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THE BIGGER PICTURE – A GLOBAL & AUSTRALIAN ECONOMIC PERSPECTIVE

National Australia Bank

The Coronavirus outbreak that emerged in January – centred on China, the world's largest economy – is likely to lead a major shift down in global growth with the impact concentrated in the East Asia region. The result in Q1 is expected to be the weakest rate of growth (in year-on-year terms) since the Global Financial Crisis, and the Chinese economy is expected to show no growth (compared with an increase of 1.5% q/q in Q4). As a result, we have revised down our forecasts for global growth in 2020. For the full year, we forecast global growth of 3.0% (3.2% previously) but with a recovery in 2021 to around 3.5%. This outlook is predicated on a relatively short (single quarter) disruption in activity followed by a recovery in Q2; a 'best-case' scenario. However, it is highly uncertain how long the virus will continue to spread and the containment measures remain in place. Should it prove to be a prolonged period, this would add significant additional downside risk to our forecasts. The Coronavirus struck when the global economy, while still fragile, was in slightly better shape with underlying momentum stronger than for much of 2019. Importantly, this also applied to India which had been seriously underperforming. Moreover, there had been some alleviation in trade policy headwinds with the US-China Phase One trade deal and USMCA ratification almost complete.

- The outbreak of the 2019-nCoV or Coronavirus in China is likely to have a significant impact on both the Chinese and global economies. Efforts to contain the Coronavirus will likely restrict global trade and manufacturing activity in the short term (including through supply chain disruption), along with personal services in affected regions, and tourism & travel services worldwide (particularly in markets when Chinese tourists comprise the largest share of visitors). While difficult to quantify the duration of the virus and associated containment measures, for now we assume a short-term downturn (in Q1) and rebound in subsequent quarters, similar to the profile exhibited with the SARS outbreak in 2003.
- The **coronavirus** outbreak, and the economic impact of the associated containment efforts, jolted **financial markets**, with falls in stock markets, commodity prices (particularly energy), bond yields and some increase in spreads and volatility. However, since early February markets have either stabilised or recovered to some degree. Major AE **central banks** are likely to 'look through' the virus impact initially; but if virus containment efforts are maintained for a sustained period, the resulting economic damage (and risk of a downward spiral) would likely prompt a re-think, at least for the AEs with policy room (US, Canada and UK). In contrast, EM central bank policy continues to loosen – already in February China, Brazil, Russia, Thailand and the Philippines have eased monetary policy settings.
- Overall major **advanced economy (AE)** growth was likely very subdued in Q4 2019, and another sluggish quarter of growth is expected in Q1 2020. Business surveys, which stabilised towards the end of 2019, strengthened in January suggesting an underlying improvement in AE economies was underway as trade risks receded. However, the fall-out from coronavirus containment efforts, and other one-off factors such as the Boeing 737 MAX aircraft production halt, is likely to delay a substantive improvement in AE growth until mid-2020.
- While economic conditions in **Emerging Markets (EMs)** appeared to stabilise in the latter months of 2019 and into 2020, the Coronavirus outbreak in **China** is likely to have a large negative impact, primarily in China and East Asia, with spill over via trade and travel links with other regions. Our forecast assumes a sharp slowdown in Q1 – with no quarter-on-quarter Chinese growth (compared with an increase of 1.5% in Q4). The duration of the outbreak and associated containment efforts, is very uncertain. At this stage we assume a recovery in Q2, however there remains the risk of a larger and more prolonged downturn. As a result, we now expect China's full year growth will be 5.5% in 2020 (revised from 5.9%). Our forecast for 2021 is unchanged at 5.8% – a modest recovery from this year, but in line with a longer-term trend slowdown in growth.
- A key driver of the relative strength in the EM January PMI readings was **India**; the surveys point to stronger domestic demand and better employment indicators. A loosening in fiscal policy in FY 2020/21 will also assist a recovery in Indian economic growth in 2020, which is critical to underpinning stable global growth this year.
- Reflecting the impact of Coronavirus counter-measures on economic activity – primarily in China and, to a lesser extent, in East Asia, we have revised down our forecasts for **global growth** in 2020. For the full year, we forecast growth of 3.0% – the same rate of increase as 2019, and below the long-term trend (3.5%). Most major economies and regions are expected to record weaker growth in 2020 – most notably the US, Japan and China – with the stable rate of growth dependent on a recovery in India (the world's third largest economy), Latin America and the Middle East.
- For more detail on the global outlook, please see the Forward View – Global, released yesterday.

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***Australia**: Private demand remained very weak at the end of 2019 and we expect very modest growth in Q4 – mainly due to net exports and public spending. Onto that weak base we have attempted an early view on what Bushfires and the Coronavirus might do to the forecasts. We now expect a small negative for Q1 2020 growth, driven by weaker consumption and a hit to tourism, education, commodity prices and incomes. It also seems likely that wage growth momentum eased into late 2019/early 2020. While we assume that most of the negative impacts from the virus and bushfires have passed by Q2 this still could see y/y growth to Q2 2020 slow to around 1%. By H2 2020, we expect that rebuild effects from Bushfires start to cut in and stabilise the dwelling cycle - with investment in dwellings strengthening markedly in 2021. By then lower rates should have boosted household balance sheets and consumption and, hopefully, business investment. We have lowered our previous GDP forecasts by around ½% in 2020 to around 1.5% but boosted 2021 by around 0.3% to 2¾%. We still expect the labour market to weaken with the unemployment rate expected to reach 5.5% in H2 2020. Reflecting these factors, and subdued inflation, we still expect two more cuts – the first in April and another by around mid-year, and there is a risk of a move to 'unconventional' policy in H2 2020.*

- Clearly the **RBA**, given its current forecasts, don't see the need for further cuts. But we fear the RBA forecasts will be proved overly optimistic very soon. Hence, we still expect two more cuts – the first in April (albeit the exact timing will be data dependent) and by around mid-year. Beyond that, the risk of a move to 'unconventional' policy in H2 2020 will depend critically on whether the labour market deteriorates more significantly than we forecast. Hopefully fiscal stimulus will also be forthcoming in the next Budget (but doubt the Surplus will be maintained in 2021/22).
- The **unemployment rate** edged down to 5.1% in December, with employment growing by 29k in the month. The participation rate remained close to its record high. Over the year, employment rose by 2.1%, a strong outcome and faster than working age population growth. The participation rate also rose 0.3ppt over the year, so while employment demand has remained robust, there has been a large supply response in the labour market which has seen the unemployment rate remain broadly unchanged over the year. Given the supply response, growth (and employment demand) has been insufficient to drive down spare capacity in the labour market – resulting in little improvement in wage growth. While the labour market continues to see favourable conditions, econometric modelling suggests that the slowing in economic growth will translate into a slowdown in employment demand. Importantly, this month, the monthly business survey employment index softened.
- Nominal retail sales declined by 0.5% in December, although this followed strong growth in November (likely reflecting the impact of the Black Friday sales in November). The ABS noted that some retailers reported that December sales were affected by bushfires in NSW. The Coronavirus will be an additional headwind. Retail volumes increased by 0.5% q/q in Q4, but were up only 0.4% y/y over the last year. Weak wage growth and associated household caution is likely to see ongoing restraint in **consumption** growth. We suspect that total consumption in Q4 will still be only around 0.4% for y/y growth of around 1.2%, and January retail looks weak.
- **Business investment** has remained weak over the past year. Mining sector investment has edged lower, but the post-boom decline appears to have tailed off. From here we do not expect a significant pickup in investment in the sector beyond earlier planned expansions and a higher level of sustaining capex. Of more concern is the softness in the non-mining sector which has tracked sideways over the past two years, despite record low interest rates and a significant pipeline of public infrastructure work (which is largely completed by the private sector). The monthly business survey suggests that there has been a broad-based deterioration in conditions since early 2018. While the past few surveys have seen conditions stabilise, it is at a below average level. Confidence is also low (and negative) suggesting firms do not expect a significant improvement from here.
- **Dwelling prices** in Sydney and Melbourne have continued to recover strongly in recent months. Since reaching a trough in May, prices in each city have risen by over 10% and are now 5% and 2% below their prior peaks. We expect further gains in Sydney and Melbourne in 2020 and 2021, though at a slower rate. Prices will be broadly flat across the other capitals. In contrast, we expect **dwelling investment** to continue to decline this year, falling by another 7% before levelling out in 2021. While, the decline in approvals looks to have bottomed, applications for new building remain low, and imply ongoing weakness in new construction.
- **Net exports** look like contributing around 0.2% to GDP growth in Q4, for an annual contribution to growth of nearly 1 ½%. We expect exports to make a contribution in the near term to growth but that this will level off with little further expansion in the mining sector underway. Growth in exports will likely come from services such as tourism and education, but this will depend on the exchange rate, world income growth and how long the Coronavirus crunches China.
- Following on from relatively strong prices across most markets in the first half of January, **commodity prices** have generally retreated in early February in response to the Coronavirus outbreak. In annual average terms, US dollar commodity prices are forecast to fall by 13.8% in 2020 – driven by falling prices for iron ore, liquefied natural gas (LNG) and metallurgical coal
- Recent weakening of the **AUD** in the face fears of what the Coronavirus might do to China is clearly a help in Australia's adjustment to recent shocks. That said, we have not changed our currency forecast of around 0.70c by end 2020 and 0.74c by end 2021.
- For more detail on the Australian outlook, please see the Forward View – Australia, released on Wednesday.

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