

Monday, 19 July 2021



## Lockdowns Risk Another Contraction

Australia's battle with the delta variant continues to intensify.

On Saturday, tough new measures were implemented across NSW as authorities fight to contain the spread of the virus. The 3-day moving average of infections is still rising. And on Thursday, Victoria was ordered into a five-day lockdown following a spike in COVID-19 cases linked to Sydney. The Victorian lockdown was set to lift from midnight tomorrow but the restrictions are now widely expected to be extended.

It is another blow to jobs and economic growth, at least in the near-term.

NSW Premier Berejiklian announced that the construction industry across Greater Sydney will be shutdown for at least two weeks, with some exemptions for urgent work. Reflecting the gravity of the NSW government's concerns, this is a move which goes further than any previous lockdowns across Australia.

This decision has significant economic implications. Construction is the third largest industry in New South Wales, contributing \$46.8 billion to the state's economy in 2019-20 or 7.4% of gross state product. There are also approximately a quarter of a million construction workers in Greater Sydney.

Construction also has spillovers to the broader economy. It ripples upstream to industries like manufacturing and raw materials. And the large number of people employed in construction, plus those in related upstream industries, also means the health of the sector has implications for consumer spending.

Residents in parts of southwest Sydney can no longer leave their local government area although there are exemptions for some professions. The vast majority of new COVID-19 cases in NSW have been in this pocket of Sydney.

The lockdown in southwest Sydney has markedly different implications to the lockdown in city's northern suburbs over the summer. Sydney's southwest plays a vital role in supply chains as a major distribution hub for logistics, transport and manufacturing. This makes it more challenging to limit mobility in and out of the area than suburbs home to more office workers who are easily able to work from home.

Non-essential shops in NSW have been also forced to close and non-urgent residential maintenance, repairs and cleaning has been banned.

The severity of the lockdown in NSW, and the spread to Victoria, means we cannot rule out the possibility of a contraction in economic activity in the September quarter in the NSW and national economies. It would mark the first national contraction since the June quarter of last year. NSW and Victoria collectively account for 57% of the national GDP. Further, the lockdown is associated with interstate border closures to limit contagion. These border closures affect labour mobility and interstate supply chains.

On Tuesday, the Reserve Bank (RBA) will release the minutes from its July meeting, where key policy changes were announced. The cash rate was left unchanged, but the RBA announced it will begin tapering bond purchases under its quantitative easing program to \$4 billion per week, from \$5 billion per week, in September. And as widely expected, the RBA decided to leave the yield curve target pegged to the April 2024 bond, instead of rolling to the next maturity of November 2024.

The growing economic hit from the lockdowns raises the question of whether additional policy support will be enacted. There is a mounting possibility that the RBA will invoke the flexibility clause of its new quantitative easing model, and opt to not start tapering purchases in September as announced earlier this month. Indeed, it is difficult to see how the RBA would continue with plans to taper if restrictions continue to drag on. It is even possible the RBA could increase the rate of bond purchases.

State and Federal governments are likely to come under pressure to provide more money to help offset the blow from the lockdowns. New measures have been implemented, although they appear less extensive than the support businesses and households received in 2020 after the pandemic first hit. The NSW government announced a new emergency support package last week, and the Federal government is providing support through disaster relief payments, where individuals can access up to \$600 per week.

Also, this week, we will receive preliminary data for retail sales in June. We expect a 0.2% decline in the month, although there is considerable uncertainty over this figure as lockdowns continued to impact sales. Victoria entered a 14-day lockdown near the end of May that dragged on sales in June. The current lockdowns in NSW and Victoria, and mini-lockdowns across Queensland, WA and the NT will batter spending in July.

While this is a challenging period for many businesses and households, the upshot is that the economy tends to rebound sharply as restrictions ease because of pent-up demand. This partly offsets the losses from lockdowns.

It is also important to note the economy was in good shape heading into this period. Last week, June data showed that the unemployment rate fell to 4.9%. This is the lowest level in 10 years. And economic activity was back at its pre-pandemic level in the March quarter. Plus, economic activity outside of the states in lockdown remains robust.

The new round of lockdowns will weigh on jobs and economic growth in the near-term. But over the longer term, particularly as vaccines are rolled out more widely, we remain optimistic about the outlook.

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## Forecasts

End Period:	Close (16 July)	Q3 (f)	Q4 (f)	Q1 (f)	Q2 (f)	Q3 (f)	Q4 (f)
<b>Aust. Interest Rates:</b>							
RBA Cash Rate, %	0.10	0.10	0.10	0.10	0.10	0.10	0.10
90 Day BBSW, %	0.03	0.04	0.07	0.10	0.15	0.20	0.40
3 Year Swap, %	0.44	0.50	0.55	0.70	0.80	0.95	1.10
10 Year Bond, %	1.28	1.70	1.90	1.95	2.00	2.05	2.10
<b>US Interest Rates:</b>							
Fed Funds Rate, %	0.125	0.125	0.125	0.125	0.125	0.125	0.375
US 10 Year Bond, %	1.30	1.70	1.90	1.95	2.00	2.05	2.10
<b>USD Exchange Rates:</b>							
AUD-USD	0.7401	0.75	0.78	0.80	0.82	0.82	0.82
USD-JPY	110.07	111	111	112	112	112	113
EUR-USD	1.1806	1.21	1.22	1.23	1.22	1.21	1.21
GBP-USD	1.3767	1.41	1.42	1.43	1.44	1.45	1.44
NZD-USD	0.6999	0.71	0.74	0.76	0.77	0.77	0.77
<b>AUD Exchange Rates:</b>							
AUD-USD	0.7401	0.75	0.78	0.80	0.82	0.82	0.82
AUD-EUR	0.6268	0.62	0.64	0.65	0.67	0.68	0.68
AUD-JPY	81.44	83.3	86.6	89.6	91.8	91.8	92.7
AUD-GBP	0.5375	0.53	0.55	0.56	0.57	0.57	0.57
AUD-NZD	1.0571	1.06	1.05	1.05	1.06	1.06	1.06

	2019	2020	2021 (f)	2022 (f)
GDP, %	2.1	-1.0	4.8	3.2
CPI (Headline), %	1.8	0.9	2.5	2.4
CPI (Trimmed mean), %	1.5	1.2	1.6	2.2
Unemployment Rate, %	5.2	6.8	4.4	3.8
Wages Growth, %	2.2	1.4	2.4	2.7

AUD cross exchange rates have been rounded.

Financial forecasts are quarter end.

GDP, CPI, employment and wage growth forecasts are year end.

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