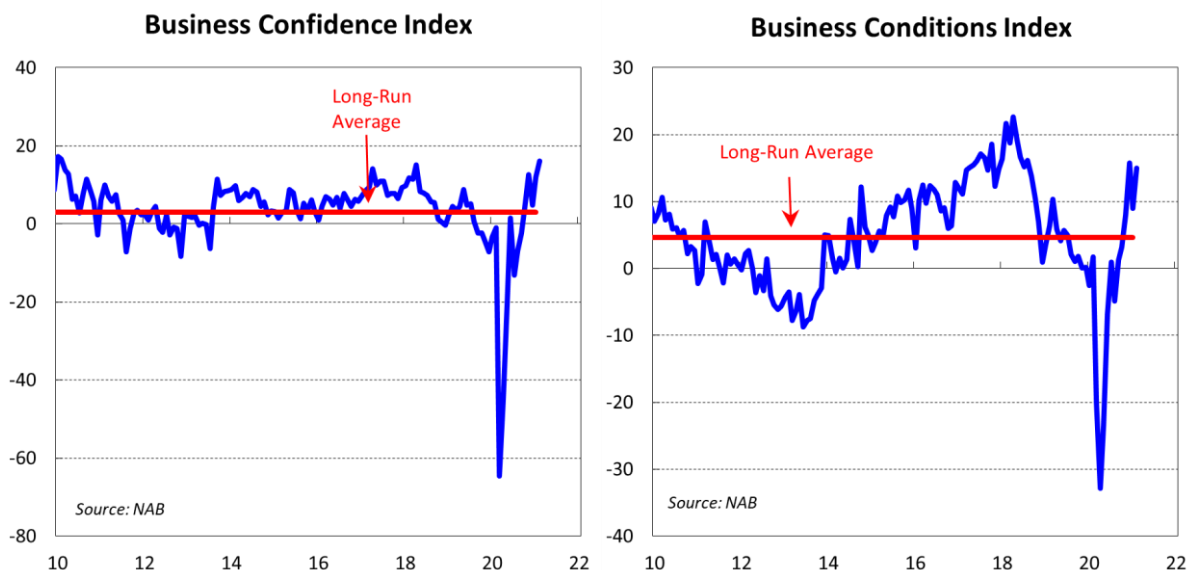


Tuesday, 9 March 2021

Business Confidence and Conditions

Confidence Hits 11-Year High

- **Businesses are upbeat.** In February, the business confidence index increased to 16, from 12 in January, reaching its highest level since early 2010. This is well above the long-run average.
- **Business conditions also improved in the month,** rising to 15, returning to close to its December level (16) which was the highest reading since 2018. All subcomponents of the business conditions index rose. Notably, the employment index increased from 3 to 8, suggesting that jobs growth remains above average.
- **Capacity utilisation increased further in February,** reaching 81.8%, its highest level since 2019. Higher capacity utilisation is associated with increases in capital expenditure and employment.
- **This is an encouraging sign for business investment,** which picked up in the December quarter, but remains subdued relative to pre-COVID levels. A further pick up in business investment will be necessary for a sustainable recovery.
- **The increase in confidence was broad-based across the states in February.** Conditions remain firmer in the smaller and less populated states which have been less impacted by social distancing measures and international border closures. By industry, conditions were strongest in mining and weakest in construction.
- **Looking forward, we expect business conditions will be supported over the coming period by low interest rates, tax incentives, the vaccine rollout and the subsequent relaxation of social distancing rules.**



Businesses are upbeat. In February, the business confidence index increased to 16, from 12 in January, reaching its highest level since early 2010. This is well above the long-run average. Together with consumer confidence, which is also around 10-year highs, this spells good news for the ongoing economic recovery.

Business conditions also improved in the month, rising to 15, returning close to its December level (16) which was the highest reading since 2018.

These results come on the back of the start of the vaccine rollout in February, which likely boosted the mood of businesses. The ongoing tapering of government support and short lockdowns in parts of the country did little to dent optimism.

The increase in capacity utilisation increased further in February, reaching 81.8%, its highest level since 2019. It is now 9.7 percentage points higher than its April 2020 trough and above the long-run average. Higher capacity utilisation is associated with increases in capital expenditure and employment. Forward orders, another leading indicator, also increased in the month.

This is an encouraging sign for business investment, which picked up in the December quarter, but remains subdued relative to pre-COVID levels. So far, consumers have done the heavy lifting in the recovery, with consumption rebounding faster than business investment. A further pick up in business investment will be necessary for a sustainable recovery.

All subcomponents of the business conditions index rose. Notably, the employment index increased from 3 to 8, suggesting that jobs growth remains above average. The profitability and trading subindices also both rose and continued to hover around their highest levels since 2018.

The increase in confidence was broad-based across the states in February. Business conditions are stronger in WA, SA and Queensland than the rest of the country. The smaller and less populated states have tended to outperform in the past year as they have been less impacted by social distancing measures and international border closures. Conditions in Victoria have caught up to NSW and are now only slightly below the national level, after lagging over the second half of 2020 alongside Melbourne's extended lockdown.

Business conditions are the strongest in mining, followed by the retail and wholesale sectors. The strength in mining follows the run up in commodity prices over the last year. The retail sector has benefitted from substitution away from spending on services, towards goods consumption, as well as income support payments and lower mortgage rates. This has flowed upstream to wholesalers.

Conditions remained weakest in construction, and recreation and personal services. Over the coming months, the upturn in the housing market will likely provide support for construction. We may also start to see a reversal of the substitution away from services as restrictions ease, which will benefit recreation and personal services.

Outlook

Business conditions and sentiment, as well as capacity utilisation, have rebounded sharply and are at high levels. This is a positive indicator for business investment and employment. We expect conditions will be supported over the coming period by low interest rates, tax incentives, the vaccine rollout and the subsequent relaxation of social distancing rules.

However, businesses still face headwinds. The withdrawal of JobKeeper at the end of March may temporarily hinder consumer spending and in turn weigh on business conditions. Uncertainty also remains elevated. We are, after all, still in the middle of a global pandemic. And so, while we expect investment to increase, high uncertainty will likely hold back some capital expenditure.

Matthew Bunny, Economist, Ph: 02-8254-0023

Contact Listing

Chief Economist

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

Senior Economist

Hans Kunnen
hans.kunnen@bankofmelbourne.com.au
(02) 8254 1316

Economist

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

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