ECONOMIC UPDATE

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WEEK ENDING 13TH AUGUST 2021

BOQ GROUP

Summary

- Consumer and business confidence has been hit by the length and severity of the Greater Sydney-plus lockdowns;
- But actual business conditions and views about the state of family finances have held up better;
- The data so far is consistent with negative economic growth in Q3;
- The outlook for the following couple of years remains positive.

The economy entered the third quarter powering along in top speed. It then hit a pothole created by the Greater Sydney (-plus) lockdowns. Business confidence has declined sharply, with the decline to date reminiscent of what took place during the Melbourne lockdown of last year.

The decline in firms' views about business conditions has not been as stark. The worry is that new orders are starting to thin. Price rises remain a visible part of the business landscape. But in many cases firms' have had to raise prices as their input costs have risen strongly.

Lockdowns are impacting regions and industries differently. The current lockdown is having a bigger impact on NSW than the other states. The mining sector is reporting the strongest conditions, with things toughest in the transport and recreation sectors.

One good sign is that employment intentions are still quite high. This suggests that a good portion of firms still have confidence about the future. But intentions (and job ads) have started to decline. Households have noticed a change in temperature in the jobs market. Fear of unemployment has risen across states, particularly in NSW.

There has been a reduction in confidence about buying a home over the past couple of months. A combination of increased fear of unemployment and the big house prices making home purchases less affordable has likely weighed on sentiment. Despite the fall in buying sentiment house price growth is likely to remain strong over the remainder of this year. In places most impacted by lockdowns (notably Sydney) house prices are being supported by a decline in the supply of new listings. And the extremely low level of interest rates and rising house prices makes housing an increasingly attractive asset class for investors'.

The path out of the pandemic was always going to be bumpy and not a smooth straight line. Economic growth will be weak in Q3. What happens in Q4 will depend upon the effectiveness of the lockdowns and the efficiency of the vaccine rollout. The data to date is consistent with the pace of the economy we saw in Q3 2020. And clearly better than what was posted in Q2 last year (-7%). The outlook for 2022 remains good.

Short-term economic impact is negative

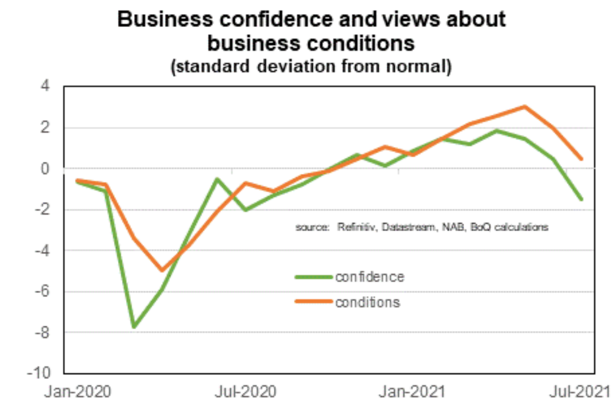
The economy entered the third quarter powering along in top speed. It then hit a pothole created by the Greater Sydney (-plus) lockdowns. We haven't yet seen much of the picture painted by the so-called 'real' data (such as monthly retail sales). But the snapshot provided by the recent release of the business and consumer confidence surveys provides us with a pretty good idea as to what that picture will look like. According to the NAB survey, business confidence declined sharply over June and July to be well below 'average' levels. The decline to date is more reminiscent of what took place during the Melbourne lockdown of last year than the economy-wide shutdown of Q2 2020.

The decline in firms' views about business conditions has not been as stark. With capacity utilisation levels high across most sectors firms indicate they still have decent-sized Capital budgets (although some investment spending has been put on the backburner). The worry though is that new orders are starting to thin. Price rises remain a visible part of the business landscape. But in many cases firms' have had to raise prices as their input costs have risen strongly.

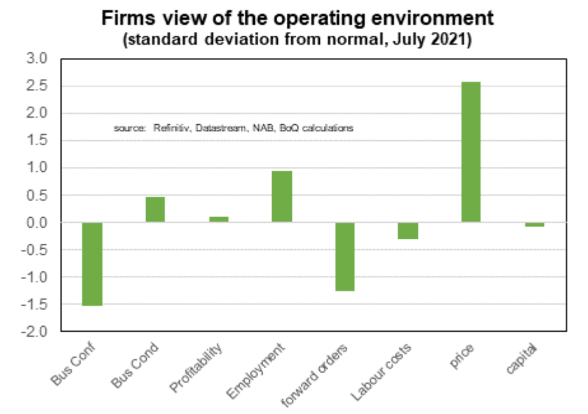
Lockdowns are impacting regions and industries differently. The current lockdown is having a bigger impact on NSW than the other states. Again so far in all states the impact on confidence has been bigger than for actual conditions. Conditions are deemed decent in most other states (including Victoria).

The mining sector is reporting the strongest conditions helped by few restrictions and high commodity prices (agriculture would be the same). The finance and property sector is helped by strong interest in the property market (although there has been a reduction in the number of house listings in Sydney). Conditions are reportedly toughest in the transport and recreation sectors.

So far the decline in business confidence has been more substantial than for actual conditions.

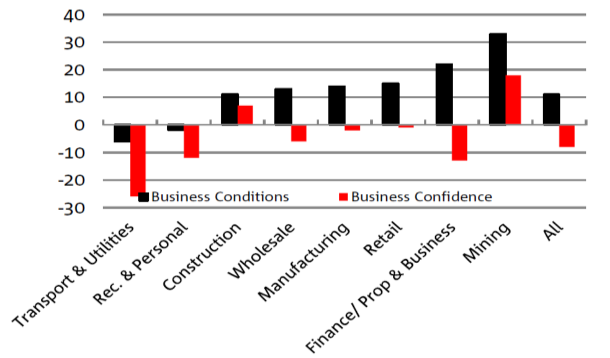


Hiring intentions are still above average, and so are price rises. But new orders are slowing.



Mining is doing well, but transport and recreation are struggling.

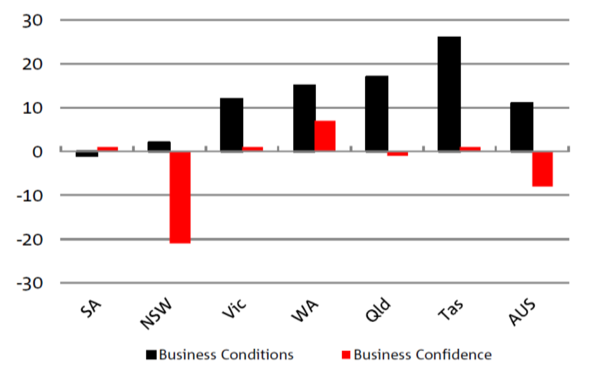
CHART 3: CONFIDENCE AND CONDITIONS BY INDUSTRY (NET BAL., SA)



Source: NAB Business survey July 2021

The impact of the lockdowns is mixed across sectors.

CHART 2: CONFIDENCE AND CONDITIONS BY STATE (NET BAL., SA)



Source: NAB Business survey July 2021

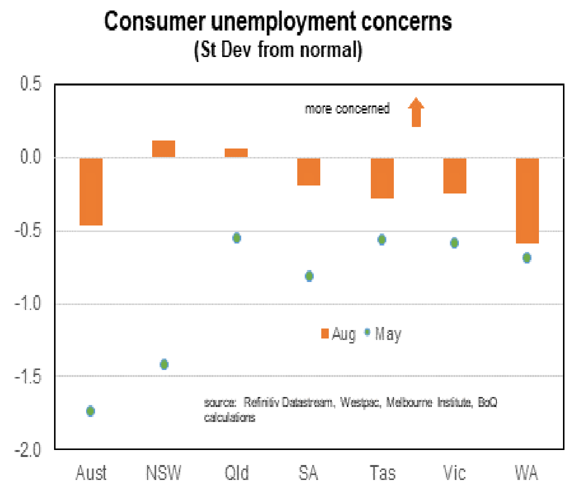
One good sign is that employment intentions are still quite high. This suggests that a good portion of firms still have confidence about the future. And they are taking the opportunity to fill vacancies following a period when a growing problem for many firms was the lack of skilled workers.

But hiring intentions (and job ads) have started to decline. This is consistent with the results from the Federal Department of Employment skill vacancy survey that showed the number of vacancies dropping across all states (except Victoria) in July. The biggest drop was in NSW (down 10%).

Households have noticed a change in temperature in the jobs market. Fear of unemployment has risen across states, particularly in NSW. That has been less the case in WA given that they have had fewer worries about COVID and the strength of the mining and their construction sectors.

Business hiring intentions is above average, although it has softened over the past couple of months.

Consumer worries about unemployment has risen across all states, most notably NSW.

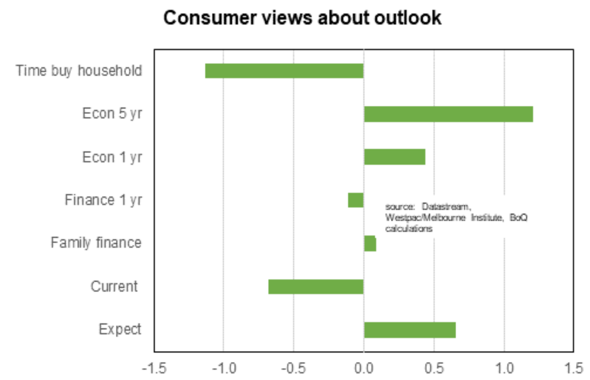


The Westpac/Melbourne Institute survey suggests that worries about the jobs market has seen consumers become a little more cautious about their own finances. But not too worried given the extent of the Government income support packages. But households are indicating they are not about to go on a spending splurge (although a lockdown does reduce the opportunities to spend). Consumers still have confidence about the outlook for next year. And even more about how the economy will evolve over the medium term.

Confidence has declined across age groups over the past three months. The biggest declines has been for 18-24 year olds, the age group that would feel the impact of social isolation from lockdowns the most. That is also the age group that has high representation in Recreation, and Accommodation and Food services, sectors heavily impacted by the lockdowns. There has also been a sharp fall of confidence amongst older households over the past month, most likely reflecting their worries about the increased spread of the virus.

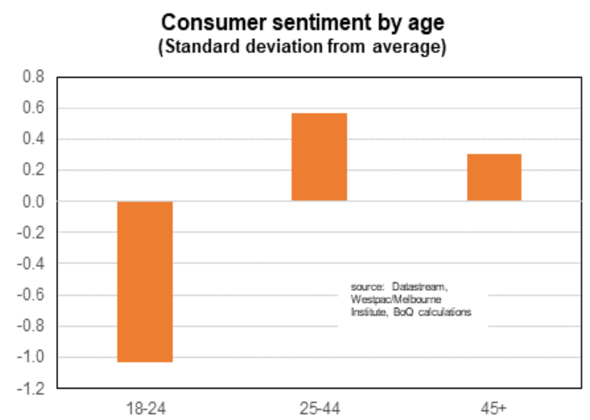
The largest decline of confidence over the past couple of months has been in Sydney (there was also a fall in Melbourne in July). Confidence in the other capital cities has been broadly flat. The level of confidence in the two largest cities is about where it was during the Melbourne lockdowns last year. That is similar to the story told in the business surveys.

The current situation has got consumer worried. But they remain confidence about the medium term.

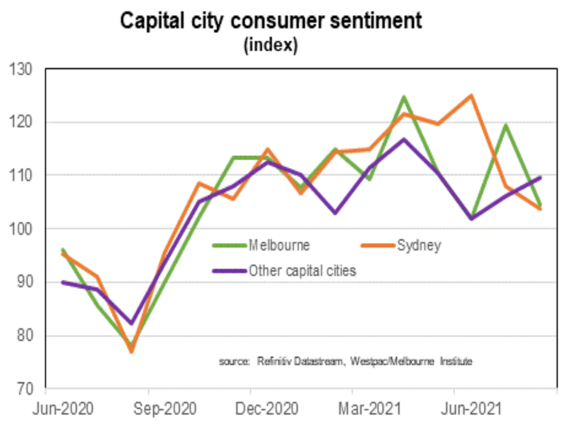


There is mixed views in the business community about the outlook for next year.

Sentiment has declined most sharply for the 18-24 year olds.



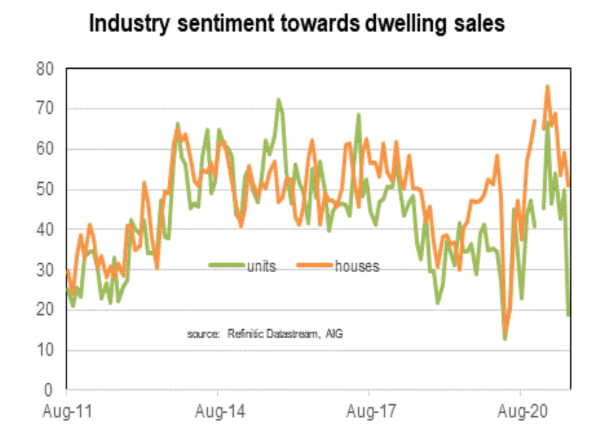
Consumer confidence in the two big cities is about where it was during last year's Melbourne lockdown.



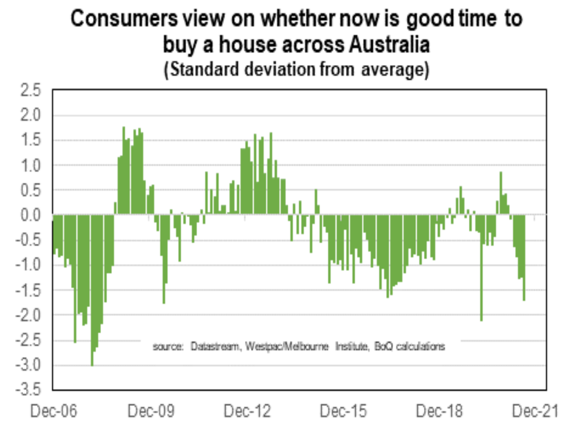
There has been a reduction in confidence about buying a home over the past couple of months. A combination of increased fear of unemployment and the big house price rises making home purchases less affordable has likely weighed on sentiment. The industry reports that sentiment remains stronger towards houses than units. At some stage the greater affordability will make them look more attractive to prospective buyers.

Despite the fall in buying sentiment house price growth is likely to remain strong over the remainder of this year. In places most impacted by lockdowns (notably Sydney) house prices are being supported by a decline in the supply of new listings. And the extremely low level of interest rates and rising house prices makes housing an increasingly attractive asset class for investors'.

The industry reports a decline in house buyers' sentiment.



And this is consistent with the feedback from households.



The path out of the pandemic was always going to be bumpy and not a smooth straight line. Economic growth will be weak in Q3. What happens in Q4 will depend upon the effectiveness of the lockdowns and the efficiency of the vaccine rollout. The data to date is consistent with the pace of the economy we saw in Q3 2020. And clearly better than what was posted in Q2 last year (-7%).

The outlook for 2022 remains good. A higher vaccination rate minimises the chances of any widespread lockdowns (but there might be periods of restrictions). Fiscal and monetary support remains strong. There is plenty of work still be done for house builders and on infrastructure. Firms need to rebuild their inventory levels. The global economy is improving. How good next year ends up being will depend upon any new virus developments.

We live in interesting times.

Regards,

Peter Munckton
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