July
2020

Economic and market update

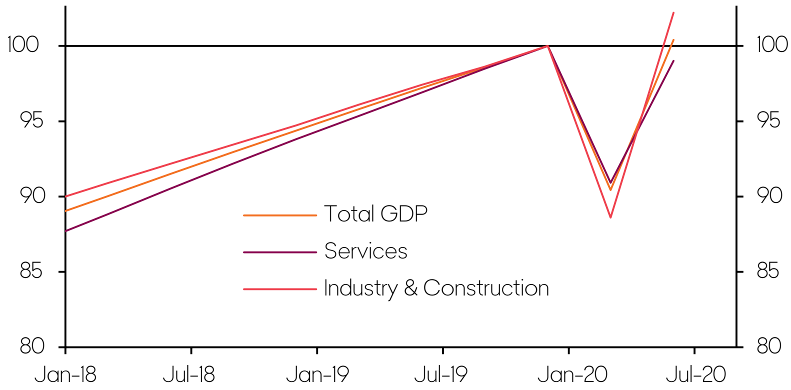
Economic Overview – as of 23rd July 2020

Global markets

Despite the devastating COVID-19 infection rates in so many regions around the world, especially in North and South America, risk appetite and stock markets have continued to improve persistently. Beyond ever increasing fiscal support, the progress on a vaccine seems to be the primary driver, with Oxford University trials of AZD1222 leading the way. Despite it's highly questionable sustainability in regions that are yet to effectively contain the virus, economic data has beaten market expectations in the US, EU and China and has contributed to stock market improvement. In China the GDP recovery from the Q1 collapse of 9.8 % was stunning, up 11.5% for Q2.

The recovery in China has been strongest via construction and industry rather than retail activity but does appear to have strong momentum going in to Q3, thanks to the size of policy stimulus. GDP as a result is higher than pre-pandemic levels. While there is some scepticism about some of the data coming out of China, it is interesting to note that the official manufacturing Purchasing Managers Index (PMI) fell further

Chinese GDP (seasonally adjusted, Q4 2019 = 100)



Source: Capital Economics

in Q1 than the independent PMI survey, and both have recovered to similar levels now. This all bodes well for demand for Australian exports, notwithstanding the recent trade tensions. Chinese imports rose 14% in June with iron ore volumes near record highs set in late 2017.

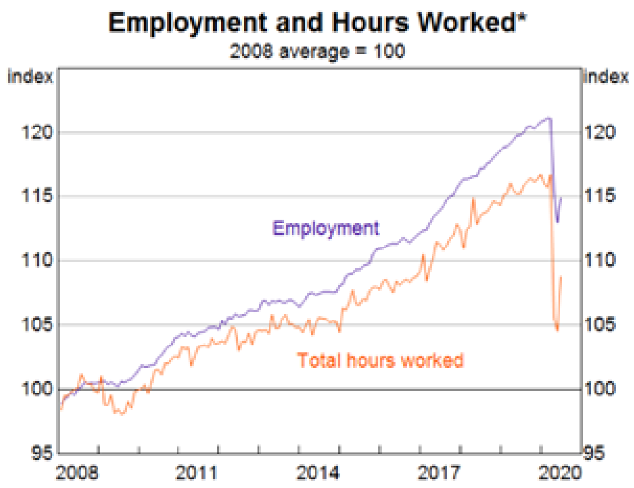
US economic data has also been better than forecast including home sales, retail sales and industrial production, however jobless claims remain high and the jobless rate is still over 11%. The pressure is on Congress to extend emergency stimulus support, much of which expires at the end of this month. Beyond this, the growing COVID-19 cases risk more permanent damage to the US jobs market, with over 4 million cases so far and 2 million still active. The US dollar is sharply weaker, which in turn has pushed the price of gold near record highs from 2011.

European Union leaders struggled to agree further stimulus measures, but finally this week delivered a €750 billion rescue fund. The largest share is heading to southern Europe, especially Italy and Spain. These economies are forecast to contract over 10% during 2020 with the collapse in international tourism, so the package gives a glimmer of hope to their 2021 recovery, and to the viability of the Union itself.

Domestic economy

The rise in the Australian dollar to a fifteen-month high above 71c could be interpreted as market confidence that the worst of the recession and associated damage to labour markets is behind us. While that may be true beyond Victoria, with 20% of the population back in lockdown the path to recovery will be as challenging as ever. The restrictions for Melbourne and Mitchell Shire risk a two-speed recovery as the rest of Australia gets back to business, so it is vital that the restrictions are effective to minimise this period of time, and vital that we avoid the need for similar lockdowns in other regions.

The jobs data remains the most timely and insightful measure of the impact and the path through recession. In February there were 13 million Australians in employment, which reduced to 12.1 million in May and then recovered to 12.33 million in June. The fall in hours worked was 10% from peak to trough before recovering last month which is half the size of the fall feared in initial RBA forecasts. See chart below for further detail. This does compare favourably to other similar economies, but the events in Melbourne risk the recovery from here. The headline unemployment rate itself may be less timely in monitoring these trends.



* Seasonally adjusted
Sources: ABS, RBA

The fears of a premature end to fiscal support in September were allayed by the Government's extension of JobKeeper and JobSeeker. While the schemes are now tiered and tapered, they equate to an additional $17 billion in fiscal support. June retail sales were over 8% higher than the same month last year, suggesting that the monetary and fiscal policy has been effective thus far, but the impact on the budget and government debt is being keenly debated. RBA head Philip Lowe strongly encouraged further government spending in his speech on Tuesday, and while he played down any suggestion of monetising government debt, he did sensibly suggest that the government is not challenged in accessing debt at record low rates, and doesn't need to rely on the RBA significantly increasing money supply.

With the Consumer Price Index certain to come in at a negative rate for Q2, coupled with the outlook for jobs, the outlook for inflation does confirm negligible (or zero) inflationary risk in increasing government debt. Our relatively low debt/ GDP ratio allows ample scope to both afford the latest fiscal support and add more next year if required.

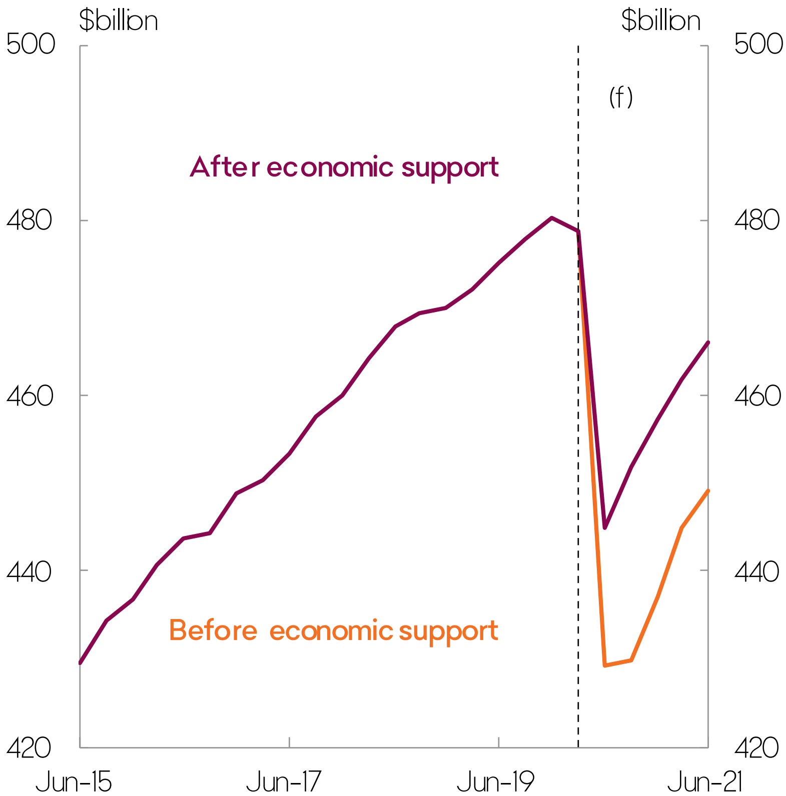
Interest Rate Outlook

The RBA has cut the cash rate to its effective floor of 0.25%, and has stated that they expect the Official Cash Rate to remain at this level for some years. Quantitative easing yield curve control measures will also anchor the three year bond rate at 0.25%, so a very flat yield curve is very likely to remain in place for at least another year.

	31/5/19	30/5/20	30/6/20	23/7/20
90-day bills	1.42%	0.10%	0.10%	0.10%
3-year swap	1.19%	0.25%	0.23%	0.21%
5-year swap	1.41%	0.44%	0.44%	0.38%
AUD/USD	.6935	.6730	.6905	.7130
ASX 200	6 397	5 756	5 898	6 095
Credit Index (iTraxx- 5 yr)	76	101	88	78

Appendix - Australian government stimulus, and debt profile

Effect of fiscal rescue package on real GDP



Source: ABS cat. no. 5206.0 and Treasury

Federal budget aggregates

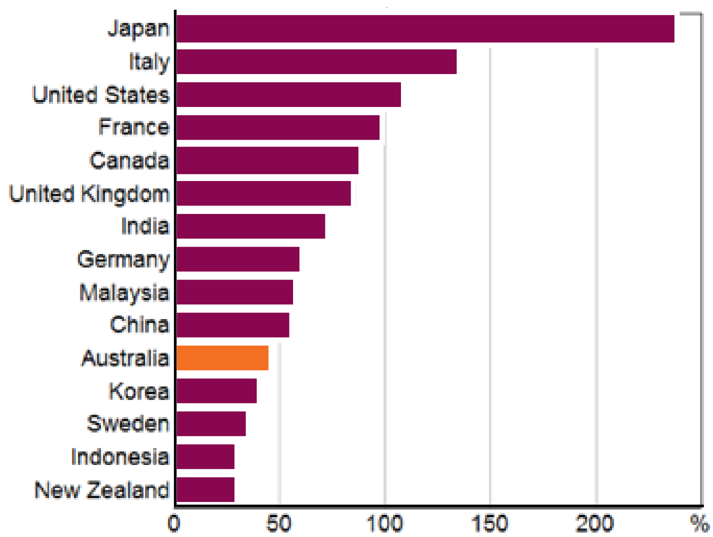
	Actual	Estimates	
	2018-19	2019-20	2020-21
	$b	$b	$b
Underlying cash balance (a)	-0.7	85.8	184.5
Per cent of GDP -	0.0	-4.3	9.7
Gross debt (b)	542.0	684.3	851.9
Per cent of GDP	27.8	34.4	45.0
Net debt (c)	373.6	488.2	677.1
Per cent of GDP	19.2	24.6	35.7

a. Excludes expected net Future Fund earnings before 2020-21.

b. Gross debt measures the face value of Australian Government Securities (AGS) on issue. The 2019-20 number is the actual face value at 30 June 2020.

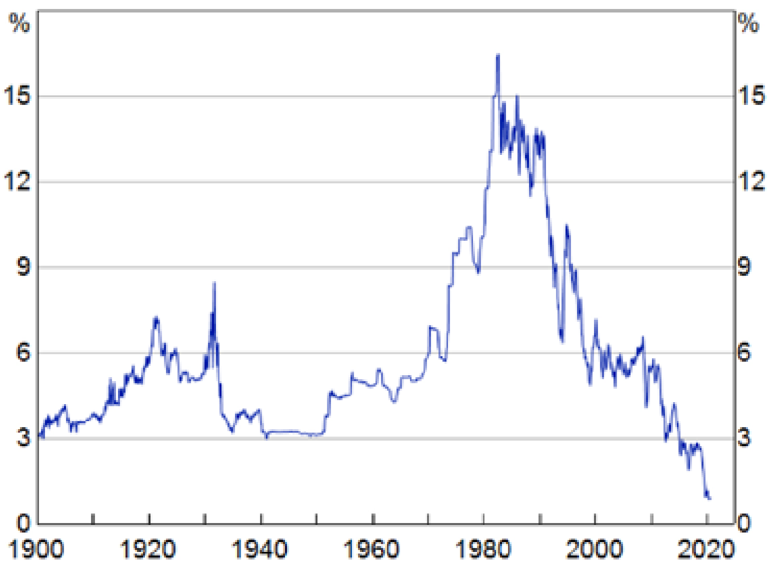
c. Net debt equals the sum of interest bearing liabilities (which includes AGS on issue measured at market value) minus the sum of cash and deposits, advances paid and investments, loans and placements.

General Government Gross Debt
2019, percent of GDP



Sources: IMF

10 year Australian Government Bonds*



* Monthly average of daily yields from January 1995; prior data are end-of-month yields

Sources: GFD, RBA, Yieldbroker