STATE STREET GLOBAL ADVISORS

Australian Macro Outlook

Raf Choudhury, Head of Investment Strategy & Research, Australia
Kaushik Baidya, Economist

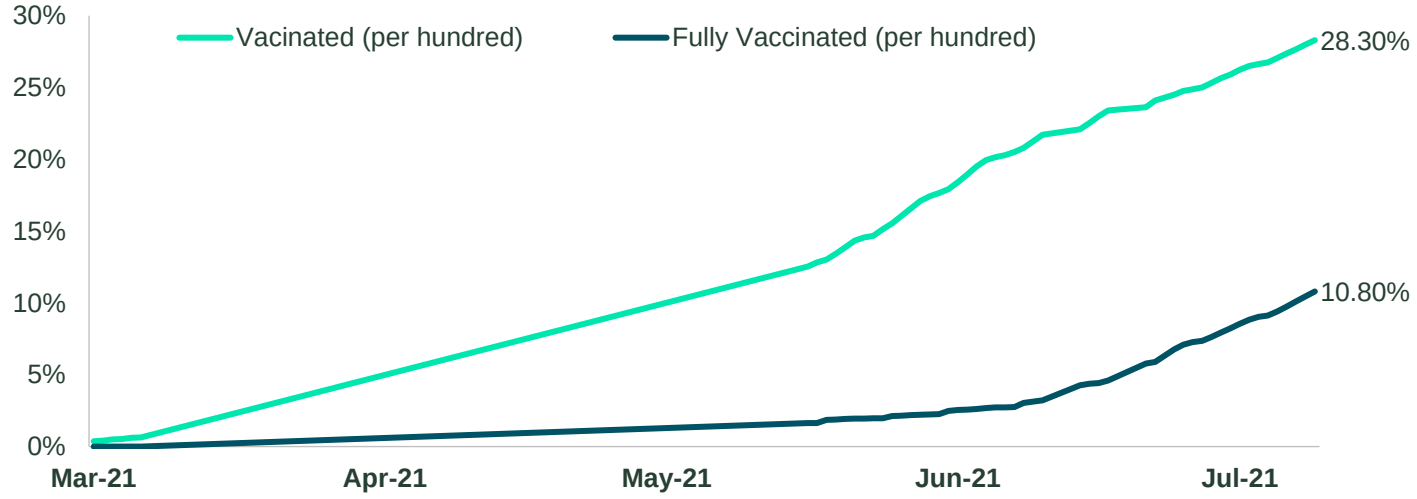
- Fresh Covid-19 outbreaks and lockdowns will put a temporary dent in growth
- Reserve Bank of Australia (RBA) likely to delay tapering decision
- Sino-Australian tensions have intensified and are a key risk to the outlook

Fresh outbreaks of the highly contagious Covid-19 Delta variant across Australia have prompted a snap lockdown across the country. At the start of July, Sydney initially entered a two week lockdown which was extended to the end of the month and now beyond. Other cities and states also face fresh outbreaks having experienced spikes in the number of people infected—with Darwin having already seen a two-day shutdown and Queensland reintroducing mandatory masks and limited home gatherings in several areas following a similar move in Perth. Victoria and South Australia have also experienced lockdowns although these have subsequently been lifted.

The good news is that the rate of vaccinations in Australia has picked up with currently around 30% of the population having received at least one dose of a vaccine. Initially the government indicated that effective herd immunity should be reached by October. But, with the slow start to the vaccination program, because of supply issues and vaccination hesitancy, they now estimate this will be reached by the end of the year. However we should see the number of people fully vaccinated quickly increase as:

1. More facilities are being brought online to administer the vaccine
2. Supply issues are gradually being resolved
3. New guidance released in relation to administering the second dose.

Figure 1: Percentage of People Vaccinated in Australia



Source: Our World In Data, as of 17 July 2021.

Looking Beyond the Recent Outbreak

Despite the recent outbreaks, effective containment strategy (compared to other nations) combined with accommodative monetary and fiscal policies are supporting the recovery. News reports suggest that the lockdown of Greater Sydney will cost A$143 million a day[1] in lost activity and that the initial two week lockdown would impact gross domestic product by more than A$2 billion[2], with this number increasing the longer the lockdown continues. This is likely to put a major dent in the June quarter economic growth figures which had seen gross domestic product (GDP) exceed its pre-Covid peak. We had revised our GDP forecast for 2021 by 0.7 percentage points to 4.5%, while maintaining the forecast for 2022 at 3.0% which are lower that the RBA's own estimates but the longer that these lockdowns continue, the greater the likelihood these will need to be revised down.

Household consumption rose 1.2% in the quarter[3], mostly driven by spending on services, and the savings rate remained high at 11.6%[4] so there is plenty of room for spending to resume at some stage. However, retail sales dropped 1.8% month on month in June[5], which is much more than anticipated, driven by Victoria (-3.5%) and New South Wales (-2.0%) The closure of construction activity in Greater Sydney and South Australia means the economic impact will be larger than in previous lockdowns but updates to extended lockdowns should see some construction activity resume. Business conditions also point to ongoing solid expansion, and high levels of capacity utilisation will support investment. The labour market recovery is poised for further gains, with job ads running nearly 30%[6] above pre-pandemic levels.

Our inflation forecasts have also been revised upward to 2.3% in 2021 and moderate to 1.8% in 2022. Consumer price inflation should top 3% in the coming months due to base effects from earlier Covid-19 related policy measures and energy prices. Services inflation (disproportionately impacted by mobility restrictions) will be the biggest contributor to near term price volatility. Goods inflation has proven relatively stable. A tightening labour market should support wages and, ultimately, inflation.

Some downside risks still remain. The recent stimulus announcements are likely to be only temporary and fiscal policy is on a tightening track. In the June policy meeting, the RBA had decided to continue the asset purchase program beyond its current expiry in September, but at a slower pace of A$4 billion per week from A$5 billion earlier. The most recent RBA minutes reiterated its existing forward guidance—that rates were unlikely to rise until 2024 "at the earliest" and announced to fix the end of the Yield Curve Control (YCC) to April 2024 as expected. But the minutes showed there was some debate around the decision to taper Quantitative (QE) taper purchases. In the light of worsening health scenario, we expect the RBA to reverse its tapering decision at the August meeting.

Don't Forget Trade Wars

One other area we think should be given careful attention is the evolving relationship between Australia and China. It has been a while since we have spoken about trade wars and the relationship between China and the US is still fragile. Biden, not unexpectedly has taken a very different approach to his predecessor that involves corralling together his allies. That has added extra pressure to the relationship between Australia and China. As a result, Sino-Australian tensions have intensified and are a key risk to the outlook. Deep economic interconnectivity means diplomatic tensions can manifest through various economic channels. For instance, China has significantly reduced its purchases of Australian coal but some relief can come from reorienting exports to other destinations. Tourism and education are also big services exports and might suffer. Our baseline view is one of "partial economic decoupling", with no significant impact on Australia's growth in the short to medium term as the slack is picked up elsewhere, but there is always a risk of escalation. In the long term, the impact on items like coal exports will depend on other factors as well, including Australia's commitment to carbon neutral policies.

[1] Source: AFR, "NSW lockdown will deliver $2b economic hit", as of 27 June 2021.
[2] Source: AFR, "NSW lockdown will deliver $2b economic hit", as of 27 June 2021.
[3] Source: Australian Bureau of Statistics as of 30 June 2021.
[4] Source: Australian Bureau of Statistics as of 30 June 2021.
[5] Source: Australian Bureau of Statistics as of 30 June 2021.
[6] Source: Australian Bureau of Statistics as of 30 June 2021.

Important Disclosures