# ECONOMIC UPDATE

PETER MUNCKTON – CHIEF ECONOMIST

11TH DECEMBER 2020

BOQ GROUP

## Summary


- **The strong economic momentum has continued into November and December;**
- **Firms are getting more confident about the economy;**
- **But are not yet confident enough to substantially boost capex budgets;**
- **And despite higher confidence consumers are still doing plenty of saving;**
- **Stronger momentum is needed as the economy is about to be hit by a number of cross winds.**

It is widely agreed that the economy is improving. And so it should. A lot of the improvement can be put down to re-opening much of the economy up after shutting it down. Business and consumer confidence is on the up. The fiscal stimulus has been substantial. GDP growth will be strong in H2 of this year.

So the economy will enter the New Year with a fair bit of momentum. It will need that momentum as it is about to hit some cross winds. The US and (particularly) Europe is going through a bumpy patch with the rise of COVID cases (although the strength of the Chinese economy is an important offset). The Australia-China trade dispute is a negative (although at this point only modestly so). The freeze on the insolvency regime finishes at the end of this year so that there is likely to be a rise in bankruptcies. JobKeeper and the mortgage payment holidays end in March. The $A is heading higher. Longer-term interest rates are above their year lows (for the 'good' reason that investors' have become more confident about the economic outlook).

Perhaps the most significant upcoming headwind is that the degree of fiscal support to the economy is projected to drastically slow at the end of H1 next year. Given the cross winds and the extent of fiscal policy removal the clear risk is that both Governments and the RBA will need to do more next year. The good news is if they have to do more they will.

The feedback from private-sector firms is conditions have increased over recent months to be around their long-term average in November. Importantly order books have got noticeably thicker indicating that a further improvement of business conditions is likely in coming months. But they are not yet confident enough about tomorrow to up their investment spend on either capital or labour.

Consumers agree that things are picking up. They believe that the economy will get better next year. And they are particularly optimistic about the medium-term outlook. But right now households are reluctant buyers.


### The economic flight path

It is widely agreed that the economy is improving. And so it should. A lot of the improvement can be put down to re-opening much of the economy up after shutting it down. Business and consumer confidence is on the up. The fiscal stimulus has been substantial. GDP growth will be strong in H2 of this year.

 Bank of Queensland Limited ABN 32 009 656 740 (BOQ).

So the economy will enter the New Year with a fair bit of momentum. It will need that momentum as it is about to hit some cross winds. The US and (particularly) Europe is going through a bumpy patch with the rise of COVID cases (although the strength of the Chinese economy is an important offset). The Australia-China trade dispute is a negative (although at this point only modestly so). The freeze on the insolvency regime finishes at the end of this year so that there is likely to be a rise in bankruptcies. JobKeeper and the mortgage payment holidays end in March. The $A is heading higher. Longer-term interest rates are above their year lows (for the 'good' reason that investors' have become more confident about the economic outlook).

Perhaps the most significant upcoming headwind is that the degree of fiscal support to the economy is projected to drastically slow at the end of H1 next year. Government policies have allowed household (and corporate) disposable incomes to rise. This has allowed consumers to significantly boost saving, providing plenty of spending ammunition that can be fired once confidence in the economic outlook improves significantly enough.

But that level of fiscal support changes dramatically in the second half of next year. Current forecasts has the Federal Government budget deficit halving in 2021-22 from this financial year (11% down to 5.6%). Hopefully the domestic economy will have gained enough momentum by then not to need more assistance. Clearly the timing of when vaccines are rolled out will matter, as will the efficiency in immunising a large enough swathe of the population. And how governments respond in unwinding any remaining (domestic) restrictions on economic activity. As well as the impact on business and consumer confidence.

But given the cross winds and the extent of fiscal policy removal the clear risk is that both Governments and the RBA is still that they will need to do more next year. The good news is if they have to do more they will.

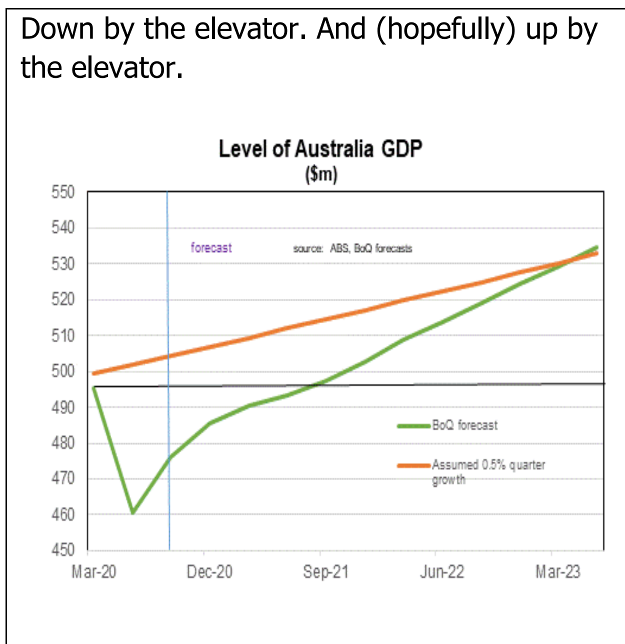
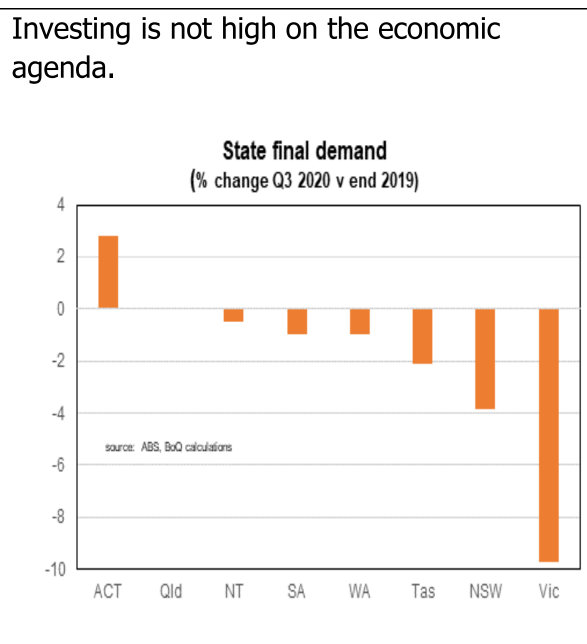
### The economic checklist

But the better economy has also led to an increasing amount of discussion as to whether there has been too much policy stimulus. Given the upcoming cross winds I think that is a cart that has been assembled well before the type of horse needed has been fully considered. But the discussion does raise the question of what evidence we should look for when policy stimulus will be removed. The RBA has set two tests. One is that there is a substantial decline in the unemployment rate (to at least under 6%). The second is the inflation rate moving sustainably above 2%. The achievement of the first objective helps achieve the second objective (lower unemployment rate leads to higher wages that in turn leads to higher inflation).

Clearly all this can only be achieved if there is strong economic growth. And there are a number of milestones to be ticked off on that journey. One is when the economy returns to the same size as it was at the end of 2019. The RBA thinks that will happen by the end of next year. Given the evident momentum in the economy I think it might be a little quicker (Q3 2021). Using domestic demand1 as a guide the ACT and Queensland have already achieved that goal by the September quarter of this year (Victoria and NSW were well below their end 2019 level).

[1] Domestic demand differs from GDP as it excludes interstate and international trade.

A second milestone will be when the economy returns to the path it would have been on if it had of grown at the same pace as it did in 2019 (where quarterly GDP growth averaged around +0.5%). My forecasts suggests that will be sometime in 2023.

| Down by the elevator. And (hopefully) up by the elevator. | Investing is not high on the economic agenda. |
| --- | --- |
|  |  |

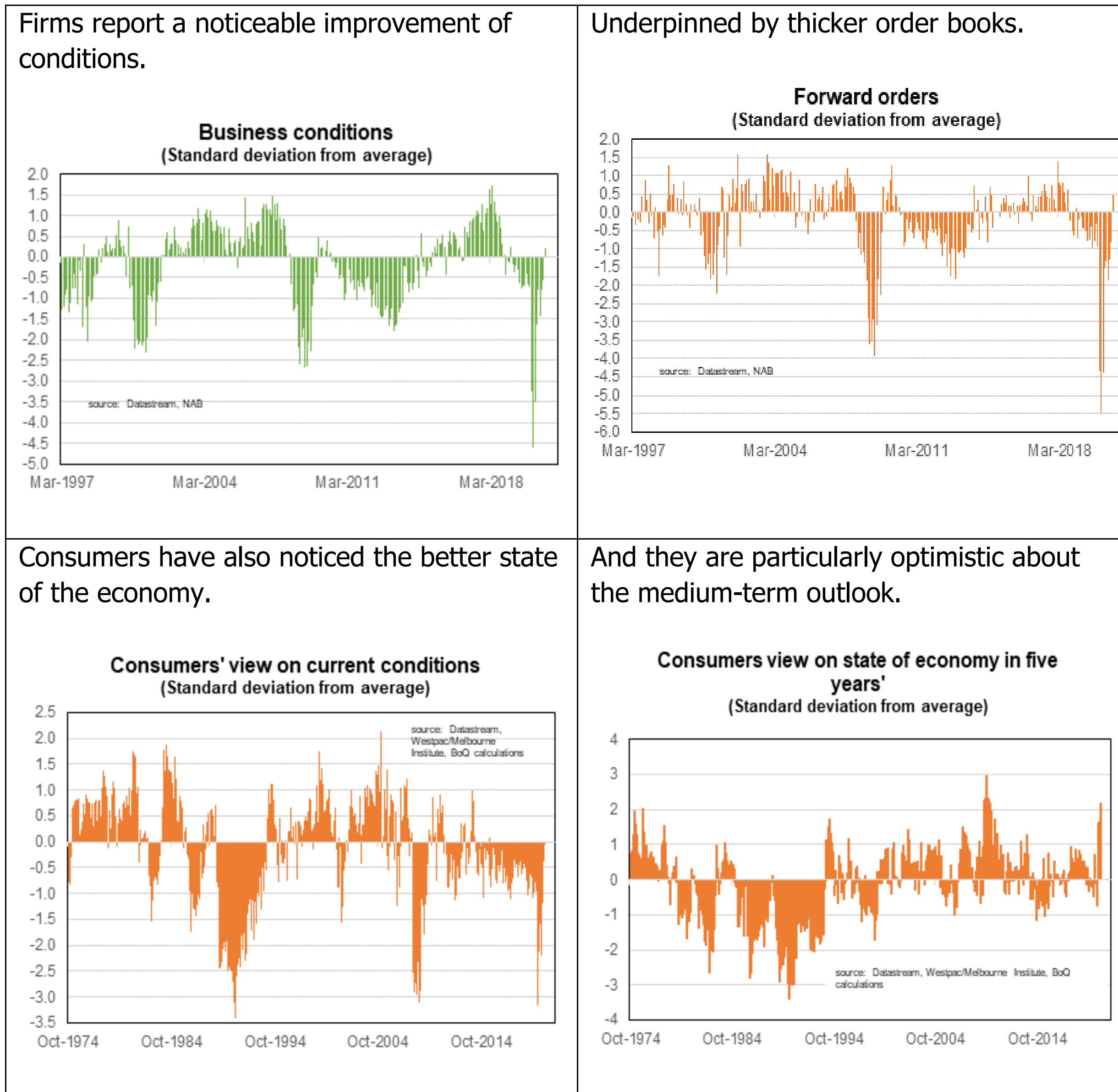




### The economy has yet to achieve takeoff speed – but it is getting there

Much of the data has been stronger than expected. As noted mostly that reflects the removal of restrictions. But there are encouraging signs that the 'underlying' momentum of the economy is picking up. The feedback from private-sector firms is conditions have increased over recent months to be around their long-term average in November. Surveys of companies in the construction, manufacturing and service sectors all point to a return to growth over the few months. Importantly order books have got noticeably thicker indicating that a further improvement of business conditions is likely in coming months.

BOQ GROUP



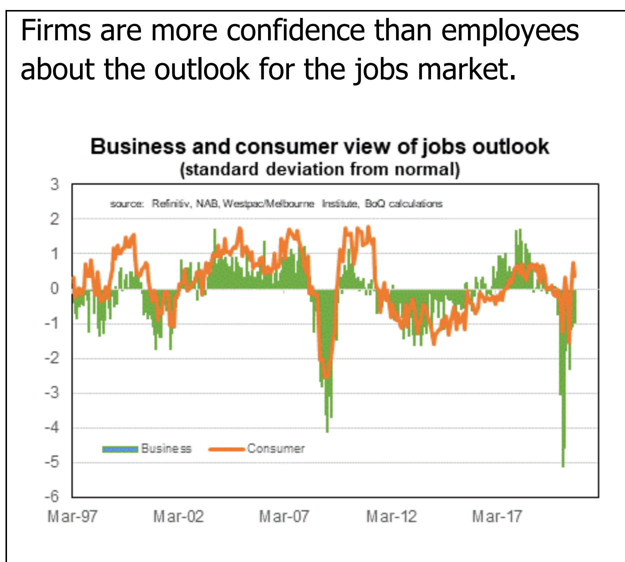

So firms are getting more confident about today. But they are not yet confident enough about tomorrow to up their investment spend on either capital or labour. Surveys of firm investment intentions remain weak (although Federal Budget incentives is likely to lead to an upping of money spent on equipment).

Firms are also indicating that they have limited desire to substantially boost the size of their workforce. At the same time employees are indicating that they have few concerns about unemployment. Maybe that combination reflects that while employers may not be hiring better economic conditions (and JobKeeper) means they are also not firing. But unless employers start to substantially boost their hiring the risk is that consumers might get worried about the state of the jobs market.

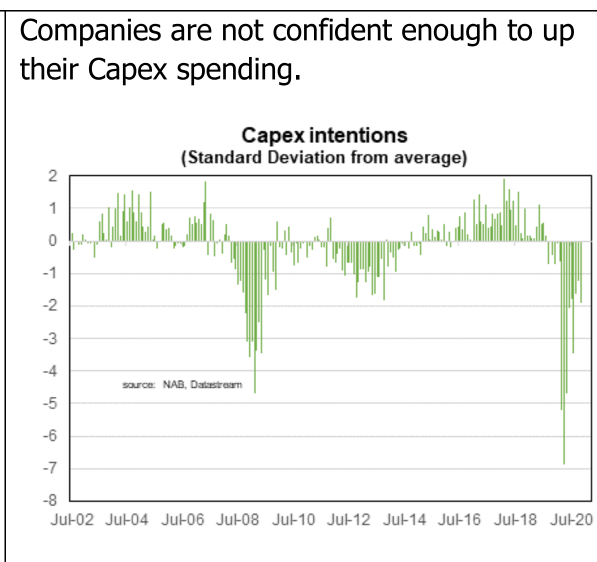
This matters because getting consumers to spend a chunk of their saving mountain is one of the big potential upside factors for the economy over the next two years. Consumers agree that things are picking up. They believe that the economy will get better next year. And they are particularly optimistic about the medium-term outlook. But right now households are reluctant buyers. Spending in cafes and restaurants is still well below it was at the end of last year (but it is starting to get harder to get a table booking).

Low interest rates and greater confidence about the labour market has meant that households have become more confident over recent months about buying a house. New home sales have risen, while order books for builders of standalone houses is starting to bulge. Confidence about buying a house is currently highest in Sydney and Melbourne, likely a reflection of the drop in house prices over recent months. By contrast, a desire to buy a house apparently has declined a little recently in some states (notably WA, SA and Tasmania) probably reflecting the rise of house prices in those states over recent months.

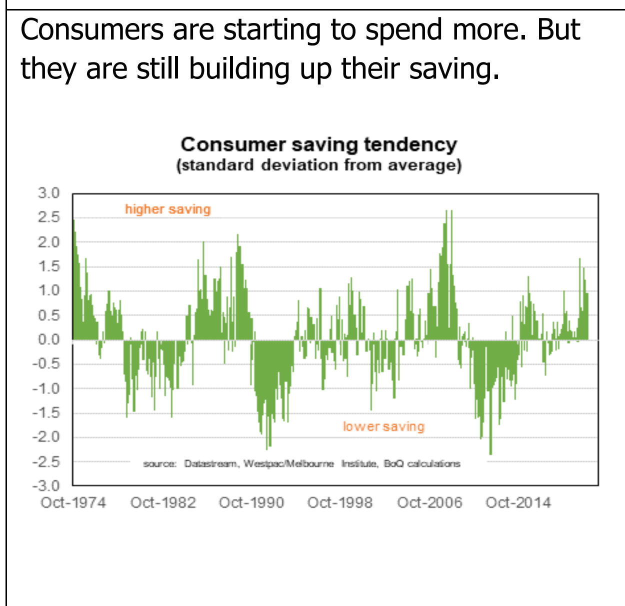
Firms are more confidence than employees about the outlook for the jobs market.



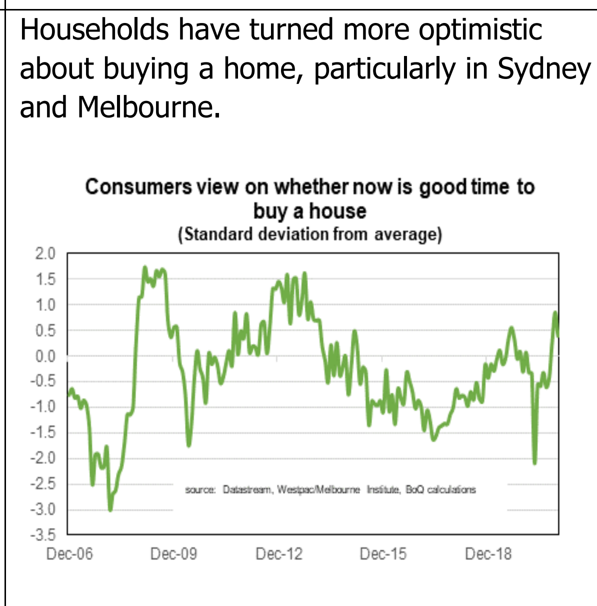

Companies are not confident enough to up their Capex spending.




Consumers are starting to spend more. But they are still building up their saving.



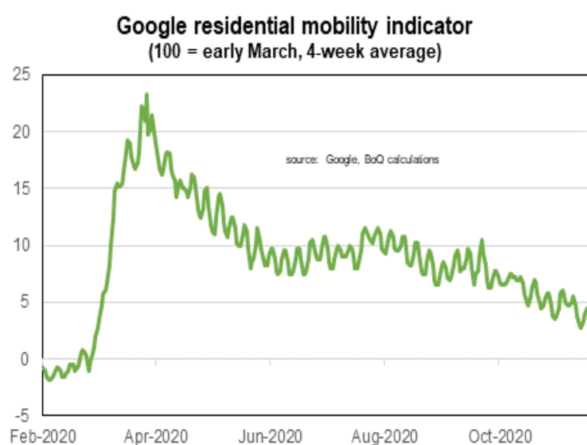

Households have turned more optimistic about buying a home, particularly in Sydney and Melbourne.



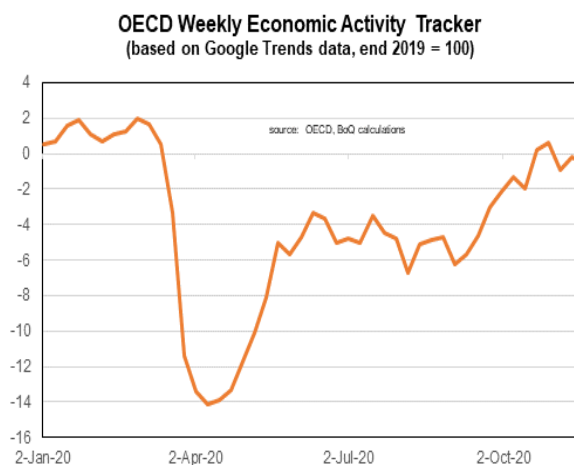
## Alternative economic evidence

The improvement in both the 'hard' economic data (such as GDP and retail sales numbers) and business surveys is consistent with the alternative higher frequency data. The OECD have created a weekly economic indicator based on data sourced from Google Trends. The indicator suggests that after the lull created by the virus 'second wave' economic activity over recent weeks has largely returned to pre-COVID norms. Mobility data based on how much time people are spending at home is still a bit above pre-COVID times. This may reflect ongoing restrictions (such as being unable to travel overseas) and lingering concerns about going to a restaurant. It also has something to do with consumers' desire to save. At least as important is that many office workers are still spending much of their working time at home.

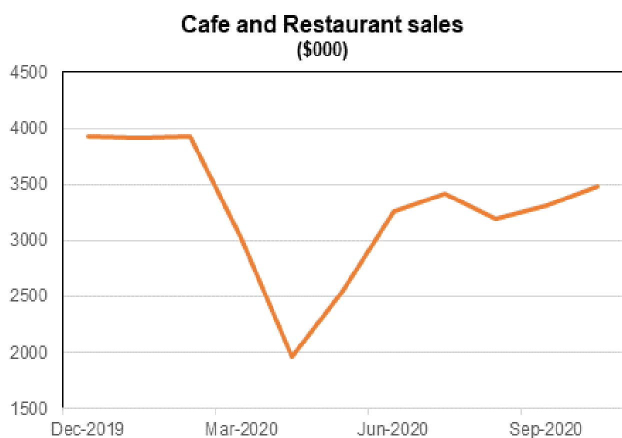
Mobility in the economy is returning to normal.



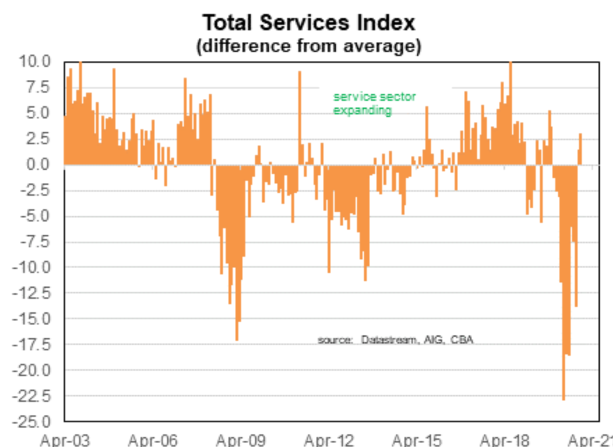

Other high-frequency indicators suggest that the economy already has.




Life is starting to return to cafes and restaurants.




Which is consistent with surveys of the service sector.




 Bank of Queensland Limited ABN 32 009 656 740 (BOQ).

After an extremely turbulent few months, the weather has cleared and the economy is starting to soar. But the nature of this particular trip means that more cross winds are likely to hit the economy. Hopefully the economy will have achieved cruising altitude before then. If not Governments and the RBA will have to provide the economy with an extra thrust. Both have made it clear if they need to do more they will. Consumers are right to think there are better economic times ahead. The main question is how much economic scarring (the level of the underutilisation rate) happens in the meantime.

We live in interesting times.

**Peter Munckton**
**Chief Economist**
**BOQ Group**