Wednesday 8 July 2020

Metro-Melb Lockdown Sours Outlook

- **The nascent economic recovery became more fragile after the Victorian government yesterday announced metropolitan Melbourne and the Mitchell Shire would be returned to lockdown for six weeks.**
- **This lockdown means economic activity will collapse in the first half of this September quarter in much of Victoria, as restrictions bite on consumer spending and many businesses close or wind back operations again.**
- **It also means that economic activity in the Australian economy will be softer than previously expected in this September quarter. The Victorian economy accounts for 24% of economic output nationally with the Melbourne economy nearly 20% of the Australian economy.**
- **The lockdown also has the potential for spill-over effects in terms of confidence to other parts of the economy. The most recent consumer confidence survey is for the week to July 5, published by Roy Morgan. It shows a slight fall but precedes the lockdown announcement.**
- **There is also the increased risk of lockdowns elsewhere, primarily other regional areas of Victoria and NSW, if infections have spread. The NSW Health Minister has said there is a "possibility but not a high probability" that NSW could be forced back into lockdown.**
- **As flagged yesterday in our RBA note, the recovery will be weaker in the current September quarter due to the lockdown in metropolitan Melbourne and Mitchell Shire. If the infection has spread to NSW, then the hit to the recovery will be harder and sharper and, in fact, a longer recession could be in store.**
- **We previously estimated that growth in the September quarter for the national economy will be 1.5%. We now expect weaker growth of 1.1% to be followed by growth of 2.2% in the December quarter. These forecasts are conditional on Melbourne reopening after six weeks.**
- **It leaves national GDP growth down 4.2% for calendar year 2020 compared with a 4.0% decline forecasted previously.**
- **The national recovery over the second half of this year also depends on Australia avoiding the looming "financial cliff" at the end of September.**
- **The financial cliff became a bit smaller this morning when the Australian Bankers' Association (ABA) announced loan deferrals would be extended by the banking industry for up to four months for eligible borrowers. This decision will help minimise mortgage stress for borrowers.**
- **We also expect JobKeeper to be extended, but it may diminish in size or become more targeted. An announcement around JobKeeper is expected on July 23.**
- **The Treasurer has also said he is considering bringing forward the next phase of personal income tax cuts, which we would also welcome.**

A More Fragile Recovery Ahead

Last week we published a note that considered the possible shapes of the fragile, nascent economic recovery. We likened the possible shapes to an alphabet soup and preferred the back-to-front J-shaped recovery, although perhaps one drawn by my pre-schooler child!

This shape encompasses our view that the road to recovery is a long one with the economy unlikely to fully recover back to pre-crisis levels and the unemployment rate unlikely to drop back down to 5% for some time.

Lockdown in Metropolitan Melbourne & Mitchell Shire Council

Yesterday, the Victorian government announced metropolitan Melbourne and the Mitchell Shire would be returned to lockdown effective midnight tonight for six weeks. It follows a lockdown of postcodes earlier this month identified as hotspots of the pandemic. It also follows a rise in the number of daily infections in Victoria yesterday to 191.

This lockdown means economic activity will collapse in the first half of this September quarter in much of Victoria, as restrictions bite on consumer spending and as many businesses close or wind back operations again.

The lockdown also means that economic growth in the Australian economy will be softer than previously expected in this current September quarter. The Victorian economy accounts for 24% of economic output nationally with the Melbourne economy nearly 20% of the Australian economy. Victoria's population is 26% of the total nationally.

Broader Risks from this Lockdown

The lockdown also has the potential for spill-over effects in terms of confidence to other parts of the economy. The most recent consumer confidence survey is for the week to July 5, published by Roy Morgan. It shows a slight decline in consumer confidence of 0.9 points to 92.1 but precedes the lockdown announcement yesterday.

There is also the increased risk of other parts of the Australian economy having to lockdown suburbs or postcodes and a wider spread lockdown occurring in Victoria to encompass regions not already in lockdown.

The NSW government closed the border with Victoria earlier this week, but there are some fears that infections might already be rising, with infections noted in Albury-Wodonga and private school holidays in Victoria and NSW beginning at the end of the school day on June 26.

The NSW Health Minister, Brad Hazzard, has said there is a "possibility but not a high probability" that NSW could be forced back into lockdown.

One of the key original sources of Victoria's outbreak is attributed to the management of residents returning from overseas. We expect there will be much greater scrutiny across the country around international borders and those people disembarking from international flights in Australia.

The World Health Organisation (WHO)'s special envoy, Dr Navaroo, recently warned the world might be 2.5 years away from a commercial vaccine available globally. Australia and other countries will need to adapt to the pandemic with partial or targeted lockdowns and rigorous testing, tracking and quarantining as much as possible. It suggests this pandemic's effect on the economy will have a long tail and recovery will be fragile and bumpy.

The Mitchell Shire in Victoria is part of the Hume region, an economic rural region located in the north-eastern part of Victoria. There is a higher risk that other regions near Mitchell might have to lockdown in time as well, for example, Bendigo.

Revised GDP Growth Forecasts

What does a second Victorian lockdown mean for our growth forecasts then? As flagged yesterday in our RBA note, the recovery will be weaker in the current September quarter due to the lockdown in metropolitan Melbourne and Mitchell Shire.

If the infection has spread to NSW (which we will not know for some weeks), then the hit to the recovery will be harder and sharper and a longer recession could be likely. Currently, we anticipate the recession will be limited to the first half of this year, although economic activity will be in the slow lane for some time.

We previously estimated that growth in the September quarter for the national economy to be 1.5%. We now expect growth of 1.1% to be followed by growth of 2.2% in the December quarter. These forecasts include the disruptions to the NSW economy from the closure of the NSW-Victorian border and interstate travel. These forecasts are also conditional on Melbourne and Mitchell Shire reopening after six weeks as currently planned. It leaves GDP growth for Australia down 4.2% for calendar year 2020 compared with a 4.0% decline forecasted previously.

For Victoria, we estimate economic activity will shrink 1.5% over the next 6 weeks due to the lockdown restrictions in metropolitan Melbourne and the Mitchell Shire. Pent-up demand (that will build while many Victorians are in lockdown) means that Victorian economic activity might be firmer in the December quarter; we estimate economic growth could be 2.7% in Victoria compared with 2.0% nationally ex-Victoria.

The unknown variable in our forecasts and one that is difficult to forecast is the impact on national confidence. Confidence is a critical determinant in the recovery story. That is, confidence around how the pandemic is being contained and confidence over the economic outlook.

Looming "Financial Cliff" and New Developments – Loan Deferrals and Tax Speculation

The recovery over the second half of this year also depends on Australia avoiding the looming "financial cliff" at the end of September.

The financial cliff became a bit smaller this morning when the Australian Bankers' Association (ABA) announced that loan deferrals would be extended by banks by up to four months for eligible borrowers. The current program is in place for six months and was due to end for many borrowers in September.

The mortgage moratorium extensions will help reduce mortgage stress and prevent some households from being forced to sell their homes.

The largest chunk of the cliff is JobKeeper, due to end on September 27. The hospitality, arts & recreation, transport, postal & wholesale and education & training industries have a significant number of workers on this wage-subsidy scheme and are industries that have been among the hardest hit by lockdown measures and the pandemic more broadly.

The JobKeeper scheme is currently under review with an announcement of the review expected on July 23.

We anticipate the still challenging economic conditions many businesses face mean the Federal government will extend JobKeeper, although it may diminish the size of the scheme or change the scheme to be more targeted.

The coronavirus supplement of $550 per fortnight paid to people on JobSeeker and other social-welfare programs is also due to end at the end of September. We expect this may not be fully wound back.

In the wake of Victoria's announcement yesterday, Treasurer Frydenberg has said there would be another phase of income support to be announced as part of his economic and fiscal update, which will be announced on July 23.

Frydenberg has also said he is considering bringing forward the next phase of planned personal income tax cuts. The first stage of the income tax cuts has already been implemented. The second stage, which is scheduled to begin in July 2022, includes cutting taxes for people earning between $90,000 and $120,000 and raising the threshold on the lowest tax rate. We would welcome the acceleration of the timing of personal income tax cuts given the challenging conditions still faced by consumers and businesses.

For a comprehensive overview of the stimulus measures announced by the Federal government since March, as well as measures from the State & territory governments and the Reserve Bank, please refer to our wrap published on June 19.

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