Westpac Market Outlook

February 2020.

Australia and the global economy

Westpac Institutional Bank

Contents

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Executive Summary

The 2020 year is shaping up to be another challenging one for the economy, both globally and domestically. Our central case is for world growth to remain subdued, having slowed materially since 2017. Trade tensions persist and tariffs remain in place despite the phase I trade deal between the US and China, and the US faces uncertainty ahead of the Presidential election on November 3. Closer to home, conditions in Australia are set to be stuck at a below trend pace. We expect two further rate cuts from the RBA (April and August), as well as QE, and three cuts from the US FOMC. Central bankers, particularly the RBA, appear content to watch and wait, for now, which could delay the timing of these rate cuts.

Adding to the uncertainty is the outbreak of the coronavirus, the epicentre of which is China, an event which has sent shock waves around the world. The full impacts of this epidemic remain highly uncertain, including from an economic perspective. There are widespread disruptions to China's economy with the Lunar New Year holiday period extended and with more recent tentative efforts to return the economy to work yet to be effective. The movement of people in and out of China is all but shut-down, significantly disrupting global tourism and global education - including for Australia and New Zealand.

A central case scenario, discussed in our detailed report on February 6, based on intense disruptions persisting for a couple of months, would see a sharp shock to growth in China and in Australia in the March quarter, with a rebound spread over the June and September quarters. For 2020, we have lowered forecast growth for China (to 5.3% from 5.8%) and for the world (to 2.8% from 3.0%), as well as for Australia (to 1.9% from 2.1%).

The response to date of financial markets has been mixed. There has been a flight to safety, sending the Australian dollar lower, so too global longer term bond yields. Equity markets in the US and Australia have been relatively benign. Investors recognise that this is an event, not a trend and are aware that central banks are willing to provide additional support if needed.

Australia: Output growth is expected to remain stuck below trend at around 2% in both 2019 (2.1%) and 2020 (1.9%). Powerful headwinds persist, around: weak wages; the home building downturn; and the subdued global backdrop. The bushfires and coronavirus disruptions will, together, be significant, with growth potentially stalling in Q1, ahead of a rebound over Q2 and Q3.

Commodities: The coronavirus is having a mixed impact on commodities. Mostly it is downwards, with falling crude oil and iron ore prices. Chinese mining production has also been impacted, leading to rising coal prices. These price movements will reverse as the disease is contained and Chinese activity returns to normal. Beyond that, while the government's policy response to the slowdown presents upside risk, we still expect iron ore and coal prices to soften into end 2020 as supply conditions improve.

Global FX markets: The past month has seen coronavirus take over from trade tensions as the market's fear. A flight to safety has clearly been seen in the US dollar, even against the Japanese Yen. As 2020 progresses however, we expect that relative growth and policy differentials will reassert as the key determinants of FX pairs. This will be to the detriment of the US dollar.

New Zealand: New Zealand's economic outlook has been improving on the back of higher consumer and government spending. However, the coronavirus has thrown a very large spanner in the works. We are working to a scenario in which economic life is disrupted for only a couple of months. Even then, our forecast for March quarter GDP is now only 0.1%.

United States: As 2019 drew to a close and 2020 began, the US economy clearly lost momentum. This is not a harbinger of recession by any means. But it does highlight that, for growth to print at trend or above in coming years, consumption and business investment will have to fire. Notable in recent communications from the FOMC has been a much closer eye on sub-par inflation. This shift gives us greater confidence that the FOMC will cut the fed funds rate three times in 2020.

China: The coronavirus will prove a significant shock to GDP growth, even if the outbreak is contained within a quarter, as the SARS outbreak in 2003 was. We have taken 0.5ppts from our 2020 forecast, but if the crisis persists into Q2 and/or authorities are slow to deliver offsetting stimulus, then the slowdown could be much more severe. For the global economy, the spill overs to neighbouring nations are as significant as the deterioration in China. Each factor will take 0.1ppts off 2020 world growth.

Europe: Just as the risk of a further escalation in trade tensions ebbed, Europe has now been hit by another wave of uncertainty as a result of the coronavirus outbreak. If the region's economy was firing, then there wouldn't be any need for concern. However, this is not the case. The Continent's consumer remains in good shape, but business lacks the confidence to invest. This is true both of firms exposed to trade as well as those engaged in domestic demand.

Summary of world GDP growth *(year average)*

Real GDP %ann*	2015	2016	2017	2018	2019f	2020f	2021f
United States	2.9	1.6	2.4	2.9	2.3	1.6	1.5
China	6.9	6.7	6.8	6.6	6.1	5.3	6.1
Japan	1.2	0.6	1.9	0.8	0.8	0.4	0.4
India	8.0	8.2	7.2	6.8	5.4	5.5	6.0
Other East Asia	3.8	4.0	4.5	4.3	3.6	3.3	3.9
Europe	2.1	1.9	2.5	1.9	1.2	1.0	1.2
Australia	2.3	2.8	2.5	2.7	1.8	1.8	2.6
New Zealand	3.5	3.9	3.1	3.2	2.3	2.3	3.4
World	**3.5**	**3.4**	**3.8**	**3.6**	**3.0**	**2.8**	**3.2**

Sources: IMF, Westpac Economics. Aggregates weighted using purchasing power parity exchange rates.
***Year average growth estimates,** the profile of which can differ from that of the 'growth pulse'.

Australian dollar: under the weight …

The Australian dollar has taken a tumble…

After reaching a peak just above USD0.70 at the turn of the year, the weight of the world has come to bear on the Australian dollar. Currently the pair sits at USD0.67, but this follows a number of days when the currency traded below that mark in early February as coronavirus concerns peaked.

… as global risks flared once again.

It is not surprising that the coronavirus could have such a marked impact on the Australian dollar in such a short time. China is our number one trading partner and, even if the outbreak is contained by the end of the first quarter, the shock to growth will be substantial. Based on the SARS outbreak of 2003 and the evolution of China's economy since that time, we expect the coronavirus to take 0.5ppts from year-average growth for China, taking it down to 5.3%. Combined with the spill overs to neighbouring nations, this will take 0.2ppts off global growth in 2020 (now forecast at 2.8%).

Equity markets have, to date, brushed off this real economy shock, showing little concern for the potential cost to future profits, or perhaps simply expressing a belief that central banks will act to offset any downside. The sustained move in commodities however franks the economic significance of the coronavirus.

Commodity prices speak to the risks for the economy and AUD.

The largest move has been in oil, with Brent falling close to 20% from its level at end-December. This came as a result of the sharp decline in Lunar New Year travel and subsequent multi-week travel bans within and outside of China.

For iron ore however, supply disruptions in Australia and Brazil kept the price decline to 12%. Supply developments have more than offset the shock to coal, thermal coal prices rising 2% since the beginning of January and met coal +12%. With regards to fair value for the Australian dollar, the net effect of commodities over the past two months is then negative, but limited in scale.

But for AUD, the US/Australia policy differential is an offset…

The other key variable that determines fair value for the Australian dollar is the interest rate differential between Australia and the US. Since our last Market Outlook, there has been no change in the policy rate in either jurisdiction. But expectations for 2020 have shifted.

Whereas in December, the next cut by the RBA was priced by March 2020, the market now does not anticipate it until August 2020. Meanwhile, on the other side of the world, the odds of policy easing have firmed, an additional 11bps priced in to fed funds rate expectations by year's end.

… one Westpac expects to persist.

In net terms, this is a supportive development for the Australian dollar, one we expect to persist. Westpac's expectation for monetary policy in the US is more aggressive than the market. Over the second half of 2020, we believe the FOMC will be required to cut the federal funds rate three times, taking the midpoint of the fed funds range down to 0.875%.

Our timing has the RBA lowering rates in April (ahead of the US) and then again in August, down to 0.25%. With the three rate cuts in the US timed for the second half of the year, this will put a floor under the Australian dollar around mid year and may then see our currency begin to rise.

The stabilisation in AUD anticipated in 2020…

Our forecast for the Australian dollar to only rise a cent from June 2020 to December 2020 could be regarded as evidence that this is a benign risk. However, this forecast necessitates that the RBA provides additional stimulus as it moves to unconventional measures.

… will depend on the RBA cutting to 0.25% and beginning QE.

Having cut the cash rate to 0.25%, we continue to forecast that the RBA will embark on a QE program that will last for at least a year from late-2020. Absent this step, Australia's competitiveness and corporate profitability could become impaired, and the lift back to trend GDP growth that we anticipate for 2021 (led by an emerging upturn in home building activity) may prove a stretch.

The other factor holding the Australian dollar down through the remainder of 2020 is a further broad-based decline in commodity prices. Without this trend, the Australian dollar would likely strengthen over the period.

AUD will then gain in 2021 as policy proves effective for growth.

Looking forward to 2021, a combination of a benign global outlook and a sense of stability in commodity markets should aid the Australian dollar back above USD0.70. The further we move into that year, the more monetary policy will have been seen to be effective, as Australian GDP growth tends back to trend on broad-based gains across household demand and business investment. A peak of USD0.72 is seen at the end of 2021.

Elliot Clarke, CFA Senior Economist

... of the world

Chart 1.

AUD/USD & AUD TWI

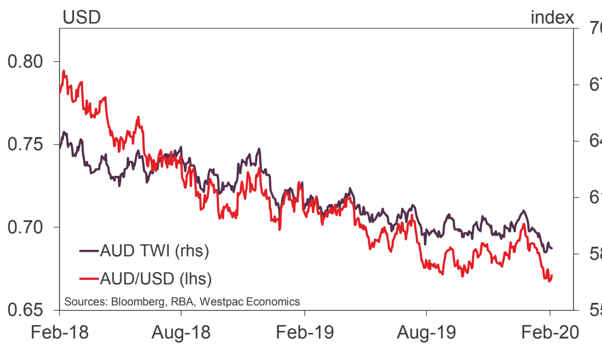


Chart 2.

AUD/EUR & AUD/NZD

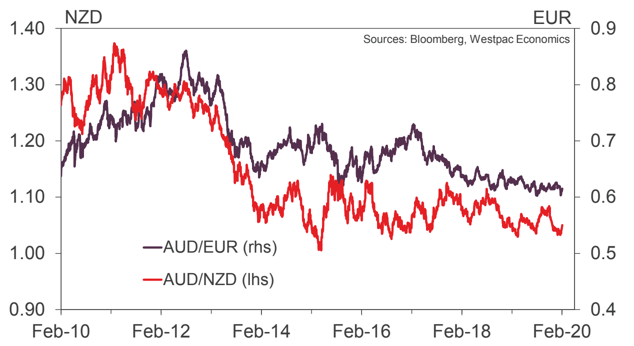


Chart 3.

Australian growth to underperform the US

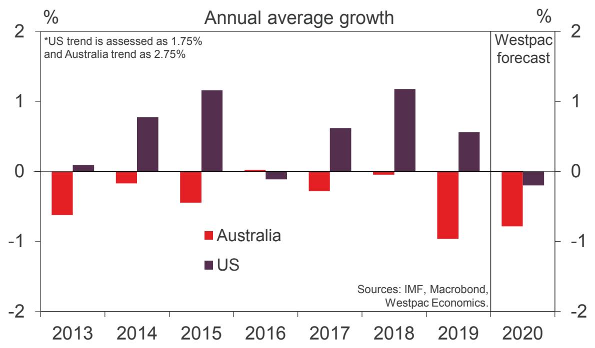


Chart 4.

But FOMC to cut further than RBA

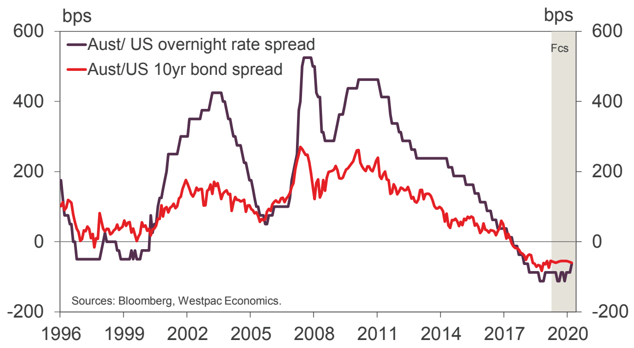


Chart 5.

Australian QE necessary to hold AUD down

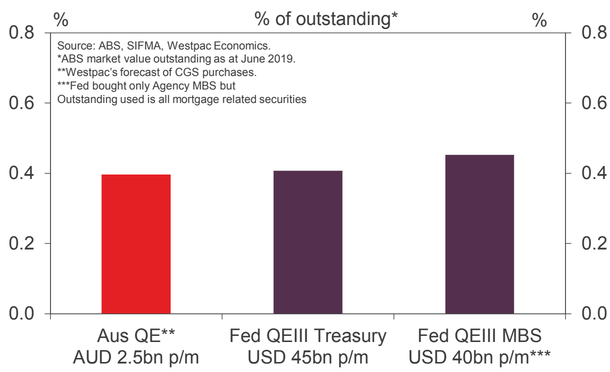
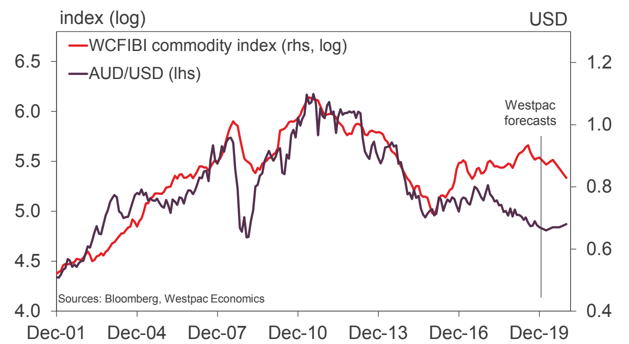


Chart 6.

So too softer commodity prices



Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

Australian interest rates: RBA's 2020 vision

RBA holds ...

Early February has seen a flurry of RBA communication including the Board's first policy decision for 2020, a speech from Governor Lowe on "the year ahead", the semi-annual testimony to Parliament and the February Statement on Monetary Policy (SMP). The main themes have been: 1) a surprisingly confident outlook, notwithstanding a weaker recent performance and near term outlook due to bushfires and the coronavirus; 2) a more positive view on housing, most notably around construction; 3) a continued preparedness to cut rates further, if needed, particularly if the labour market weakens; and 4) more weight in the 'balance of risks' assessment being placed on the potential for further rate cuts to drive a renewed increase in household debt.

... and retains a surprisingly confident outlook ...

The SMP provides the fullest account of the RBA's assessment. The central message here is that despite some downward adjustments to near term estimates: "... the medium-term outlook for the Australian economy is broadly unchanged from three months ago." The bank's forecasts have GDP growth of 2% for 2019, 2.7% for 2020 and 3% 2020. That compares to 2.3%, 2.8% and 3.1% in the previous SMP in November. The medium term 'central case' view is of a gradual return to 'around trend' this year and rising slightly above trend in 2021. Similarly, the unemployment rate is expected to hold in the 5-5¼% range near term before gradually declining heading into 2021.

... despite weak momentum ...

We are particularly surprised that the RBA has retained its 'around trend' growth forecast for 2020 given the weaker momentum apparent in the September quarter national accounts; developing questions around the global economy; and the softer tone from a range of labour market lead indicators. Westpac's forecast is more downbeat, coming from a weaker starting point. We expect growth, which was around 2% in 2019, to remain stuck at this pace in 2020 as powerful headwinds continue to impact, compounded by disruptions from the coronavirus and the bushfires. That in turn is expected to see the unemployment rate drift higher, and more policy easing from the RBA with 25bp cuts in April and August followed by QE.

... and clear threats from bushfires and the coronavirus.

Note that the RBA's latest forecasts include preliminary assessments of the impact of both bushfire and the coronavirus, although the high degree of uncertainty around the latter is stressed. It's more detailed forecasts show a material downgrade to the first half of 2020 with annual growth to June 2020 downgraded to 1.9% from 2.6% previously. As the largely unchanged calendar year forecasts imply, this is offset by a rebound in the second half.

For now, the RBA is content to watch and wait...

Key to the RBA's positive full year outlook are signs that last year's policy easing is working to generate a lift in momentum – especially in the housing sector – and a view that this will continue as the 'long and variable lags' flow through to other areas, consumer demand in particular. From the SMP: "The transmission of monetary policy is evident in established housing markets ... It is too soon to see any response to this in household spending, but over time the drag on consumption growth from the earlier decline in housing prices and activity should wane."

... as the 'long and variable' lags from policy easing come through.

This lift in spending is expected to come despite headwinds for household income. One of the more striking shifts in the RBA's forecasts vs November is a hefty downgrade to real household disposable income growth for 2020, from 2.3% to 1.4%. The path for spending implies that this is largely offset by a significant decline in the household savings rate. Elsewhere, there have also been lifts to the 2020 forecasts for home building (to -1.9% from -2.6% in November) and business investment (9.3% from 6.2%), the latter driven by mining investment.

The RBA's global view is fluid ...

The RBA's messaging on the global backdrop has been a little uneven. The main emphasis in the Governor's decision statement and speech was that "global growth is expected to be a little stronger this year and next than it was last year". However, the SMP notes that "overall growth in Australia's major trading partners is expected to be a little lower in 2020" – the difference possibly reflecting some late changes to allow for the emerging coronavirus shock. Either way, this is clearly an area open to future downgrades as this shock unfolds.

... and it is prepared to ease policy further ...

Despite the confident rhetoric on its 'central case' outlook, the Bank remains open to further policy easing, the Governor's decision statement noting the bank is prepared to ease "if the unemployment rate were to be moving materially higher and there was no further progress being made towards the inflation target."

... albeit with a bit more sensitivity around risks to household debt ...

However, there has been a notable shift in the way the Board is assessing the case for further cuts. Back in late November the RBA Governor indicated he was not particularly worried about the resurgence in house prices. In contrast, the February SMP explicitly notes that in considering the case for further policy easing "... a balance needs to be struck between the benefits of lower interest rates and the risks associated with having interest rates at very low levels", namely that lower rates could "encourage more borrowing by households ... when housing debt is already quite high."

... making the timing of this year's cuts uncertain.

Westpac continues to expect that a combination of weak economic growth and a deterioration in the labour market will require a further policy response. However, the RBA's surprisingly confident forecasts, as well as likely near-term volatility associated with current temporary shocks, casts doubt over how quickly they will respond. Currently we have April pencilled in for the next cut but the Governor may need more time to be convinced.

Matthew Hassan, Senior Economist

… looking decidedly 'rose-tinted'

Chart 1.

RBA: Westpac forecast and market pricing

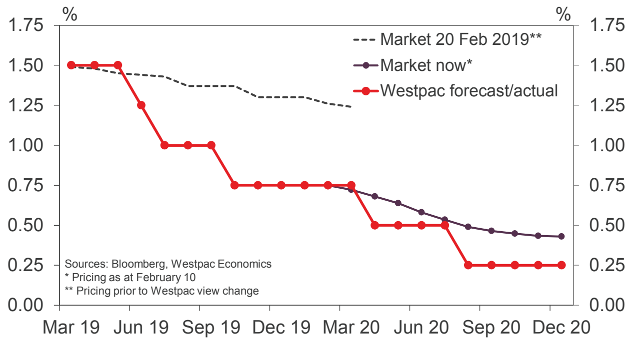


Chart 2.

10 year bonds yields: rally on flight to safety

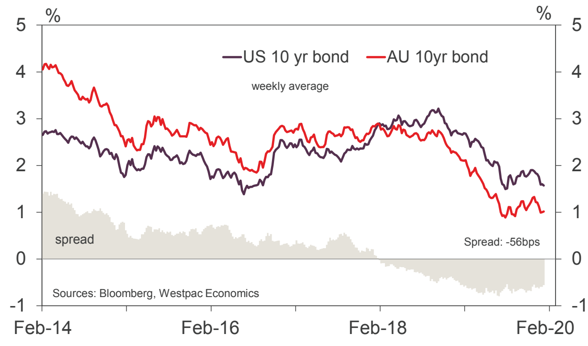


Chart 3.

Confidence weakens: businesses and consumers

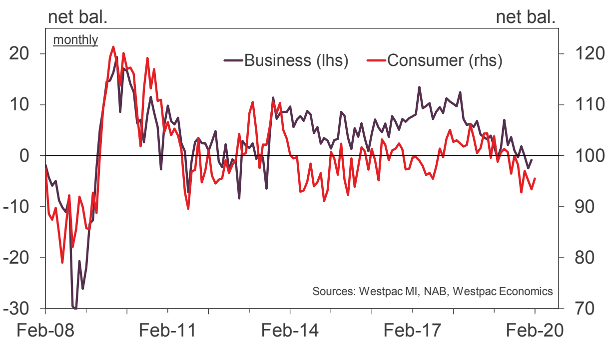


Chart 4.

Dwelling prices: Sydney & Melbourne rebound

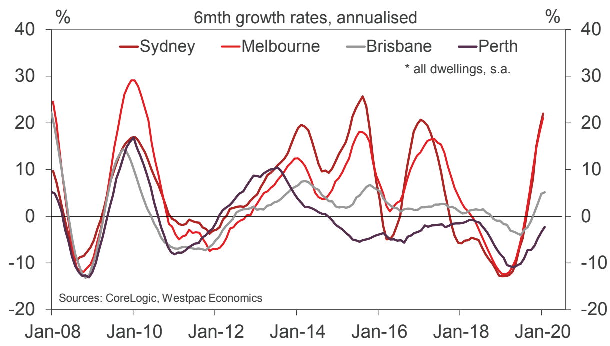


Chart 5.

Core CPI inflation: below target band

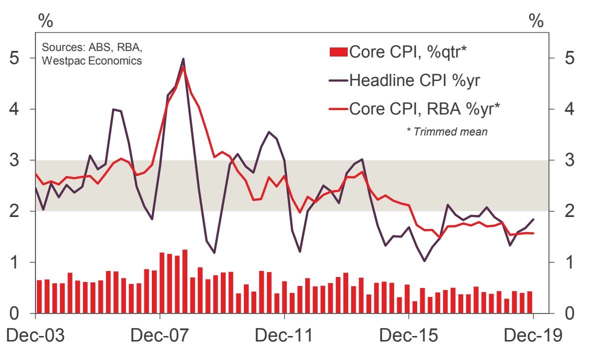
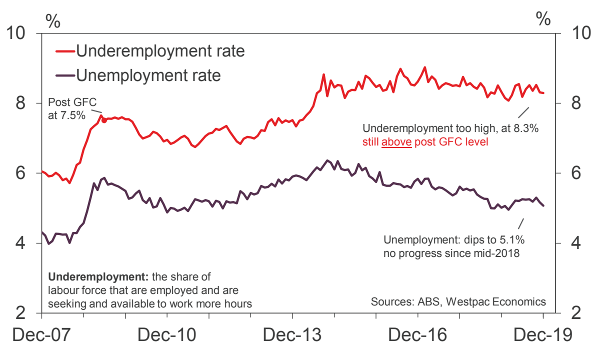


Chart 6.

Labour market: considerable slack persists



Australia: a weak start to 2020 …

Australian economy faces a number of challenges.

The 2020 year will be another challenging one for the Australian economy. Powerful headwinds continue to impact. In addition, disruptions from the bushfires and the coronavirus (the full extent of which is highly uncertain) point to a weak start to the year, followed by a rebound.

Our central case is for real GDP growth to be stuck below trend, at around 2% in both 2019 (2.1%) and in 2020 (1.9%). In 2021, conditions are then expected to improve, with growth lifting to a forecast 2.7%, supported by an emerging upturn in the home building cycle.

In 2020, growth to be stuck below trend, at 2%.

Recent policy stimulus and the lower Australian dollar will provide some support to activity, so too a mining investment uptrend. RBA rate cuts have had an impact on the housing sector, most notably with a sharp rebound in prices. Although, modest income tax rebates appear – to date – to have been largely saved by households.

Consumer spending improvement to be only gradual…

We assess that powerful headwinds continue to impact the economy. These forces are cyclical, structural and global in nature. First, the economy is navigating a period of cyclical weakness centred on the construction sector (particularly housing). Second, a more enduring force, structural weakness in real wages, is constraining consumer spending. Third, the world economy has slowed as the trade and technology war takes a toll – denting both business confidence and investment plans. Partial indicators (eg private business surveys), suggest that conditions in the economy have stabilised at weak levels, after the sharp loss of momentum in mid-2018.

… a forecast 1.6% for 2020, constrained by weak incomes, high debt.

Against this backdrop, growth has been highly concentrated, centred on exports and government spending (in the form of public demand), with a focus on health and investment. In the year to the September quarter 2019, public demand grew by 5.2%, directly adding 1.2ppts to activity. Private demand contracted by 0.3% in the quarter and declined by 0.4% over the year. Looking ahead, some loss of momentum in public demand is widely anticipated, with the states facing weaker revenue growth and with the end of the NBN and NDIS roll-outs.

Home building, further downside in 2020…

Near-term, disruptions from the bushfires and the coronavirus will be significant. We now expect output to stall in the March quarter, followed by a rise of 0.8% in the June quarter. On our figuring, the bushfires subtract 0.1ppt from activity in both the December and March quarters, followed by a rebuild boost later in the year, such that 2020 growth is unchanged. The coronavirus impact – which remains highly uncertain – is expected to be: –0.4ppts in Q1; +0.3ppts in Q2; and –0.2ppts for 2020. Disruptions to tourism and foreign students from China will be at the centre of uneven growth over the first half of 2020, while weaker consumer and business confidence will weigh on growth over the year as a whole. See our earlier analysis for a more detailed discussion of the bushfires and the coronavirus.

… upturn emerging in 2021, on lower rates and rising population.

The home building cycle is a key uncertainty for the 2020 outlook. The RBA expects "the trough in dwelling construction …. to occur in the second half of 2020, before a recovery in residential construction gets underway through 2021". We see the risk of a more prolonged downturn, particularly around the high-rise segment, where financing is difficult and where lead times are considerable. We expect total home building activity to fall further in 2020, down 7%, with declines front-loaded and an emerging stabilisation in the December quarter.

Bushfires and coronavirus disruptions point to a soft start to 2020…

Consumer spending grew by only 1.2% in the year to the September quarter. The outlook is for spending to remain sluggish, improving only gradually, with growth forecast at 1.6% for 2020 (broadly flat in per capita terms), followed by a 2.6% increase in 2021 as homebuilding activity trends higher. Positives for households are that: house prices are now rebounding, after falling sharply in Sydney and Melbourne until mid-2019, providing a boost to wealth; and cash flows have improved on lower interest rates and modest tax rebates. Nevertheless, households remain under pressure from weak wages growth and high debt levels, as well as weakness in non-wage incomes and an underlying uptrend in tax payments. Real wages have been broadly flat since 2013, in contrast to 1.5% annual growth averaged through the 1990s to 2007. Against this backdrop the consumer mood is decidedly downbeat early in 2020, with the Westpac-MI Consumer Sentiment at 95.5 in February. It is perhaps not surprising then that households - to date – appear to have directed improved cash flows more towards strengthening their balance sheets than to boosting spending.

… with a rebound over June and September quarters.

Business investment is expected to decline by an estimated 1.7% in 2019, followed by a modest rise of 1.3% in 2020 and then a 4.5% increase in 2021 as the economy gains momentum. The near–term lift is centred on the mining sector, with an emerging uptrend following six years of decline. Across the non–mining sectors, investment (particularly equipment spending) is expected to be soft in 2020 in response to sluggish domestic demand and an uncertain and subdued global economy - an environment in which business confidence has evaporated.

Andrew Hanlan, Senior Economist

... in another challenging year

Chart 1.

Australian output per capita: 0.2%yr

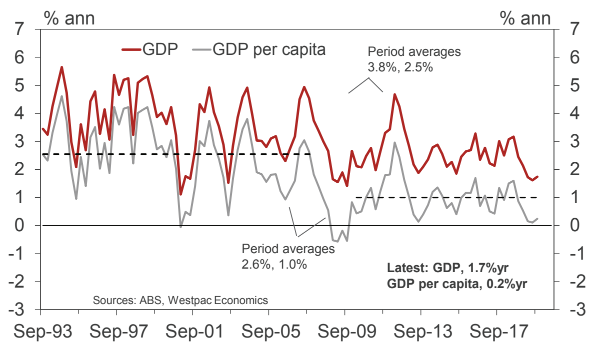


Chart 2.

Australia: the growth mix

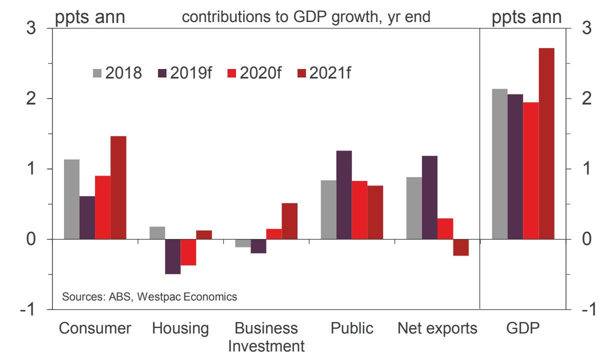


Chart 3.

Real wages weakness: a key structural challenge

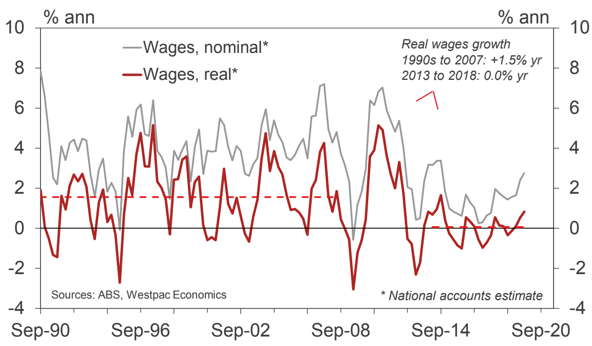


Chart 4.

Dwelling approvals: slump deepened in 2019

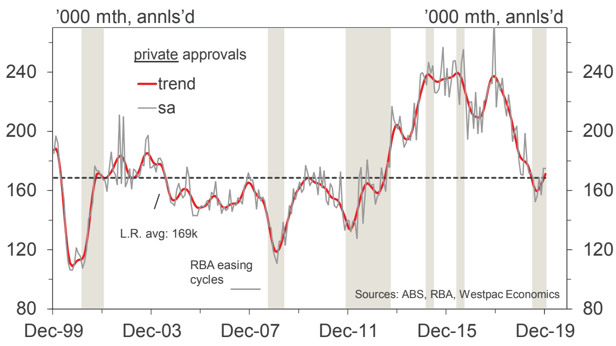


Chart 5.

Domestic demand: a private / public divide

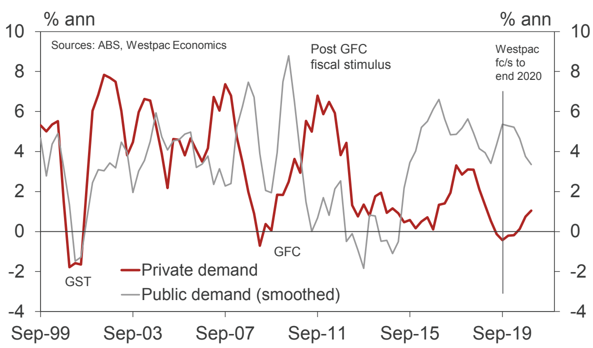
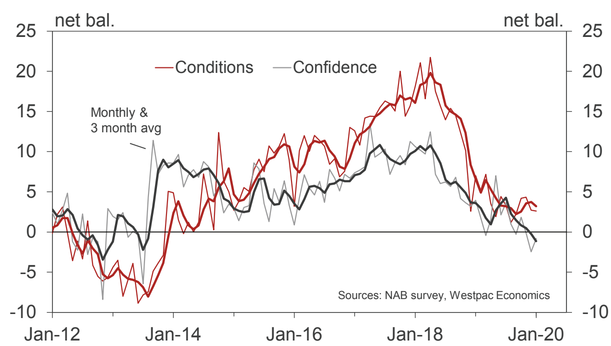


Chart 6.

Business conditions and confidence



Commodities: coronavirus hits prices …

China's dominance in commodity demand shifts the balance of risks …

China dominates commodity demand in the 21st century, altering the way commodity markets behave. But this shift has had other dimensions – changing supply arrangements (China is also a major producer of many commodities) and new pricing arrangements (there was no spot iron ore market in 2003) mean direct comparisons to the SARS event of 2003 are difficult. The SARS outbreak was followed by a broad depreciation in commodity prices following the WHO's global alert of mid March 9 (–11% for our broad WCFI). A recovery in prices soon followed once the outbreak was contained (+7% by end Sep). In 2020, our broad index has only fallen around 3% as coal prices have been supported by falling Chinese supply. Looking ahead, unlike in 2003 when the government prioritised growth above all else, the Chinese government appears to be reluctant to overstimulate the property sector. In addition, China's desire to develop new industry and export markets to offset the ongoing trade war with the US means fiscal stimulus and support for the private sector will be measured and targeted.

… due to disruptions from the coronavirus.

To date the most significant impact has been on crude oil. Chinese demand for crude collapsed 20% in Jan as travel and transport industries were shut down. Brent has fallen 20%. Other commodities have been more resilient, partly due to a range of supply issues. Coal has risen (+2% for thermal coal, +12% for met coal) with Chinese supply being curtailed by regional quarantines, while iron ore prices are down 12% with some modest support from reduced tonnages from Brazil. Copper has fallen around 8%, Nickel and Zinc are down 7% with lead down 5%. Softs/farm commodities have been more mixed, with supply playing an important role – as an example, Australian beef prices have risen almost 30% this year due to the drought.

Demand for crude has collapsed …

Commodity prices should hold around current levels until Chinese activity and demand recovers heading into the second half. Nevertheless, the overriding story for **iron ore** will be the recovery in supply, mostly from Brazil but also from Australia, pushing 62%fe down to **US$65/t** by end 2020. **Coal** prices are also likely to be facing increased supply (for thermal) and softer demand resulting in a modest easing in prices by year end; **US$125/t for met** and **US$63/t for thermal**. Softer global demand and robust supply will see **Brent around US$55/bbl** by end 2020 which, along with an ongoing increase in LNG supply, will drag LNG prices lower. **Base metals** are expected to be broadly softer. **Softs/farm commodities** will be affected by both demand and supply, and so have a more uncertain outlook.

Looking ahead, there are a number of factors we are keeping our eye on in 2020.

… and iron ore prices have eased as supply has firmed …

For **iron ore supply** will be a major factor with a focus on the recovery of Vale's production lost in 2019. The 60mt loss from the Vale mine disaster was the single biggest factor in the iron ore seaborne trade last year. Vale has the potential to again be the biggest swing factor with signs of a significant recovery in production this year pointing to the miner's exports lifting by 30mt. A secondary supply issue will be the response of **Chinese iron ore production to falling prices**. As imports tightened in 2019, and prices firmed, Chinese miners lifted production to be 12% higher in the year to December. Looking ahead, production should broadly stabilise. With only 25% of Chinese ore production exposed to import competition, and the remainder captive to steel producers or located in inland uncontestable regions, Chinese ore production is more dependent on safety and environmental regulations than seaborne prices.

… but the shut-down of China's coal industry has boosted coal prices.

Iron ore premiums are the final factor. In 2018 the spread between 65%fe and 62%fe peaked at 40% as record high steel margins saw producers focus on productivity and reducing emissions. During 2019, margin compression forced Chinese steel mills to switch focus to cost control, narrowing the spread to 7%. Westpac is forecasting the premium to hold around 14% this year.

Base metals have seen a demand shock induced fall in prices.

The outlook for **met coal** has a number of contrasting factors. **The first** is the peaking of steel production in 2020. Our forecast has year on year steel production up just 0.4%. The previous low in growth was 2.6% in 2016. The industry focus is now more about reducing capacity and swapping new capacity for old to improve efficiency and the long term viability of the industry rather than lifting output. The **second** contrasting factor is that growth in supply is becoming more challenging. Australian miners saw a rash of fatalities in 2019 and the Qld government is introducing new legislation in 2020 to make mining manslaughter an offence. In addition Australian mines are facing disruptions from bushfires, declining water supply and heightened Environmental, Social and Governance (ESG) expectations from investors and financiers. For the **longer term**, we are closely watching a ThyssenKrupp test project to replace PCI (soft met coal) with hydrogen, a potential step forward in decarbonising steel production.

Prices to be supported by recovery driven bounce before easing again into year end.

Thermal coal faces the prospect of **Chinea's domestic market** remaining oversupplied in 2020 even when the coronavirus shutdown ends, as the ramp up of new projects sustains a lift in supply that outpaces growth in demand. The Chinese government may make some adjustments to keep supply under control but they appear to prefer a slightly over-supplied situation to keep prices in a desired range. **Indian imports** should weaken as Indian production recovers and demand growth for coal slows. Finally, **low prices for LNG** will remain a drag on Atlantic coal demand as LNG supply continues to grow, suggesting LNG prices have further to fall.

Justin Smirk, Senior Economist

... but fundamentals are key for end 2020

Chart 1.

The impact is more mixed this time

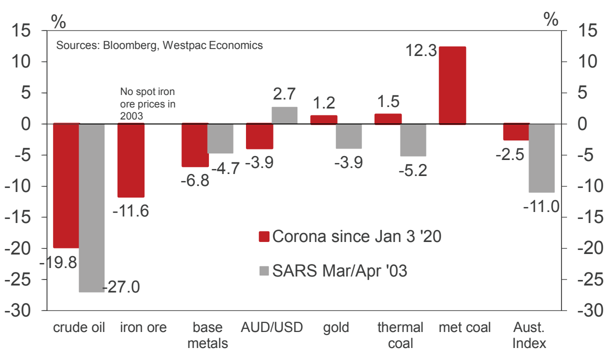


Chart 2.

Chinese iron ore production lifted in 2019

Chart 3.

Iron ore premium/discount to 62%fe

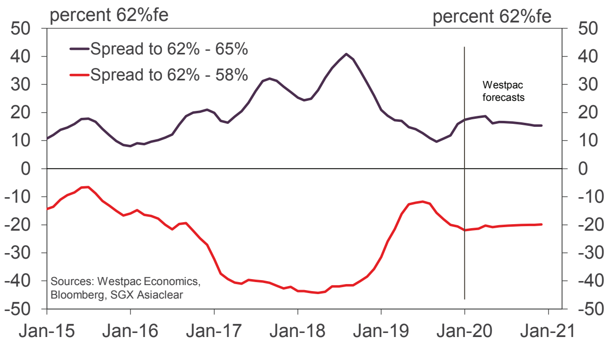


Chart 4.

Steel production & Chinese housing starts

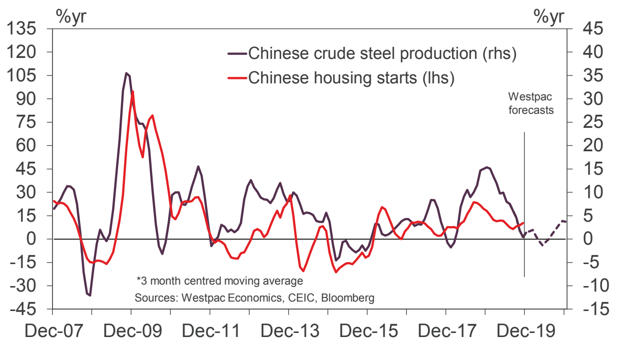


Chart 5.

Chinese steel mill margins

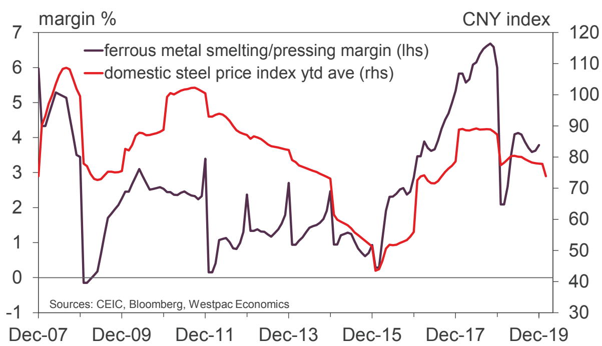
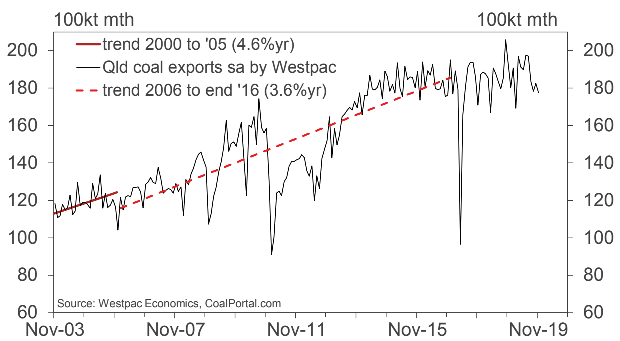


Chart 6.

Qld coal exports going sideways



Global FX: risks to abate and put focus ...

The US dollar has gained...

Since our last edition in December, the US dollar has gained strength amid global risks and as the US economy continued to grow at an above-trend pace. As we look ahead, we believe uncertainty will persist, supporting the US dollar. However, there is likely to be an offsetting shift in relative growth dynamics and a consequent turn in US monetary policy. This will leave the US dollar lower at the end of the year than its starting level.

At 98.7, the US dollar (on a DXY basis) is 1.3% higher than at the time of the December Market Outlook. While US/China trade tensions have entered hibernation, the coronavirus outbreak in China has quickly taken centre stage.

... as the coronavirus has spread.

Evident in global currency pairs and equities is a belief that this outbreak is foremost a concern for China and, to a lesser extent, the rest of Asia. Highlighting this, USD/CNY has held near the 7.00 figure, while USD/SGD lifted from 1.3585 to 1.3872 currently. The Yen typically also sees a strong safe-haven bid during global risk episodes; but in this instance, arguably owing to Japan's proximity to the virus, the currency has lost ground against the US dollar – USD/JPY up 1.0% since December to 109.83. Ahead, Japan's strong health system and already-announced fiscal stimulus should limit the negative shock that their economy will experience. As this becomes apparent in the data in coming months, sentiment surrounding the Yen should turn once again.

This is principally seen as a risk for China and, to a lesser extent, Asia.

This will see the Yen reverse its move since December (to around JPY109, or a little below), but the factor that will then extend this move down to the JPY105 level we expect in the second half of 2020 is a shift in the US/ Japan monetary policy differential. The Bank of Japan has already taken their policy stance to the extreme of unconventional monetary policy; hence only a material adverse development would justify another step into the policy unknown. Meanwhile in the US, the FOMC is comfortably within the bounds of traditional monetary policy and is a strong believer in the capacity and scope of policy easing to counter any threat to growth.

The US dollar trend will turn in coming months...

As GDP prints below trend through the first half of 2020, circa 1.4% annualised, and 2.0%yr core PCE inflation proves a stretch, the FOMC will shift its bias and then act. Three 25bp cuts are then expected to be delivered by the Committee, from June to December.

Note, this easing will not only impact USD/JPY but also EUR/USD as the ECB effectively holds the line with policy as financial conditions remain highly accommodative.

... as the FOMC shift their bias and inevitably cut, while BoJ and ECB hold.

The move higher for Euro will be measured and steady, with EUR/USD unchanged at its current level until March, and then only rising a cent per quarter to USD1.12 at year's end. This trend is set to continue in 2021, through to USD1.15.

On our read, this is not a trajectory that would alarm the ECB (particularly given the Governing Council is now focused on a year-long assessment of policy and communication). That said, if Euro were to gap higher and/or GDP growth disappoint our 1.0%/1.2% expectation for 2020/2021, then the ECB may look to jawbone the currency. This would be done through the Governing Council highlighting their willingness to accelerate asset purchases for a time. Although we are forecasting a 10bp cut to the deposit rate mid-year in response to the FOMC's first cut, this should only be regarded as a token gesture. There is no economic or financial market justification to take the deposit rate towards –1.0%, or any belief that it would be effective.

Sterling's Brexit honeymoon has ended.

In the lead in to Brexit at the end of January, we anticipated Sterling strength. By and large, this is what we saw. However, the honeymoon has proven much shorter than anticipated. Whereas we had forecast GBP/USD to hold around 1.32/33 through the first half of 2020, it is instead already down below USD1.30. This is likely in part because of the US dollar flight to safety discussed above, which will reverse hence. And, on our current forecasts, the BOE rate cut in March will quickly be overrun by the three cuts from the FOMC, altering the monetary policy balance. That said, the US will remain in the dominant position with respect to GDP growth and presumably trade relations. We therefore look for GBP/USD to essentially mark time through 2020 and 2021 around USD1.30.

China's structural strength and policy will inevitably assert.

For China, despite the rapid spread of coronavirus, it still seems most appropriate to anticipate it will be a temporary weight on growth and the Renminbi. The number of cases of coronavirus is a multiple of SARS, and this has occurred in a much shorter period. But the testing and quarantine/ treatment regime is more strict, and the mortality rate much lower and steady. Further, fiscal stimulus is ready and the Government is willing. Our base case is therefore that this outbreak will be contained by the end of Q1 and that USD/CNY will then fall as momentum in China's economy rebounds. We target CNY6.80 at end-2020 and USD6.60 at end-2021, a sizeable move from the current level just below CNY7.00.

Elliot Clarke, CFA Senior Economist

... on relative growth and policy stance

Chart 1.

DXY benefitting from safe-haven flows

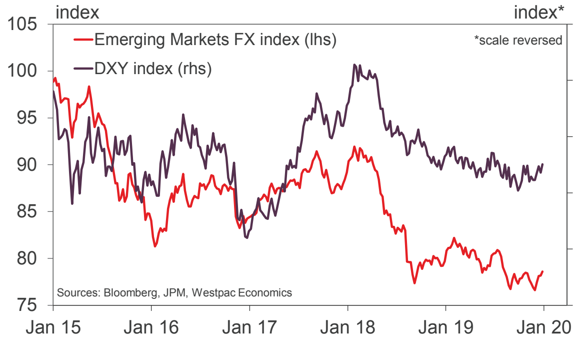


Chart 2.

USD/JPY affected by proximity of coronavirus

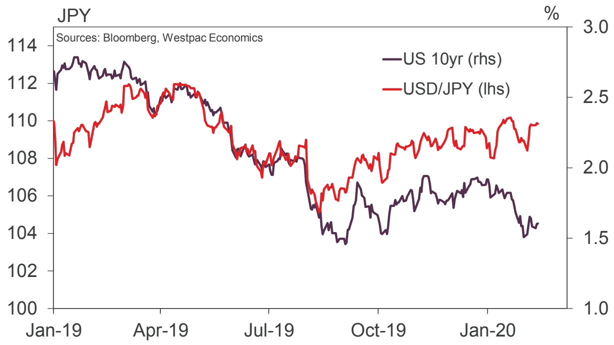


Chart 3.

Coronavirus has replaced trade as China concern

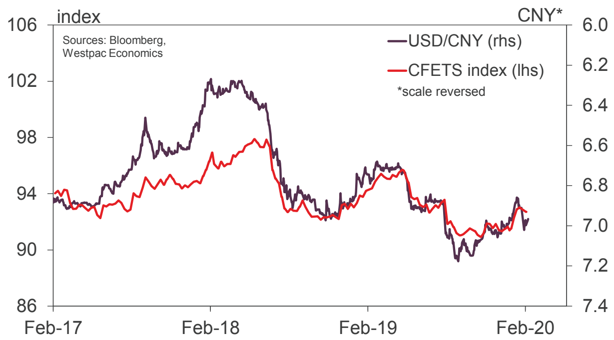


Chart 4.

Equities see offset from monetary policy

Chart 5.

Sterling's Brexit optimism proved fleeting

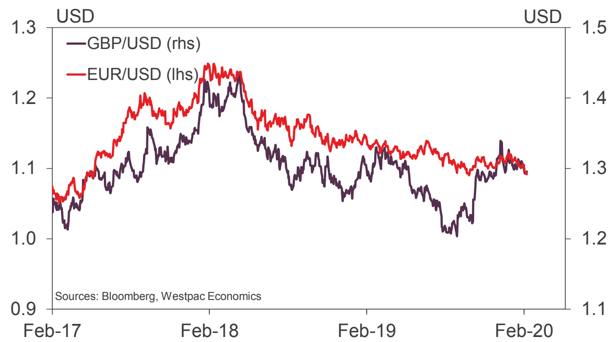
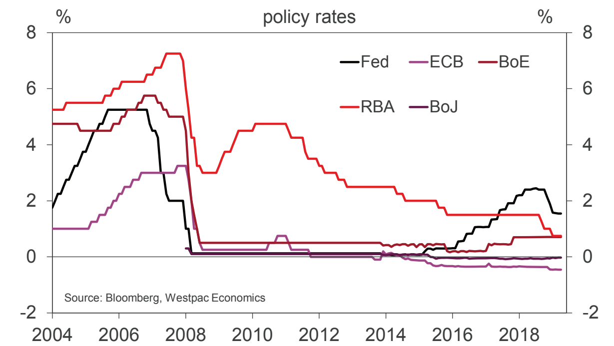


Chart 6.

US to keep cutting, but from well above others



Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

New Zealand: a strong backdrop ...

Consumer and government spending is now clearly boosting the economy…

Prior to the emergence of the novel coronavirus, it looked as though the need for OCR cuts in New Zealand was receding. GDP data showed that quarterly growth had recovered to 0.7% in September, after a slowdown earlier in 2019. Consumer spending was the highlight, and earlier indications were that the spending spree had rolled on into the December quarter. The Government announced a major infrastructure spending plan at the December Half Year Economic and Fiscal Update, which will stimulate the economy. Unemployment dropped further to 4%. And the housing market is picking up very much in the way we predicted last year.

…and house prices are rising as we anticipated…

In April 2019 Westpac was the only major forecaster to predict a housing market upturn, based on a big reduction in mortgage rates and the cancellation of earlier plans to introduce a capital gains tax. It now looks as though our then-controversial forecast of 7% house price inflation will be realised early this year. However, we do not expect the current housing market upturn to last long, as fixed mortgage rates are already rising.

…although businesses and farmers remain downbeat.

To be fair, it has not been all positive news. Businesses remain downbeat and some export commodity prices were worsening even before coronavirus became a factor. Most importantly, meat prices were previously sky-high due to African Swine Fever striking China's pigs, but they retreated after the Chinese Government loosened import restrictions on meat and liquidated some inventories. Dry weather in northern New Zealand is also impacting meat prices, as farmers are reducing the stock numbers on the parched land.

Prior to the emergence of coronavirus, we judged that the consumer- and government-led positives outweighed the business and export negatives. Accordingly, we predicted that the Reserve Bank of New Zealand would abandon its easing bias in favour of a more neutral OCR outlook.

But coronavirus has cast uncertainty over the outlook.

However, coronavirus has thrown a very large spanner into the works. The economic impact is wildly uncertain, but it is looking likely to be more severe than SARS, which blew over quickly. Since 2003 China has gone from 4% of global output to 16%, from 7% of New Zealand goods exports to 26%, and from 3% to 12% of New Zealand visitor arrivals.

Travel disruptions…

The quarantine efforts associated with coronavirus are much more draconian and widespread than they were for SARS. China has suspended indefinitely all outbound travel booked through the Chinese Travel Bureau and New Zealand has barred entry to all foreigners arriving from China, which will decimate New Zealand's tourism industry.

We are working to a simplistic baseline scenario in which New Zealand receives zero visitor arrivals from China for two months, visitor arrivals from the rest of Asia are down 20%, and there is a third month of partially disrupted travel. That, on its own, would reduce New Zealand's March quarter GDP by around 0.4 percentage points.

…cancelled log exports…

Meanwhile, China's own quarantine efforts and factory closures are severely impacting goods exports from New Zealand. China accounts for 80% of New Zealand forestry exports, but log shipments to that country have virtually ceased overnight. As logs start piling up on New Zealand wharves, the next step will be reduced lumber harvesting, with consequences for employment. If lumber shipments are disrupted for just one month, another 0.15% will be shaved off New Zealand quarterly GDP. However, unlike tourism, forestry exports will bounce back very quickly when China's factories restart – in fact, there will probably be a catch-up period of extra demand as Chinese factories work overtime to address shortages of finished goods.

…and lower prices for food exports…

Food exports are feeling the effect of lower Chinese demand via price impacts. The price of rock lobster fell by a third after many orders from China were cancelled, and the latest dairy auction registered a price decline of 6%. We expect to see big declines in meat and fruit prices in the near future, with a further impact on GDP.

…will reduce Q1 GDP growth by 0.6%, to 0.1%.

Overall, we are working to a scenario in which economic life is disrupted by coronavirus for just a couple of months. On that basis, we have reduced our forecast of March quarter GDP from 0.7% to 0.1%. In this scenario economic activity would quickly rebound to normal levels, meaning quarterly growth rates of around 0.9% for the remainder of 2020 (compared to about 0.7% per quarter without coronavirus).

The RBNZ will adopt a wait and see approach.

The actual impact is highly uncertain, and could be much worse depending on how long quarantine and other disruptions last. During this period of uncertainty, we expect the Reserve Bank to keep the OCR on hold but say that it stands ready to reduce the OCR if required by the coronavirus situation.

Dominick Stephens, Chief Economist NZ

... derailed by coronavirus

Chart 1.

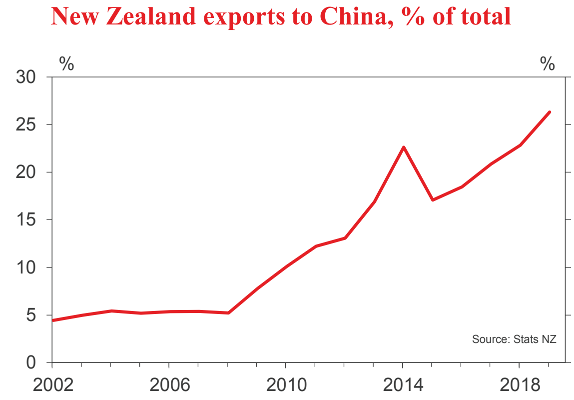


Chart 2.

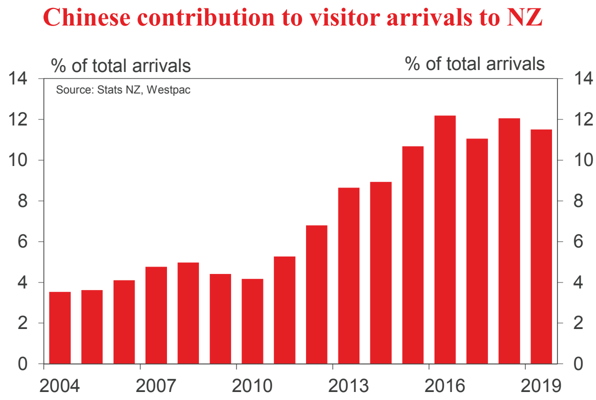


Chart 3.

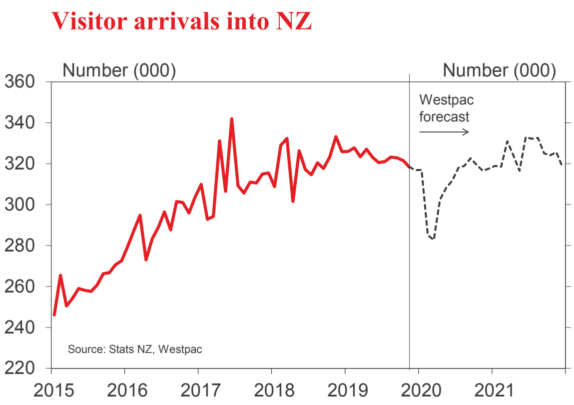
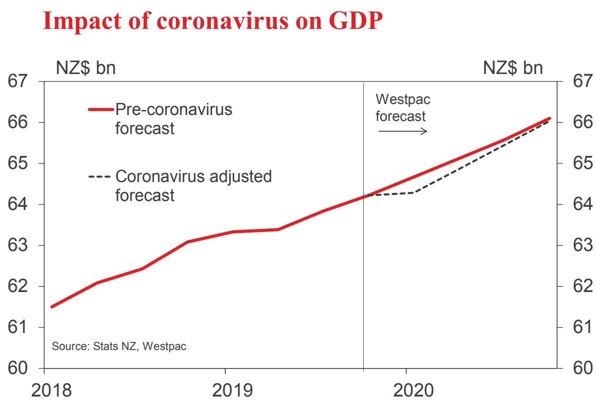


Chart 4.



Key New Zealand indicators

	2019										2020
Monthly data	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**	**Jan**
REINZ house sales %mth	–3.6	–4.1	1.2	2.0	8.0	–2.4	–1.8	3.5	4.5	–1.5	–1.7	–
Residential building consents %mth	3.1	–7.1	–8.5	16.1	–4.2	–1.2	0.7	7.0	–1.2	–8.4	9.9	–
Electronic card transactions %mth	–0.4	0.1	0.6	0.0	0.4	–0.1	1.4	0.7	–0.3	0.9	–0.6	–
Private sector credit %yr	5.5	5.7	5.6	5.4	5.4	5.9	5.7	5.6	5.6	5.7	5.7	–
Commodity prices %mth	2.8	4.1	2.6	0.0	–3.9	–1.4	0.3	0.0	1.2	4.3	–3.4	–0.9
Trade balance $m	–498	83	–422	–318	–91	–732	–532	–343	–372	–387	63	–

Quarterly data	**Q1:18**	**Q2:18**	**Q3:18**	**Q4:18**	**Q1:19**	**Q2:19**	**Q3:19**	**Q4:19**
Westpac McDermott Miller Consumer Confidence	111.2	108.6	103.5	109.1	103.8	103.5	103.1	109.9
Quarterly Survey of Business Opinion	14	7	1	4	–2	–4	–11	–11
Unemployment rate %	4.3	4.5	4.0	4.3	4.1	4.0	4.1	4.0
CPI %yr	1.1	1.5	1.9	1.9	1.5	1.7	1.5	1.9
Real GDP %yr	3.2	3.2	3.2	3.2	3.1	2.7	2.8	–
Current account balance % of GDP	–2.8	–3.2	–3.6	–3.8	–3.6	–3.3	–3.3	–

Sources: ANZ, Statistics NZ, REINZ, RBNZ, NZIER, Westpac Economics.

United States: FOMC to act on below trend …

The strength of prior years is giving way.

2017 to 2019 was a particularly strong period for the US economy. President Trump's tax cuts and the increase in government spending agreed to by both parties brought momentum and confidence to the economy. Annual GDP growth averaged 2.5% over the three calendar years – a rate materially above potential growth, which we put at 1.75%.

While during 2017 and 2018, growth in private demand was broad based across the consumer and business sectors, firms' willingness to invest to expand capacity evaporated in 2019 as trade tensions escalated and were then sustained.

Business investment is weak.

To give context, in 2017 and 2018, business investment grew by close to 6%. In 2019 however, investment was broadly flat. Indeed, investment in real assets declined through the year (structures fell 7%yr and equipment spending –1.5%yr), offset by a 6.2%yr increase in intangible investment. It is also important to highlight that investment's loss of momentum was persistent over the nine months to December, and leading indicators point to further weakness in 2020.

Above-trend growth was only able to be sustained in 2019 because of a temporary increase in Federal government spending and, much more importantly, due to continued strength in household demand. Of the 2.3%yr growth in GDP the US experienced in 2019, household consumption contributed 1.8 percentage points. As we look ahead, the health of the consumer is therefore paramount.

And consumer spending is now slowing.

From the December quarter GDP detail and nominal retail sales, it is evident household consumption is slowing. From a peak of 3.4%yr at September 2018, annual growth has since slowed to 2.6%yr. This has occurred at a time of record-low unemployment and sustained above-average confidence amongst households in the US economy. What then has led to this deceleration, and is it likely to be persist?

Because consumer confidence has held at above-average levels, we do not believe trade tensions have driven this result. Instead, it has primarily been due to a loss of momentum in wage and employment growth.

This is despite a still low unemployment rate.

Despite the US labour market having very little slack remaining, annual hourly earnings growth slowed from 3.4%yr at February 2019 to average 3.1%yr over the three months to January. Growth in non-wage benefits paid to workers also slowed over the year according to the employment cost index, further accentuating the loss of momentum in total household income.

While it is difficult to believe that wage gains will fall sharply from here given the limited slack remaining in the US labour market, there is also no justification to believe that an acceleration is immanent. If, as we expect, employment growth continues to slow back towards population growth in 2020, in the absence of an offsetting wage acceleration, total household income growth will continue to fade.

Wage gains will not offset softer employment growth.

This narrative is the basis for our view that the near 2 per cent annualised consumption growth of the most recent quarter will be sustained during 2020. For as long as business investment remains weak, this will see US GDP growth below trend.

More than a decade into this expansion, and given global risks, this is not a development that the FOMC can remain unresponsive to. Particularly if below-target inflation shows further signs of becoming entrenched.

Inflation is coming to the fore for the FOMC.

At face value, the change made to the January FOMC decision statement implied greater confidence in the inflation outlook, the current stance being seen as "appropriate to support… inflation returning to… [the] 2 percent objective" in January versus merely "near the Committee's symmetric 2 percent objective" back in December.

But this is not the case. In the press conference, it was instead made clear by Chair Powell that the change in language in the statement was intended to highlight the Committee is "not comfortable" with inflation running "persistently below 2.0%yr" (i.e. "near" 2.0%yr) and is determined to avoid it.

And will justify easing in 2020, along with GDP.

Persistent disappointment is exactly the outturn that core PCE inflation (excluding food and energy) and inflation expectations currently imply will occur. If sustained, this trend will therefore soon offer cause for the Committee to cut rates to strengthen inflation to the medium-term target, or indeed above it if the Committee desires inflation to average 2.0%yr over the cycle. Hence we look for the FOMC to cut three times in 2020, beginning in June. Our base expectation is that this stimulus will be able to stabilize US growth at trend in 2021 and bring inflation close to target. A robust outcome certainly, but materially weaker than the past three years.

Elliot Clarke, CFA, Senior Economist

… growth and inflation disappointment

Chart 1.

US unemployment rate at 50-year low

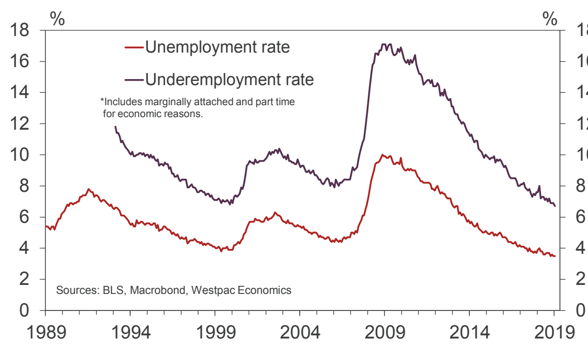


Chart 2.

US consumer sentiment above average

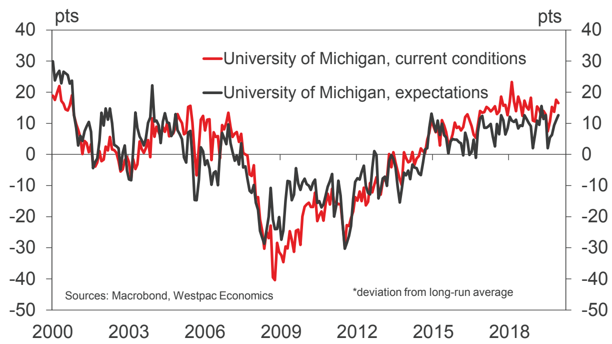


Chart 3.

US personal income growth in downtrend

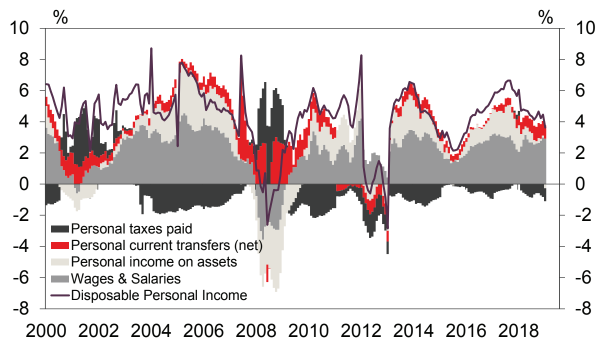
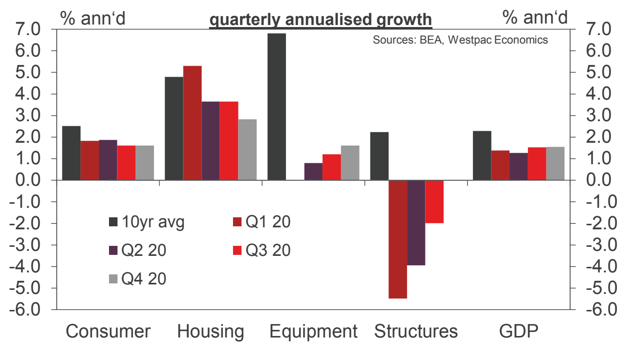


Chart 4.

US GDP to print below trend in 2020



	2019										2020
Monthly data	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**	**Jan**
PCE deflator %yr	1.3	1.4	1.5	1.4	1.4	1.4	1.4	1.3	1.4	1.4	1.6	–
Unemployment rate %	3.8	3.8	3.6	3.6	3.7	3.7	3.7	3.5	3.6	3.5	3.5	3.6
Non-farm payrolls chg '000	1	147	210	85	182	194	207	208	185	261	147	225
House prices* %yr	2.8	2.5	2.4	2.3	2.2	2.0	2.0	2.1	2.2	2.5	–	–
Durables orders core 3mth %saar	0.7	8.7	–1.8	–2.1	0.2	4.8	0.6	–5.1	–1.3	1.7	0.5	–
ISM manufacturing composite	54.1	54.6	53.4	52.3	51.6	51.3	48.8	48.2	48.5	48.1	47.8	50.9
ISM non-manufacturing composite	58.5	56.3	55.7	56.3	55.4	54.8	56.0	53.5	54.4	53.9	54.9	55.5
Personal spending 3mth %saar	–1.4	6.0	6.5	8.7	6.0	5.4	4.7	4.0	2.7	3.4	4.0	–
UoM Consumer Sentiment	93.8	98.4	97.2	100.0	98.2	98.4	89.8	93.2	95.5	96.8	99.3	99.8
Trade balance USDbn	–51.1	–53.1	–51.5	–54.8	–54.1	–53.1	–54.0	–51.5	–47.4	–43.7	–48.9	–

Quarterly data	**Dec-18**	**Mar-19**	**Jun-19**	**Sep-19**	**Dec-19**	**Mar-20f**
Real GDP % saar	1.1	3.1	2.0	2.1	2.1	1.4
Current account USDbn	–143.9	–136.2	–125.2	–124.1	–	–

Sources: Government agencies, Bloomberg, *S&P Case-Shiller 20-city measure.

China: severe shock to growth to …

As trade risks receded…

2020 has commenced in a highly uncertain fashion for China, with the coronavirus outbreak not only putting the lives of China's people at risk, but also bringing the economy to an abrupt halt. With data from this episode of history some months away, we look to assess the potential cost based on the singular historic precedent of SARS in 2003 and China's economic evolution since.

In 2003, annualised Chinese GDP growth fell from 12% in Q1 to around 4% in Q2, when the outbreak was most active, but subsequently rebounded to 15% in Q3 and was strong again in Q4 (11%) once the outbreak had been effectively contained.

… China has experienced another material shock…

If we interpolate a profile for the 2020 coronavirus episode using the SARS experience, annualised growth would be expected to fall from 6% in Q4 2019 to 2% in Q1 2020, then rebound to 8% in Q2 and settle at 6% in the second half of 2020. If this occurred, our existing 5.8% year-average growth forecast for 2020 would fall to 5.5% – a 0.3ppt reduction.

As mooted above however, we must recognise that there are a number of differences between 2003 and 2020. Most notably, the 2020 coronavirus outbreak was active during the Lunar New Year holiday period – the peak time for household consumption and travel. Further, given the scale of Wuhan's population, its position as a large transport hub for central China as well as the virus' highly-contagious nature (more akin to influenza than SARS), the coronavirus looks to be spreading much more rapidly and broadly than SARS, making it more difficult to contain. The stringent imposition of travel restrictions by China and other nations will hopefully prove a positive in time, but while in place these will amplify the shock to the economy.

… the duration of which is currently unknown.

Taking these factors into consideration, we believe growth in Q1 will be weaker than the SARS benchmarking suggests. We expect growth to stall in the three months to March instead of rising 2.0% annualised. Assuming the virus can be contained by March, we look for growth to rebound in Q2 and beyond, broadly in line with the SARS experience. Year-average growth for 2020 would then print at 5.3% and recover to 6.1% in 2021.

This is why risks are skewed to the downside.

The risks to this view clearly lay to the downside. Most notably, the virus is still spreading and underlying momentum in China's economy is materially weaker than in 2003. Ahead, headwinds for growth from trade tensions, modest global growth, as well as the authorities continued focus on the quality of investment and financing, will also remain. To highlight the scale of these risks, if containment and the ensuing recovery were delayed by an additional three months, resulting in nil growth in Q2 as well, then year-average growth for 2020 would fall below 4.0%. A dip into outright contraction in Q1 could result in a similar outcome, depending on authorities actions.

Fiscal stimulus will counteract in time.

Such a weak outcome is unlikely to eventuate because fiscal stimulus from the Government will be proportional to the shock that China's economy experiences. There is no real limit on the support the Central Government can provide, and local governments are well positioned to finance investment through new market issuance following the financial sector reforms of 2017–2019. Note also that the longer the outbreak lasts, the greater the 'benefit' to Chinese GDP from reduced service imports. China's services deficit was negligible in 2003, but now amounts to 2% of GDP.

If containment were to take six months, a year-average 2020 growth outcome near or slightly below 5.0% is more plausible than 4.0%.

All new spending will be consistent with 'quality growth' agenda.

Whether our new baseline forecast proves accurate, or downside risks eventuate, stimulus provided by Chinese authorities to their economy is expected to be targeted and consistent with their long-term development agenda.

In the short-term, financial relief for affected businesses and households is expected, and there will be additional spending on health services and infrastructure. This spending will be broadened to other components of essential infrastructure across the nation over the remainder of 2020. Support given to local governments to undertake investment will be proportional to need and regional development opportunities. The expected return and risks of each project will still be assessed carefully.

Private business will receive support too.

The provision of additional liquidity to the banking system (through RRR cuts and the MLF) will aid the private sector by reducing the cost of credit and increasing its availability. However, for the economy to benefit from these initiatives, the private sector's confidence in the outlook will have to return – hence the need to act quickly to stop the virus' spread.

With real estate investment and price gains remaining robust, we do not anticipate any targeted easing of housing policy.

Elliot Clarke, CFA, Senior Economist

… reverse following containment

Chart 1.

China's economy was soft ahead of coronavirus

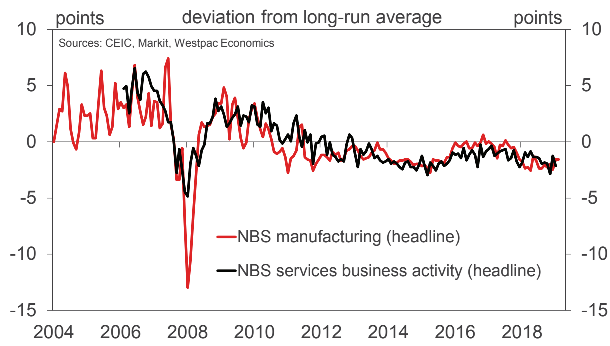


Chart 2.

Investment will receive support, but it'll take time

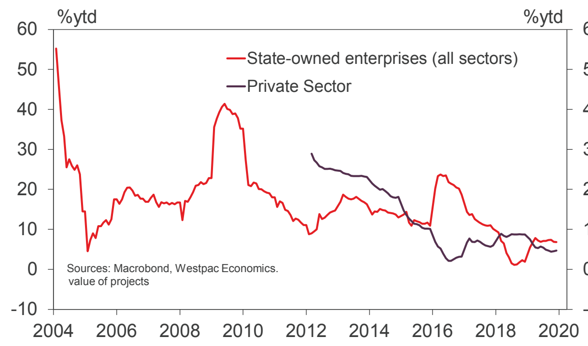


Chart 3.

China travel bans to reduce services GDP drag

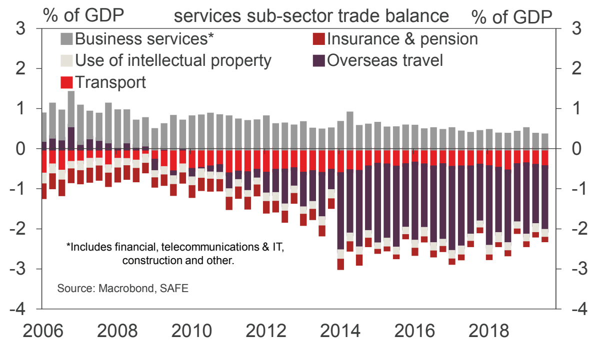
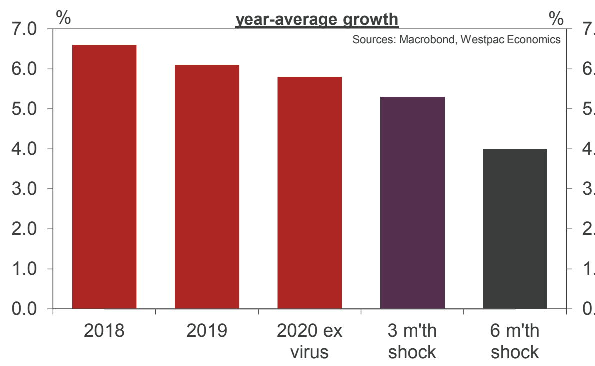


Chart 4.

2020 coronavirus: potential shock to growth



	2019										2020
Monthly data %yr	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**	**Jan**
Consumer prices – headline	1.5	2.3	2.5	2.7	2.7	2.8	2.8	3.0	3.8	4.5	4.5	5.4
Money supply M2	8.0	8.6	8.5	8.5	8.5	8.1	8.2	8.4	8.4	8.2	8.7	–
Manufacturing PMI (official)	49.2	50.5	50.1	49.4	49.4	49.7	49.5	49.8	49.3	50.2	50.2	50.0
Fixed asset investment %ytd	6.1	6.3	6.1	5.6	5.8	5.7	5.5	5.4	5.2	5.2	5.4	–
Industrial production (IVA)	5.3	8.5	5.4	5.0	6.3	4.8	4.4	5.8	4.7	6.2	6.9	–
Exports	–20.7	14.0	–2.7	1.1	–1.5	3.4	–1.0	–3.2	–0.8	–1.3	7.9	–
Imports	–4.4	–7.2	4.5	–8.2	–6.8	–4.9	–5.5	–8.2	–6.2	0.8	16.5	–
Trade balance USDbn	3.0	31.5	13.1	41.3	49.6	44.1	34.6	39.0	42.5	37.6	47.2	–

Quarterly data	Q3:18	Q4:18	Q1:19	Q2:19	Q3:19	Q4:19
Real GDP %yr	6.7	6.5	6.4	6.2	6.0	6.0
Nominal GDP %yr	10.2	9.9	7.9	8.3	7.6	7.4
Total credit supply %GDP*	26.4	24.5	26.8	26.9	25.8	25.8
Central fiscal position %GDP*	–3.4	–4.1	–5.1	–5.4	–5.5	–5.5
Current account %GDP*	0.5	0.4	0.9	1.2	1.4	–

Sources: Government agencies, Bloomberg, CEIC, Westpac Economics. Some data omitted from certain series due to Lunar New Year distortions. *4qma

Europe: domestic demand challenged …

Euro Area GDP has become dependent on domestic demand.

The Euro Area faces another challenging year in 2020. While global trade risks have retreated, the tariff measures already in place will continue to weigh on global growth and European export opportunities. It is still early days in understanding the scale of the impact, the coronavirus outbreak in China will also act as a headwind for trade and investment in Europe.

Momentum here is modest and increasingly at risk.

If momentum coming into 2020 was strong, there would be little reason for concern. But this is not the case. The advance reading for Q4 2019 growth came in at just 0.1%, leaving annual growth below trend at 1.0%. Adding a further layer of uncertainty, activity contracted in both France and Italy in the December quarter, and is expected to in Germany as well.

The consumer remains in good health.

We are yet to receive sectoral detail on growth in Q4 2019, but partial data provides guidance on its distribution across the economy and the risk of the economy stalling.

The underlying health of the Euro Area consumer remains a significant positive for the region. At December, the unemployment rate reached its lowest level since mid–2008 at 7.4%. Importantly, this downtrend is evident across the entire Euro Area. Ongoing job and wage gains then look set to support robust consumption growth through the year.

And credit supply is also supportive.

From the bank lending survey, it is also apparent that both the supply and demand of credit is supportive of moderate growth in total household demand. This is applicable primarily to house purchases and investment; however, in recent quarters, consumer credit demand has also stabilised after decelerating over the year to June 2019.

The demand for credit from firms is a striking contrast to households however. Having decelerated since the beginning of 2018, at the beginning of 2020, demand for credit from firms looks to have moved into outright contraction. This is despite monetary policy clearly creating highly supportive financial conditions and ample credit availability.

But firms appetite to invest is dwindling.

From the ECB's bank lending survey, credit demand associated with fixed asset investment in particular has disappeared over the past year across the Euro Area and is expected to remain absent in 2020. It is notable that the strongest country in the Euro Area, Spain, has led this deterioration in investment. It implies that not only are the manufacturers (of Germany) unwilling to chance investment in this climate, but so too are domestic–demand and service centric businesses in Spain and elsewhere –– even after a number of years of proven returns.

If a significant shock from coronavirus comes, GDP could stall.

The take home from the above analysis is that growth in Euro Area domestic demand will likely remain modest as stalled investment offsets modest consumption growth. Without a meaningful contribution from net exports then, GDP growth will struggle to achieve a trend outcome. Our unrevised growth view for 2020 and 2021 incorporates these views. However, the longer the coronavirus outbreak persists, the greater the chance of a negative shock from net exports, and consequently of the stalling of growth over multiple quarters.

Elliot Clarke, CFA, Senior Economist

	2019											2020
Europe	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**	**Jan**
Eur consumer prices %yr	1.5	1.4	1.7	1.2	1.3	1.0	1.0	0.8	0.7	1.0	1.3	–
Eur unemployment rate %	7.8	7.7	7.6	7.6	7.5	7.6	7.5	7.5	7.5	7.5	7.4	–
Eur industrial production %yr	–0.1	–0.6	–0.8	–0.9	–2.4	–2.0	–2.4	–1.8	–2.8	–1.5	–	–
Eur retail sales volumes %yr	2.9	2.1	2.2	1.5	2.5	2.4	2.7	2.8	1.8	2.2	1.4	–
Eur consumer confidence	–6.9	–6.6	–7.4	–6.5	–7.2	–6.6	–7.1	–6.6	–7.6	–7.2	–8.1	–8.1
Eur current account balance €bn	30.9	27.7	26.5	24.1	19.9	28.3	40.2	32.2	35.8	33.9	–	–
United Kingdom												
UK Consumer price index %yr	1.9	1.9	2.1	2.0	2.0	2.1	1.7	1.7	1.5	1.5	1.3	–
UK unemployment rate %(ILO)	3.8	3.8	3.8	3.9	3.8	3.9	3.8	3.8	3.8	–	–	–
UK industrial production %yr	–0.1	0.9	–2.0	–0.7	–1.6	–1.9	–2.5	–1.8	–1.6	–2.5	–1.9	–
UK retail sales volumes %yr	4.3	6.8	5.0	2.5	3.8	3.5	2.6	2.9	3.2	0.8	0.8	–
UK consumer confidence	–13	–13	–13	–10	–13	–11	–14	–12	–14	–14	–11	–9

Quarterly data	Q2:18	Q3:18	Q4:18	Q1:19	Q2:19	Q3:19	Q4:19
Eur GDP %qtr/%yr	0.4/2.2	0.2/1.6	0.3/1.2	0.4/1.4	0.2/1.2	0.3/1.2	0.1/1.0
UK GDP %qtr/%yr	0.5/1.3	0.6/1.6	0.2/1.4	0.6/2.0	–0.1/1.3	0.5/1.2	0.0/1.1
UK current account balance £bn	–18.6	–19.6	–26.6	–37.4	–24.2	–15.9	–

Source: Official agencies.

... coronavirus shock a risk

Chart 1.

Euro Area GDP relying on domestic demand

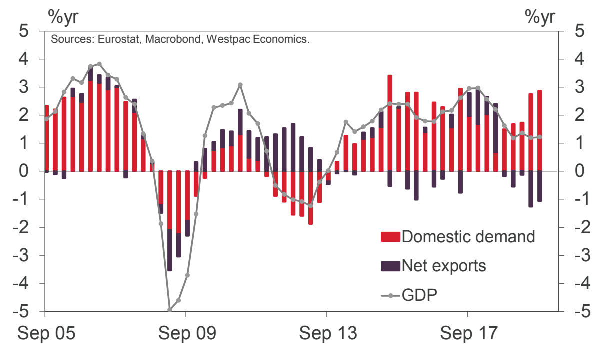


Chart 2.

Euro area unemployment rate in downtrend

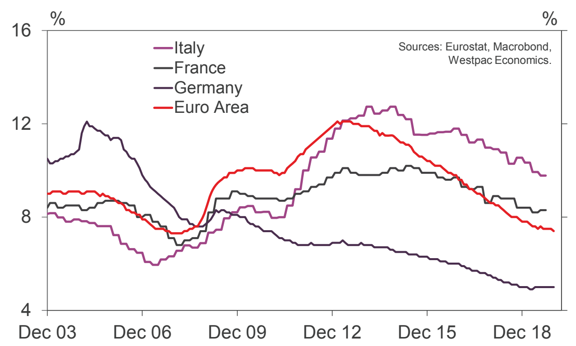


Chart 3.

Survey expectations have found a base

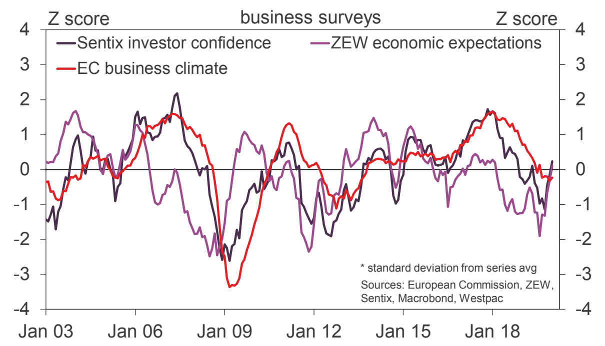


Chart 4.

Euro Area monetary policy supportive of growth

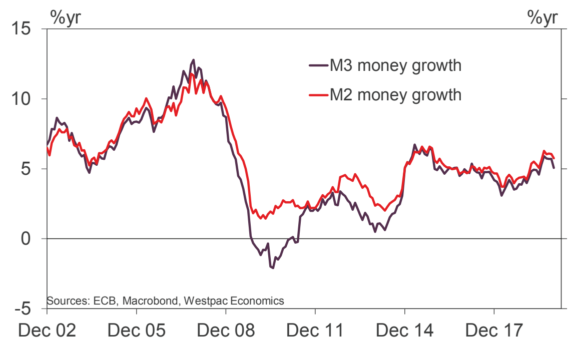


Chart 5.

Euro Area household loan growth

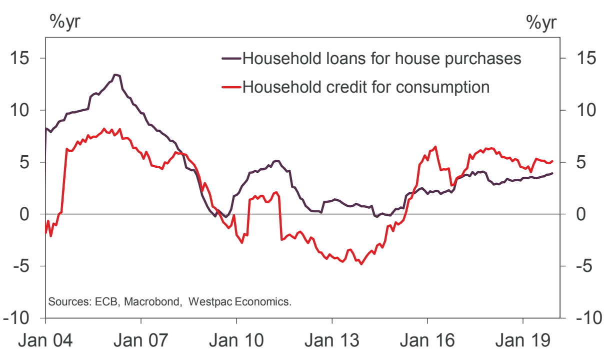
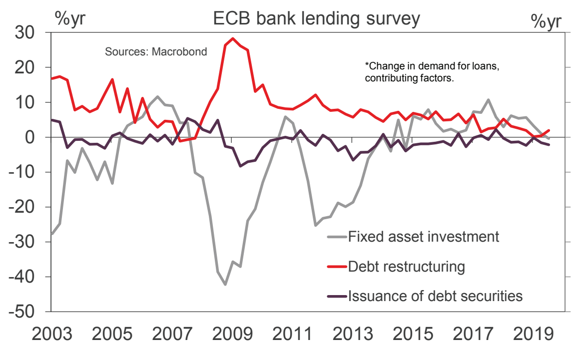


Chart 6.

Euro Area business in wait and see mode



Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

Financial forecasts – Australia

Interest rate forecasts

	Latest (12 Feb)	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Dec-21
Cash	0.75	0.75	0.50	0.25	0.25	0.25	0.25	0.25
Market implied*	na	0.69	0.55	0.46	0.43	na	na	na
90 Day BBSW**	0.92	0.85	0.70	0.45	0.45	0.50	0.50	0.50
3 Year Swap	0.74	0.70	0.60	0.50	0.55	0.60	0.65	0.75
3 Year Bond	0.72	0.68	0.58	0.48	0.53	0.58	0.63	0.73
10 Year Bond	1.04	1.00	0.95	0.90	0.80	0.80	0.85	1.05
10 Year Spread to US (bps)	-56	-60	-55	-55	-60	-65	-65	-65

* Market implied rate is the anticipated target rate in the OIS market at the date of publication. Sources: Bloomberg, Westpac Strategy.

** Assumed to set at a spread to 3 month OIS. 3 month OIS is assumed to set at the cash rate unless we believe there will be a change in the cash rate in the quarter ahead.

Currency forecasts

	Latest (12 Feb)	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Dec-21
AUD vs								
USD	0.6714	0.67	0.66	0.67	0.67	0.68	0.69	0.72
USD forward^	na	0.67	0.67	0.67	0.68	0.68	0.68	0.68
JPY	73.74	71.7	70.0	70.4	70.4	72.1	73.8	78.5
EUR	0.6152	0.61	0.60	0.60	0.60	0.60	0.61	0.63
NZD	1.0482	1.05	1.01	1.02	1.02	1.03	1.05	1.07
CAD	0.8926	0.88	0.87	0.88	0.88	0.89	0.90	0.94
GBP	0.5182	0.52	0.51	0.52	0.52	0.52	0.53	0.55
CHF	0.6551	0.66	0.65	0.65	0.65	0.66	0.66	0.69
DKK	4.5966	4.59	4.48	4.51	4.47	4.50	4.52	4.68
SEK	6.4689	6.46	6.31	6.35	6.29	6.33	6.36	6.58
NOK	6.2072	6.20	6.05	6.09	6.03	6.07	6.11	6.32
ZAR	9.94	9.95	10.03	10.10	10.10	10.18	10.25	10.48
SGD	0.9315	0.93	0.92	0.92	0.92	0.92	0.92	0.94
HKD	5.2135	5.21	5.15	5.23	5.23	5.30	5.38	5.62
PHP	33.97	34.0	33.4	33.9	33.6	34.0	34.4	35.8
THB	20.97	20.9	20.5	20.5	20.5	20.4	20.7	21.5
MYR	2.7739	2.78	2.71	2.73	2.71	2.74	2.77	2.88
CNY	4.6769	4.66	4.55	4.59	4.56	4.62	4.66	4.75
IDR	9178	9112	8844	8945	8911	9010	9122	9486
TWD	20.17	20.0	19.5	19.7	19.6	19.9	20.0	20.7
KRW	795	804	779	781	774	779	783	806
INR	47.86	47.8	47.1	47.6	46.9	46.9	46.9	47.5

^Approximate market forward price for AUD/USD, not a forecast. Sources: Bloomberg, Westpac Economics.

Economic forecasts – Australia

Activity forecasts*

	2019			2020				Calendar years			
%qtr / yr avg	**Q2**	**Q3**	**Q4f**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**2018**	**2019f**	**2020f**	**2021f**
Private consumption	0.3	0.1	0.3	0.2	0.4	0.5	0.5	2.7	1.4	1.2	2.3
Dwelling investment	–3.7	–1.7	–1.8	–2.9	–2.1	–1.5	–0.7	4.7	–7.0	–8.3	–0.5
Business investment*	–0.4	–2.0	0.0	0.3	0.0	0.3	0.7	1.7	–1.4	–0.5	3.3
Private demand *	–0.1	–0.3	0.1	0.0	0.2	0.3	0.4	2.4	–0.1	0.4	2.3
Public demand *	1.7	1.7	0.8	0.9	0.8	0.9	0.8	4.4	4.8	4.0	3.1
Domestic demand	0.3	0.2	0.3	0.2	0.4	0.5	0.5	2.9	1.1	1.3	2.5
Stock contribution	–0.4	0.1	0.1	0.0	0.0	0.0	0.0	0.1	–0.3	0.1	0.1
GNE	0.0	0.3	0.4	0.3	0.4	0.5	0.5	3.0	0.8	1.4	2.6
Exports	1.3	0.7	0.5	–2.1	3.6	0.8	0.7	5.1	3.5	2.2	3.5
Imports	–1.1	–0.2	0.0	–1.0	1.8	0.3	0.7	4.1	–1.4	0.2	3.6
Net exports contribution	0.5	0.2	0.1	–0.3	0.4	0.1	0.0	0.2	1.1	0.4	0.1
Real GDP %qtr / yr avg	**0.6**	**0.4**	**0.5**	**0.0**	**0.8**	**0.6**	**0.6**	2.7	1.8	1.8	2.6
%yr end	**1.6**	**1.7**	**2.1**	**1.5**	**1.7**	**1.9**	**1.9**	**2.1**	**2.1**	**1.9**	**2.7**
Nominal GDP %qtr	1.5	1.1	–0.3	0.3	1.1	0.2	–0.2				
%yr end	5.5	5.5	4.0	2.6	2.2	1.4	1.4	5.5	4.0	1.4	4.1

Other macroeconomic variables

	2019			2020				Calendar years			
% change	**Q2**	**Q3**	**Q4f**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**2018**	**2019f**	**2020f**	**2021f**
Employment (2)	0.6	0.6	0.3	0.2	0.0	0.5	0.4	–	–	–	–
%yr	2.5	2.5	2.0	1.7	1.1	0.9	1.1	2.3	2.0	1.1	2.0
Unemployment rate % (2)	5.2	5.2	5.2	5.3	5.5	5.5	5.4	5.0	5.2	5.4	5.2
Wages (WPI) (2)	0.5	0.5	0.5	0.6	0.5	0.6	0.6	–	–	–	–
%yr	2.3	2.2	2.2	2.2	2.2	2.3	2.3	2.3	2.2	2.3	2.2
CPI Headline (2)	0.6	0.5	0.7	0.3	0.3	0.7	0.6	–	–	–	–
%yr	1.6	1.7	1.8	2.1	1.7	1.9	1.8	1.8	1.8	1.8	2.0
Core inflation trimmed mean	0.4	0.4	0.4	0.5	0.5	0.5	0.4	–	–	–	–
%yr (2)	1.6	1.6	1.6	1.8	1.8	1.9	1.9	1.8	1.6	1.9	1.8
Current account AUDbn	4.7	7.9	1.5	–0.5	1.5	–1.5	–7.5	–39.0	12.3	–8.0	–40.0
% of GDP	0.9	1.6	0.3	–0.1	0.3	–0.3	–1.5	–2.1	0.6	–0.4	–2.0
Terms of trade annual chg (1)	8.2	7.8	0.2	–3.3	–4.9	–8.7	–9.0	1.8	5.5	–6.5	–7.5

Calendar year changes are (1) period average for GDP, terms of trade, unless otherwise stated (2) through the year for inflation, wages and employment. Unemployment is year end.
* GDP & component forecasts are reviewed following the release of quarterly national accounts.
** Business investment and government spending adjusted to exclude the effect of private sector purchases of public sector assets.

Macroeconomic variables – recent history

	2019									2020	
Monthly data	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**	**Jan**	**Feb**
Employment '000 chg	31.5	38.2	4.1	30.3	38.3	12.8	–23.9	38.5	28.8	–	–
Unemployment rate %	5.2	5.2	5.3	5.2	5.3	5.2	5.3	5.2	5.1	–	–
Westpac–MI Consumer Sentiment	100.7	101.3	100.7	96.5	100.0	98.2	92.8	97.0	95.1	93.4	95.5
Retail trade %mth	–0.1	0.2	0.2	0.0	0.5	0.2	0.1	1.0	–0.5	–	–
Dwelling approvals %mth	–4.6	0.9	–1.3	–9.9	1.7	7.7	–6.3	10.9	–0.2	–	–
Credit, private sector %yr	3.7	3.6	3.3	3.1	2.9	2.7	2.5	2.4	2.4	–	–
Trade balance AUDbn	4.6	6.0	8.1	7.5	6.3	5.8	4.0	5.5	5.2	–	–

Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

Forecasts – New Zealand

Interest rate forecasts

	Latest (12 Feb)	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Dec-21
Cash	1.00	1.00	1.00	0.75	0.75	0.75	0.75	0.75
Market implied	na	0.93	0.85	0.81	0.81	na	na	na
90 Day Bill	1.22	1.20	1.10	0.90	0.90	0.90	0.90	0.90
2 Year Swap	1.11	1.10	1.05	1.00	1.00	1.00	1.05	1.15
10 Year Bond	1.32	1.35	1.25	1.25	1.25	1.35	1.40	1.55
10 Year Spread to US	–28	–25	–25	–20	–15	–10	–10	–15
10 Year Spread to Aust	27	35	30	35	45	55	55	50

* Market implied rate is the anticipated target rate in the OIS market. Sources: Bloomberg, Westpac Strategy.

Currency forecasts

	Latest (12 Feb)	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Dec-21
NZD vs								
USD	0.6406	0.64	0.66	0.66	0.66	0.66	0.66	0.67
USD forward^	na	0.64	0.64	0.64	0.64	0.64	0.64	0.64
JPY	70.35	68.5	69.4	69.3	69.3	70.0	70.6	73.0
EUR	0.5869	0.59	0.60	0.59	0.59	0.58	0.58	0.58
AUD	0.9541	0.96	0.99	0.99	0.99	0.97	0.96	0.93
CAD	0.8515	0.84	0.86	0.87	0.86	0.86	0.86	0.87
GBP	0.4944	0.49	0.50	0.51	0.51	0.50	0.50	0.51
CHY	4.462	4.45	4.52	4.52	4.49	4.49	4.46	4.42

^ Approximate market forward price for NZD/USD, not a forecast. Sources: Bloomberg, Westpac Economics.

Activity forecasts

Annual Average	2019			2020				Calendar years			
% change	**Q2**	**Q3f**	**Q4f**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**2018**	**2019f**	**2020f**	**2021f**
Private consumption	3.0	2.9	2.9	2.8	3.0	3.2	3.3	3.2	2.9	3.3	3.8
Government consumption	3.4	3.8	3.8	3.8	4.1	3.9	3.6	3.7	3.8	3.6	2.9
Residential investment	2.2	3.3	4.0	3.3	3.2	3.7	4.3	0.1	4.0	4.3	2.1
Business investment	2.6	2.3	2.7	2.7	2.9	2.8	2.7	7.6	2.7	2.7	3.3
Stocks (ppt contribution)	–0.6	–0.7	–0.9	–0.1	0.4	0.1	0.3	0.4	–0.9	0.3	0.0
GNE	2.2	2.1	2.1	2.8	3.4	3.2	3.5	4.1	2.1	3.5	3.4
Exports	2.9	2.6	2.2	0.1	–1.0	–0.4	–0.3	2.6	2.2	–0.3	2.8
Imports	1.8	1.2	1.2	1.8	2.8	2.6	3.0	5.8	1.2	3.0	3.4
GDP (production)	**2.8**	**2.7**	**2.3**	**1.9**	**2.0**	**2.1**	**2.3**	**3.2**	**2.3**	**2.3**	**3.3**
Employment annual %	1.5	1.1	1.0	1.4	1.1	1.3	1.8	1.9	1.0	1.8	2.0
Unemployment rate % s.a.	4.0	4.1	4.0	4.1	4.3	4.2	4.2	4.3	4.0	4.2	3.9
Labour cost index, all sect incl o/t, ann %	2.1	2.4	2.6	2.6	2.7	2.5	2.4	1.9	2.6	2.4	2.5
CPI annual %	**1.7**	**1.5**	**1.9**	**2.2**	**2.0**	**2.0**	**1.8**	**1.9**	**1.9**	**1.8**	**1.7**
Current account balance % of GDP	–3.3	–3.3	–3.0	–3.0	–3.2	–3.3	–3.4	–3.8	–3.0	–3.4	–3.3
Terms of trade annual %	–1.0	1.0	5.7	3.3	0.1	–1.4	–2.0	–4.8	5.7	–2.0	0.8

Sources: Statistics NZ, Westpac Economics.

Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

Forecasts – commodity prices

end of period	Latest (12 Feb)	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Dec-21
Australian commodities index#	**255**	**237**	**248**	**228**	**207**	**203**	**202**	**213**
Bulk commodities index#	**348**	**319**	**331**	**298**	**274**	**268**	**264**	**279**
iron ore finesTSI @ 62% US$/t	83	80	90	75	65	64	62	67
Qld coking coal index (US$/t)	136	135	130	127	125	126	124	139
Newcastle spot thermal coal (US$/t)	72	70	67	65	63	63	63	64
crude oil (US$/bbl) Brent ICE	55	55	60	60	55	55	56	58
LNG in Japan US$mmbtu	8.47	8.5	7.6	8.2	8.2	7.5	7.5	7.8
gold (US$/oz)	1,572	1,570	1,550	1,525	1,461	1,461	1,477	1,509
Base metals index#	**141**	**142**	**144**	**145**	**128**	**128**	**131**	**138**
copper (US$/t)	5,680	5,700	5,800	5,800	5,123	5,123	5,235	5,589
aluminium (US$/t)	1,712	1,710	1,710	1,710	1,511	1,511	1,545	1,603
nickel (US$/t)	12,861	12,900	13,300	13,500	12,263	12,263	12,530	13,068
zinc (US$/t)	2,172	2,200	2,250	2,250	1,969	1,969	2,012	2,098
lead (US$/t)	1,824	1,830	1,870	1,870	1,636	1,636	1,669	1,735
Rural commodities index#	**133**	**132**	**129**	**129**	**123**	**123**	**126**	**131**
NZ commodities index ##	**298**	**275**	**273**	**278**	**283**	**284**	**286**	**288**
dairy price index ^^	271	251	257	261	262	262	263	264
whole milk powder US$/t	3,039	2,963	3,105	3,142	3,154	3,165	3,177	3,200
skim milk powder US$/t	2,907	2,834	2,970	3,005	3,004	3,003	3,002	3,000
lamb leg UKp/lb	576	526	485	485	499	509	509	509
bull beef US¢/lb	236	213	203	213	226	233	238	238
log price index ##	160	148	151	155	159	160	161	163
strong wool US¢/kg	190	167	177	183	188	191	194	200

	levels				% change			
annual averages	**2018**	**2019**	**2020f**	**2021f**	**2018**	**2019**	**2020f**	**2021f**
Australian commodities index#	**235**	**262**	**237**	**207**	**5**	**12**	**–10**	**–13**
Bulk commodities index#	**302**	**360**	**318**	**274**	**2**	**19**	**–11**	**–14**
iron ore finesTSI @ 62% USD/t	70	93	80	64	–2	34	–14	–20
LNG in Japan $mmbtu	10	9	8	8	32	–10	–11	–6
ave coking coal price (US$/t)	172	159	127	121	12	–8	–20	–5
ave thermal price (US$/t)	92	75	69	65	12	–18	–9	–5
iron ore fines contracts (US¢ dltu)	92	124	111	78	–8	34	–11	–29
coal coking contracts (US$/t)	208	184	132	126	–1	–11	–28	–4
crude oil (US$/bbl) Brent ICE	71	64	58	56	30	–11	–9	–3
gold (US$/oz)	1,274	1,398	1,536	1,481	1	10	10	–4
Base metals index#	**165**	**152**	**141**	**132**	**7**	**–8**	**–7**	**–7**
copper (US$/t)	6,540	6,021	5,678	5,301	6	–8	–6	–7
aluminium (US$/t)	2,113	1,806	1,683	1,550	7	–15	–7	–8
nickel (US$/t)	13,148	13,917	13,086	12,598	26	6	–6	–4
zinc (US$/t)	2,904	2,527	2,195	2,023	1	–13	–13	–8
lead (US$/t)	2,248	2,003	1,825	1,677	–3	–11	–9	–8
Rural commodities index#	**140**	**129**	**130**	**127**	**10**	**–8**	**1**	**–2**
NZ commodities index ##	292	299	279	286	1	2	–7	2
dairy price index ##	250	265	259	263	–4	6	–2	1
whole milk powder US$/t	2,985	3,118	3,093	3,178	–2	4	–1	3
skim milk powder US$/t	1,950	2,569	2,955	3,002	–5	32	15	2
lamb leg UKp/lb	467	575	505	509	–2	23	–12	1
bull beef US¢/lb	208	267	215	236	–7	29	–20	10
log price index ##	176	165	153	161	11	–6	–7	5
strong wool US¢/kg	231	202	179	195	–8	–13	–11	9

Chain weighted index: weights are Australian export shares. * Australian export prices fob – ABS 5432.0 Merchandise Trade Exports. ** WCFI – Westpac commodities futures index. *** Weekly averages except for the Bulks Index. ^ AWEX market prices. Sources for all tables: Westpac Economics, Bloomberg ##ANZ NZ commodity price index ^^ GlobalDairyTrade

Forecasts – United States

Interest rate forecasts

	Latest (12 Feb)	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Dec-21
Fed Funds*	1.625	1.625	1.375	1.125	0.875	0.875	0.875	0.875
Market implied^	na	1.55	1.43	1.34	1.19	na	na	na
Fed balance sheet $trn	4.17	4.28	4.43	4.55	4.61	4.67	4.73	4.85
10 Year Bond	1.60	1.60	1.50	1.45	1.40	1.45	1.50	1.70

^ Market implied is the anticipated rate in the OIS market (or equivalent) at the close prior to the date of publication. Sources: Bloomberg, Westpac Strategy. * +12.5bps from the Fed Funds lower bound (overnight reverse repo rate). Sources: Bloomberg, Westpac Strategy.

Currency forecasts

	Latest (12 Feb)	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Dec-21
USD vs								
DXY index	**98.72**	**98.4**	**97.7**	**97.0**	**96.3**	**95.8**	**95.3**	**94.9**
JPY	109.83	107	106	105	105	106	107	109
EUR	1.0914	1.09	1.10	1.11	1.12	1.13	1.14	1.15
AUD	0.6714	0.67	0.66	0.67	0.67	0.68	0.69	0.72
NZD	0.6406	0.64	0.66	0.66	0.66	0.66	0.66	0.67
CAD	1.3294	1.32	1.32	1.32	1.31	1.31	1.30	1.30
GBP	1.2956	1.30	1.30	1.30	1.30	1.31	1.31	1.32
CHF	0.9758	0.98	0.98	0.97	0.97	0.97	0.96	0.95
ZAR	14.81	14.9	15.2	15.1	15.1	15.0	14.9	14.6
SGD	1.3872	1.39	1.39	1.38	1.37	1.35	1.33	1.30
HKD	7.7652	7.78	7.80	7.80	7.80	7.80	7.80	7.80
PHP	50.60	50.8	50.6	50.6	50.2	50.0	49.9	49.7
THB	31.24	31.2	31.0	30.6	30.6	30.0	29.9	29.8
MYR	4.1322	4.15	4.10	4.08	4.04	4.03	4.02	4.01
CNY	6.9657	6.95	6.90	6.85	6.80	6.80	6.75	6.60
IDR	13670	13600	13400	13350	13300	13250	13221	13176
TWD	30.05	29.9	29.6	29.4	29.3	29.2	29.0	28.8
KRW	1183	1200	1180	1165	1155	1145	1135	1119
INR	71.29	71.4	71.3	71.0	70.0	69.0	68.0	66.0

Activity forecasts

	2019			2020				Calendar years			
% annualised, s/adj	**Q2**	**Q3**	**Q4**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**2018**	**2019**	**2020f**	**2021f**
Private consumption	4.6	3.1	1.8	1.8	1.9	1.6	1.6	3.0	2.6	2.1	1.8
Dwelling investment	–2.9	4.6	5.8	5.3	3.6	3.6	2.8	–1.5	–1.5	4.1	3.1
Business investment	–1.0	–2.3	–1.5	0.4	1.0	1.4	1.8	6.4	2.3	0.0	2.1
Public demand	4.8	1.7	2.7	2.0	1.2	0.8	0.8	1.7	2.3	1.9	0.8
Domestic final demand	3.6	2.2	1.6	1.8	1.7	1.5	1.5	3.1	2.4	1.8	1.7
Inventories contribution ppt	–1.0	0.0	–1.3	0.2	0.0	0.1	0.1	0.1	0.1	–0.2	0.0
Net exports contribution ppt	–0.8	–0.2	1.8	–0.7	–0.5	–0.2	–0.2	–0.4	–0.2	0.0	–0.3
GDP	**2.0**	**2.1**	**2.1**	**1.4**	**1.3**	**1.5**	**1.6**	**2.9**	**2.3**	**1.6**	**1.5**
%yr annual chg	2.3	2.1	2.3	1.9	1.7	1.6	1.4	–	–	–	–

Other macroeconomic variables

Non-farm payrolls mth avg	146	172	191	170	130	110	100	221	179	128	96
Unemployment rate %	3.6	3.6	3.5	3.4	3.4	3.4	3.4	3.9	3.7	3.4	3.5
CPI headline %yr	1.7	1.7	2.0	1.9	1.9	1.9	1.9	2.4	1.8	1.9	1.9
PCE deflator, core %yr	1.6	1.7	1.4	1.5	1.4	1.5	1.8	2.0	1.5	1.9	1.9
Current account %GDP	–2.6	–2.6	–2.6	–2.6	–2.6	–2.5	–2.5	–2.3	–2.6	–2.5	–2.4

Sources: Official agencies, Factset, Westpac Economics

Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

Forecasts – Europe & the UK

Interest rate forecasts

	Latest (12 Feb)	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Dec-21
Euro area								
ECB Deposit Rate	-0.50	-0.50	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60
Market implied*	na	-0.46	-0.48	-0.50	-0.50	na	na	na
ECB balance sheet €trn	4.67	4.73	4.79	4.85	4.91	4.97	5.03	5.15
Monthly purchase pace	20	20	20	20	20	20	20	20
10 Year Bund	-0.39	-0.40	-0.40	-0.40	-0.40	-0.35	-0.30	-0.10
10 Year Spread to US	-199	-200	-190	-185	-180	-180	-180	-180
United Kingdom								
BoE Base Rate	0.75	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Market implied*	na	0.68	0.58	0.51	0.47	na	na	na
Asset purchase program £bn	445	445	445	445	445	445	445	445
10 Year Gilt	0.57	0.50	0.45	0.40	0.40	0.45	0.50	0.70
10 Year Spread to US	-103	-110	-105	-105	-100	-100	-100	-100

* Market implied rate is the anticipated target rate in the OIS market (or equivalent) at the Sydney close prior to the date of publication. EONIA is currently setting 5bps below the deposit rate. Sources: Bloomberg, Westpac Strategy.

Currency forecasts

	Latest (12 Feb)	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Dec-21
euro vs								
USD	1.0914	1.09	1.10	1.11	1.12	1.13	1.14	1.15
JPY	119.87	117	117	117	118	120	122	125
GBP	0.8424	0.84	0.85	0.85	0.86	0.86	0.87	0.87
CHF	1.0651	1.07	1.08	1.08	1.09	1.09	1.09	1.10
DKK	7.4721	7.47	7.47	7.47	7.47	7.47	7.47	7.47
SEK	10.5164	10.52	10.52	10.52	10.52	10.52	10.52	10.52
NOK	10.0898	10.09	10.09	10.09	10.09	10.09	10.09	10.09
sterling vs								
USD	1.2956	1.30	1.30	1.30	1.30	1.31	1.31	1.32
JPY	142.29	139	138	137	137	139	140	144
CHF	1.2642	1.27	1.27	1.26	1.26	1.27	1.26	1.26
AUD	0.5182	0.52	0.51	0.52	0.52	0.52	0.53	0.55

* 1 euro equals: 1.95583 Deutschemarks, 6.55957 French francs, 1936.27 Italian lira, 166.386 Spanish peseta, 0.787564 Irish punt, 200.482 Portuguese escudos, 40.3399 Belgian francs, 40.3399 Luxembourg francs, 2.20371 Netherlands guilders, 13.7603 Austrian schillings, 5.94573 Finnish markka, 340.750 Greek drachmae. Source: ECB.

Activity forecasts

Annual average % chg	2016	2017	2018	2019f	2020f	2021f
Eurozone GDP	1.9	2.7	1.9	1.2	1.0	1.2
private consumption	1.9	1.8	1.4	1.3	1.3	1.2
fixed investment	4.0	3.7	2.4	6.9	1.9	1.0
government consumption	1.9	1.3	1.1	1.5	1.0	1.0
net exports contribution ppt	-0.4	0.5	0.4	-0.9	-0.3	0.2
Germany GDP	2.1	2.8	1.6	0.6	0.6	1.1
France GDP	1.0	2.4	1.7	1.3	1.0	1.1
Italy GDP	1.4	1.8	0.7	0.2	0.3	0.6
Spain GDP	3.0	2.9	2.4	2.0	1.7	1.8
Netherlands GDP	2.1	3.0	2.5	1.7	1.2	1.2
Rest of Eurozone	2.2	3.4	3.2	2.4	1.8	1.8
memo: United Kingdom GDP	1.9	1.9	1.4	1.4	0.8	1.5

Sources: Official agencies, Westpac Economics

Forecasts – Asia

China

Calendar years	2015	2016	2017	2018	2019f	2020f	2021f
Real GDP	7.0	6.8	6.9	6.7	6.1	5.3	6.1
Consumer prices	1.6	2.1	1.8	1.9	4.5	3.2	2.0
Producer prices	–5.9	5.5	4.9	0.9	–0.5	0.5	0.7
Industrial production (IVA)	6.1	6.0	6.6	6.2	5.7	4.5	5.4
Retail sales	10.7	10.4	10.2	9.0	8.0	7.0	8.0
Money supply M2	13.3	11.3	8.2	8.1	8.7	8.5	8.5
Fixed asset investment	10.0	8.1	7.2	5.9	5.4	5.0	6.0
Exports	–2.8	–4.0	12.7	–4.4	6.3	–1.5	1.5
Imports	–7.6	6.9	8.7	–7.6	11.8	–3.0	3.0
Trade balance USDbn	594	510	420	351	422	447	423

Source: CEIC.

Chinese interest rates & monetary policy

	Latest (12 Feb)	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Dec-21
Required reserve ratio %*	12.50	12.00	11.50	11.00	11.00	10.50	10.50	10.50
Loan Prime Rate, 1-year	4.15	4.00	3.95	3.90	3.90	3.90	3.90	3.90

* For major banks.

Japanese interest rates & monetary policy

	Latest (12 Feb)	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Dec-21
Basic balance deposit rate*	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Policy-rate balance deposit rate*	–0.10	–0.10	–0.10	–0.10	–0.10	–0.10	–0.10	–0.10
Monetary base ¥trn nsa	517	522	527	532	535	537	540	545
10 Year JGB	–0.06	–0.05	–0.05	–0.10	–0.10	–0.05	0.00	0.20

* The Bank of Japan introduced a three-tier interest rate structure for bank deposits in January 2016.

Currency forecasts

USD vs	Latest (12 Feb)	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Dec-21
JPY	109.83	107	106	105	105	106	107	109
SGD	1.3872	1.39	1.39	1.38	1.37	1.35	1.33	1.30
HKD	7.7652	7.78	7.80	7.80	7.80	7.80	7.80	7.80
PHP	50.60	50.8	50.6	50.6	50.2	50.0	49.9	49.7
THB	31.24	31.2	31.0	30.6	30.6	30.0	29.9	29.8
MYR	4.1322	4.15	4.10	4.08	4.04	4.03	4.02	4.01
CNY	6.9657	6.95	6.90	6.85	6.80	6.80	6.75	6.60
IDR	13670	13600	13400	13350	13300	13250	13221	13176
TWD	30.05	29.9	29.6	29.4	29.3	29.2	29.0	28.8
KRW	1183	1200	1180	1165	1155	1145	1135	1119
INR	71.29	71.4	71.3	71.0	70.0	69.0	68.0	66.0

Summary of world output

Economic growth forecasts#

Real GDP %ann	2015	2016	2017	2018	2019f	2020f	2021f
World	**3.5**	**3.4**	**3.8**	**3.6**	**3.0**	**2.8**	**3.2**
United States	2.9	1.6	2.4	2.9	2.3	1.6	1.5
Japan	1.2	0.6	1.9	0.8	0.8	0.4	0.4
Euro zone	2.1	1.9	2.5	1.9	1.2	1.0	1.2
Group of 3	**2.4**	**1.6**	**2.4**	**2.3**	**1.7**	**1.2**	**1.2**
United Kingdom	2.3	1.8	1.8	1.4	1.3	0.8	1.5
Canada	0.7	1.1	3.0	1.9	1.5	1.5	1.5
Australia	2.3	2.8	2.5	2.7	1.8	1.8	2.6
New Zealand	3.5	3.9	3.1	3.2	2.3	2.3	3.3
OECD total	**2.3**	**1.7**	**2.4**	**2.3**	**1.7**	**1.4**	**1.4**
China	6.9	6.7	6.8	6.6	6.1	5.3	6.1
Korea	2.8	2.9	3.2	2.7	1.8	1.8	2.2
Taiwan	0.8	1.5	3.1	2.6	2.1	1.9	2.1
Hong Kong	2.4	2.2	3.8	3.0	–1.0	–0.7	0.2
Singapore	2.9	3.0	3.7	3.1	0.4	0.8	2.0
Indonesia	4.9	5.0	5.1	5.2	5.0	4.6	5.2
Thailand	3.1	3.4	4.0	4.1	2.8	2.0	3.0
Malaysia	5.0	4.5	5.7	4.7	4.4	3.8	4.1
Philippines	6.1	6.9	6.7	6.2	5.9	5.3	6.0
Vietnam	6.7	6.2	6.8	7.1	6.5	6.2	6.5
East Asia	**5.9**	**5.8**	**6.0**	**5.8**	**5.3**	**4.7**	**5.4**
East Asia ex China	3.8	4.0	4.5	4.3	3.6	3.3	3.9
NIEs*	**2.2**	**2.5**	**3.3**	**2.8**	**1.4**	**1.5**	**1.9**
India	8.0	8.2	7.2	6.8	5.4	5.5	6.0
Russia	–2.3	0.3	1.6	2.3	1.1	1.3	1.7
Brazil	–3.6	–3.3	1.1	1.1	0.9	1.0	1.5
South Africa	1.2	0.4	1.4	0.8	0.7	0.9	1.4
Mexico	3.3	2.9	2.1	2.0	0.4	0.9	1.9
Argentina	2.7	–2.1	2.7	–2.5	–3.1	–2.0	1.4
Chile	2.3	1.7	1.3	4.0	2.5	2.5	3.2
CIS^	–1.3	2.0	4.3	4.1	4.0	2.8	2.6
Middle East	2.5	5.3	1.8	1.4	1.3	2.5	2.8
C & E Europe	1.4	–0.8	–0.3	0.3	–1.1	2.0	2.0
Africa	3.1	1.4	3.0	3.2	3.2	3.6	3.7
Emerging ex-East Asia	**2.5**	**3.2**	**3.2**	**3.1**	**2.3**	**2.9**	**3.4**
Other countries	5.0	4.3	6.0	4.0	3.5	3.0	2.4
World	**3.5**	**3.4**	**3.8**	**3.6**	**3.0**	**2.8**	**3.2**

#Regional and global groupings are weighted using PPP exchange rates updated to reflect ICP 2011 benchmark revisions.* "NIEs" signifies "Newly Industrialised Economies" as defined by the IMF, viz; Republic of Korea, Hong Kong SAR, Taiwan Province of China, and Singapore. ^ CIS is the Commonwealth of Independent States, including Mongolia. Sources: IMF, Westpac Economics.

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