Weekly Economic Outlook

Bank of Melbourne

Monday, 6 September 2021

Growth Cut on Vic Lockdown, Softer Rebound

We have revised our growth forecasts after case numbers in Victoria have continued to grow, with the Victorian government subsequently abandoning its elimination strategy.

We now expect a 4.0% contraction in GDP over the September quarter, down from a 2.6% contraction previously. This reflects our expectation that the lockdown in Melbourne will be extended to the end of October. With Australia's two largest cities now expected to be in lockdown until the end of October, activity in the December quarter will be impacted. The rebound through the latter part of the quarter will also likely be softer than previous experience. Subsequently, we have lowered our GDP forecast for the December quarter to 1.6% from 2.6%.

These downgrades will erase gains from earlier in the year, meaning growth in 2021 will be around 0%, down from the mid 2s. We have also boosted our forecast for 2022 from around 5.0% to the mid 7s, reflecting our expectation of a strong rebound in 2022.

Our previous forecasts, released on 16 August, assumed that the Victorian lockdown would be eased in early September. We flagged there was a risk that restrictions would be extended. And unfortunately, that risk has materialised. Case numbers continue to grow in Victoria. Today 246 cases were recorded. In response, last week Premier Andrews shifted his guidance, abandoning the elimination strategy in favour of vaccination targets, following in the footsteps of NSW.

We now assume Melbourne will be in lockdown until the end of October and expect the Victorian economy will contract by more than 5½% in the September quarter. We have pencilled in a recovery of almost 2% for the Victorian economy in the December quarter.

These forecasts continue to assume the NSW lockdown will last until the end of October and that there will not be significant lockdowns elsewhere in the country. We have maintained our forecast of a contraction in the NSW economy in the low 8s in the September quarter. We expect the NSW economy to recover by around 2% in the December quarter.

In recognition of the hit to the labour market, we have increased our unemployment rate forecast for December 2021 from around 5.0% to 5.4%. The unemployment rate will rise in the coming months, likely to around the high 5s. Reflecting the strong recovery we expect next year, we continue to expect the unemployment to fall to around 4.0% by the end of 2022. This represents solid conditions in the jobs market – the unemployment rate hasn't been around the low 4s since 2008.

A key question for outlook is how will the recovery shape up?

We have reviewed our assumptions around the recovery in the December quarter, once restrictions are eased in NSW and Victoria.

Critically, the move to learning to live with the virus means we now expect NSW and Victoria will be reopening while case numbers are still high. This was not the case when restrictions were eased in the past. Recall, economic activity bounced back strongly following lockdowns last year, with consumers eager to get back out to shops and restaurants. With case numbers still high, consumers may be more cautious this time around.

Plus, businesses are feeling the pinch from another round of lengthy lockdowns, especially those in sectors hard hit by restrictions like hospitality and tourism. Policy support is helping to cushion the blow but generally is it is less generous than previous measures, including JobKeeper.

These factors will temper the recovery in the December quarter.

In 2022, we expect that GDP growth will be bolstered by the ongoing lift in activity in NSW and Victoria after a slower start in the December quarter. Plus, ongoing fiscal stimulus, low interest rates, elevated household savings, a strong housing market, a recovering global economy and the reopening of international borders around the middle of next year will all underpin growth. This is reflected in our expectation of 7.4% growth in 2022.

These forecasts are our central scenario. However, it is worth highlighting, there are still larger-than-usual risks around the medium-term outlook as the health situation continues to evolve.

The evolution of vaccine-resistant strains of the virus is a key risk to the outlook, both domestically and globally, especially given the low level of vaccinations in some emerging market economies. If such a strain were to emerge and break out in Australia, this may force the reimposition of restrictions which would again hit economic growth.

This week, all eyes are on the Reserve Bank (RBA) meeting tomorrow. Last month, the Board surprised us and the market by sticking to its decision to taper bond purchases under its quantitative easing program from September. The decision was first announced at the July meeting, very early in the NSW outbreak, before the near-term outlook deteriorated drastically.

The minutes of the last meeting highlight two reasons to press ahead with tapering in September. First, the RBA noted that fiscal policy is better placed to respond to the localised and temporary losses of income which result from lockdowns. And second, that because of lags in monetary policy, any addition support from the RBA now would be felt most next year, when the economy is expected to be rebounding strongly.

However, the RBA did leave the door open to adjust purchases “in response to further bad news on the health front” that would lead to a more “significant setback to the economic recovery”.

The RBA also continued to underscore that its central scenario is that the cash rate will not increase until 2024 at the earliest.

Tomorrow markets will be focused on whether the RBA will reverse its decision on tapering. We expect it will be a finely balanced call. However, the case to defer tapering has strengthened considerably since the last meeting. The health situation in NSW has worsened and Victoria is now also facing a lengthy lockdown.

At the time of the last meeting, the Board was advised the economy will contract around 1% in the September quarter, with 4% growth in 2021. Clearly, these forecasts are now grossly out of date. Plus, as outlined above, it now looks like the recovery in the December quarter will not be a strong as previously anticipated.

On the basis of the sharp downgrade to the outlook since the last meeting, it would be reasonable for the RBA to defer tapering bond purchases. Any extra support would be welcomed in this challenging period.

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Forecasts

		2021		2022			
End Period:	**Close (3 Sep)**	**Q3 (f)**	**Q4 (f)**	**Q1 (f)**	**Q2 (f)**	**Q3 (f)**	**Q4 (f)**
Aust. Interest Rates:							
RBA Cash Rate, %	0.10	0.10	0.10	0.10	0.10	0.10	0.10
90 Day BBSW, %	0.01	0.04	0.07	0.10	0.15	0.20	0.40
3 Year Swap, %	0.43	0.50	0.55	0.70	0.80	0.95	1.10
10 Year Bond, %	1.22	1.30	1.55	1.70	1.80	1.90	2.00
US Interest Rates:							
Fed Funds Rate, %	0.125	0.125	0.125	0.125	0.125	0.125	0.375
US 10 Year Bond, %	1.29	1.45	1.60	1.70	1.80	1.90	2.00
USD Exchange Rates:							
AUD-USD	0.7406	0.72	0.75	0.76	0.77	0.78	0.78
USD-JPY	110.02	111	111	112	112	112	113
EUR-USD	1.1878	1.21	1.22	1.23	1.22	1.21	1.21
GBP-USD	1.3833	1.41	1.42	1.43	1.44	1.45	1.44
NZD-USD	0.7118	0.69	0.71	0.72	0.73	0.74	0.74
AUD Exchange Rates:							
AUD-USD	0.7406	0.72	0.75	0.76	0.77	0.78	0.78
AUD-EUR	0.6272	0.60	0.61	0.62	0.63	0.64	0.64
AUD-JPY	81.74	79.9	83.3	85.1	86.2	87.4	88.1
AUD-GBP	0.5382	0.51	0.53	0.53	0.53	0.54	0.54
AUD-NZD	1.0406	1.04	1.06	1.06	1.05	1.05	1.05

	2019	**2020**	**2021 (f)**	**2022 (f)**
GDP, %	2.1	-0.9	0.0	7.4
CPI (Headline), %	1.8	0.9	2.6	2.2
CPI (Trimmed mean), %	1.6	1.2	1.9	2.6
Unemployment Rate, %	5.2	6.8	5.6	4.0
Wages Growth, %	2.2	1.4	2.1	2.6

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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