Market Update – 20 March 2020
Coordinated Package

This is the third of our series of Market Updates brought about by the coronavirus. Most importantly we hope you and your families remain in good health as the broader health, social and economic ramifications of this terrible virus become apparent around the world.

This article covers the unprecedented Monetary Policy package announced by the Reserve Bank of Australia (RBA) on Thursday 19th March, the response by both the banks and Government plus our analysis and thoughts.

Overview of the Coordinated Package

As you will be well aware, economic activity is rapidly slowing down substantially both in Australia and around the world, as ever-increasing restrictions are placed on the movement of people. This reduces and, in some cases, almost completely eliminates demand, hence threatening the viability of businesses. This in turn places pressure on jobs with the result of severe layoffs. Consequently, the following significant Monetary Policy package was announced by the RBA.

1. A further reduction in the cash rate by 0.25% to a historic low of 0.25% and a commitment to keep it at this rate until progress is being made towards full employment.
2. A programme of Quantitative Easing to purchase Government and semi government securities. This injects liquidity into the system and reduces the market interest rate of Australian Government bonds.
3. A term funding facility (3 years at 0.25%) for at least A$90bn for the banking system with particular support for credit to small and medium sized businesses.
4. Bank settlement balances at the Reserve Bank will earn interest at 0.1% rather than nil.

Impact: Apart from keeping interest rates low for the medium term, the measures inject over A$90bn into the banking system to allow banks to support individuals and small business customers.

Action by the banks: The banks have announced a variety of measures to assist their personal and small business borrowers including reductions in lending rates (sometimes by up to 2%) and the ability to cease payments for up to six months. The banks have also announced increases in certain term deposit rates.

Action by the Government: The Government announced a number of measures including a package of A$15bn to assist smaller lenders and an enhanced package to support workers as they are laid off and enter the Social Security system.

Our Analysis

Government policy on restricting people movement and interaction seeks to "flatten the curve" so that hospital admittance rates can be kept within capacity and hence minimise the number of deaths from the coronavirus. We have been told that the flattening of the curve means at least a six month time horizon before we can start to get back to some sort of normality. However, this may be longer and subject to the success of curtailing the spread of the Coronavirus.

In the meantime, economic activity will slow significantly and for some parts of the economy (e.g. tourism, hospitality etc.) grind to a halt as ever-increasing restrictions are placed on our movement.

The above package means that many small businesses will need to close and / or lay off staff. Some may do as Qantas have announced and ask staff to use up all leave entitlements, take unpaid leave, seek temporary employment elsewhere and eventually return to their original employer once the pandemic is over.

The life support offered by the RBA via the banks may allow many small businesses to survive by increasing loan amounts and stopping loan repayments for up to six months. The commitment to keep interest rates low until we get closer to full employment will provide businesses with time to recover. This will however require the cooperation of landlords and employees. The impact on larger companies, especially those in the most affected industries, is less certain.

If the plan works, we will come out the other end of this crisis having saved many lives. The whole fabric of our society may change. Some businesses will come out better and stronger.

Unfortunately, many countries around the world (particularly the poorer ones) may not fare well as they will be unable to pull together such a bold plan and their hospital systems may be totally inadequate. Even in developed nations, as we have seen, where lock down has not happened quickly enough or effectively (e.g. Italy and Spain), the impact on human life is exacerbated.

Market Movements

The last week has seen continued volatility and downward pressure on world stock exchanges. For example, Australian equities are down around 10% for the week.

While global equity portfolios have suffered, unhedged holdings in international equities have received some respite in recent weeks. with the Australian dollar going into free fall after the above announcement, at one stage hitting almost 55c versus the US Dollar.

Conclusion

We see more downward pressure on equity markets in the short term as the bad news swamps the good. Those with significant cash balances (or willing to move from fixed interest to equities in the medium term) may take this as a buying opportunity within the next few months. While no one knows when the bottom will come, a fall in the rate of increase in reported cases of virus, is likely to provide some light at the end of the tunnel.

Source: RBA