Stimulus efforts to avert a potential Australian recession

25 March 2020

Overview

Coronavirus cases continue to grow around the world. Italy (69,176 cases) and New York City (over 15,800 cases) are amongst the worst-affected areas. Australian cases have also risen to 2,044 driven by Australians returning from overseas travel. This has seen governments react with major lockdowns on state borders and the inevitable shutdown of many businesses. Governments and central banks, such as the Reserve Bank, are acting to stimulate the economy and help people who have lost their jobs.

These moves have negative implications for the economy and mixed ones for your investments.

Australia

Government efforts to reduce virus cases include:

- States closing their borders to non-essential travel.
- Limiting large gatherings both inside and outside
- State governments in NSW and Victoria are also imposing a shutdown of non-essential businesses such as restaurants and gyms.
- Starting school holidays early in Victoria.

Our health response appears to be doing reasonably well with 8 reported deaths in Australia. For context other countries with similar numbers of infected cases had substantially more deaths and intensive care cases.

Economic impact

Some of these measures cause substantial economic damage with people in the hospitality sector amongst the hardest hit. Given pubs and restaurants for example have been forced to close for the foreseeable future, these employers have had little choice but to let staff go. This has seen a surge in Centrelink applications this week as reported in the media.

The government has been trying to help by announcing:

- One-off payments to pensioners and other welfare recipients at the end of March and during July.
- Cheaper business lending via the Reserve Bank, and
- Increased fortnightly payments to the unemployed including those most recently affected.
- Returning tax payments to businesses.
- Letting people impacted by job changes access their super early

Will the stimulus work?

The government measures will help support people that lost their jobs because of the impact of this outbreak.

However, there is also a higher chance of an Australian recession for the first time since the early 1990s because of the job losses and business shutdowns that are happening.

In addition, there are flaws in the current stimulus that means recovering could take longer for our economy. We may see higher unemployment rates and increased Centrelink reliance for some time.

What is being done elsewhere?

- In the US, over $1 trillion in stimulus is being negotiated to support bailouts and increased unemployment benefits.
- In the UK a £60bn stimulus plan is also underway

This will help the global economy eventually recover from the actions taken to stop the spread of the virus.

What does this mean for your investments?

The Government stimulus and RBA policies will help stabilise the economy in the medium term.

Be prepared for:

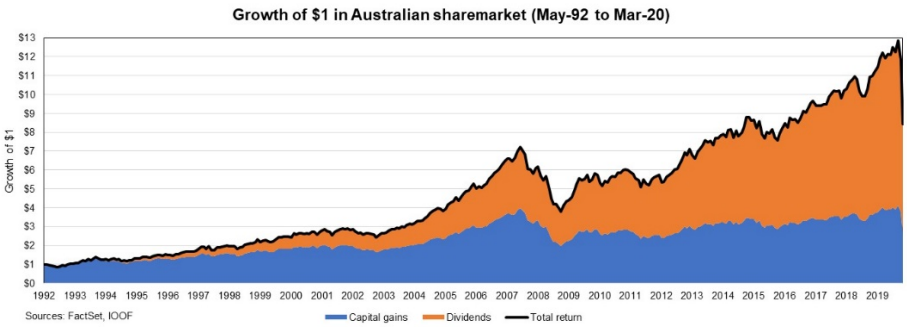
- **Low returns on cash** e.g. term deposits and **bonds** for the next three years at least (RBA is targeting lower yields in Australia).
- Potential weakness in **property markets** from rising unemployment (people defaulting on loans). **Rents** to come under pressure potentially from rising unemployment rates reducing the income of any direct property you hold in the short-term.
- **Dividends will come under pressure in the short term**. Many listed companies will struggle to keep their performance going. Be prepared for cuts to dividend income and/or franking.

Good news stories:

- Your investments won't just include shares. You may have exposure to alternatives or government bonds that have helped protect your assets during this time with some of these experiencing positive performance during this period.
- Equities and listed property to experience some share price weakness over the next 12 months but stronger **long-term** returns.
- **Age Pension** to be more accessible through lower deeming rates legislated by government. This will help offset weaker income from cash and term deposits.

One of the best times to stay invested was at the end of the GFC in February 2009. Equity markets had fallen a lot and investors gained from holding and reinvesting those dividends back into their portfolios (to buy more shares).

- If you invested $1 in May 1992, that has grown to $8.42 as of 24 March this year with 68% of this coming from holding and reinvesting your dividends.



This is an example of how staying invested for the longer-term makes a difference and the gains that you can make by holding the course.

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