ECONOMIC & FINANCIAL MARKET UPDATE

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BOQ GROUP

Summary

- **June was an improving month for the domestic economy;**
- **But Victoria going into lockdown means Australian economy has taken two steps forward and one step back;**
- **Consumer and business confidence is likely to remain subdued for some time;**
- **The Melbourne outbreak underlines that the only certainty right now is uncertainty.**

After a slow start, China has dealt with the crisis well. The good health outcome has enabled the economy to bounce back with impressive growth in Q2. Weak consumer and business confidence though is a feature of other economies that have dealt with the health aspects of the virus well.

Consumer confidence in Australia is also subdued, falling across all states in July. Despite the economic worries, households are not unduly pessimistic about the housing market (albeit sentiment did decline a little in July). Jobs growth jumped by over 200,000 in June. But an underutilisation rate of 19% shows that the labour market is still not in good nick. Jobs growth should improve further in coming months (although there have been recent signs of slowing). The unemployment rate though is likely to head higher yet.

A key factor determining whether the jobs market improves is whether firms become more confident about the outlook. Business confidence did jump in June as the economy re-opened (a reversal can be expected in July). But while confidence has improved firms reported that conditions in June remained tough.

Economic Update

The old sporting saying 'it ain't over until it's over' has never been so true. This time last month restaurant bookings were soaring and holiday plans with kids were being made. Four weeks later lockdown returned to Melbourne. At the time of writing, the shutdown is not as extreme as it has been elsewhere (such as New Zealand) and is limited to Greater Melbourne. But if this year has made anything clear it is that the future path of the virus is far from certain.

What is clear is that the lockdown will have a notable impact on the economy given that Victoria is around one quarter of Australia's GDP. How big that impact is not yet clear, given there is uncertainty as to whether any other parts of the national economy will need to be closed or whether stricter social distancing guidelines will need to be put in place. But a starting point of GDP growth being around 1 percentage points lower in Q3 than otherwise if Melbourne had of remained open feels right.

But lower growth does not (necessarily) mean that Q3 will have weak growth. While the Victorian economy will be stuck in first gear for a while, activity in the other 75% of the economy is getting stronger. Worries about the virus has hit consumer and business confidence. But it is still very likely that there will be a substantial increase in GDP growth in the September quarter. The big proviso is that Sydney does not get put in lockdown in coming weeks. And as Victoria (hopefully) opens up from mid-August the economy should gain momentum entering into the final quarter of the year (unless of course there is shutdown elsewhere).

International

The global economy has always been important for Australia. But if anything now its importance is currently elevated. Not only is it a key input into the outlook for our GDP growth it also provides an indication of how different economies have been impacted by the virus.

In Europe (apart from Sweden) most countries have gone for a suppression strategy (although it took some countries such as the UK longer to go down that path). Having largely got the virus under control, the European economy is opening up (including travel but not with all countries). Most European countries introduced wage subsidy schemes with an explicit aim to reduce unemployment. Many have also implemented aggressive fiscal support. This is less the case with countries such as Italy and Spain that have huge government debt burdens (although it is likely that they will receive substantial EU grants later this year).

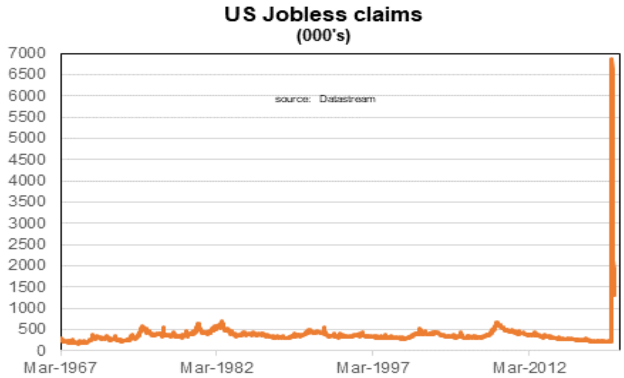
There has been no political agreement in the US about the economic/health tradeoff. The result has been a mis-mash of outcomes. Many parts of the US prioritised the economy but are now having to again shutdown substantial parts of their recreation and food services industries because of the stress on their health systems. The US Government provided households with a substantial cash handout that has supported consumer spending over recent months. But it has not provided employers with any incentive to maintain employment. The result is a very high unemployment rate. And the risk is that the longer the unemployment rate is high, the longer it will stay high.

In many respects the issues are even graver in many Emerging Markets. Most have less ability to shut down their economy, are far more reliant on tourism and have governments that do not have the firepower to support the economy. The result is that many emerging economies have weak economic growth, rising unemployment and high COVID cases. The good news is that many of these countries have a relatively young populations that has so far kept a cap on mortality rates. But they have no choice but to live with the virus.

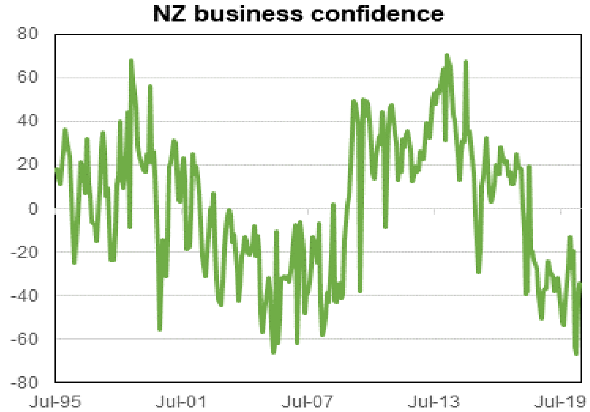
After a slow start, China has dealt with the crisis well. China has minimised the spread of subsequent outbreaks by implementing quick localised shutdowns. The good health outcomes has enabled the economy to bounce back impressively. After a very weak March quarter, the economy rose by over 11% in Q2. But while factories are humming (industrial production is up almost 5% over the year to June) consumers remain cautious (retail sales fell almost 2% over the same time). High levels of Government spending will be needed for a while.

Weak consumer and business confidence is a feature of other economies that have dealt with the health aspects of the virus well (New Zealand, Taiwan, Korea and Japan). Worry about potential virus flare-ups is probably part of the reason. But ongoing uncertainty about the economy and the jobs market is the bigger issue.

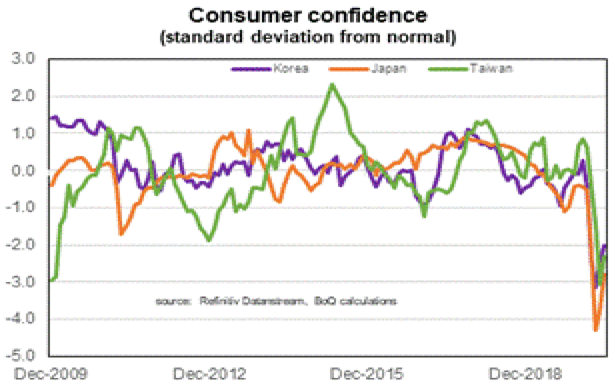
The US jobs market has improved but there is a long way to go.



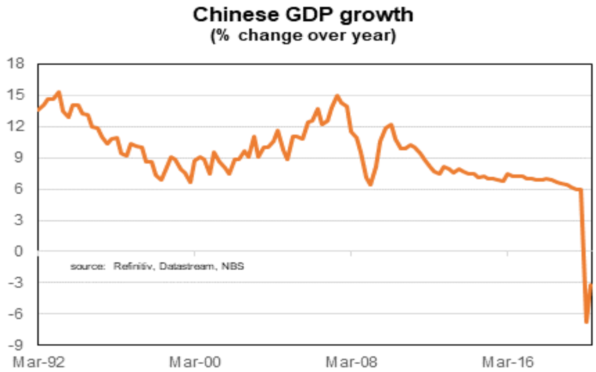
Business confidence remains weak in NZ.



As is consumer confidence in Asia.

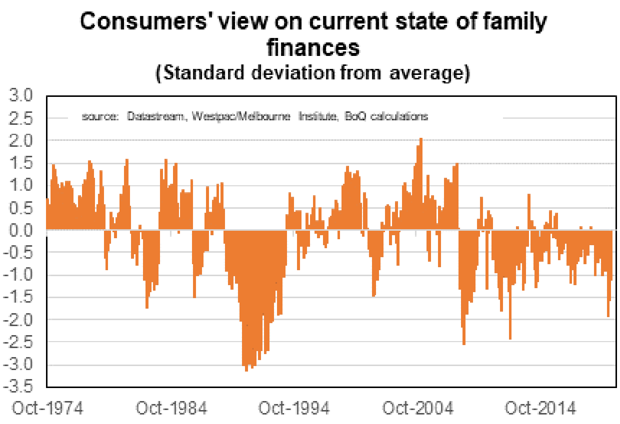
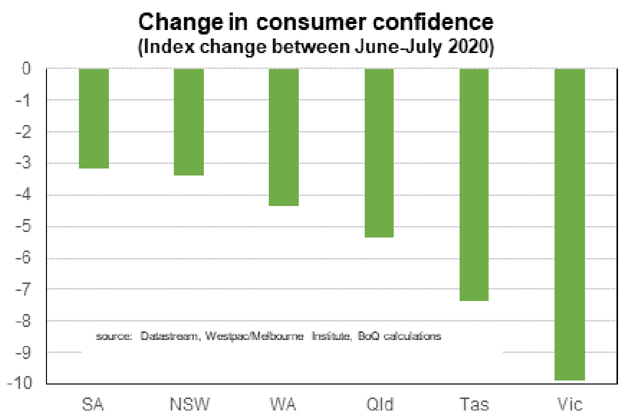


The Chinese economy is bouncing back



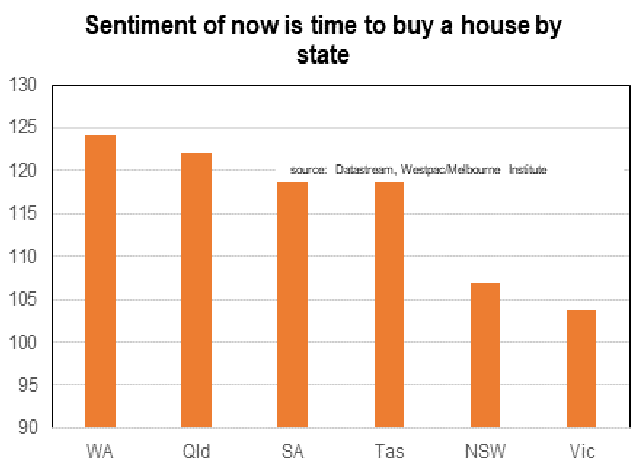
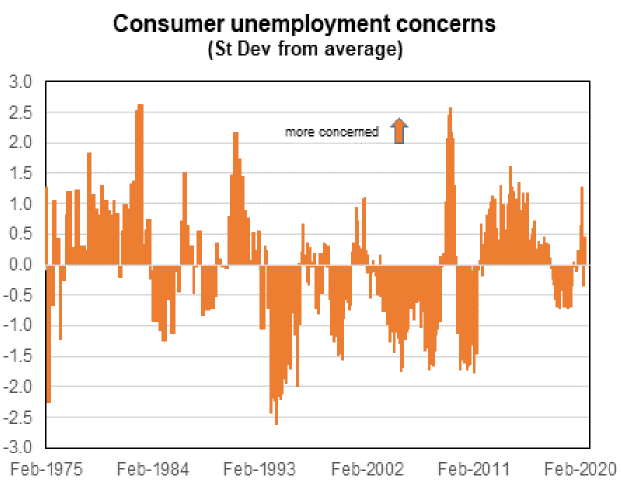
Domestic

Despite the recent outbreak Australia has (so far) been seen to have handled the outbreak well. Despite this consumer confidence is subdued. Confidence fell across all states in July (the survey is conducted early in the month), most likely a result of the COVID outbreak. Younger consumers became more confident while older ones became more worried in the month. This probably reflects that a lot of younger workers got a job over June, while the reappearance of COVID is a greater worry to the old.

Family finances remain tight.	**Confidence took its biggest dip in Victoria.**
	

Despite the economic worries, households are not unduly pessimistic about the housing market (albeit sentiment did decline a little in July). Views about housing are mixed between regions. Sentiment about housing is weakest in the two most popular states, reflecting the reappearance of COVID and that they have the highest priced markets. By contrast, an improving economy and better affordability is aiding sentiment in WA and Queensland. This is particularly the case with first home buyers.

One of the key factors for the property market (and wider economy) is the jobs market. Consumer concerns about unemployment have risen a little over recent months. But they remain below the sort of levels seen during previous recessions or during the GFC.

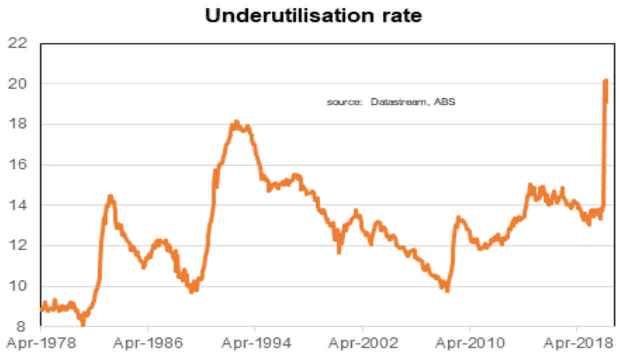
Consumer sentiment about housing is strongest in WA and QLD, weakest in NSW and Vic.	**Consumers are alert but not yet alarmed about the local jobs market**
	

And their relative lack of concern remains despite the jobs market not being in great nick. Yes, jobs growth jumped by over 200,000 in June. The unemployment rate went up but that could be put down to more people re-entering the labour force. But the underutilisation rate remains a sky-high 19% (despite falling in June). And while the unemployment rate is 'only' 7.4% that is the highest rate in over 20 years. The participation rate remains almost 2 percentage points below where it was in March.

Employment conditions are tougher in Western Australia and South Australia, ironically two of the states that have handled the virus the best. State unemployment rate is lowest in NSW, Tasmania and Victoria, the states that entered the downturn in the best shape (the lowest unemployment rates in June were in the two territories).

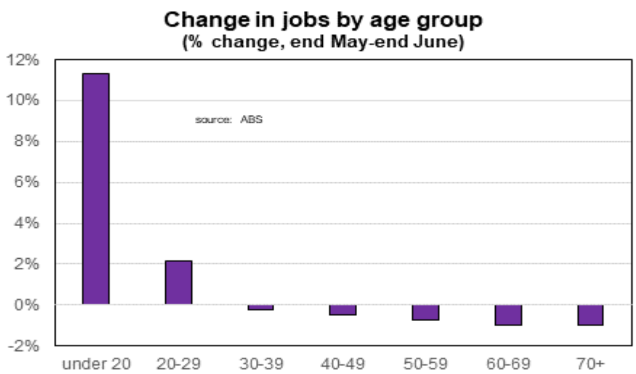
Jobs growth should improve further in coming months (although there has been some recent signs of slowing). The unemployment rate though is likely go higher yet. The participation rate will rise as more jobs attracts more people back into the workforce to look for a job. Victoria is likely to have the weakest economy over the next 1-2 years and potentially the highest unemployment rate.

There is plenty of need for full-time jobs.

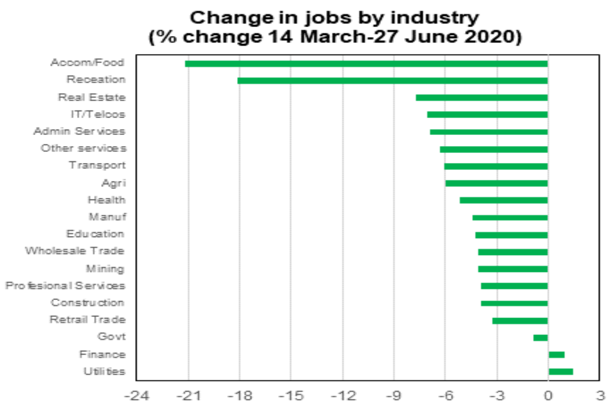


Unemployment rate is high notably in WA and SA.

June was a good month for young workers.

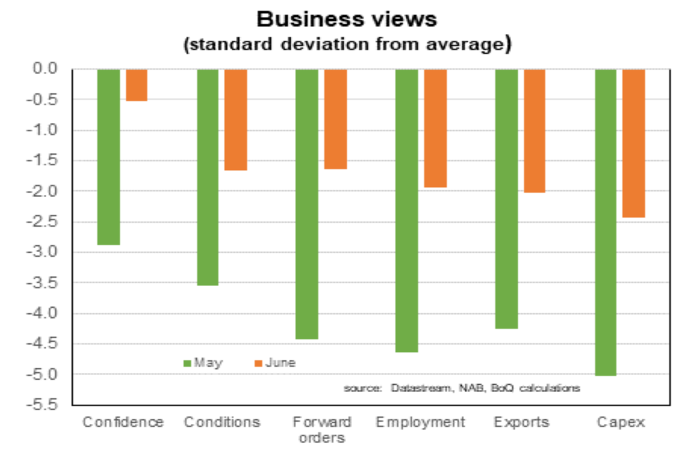


COVID has hit some sector particularly hard.

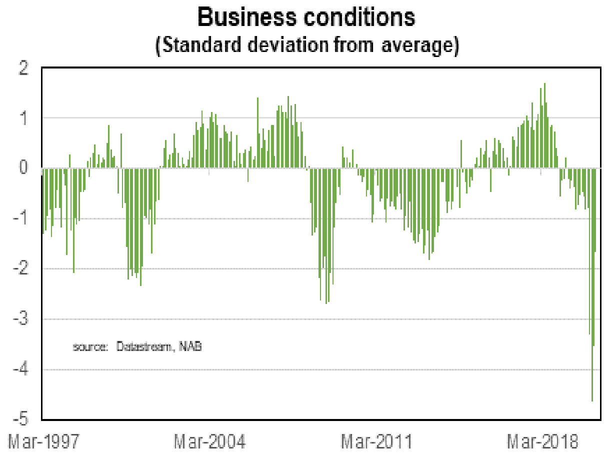


A key factor determining whether the jobs market improves is whether firms become more confident about the outlook. Business confidence did jump in June as the economy re-opened (a reversal can be expected in July). But while confidence has improved firms reported that conditions in June remained hard. Order books are not looking quite as bleak as they were a couple of months ago but they certainly can't be described as strong. Firms will likely at first save any improvement in cash flow as opposed to boosting the size of the payroll or capex budgets. The export environment remains tough.

Business confidence in June was almost back to normal.



...but conditions are still tough.



The overall story is pretty clear. The economy is improving and better economic numbers lie ahead. But business and consumer confidence remains subdued and will likely remain so at least until it is clear that the economy is humming away in top gear. And the outbreak in Melbourne reminds us that the only certainty these days is higher uncertainty. The fallout from the arrival of COVID certainly 'aint over' and won't be for some time.

We live in interesting times.

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