# ECONOMIC UPDATE

PETER MUNCKTON – CHIEF ECONOMIST

28TH MAY 2021

BOQ GROUP


## Summary:

- **The strong economy has boosted business confidence;**
- **Confident firms means more investment;**
- **This comes after a period of weak capex spending, at least partially reflecting the end of the mining boom;**
- **Investment boosts the economy in both the short- and long-term.**


Go back a year and the consensus view was that the economic impact of the virus would be short. But it looks increasingly likely that any 'scarring' to the economy will be barely visible. The economy has roared back to life spurred on by very low interest rates and big budget deficits. Firms' say they have not seen conditions like these for at least twenty years. Business investment is picking up powered by higher-than-expected capacity use and significant government incentives.

Firms are not only saying that they will invest more, they already are. Capex in the March quarter 2021 rose by over 6%. Spending on plant and equipment rose notably.

Concern about a lack of business investment was an issue well before COVID. Back then low capex spending was put down to an uncertain economic environment. But the other important factor reason was the end of the mining boom.

Investment spending is expected to rise strongly next year. A recent ABS survey suggested that firms might increase their investment spending by 15% next year, with particularly large rises in some of the services (including accommodation) and retail sectors.

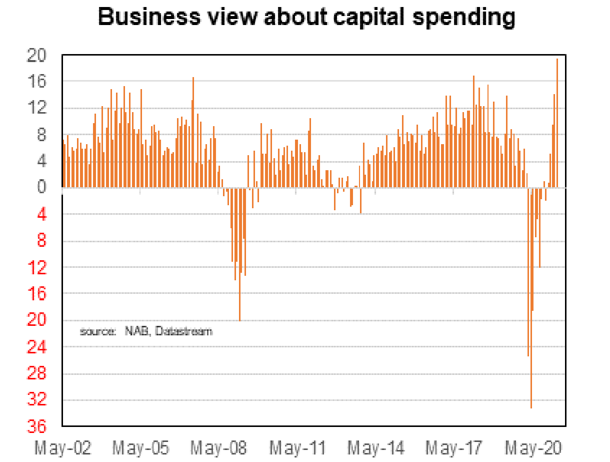
There are economic benefits in the short term from more capex spending. And in the long term productivity growth needs stronger investment growth. Governments' have significantly boosted budgeted infrastructure spending (although there has yet to be the same boost to actual spending). This is all good news. But sustained strong economic growth will require widespread immunity to the virus. In the long term stronger population growth will also be important.

### A better economy means more confident firms

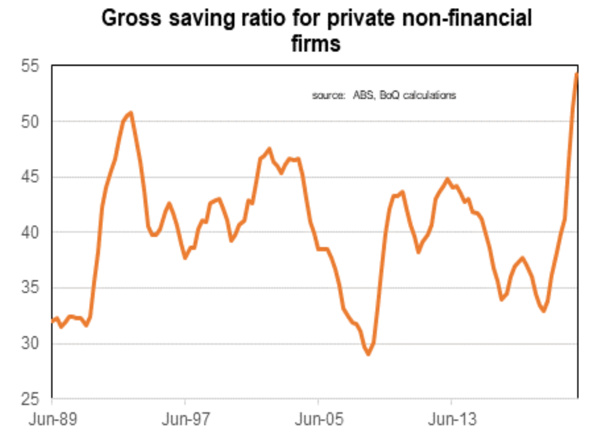
Go back a year and the consensus view was that the economic impact of the virus would be short. Certainly the economy was going to take a significant hit from the shutdown but then bounce back strongly once it re-opened. Forecasters turned more pessimistic following the Melbourne lockdown in July last year. The concern was that business confidence would plunge leading to lower jobs growth and ongoing cuts to capex budgets. Higher unemployment and lower investment would become the lasting 'scars' of the COVID economic slowdown.

But it looks increasingly likely that any 'scarring' to the economy will be barely visible. The economy has roared back to life spurred on by very low interest rates and big budget deficits. Firms' say they have not seen conditions like these for at least twenty years. Business investment is picking up strongly powered by higher-than-expected capacity use and significant government incentives. Low interest rates means financing stronger investment is not a concern. Business credit growth is low reflecting the large amount of saving that firms were able to sock away last year. But lending to firms' has begun to grow.

**Firm's capital spending intentions have risen strongly.**



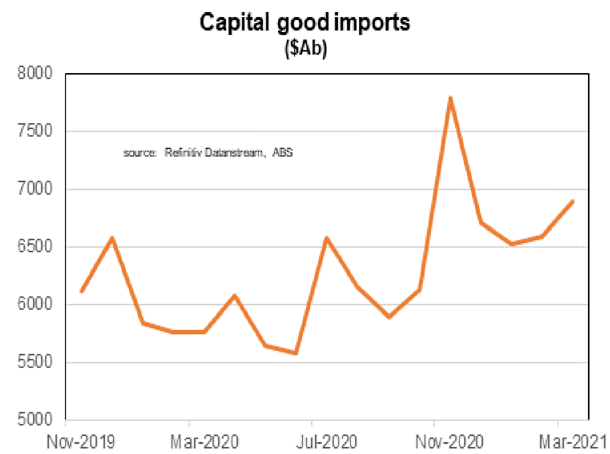

**Business will be able to fund a large part of expanded capex budgets from saving.**



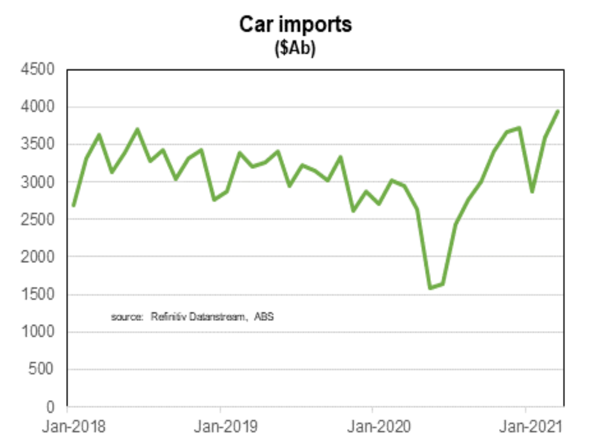

## And this is leading to more business investment

Firms are not only saying that they will invest more, they already are. Capex in the March quarter 2021 rose by over 6%. Much of that was plant and equipment (uncertainty about the future of the Office and physical shopping is weighing on non-residential investment). The need for more equipment has driven the pickup of imports of capital goods over the past 6-9 months. Car imports are on the rise.

**A significant portion of equipment investment needs to be imported.**




**There has been a rise of car imports boosted by government incentive programs.**



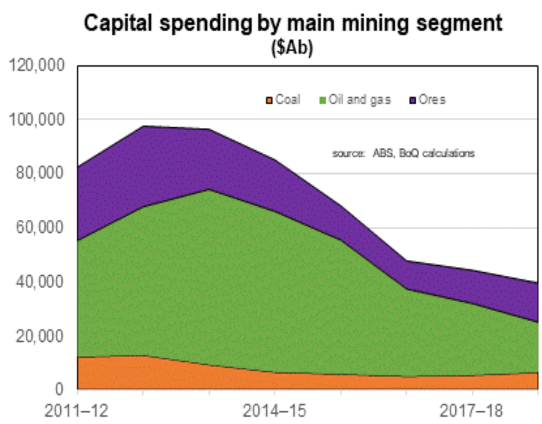
## With even bigger capex budgets likely for next year

Concern about a lack of business investment was an issue well before COVID. Back then low capex spending was put down to an uncertain economic environment. The impact of technology and changes in consumer tastes also had an impact. For example, what long-term investments should the 'traditional' retail sector make when confronted by the rise of online shopping. The more capital-intensive sectors (such as manufacturing) have also become a smaller part of the economy.

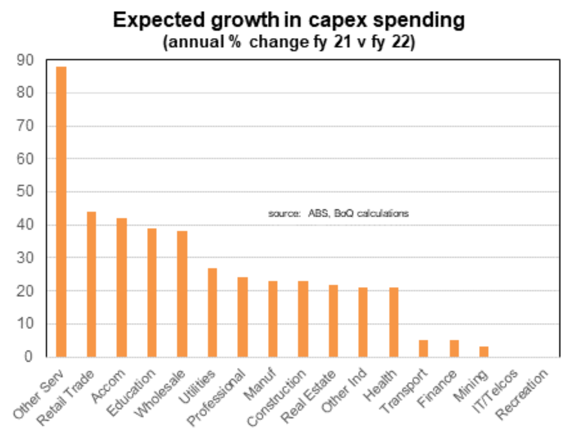
But the other reason why there has been less investment is the end of the mining boom. The boom was the largest in Australia's history and led to a massive rise in mining investment. This was particularly the case for the gas industry, although there was also a big rise in capex budgets in the iron ore sector. Inevitably once the investment had been completed there was a sizeable reduction in capex budgets. But those cutbacks were too swinging. At a minimum miners had to boost maintenance spending.

More generally investment spending is expected to rise strongly next year. A recent ABS survey suggested that firms might be increasing their investment spending by 15% next year, with particularly large increases projected in some of the services (including accommodation) and retail sectors.

There has been a significant fall of mining investment.




But a big rise in capex spending is planned across most sectors next financial year.




There are economic benefits in the short term from more capex spending. And in the long term productivity growth needs stronger investment growth. Governments' have significantly boosted budgeted infrastructure spending (although there has yet to be the same boost to actual spending). Companies keep planning for a significant rise in digitization investment.

This is all good news. And the big budget deficits and very low interest rates will make sure the economy is humming. But sustained strong economic growth will require widespread immunity to the virus (as we have been reminded by recent events in Victoria). A key question is when population growth will return to pre-COVID times'. Another is what policy changes (if any) will be made to encourage stronger productivity growth.

We live in interesting times.

**Peter Munckton**
**Chief Economist**
**Bank of Queensland**