.63
AUD-JPY	68.62	66.3	67.2	70.0	72.8	72.8
AUD-GBP	0.5135	0.51	0.52	0.53	0.54	0.54
AUD-NZD	1.0592	1.03	1.05	1.08	1.08	1.06

	2018	**2019 (f)**	**2020 (f)**
GDP, %	2.2	2.2	-5.0
CPI (Headline), %	1.8	1.8	0.3
CPI (Trimmed mean), %	1.8	1.6	1.1
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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