Monday, 5 July 2021

RBA and NSW lockdown on centre stage

Australia starts the week with its most populous state, New South Wales, still in lockdown. Queensland has emerged from nearly a week of lockdown and lockdowns in Western Australia and the Northern Territory concluded on Friday. The lockdown in New South Wales is due to expire on Friday, but there is a risk that it will be extended. A decision is yet to be made by the New South Wales government.

Another 35 infections were recorded in New South Wales in the last 24 hours, taking the total of this outbreak to 313. This “Bondi” outbreak is much larger than the “Northern Beaches” outbreak. In the December and January period of “Northern Beaches” outbreak, there were a bit over 200 cases of community transmission in New South Wales, which resulted in a three-week lockdown.

We’ve estimated the two-week lockdown in New South Wales will cost the economy around $750 million a week, and possibly as much as $1 billion a week, provided the lockdown is relatively short. A longer lockdown will have a bigger impact. In the September quarter, this lockdown could wipe 0.2 percentage points off GDP. But GDP growth in 2021 should still be solid.

Consumers and businesses are grappling with the uncertainty of how long it will take for this outbreak to be contained in New South Wales and for restrictions to ease. A weekly survey of consumer confidence published by Roy Morgan showed consumer confidence took a dent, falling by 4.6% in Sydney in the week ended June 27, which captured only some of the lockdown. Nationally, consumer confidence was little changed.

Confidence in the lead up to “Bondi” outbreak had been elevated, supporting spending and activity in the economy. A short lockdown could see confidence snap back relatively quickly, but a more extended lockdown poses greater downside risks to confidence, spending and activity.

The uncertainty around international borders also continues, despite the Prime Minister’s four-stage plan announced last week. Under phase one, the current phase, the international arrivals cap is being halved by 50%. This cap is expected to be in place until at least the end of the year. There are some fears that halving the cap will lead to fewer airlines flying to Australia until international borders reopen, and that this will result in higher freight costs. Many passenger airlines are carrying cargo in place of people to minimise the impact of the pandemic on revenues.

Phase one also includes some states trialling a system where returned vaccinated travellers will be able to quarantine at home for only seven days.

The biggest event in the world of economics this week is the Reserve Bank (RBA) board meeting tomorrow. Back in May, the RBA flagged it would make a big decision on its yield curve control (YCC) and quantitative easing (QE) programs at its July meeting. These policies help lower lending rates in the economy. They also help to produce a weaker Australian dollar than otherwise would be the case.

YCC involves the RBA buying and selling bonds to keep the 3-year government bond yield at around 0.10%. It is currently tied to the April 2024 bond. The RBA needs to decide whether to leave it pegged at April 2024 or extend it to the next bond maturity at November 2024.

We anticipate the RBA will keep its YCC target pegged to the April 2024 bond. If the peg were extended to the November 2024 bond, it would imply the RBA does not intend to increase the cash rate until 2025, which is too late given the robust economic conditions.

The QE program involves the RBA buying $5 billion of government bonds per week with maturities of 5 to 10 years over a period of about six months. The value of purchases will total $100 billion. The RBA needs to decide whether to extend this program and if there is an extension, what form this extension might take.

We expect the QE program will be extended but take will the form of an open and flexible program with $5 billion per week in purchases. The RBA is likely to review this program again around December. We still expect the RBA to continue the program to the middle of 2022, but the pace of purchases in 2022 is likely to be lower than in 2021.

The term funding facility (TFF) for banks has already concluded. With the expiry of the TFF and announcements of adjustments to these other two programs for the RBA imminent, the upward pressure on swap rates, bond rates, and therefore, fixed borrowing rates is likely to continue.

We expect the RBA to start hiking in early 2023. The RBA has had a mantra since the pandemic started that it does not think conditions in the economy will justify an increase in the cash rate before 2024. But we think the conditions are likely to be met much sooner than the RBA had previously anticipated. Australia's economic performance has consistently surprised to the upside, especially for the labour market.

Tomorrow, there is also the release of weekly payroll jobs and wages for the week ending June 9, which has been giving us some early indications of the shape of the labour market ahead of the release of the official labour force survey. Last month, employment spiked by over 115k and cemented expectations that the RBA would not be able to wait until 2024 to hike rates.

As usual, the RBA will release a statement on the monetary policy decision tomorrow at 2:30pm AEDT. But in a rare occurrence, it will follow with a press conference by Reserve Bank Governor Philip Lowe at 4:00pm AEDT. Lowe will also give a speech on Thursday.

On Thursday night, the minutes of the Federal Reserve's last meeting in mid June will be published. The Fed surprised markets last month by signalling they could increase the policy rate sooner than previously indicated alongside higher inflationary pressures and strong growth. The Fed's revised dot plot showed interest rate increases in 2023, a significant change from the last forecasts in March when the dot plot had rates on hold until at least 2024.

Earlier today, there were a couple of domestic data releases. There were building approvals for May, which showed a fall of 7.1%. This fall reflected the unwinding the HomeBuilder effect, but importantly, building approvals remain at a high level. Furthermore, the strong trend in building approvals in recent months still points to a solid upturn in residential construction activity, especially as approvals tends to lag construction.

Today, the final figure for retail sales was also published for May. A rise of 0.4% in the month was recorded. However, the recent lockdowns in Victoria, Queensland and WA, as well as the current lockdown in NSW, will disrupt retail sales in June and July. More generally, retailing has remained robust this year, underpinned by elevated confidence, low rates and falling unemployment.

Besa Deda, Chief Economist
(02) 8254 3251

Forecasts

		2021		2022			
End Period:	**Close (2 July)**	**Q3 (f)**	**Q4 (f)**	**Q1 (f)**	**Q2 (f)**	**Q3 (f)**	**Q4 (f)**
Aust. Interest Rates:							
RBA Cash Rate, %	0.10	0.10	0.10	0.10	0.10	0.10	0.10
90 Day BBSW, %	0.03	0.04	0.07	0.10	0.15	0.20	0.40
3 Year Swap, %	0.46	0.50	0.60	0.80	0.95	0.10	1.25
10 Year Bond, %	1.48	1.95	2.10	2.20	2.30	2.40	2.50
US Interest Rates:							
Fed Funds Rate, %	0.125	0.125	0.125	0.125	0.125	0.125	0.375
US 10 Year Bond, %	1.42	1.85	2.00	2.10	2.20	2.30	2.40
USD Exchange Rates:							
AUD-USD	0.7526	0.78	0.80	0.82	0.85	0.85	0.84
USD-JPY	111.05	111	111	112	112	113	113
EUR-USD	1.1865	1.22	1.23	1.24	1.23	1.22	1.21
GBP-USD	1.3824	1.42	1.43	1.43	1.44	1.45	1.45
NZD-USD	0.7026	0.72	0.74	0.76	0.78	0.78	0.77
AUD Exchange Rates:							
AUD-USD	0.7526	0.78	0.80	0.82	0.85	0.85	0.84
AUD-EUR	0.6343	0.64	0.65	0.66	0.69	0.70	0.69
AUD-JPY	83.57	86.6	88.8	91.8	95.2	96.1	94.9
AUD-GBP	0.5446	0.55	0.56	0.57	0.59	0.59	0.58
AUD-NZD	1.0709	1.08	1.08	1.08	1.09	1.09	1.09

	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.

Contact Listing

Chief Economist
Besa Deda
dedab@stgeorge.com.au
(02) 8254 3251

Economist
Matthew Bunny
matthew.bunny@stgeorge.com.au
(02) 8254 0023

Senior Economist
Jarek Kowzca
jarek.kowzca@stgeorge.com.au
(02) 8254 3251

Research Assistant (Secondment)
Sonali Patel
sonali.patel@stgeorge.com.au
(02) 8254 0030