

Australian outlook

Sydney outbreak to drive a sharper slowdown

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- ◆ Our forecasts already incorporated a marked slowdown in growth, from the recent rapid growth rates, in 2H21 and 2022
- ◆ We now expect the Sydney outbreak to see growth stall in 2H21, before picking up in 2022 as vaccination rates rise
- ◆ We lower our GDP growth forecasts for 2021 to 4.5% (from 5.1%) and for 2022 to 2.4% (from 2.8%)

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Another outbreak... and Delta could be different

An outbreak of the Delta variant has put Greater Sydney into lockdown from 26 June. The latest guidance from the authorities suggest it will be 'at least' five weeks in total, but the risk is that it is longer. As a point of comparison, the lockdown in Victoria in 2H20, which was more stringent and dealing with a less transmissible strain of the virus, was in place for 16 weeks, in order to drive the case numbers back to zero.

NSW Treasury estimates that every week of lockdown reduces GDP by AUD850m. On these estimates a six-week lockdown would knock 0.25% off annual GDP (1.0% off quarterly), while a 16-week lockdown would knock 0.7% off annual GDP. There is some risk that the lockdown will not get the case numbers back to zero, given the rapid transmission of the Delta variant. In this case, Sydney could be in some form of lockdown until vaccination rates are near herd immunity levels, which is unlikely until March 2022, at the earliest.

Other states have mostly closed their borders to Greater Sydney, and there has been some early spread of the outbreak to Victoria, which has seen that state announce a 5-day lockdown from 16 July. There are a small number of cases in Queensland but the remaining states and territories have no community transmissions at this stage.

Policymakers have delivered fiscal support measures for affected households and businesses, but on a smaller scale than the large earlier COVID-19 fiscal programmes.

Even before the Sydney outbreak we had expected Australia's growth to slow from its recent rapid growth rates, as population growth has stalled due to the closed border and as the fiscal impulse fades. After growth averaged 2.8% q-o-q a quarter in the three quarters to 1Q21, we had forecast it to slow to 0.6-0.7% q-o-q a quarter.

We now assume the Greater Sydney lockdown will see q-o-q GDP contract by -0.3% in 3Q21 and rise by only 0.3% in 4Q21, before bouncing back in 2022. The other headwinds to growth in 2022, including the only slowly re-opening border and tensions with China, are expected to remain.

This is an abridged version of a report of the same title published on 16 July 2021. Please contact your HSBC representative or email AskResearch@hsbc.com for more information.

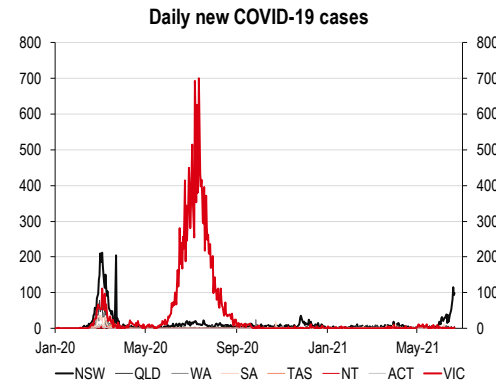
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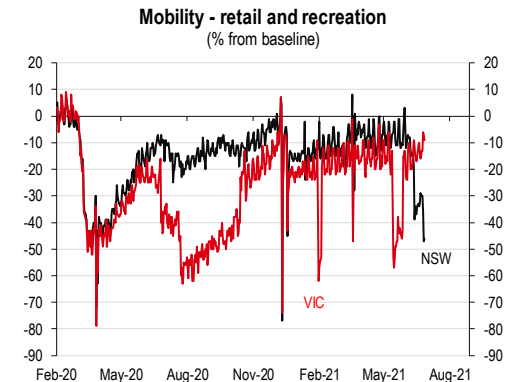
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1. COVID-19 cases in NSW have been increasing rapidly...



Source: Our World in Data, Covidlive.com.au; HSBC

2. ...with the 'Delta' variant moving faster than NSW lockdown restrictions



Source: Google, HSBC

The COVID-19 'Delta' variant...

The COVID-19 virus has undergone mutations since the initial stages of the pandemic Australia grappled with last year. The current 'Delta' strain is more contagious than the original, with the WHO calling it "the fastest and fittest" – The Delta variant is spreading 50% faster than the Alpha, variant, which was 50% more contagious than the original strain of SARS-CoV-2. It is estimated that the average person infected with the original coronavirus strain will infect 2.5 other people, while the Delta variant would spread from one person to 3.5 or 4 other people (*Yale Medicine*, 2021). While Australia's closed international border, hotel quarantine system, contact tracing, and lockdown measures worked well in the face of the original pandemic, the Delta variant presents a greater challenge.

The Delta variant is different and may be much harder to eliminate

...is spreading in the Greater Sydney region

The latest COVID-19 outbreak in Australia originated in Sydney's Bondi area on 17 June. Since then, NSW has recorded 925 cases (Chart 1, as at 14 July). Australia has recorded a total of 1,140 cases over the same period, with an emerging linked cluster in Victoria.

The main concern for authorities is the number of unlinked COVID-19 cases (that is, those with an unidentified source of transmission), and cases that have been in the community while infectious. Since the start of July, NSW has recorded 186 unlinked COVID-19 cases, and 198 cases who were infectious while in the community.

To combat the spread, the NSW government has implemented lockdown measures. These measures are similar to ones implemented at the peak of the pandemic in 2020, and those in Melbourne's outbreaks (Chart 2). According to Google mobility data, mobility has been limited similar to Victoria's previous lockdowns. The restrictions include stay at home rules, where a citizen can only leave their home for 'essential' reasons, such as food, exercise, and essential work.

Australia's vaccine rollout is now front and centre...

A key challenge is that Australia has had a slow COVID-19 vaccine rollout, by global standards. Only around 10% of the population has been fully vaccinated. The current bulk of the vaccine supply is also the AstraZeneca vaccine, making up around 77% of the weekly vaccine doses available (2.2m doses per week in July). The government has emphasised the Pfizer vaccine is preferred for under 60 year olds, but at 22% of available doses (650k) supply is still limited.

The outbreak in Greater Sydney has led to a lockdown

The vaccine rollout has been slow in Australia

Pfizer is due to ramp up to 930k doses per week in September (49%), and 1.7m doses per week from October (80%).

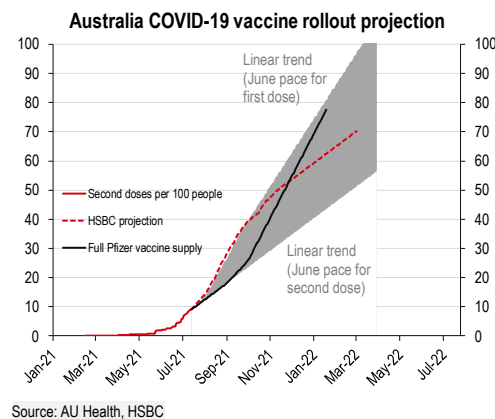
HSBC's expectation is that herd immunity will not be reached until 1Q22 (Chart 3).

We forecast herd immunity of around 70% coverage will not be reached until March 2022

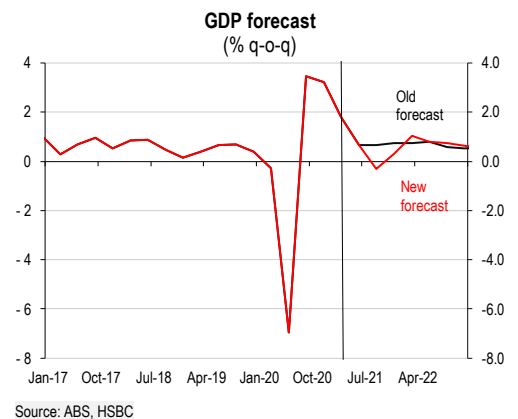
Our projections assume that vaccine rollout increases from its June pace of around 0.18% of the population fully vaccinated each day, to 0.3% of the population, which is more in line with the increased pace of initial vaccinations underway. From October, we factor in some slowdown in pace by applying the trend seen in the United States for the vaccine rollout once it hits around 50% of the population. There is large uncertainty here, with a downside risk of slow vaccine supply, but an upside risk of a renewed push from the government for citizens to get vaccinated.

Given the vaccine delivery timeline and current pace, there is a risk that Sydney could see some form of lockdown maintained until herd immunity is reached.

3. Herd immunity is projected to be reached in 1Q22



4. The current outbreak means we lower our GDP forecast



...with a hit to GDP growth in 2H21

NSW Treasury estimates that every week of lockdown reduces GDP by AUD850m. With Australia's annual GDP currently around AUD1931bn, each week of lockdown would reduce annual GDP by 0.04%. A six-week lockdown would reduce annual GDP by 0.25%, or, over 3Q21, a 1% reduction in quarterly GDP. These same estimates would suggest a 16-week lockdown, therefore, would be 0.7% off annual GDP, or 2.8% off in the quarter. Of course, there is considerable uncertainty with estimates such as these and a risk that a longer lockdown does more permanent damage, such as through increased business failures.

We see GDP contracting in 3Q21 as a result of the Sydney outbreak

Using these estimates as a guide, we lower our GDP forecasts. After growth averaged 2.8% q-o-q a quarter in the three quarters to 1Q21, we had expected it to slow to 0.6-0.7% q-o-q a quarter. Now, we are now assuming the Greater Sydney lockdown will see q-o-q GDP contract by -0.3% in 3Q21 and rise by only 0.3% in 4Q21, before bouncing back in 2022. Essentially, we expect this reduction to come through household consumption, particularly in services.

The labour market is also likely to be negatively affected over 3Q21. Around 22% of national employment is in Sydney, and employment is likely to reduce while the lockdown persists. The fiscal support (outlined below) should help keep some people in jobs, but not to the same extent as 'JobKeeper'. We expect the unemployment rate to rise in 3Q21, after having fallen in recent quarters. Although the fall in employment would typically lead to an even higher unemployment rate, we assume that the participation rate declines temporarily as workers would be unable to look for new jobs during the lockdown.

Fiscal support package

In response to the outbreak and lockdown, both the NSW State government and Federal government have announced various support packages for businesses and individuals. The Commonwealth and NSW government will split the cost of the support package equally. The targeted fiscal support does offer some support to 3Q21 GDP, but we expect the effects of the lockdown to still be felt. The fiscal package includes:

Payments to individuals

AUD600 per week will be provided for individuals losing more than 20 hours of employment per week, increased slightly from the AUD500 per week provided in Melbourne in May and June, and for the first three weeks of the Sydney lockdown.

AUD375 per week will also be provided for individuals who lose 8 to 20 hours per week, up from AUD325 per week provided in Melbourne and the first three weeks of Sydney lockdown, with the liquid assets test (previously you were unable to get the payments if you had enough liquid assets) being removed.

Compared to the government's ongoing 'JobSeeker' support, this financial assistance is almost double. Compared to the government's 'JobKeeper' programme, the payments are relatively similar, with 'JobKeeper' offering AUD600 per week for employees who work more than 20 hours, and AUD375 per week for employees who work less than 20 hours (although this dropped to AUD500 and AUD325, respectively, from January 2021 until the programme ended in March 2021).

Support for businesses

A maximum of AUD10,000 per week will be provided to businesses, with turnover between AUD75k and AUD50m, suffering a 30% decline in annual turnover (relative to pre-pandemic), on the condition that no employees are laid off.

Sole traders will be eligible for AUD1,000 per week.

RBA to remain dovish

We have long been of the view that the RBA will remain dovish as it faces a significant challenge getting inflation back to target.

We maintain our view that the RBA will keep its cash rate steady at 0.10% in 2021 and 2022, and maintain its 0.10% target on April 2024 three-year bonds. We expect the QE programme to continue beyond September. The RBA announced in early July that it was set to taper its bond purchases from AUD5bn a week to AUD4bn a week from late September. The sharper-than-expected slowdown in growth, as a result of the Greater Sydney outbreak, raises the risk that the RBA decides not to taper after all.

Fiscal support has been announced, but it is smaller in scale than the earlier programmes

We see the RBA remaining dovish

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