1. International Economic Conditions

Global economic conditions have deteriorated significantly since the February *Statement on Monetary Policy*. Around the world, the COVID-19 pandemic has led to social distancing measures of various degrees to slow the spread of the virus, which has necessarily constrained economic activity. Monetary and fiscal authorities have implemented extensive and timely supporting policies. In the short term, these measures will provide support by offsetting some of the income that is being lost because of the public health measures. They will also help economies recover faster when these measures are eventually relaxed. The speed of the recovery in each economy is highly uncertain and will depend on how quickly the virus is contained so that activity restrictions can be relaxed, and on how persistent behavioural changes are as a result of the pandemic.

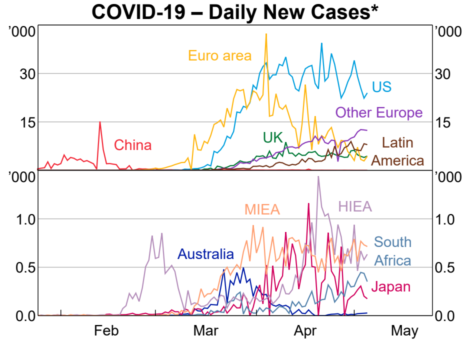
The COVID-19 pandemic has led governments to impose varying degrees of social distancing policies

Despite efforts to control the spread of the virus that causes COVID-19, the virus still spread globally. New infections in China peaked in the first half of February, and the virus had reached a number of other Asian economies by the end of February. By mid March, a global pandemic was declared by the World Health Organization as new infections rose rapidly in some parts of Asia, Europe and North America (Graph 1.1). To contain the spread of the virus, many governments imposed a number of public health measures, particularly travel restrictions, quarantine, testing, tracing and social distancing; the extent of these restrictions has varied across jurisdictions.

Some countries have had more success in limiting the number of new cases than others. South Korea imposed travel restrictions earlier than most, and conducted extensive testing, tracing and quarantining. However, in some other economies that had early success in slowing the spread of the virus, including Japan and Singapore, infections have increased since late March, which has led to the introduction of stricter containment measures. In Europe, new cases peaked shortly after the rollout of strict social distancing measures in mid March and some countries have recently begun to relax some containment measures. By April, the epicentre of the pandemic had shifted to the United States. Although strict social distancing policies were introduced in most US states, they have recently been partially relaxed in some.

Graph 1.1

COVID-19 – Daily New Cases*



* Euro area includes France, Germany, Italy and Spain; other Europe includes Turkey, Russia and Poland; Latin America includes Brazil and Mexico; HIEA includes South Korea, Singapore and Taiwan; MIEA includes Indonesia, Malaysia, Thailand, Philippines and Vietnam

Sources: Johns Hopkins CSSE; RBA

Many emerging economies, where new cases have grown rapidly since mid March, face greater challenges in dealing with the pandemic. Healthcare capacity in many of these countries is more limited than in most advanced economies (Graph 1.2). The risk of a large caseload is also greater in those economies with higher population densities and higher shares of informal employment, which can make social distancing measures harder to implement. In some emerging economies, like India and South Africa, strict country-wide containment measures have been implemented, while in others, like Indonesia, the measures are more localised.

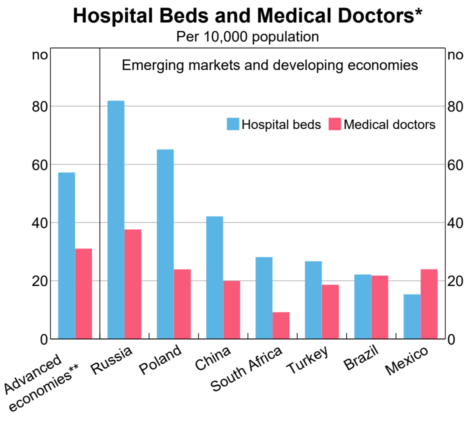
In China, where new infections are now low and manageable, authorities have begun relaxing restrictions on domestic movements. However, after a recent rise in cases from international arrivals, China has imposed very tight controls at its border, forbidden entry for almost all foreigners, and placed restrictions on areas at risk of another outbreak.

Social distancing is driving a significant contraction in global economic activity

The public health response to the pandemic necessarily involves significant constraints on economic activity. In the United States, the euro area and the United Kingdom, around one-third of economic activity has been affected by the lockdowns (Graph 1.3); the level of quarterly GDP is estimated to be around 2 to 3 per cent lower for every week these lockdowns are in place. Elsewhere, the economic effect is estimated to be smaller because containment measures have been more targeted. The effects of local lockdowns will be compounded by:

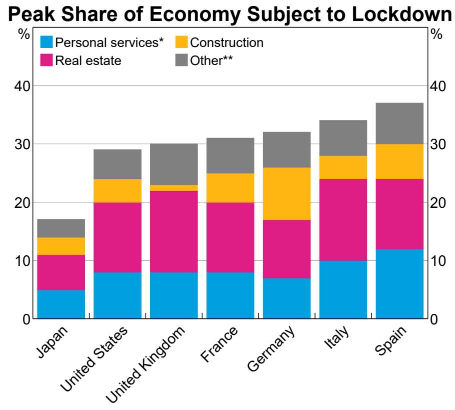
- general economic uncertainty and expectations of future income loss
- weak global demand given the synchronised nature of this downturn
- widespread supply chain disruptions
- tighter financial conditions
- the sharp fall in commodity prices, especially for oil, weighing on business investment in some sectors; lower oil prices are unlikely to support near-term economic activity in net oil-importing economies because of the restrictions on activity.

Graph 1.2



* Latest available data for each economy
** Simple average of Canada, France, Germany, Italy, Japan, United Kingdom and the United States
Sources: RBA; WHO

Graph 1.3



* Includes accommodation & food services and wholesale & retail trade
** Includes art, entertainment, recreation and other services
Sources: OECD; RBA

The duration of the lockdowns and how quickly they are eased will affect the size of the economic contraction and the speed of the subsequent recovery. Most lockdowns were initially for less than a month but have been extended in many cases to around six to eight weeks. Many restrictions, including border controls, may remain for an extended period. Containment measures have started to be gradually relaxed in many countries.

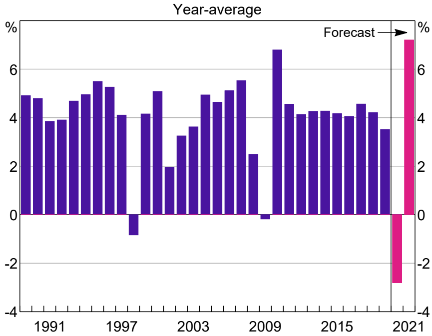
Apart from China, where the recovery is already underway, the contraction in activity is expected to be concentrated in the June quarter. In the major advanced economies, GDP is expected to contract in 2020 by 3 to 7 per cent in year-average terms with peak-to-trough declines in GDP of 10 to 15 per cent. For economies in the Asian region that have so far used targeted containment measures, the decline in domestic activity is expected to be smaller, but weaker external demand will slow growth in the region. In year-average terms, the GDP of Australia's major trading partners is expected to contract by around 3 per cent in 2020 (Graph 1.4).

In China, supply constraints are beginning to ease, and demand will become increasingly important as the main factor determining the pace of recovery. Weaker external demand will weigh on China's recovery, but authorities have stated that fiscal and monetary policy will be more accommodative in the coming months. Fiscal and monetary policy measures are also expected to replace some of the lost spending in advanced economies and aid the recovery in the second half of 2020. However, the level of GDP is likely to remain below its pre-COVID-19 trajectory because of severed employment and supplier relationships due to job losses, business failures, lower private investment, and voluntary social distancing. In year-average terms, the GDP of Australia's major trading partners is expected to expand by 7 to 8 per cent in 2021 (Graph 1.4).

Graph 1.4

Australia's Major Trading Partner Growth

Year-average



Sources: ABS; CEIC Data; Oxford Economics' Global Economic Model; RBA; Refinitiv

The risks to the global outlook are skewed to the downside. In some countries, limited testing, less extensive containment measures or premature relaxation of restrictions could lead to another surge in new cases and a reintroduction of restrictions, which will lead to a more protracted contraction. The negative effects of such a scenario would have longer lasting effects as more businesses close, people experience longer spells of unemployment and lower investment lowers future productive capacity.

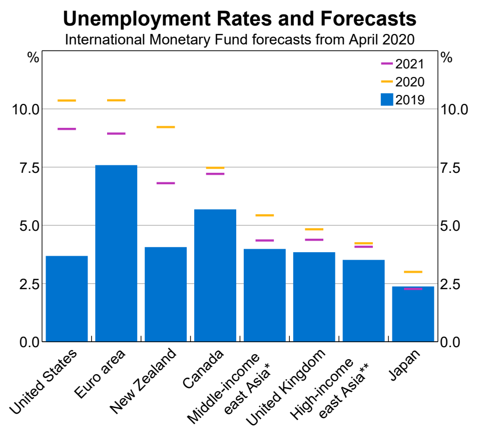
Unemployment rates in advanced economies are expected to increase significantly and are likely to take longer than GDP to return to their pre-COVID-19 levels. More of the labour market adjustment is likely to take place through reduced hours worked and earnings in economies that have expanded or created wage subsidy programs. This includes many euro area economies, the United Kingdom, Canada and New Zealand. In Germany, which has a long track record with such programs, the unemployment rate is expected to increase by less than 1 percentage point, while Spain's central bank expects the unemployment rate to increase by 4 to 8 percentage points in 2020. However, in economies where such programs are being introduced for the first time, new job losses are still expected to be relatively high. For example, the Office for Budget Responsibility expects the

UK unemployment rate to increase by 6 percentage points in the June quarter.

In economies with less comprehensive wage subsidy programs, such as the United States, more of the adjustment is expect to occur through job losses. The Congressional Budget Office expects the US unemployment rate to peak at 16 per cent in the September quarter and average around 11.5 and 10 per cent in 2020 and 2021, respectively. The International Monetary Fund (IMF) expects the increase in the US unemployment rate to be the largest of the advanced economies and the increase in unemployment in economies with wage subsidies to be smaller but still sizeable (Graph 1.5).

Global inflation is expected to be subdued. In the short term, weaker demand and very low oil prices will reduce inflation despite the disruptions to global supply chains and the temporary upward price pressures on staple goods. In the medium term, spare capacity in the labour market will lead to ongoing downward pressure on inflation. Inflation is likely to remain below most central bank targets for an extended period.

Graph 1.5



* Includes Indonesia, Malaysia, Philippines and Thailand
** Includes Hong Kong, South Korea and Taiwan
Sources: IMF; RBA

In China, economic activity in many sectors is approaching usual levels

The tight restrictions imposed to contain COVID-19 cases resulted in a contraction of 9.8 per cent in Chinese GDP in the March quarter (Graph 1.6). Business shutdowns caused both industrial production and fixed asset investment to fall to levels last recorded in the mid 2010s. The contraction in consumer demand was reflected in a sharp fall in retail sales. Some capital-intensive industries, such as steel-making, fared better than other sectors because they were less affected by labour supply disruptions and production was supported by expectations of future higher infrastructure spending. Following the easing of restrictions, industrial production recovered strongly in March to be only 3.5 per cent lower than at the end of 2019 and fixed asset investment picked up a little, but retail sales remained weak.

Property sales effectively ceased during the shutdown and were slow to recover (Graph 1.7). The extended suspension of property sales could put further financial pressure on developers because they have recently relied more on pre-sales for funding. Residential real estate investment, starts and completions increased in March after contracting sharply in January and February.

Graph 1.6

* Seasonally adjusted; RBA estimates prior to December quarter 2010
Sources: CEIC Data; RBA

Production disruptions led to a sharp fall in exports in February, but as disruptions and logistical challenges in transporting goods eased, exports began to recover, particularly to Asia. The decrease in imports was more muted, which is likely to reflect both disruptions to the domestic production of commodities, and ongoing activity in downstream industries (such as steel production).

Weak demand and supply disruptions have had a limited short-term effect on inflation in China (Graph 1.8). Core inflation has fallen over the past year to around 1¼ per cent owing to slower growth in economic activity. Disruptions to transportation caused some food prices to rise in February. But as transportation returned to normal and authorities continued to release pork reserves in March, headline consumer price inflation declined. Producer prices declined in February and March because of lower oil prices and weaker domestic demand.

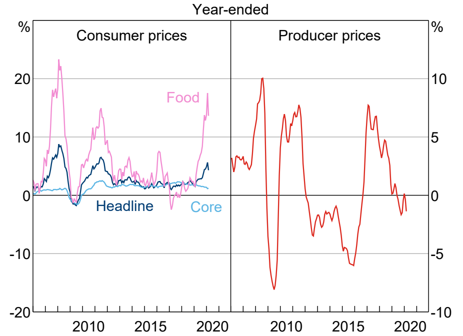
China's recovery is expected to gather pace as the balance shifts from containment measures to policies that support growth. Higher-frequency data suggest that activity generally rose to around 90 per cent of normal levels by the end of April (Graph 1.9). While many businesses have re-opened, capacity utilisation remains below pre-outbreak levels because of widespread workforce shortages (with many migrant workers yet to return to urban areas), continued lockdown measures in some cities, and the weak recovery in demand. Economic activity is expected to rebound in the June quarter and recover further in the second half of the year as businesses gradually return to normal levels of production and the economy continues to receive policy support.

China's fiscal response was initially focussed on improving business liquidity. To help local governments provide more fiscal support, the interim quota for local government bond issuance was raised by CNY 1 trillion to be around 85 per cent of total 2019 issuance. The People's Bank of China has also provided further

Graph 1.8

China – Inflation*

Year-ended



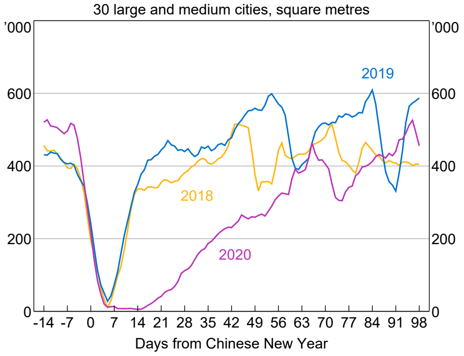
* Seasonally adjusted by the RBA

Sources: CEIC Data; RBA

Graph 1.7

China – Property Sales*

30 large and medium cities, square metres

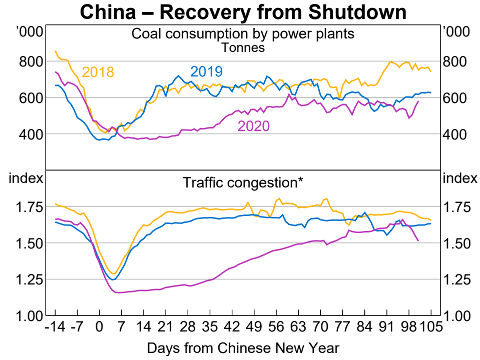


* Seven-day moving average

Sources: RBA; WIND

Graph 1.9

China – Recovery from Shutdown



* Seven-day moving average

Sources: RBA; WIND

monetary support to the economy (see 'International Financial Conditions' chapter).

The strict containment measures have sharply curtailed activity in the advanced economies

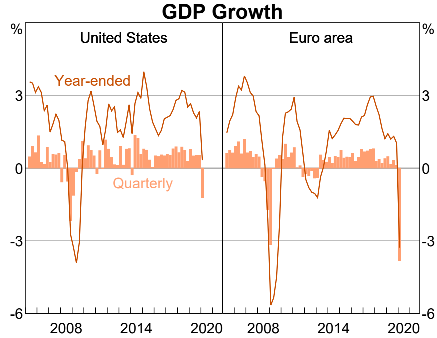
It is already clear that there was a simultaneous contraction in economic activity in the advanced economies in March and April that was unprecedented in terms of its speed and combined size. Some of the contraction appears to have begun before the government-mandated lockdowns as households took health precautions and reduced discretionary consumption. The deterioration in labour market conditions has been extremely swift and will have exacerbated the direct effects of the public health measures on spending.

GDP contracted by 1.2 per cent in the United States and by 3.8 per cent in the euro area in the March quarter, even though the containment measures had only been in place for a couple of weeks at the end of the quarter (Graph 1.10). The fall in GDP was largest in France despite Spain and Italy being hit hardest by the virus. Surveyed business conditions in the major advanced economies declined further in April after sharp falls in March that were consistent with the contraction in overall output. The deterioration in business conditions has been the sharpest in the services sector, which is most affected by social distancing measures (Graph 1.11). Surveyed future business conditions have also deteriorated, suggesting that firms expect weak business conditions to persist over the next year.

Consumer confidence and retail sales in the major advanced economies have declined sharply since March (Graph 1.12). Consumption of essentials, such as food and beverages, and online shopping have increased, but this has been far outweighed by very large falls in most other categories. Discretionary and high-value categories of consumption have been especially weak. Motor vehicle sales have collapsed to their weakest level in over 30 years in the United States and the euro area.

Graph 1.10

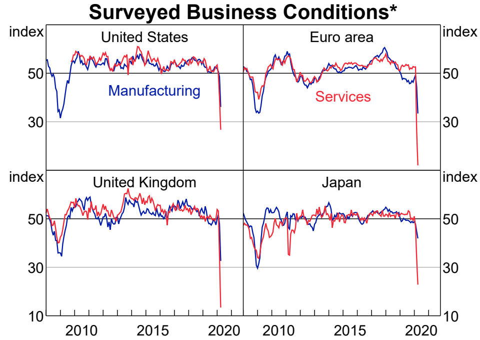
GDP Growth



Source: Refinitiv

Graph 1.11

Surveyed Business Conditions*

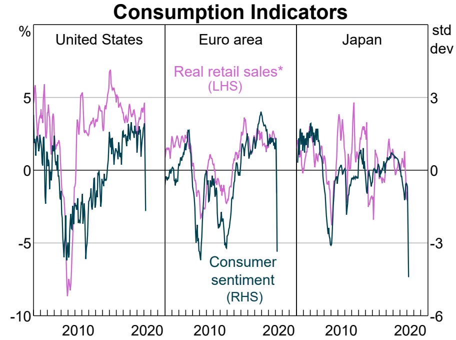


* Purchasing Managers' Index; below 50 indicates that activity is contracting

Sources: Markit; RBA

Graph 1.12

Consumption Indicators



* Year-ended growth; smoothed; consumption index for Japan

Sources: CEIC Data; RBA; Refinitiv

Industrial production declined sharply in March in the United States and Japan. The decline in manufacturing output was mostly due to the sharp reduction in demand for non-essential items and production disruptions; the industrial sector was deemed to be essential in these countries so was not subject to strict lockdown measures. Investment intentions have declined sharply in the United States and lower oil prices are expected to exacerbate the decline in energy-sector investment.

Labour market conditions have deteriorated rapidly. Total initial claims for unemployment in the United States since mid March have exceeded 30 million, or 21 per cent of the labour force; this is far higher than during any US recession since at least the late 1960s. Unemployment claims have also increased very sharply in other advanced economies. Large uptake has been reported for government-sponsored wage subsidy schemes in many European economies. In Germany, applications for support rose sharply in April and exceed the peak number of applications during the global financial crisis.

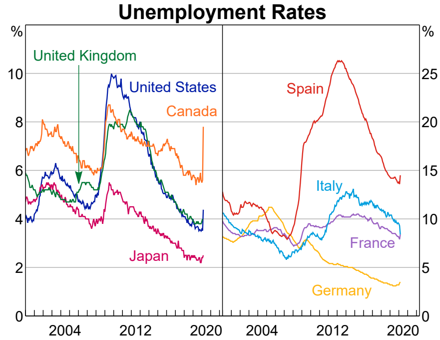
Published unemployment rates do not yet fully reflect the effect of containment efforts (Graph 1.13). Recent published unemployment rates for March were measured before the lockdowns went into effect in a number of economies, including the United States (4.4 per cent, up by nearly a percentage point from February) and Japan (2.5 per cent, little changed from the previous month). The March unemployment rate in Canada (7.8 per cent, up by 2.2 percentage points since February) was measured in the initial stages of the lockdown. Unemployment rose sharply in Spain because the lockdowns were very strict, the large tourism sector was effectively shut and a high share of workers are typically on short-term contracts. Italian unemployment fell sharply despite the country's longer and stricter lockdown; the number of people actively looking for work fell sharply and the government also placed restrictions on employment terminations in March and April.

Fiscal policy has been used aggressively to support activity

Governments in advanced economies have quickly responded with very large and targeted fiscal packages (Graph 1.14). The objective has been to fund the healthcare response and to preserve some level of income, business viability and employment relationships, so that activity can resume quickly when the containment measures are wound back.

Graph 1.13

Unemployment Rates

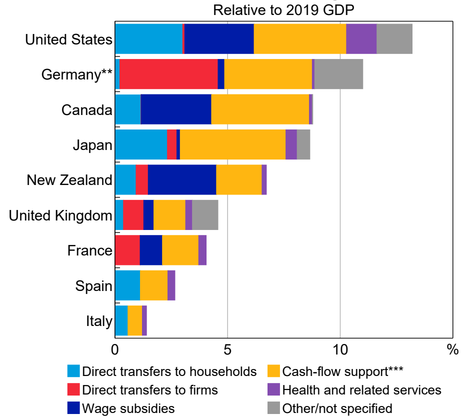


Sources: RBA; Refinitiv

Graph 1.14

Direct Fiscal Response*

Relative to 2019 GDP



* Excludes loan guarantees

** Not specified includes wage support

*** Includes loans for firms, and deferred tax and debt payments

Sources: National sources; RBA

The household and business fiscal support measures include:

- expanding existing automatic stabilisers by increasing their size and duration, e.g. an additional US$600 per week in unemployment benefits in the United States and additional compensation for loss of employment of C$2,000 per month for four months in Canada
- direct payments to individuals, for example a one-time payment in the United States of US$1,200 for those with annual earnings under US$75,000, and ¥100,000 for every resident in Japan
- direct funding for small businesses and self-employed individuals, for example a €50 billion package in Germany and £10,000 to £25,000 for eligible small UK businesses
- business incentives to maintain employment, including funding to help cover wages and other expenses, e.g. loans that can be turned into grants for small US businesses that spend 75 per cent of the loan on employee compensation; a 75 per cent wage subsidy for small businesses in Canada; 80 per cent wage subsidy in the United Kingdom; and expanded wage-employment subsidy programs that pay significant part of wages in Germany, France and Spain
- deferring tax payments, direct loans and substantial loan guarantees (see 'International Financial Conditions' chapter)
- pausing certain contractual obligations, which would reduce payments by affected individuals and firms for a period of time, including freezing or postponing payments for rent, utilities and mortgages.

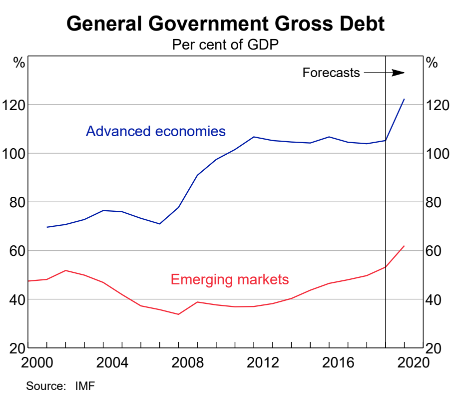
The direct fiscal support will contribute to a significant increase in government debt levels; at the same time, tax revenue will be lower and the call on the existing automatic stabilisers will raise spending until the recovery is well under way. Governments will be issuing debt in an environment with very low interest rates, high demand for safe assets, and weak private investment. The IMF estimates that advanced economies' debt-to-GDP ratio will increase by over 17 percentage points in 2020, primarily as a result of the direct fiscal response to COVID-19 (Graph 1.15).

Domestic outbreaks and a decline in external demand have affected economic activity in east Asia

The spread of COVID-19 to east Asia's other major trading partners has kept external demand conditions weak into the June quarter despite the recovery in China. New export orders continued to decline in April for most of the region (Graph 1.16). Inbound tourism has virtually ceased due to global travel restrictions; tourism makes up a significant proportion of activity in many economies in the region, especially Thailand.

Consumer sentiment, business confidence and conditions in the region's manufacturing sector have declined sharply since the COVID-19 outbreak. The deterioration in conditions started in February because the region was affected by its large trade exposure

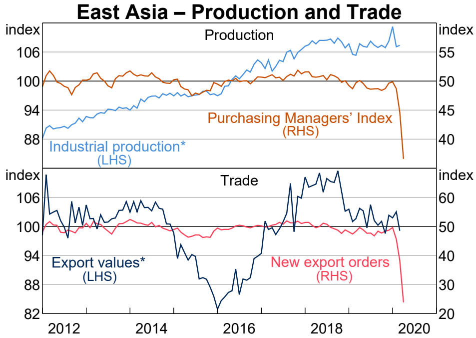
Graph 1.15



to China and its earlier implementation of measures to contain local outbreaks. As a result, activity contracted in some economies in the region in the March quarter. In South Korea, weaker household consumption was the main driver of the 1.4 per cent contraction in GDP, reflecting both voluntary and mandated social distancing. Larger contractions are expected in the June quarter in the region; most economies have tightened their public health measures and external demand has deteriorated further. Furthermore, the easing in supply chain disruptions related to China is being offset by supply chain disruptions originating elsewhere. Supplier delivery times across economies have lengthened significantly since February (Graph 1.17).

Graph 1.16

East Asia – Production and Trade

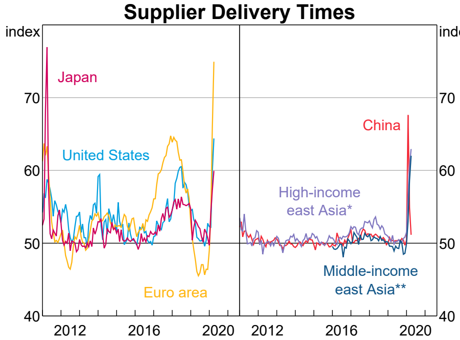


* Average since 2012 = 100

Sources: CEIC Data; Markit; RBA

Graph 1.17

Supplier Delivery Times



* Hong Kong, Singapore, South Korea and Taiwan

** Indonesia, Malaysia, Philippines, Thailand and Vietnam

Sources: Markit; RBA

Most economies in the region have introduced sizeable fiscal packages, with the largest package in Singapore (Graph 1.18). South Korea has announced fiscal measures to maintain employment, assist small businesses and support key industries that have been most affected by the decline in external demand. In Indonesia, a cap on deficits introduced after the Asian Financial Crisis has been temporarily lifted to enable the government to respond to the crisis. Many governments are also providing loan guarantees and moratoria on loan repayments. The monetary policy response in the east Asian region has been more muted than in the major advanced economies (see 'International Financial Conditions' chapter).

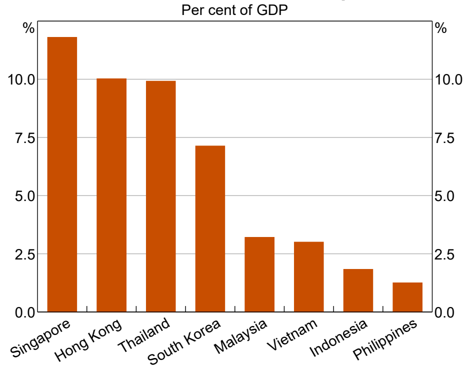
Many emerging and developing economies have more limited capacity to respond to COVID-19

The economic and health effects of COVID-19 may ultimately be more severe in some of the emerging economies. Because of the more limited social safety nets in these economies, the very poor are likely to need to continue working. These economies are also more vulnerable to a tightening in external financing conditions, abrupt exchange rate depreciations and weak external demand (see

Graph 1.18

East Asia – Direct Fiscal Response*

Per cent of GDP



* Excludes loan guarantees, loan moratoriums and other unspecified fiscal support

Sources: IMF; National sources; RBA; UBS

'International Financial Conditions' chapter). These issues will be compounded by lower commodity prices for commodity-exporting countries.

Moreover, many emerging market economies are facing the COVID-19 crisis from a weaker starting point. Growth had slowed markedly in some of the larger emerging market economies in recent years and some, including Brazil and Russia, had recently exited prolonged recessions. The IMF forecasts that GDP in emerging market and developing economies (excluding China and India) will contract by 2.9 per cent in 2020. This would be the biggest decline in emerging market GDP since at least 1980.

COVID-19 is expected to lead to a sharp contraction in Indian GDP

India entered into a widespread lockdown in late March. This, combined with weaker external demand, is expected to lead to a large contraction in Indian GDP in the first half of 2020. The unemployment rate appears to have risen sharply to around 25 per cent as a result of the shutdown (Graph 1.19). There are also widespread reports of harvest delays. Growth is expected to rebound in the second half of 2020 as the Indian authorities relax their restrictions and provide a range of fiscal and monetary support. Fiscal policy has been targeted at vulnerable individuals in the form of food assistance and cash transfers, as well as support for business. The Reserve Bank of India has taken a number of steps to provide cheaper financing to the private sector and eased regulatory requirements for banks among other measures.

Oil prices have fallen sharply

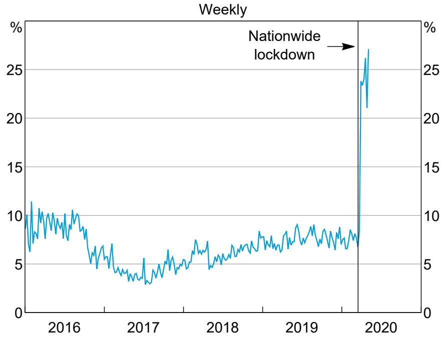
The price of Brent crude oil reached its lowest level since the early 2000s in April (Graph 1.20). The COVID-19 pandemic has significantly reduced global oil demand, and the collapse in earlier OPEC+ negotiations resulted in key oil producers pledging to increase supply. In an attempt to stabilise the market, OPEC+ members met for an emergency meeting in April and agreed to cut production by about 10 per cent of global supply over the next couple of months. Since then, there have been large moves in oil prices around concerns that the production cuts would be insufficient to stabilise prices given the significant drop in demand. More recently, oil prices have increased in part because some countries have started to ease restrictions. In the United States, oil inventories have increased and reports that crude storage facilities are reaching capacity contributed to the large moves in some benchmark oil prices in late April, with prices implied by some futures contracts briefly turning negative.

The recent sharp fall in oil prices has implications for Australian LNG exporters. The bulk of Australia's LNG exports are sold via long-term contracts that are priced with reference to oil prices with a lag; as a result, recent falls in oil prices are expected to reduce significantly the average price received by LNG exporters from the June quarter. For LNG exports sold in the spot market, prices have declined since mid December 2019 (Graph 1.21). Lower prices have also meant that some LNG projects in Australia

Graph 1.19

India – Unemployment Rate

Weekly



Sources: CMIE; RBA

are now unlikely to go ahead within previously expected timeframes.

Iron ore prices have held up, while most other commodity prices have fallen

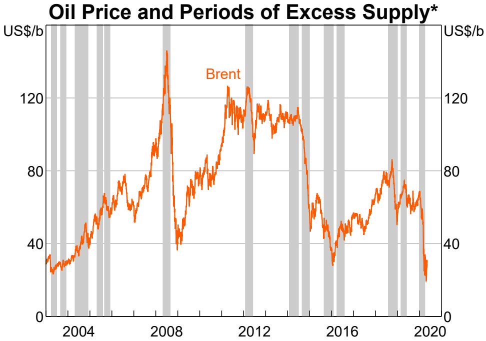
The iron ore price has been relatively stable over recent months, despite the outbreak of COVID-19 (Graph 1.22, Table 1.1). Chinese demand for imported iron ore has remained fairly strong, reflecting some disruptions to domestic production, the gradual resumption of domestic economic activity and rebuilding of inventories in anticipation of government stimulus, which could boost demand for steel. At the same time, iron ore supply had declined because of weather-related supply disruptions in Australia and Brazil, which together account for around three quarters of global iron ore exports.

Coal prices have declined over the past month, largely driven by lower demand, especially for coking coal, outside China. Some steel producers, including India, which accounts for 15 per cent of global coking coal imports, have scaled back production as part of domestic containment measures. At the same time, the recovery in Australian supply of coking coal following weather-related disruptions, as well as the partial lifting of Mongolia's ban on coal exports to China, have weighed on prices.

Base metal prices have also fallen in recent months as a result of lower expected demand and disrupted global supply chains (Graph 1.23). The price of copper, which has a range of industrial uses, has declined by around 10 per cent since the previous *Statement*. In contrast, the price of gold, which many investors view as a relatively safe asset, has increased by around 10 per cent. The COVID-19 pandemic has weighed on some rural commodity prices, with wool and sugar prices falling the most over the past couple of months.

Graph 1.20

Oil Price and Periods of Excess Supply*

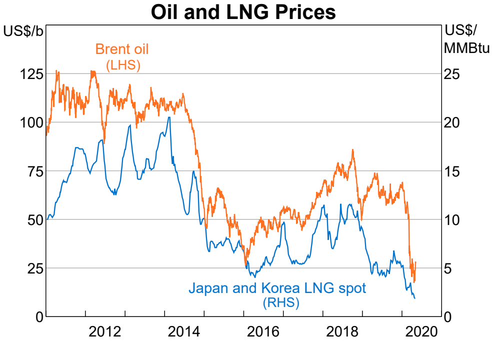


* Shaded periods indicate supply exceeding demand for three consecutive months or more

Sources: EIA; RBA

Graph 1.21

Oil and LNG Prices

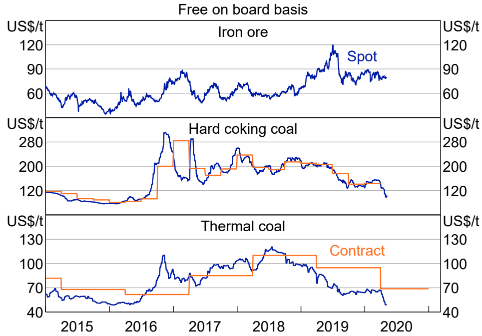


Sources: Bloomberg; Refinitiv

Graph 1.22

Bulk Commodity Prices

Free on board basis



Sources: Bloomberg; Department of Industry, Innovation and Science; IHS Markit; RBA

Table 1.1: Commodity Price Changes[a]

Per cent

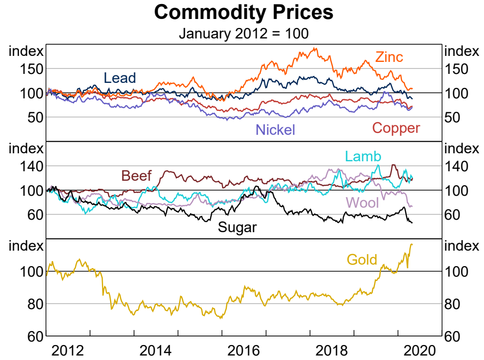
	Since previous *Statement*	Over the past year
Bulk commodities	–6	–24
– Iron ore	5	–8
– Coking coal	–28	–48
– Thermal coal	–22	–42
Rural	–7	–5
Base metals	–12	–16
Gold	9	33
Brent crude oil[b]	–50	–61
RBA ICP	–2	–9
– Using spot prices for bulk commodities	–5	–14

(a) Prices from the RBA Index of Commodity Prices (ICP); bulk commodity prices are spot prices

(b) In US dollars

Sources: Bloomberg; IHS Markit; RBA

Graph 1.23



Sources: Bloomberg; MLA; RBA