

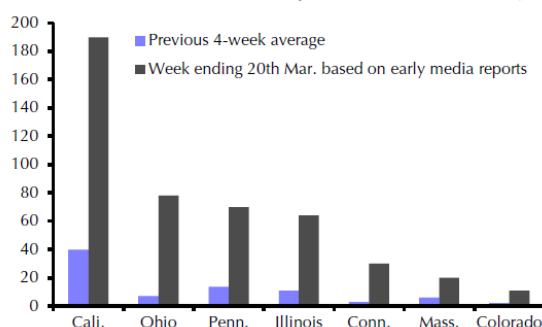
Economic Overview – as of 23 March 2020

Global markets

It is difficult to reconcile that one month ago stock markets were at record highs, and the coronavirus outbreak was essentially being considered a China specific issue – the 33% fall in most stock indices in less than four weeks is one measure of this extreme disruption since then. Financial markets have experienced extreme volatility during this period, especially over the last week. The response to the virus from central banks (most at zero percent cash rates now) and from governments around the world, doing everything in their power to limit the economic damage while managing the health crisis is unprecedented.

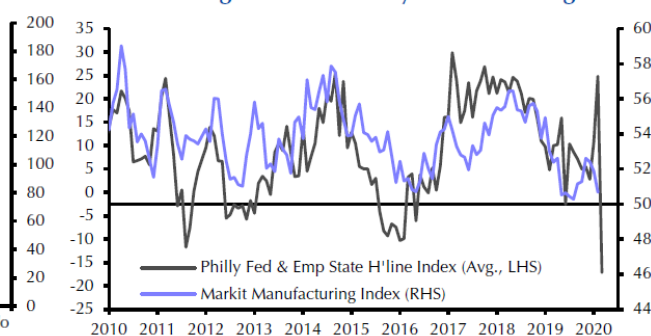
Economic data is generally yet to show this impact beyond China, who were first to have to deal with COVID-19 (and may ultimately fare better in the wake of it), however the two critical questions to address are how effectively can governments prop up their economies while imposing shutdowns, and how long will this all last for, before a meaningful recovery? These questions are complicated by large variances in reported infection cases and mortality rates, and this in turn is dependent on data accuracy and (refer appendix) testing rates of COVID-19, country by country.

Chart 1: State Initial Jobless Claims (000s)



Sources: Refinitiv, Various Media Reports
Source: Capital Economics

Chart 2: Regional Fed Surveys & Markit Mfg PMI



Sources: Refinitiv, Markit

The US unemployment rate is 3.5%, its lowest level for fifty years, however the widespread shutdowns (including the states of California and New York) will see jobless claims leap at a much faster pace than the GFC- so forecasts of how high US unemployment will reach, and how large the economic contraction for Q2 will be, are being revised up daily. Manufacturing and service sector indices will similarly fall dramatically, as Chinese PMI surveys did last month, so (along with the global economy) a US recession appears inevitable, despite the US\$1 -2 T stimulus package being planned. [Comment from St. Louis Fed chair James Bullard](#) that US unemployment might reach 30% appear extreme and may have been primarily a plea for urgent action in getting the package through Congress; but the mood is dire.

The economic impact of COVID-19 will vary around the world dependent on (amongst other things) health systems, demographics and each country's fiscal position going in to the crisis, but in the case of Italy, the impact may be one of the most severe. The Italian economy is highly dependent on tourism, it was already in a stressed state ahead of the virus, and with 23% of Italians over 65 it is one of the oldest populations in the world- so beyond the human tragedy, the economic impact will be devastating and will make the recovery far more challenging. Other parts of the European Union are facing similar challenges, making the ongoing viability of the euro currency (but not the Union itself) a renewed topic of debate. A world with suddenly no international travel is a hard one to comprehend.

Naturally economic news and market gyrations are secondary to health priorities, however it is noteworthy to observe that some traditional safe haven assets such as US Treasuries and gold weakened significantly last week, despite the flight to safety of the US dollar. This seems to have been driven by funding for distressed

assets needing to come from quality assets- although central bank liquidity has helped over the last few days to boost bond markets, pushing yields back down. The price of oil remains at multi-decade lows as production is not being lowered in the face of a collapse in demand, with OPEC and Russia unable to compromise, however the Iron Ore price remains firm, ahead of another wave of likely Chinese infrastructure investment.

Domestic economy

The Australian economy is heavily weighted to the services sector – over 70% of GDP and jobs come from services – so state and federal government responses to address COVID-19 are understandably unprecedented. International travel restrictions are not surprising, but state lockdowns and other containment measures have rapidly escalated, and obviously going to be crippling to the economy in the short term.

Like the rest of the world, estimates of how high the unemployment rate will rise, and how large the contraction in will be are being steadily revised higher. Last week's pleasing 5.1 % unemployment rate data will be a base line, from which to measure the impact of the virus outbreak.

The \$189 B rescue/ stimulus package in total is around 10 % of Australia's annual GDP, which together with the two RBA rate cuts in March aims to minimise the depth of the impending economic contraction. The table below summarises the primary components:

Lending packages	RBA term-funding facility	\$90 B	Read more
	'Smaller lender' facility	\$15 B	Read more
	Government guaranteed unsecured lending to SMEs	\$20 B	Government guarantee provided directly to Australian banks; 50 % of a \$40 B scheme
Other business support	Boosting Cash Flow for Employers	\$32 B	SMEs and NFPs to receive between \$20k and \$100k in cash, in April and July
	Accelerated depreciation	\$3.2 B	Deductions allowed in FY20 tax return
	Other SME support measures	\$3.7 B	Incentives to retain employees, etc
Individuals & household support	Doubling of Newstart from \$550 to \$1100	\$14 B	Now called the 'Jobseeker Payment', with a temporary coronavirus supplement
	Two \$750 cash payments; reduction in deeming rate	\$9.8 B	Available to welfare recipients
	Temporary early super release	\$1.2 B	Available to individuals and sole-traders impacted by COVID-19, tax free (2 x \$10k)

Making accurate forecasts in this environment is close to impossible, which is why the Federal Budget has been deferred from May until October 6th, however history suggests that even deep recessions are generally followed by strong recoveries. The fact that this downturn is being caused by an event that presumably will be resolved (via a vaccine) within a finite period of time adds to the argument not to forget the inevitable recovery; although with stock markets off another 5 % today pessimism reigns.

Three factors that may help the domestic economy in the months ahead are:

- The low level of the Aussie Dollar- down to .5510 last week
- The likelihood that China will be 'first in, first out'- our largest trade partner
- Our AAA credit rating and (relatively) low levels of government debt made the above package more affordable – although where debt/ GDP ultimately peaks now will be a challenge for the future.

Interest Rate Outlook

The RBA have cut the cash rate to its effective floor of ¼ %, and have said they expect the OCR to remain at this level for some years. Quantitative Easing and 'yield curve control' measures will also anchor the three year bond rate near 0.25 %, so a flat curve with ten year bonds around 1%.

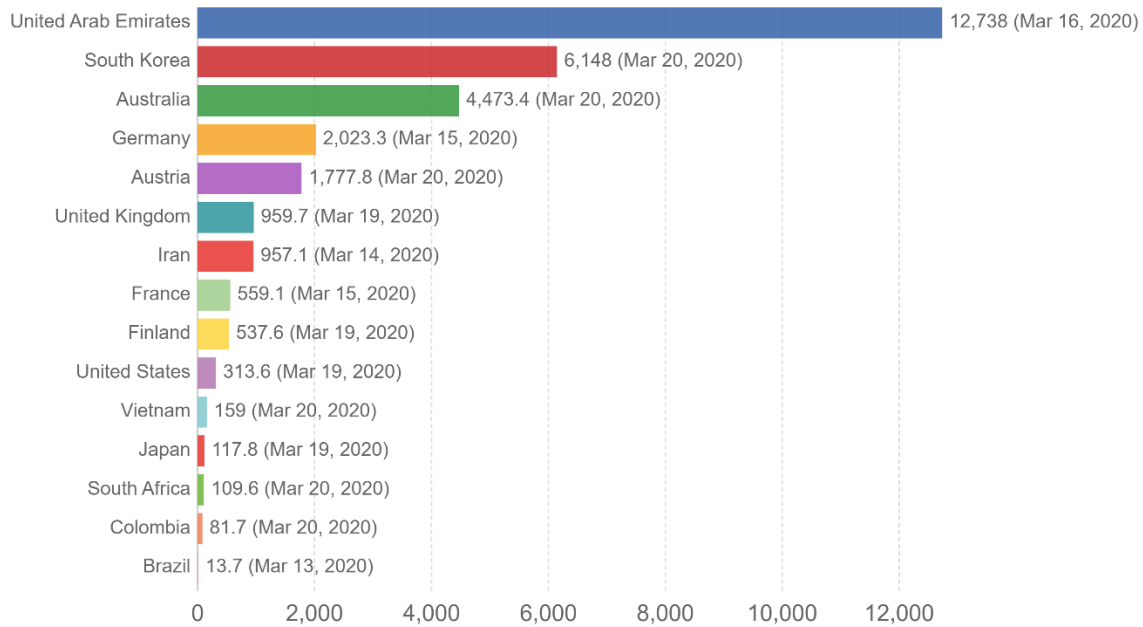
	28 Dec 19	31 Jan 20	28 Feb 20	23 Mar 20
90-day bills	1.87%	0.88%	0.81%	0.46%
3-year swap	1.77%	0.66%	0.57%	0.47%
AUD/USD	0.7100	0.6686	0.6580	0.5760
ASX 200	6 169	7 017	6 441	4 590

Appendix- Assorted charts on COVID-19 testing, mortality rates and impact

Total COVID-19 tests performed per million people



Most recent data as of 20 March [18.00GMT]. Data collected by Our World in Data from official country reports. For some countries the number of tests corresponds to the number of individuals who have been tested, rather than the number of samples.

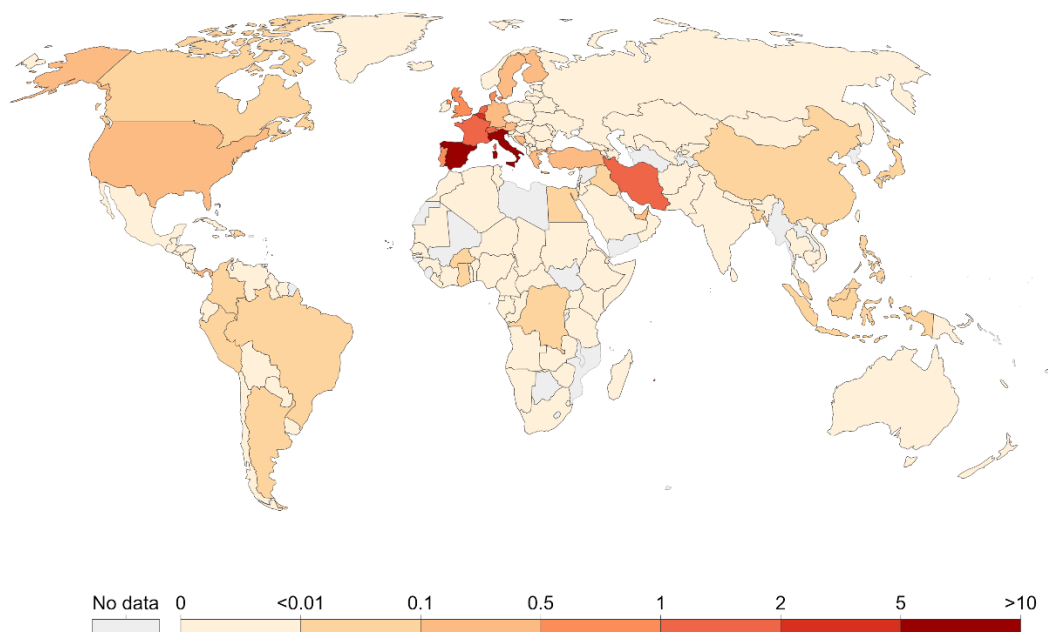


Source: Our World in Data

Note: Data for the United States corresponds to estimates from the COVID-Tracking Project.

OurWorldInData.org/coronavirus • CC BY

Daily new confirmed deaths due to COVID-19 per million people, Mar 22, 2020

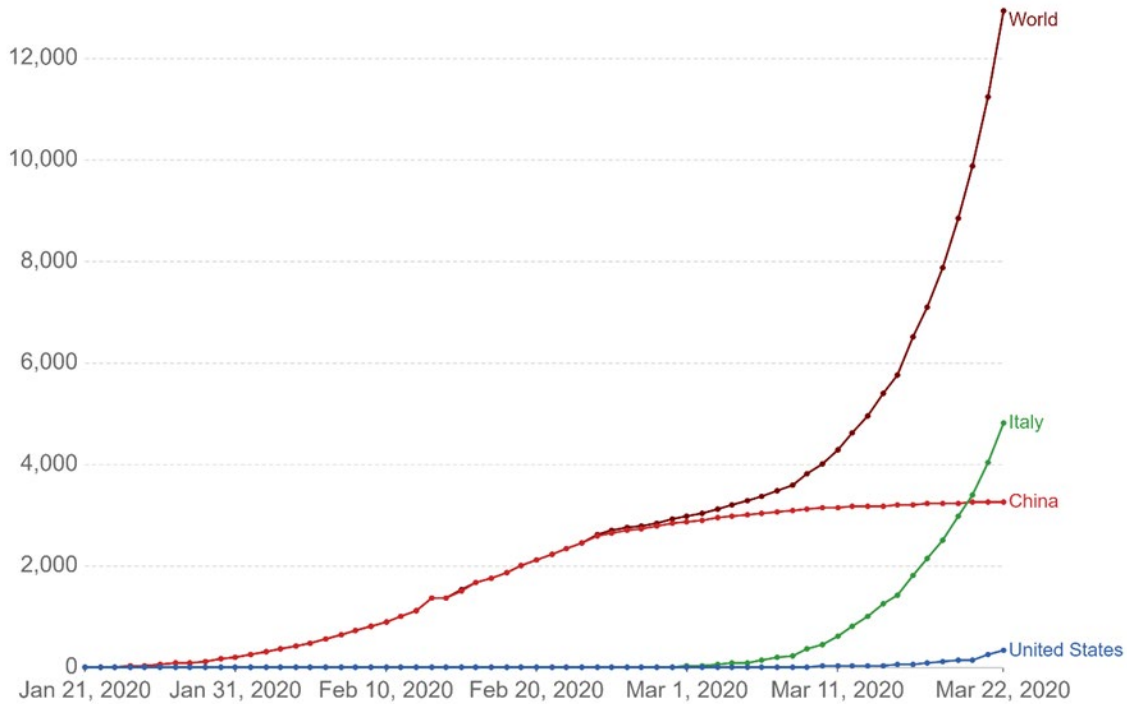


Source: European CDC – Latest Situation Update Worldwide

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Total confirmed deaths due to COVID-19

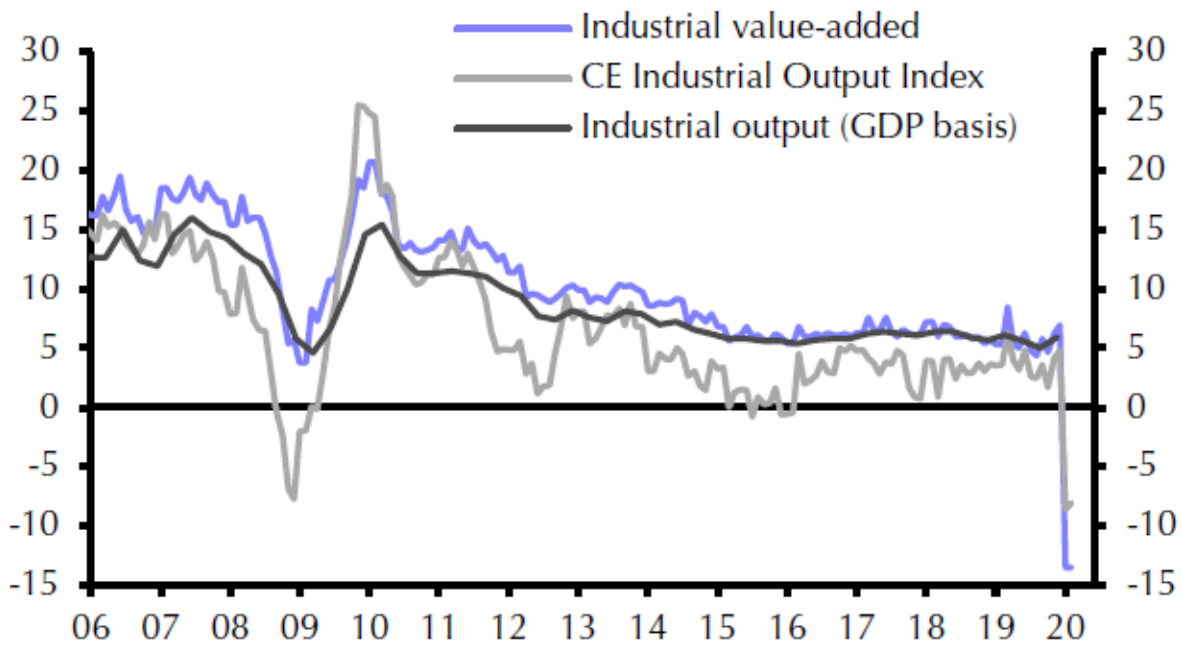
Our World in Data



Source: European CDC – Latest Situation Update Worldwide

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Chinese Industrial Production (real, % y/y)



Source: Capital Economics