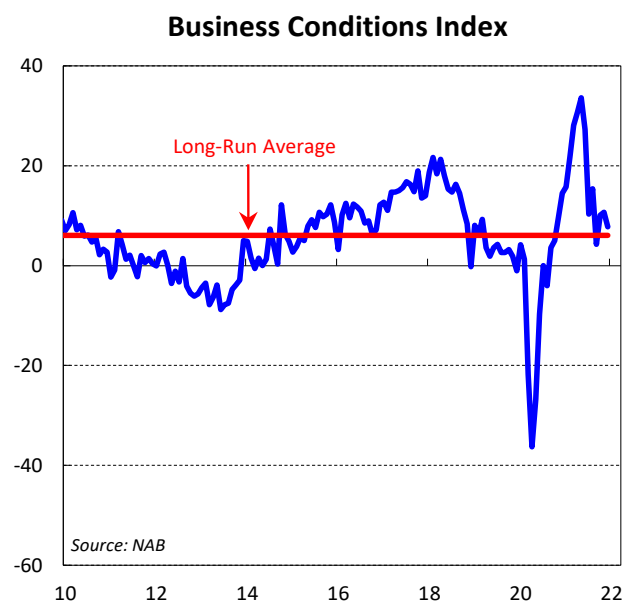
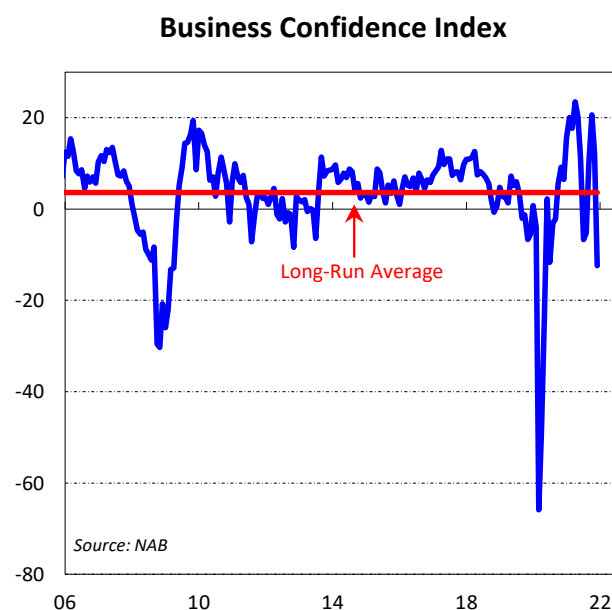


Tuesday, 25 January 2022

Business Confidence and Conditions

Confidence Plummets on Omicron Hit

- The business confidence index plunged 25 points to -12 in December. This marks the lowest reading since May 2020 and the sharpest monthly decline since March 2020. The fall in confidence was broad-based across the states.
- Businesses have faced fresh challenges following the surge in COVID-19 cases, as isolation requirements have exacerbated labour shortages and supply disruptions.
- Encouragingly, the fall in business conditions in December was less pronounced. Conditions slid 3 points to +8, narrowly above the 10-year average of +6. The result showcases how business have found ways adapt to changing conditions throughout the pandemic.
- The decline in conditions was underpinned by a fall in the employment sub-index, despite the strong growth in employment in the month. This reflects the complexity of labour market dynamics, as businesses battle a drastic increase in absenteeism alongside surging infections.
- Price pressures are continuing to build. All four price measures recorded in the survey increased to near-record highs and are well above pre-pandemic levels.
- Beyond the near-term uncertainty, confidence and conditions are likely to improve as case numbers fall. Underlying conditions remain strong, and the speedbumps presented by Omicron are likely to only delay, rather than derail the recovery.



Business confidence plunged in December, alongside surging COVID-19 cases. Business confidence fell 25 points to -12, according to the NAB survey. It is the lowest reading since May 2020 and the sharpest monthly decline since March 2020. The December result is considerably lower than the peak of the Delta outbreak, when the index dropped to -7. However, confidence remains well above the extreme lows of March 2020, at the outset of the pandemic.

The survey was conducted following the rapid rise of COVID-19 infections, after the arrival of the Omicron variant. This has exacerbated labour shortages as millions of Australians entered isolation. Many businesses have been forced to temporarily close their doors or operate with reduced hours. Others have struggled to fill their shelves as supply chains buckled. Businesses have also been confronted with growing price pressures and softening demand, as consumers reduce activity to evade infection. And while we expect the crunch will be short-lived, the combination these factors have weighed heavily on confidence.

By States

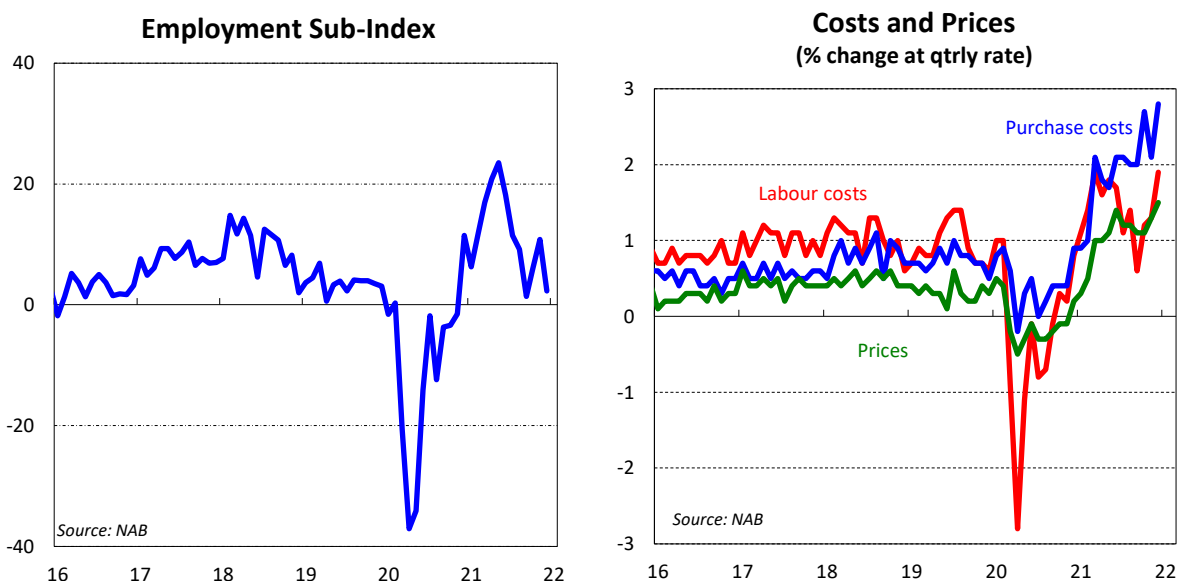
The fall in confidence was broad-based across the states. NSW experienced the largest fall, followed by Victoria, Tasmania and Queensland. Similarly, confidence dropped in every industry, apart from the mining sector.

Encouragingly, the fall in business conditions in December was less pronounced. Conditions slid 3 points to +8, narrowly above the 10-year average of +6. The resilient outcome is another example of how businesses have found ways adapt to challenging conditions throughout the pandemic.

Business conditions actually improved in Victoria, Tasmania, WA and SA despite the spread of Omicron. However, this was more than offset by a sharp decline in conditions in Queensland and a fall in conditions in NSW.

By Sub-Component

Of the three sub-components of the conditions index – trading, profitability and employment – employment drove the fall in December. This is despite the strong growth in employment in the month. The employment index fell 9 points to +2, reflecting the complexity of labour market dynamics, as businesses battle a drastic increase in absenteeism alongside surging infections. Trading conditions edged down to +14 from +15, while profitability improved 1 point to +10.



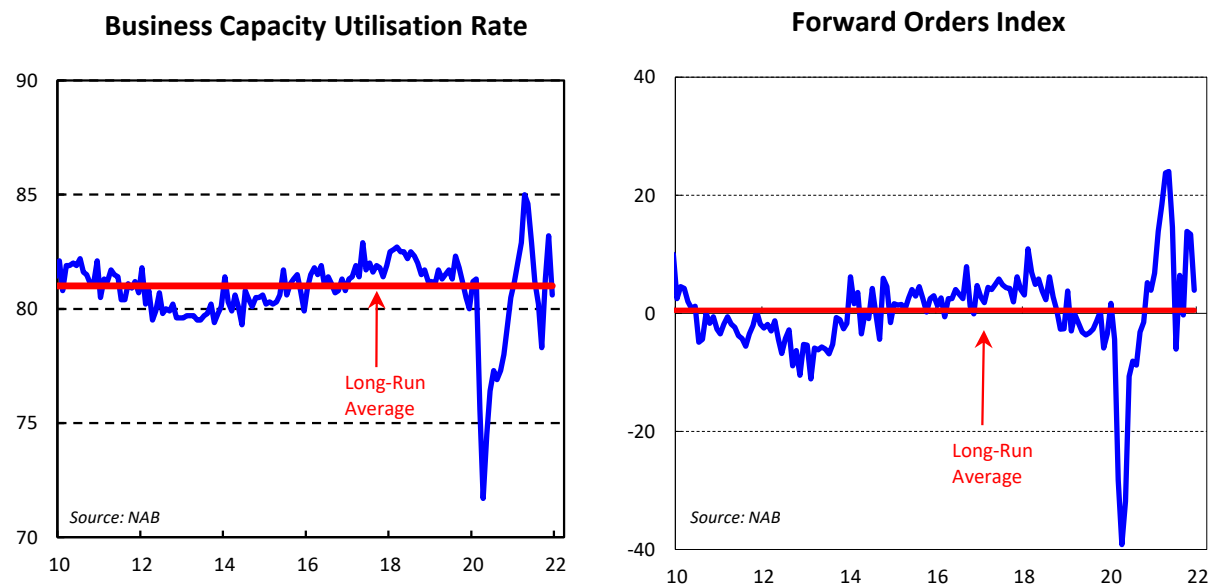
By Industry

By industry, conditions improved in the transport & utilities and retail sectors, while conditions

deteriorated most in wholesale and finance, business & property industries. The deterioration in employment was most pronounced in wholesale and recreation & personal services. In trend terms, conditions remain strongest in the mining and retail sectors and weakest in recreation & personal services.

Pricing Pressures

Meanwhile, price pressures are continuing to build. All four price measures recorded in the survey increased to near-record highs and are well above pre-pandemic levels. The Omicron outbreak has exacerbated labour shortages and supply chain bottlenecks, pushing input and labour costs further north. Previously, it did not appear that businesses had passed these costs on to consumers. However, the survey reveals that product prices and retail inflation are also picking up, as businesses are forced to raise prices to offset shrinking margins.



Capacity Utilisation

Forward-looking indicators suggest the economy is losing some of its post-lockdown momentum. Capacity utilisation dropped back to 80.6%, from 83.2% in November. This is just below the 10-year average of 80.7%. Forward orders pulled back sharply in December, dropping to +4 from +13 the month prior. Despite the pull-back, these indicators remain solid and are above or around historical levels. This is a promising sign that the Omicron will not derail the recovery.

Outlook

The emergence of Omicron and the related surge in COVID-19 infections has dealt a blow to businesses. This coupled with growing inflationary pressures, and heightened uncertainty has stifled business confidence. Conditions have also deteriorated; however, businesses have managed to adapt, and underlying conditions remain solid.

Beyond the near-term uncertainty, confidence and conditions are likely to improve as case numbers fall. Underlying conditions remain strong, and the speedbumps presented by Omicron are likely to only delay, rather than derail the recovery. However, growing inflationary pressures may weigh more heavily on businesses in the future. The strong possibility that the Reserve Bank will start raising rates this year is another factor for businesses to consider.

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