Weekly Economic Outlook

Bank of Melbourne

Monday, 22 November 2021

Shot of Confidence for Investment Plans

Business investment is in focus this week with the release of construction work done and private business capital expenditure data on Wednesday and Thursday, respectively.

The data will reflect how investment performed through the Delta outbreak.

Robust business investment will be critical to the economic recovery. We know that consumer spending looks set to bounce back strongly. So, what about investment?

Well, taking it back a step, ahead of the recent lockdowns, business investment was on a firm upwards trajectory. Private capital expenditure had recovered to above pre-pandemic levels, as at December 2019. It grew 4.4% in the June quarter, following robust growth over the preceding six months.

In the first half of this year, the landscape was ripe for business investment. Business confidence and capacity utilisation were around record highs while businesses had recorded strong profit growth. And while temporary government support measures had been wound back, their effects were still being felt throughout the economy. Key tax incentives for investment were also still in place. Namely, the temporary full expensing and the loss carry-back schemes.

But then the Delta variant hit our shores.

The lockdowns in 2020 underpinned significant disruptions to business spending. Capital expenditure fell by nearly 10% over the first three quarters of 2020.

So, will this time be different?

In short, yes.

We still expect a material hit to investment in the September quarter – we have forecast a decline of 4.8% in the quarter. This is a large decline and reflects the setbacks to activity from lockdowns in Sydney and Melbourne. The construction industry was hit hard by restrictions, which included periods of total shutdown in Sydney and Melbourne. This differs to previous lockdowns, where construction has generally been able to continue, albeit with restrictions.

However, there is a key difference to highlight between the lockdowns last year and the Delta episode. The Delta lockdowns hit as Australia’s vaccine rollout was ramping up. While Australia was initially a laggard in the global vaccine race, we have rapidly made up for lost ground. Our double-dose rate has now overtaken the US, UK and Europe

The success of the vaccination program, alongside reopening roadmaps, has provided businesses with comfort that lockdowns will come to an end. This supported business confidence, which held up far better during the Delta lockdowns than in 2020.

As a result, business investment is expected to lend momentum to the recovery. Liaison conducted by the Reserve Bank suggests businesses have generally not scaled back their investment plans, unlike last year, because they have viewed the recent disruptions as a temporary setback. Generous government tax incentives, which will remain in place until mid 2023, will also provide support.

The fourth estimate of capital expenditure plans for 2021/22 will be released this week. With the backdrop above in mind, we expect Estimate 4 to print around $131 billion, a 2.5% upgrade on the previous estimate.

Data on construction work done in the September quarter will also be released this week. We expect a 3.2% decline in the quarter. This is coming off gains of 2.4% and 0.8% in the previous two quarters, boosted by policy support, in particular HomeBuilder. The hit to construction work reflects stringent restrictions on the industry in NSW and Victoria. In NSW, this included a two-week shutdown and limiting the ability of workers who lived in "Local Government Areas (LGAs) of concern" from leaving their LGA.

Retail sales data for October will be published on Friday. We have forecast a 1.0% increase in the month, as lockdowns lifted in NSW and Victoria. This follows a 1.3% gain in September. Card spending data suggests a continued improvement through October, led by NSW. However, expenditure switching between retail and non-retail spending categories could weigh on the print for October. Our partial data points to a much bigger gain in November.

Finally, the Reserve Bank of New Zealand (RBNZ) has a highly anticipated meeting on Wednesday, where a 25 basis point rate hike is all but assured. The RBNZ lifted its policy rate for the first time in seven years in October. Inflation is running red hot – up 4.9% over the year to the September quarter. And with price pressures continue to build, even a 50 basis point rate hike could be on the cards for Wednesday.

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Forecasts

		2021	2022				2023
End Period:	**Close (19 Nov)**	**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, %	0.04	0.07	0.10	0.15	0.20	0.40	0.65
3 Year Swap, %	1.31	1.30	1.30	1.25	1.20	1.20	1.30
10 Year Bond, %	1.83	1.95	2.05	2.15	2.25	2.30	2.30
US Interest Rates:							
Fed Funds Rate, %	0.125	0.125	0.125	0.125	0.125	0.375	0.625
US 10 Year Bond, %	1.55	1.75	1.90	2.00	2.10	2.20	2.25
USD Exchange Rates:							
AUD-USD	0.7280	0.75	0.76	0.77	0.78	0.78	0.79
USD-JPY	114.34	114	115	115	115	116	116
EUR-USD	1.1356	1.18	1.18	1.18	1.17	1.17	1.16
GBP-USD	1.3490	1.38	1.39	1.40	1.41	1.41	1.40
NZD-USD	0.7042	0.71	0.72	0.73	0.74	0.74	0.74
AUD Exchange Rates:							
AUD-USD	0.7280	0.75	0.76	0.77	0.78	0.78	0.79
AUD-EUR	0.6411	0.64	0.64	0.65	0.67	0.67	0.68
AUD-JPY	83.240	85.5	87.4	88.6	89.7	90.5	91.6
AUD-GBP	0.5397	0.54	0.55	0.55	0.55	0.55	0.56
AUD-NZD	1.0338	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	3.0	2.5
CPI (Trimmed mean), %	1.5	1.1	2.3	2.8
Unemployment Rate, %	5.2	6.8	5.3	3.8
Wages Growth, %	2.2	1.4	2.2	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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