Year in Review; Year in Preview

Economic & financial perspectives

- **Record expansion**: After 28 years, Australia’s record economic expansion has seemingly come to an end at the hands of the COVID-19 coronavirus. The economy contracted 0.3 per cent in the March quarter and is likely to contract around 8 per cent in the June quarter. The World Bank estimates that 90 per cent of global nations are expected to experience a recession over the first half of 2020.

- **State of play**: Australia is ending 2019/20 with the cash rate at 0.25 per cent, unemployment rate at 7.1 per cent and underlying inflation rate at 1.75 per cent.

- **Shares retreat from highs**: Before the full force of the coronavirus hit, the Australian sharemarket hit record highs on February 20. Total returns on shares are currently down 6.4 per cent in 2019/20.

The report is useful to assist investors to start planning for 2020/21.

What does it all mean?

- The 2019/20 financial year is almost complete and it is an opportune time to see how investments, financial markets and economies have performed over the past year.

- Not to put too fine a point on it, the past year has been difficult. The US-China trade stoush and Brexit dominated in the first half of 2019/20, causing businesses and consumers to restrain spending, employment and investment. And, just when there were signs of hope that these two factors would be less depressing for the global economy, the coronavirus emerged. It is now acknowledged that COVID-19 poses the biggest threat to the global economy in 90 years.

- Central banks have slashed interest rates and governments have provided unprecedented amount of fiscal support and stimulus for their economies. Governments started to impose lockdown measures on businesses and the movement of people from late January with the strictest measures applied from March to May. Countries have had varying success in suppressing the virus, but the financial year is ending with countries coming out of lockdown and returning their economies to some sense of normalcy.
What does the data show?

**Interest rates**
- Over 2019/20 there have been four interest rate cuts, each of 25 basis points. The cuts occurred on July 3, October 2, March 4 and March 20. The cash rate now stands at a record low of 0.25 per cent or 25 basis points.
- The rate cuts in July and October, 2019 were made with the intention of speeding up the economy and driving unemployment lower. The rate cuts in March 2020 were designed to shore up the economy against the depressing economic effects of COVID-19.
- On March 20, the Reserve Bank also set a target for the 3-year government bond yield at 25 basis points. The Reserve Bank also implemented a term funding facility designed to provide financial assistance for small and medium sized businesses.

**Currencies**
- The Aussie dollar began the financial year near US70 cents and is ending the year near US69 cents. But those values mask some volatility, especially in 2020. The high for the Aussie was US70.82 cents on July 19. The low (actually a 17-year low) was set on March 19 at US55.06 cents. The low point largely corresponded to lows for global sharemarkets and marked the peak of the virus panic – the fears about the spread of the virus and the implications for economies. It has been the most volatile year for the currency in five years.
- Over 2019/20 we have calculated that the Aussie is the 70th strongest currency against the US dollar of 120 currencies tracked (down 1.7 per cent). The currencies of Netherlands Antilles, Taiwan, Afghanistan and Malawi all rose 4.0-5.5 per cent. The weakest currencies were from the economies of Argentina, Brazil, Zambia, the Seychelles and South Africa. Only 19 currencies of 120 currencies have lifted against the greenback over the year.
- In the first six months of 2020, the Aussie dollar has also fallen 1.6 per cent against the US dollar, making it the 73rd strongest of 120 currencies tracked. The currencies of Japan, Switzerland and Taiwan have lifted by around 1-2 per cent. The weakest currencies are from the economies of Brazil, Zambia, the Seychelles and South Africa. Only 13 currencies have lifted against the greenback so far this year.

**Commodities**
- Commodity prices eased over the second half of 2019/20 as COVID-19 fears dominated. The Commodity Research Bureau futures index fell by 24 per cent over 2019/20, but the CommSec daily index eased by only 13 per cent.
- The difference between the two indexes is gold, with its price up 26 per cent over 2019/20 while beef has risen by 7 per cent and sugar is down by only 4 per cent. Amongst base metal prices, nickel has lifted by almost 1 per cent and copper is down 1.5 per cent. Oil has fallen 31 per cent, while spot natural gas has slid 54 per cent and iron ore is down by 13 per cent.

**Sharemarket**
- The Australian sharemarket started 2019/20 with the All Ordinaries near 6,700 points and the ASX 200 near 6,620 points. The All Ords is ending the year near 6,060 points (down 9.4 per cent) with the ASX 200 near 5,950 points (down 10.0 per cent). If we focus on the ASX 200, the index hit record highs of 7,162.5 on February 20 with lows hit around a month later on March 23 at 4,546 points.
- We have estimated that Australia (-9.4 per cent) is the 39th strongest of 72 global bourses so far in 2019/20.
Interestingly only 15 of the 72 bourses have recorded gains over the year. The best performers were hyperinflation-affected Zimbabwe and Venezuela but Denmark is up 26 per cent. Notably the US Dow Jones fell by 3 per cent while the NASDAQ has lifted 24 per cent. New Zealand has risen by 12.4 per cent and has been the 5th strongest bourse.

- The worst performers include Cyprus, Lebanon, Kenya, Colombia and Greece.
- **In the first six months of 2020**, the All Ordinaries has fallen by almost 11 per cent, ranking Australia 31st of 72 nations. Only 8 of 72 bourses are up so far this year. Again Denmark and New Zealand are amongst the out-performers with Cyprus, Greece, Austria, Colombia and Kenya amongst the laggards.

**Investment returns**

- **Total returns on Australian shares** have fallen by 6.4 per cent over 2019/20 which, if maintained, would be the first decline in returns in eight years. Returns on dwellings have lifted by 12.3 per cent while returns on government bonds have lifted by 4.3 per cent.

**Sectors & size groupings**

- Of the 22 identified industry sub-sectors, only eight have recorded gains in 2019/20.
- Leading the gains is Consumer durables & apparel (up by 45.9 per cent) followed by Pharmaceutical & Biotech (up 32.3 per cent), Software & services (up 19.9 per cent) and Retailing (up 15.2 per cent).
- At the other end of the scale, Energy has fallen the most (down 29.2 per cent) from Banks (down 27.9 per cent) and Insurance (down 23.9 per cent).
- Of the size categories, the MidCap50 has out-performed (down 2.1 per cent) from the Small Ordinaries (down 5.4 per cent) the ASX100 (down 10.6 per cent) and the ASX50 (down 12 per cent).

**What are the implications for investors?**

- Now it’s all about COVID-19. The economic outlook depends on the success or otherwise achieved by governments, health authorities and communities in suppressing the spread of the virus. If the virus is contained and the active case load remains manageable, then more parts of the economy can re-open and a degree of normality can return to society and the economy.
- As economies re-open, setbacks can be expected in suppressing the spread of COVID-19. There is no road map to follow, governments will need to quickly respond to changes in circumstances.
Ideally, a vaccine or treatment will be found. But economies can still rebound from lockdown-driven lows in the absence of a vaccine. If and when a vaccine is found, it will still take time for testing and commercialisation. The main short-term implication of finding a vaccine is a boost to confidence, encouraging businesses to invest and hire workers and encouraging consumers to spend.

Prospects for sharemarkets will depend on businesses returning to normal and people returning to their workplaces.

CommBank Group economists tip a 3.2 per cent fall in the global economy in 2020 and then a 4.7 per cent lift in 2021. In Australia, the economy is tipped to fall 3.9 per cent in 2020 before recovering 3.0 per cent in 2021. The recovery in Australia will be restrained by the drying up of external migration, affecting tourism, education and real estate markets.

We assume that Australian governments and the Reserve Bank will live up to the promise of doing “whatever it takes” to restore the economy to full health – especially restoring health to the job market. This means leaving the cash rate at record lows and continuing to provide fiscal support measures.

Governments will need to balance health risks with economic risks. But we expect the Federal Government to live up to the mantra of protecting jobs. There are still a few weeks until the July 23 Budget update where the Government will assess whether to extend JobKeeper in some form.

We expect the unemployment rate to peak near 8.4 per cent in the September quarter before easing toward 7 per cent by December quarter 2021.

The good news for the government is that the Budget was balanced before the virus hit. That has allowed the Federal – as well as State and Territory governments – to provide all the necessary support for economies. We estimate that around $295 billion of fiscal and financial support (almost 15 per cent of GDP) has been provided by all governments and the Reserve Bank.

Budget deficits near $130 billion are expected in 2019/20 and 2021/21 (around 7 per cent of GDP). Net debt may lift from around 20 per cent of GDP to around 30-35 per cent of GDP – still low compared with other advanced nations.

The cash rate is expected to remain at 0.25 per cent until 2022.
• In terms of the sharemarket, last year we noted: “Over the coming year CommSec expects the All Ordinaries index to be near 6,700-7,000 points in December 2019 and 6,800-7,100 points in June 2020.” The first forecast was achieved. Clearly COVID-19 has ensured that the June 2020 forecast won’t be achieved.

• Over the coming year CommSec expects the All Ordinaries index to be near 6,100-6,400 points in December 2020 and 6,500-6,800 points in June 2020.”

• The Aussie dollar is expected to trend higher over the coming year in line with expectations of economic recovery at home and abroad. CommBank currency strategists are tipping the Aussie dollar to lift to US72 cents by December 2020 and US76 cents by June 2021. But the strategists warn “The increasingly fraught relations between US-China and Australia-China will be an intermittent downside risk to AUD/USD. Some of these tensions reflect ‘great power’ rivalry between the US and China that will not go away soon.”

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