ECONOMIC UPDATE
PETER MUNCKTON – CHIEF ECONOMIST
WEEK ENDING 11TH FEBRUARY 2022

BOQ GROUP

Key points

- **Firms say that activity moderated in January;**
- **But they report that order books continue to fill up;**
- **Rising prices is impacting consumer sentiment;**
- **Households are comfortable about the state of the jobs market.**

Summary

At the start of each month a swathe of business and consumer surveys are released. The glass half-empty view from the NAB business survey is that firms saw a notable slowing of conditions in January to a below average level. A more realistic interpretation is that this was a pretty good result given the slowdown of spending due to consumer concerns about COVID (and some tightening of government regulations). Another positive sign was in a survey of the service sector conducted by Markit that service sector firms are seeing a bounce in their orders books.

Material shortages have led to a big rise in purchasing costs. Firms are indicating that so far the rise in final prices has not matched the rise in costs. The other problem that material and labour shortages are causing is delays in delivering goods and services. A survey of the construction industry indicated a big mismatch between builders' order books and completions.

Consumer sentiment has declined over recent months, particularly their view about the current situation. That could reflect concerns about COVID or worries about rising interest rates (evidenced by the number of fixed-rate mortgages). But I think the biggest issue is that rising prices is starting to cut households real wages (wages after taking into account price rises). The result has been a significant markdown in views about the state of family finances.

With a bit of luck with COVID there is a good chance that consumer sentiment will improve in coming months. Concerns about unemployment is very low across all states, and has fallen in most (apart from NSW) over the past half year.

One thing that is unlikely to improve this year is views about the housing market. Housing affordability is the big concern across all states, but particularly in Tasmania and NSW. It is less of a concern in Perth and Darwin (but only relative to other states). First home buyers are most impacted by affordability. Rising prices and rents continues to attract more investors, particularly in an environment of very low interest rates.

By and large the surveys confirm what we know. The economy slowed in January and rising prices are starting to worry households. A better run from COVID will help unclog supply chains. And will re-balance demand towards the service sector. The result will be moderating inflation. Together with rising wages growth that should put consumers' in a happier mood. And that will make businesses happy.

Cautious near term, optimistic longer term

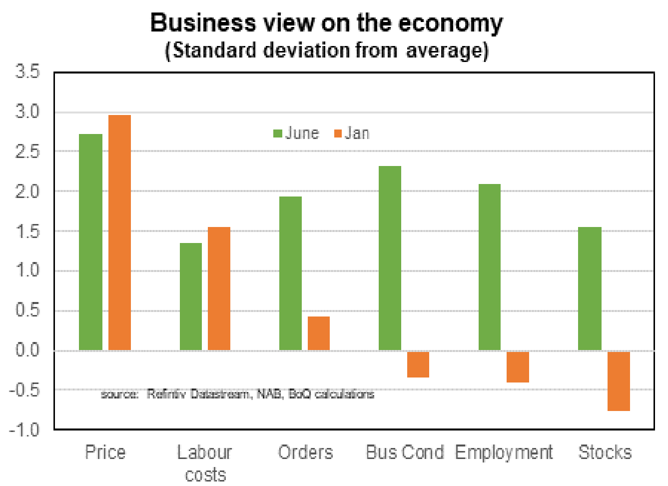
At the start of each month a swathe of business and consumer surveys are released. The surveys by and large provide a 'qualitative' view on how the economy is performing. But they also provide an important 'sense check' on the 'official' data released by the ABS. Importantly they are also more timely.

The best of the business surveys is the one released by NAB. The glass half-empty view from their recent survey is that firms saw a notable slowing of conditions in January to a below average level. A more realistic interpretation is that this was a pretty good result given the slowdown of spending due to consumer concerns about COVID (and some tightening of government regulations). Following previous waves there was a notable bounce back in business activity. There are signs that is likely to happen again with firms seeing their order books increase at an above average level.

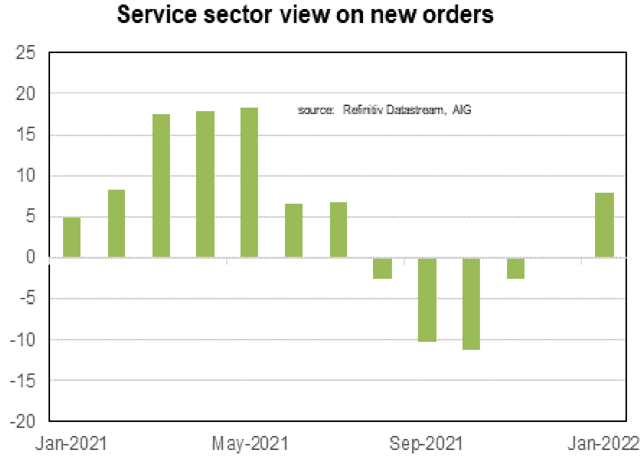
The latest business surveys highlight that stock levels are still low due to strong demand and supply shortages. That combination is leading to strong inflationary pressure, whether that be on prices or labour costs. The NAB surveys also indicated firms' employment intentions were subdued. Maybe that was the indeed the case in January (we will find out soon when the labour market numbers are released on the 17th February). The high level of job ads and vacancies point to strong jobs growth in the months ahead.

Another positive sign was in a survey of the service sector conducted by Markit. That showed that firms in the services sector are seeing a bounce in their order books. A return to strong growth by the services sector will be important to get a better balanced economy that will help reduce inflationary pressure.

Firms reported softer business conditions in January.

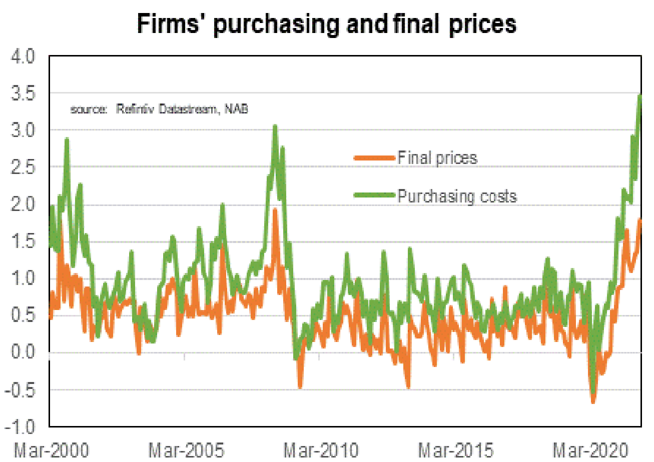


Service sector firms are seeing a bounce in their order books.

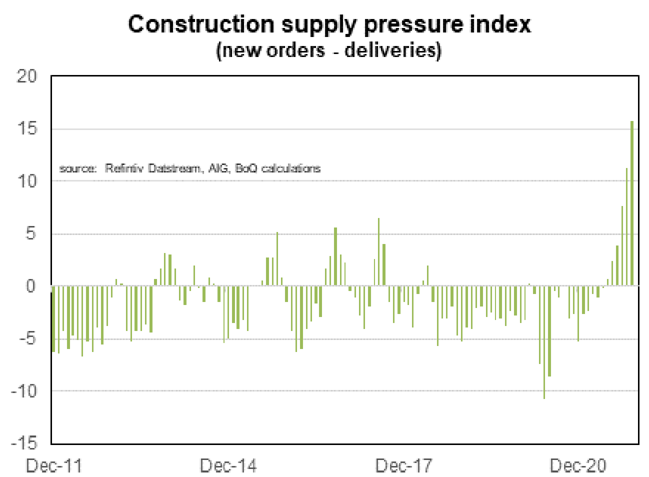


A better-balanced economy is important as the supply problems are creating significant issues for the economy. Material shortages have led to a big rise in purchasing costs. There are growing anecdotes that more of these costs are being passed onto customers. But firms are indicating that so far the rise in final prices has not matched the rise in costs. The other problem that material and labour shortages are causing is delays in delivering goods and services. A survey of the construction industry indicated a big mismatch between builders' order books and completions.

Rising purchasing costs are putting pressure on margins.



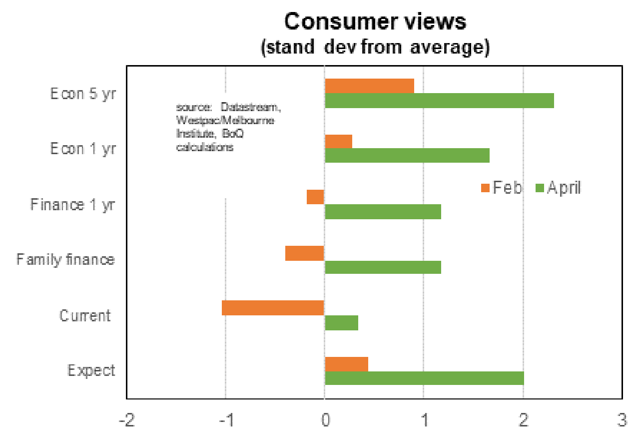
Materials and workers shortages are also constraining output.



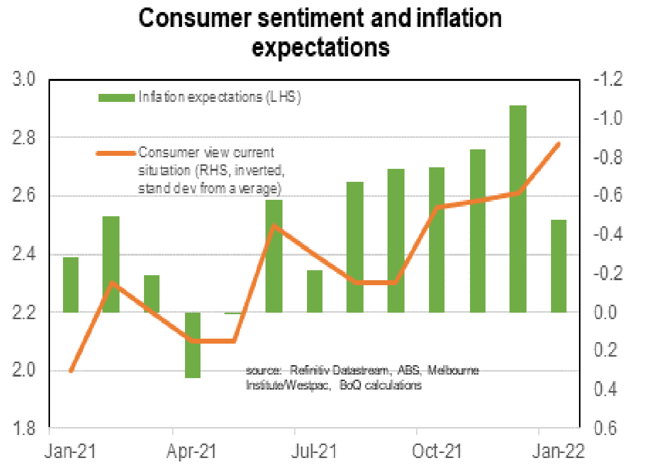
Consumers have also grown more cautious. Sentiment has declined over recent months, particularly their view about the current situation. That could reflect concerns about COVID or worries about rising interest rates (evidenced by the number of fixed-rate mortgages).

But I think the biggest issue is that rising prices is starting to cut households real wages (wages after taking into account price rises). The result has been a significant markdown in views about the state of family finances. Concerns about the potential for ongoing COVID waves and declining real wages has likely also lead to a markdown of views on the economic outlook. Importantly though those views remain positive.

Consumers' remain positive about the economic outlook, less so about their own finances.

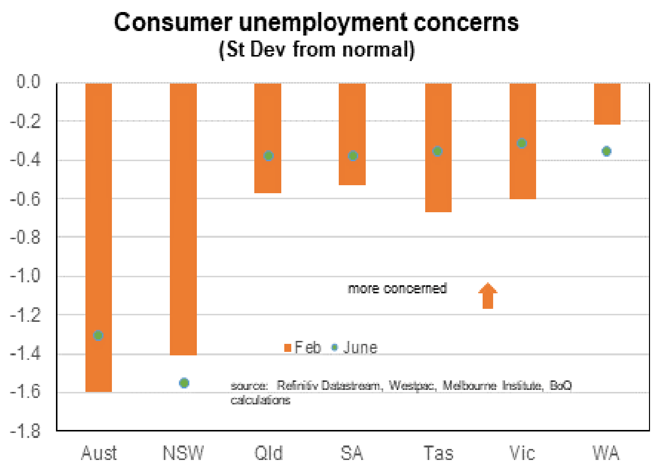


Rising inflation is playing an important role in dampening sentiment.

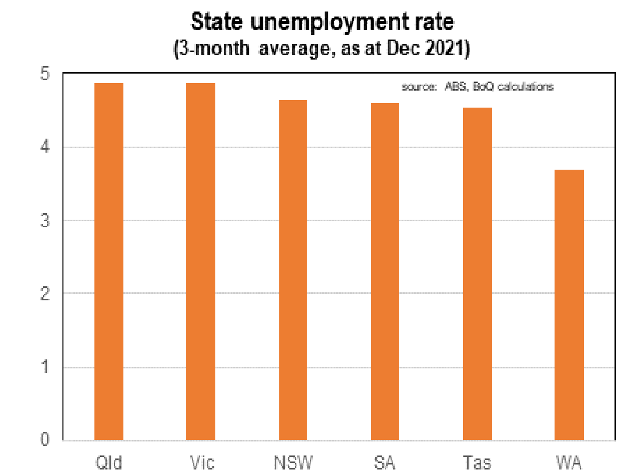


With a bit of luck with COVID there is a good chance that consumer sentiment will improve in coming months. Concerns about unemployment is very low across all states, and has fallen in most (apart from NSW) over the past half year. This is likely to remain the case given the low unemployment rate and high number of job vacancies. A strong jobs market, rising inflation expectations, employer concerns about worker shortages and strong demand for labour all point to rising wage growth over this year (the most important data for the interest rate outlook). The combination of rising wages and some moderation in the inflation rate should see an improvement in consumer confidence as the year progresses.

Households have few worries about the jobs market.

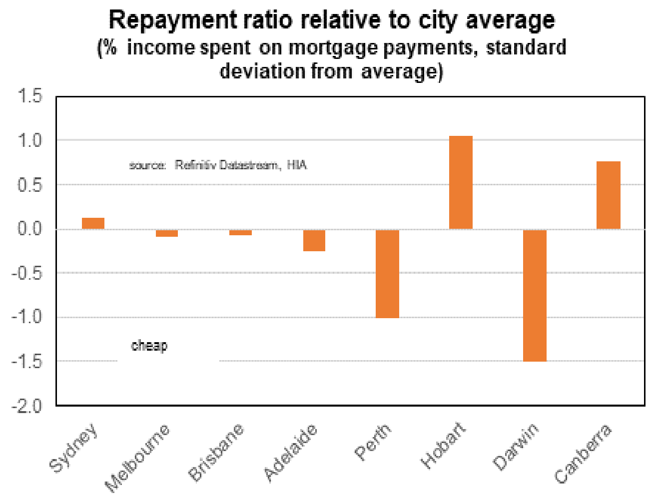


The unemployment rate is low across all states, particularly in WA.

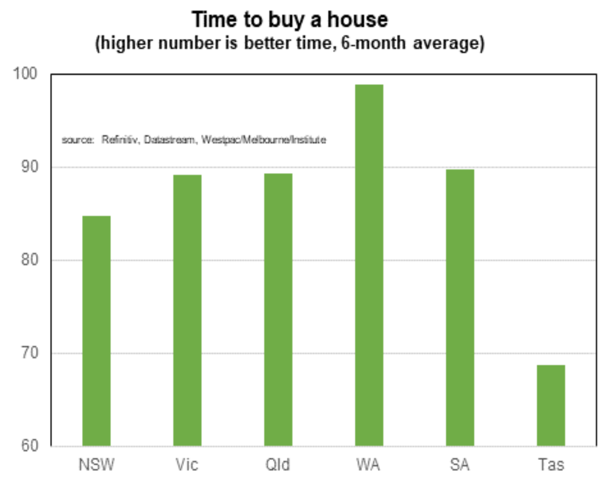


One thing that is unlikely to improve this year is views about the housing market. House prices across Australia have risen a lot. Rising concerns about inflation are likely to mean that interest rates will increase, almost certainly beginning in the second half of this year. Housing affordability is the big concern across all states, but particularly in Tasmania and NSW. It is less of a concern in Perth and Darwin (but only relative to other states). First home buyers are most impacted by affordability. Rising prices and rents continues to attract more investors, particularly in an environment of very low interest rates.

Affordability concerns differ across states.



Households are most attracted to the WA housing market, less so in Tasmania.



By and large the surveys confirm what we know. The economy slowed in January and rising prices are starting to worry households. A better run from COVID will help unclog supply chains. And will re-balance demand towards the service sector. The result will be (some) moderation of inflation. Together with rising wages growth that should put consumers' in a happier mood. And that will make businesses happy.

We live in interesting times.

Regards

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