A TEST TO AUSTRALIA’S RESILIENCE

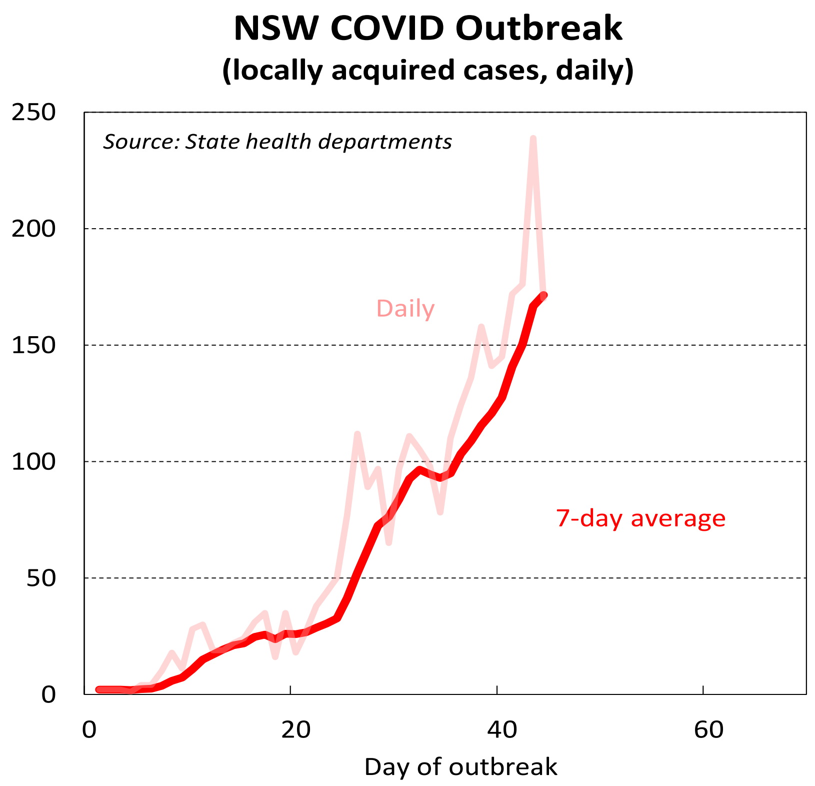
Updated economic forecasts amid the extension of NSW’s lockdown
30 July 2021

CONTENTS

KEY POINTS

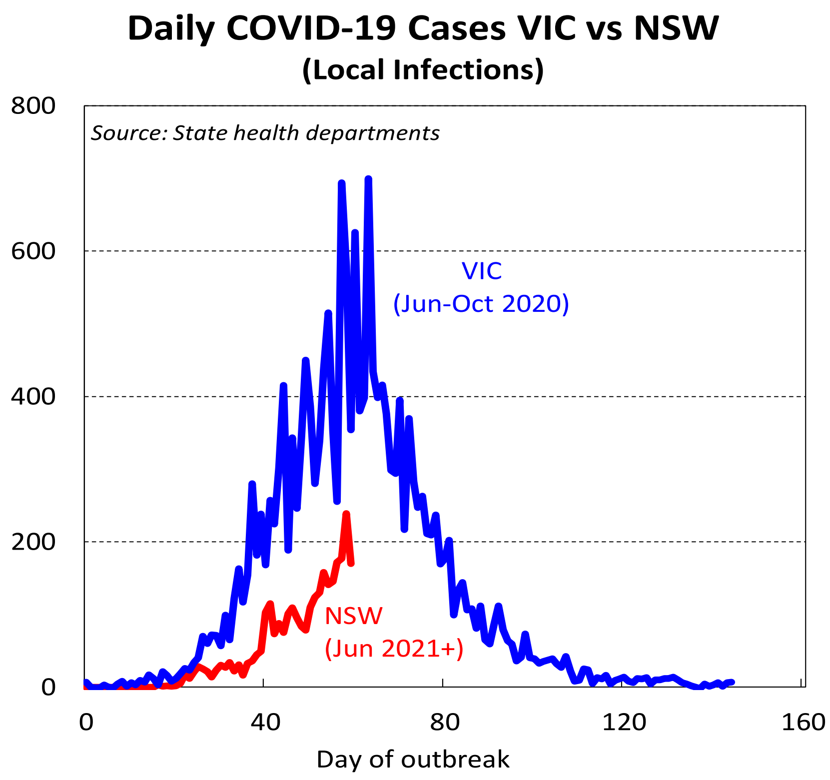
- The Australian economy has had a remarkable recovery from the downturn last year. Indeed, the Australian economy showed incredible resilience; GDP contracted just 1% last year when forecasts early in the crisis from policymakers were for a contraction of 7-8%.
- The Australian economy has picked up momentum since the second half of last year, led by solid consumer spending and more recently by a recovery in business spending. But the Australian economy's resilience is being tested by the latest virus outbreak. Large parts of the NSW economy have been locked down for 5 weeks and another 4 weeks of lockdown is now sealed.
- So far, there are no convincing signs of a peak in the number of daily infections and drawing on comparisons with Victoria's second lockdown last year, we estimate the lockdown will last to at least the end of September.
- NSW accounts for around 31% of output and around 32% of the population. We estimate the NSW economy will contract by nearly 8% in Q3, before rebounding by almost 6% in Q4. Feeding into our forecasts is that a large share of workers in the 8 LGAs with tighter restrictions are construction workers, meaning a sharp drop in construction activity is likely.
- Our forecasts for the national economy are also revised. We now expect the national economy to grow by 3.2% in 2021, which is down from nearly 5% growth expected before the outbreak. It reflects a national contraction of 2.2% for the current quarter.
- We expect the contraction in the national economy to be short lived and confined to one quarter with a recovery of 3% pencilled in for Q4.
- However, these forecasts rely on NSW emerging from the lockdown at the end of September and other states and territories avoiding further lengthy lockdowns.
- The revision to the growth forecasts means our expectations for the jobs market have also shifted because the two are intricately linked. We now expect the unemployment rate to be at 4.8% at the end of 2021 and at 4.0% by the end of 2022. Job losses are likely over August and September.
- As flagged previously, we expect the RBA will respond by next week announcing it will delay the start date for the tapering of its bond-buying program. There is also a possibility that the RBA will actually lift the volume of its weekly bond purchases to support economic activity whilst NSW continues to grapple with the outbreak.

COVID-19 INFECTIONS IN NSW – WHERE IS THE PEAK?



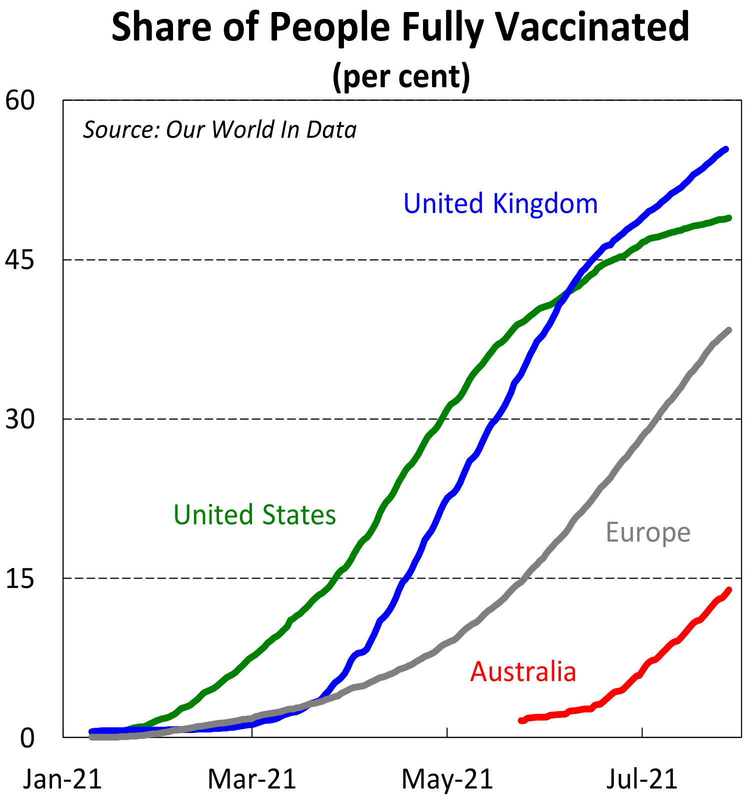
- The number of daily infections in NSW in the local community today was 170, taking the total number of infections in this outbreak to 2,980.
- The highest number of daily infections so far in this outbreak was yesterday at 239.
- The 7-day moving average, which smooths out the day-to-day volatility, is still rising.
- It means that it is too early to determine if the outbreak has peaked in NSW.

LOCKDOWN COMPARISONS



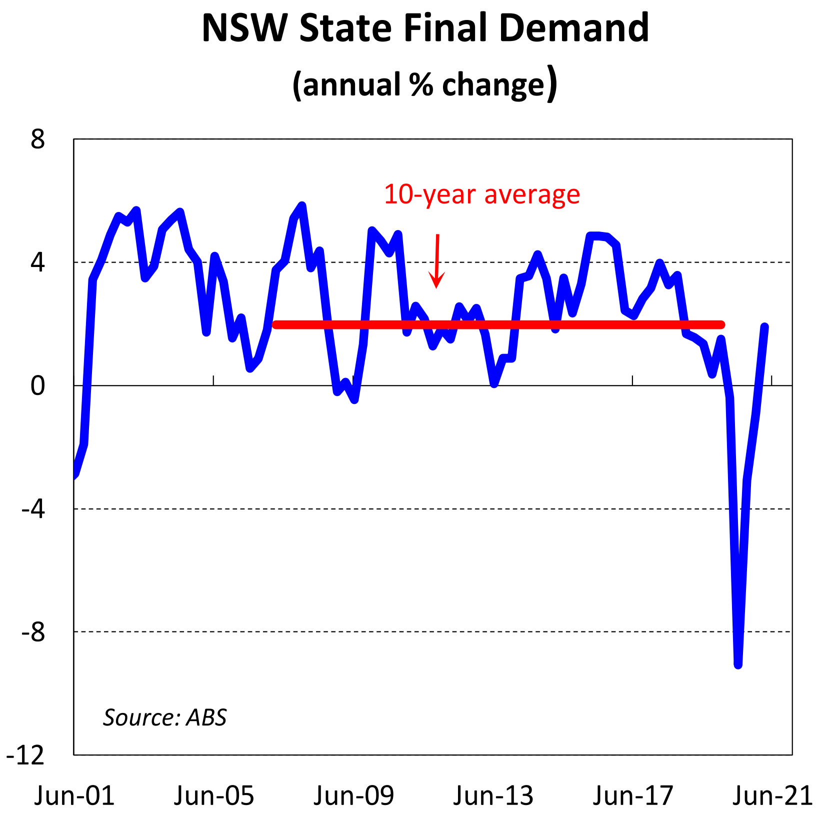
- The lockdown in Victoria last year started on 7 July and ended on 26 October, lasting a total of 111 days.
- When Victoria emerged from the lockdown, there were tight trailing restrictions.
- The VIC lockdown last year and this year's NSW lockdown have some similarities. They also have differences, including around curfews and variants of the virus (alpha vs delta).
- However, some comparisons between the two lockdowns might still be worthwhile to consider.
- Victoria's peak daily infections occurred on 5 August at 725 (since revised to 700) and it took 82 days or nearly 12 weeks from that peak for the lockdown to finish. It took about 8 weeks to get daily infections down to the low digits.
- If we apply similar methodology, it could take at least until the end of September for NSW to exit the lockdown assuming we peak over the next week.

VACCINE ROLLOUT TO IMPROVE AFTER A SNAIL-SLOW START



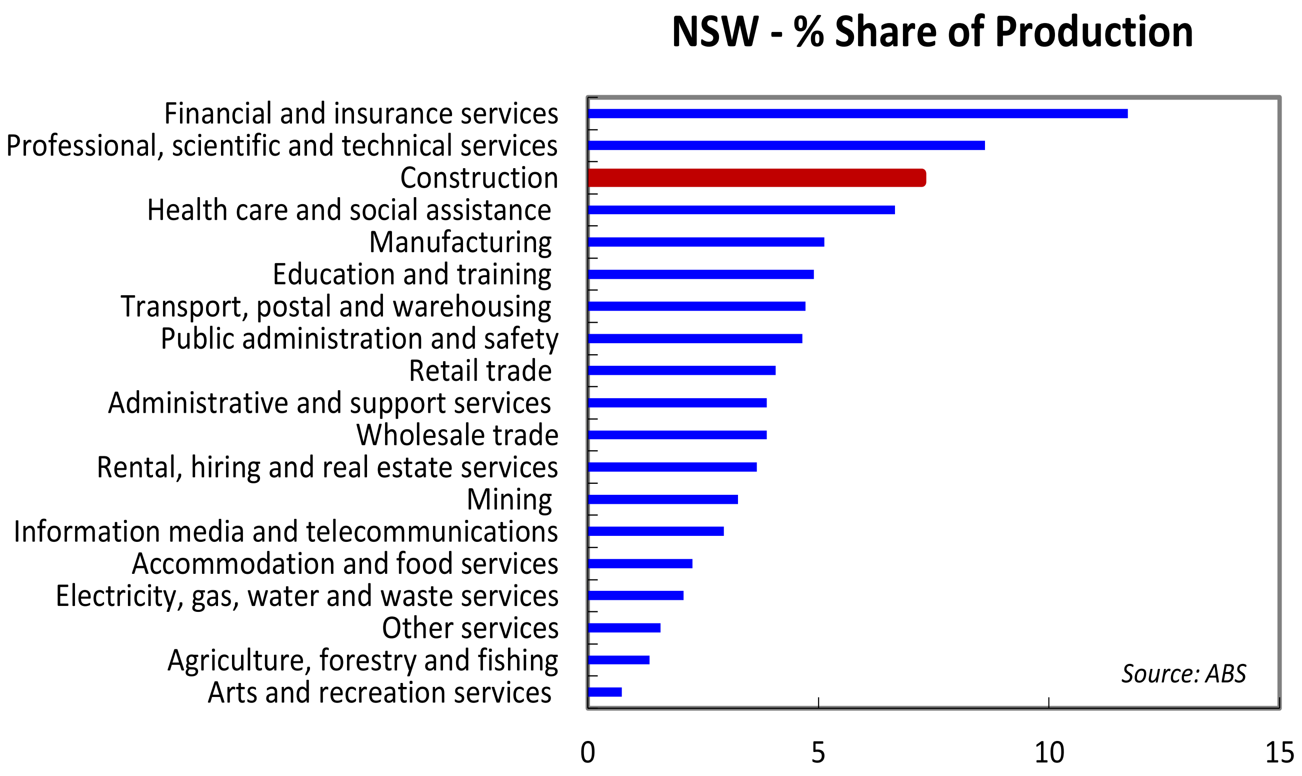
- The lockdowns demonstrate the importance of the vaccine rollout and ensuring a sufficient proportion of the population is vaccinated.
- As at 28 July, almost 32% of the population had received at least one jab and 14% of the population was fully vaccinated.
- The vaccine rollout has been slow in Australia, constrained by supply constraints with Pfizer and a reluctance to take up AstraZeneca. Supply of Pfizer is expected to improve in the coming months.
- We estimate that it would take until late this year at the earliest to have a high share of the population vaccinated.
- Importantly, as the rollout continues, there should be some benefits, including at least limiting hospitalisations, especially as we move into September and beyond.

NSW ECONOMY HITS A POTHOLE



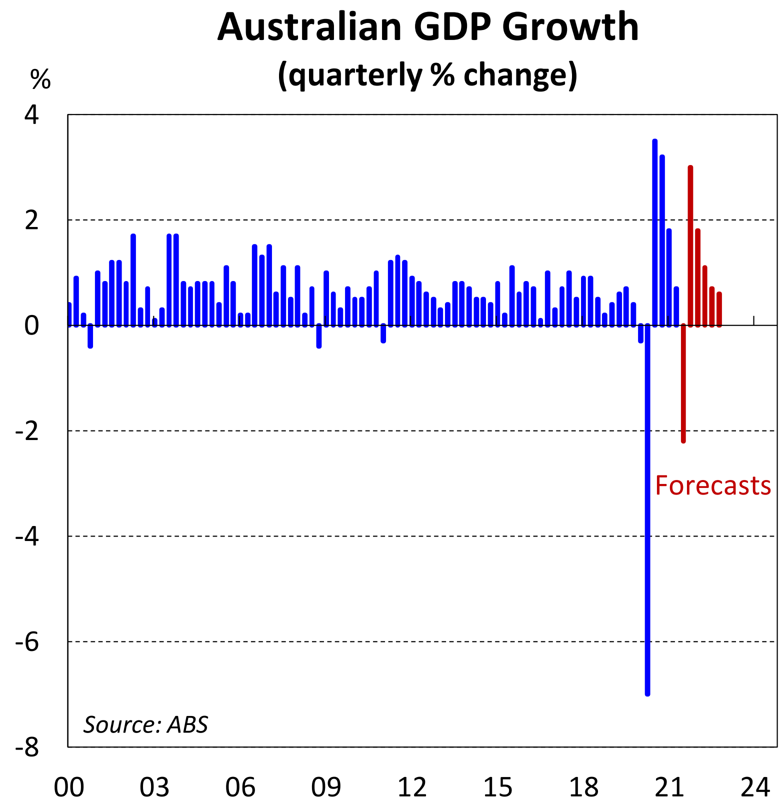
- Ahead of this outbreak, the Australian economy was humming along nicely. So much so that we anticipated GDP growth this year of nearly 5% in 2021. To put that number into perspective, the long-run average (the sweet spot) is 2.6%.
- The NSW lockdown and, to a lesser extent, the snap lockdown in Victoria means that this economic expansion has hit a pothole. The recent one week lockdown in South Australia will have limited implications for national economic activity.
- NSW accounts for around 31% of the national economy in terms of output and around 32% in terms of the population. The lockdown in NSW also means interstate supply chains, demand and labour mobility are impacted.
- We estimate the NSW economy will contract by 7.8% in this current September quarter and rebound by nearly 6% in the December quarter.
- History has shown the economy tends to recover quickly as restrictions lift. Pent-up demand, savings and policy responses support the recovery.
- We are expecting only a minor contraction in Victorian economic activity in the September quarter and growth to continue in South Australia.

NSW CONSTRUCTION SECTOR



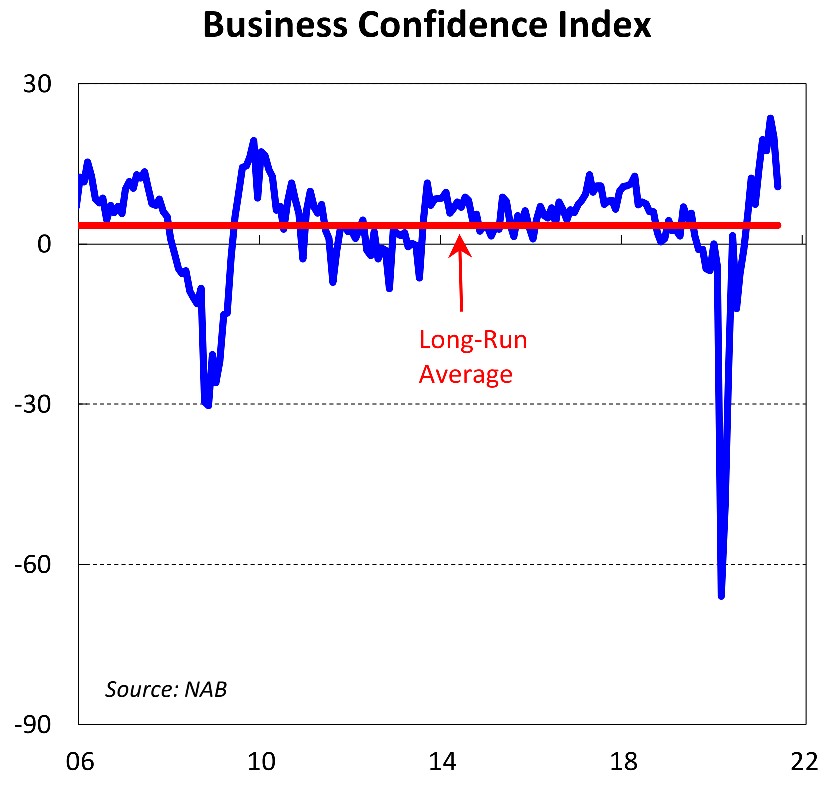
- The reduction in NSW economic activity will be driven by a drop in consumer spending, despite online spending rising among households.
- It will also be driven by a pause on business investment.
- And it will be primarily be driven by a very sharp fall in construction activity in NSW – both in terms of work done and hours worked.
- There are 8 LGAs in Sydney that cannot leave their home to work in the construction industry. These LGAs cover a large share of people that work in the construction industry.
- We assume that in terms of hours worked, there is at least a 40% drop in construction work. It includes the drop in hours due to the COVID-19 safe plans that require distancing on construction sites.
- Construction makes up more than 8% of employment and 7.2% of output in NSW. It has very important direct and indirect linkages in the economy.

NATIONAL GDP FORECASTS



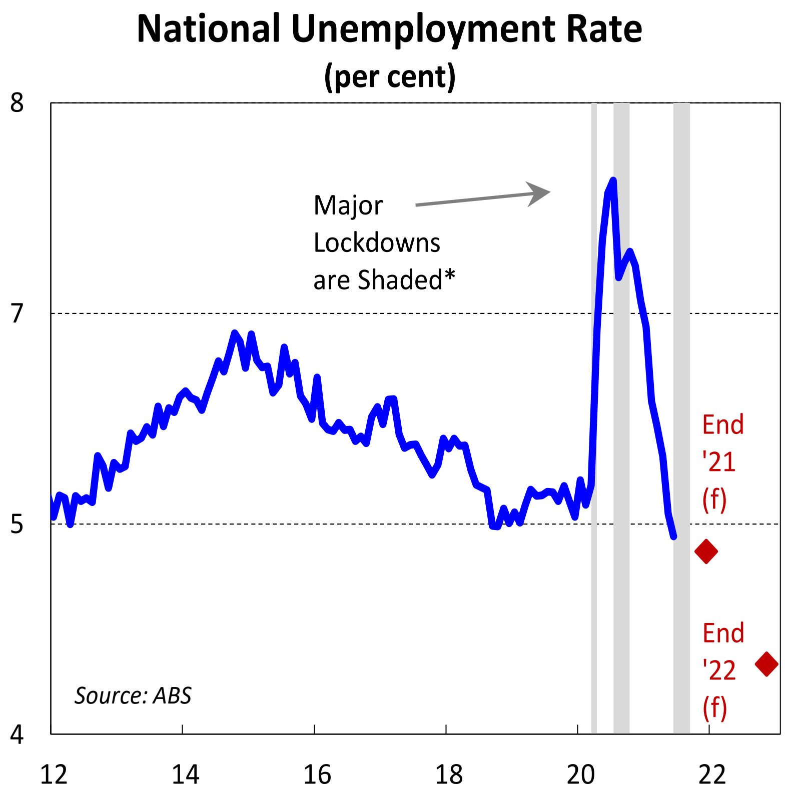
- We have revised our forecasts lower for national GDP. We expect GDP to contract by 2.2% in the September quarter. This is revised down from a fall of 0.7% ahead of the 4-week extension to the NSW lockdown and compares to quarterly growth of almost 1% before the outbreak.
- We are anticipating this contraction in economic activity will be short lived – that is, it won't extend to the December quarter to mark a "technical" recession.
- We anticipate a rebound in economic growth of 3% in the December quarter.
- There remains a lot of uncertainty. These forecasts critically rest on NSW coming out of lockdown by the end of September and the outbreak not spilling over to other states and territories in a material way. If these assumptions are not correct, then the forecasts will change.
- Annual growth of GDP for 2021 comes down to 3.2%, from nearly 5% before the outbreak, but remains solid and above the long-run average. We have revised up our GDP 2022 forecast to 4.2%.

BUSINESS SUPPORT MEASURES



- The Federal and state government support measures announced for households and businesses in particular will help negate some of the severity of the downturn in economic activity as a result of this outbreak and current lockdown.
- The support measures have focussed on boosting the cash flow of businesses and households, and keeping workers in jobs.
- They have included COVID-19 lockdown-related grants and JobSaver. There is also specific support for industries harder hit by the lockdown.
- For a full pack of the support measures and their details, please contact us.
- These support measures will also help limit the decline in business confidence about the outlook. Business confidence measures are published with a lag. The June data revealed business confidence had pulled back from a record high. Anecdotes suggest another fall is likely in July.

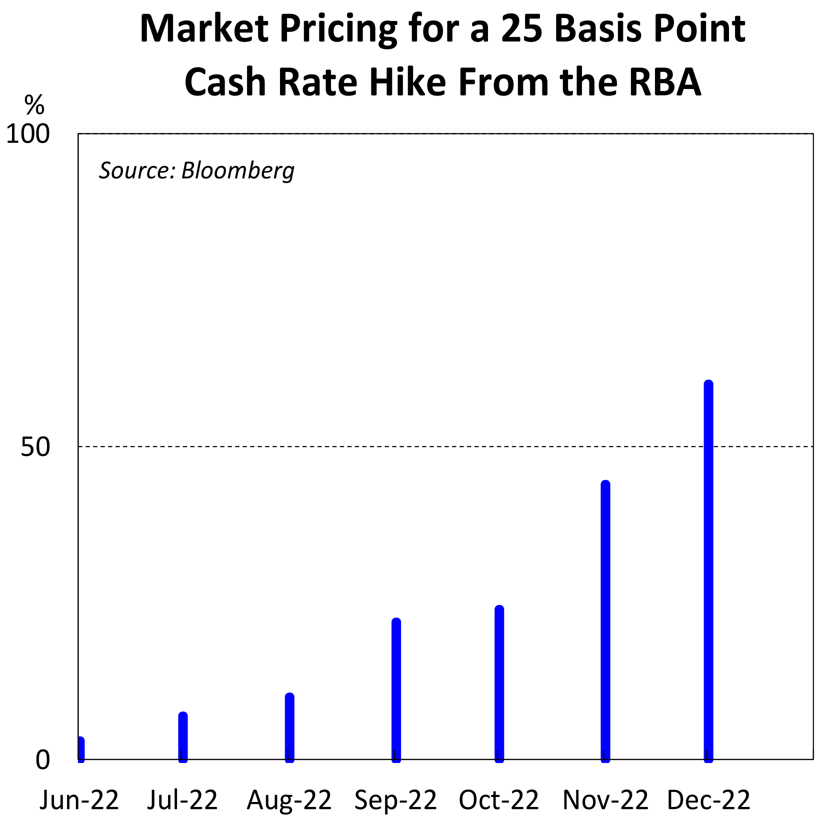
LABOUR MARKET OUTLOOK – UNEMPLOYMENT TO HIT 4% END '22



*National lockdown 2020, VIC's 2nd extended lockdown & current NSW lockdown

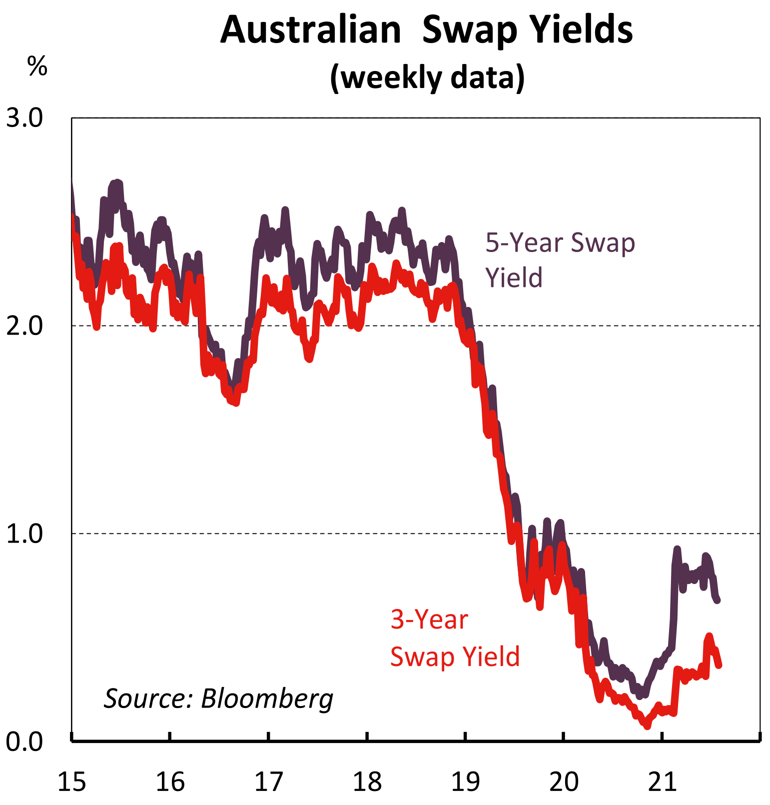
- The changes to economic activity due to the lockdowns and outbreak also change our forecasts for the unemployment rate, as the two are intrinsically linked.
- The labour market was tightening and jobs growth had a lot of momentum leading into the outbreak. Indeed, the unemployment rate had dropped to 4.9% nationally and 5% in NSW in June.
- According to the RBA, the rate of unemployment consistent with full employment is in the low 4s. The unemployment rate has fallen significantly since hitting a pandemic high of 7.4% in July 2020. The fall has been much faster than policymakers anticipated.
- With the revision to our growth forecasts, we now expect the unemployment rate to end this year at 4.8% (previously 4.4%) and for the unemployment rate to end 2022 at 4% (previously 3.8%).
- These forecasts embody job losses over August and September, before a gradual recovery over the remainder of the year.

OUTLOOK FOR RBA POLICY



- The RBA cash rate is at a record low of 0.10%. We expect it to remain there until the first half of 2023.
- The RBA has been at pains to suggest it does not expect the cash rate to rise before 2024 because it does not expect conditions in the economy to be such that a rise can occur.
- We disagree and think that a rate hike before 2024 remains on the cards. Previous lockdowns have illustrated that the economy snaps back quickly.
- Financial markets are also sceptical. Cash rate futures suggest there is a 60% probability of a 25 basis point rate hike priced in for December 2020. A 15 basis point rate hike is fully priced; we think the RBA may start its rate-hike cycle with 15 basis points, taking the cash rate from 0.10% to 0.25%.
- The stimulus packages last year were far greater and critical to helping the rebound, but this time there has been a lot of momentum in the economy leading into the outbreak.

TAPERING OF QUANTITATIVE EASING LIKELY TO BE DELAYED



- The RBA Board earlier this month said that it would start tapering its bond-buying program (i.e. quantitative easing program) in September, by reducing the volume of bonds purchased from $5 billion per week to $4 billion per week. It is unlikely tapering will begin in September, given the backdrop with infections and disruptions to economic activity.
- The RBA meets next week and as we have flagged previously, we anticipate they will announce that tapering will be delayed.
- The possibility of a lift in bond purchases is also on the cards.
- The delay in tapering will help keep longer term lending rates lower than otherwise would be the case, by influencing bond and swap rates.
- Short term lending rates will also be kept low by a cash rate at 0.10% until 2023 and the yield-curve control program, which involves the RBA buying bonds of 3-year maturities to keep the 3-year government bond yield at around 0.10%.

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