Unleashing the Caged Up Consumer

Our weekly view on asset allocation.

06 September 2021

Lockdowns Knock a Robust Recovery (Temporarily) off Course

The national accounts for the second quarter showed Australia's GDP rose 0.7% relative to the previous quarter. This was above the consensus expectation of a 0.4% rise.

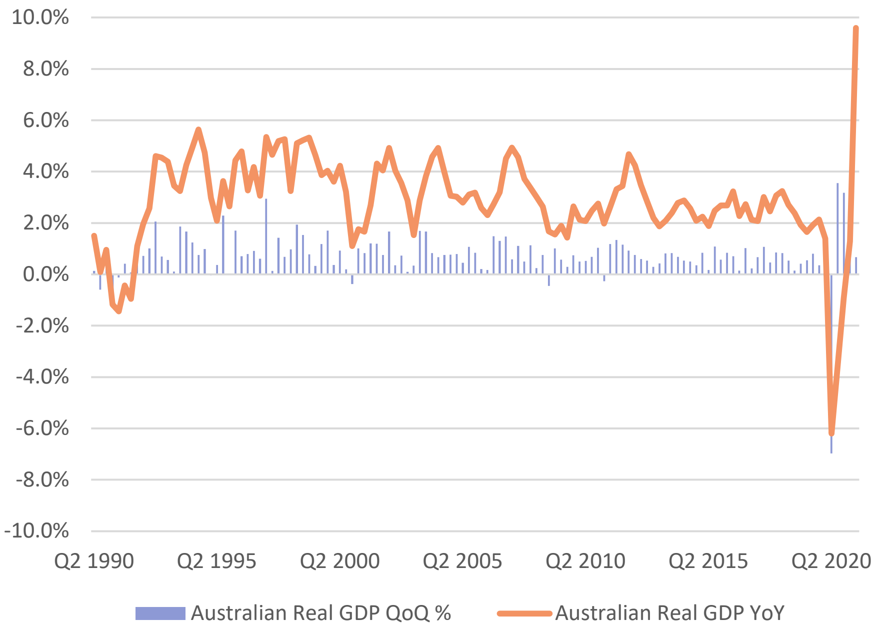
The year-on-year (YoY) pace rebounded to a record 9.6%, albeit this is based on a comparison to last year's deeply depressed second quarter.

As of the end of June, the Australian economy had recovered to be 1.6% above its pre-COVID peak (in Q419), positioning Australia among the best of the major economies (ex-China). At the sector level, spending on hospitality and transport services (includes air travel) stand out as being well below pre-COVID levels.

This solid Q2 result confirms the Australian economy's strong momentum heading into the current NSW and VIC lockdowns and suggests a strong rebound is in prospect once restrictions ease.

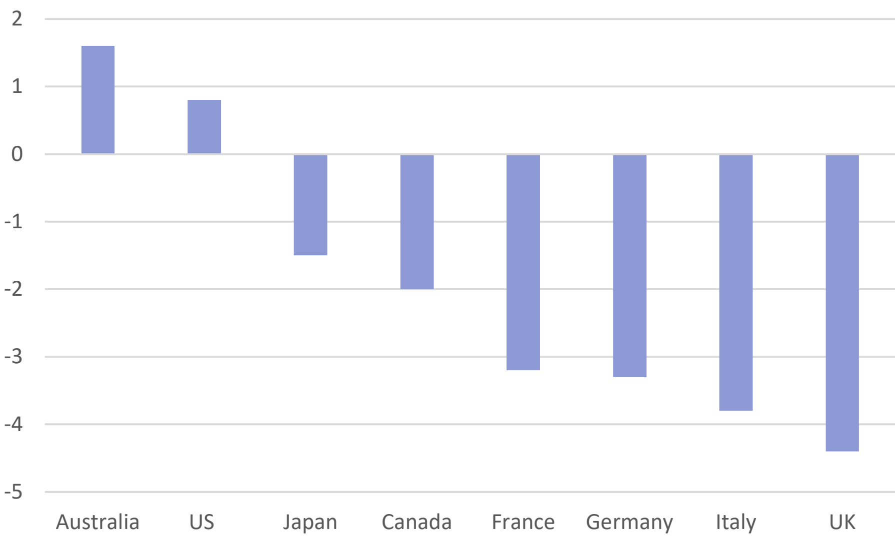
Of course, the current lockdowns will weigh heavily on the economy in the current third quarter, with market estimates putting the economic contraction at somewhere between 3% and 4.5%. In comparison, this is not as severe as the 7% contraction experienced in the Q2 national lockdown last year.

Exhibit 1: Australia had staged a dramatic economic comeback pre the recent lockdowns



Source: Refinitiv, Wilsons.

Exhibit 2: GDP (Q2) relative to pre-pandemic levels (%)



Source: Refinitiv, Wilsons.

Underlying Economic Strength Broad-Based but Consumer is the Key

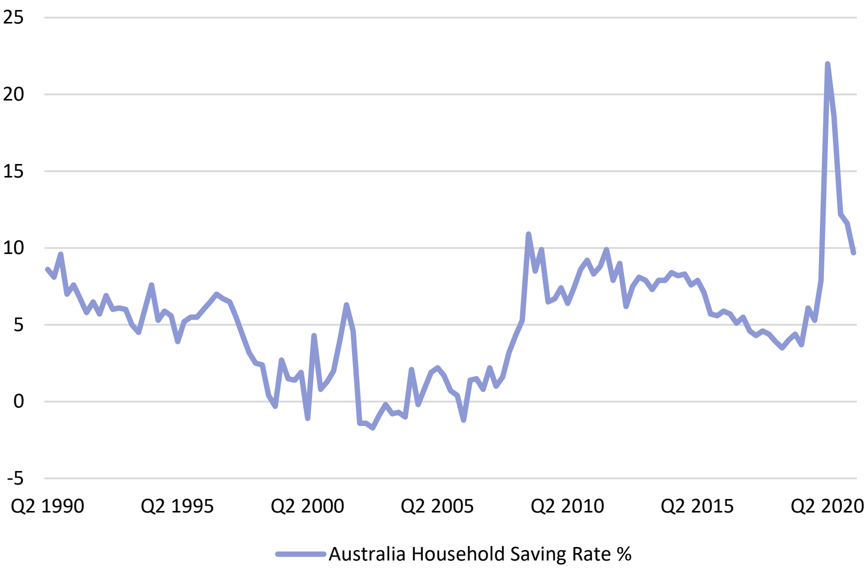
The pace of consumption moderated in Q2 to a still robust 1.1% quarter-on-quarter (QoQ). Discretionary spending continues to recover - however, this is off a low base. Overall real consumer spending was up 15.7% on the comparative period 12 months ago. Spending continued to be helped by a further decline in the savings rate (to 9.7%) as incomes fell on the back of stimulus tapering.

The Excess Savings War chest

While the household savings ratio edged down to 9.7%; it remains well above pre-COVID levels of 4-5%.
These "excess savings" of ~$300bn provide a powerful war chest to drive the economic reopening.

The huge pool of excess household savings should support a reopening-driven acceleration in growth beginning in Q4. This release of pent up demand will likely take several quarters to work through the economy, suggesting a strong growth outlook across 2022.

Exhibit 3: While the household savings rate has eased off its highs it is still well above pre-COVID levels



Source: Refinitiv, Wilsons.

Broad-Based Recovery on Show Pre-Lockdown

While a consumption acceleration remains key to the economy's revival, Q2 showed a broad-based growth pulse. Business investment increased across the board, particularly via engineering (3.0%Q) and machinery and equipment spending (2.4%Q).

The housing construction expansion slowed to 1.7% QoQ but still ended 15.7% YoY growth.

Government spending was also a strong contributor, primarily through infrastructure spending, which increased 4.7% (YoY).

Interestingly, a major headwind to the real growth rate in the quarter was trade, with exports (volumes) declining -3.2%, which, when combined with solid import growth (1.5%Q), saw net exports subtracting -1.0 from GDP.

However, factoring in the large commodity price gains seen over both the quarter and YoY saw nominal GDP rise at the fastest pace since 1981!

Big Growth Hit in Q3 but Sharp Rebound Should Begin before Year-End

While Q2 GDP is ancient history in respect of our current locked down economy, Australia has avoided the "technical" negative print some expected and beaten the average expectation quite significantly.

Looking ahead, the focus will continue to be the pace of the vaccine rollout and the path of economic reopening. NSW is likely to hit the 70% vaccination target in mid-October, with the 80% achieved in early November. VIC looks set to hit the same reopening milestones in early and mid-November.

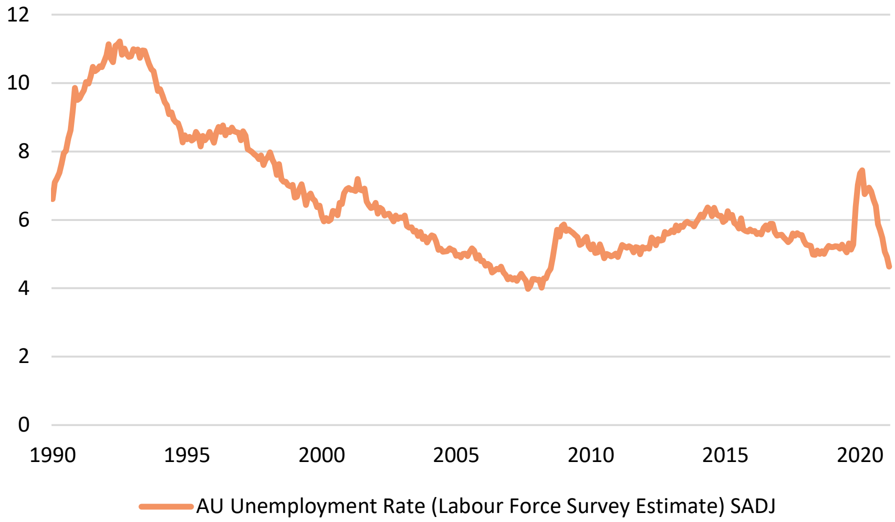
With the lockdowns hitting the economy by ~$2bn/week and fiscal support now costing ~$2bn+, we expect the RBA's September 7th meeting to delay QE tapering and keep buying bonds at the current $5bn/week.

Upcoming labour market data will be closely watched to gauge the extent of lockdown damage. The July labour market figures were surprisingly resilient; however, the survey period covered the period from early to mid-July, so the August number due later this month will give a better picture of the impact of lockdowns on the labour market.

In the national lockdowns of Q2 last year, unemployment rose from 5% to 7.5%, with the JobKeeper program keeping unemployment contained. The true rate of unemployment likely topped 10%, but JobKeeper kept many workers working zero hours connected with their employer and facilitated a rapid bounce back once lockdowns were lifted.

While JobKeeper has not been restarted, support has been significant. Even more importantly, with the prospect of reopening across October/November, we expect unemployment to stay below last year's peak.

Exhibit 4: Unemployment will likely rise short-term but remain below last year's peak



Source: Refinitiv, Wilsons.

Sharemarket Looking through Lockdown Gloom

The local sharemarket has clearly "looked through" the Q3 lockdown dislocation, with the market managing to rise 3% since the beginning of the NSW lockdown in late June.

This is likely a function of a number of factors:

- The expected "short" nature of the NSW and VIC lockdowns
- The relative insulation of many large listed companies from lockdown pressures relative to small and medium-sized businesses
- The continued positive lead from offshore markets (global shares are up 4% over the lockdown period)

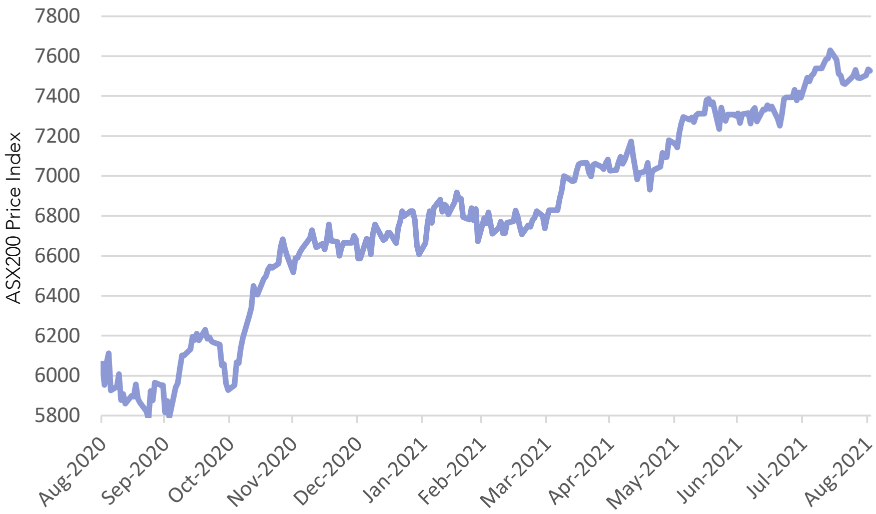
The A$ and the local bond market appear to have been impacted more by the lockdown, though there are some tentative signs that they are beginning to focus on a recovery (the A$ is up more than 2 cents from its lows in the last couple of weeks). We see both A$ and bond yields moving higher alongside a higher sharemarket over the coming 6-12 months. Internal sharemarket rotation is also showing renewed interest in COVID recovery plays after a couple of months of underperformance.

Australian House Prices Booming Despite Lockdowns

The other interesting piece of data released alongside the GDP statistics was the latest data on house prices. Prices lifted another 1.8% which takes growth to an astonishing 18% YoY. This is the strongest YoY growth since 1989. Sales volumes collapsed by ~40% month-on-month (MoM) and ~40% YoY. However, this has done little at this stage to dent the extraordinary house price gains of the past year.

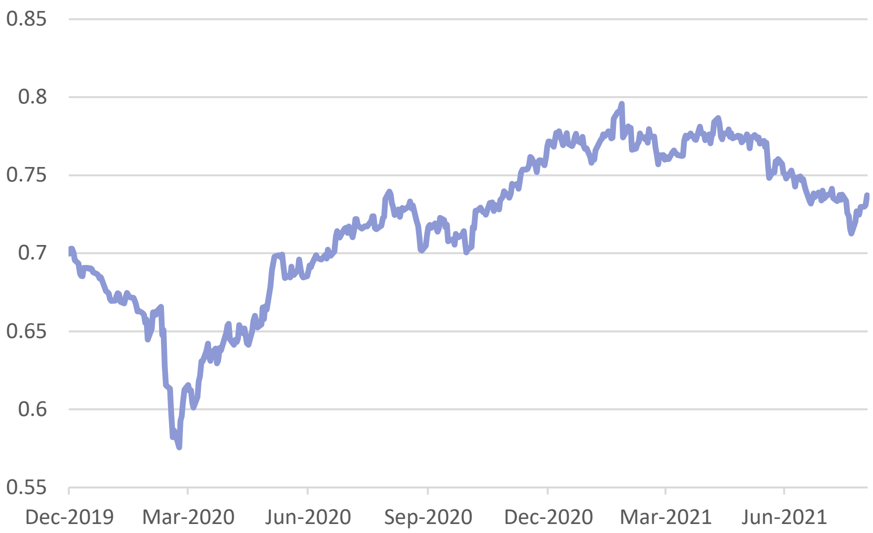
The RBA and APRA will certainly be hoping for further moderation in price gains even as the economy reopens. Policymakers may be, to some extent, thankful for the resilience of housing in the face of a contracting economy. Still, a lack of moderation in gains from here would pose a significant policy dilemma for the RBA and APRA.

Exhibit 5: Australian equities are looking through the current state lockdowns



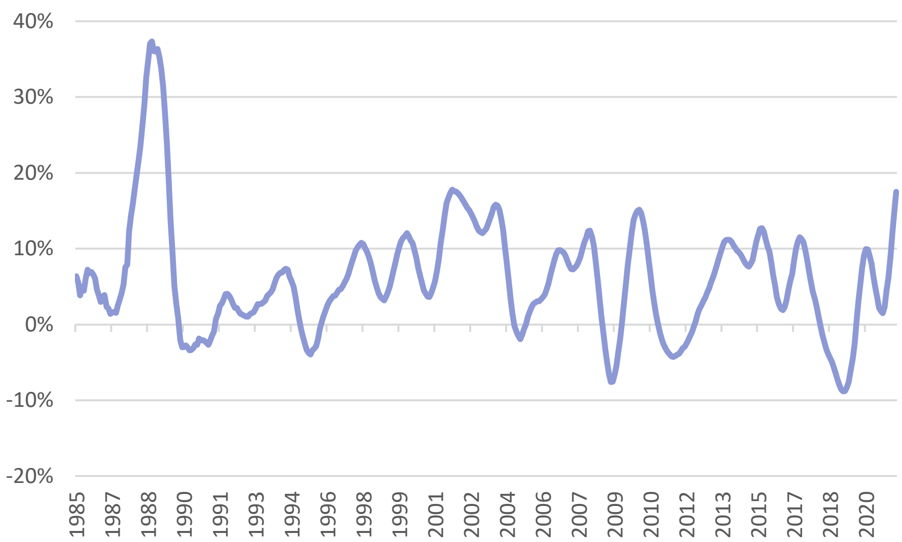
Source: Refinitiv, Wilsons.

Exhibit 6: The A$ has lost ground in the lockdown phase but is starting to rally



Source: Refinitiv, Wilsons.

Exhibit 7: Annual national house price gains are now the highest Since 1989



Source: Refinitiv, Wilsons.

The Tricky Politics of Border Reopening

While 70-80% vaccination rates form a road map to reopening, almost any plausible coverage ratio will still involve a significant rise in community transmission and hospitalisations. So, community and political risk tolerances will need to shift significantly in coming months, particularly in the COVID-free states. While prolonged border closures will not significantly constrain the prospect of a sharp national economic bounce in Q4 and early 2022, it does set the stage for a highly charged political debate over the next few months

Growth Prospects Boosted by Bumper Savings Rate

The healthy GDP Q2 statistics show the economy went into lockdown with broad-based momentum. While this will not prevent a sharp contraction in Q3, the consumer savings war chest will likely ensure a relatively strong rebound in growth as soon as the NSW and VIC economies are allowed to reopen. This (all things equal) should be supportive for both the A$ and the sharemarket, with reopening beneficiaries likely coming back into focus.

Disclaimer and Disclosures

Recommendation structure and other definitions

Definitions at www.wilsonsadvisory.com.au/disclosures.

Disclaimer

All figures and data presented in this research are accurate at the date of the report, unless otherwise stated.

Wilsons Australian Equity Focus List (Focus List) is a weighted list of the Investment Strategy Group's (ISG) preferred companies. The Focus List can hold up to 25 companies, largely taken from the S&P/ASX 300. Stocks may be substituted at any time at the discretion of the ISG. Performance numbers around the Focus List are unaudited, and should be used only as a guide to indicate returns if investors were to follow the Focus List. For further information please contact your Wilsons Advisor.

This document has been prepared by Wilsons Advisory and Stockbroking Limited (AFSL 238375, ABN 68 010 529 665) ("Wilsons") and its authors without consultation with any third parties, nor is Wilsons authorised to provide any information or make any representation or warranty on behalf of such parties. Any opinions contained in this document are subject to change and do not necessarily reflect the views of Wilsons. This document has not been prepared or reviewed by Wilsons' Research Department and does not constitute investment research. Wilsons makes no representation or warranty, express or implied, as to the accuracy or completeness of the information and opinions contained therein, and no reliance should be placed on this document in making any investment decision Any projections contained in this communication are estimates only. Such projections are subject to market influences and contingent upon matters outside the control of Wilsons and therefore may not be realised in the future. Past performance is not an indication of future performance.

In preparing the information in this document Wilsons did not take into consideration the investment objectives, financial situation or particular needs of any particular investor. Any advice contained in this document is general advice only. Before making any investment decision, you should consider your own investment needs and objectives and should seek financial advice. You should consider the Product Disclosure Statement or prospectus in deciding whether to acquire a product. The Product Disclosure Statement or Prospectus is available through your financial adviser.

Wilsons Corporate Finance Limited ACN 057 547 323, AFSL 238 383 acted as Co-Manager in the November 2019 placement EML Payments Ltd securities for which it received fees or will receive fees for acting in this capacity. Wilsons Advisory and Stockbroking Limited may have a conflict of interest which investors should consider before making an investment decision. Wilsons Advisory and Stockbroking Limited, Wilsons Corporate Finance Limited and its related bodies corporate trades or may trade as principal in the securities that are subject of the research report.

Wilsons contact

david.cassidy@wilsonsadvisory.com.au | +61 2 8247 3149

john.lockton@wilsonsadvisory.com.au | +61 2 8247 3118

rob.crookston@wilsonsadvisory.com.au | +61 2 8247 3101

www.wilsonsadvisory.com.au