

Australian Economic Insight

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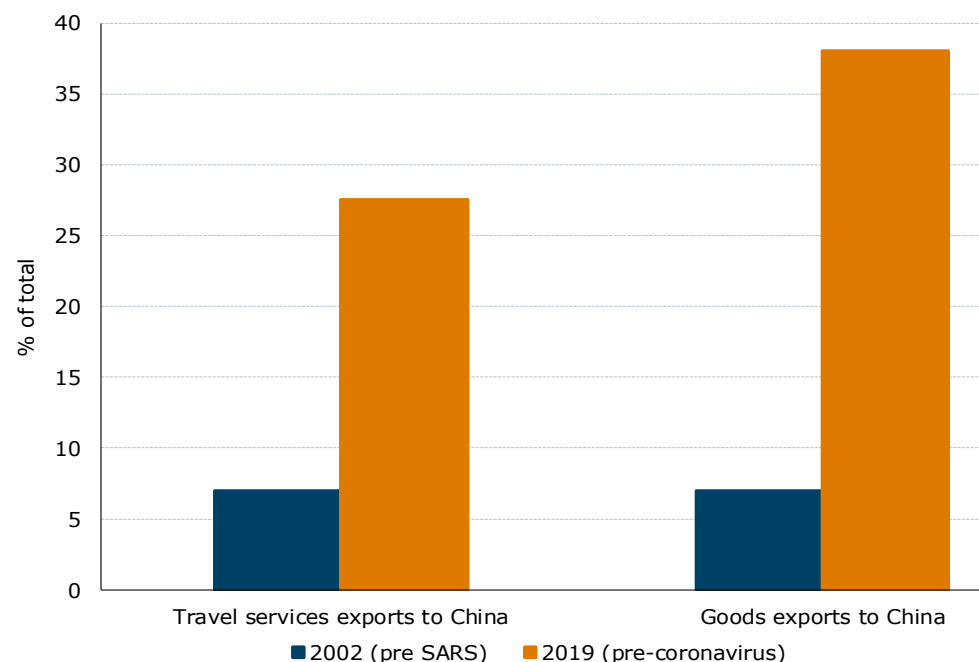
Related reports

Coronavirus: assessing the
potential economic impact on
Australia, 30 Jan 2020

Coronavirus hit to turn GDP negative in Q1

- We have revised our preliminary estimate of the impact of the coronavirus and now expect it to take around 0.5ppt off Australia's GDP in Q1. Along with a small hit from the bushfire impact, we estimate that GDP will now *fall* 0.1% q/q in Q1.
- The World Health Organisation (WHO) has declared an international emergency in response to the outbreak of the coronavirus in China. The number of cases has risen above 20,000 and tragically the number of deaths has risen to nearly 500.
- The economic impact of the virus has been brought into sharper focus by the measures taken to limit the spread. The understandable travel ban in place in Australia on all foreign nationals who have been in China, as well as airline cancellations, will act to sharply reduce the level of tourist arrivals.
- There is a very wide a range of uncertainties around the outlook. The virus's timeline, the behaviour of non-China tourism, the impact on broader Chinese and global growth, and the degree to which Australian's limit their travel abroad.
- While the hit to near-term growth is large, we expect the number of arrivals from China to turn around in Q2, with the rebound in tourism adding to growth in Q3 and Q4. Consequently the impact on year-end growth is likely to be small.
- For the RBA, a case can be made for looking through the immediate impact on demand, given the likely rebound later in the year. Our view, however, is that while the economic impact of the coronavirus does not *drive* the case for further easing, it *adds* to the weak tone in the economy and suggests further rate cuts are likely this year.

Figure 1. Australia's exposure to China has increased dramatically since the SARS virus



Source: ABS, ANZ Research

Coronavirus impact larger than earlier expected

Since our note last week assessing the [impact of the coronavirus on growth](#), the WHO has declared (for only the sixth time in history) an international emergency. The number of cases has reached 20,000 and tragically the number of deaths has risen to nearly 500. A number of airlines have cancelled flights out of China, including Qantas which has stopped all direct flights from Beijing and Shanghai until 29 March. Moreover, the Australian government issued a travel ban, on 1 February (to be reviewed 14 days after its introduction), on all foreign nationals who have been in China, with exceptions for permanent residents, and their immediate families.

These developments have prompted us to revise our earlier estimate that the impact would take 0.2ppt off growth. We now expect GDP to be around 0.5ppt lower in Q1 as a result of the virus. We also see a small negative impact from the bushfires. Accordingly, we now expect GDP to *fall* 0.1% q/q in the March quarter.

The reasoning behind our numbers was discussed in detail in our previous note, and these remain our key grounds for a downgrade. We have used the experience of the SARS virus to inform our thinking on the likely impact of the coronavirus on tourist activity. But the magnitude has changed. The announcement from WHO, the cancellation by airlines and the Australian government's travel ban have caused us to increase our estimate of the likely impact.

We have made a number of assumptions to arrive at this estimate, including:

- Tourist arrivals from China fall 85% in February, reflecting the impact of the travel ban.
- Spending from students from China falls 30% in February¹. Reports suggest that more than 50% of the entire student cohort remains outside Australia.²
- Tourism spending from non-China arrivals drops 8% in February.
- Education spending from non-China students remains unchanged.
- Recovery begins in April.

We could well be wrong on some of these assumptions.

Broader negative impacts are possible. Local consumer sentiment took a hit from the bushfires and the news regarding the virus is keeping confidence levels low. Rising uncertainty about the impact of the virus is likely to test business confidence, and there is the potential for investment plans to be delayed.

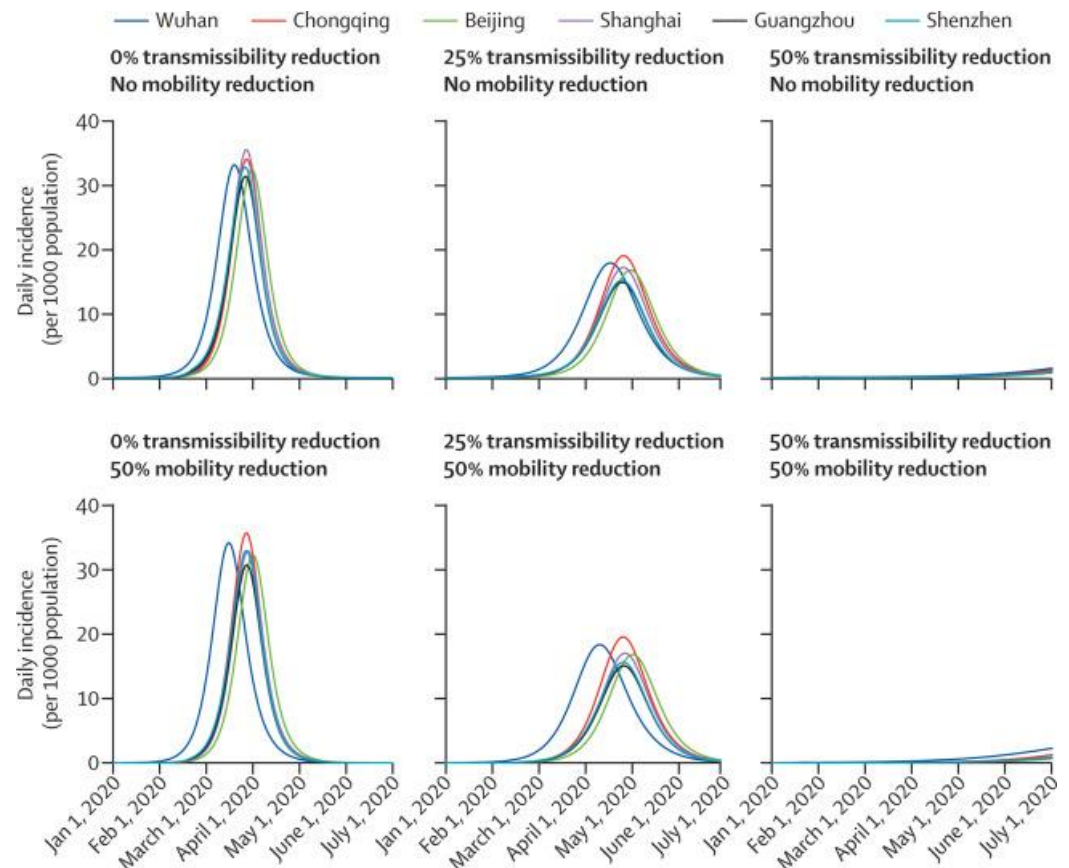
The broader economic impact from slower growth in the extended Asian region is difficult to quantify at this stage. ANZ's China economists' early estimate of the impact is to [drag Q1 GDP down to 5.0% y/y](#). Many ports in China remain closed due to the extended Lunar New Year Holiday. This is affecting delivery of Australia's exports and driving commodity prices lower. The iron ore price has dropped 14% over the past two weeks. Supply chains in the region are disrupted, with factories unable to continue production without key components from their China sources. Hyundai announced on Tuesday that it has shut down all its car factories in South Korea given a shortage of supplies from China. Other car manufacturers have warned that they too may be forced to close.

¹ For students arriving from China, around 60% come for university education, 10% come for VET, 17% for English language courses, 5% for schools and 7% for other "non-award" courses.

² <https://www.smh.com.au/politics/federal/china-not-happy-with-sudden-australian-travel-lockdown-20200204-p53xq2.html>

We have assumed in our forecasts that recovery begins in April. Predictions around the virus progression clearly have a high degree of uncertainty, but current predictions from *The Lancet* show the virus peaking in intensity around April (Figure 2). In which case, recovery may be delayed until later than we assume. This suggests that our estimate of the negative impact is relatively conservative.

Figure 2. Epidemic forecasts for Wuhan and other major cities under various scenarios



Source: *The Lancet* "Nowcasting and forecasting the potential domestic and international spread of the 2019-nCoV outbreak originating in Wuhan, China: a modelling study".

Policy makers will grapple to formulate an appropriate response. Many short-term shocks like these quickly drive down growth, and then a V-shaped recovery ensues. The RBA generally looks through short-term shocks and does not respond with monetary easing. On our calculations, this shock looks likely to be relatively severe, but our long-held belief has been that the weakness in underlying momentum in the economy justifies further monetary easing. We don't see the economic impact of the coronavirus as *driving* the case for further easing, but in the near term it will add to the weak tone in the economy and consequent calls for more interest rate cuts.

Further support from fiscal policy is possible. At this stage, the Australian Government's priority has been addressing the treatment of the people confirmed to have the coronavirus in Australia, the repatriation of Australians from China's Hubei province and implementing measures (the travel ban) to halt the spread of the virus locally.

In the wake of the bushfire emergency, the Treasurer seems to have moderated his commitment to achieving a surplus. We think this is the appropriate response and we think a further erosion of the surplus commitment would be appropriate if the economic impact of the coronavirus proves to be larger and/or extended.



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[28 January 2020]

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