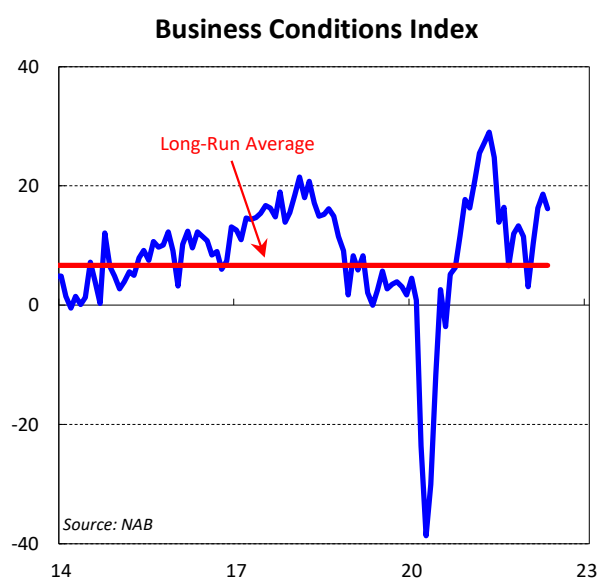
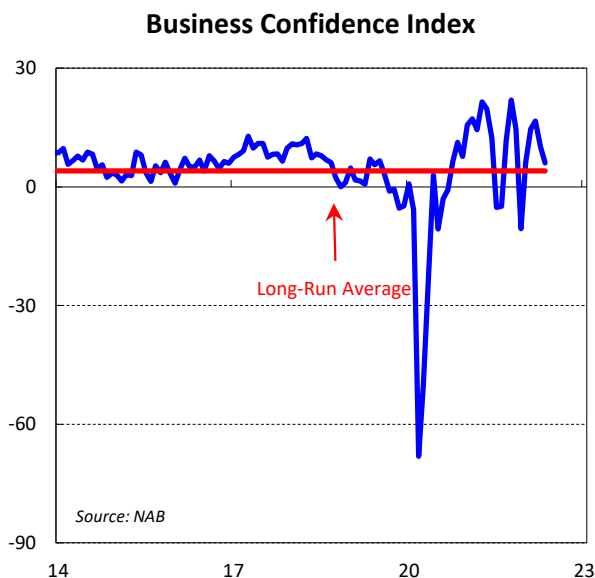


Tuesday, 14 June 2022

Business Confidence and Conditions Growing Headwinds Weigh on Confidence

- Business confidence declined by 4 index points to +6 in May but remained above the long-run average. A range of factors are impacting confidence, including inflationary pressures, labour shortages and supply-chain disruptions. The fall in consumer sentiment and increases in interest rates from the Reserve Bank are also likely weighing on business confidence.
- Business conditions declined in May to +16, ending a run of three consecutive months of improvement. Despite the decline, conditions remain well above the long-run average. The decline reflected a fall in the profitability and trading sub-indices, while employment gained.
- Conditions improved strongly in transport & utilities. This sector was affected by travel restrictions and border closures. As restrictions eased, transport spending, including air travel, has increased. However, it will likely take time before spending returns to pre-pandemic levels.
- Confidence declined sharply in construction. Surging materials costs amid supply-chain disruptions, and higher labour costs have placed significant pressure on the sector. Fixed price contracts have limited the ability for firms to pass on cost increases.
- Leading indicators point to continued economic momentum in the near term. Business investment is also likely to be supported by generous tax incentives which remain in place until June 2023.
- However, growing headwinds, including the prospect of continued pressure on supply chains as China implements its zero-COVID policy, and a risk of a slowdown in global growth may weigh on confidence in the months ahead.



Business confidence and conditions declined in May. Despite pulling back in the month, both measures remained in positive territory and above their respective long-run averages.

Business Confidence

Business confidence declined by 4 index points to +6 in May. A range of factors are weighing on confidence among businesses, including elevated inflationary pressures, labour shortages, and supply-chain disruptions. The fall in consumer sentiment and increases in interest rates from the Reserve Bank (RBA) are also likely weighing on business confidence.

The prospect of continued pressure on global supply chains as China implements its zero-COVID policy, and the risk of a slowdown in global economic growth alongside central bank policy tightening may impact confidence in the months ahead.

However, despite the growing headwinds, business confidence has been remarkably resilient over 2022 and remains above the long-run average of +4.

Across industries, confidence declined sharply in wholesale and construction. The construction industry is under increased pressure. Surging materials costs amid supply-chain disruptions, in addition to staff shortages and higher labour costs have placed significant pressure on the sector. Fixed price contracts have limited the ability to pass on costs in the short term and contributed to reduced profit margins. Conditions in construction are also the weakest across industries.

Confidence also fell in retail and transport & utilities. Bucking the trend, confidence increased across finance, property & business services.

Confidence declined across all states, with Queensland being an exception. The largest drop was recorded in Victoria and SA.

Business Conditions

Business conditions declined in May, ending a run of three consecutive months of improvement. Business conditions fell to +16, from a revised +19 in April. However, conditions remain elevated and well above the long-run average of +7.

The decline reflected a fall in the profitability and trading sub-indices. However, while both sub-indices pulled back from recent 10-month highs, they remain elevated and were at their second highest level in 11 months. Profitability and trading conditions had been improving over much of 2022 as restrictions across the country lifted and consumers adapted to living with COVID.

Employment conditions improved slightly over the month, to be more than five times higher than the long-run average. Labour demand is strong and the jobs market has become increasingly tight as the economy recovers. Businesses are finding it more difficult to find the right kind of labour as slack across the jobs market is absorbed. Reports of skills shortages are widespread. The unemployment rate has fallen to a near 48-year low of 3.9% and wage pressures are building.

By industry, conditions improved strongly in transport & utilities. This sector was affected by travel restrictions and border closures. As restrictions eased, transport spending, including air travel, has increased. However, it will likely take time before spending returns to pre-pandemic levels

Several industries reported declines, including mining, finance, property & business services, and recreation & personal services. However, conditions remain robust across all industries.

By state, conditions declined sharply in Queensland and fell in Tasmania. In trend terms, conditions remain strong across the states.

The survey was conducted between 23 and 29 May. It captures the impact of the first increase in the cash rate in 11½ years in May. However, it does not capture business's reaction to the outsized

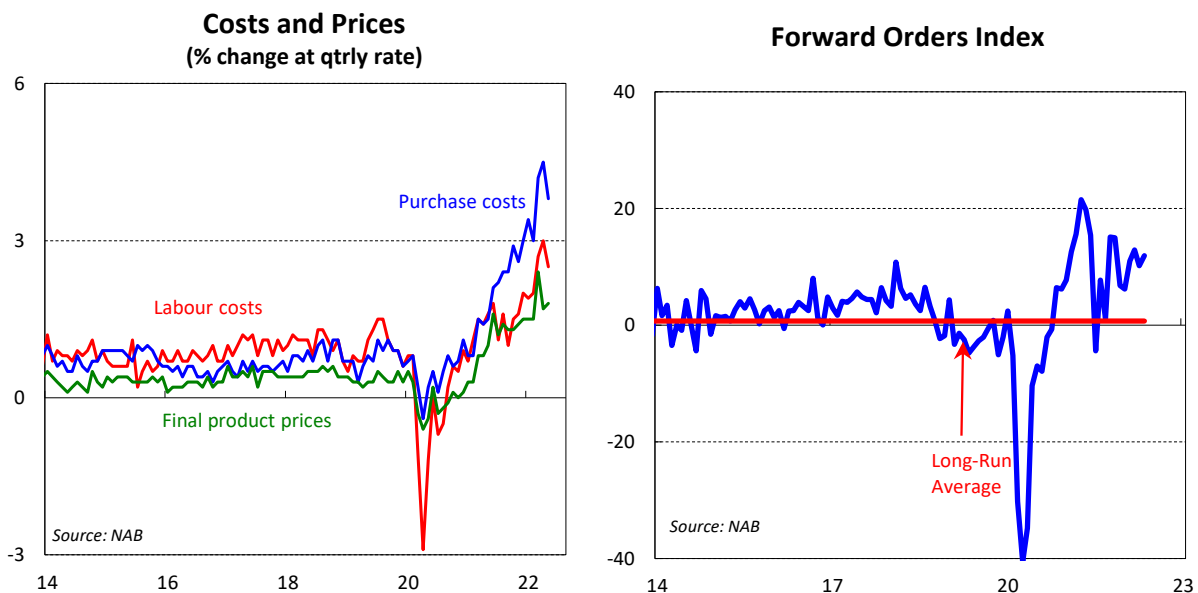
50-basis-point hike announced at the RBA's June Board meeting.

Cost Pressures

Cost pressures eased somewhat in May. Quarterly growth in purchase and labour costs pulled back to 3.8% and 2.5%, respectively. This is down slightly from the record high growth rates recorded in April. However, cost pressures remain elevated amid continued global supply-chain disruptions and a tightening domestic labour market.

Quarterly growth in final product prices accelerated in May, increasing to 1.8%. However, margins are still being squeezed as cost pressures rose at a faster pace than final prices.

Businesses are likely to face continued cost pressures. Elevated commodity prices are expected to flow through to higher energy costs over coming months. Additionally, China's zero-COVID policy and the war in Ukraine are likely to continue to place pressure on global supply chains.



Leading Indicators – Capacity Utilisation and Forward Orders

Leading indicators paint a positive outlook for businesses. Capacity utilisation rose for a fifth consecutive month to 85.0%, equalling the record high reached in April 2021. This compares to the long-run average of 80.8%. Forward orders also rose after softening in April. Forward orders jumped to +12, considerably above the long-run average of +1.

Outlook

Despite a range of challenges, business conditions and confidence have remained resilient. Leading indicators point to continued economic momentum in the near term. Business investment is also likely to be supported by generous tax incentives which remain in place until June 2023.

However, growing headwinds, including the prospect of continued pressure on supply chains as China implements its zero-COVID policy, and a risk of a slowdown in global growth may weigh on confidence in the months ahead.

Jarek Kowcza, Senior Economist

Ph: 0481 476 436

&

Jameson Coombs, Associate Economist

Ph: 0401 102 789

Contact Listing

Chief Economist

Besa Deda
dedab@bankofmelbourne.com.au
(02) 8254 3251

Economist

Matthew Bunny
matthew.bunny@bankofmelbourne.com.au
(02) 8254 1316

Senior Economist

Jarek Kowcza
jarek.kowcza@bankofmelbourne.com.au
0481 476 436

Associate Economist

Jameson Coombs
jameson.coombs@bankofmelbourne.com.au
0401 102 789

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