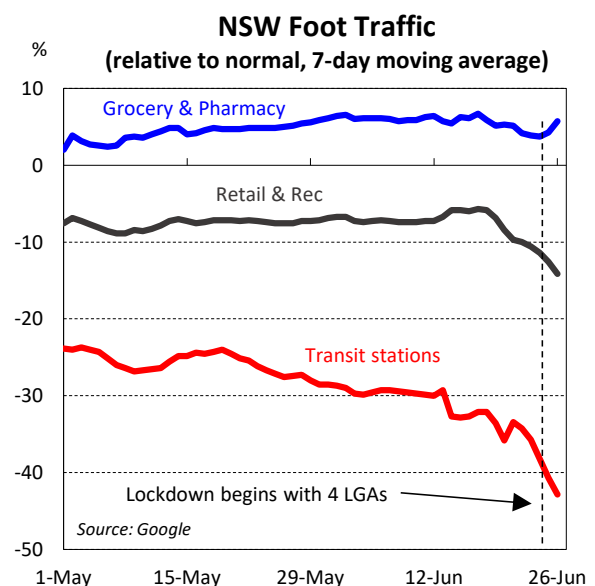
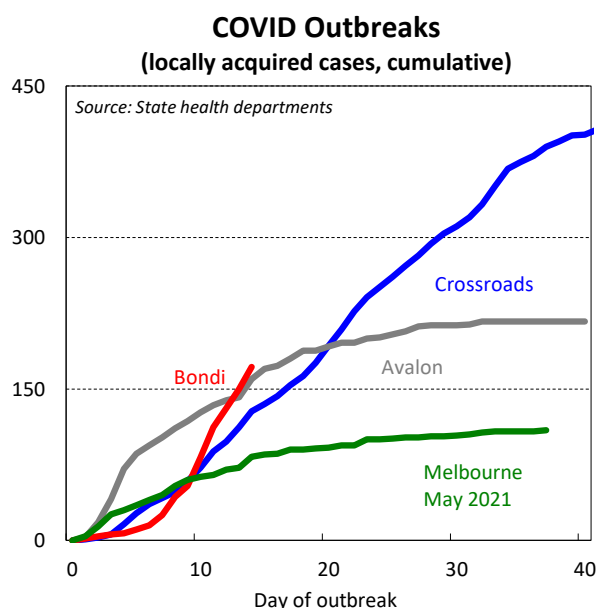


Lockdowns to Drag on Recovery

NSW Restrictions to Cost Up to \$1 Billion per Week

- An outbreak of a highly contagious COVID-19 variant has led to a two-week stay-at-home order across a large part of NSW and lockdowns in several other states. Concerningly, the outbreak has spread faster than other clusters.
- We expect the NSW lockdown to reduce economic activity by around \$750 million per week, although it could be as high as \$1 billion a week. These are broadly consistent with early estimates from NSW Treasury.
- There is a risk that the restrictions in NSW could reduce GDP growth by at least 0.2 percentage points in the September quarter. This figure could be larger if the lockdown is dragged out. We do not expect a material impact on GDP in the June quarter.
- Service-oriented businesses will be the most impacted, especially those that cannot make up the short fall from growth in online spending. High frequency foot-traffic data suggests there has been a shift in spending patterns similar to previous lockdowns.
- The economic fallout will be cushioned by pent-up spending when restrictions lift and government support. The NSW government announced a rescue package for businesses yesterday.
- If the NSW lockdown lasts only two weeks, previous experience suggests the overall economic impact will be limited. But it is incredibly difficult to predict the path of the virus. The key determinant of the economic hit will be how quickly the outbreak is contained.



Lockdowns sweep the country again

The New South Wales government has announced a two-week stay-at-home order for Greater Sydney, Wollongong, Blue Mountains and Central Coast, running until midnight 9 July. These regions account for around 25% of Australia's economic activity. The outbreak has been traced to the Delta variant of the virus. Officials advise the strain is at least twice as transmissible as previous variants in Australia. Queensland, Western Australia and the Northern Territory have also implemented lockdowns, at this stage shorter and earlier than the New South Wales lockdown, in response to new cases. Interstate borders have snapped shut around the country. South Australia has also had cases of community transmissions and tightened restrictions.

Mobility data shows a large reduction in foot traffic in New South Wales around public transport transit stations, and retail and recreation venues since the initial lockdown of four Sydney local government areas. On the other hand, foot traffic in grocery stores and pharmacies increased as people stocked up in preparation for the lockdown. These movements are consistent with spending patterns in previous lockdowns.

So far, the "Bondi" cluster is spreading faster than other outbreaks in New South Wales. As of today, or day 14 of the outbreak, there have been 172 cases of community transmission. By day 14, there were 160 locally acquired cases, in total, following the Avalon outbreak. At the same point in time, there were 128 cases of community transmission following the Crossroads outbreak.

There is some risk that the lockdown in New South Wales will last longer than two weeks, considering the high rate of transmission of the Delta variant and the geographical spread of the virus across New South Wales. As a point of comparison, the lockdown linked to the Avalon cluster lasted three weeks. The Bondi outbreak is spreading faster and is also less easily ring-fenced than the Avalon outbreak. For example, the Avalon outbreak was on a peninsula which can be partly shut off through closure of a single bridge.

Encouragingly, in a press conference earlier today, Premier Berejiklian hinted the lockdown was on track to end as planned on 9 July. The Premier noted case numbers have not surged as high as the authorities anticipated.

NSW lockdown to shave up to \$1 billion a week off economic activity

We expect the lockdown to reduce economic activity by around \$750 million per week, drawing on the experience of Victoria during its Stage 4 lockdown in late 2020. It could be as high as \$1 billion a week if the impact in regional New South Wales is similar to Greater Sydney, Wollongong, the Blue Mountains and the Central Coast. Similarly, preliminary estimates from New South Wales Treasury indicate the lockdown will cost the economy around \$850 million per week.

However, the upshot is that consumer spending tends to rebound sharply as restrictions ease, because of pent-up demand, which partly offsets the losses from the lockdowns.

The restrictions will weigh on consumer and business confidence, with most of the impact of a two-week lockdown being felt via reduced consumer spending. Indeed, consumer confidence fell 4.6% in Sydney and 6.6% in regional New South Wales in the week ending 27 June. The national consumer confidence index was largely unchanged, although the survey was mostly conducted before tighter restrictions swept across the rest of the country.

Service-oriented businesses will be the most impacted, especially those that cannot make up the short fall from growth in online spending. For example, domestic accommodation operators will be impacted in New South Wales, and other states which rely on Sydney-siders for demand during the peak school-holiday period will also be hit.

So what does this mean for national economic activity?

There is a risk that the restrictions in New South Wales could reduce GDP growth by at least 0.2 percentage points in the September quarter. This figure could be larger if the lockdown is dragged out. We do not expect a material impact on GDP in the June quarter given the lockdown was imposed in the final week of the quarter. Importantly, over 2021, the economy should still record solid growth after a contraction of 1.0% in 2020. The lockdown may also temporarily weigh on the recovery in the labour market, although if the stay-at-home order is contained to two-weeks, the overall impact on jobs is likely to be limited.

The economic fallout will be cushioned by pent-up spending when restrictions lift and government support for households and businesses. Support includes the Federal government's COVID-19 disaster relief payment for individuals and the New South Wales government's relief package for impacted small businesses, as well as tourism and hospitality operators. The New South Wales government's package includes grants between \$5,000 and \$10,000 for affected businesses, payroll tax deferrals and an extension of the Dine and Discover program to the end of August from the previous July 31 deadline. Hotels and clubs will also be given some tax relief, including the option to defer their June quarter gaming machine tax payments.

The recent setbacks from the resurgence of the virus may weigh on business credit growth in the near term. We expect business credit growth is likely to improve as the recovery in business investment continues, alongside elevated capacity utilisation. In fact, data released today showed that business credit continued to pick up through May. However, the fresh outbreaks across the country since late May could temporarily disrupt the recovery in business credit growth.

We rebounded quickly from previous lockdowns, but the near-term outlook is still uncertain

Economic forecasting in a pandemic is a humbling exercise. Indeed, since the onset of COVID-19, consensus economic forecasts and policymakers have consistently underestimated the strength of Australia's recovery. As we have learnt time and time again, it is incredibly difficult to predict the path of the virus. The critical determinant of the economic impact will be how quickly the outbreak is contained, and hence how quickly restrictions are relaxed.

The economy has been resilient in the face of short snap lockdowns over the past six months or so. If this lockdown lasts only two weeks, previous experience suggests the economic impact will be limited. Consumer and business confidence rebounded quickly from previous episodes, and the labour market generally continued to recover. It could also be argued that consumers have become more accustomed to living with the virus and adjusting their shopping habits. This may lead to less fear around avoiding crowded shopping centres, especially given vaccines are now being rolled out. In addition, many businesses learnt how to adapt their operations in response to previous lockdowns and so may be faster to adapt to restrictions, helping minimise revenue losses.

On the other hand, a key downside risk is that the lockdown is dragged out in New South Wales and that we also see longer lockdowns around the rest of the country. The longer the lockdown, the bigger the hit to the economy. In addition, last year consumer spending was boosted by a strong pick up in spending on goods, as travel, entertainment and other service-oriented businesses were shut down. There was a lift in spending on household goods, as people decked out their home offices and purchased new TVs and other electrical goods. It could be the case that consumer spending benefits less from this substitution to goods from services this time around, given many households have already adapted to the shift in our lifestyles.

If nothing else, this outbreak is a reminder that we cannot afford to be complacent about the

vaccine rollout. So far, only around 5% of the population are fully vaccinated. On Monday evening, it was announced that adults of all ages – including under-40s not yet eligible for Pfizer – could request the AstraZeneca jab from GPs, marking a massive shift in the vaccination program. The possibility of lockdowns will remain a cloud over the economic outlook until we have made much more progress in immunising the population.

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