

Weekly Economic Outlook

Monday, 22 February 2021



A Focus on Wages and Business Investment

Last week, the focus was on the labour market and retail spending. Employment rose as did retail sales. This week the focus is on wages (Wednesday) and business investment or 'capex' (Thursday).

Wages grew at 1.4% in the year to September 2020, the slowest pace in over 20 years. With unemployment at 6.4% and over 800k people unemployed, wage growth seems set to remain subdued. We expect wages grew 0.3% in the December quarter, with annual growth of just 1.1%. This is not the pace of wage growth that pushes inflation into the Reserve Bank's 2-3% inflation target range, hence the RBA's cash rate remains lower for longer – at least until 2024.

Business confidence is up but what about capital expenditure or capex? The figures due out on Thursday report on the December quarter and provide the first look at plans for 2021/22. Capex slumped during 2020. The COVID-19 recession saw capex fall 3.0% in Q3 to be down 13.8% on Q3, 2019. A contraction of 1.8% is expected for the December quarter giving rise to a 12.7% decline over the year.

We suspect that weakness in business investment for the current financial year is largely locked in. Businesses are upbeat, uncertainty has decreased, and supply disruptions have eased - however, for most businesses, excess capacity remains. In our view, an investment recovery is more likely in 2021/22, aided by government tax incentives - which should encourage a 'bring forward' of spending ahead of June 30, 2022.

Estimating what businesses plan to do in 2021/22 is difficult for the businesses themselves, let alone for economists charged with providing a forecast. Our expectation for the first read of capex for 2021/22 is for a 4.0% increase over 2020/21. This comes with high margins of error given the uncertainty associated with the shape of the economic recovery.

Three other statistics of note this week include construction work done in the December quarter, the ABS survey of business, and private sector credit.

The construction sector had slowed prior to the pandemic but 2020 saw resilience in the housing and public construction sectors. We expect a rise in Q4 of 0.7%, an increase of 6.0% on the same period in 2019. Credit to the private sector is mixed with credit for housing rising solidly while credit for business remains soft due to excess capacity. A modest 0.2% rise is expected for the January figures due out on Friday. Finally, the ABS will release its latest survey of business on the impact of COVID-19.

We have lifted our target for the US 10-year bond rate by end 2021 from 1.50% to 1.80%. In turn, the expected rate by end 2022 has been increased from 1.75% to 2.40%. Our forecasts for Australian 10-year bonds have been lifted from 1.55% to 1.90% by end 2021; 2.50% by end 2022; and 3.15% by end 2024.

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Forecasts

End Period:	2021				2022		
	Close (19 Feb)	Q1 (f)	Q2 (f)	Q3 (f)	Q4 (f)	Q1 (f)	Q2 (f)
Aust. Interest Rates:							
RBA Cash Rate, %	0.10	0.10	0.10	0.10	0.10	0.10	0.10
90 Day BBSW, %	0.01	0.02	0.02	0.02	0.02	0.04	0.06
3 Year Swap, %	0.23	0.15	0.15	0.15	0.15	0.18	0.22
10 Year Bond, %	1.37	1.50	1.60	1.75	1.90	1.40	1.75
US Interest Rates:							
Fed Funds Rate, %	0.13	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond, %	1.30	1.40	1.50	1.65	1.80	1.95	2.10
USD Exchange Rates:							
AUD-USD	0.7869	0.78	0.79	0.80	0.82	0.85	0.85
USD-JPY	105.45	106	106	106	106	107	107
EUR-USD	1.2119	1.22	1.23	1.24	1.25	1.26	1.27
GBP-USD	1.4016	1.39	1.40	1.40	1.41	1.41	1.41
NZD-USD	0.7299	0.73	0.74	0.75	0.76	0.78	0.78
AUD Exchange Rates:							
AUD-USD	0.7869	0.78	0.79	0.80	0.82	0.85	0.85
AUD-EUR	0.6494	0.64	0.64	0.65	0.66	0.67	0.67
AUD-JPY	82.98	82.7	83.7	84.8	86.9	91.0	91.0
AUD-GBP	0.5616	0.56	0.56	0.57	0.58	0.60	0.60
AUD-NZD	1.0782	1.07	1.07	1.07	1.08	1.09	1.09

	2019	2020 (f)	2021 (f)	2022 (f)
GDP, %	2.2	-2.0	4.0	3.0
CPI (Headline), %	1.8	0.9	2.6	2.2
CPI (Trimmed mean), %	1.6	1.2	1.9	2.0
Unemployment Rate, %	5.2	6.8	6.0	5.3
Wages Growth, %	2.2	1.1	1.2	1.6

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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