Weekly Economic Outlook

Bank of Melbourne

Monday, 11 October 2021

Sydney Reopens; China, UK Energy Woes

The day has finally come, well, for Sydney at least. Today Greater Sydney reopens (for the fully vaccinated) after over 100 days in lockdown.

Visitors are allowed in homes, gyms are reopening and hairdressers will be swarmed with overgrown manes (including mine). And if my attempts at getting a restaurant booking are anything to by, hospitality venues look set to be hit by a wave of eager customers. Of course, there are still restrictions in place. People who are not fully vaccinated face stricter measures. And all premises must operate with 1 person per $4m^2$ indoors. Further freedoms will be triggered from the Monday after 80% of the eligible population (those aged 16+) are double-dosed, which is likely to occur in a fortnight, and then again on 1 December.

Freshly-minted New South Wales Premier Perrottet put his stamp on the position last week by hitting the accelerator on reopening. Changes included higher caps on household and outdoor gatherings and a faster return to school.

Victoria still looks to be a few weeks away from reopening based on current vaccination numbers, while new infections in the state topped 1,900 in recent days. The ACT lockdown is slated to lift on 15 October.

Of course, reopening is great news for businesses around the country, especially those hit hard by restrictions like hospitality, physical retail stores and tourism.

Meanwhile, China and the UK are being rocked by an energy crunch. China is facing an electricity shortage which has seen blackouts imposed across the country. Soaring gas prices are pushing some United Kingdom energy companies to collapse, and a fuel petrol shortage has seen long lines clogging roads.

So what is behind all this?

Disruptions associated with COVID-19 are partly to blame but there is also range of other idiosyncratic factors underpinning the challenges. Demand for commodities has come roaring back after falling early in the pandemic, leading to supply chains bottlenecks.

The electricity shortage in China is owing to a combination of surging demand for Chinese exports, extreme weather and a push from the Chinese government to reduce carbon emissions. An unofficial ban on Australian coal exports, amid diplomatic tensions, has exacerbated the problems.

In September, China's official measure of factory activity hit its lowest reading since February 2020, when the economy was being hit by the pandemic and nationwide lockdowns. Soaring energy prices were one of the factors weighing on industrial production in September. There are concerns the energy shortage and sharp increases in prices could weigh on economic growth. And this comes fresh off the back of concerns over China's residential property market.

The power crunch could aggravate existing supply chain disruptions, further delaying the delivery of clothes and toys ahead of year-end holidays. And as some Chinese manufacturers are forced to shut or reduce output to conserve electricity, there could be flow on effects which impact Australia's commodity exports.

Chinese authorities are pushing to lift coal supply, including by ramping up domestic production, while reports suggest China has quietly resumed utilising Australian coal. However, it may be some time before there is material relief from the power shortage.

Over in the UK, soaring wholesale gas prices are squeezing the profits of energy companies, pushing some to failure. Wholesale gas prices have skyrocketed, peaking at almost 400% above prices at the start of the year, and they are still up more than 250%. However, consumer prices are capped by regulation, so the margins of energy providers are being squeezed.

At the same time, the UK has also been contending with a petrol shortage, stemming from a shortage of truck drivers to make deliveries, rather than a shortage of fuel itself. Panicked drivers rushed out to buy petrol, leading to the widespread closure of gas stations and long lines bowsers. The shortage in drivers has also impacted other supply chains, including food and medicine. The worst of the fuel shortage appears to be over, after the military was deployed to drive gas tankers, with petrol stocks at gas stations beginning to rebound.

Turning to the data this week, tomorrow the survey of business conditions and confidence for September will be released. Business confidence edged higher in August, despite lockdowns across the country, although it was still well below its long-run average. However, business confidence has been much more resilient this year than in the early stages of the pandemic, likely reflecting the strong momentum in the economy heading into the recent lockdowns and confidence that the vaccine rollout will see restrictions ease. In September, while two of Australia's major cities were in lockdown, there were improvements in the vaccine rollout which may have supported confidence. Notably, additional supply of Pfizer and Moderna vaccines was secured, and the rollout was extended to younger age groups.

On Wednesday, consumer sentiment data for October will be published. Sentiment rose in September, alongside positive news on the vaccine front. In October, pandemic developments have been mixed, but on balance, likely net positive for confidence. New infections in NSW have slowed significantly, and restrictions were eased today. At the same time, Victoria has faced rising case numbers although the state has made good progress on vaccines and restrictions are set to relax in the coming weeks.

Jobs data for September will be released on Thursday. We expect there was a 200k decline in employment in the month, and that the unemployment rate increased to 4.7% alongside a 0.9 percentage point fall in participation to 64.2%. Sydney and Melbourne remained in extended lockdowns in the month. The Victorian lockdown deepened in September with the shutdown of construction for two weeks, although because this was later in the month, it won't be captured in the September labour force numbers. In August, employment fell 146.3k (-1.1%) while the unemployment rate fell to 4.5%. However, hours worked paints the truer picture of the impact of lockdowns, and they fell 3.7% in August.

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Forecasts

		2021	2022				2023
End Period:	**Close (8 Oct)**	**Q4 (f)**	**Q1 (f)**	**Q2 (f)**	**Q3 (f)**	**Q4 (f)**	**Q1 (f)**
Aust. Interest Rates:							
RBA Cash Rate, %	0.10	0.10	0.10	0.10	0.10	0.10	0.25
90 Day BBSW, %	0.02	0.07	0.10	0.15	0.20	0.40	0.65
3 Year Swap, %	0.66	0.55	0.70	0.80	0.95	1.10	1.20
10 Year Bond, %	1.64	1.60	1.70	1.80	1.90	2.00	2.05
US Interest Rates:							
Fed Funds Rate, %	0.125	0.125	0.125	0.125	0.125	0.375	0.625
US 10 Year Bond, %	1.57	1.60	1.70	1.80	1.90	2.00	2.05
USD Exchange Rates:							
AUD-USD	0.7309	0.75	0.76	0.77	0.78	0.78	0.79
USD-JPY	112.24	112	112	113	113	114	114
EUR-USD	1.1569	1.19	1.20	1.19	1.18	1.18	1.17
GBP-USD	1.3615	1.38	1.39	1.40	1.41	1.41	1.40
NZD-USD	0.6939	0.71	0.72	0.73	0.74	0.74	0.74
AUD Exchange Rates:							
AUD-USD	0.7309	0.75	0.76	0.77	0.78	0.78	0.79
AUD-EUR	0.6311	0.63	0.63	0.65	0.66	0.66	0.68
AUD-JPY	82.02	84.0	85.1	87.0	88.1	88.9	90.1
AUD-GBP	0.5367	0.54	0.55	0.55	0.55	0.55	0.56
AUD-NZD	1.0536	1.06	1.06	1.05	1.05	1.05	1.07

	2019	**2020**	**2021 (f)**	**2022 (f)**
GDP, %	2.1	-0.9	0.0	7.4
CPI (Headline), %	1.8	0.9	2.8	2.4
CPI (Trimmed mean), %	1.6	1.2	1.9	2.6
Unemployment Rate, %	5.2	6.8	5.1	3.8
Wages Growth, %	2.2	1.4	2.0	2.8

AUD cross exchange rates have been rounded.

Financial forecasts are quarter end.

GDP, CPI, employment and wage growth forecasts are year end.

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