

# Weekly Economic Outlook

Monday, 25 May 2020

## Is Trade the New Weapon?

It was an eerie and wonderful feeling sitting in a restaurant for dinner for the first time since lockdown last week. It was a sign that some things were returning to normal. However, it was clear that not everything was back to normal. The restaurant was full, even though there were only ten customers inside. The owner was busily disinfecting the laminated menus after we touched them. And there was the flow of takeaway orders leaving the restaurant; not something you would normally see at a typical tapas bar. Staffing was still scarce – I only counted two, the chef and the owner.

We can think of economic recovery in a similar way, as restrictions begin to lift. It will be slow as restrictions are progressively lifted. Some of the loss in economic output is going to be temporary and some of it will be more long lasting.

In assessing some of the long-lasting challenges, there should be consideration of some of the issues that the economy was facing before the health crisis began.

Rewinding back to last year, the issues facing the world economy included ongoing trade tensions between the US and China. Protests were underway in Hong Kong. In Australia, we were grappling with high household debt levels, slow wage growth and anaemic consumer spending.

If anything, COVID-19 has exacerbated these concerns.

Adding to the global trade tensions, China has imposed a number of trade restrictions on Australian-sourced imports. Over the past few weeks, China has imposed an 80% tariff on Australian barley exports and suspended beef imports from four major meat processing plants. The reasons cited were over anti-dumpling allegations for the tariff hike on barley, while the ban on beef imports were due to violations of “inspection and quarantine requirements”.

Around 50% of Australia’s barley exports went to China last year, and comprise 44% of China’s barley imports. This market is likely to be severely impacted, although barley represents less than 1% of Australia’s exports to China.

By far, the largest of Australia’s exports to China are iron ore, coal, LNG and gold. Services are also important, including tourism and education, which have already been heavily impacted by COVID-19.

It is difficult to ascertain whether further trade restrictions could be imposed. Coal and other agricultural products appear vulnerable. But there may be challenges for China in finding alternative substitutes for Australia’s largest export, iron ore. Brazil may struggle to maintain iron ore production given the country is facing an escalating outbreak of COVID-19. Moreover, as China is likely to embark on further stimulus, demand for raw materials needed in construction is likely. Of course, further restrictions may depend on China’s political motivations which are not entirely clear at this point.

Somewhat encouragingly, Australia’s trade minister Simon Birmingham has said that “Australia is

not interested in a trade war. We don't pursue our trade policies on a tit-for-tat basis" implying that there will be a constructive effort to deal with the conflict.

On the data front this week, we will receive data on construction and capital expenditure on Wednesday and Thursday, respectively. These releases will further shape our view about the performance of the Australian economy over the March quarter ahead of GDP data next week.

We expect that construction work done fell 1.4% in the quarter. Housing construction may have been impacted by bushfire disruptions earlier in the year.

Restrictions to limit the spread of COVID-19 were not imposed until late March, but uncertainty regarding the outlook was likely to have dented business spending earlier in the year. We expect new private capital expenditure fell by 1.0% in the March quarter and there is downside risk attached to this forecast. The question is how quickly businesses were able to delay or cancel business investment. We receive an update on the plans for 2019/20 and the second reading for 2020/21 plans. A scaling back of investment plans, especially for non-essential capex, is likely; another sharper revision down is very likely for the June quarter, as businesses increasingly moved to focus on preserving cashflow.

The biggest hit from COVID-19-related restrictions will be over the June quarter, but we still expect economic activity contracted over the first quarter of the year. Our forecast is a contraction in GDP of 0.7% in the March quarter, leaving annual growth at 1.0%.

Private sector credit will also be released on Friday. We are expecting a rise of 0.6% in April, after a 1.1% gain in March. Credit to the private sector was boosted by a sharp lift in business credit growth in March, as businesses drew down existing lines of credit to boost liquidity ahead of the looming cash flow squeeze. This dynamic likely extended into April. The Australian Bureau of Statistics (ABS) is also continuing their additional coverage on the impact of COVID-19. Surveys on the impact of COVID-19 on businesses and households will be released on Thursday and Friday, respectively.

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*Forecasts are detailed on the following page*

## 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.

End Period:	2020				2021	
	Close (May 22)	Q2 (f)	Q3 (f)	Q4 (f)	Q1 (f)	Q2 (f)
<b>Aust. Interest Rates:</b>						
RBA Cash Rate, %	0.25	0.25	0.25	0.25	0.25	0.25
90 Day BBSW, %	0.10	0.10	0.10	0.15	0.20	0.25
3 Year Swap, %	0.26	0.25	0.30	0.30	0.35	0.35
10 Year Bond, %	0.87	0.85	0.90	0.95	1.00	1.10
<b>US Interest Rates:</b>						
Fed Funds Rate, %	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond, %	0.66	0.60	0.65	0.70	0.75	0.80
<b>USD Exchange Rates:</b>						
AUD-USD	0.6537	0.64	0.66	0.68	0.70	0.70
USD-JPY	107.64	107	105	106	107	107
EUR-USD	1.0901	1.07	1.06	1.06	1.07	1.08
GBP-USD	1.2173	1.22	1.23	1.24	1.25	1.25
NZD-USD	0.6094	0.59	0.60	0.61	0.62	0.62
<b>AUD Exchange Rates:</b>						
AUD-USD	0.6537	0.64	0.66	0.68	0.70	0.70
AUD-EUR	0.5996	0.60	0.62	0.64	0.65	0.65
AUD-JPY	70.36	68.5	69.3	72.1	74.9	74.9
AUD-GBP	0.5374	0.52	0.54	0.55	0.56	0.56
AUD-NZD	1.0726	1.08	1.10	1.11	1.13	1.13

	2019	2020 (f)	2021 (f)
GDP, %	2.2	-5.0	4.0
CPI (Headline), %	1.8	0.3	2.4
CPI (Trimmed mean), %	1.6	1.1	1.8
Unemployment Rate, %	5.2	8.0	7.0
Wages Growth, %	2.2	1.8	1.6

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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