

COVID-19 AND ITS IMPACT ON THE GLOBAL AND AUSTRALIAN ECONOMIES

ONLINE PRESENTATION ON WWW.SAUL-ESLAKE.COM

29TH JULY 2020

SAUL ESLAKE
CORINNA ECONOMIC ADVISORY PTY LTD

Agenda

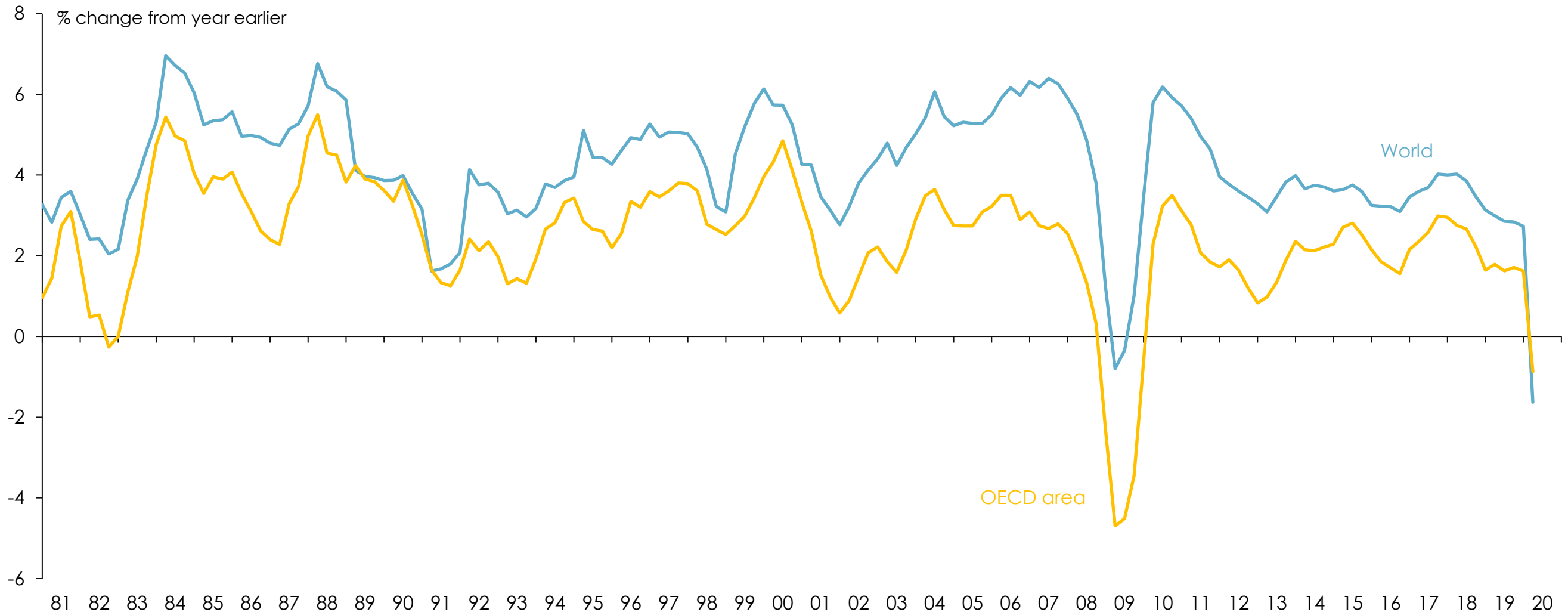
- ❑ The world economy
- ❑ The Australian economy
- ❑ The problem with Victoria
- ❑ The Australian policy response
- ❑ The outlook for the Australian economy

Note: nothing in what follows constitutes investment advice, nor should it be construed as such!

The world

The world economy experienced its sharpest year-on-year contraction for at least 40 years in Q1 this year – with worse to come in Q2

World and OECD area real GDP growth



Note: Estimates of global GDP growth compiled by Corinna using data for 95 countries accounting for 90% of 2018 world GDP as measured by the IMF; excludes constituents of the former USSR before 1993, the former Czechoslovakia before 1995, and the former Yugoslavia before 1998.
Sources: national statistical agencies and central banks; Eurostat; OECD; IMF.

All of the major international economic forecasting institutions expect 2020 to be the worst year for global growth since the 1930s

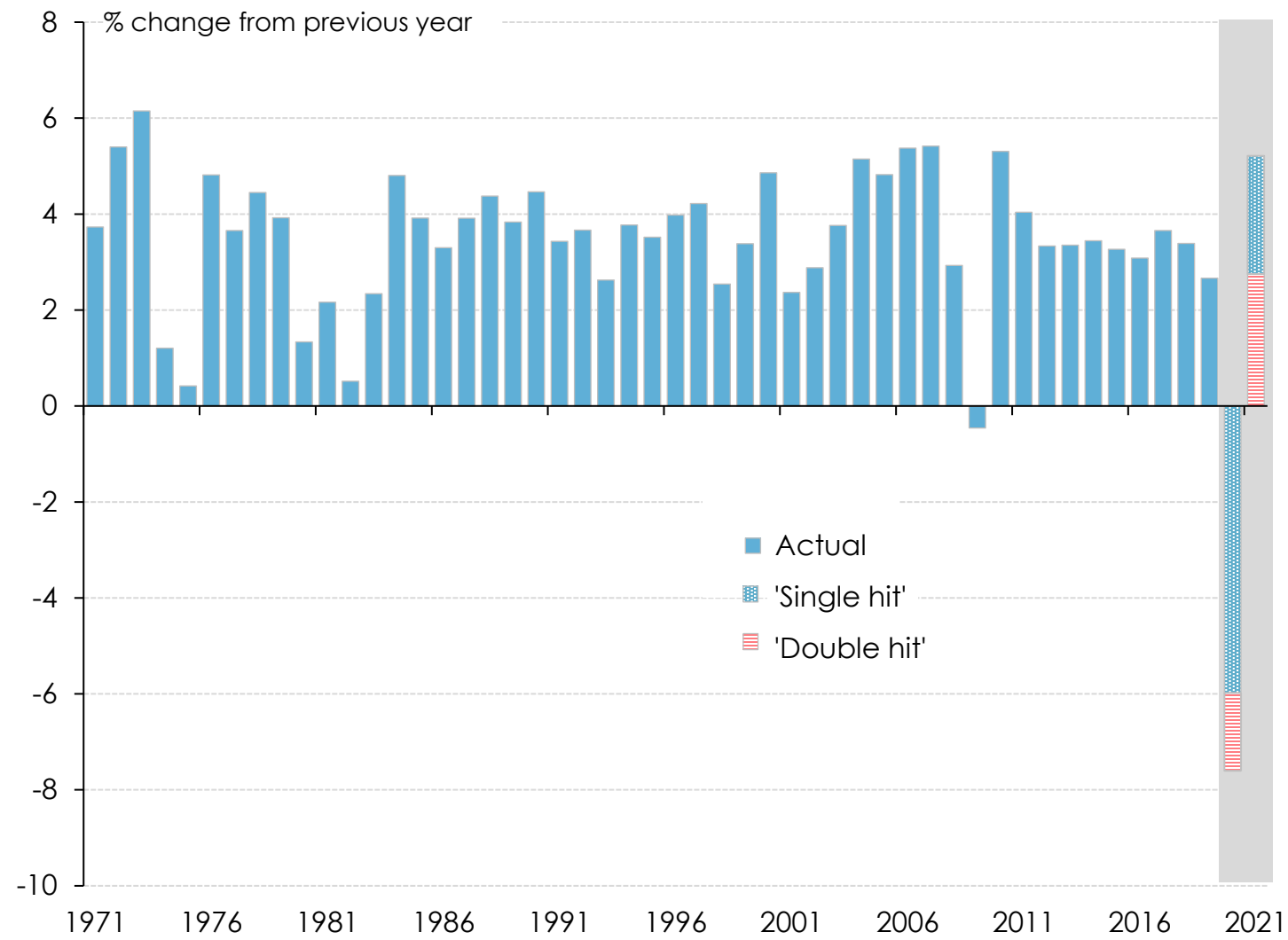
Major global institutions' growth forecasts for 2020 and 2021 compared

	<i>Actual</i>	<i>IMF</i>		<i>World Bank</i>		<i>OECD*</i>		<i>Australian Treasury</i>	
	2019	2020	2021	2020	2021	2020	2021	2020	2021
US	2.3	-6.1	4.5	-6.1	4.0	-7.3	4.1	-8.0	4.8
China	6.1	1.2	9.2	1.0	6.9	-2.6	6.8	1.8	8.3
Euro area	1.2	-7.5	4.7	-9.1	4.5	-9.1	6.5	-8.8	5.0
India	4.2	1.9	7.4	-3.2	3.1	-3.7	7.9	-4.0	4.3
Japan	0.7	-5.2	3.0	-6.1	2.5	-6.0	2.1	-6.3	2.8
UK	1.4	-6.5	4.0	na	na	-11.5	9.0	na	na
Australia	1.8	-6.7	7.1	na	na	-5.0	4.1	-3.8	2.5
New Zealand	2.2	-7.2 [†]	5.9 [†]	na	na	-8.9	6.6	na	na
World	2.9	-3.0	5.8	-5.2	4.2	-6.0	5.2	-4.8	5.0
World trade	0.9	-11.0	8.4	-13.4	5.3	-9.5	6.0	na	na

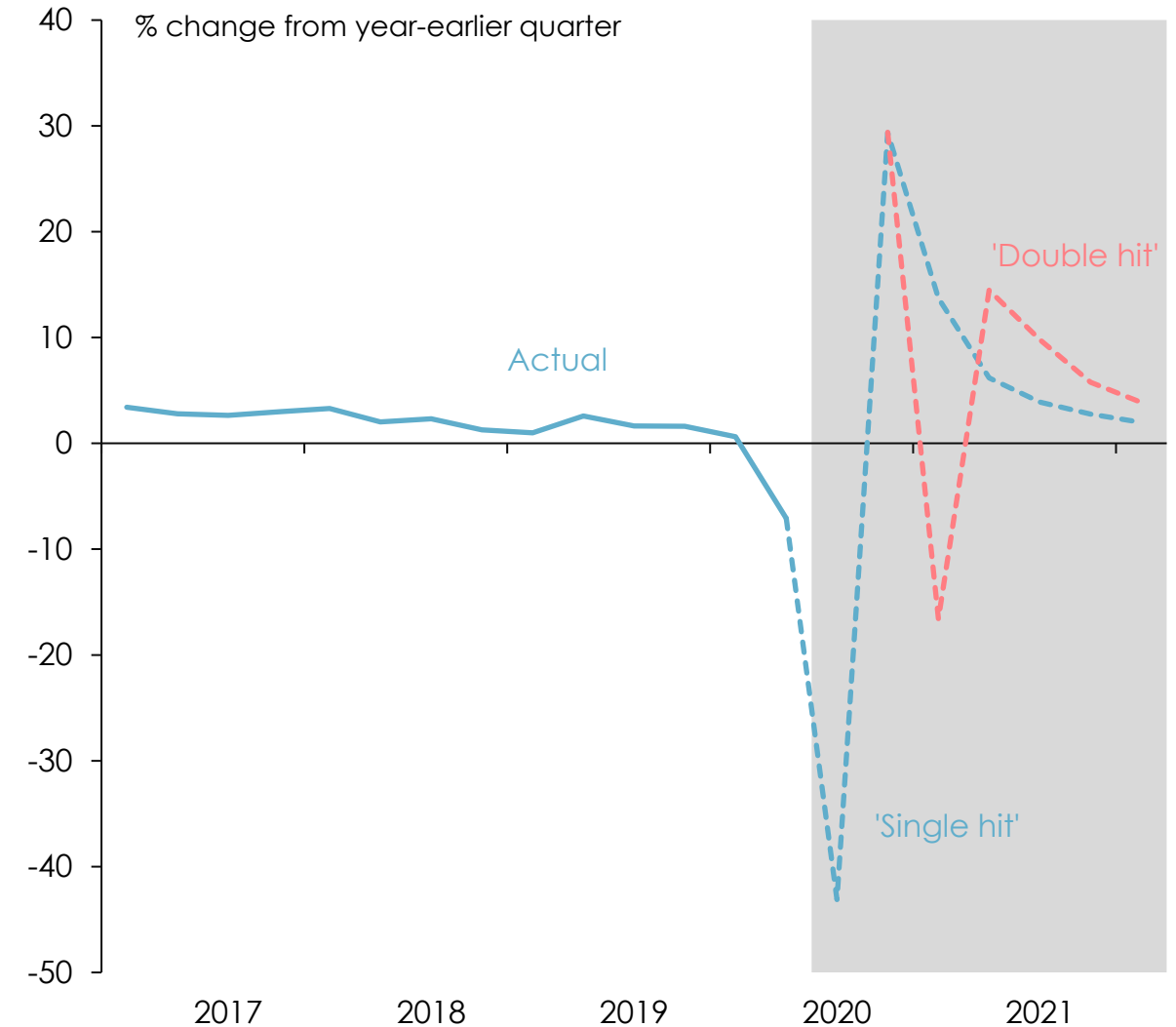
* OECD forecasts are their 'single hit' scenario to be consistent with the assumptions of the other institutions. [†] The IMF did not publish revised forecasts for New Zealand in its latest WEO publication. Sources: International Monetary Fund (IMF), *World Economic Outlook*, 24th June 2020; The World Bank, *Global Economic Prospects*, 8th June 2020; Organization for Economic Co-operation & Development (OECD), *Economic Outlook*, Volume 2020 Issue 1, 10th June 2020; Australian Treasury, *Economic and Fiscal Update*, 23rd July 2020.

The OECD forecasts a 6% decline in world GDP this year, followed by a 5.2% rebound in 2021 – or -7.2% followed by +2.8% if there's a 'second wave'

Annual growth in global real GDP, 1961-2021



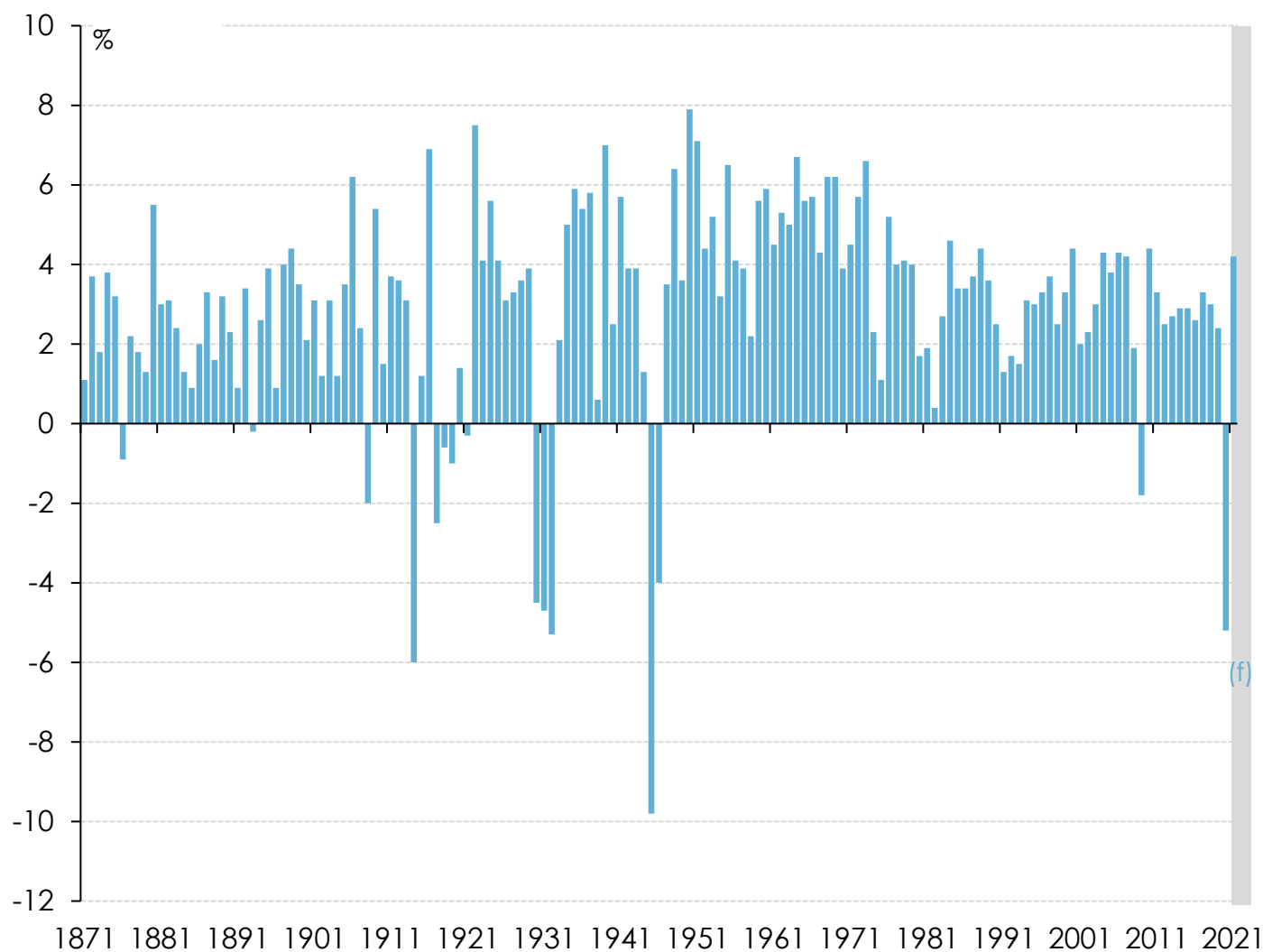
Quarterly growth and forecasts, 2017-2021



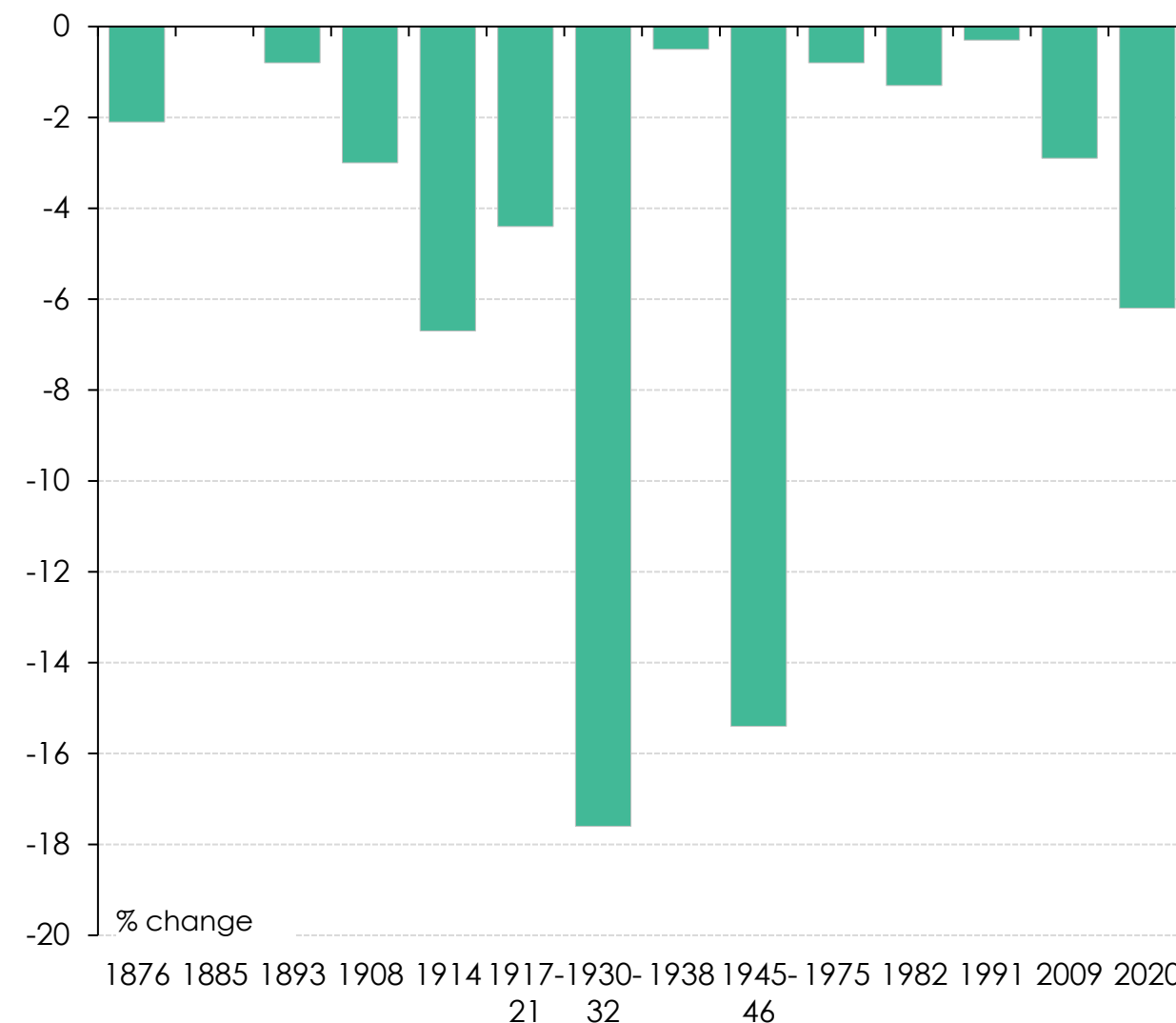
Note: The 'double hit' scenario assumes a 'second wave' of Covid-19 infections and deaths "in all economies towards the end of this year", while the 'single hit' scenario assumes this 'second wave is avoided'. The OECD regards each scenario as "equally likely". Source: OECD, *Economic Outlook*, No. 107, Volume 2020 Issue 1, 10th June 2020.

The World Bank forecasts a 5.2% decline in world GDP this year, with a 4.2% increase in 2021 - the 4th worst global downturn in 150 years

Growth in global real GDP, 1871-2001



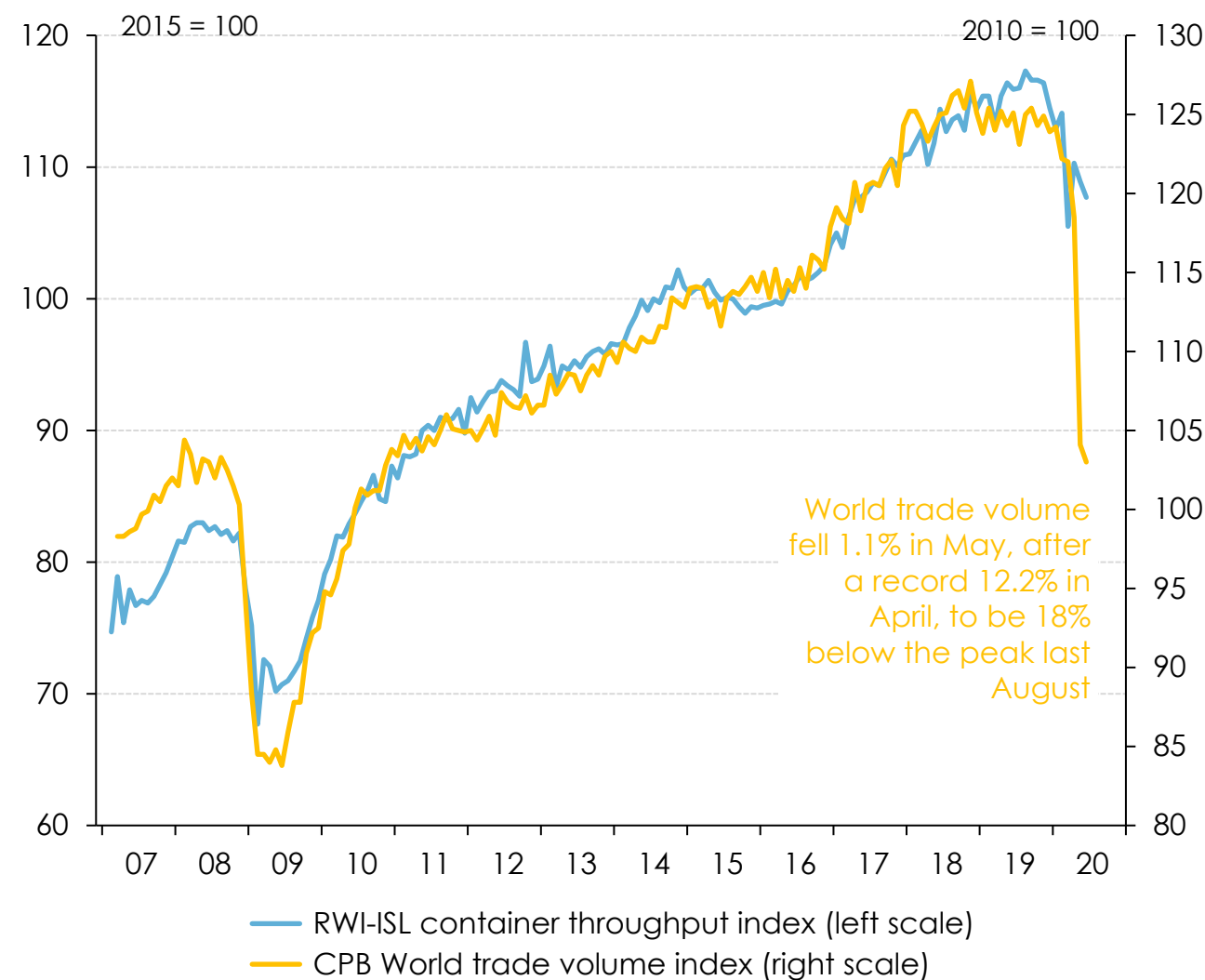
Cumulative decline in real per capita GDP during global recessions



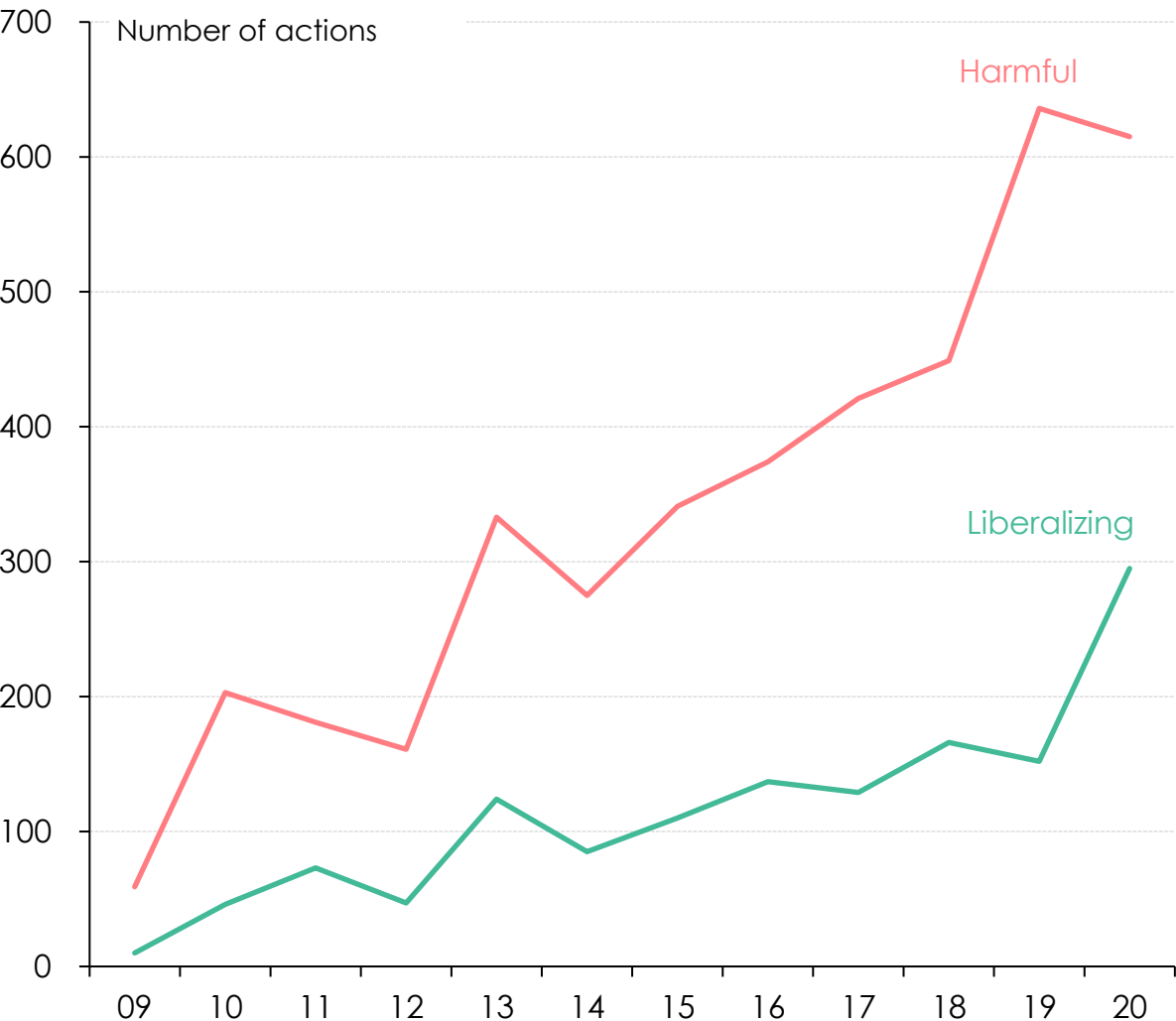
Source: The World Bank, *Global Economic Prospects*, 8th June 2020.

World merchandise trade volumes fell sharply in April

World trade volumes and container throughput



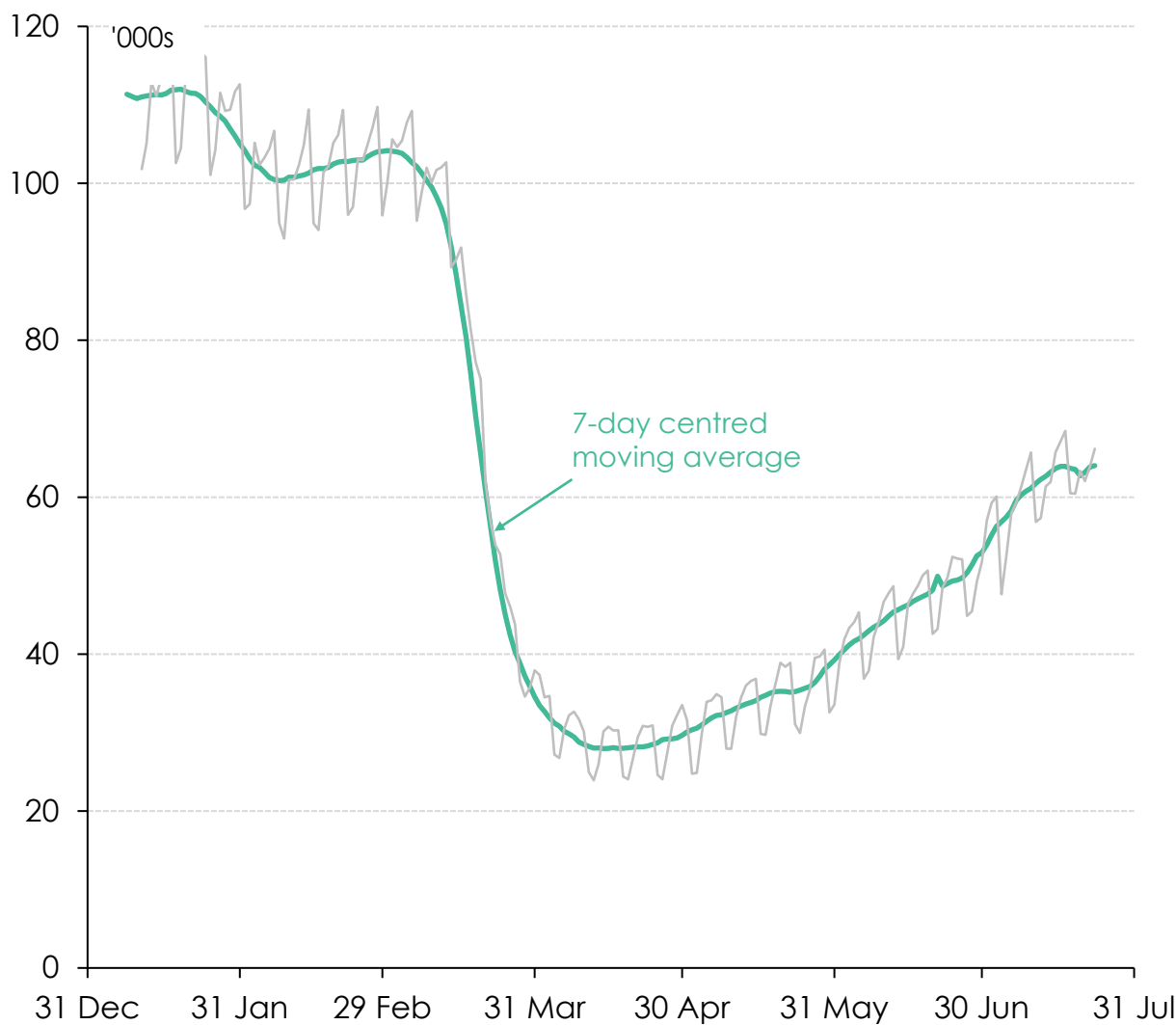
Pro- and anti-trade policy interventions



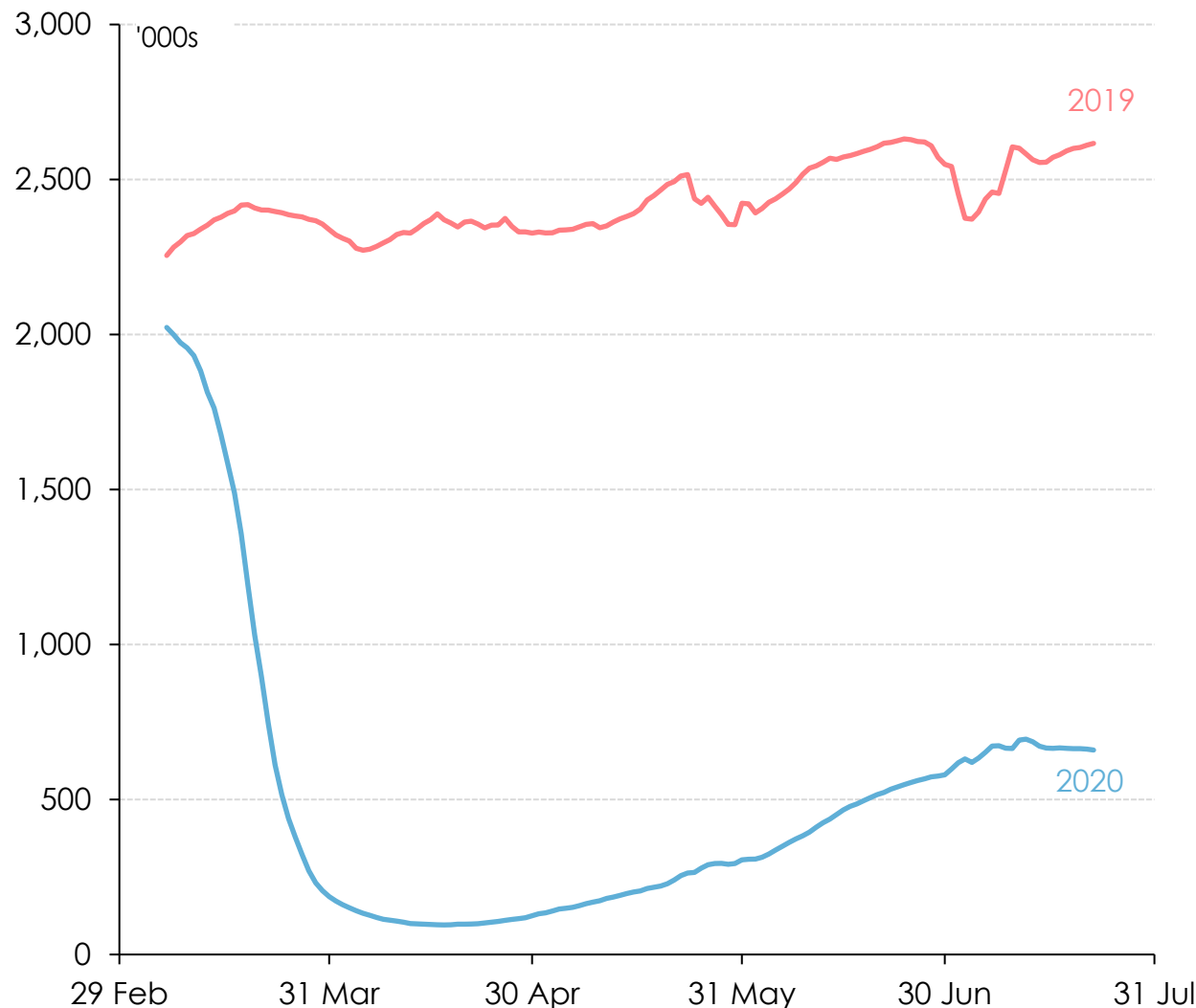
Note: The shipping container throughput index is based on reports from 91 ports around the world handling over 60% of global container shipping.
Sources: CPB Netherlands Economic Planning Bureau, *World Trade Monitor*; Institute of Shipping Economics & Logistics (ISL) and RWI Leibniz-Institut für Wirtschaftsforschung (RWI) *Container Throughput Index*; Global Trade Alert *Global Dynamics* (latest report 16th July).

The slow upturn in aviation seems to have levelled out – at 38% below pre-pandemic levels globally, and 75% below year-earlier levels in the US

Daily commercial flights worldwide



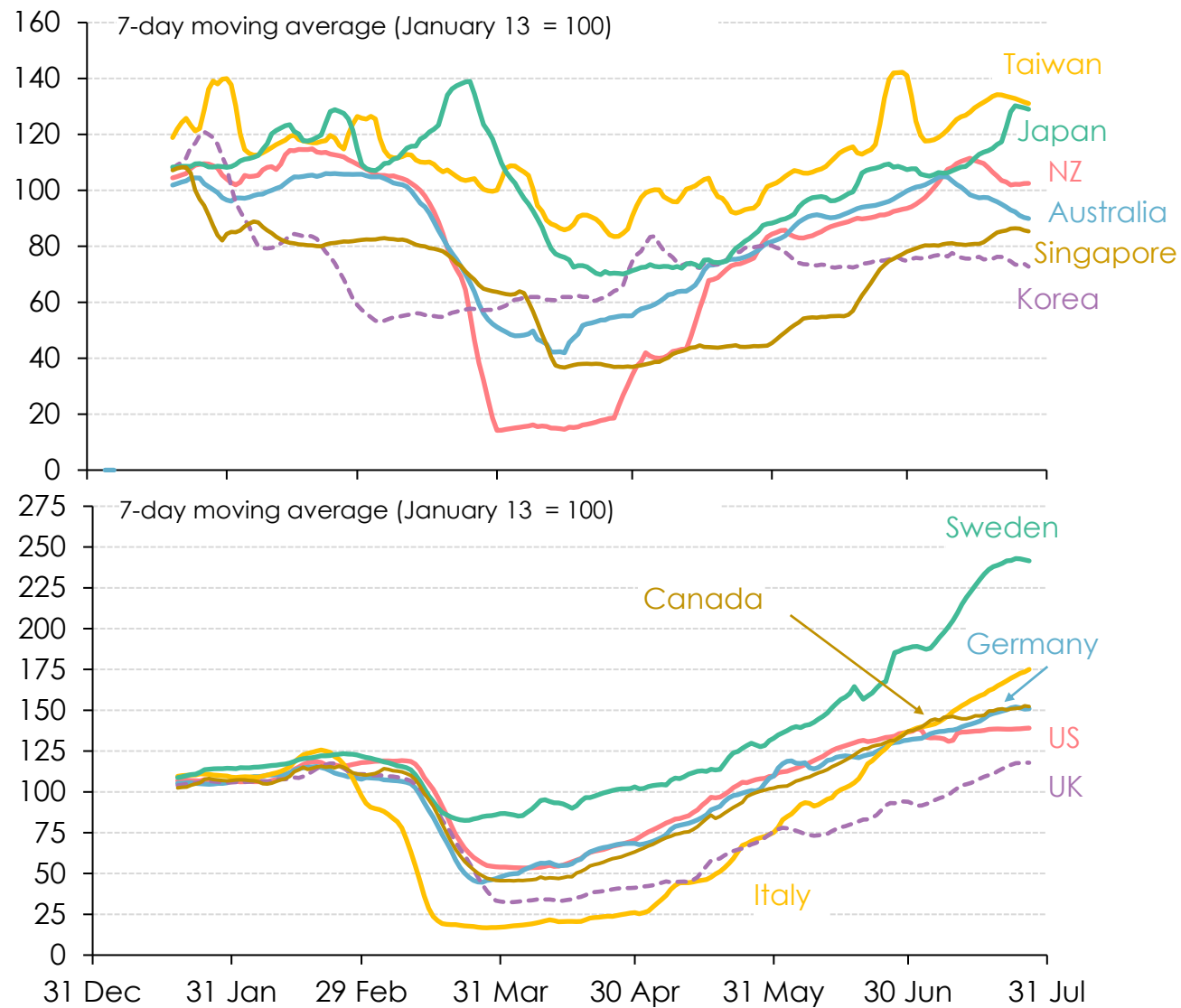
Daily US TSA security checks



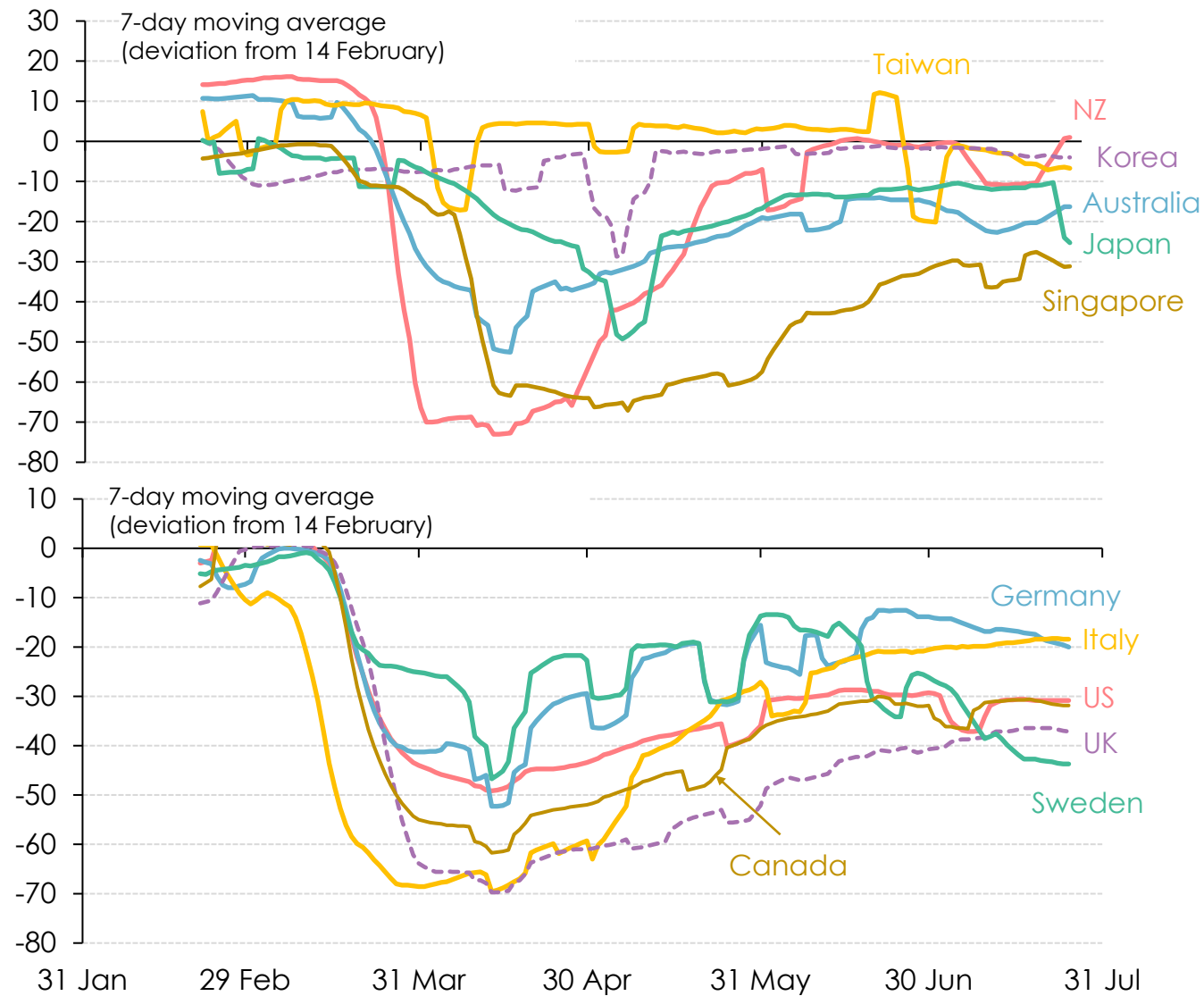
Note: Commercial flights include commercial passenger flights, cargo flights, charter flights, and some business jet flights. Data up to 23rd July.
Sources: Flightradar24.com; US Transport Safety Administration (at last, something useful produced by aviation 'security'!!!)

Mobility data suggest that much of Asia is continuing to return toward more normal levels of activity, but the US and Europe may be stalling

Time spent driving

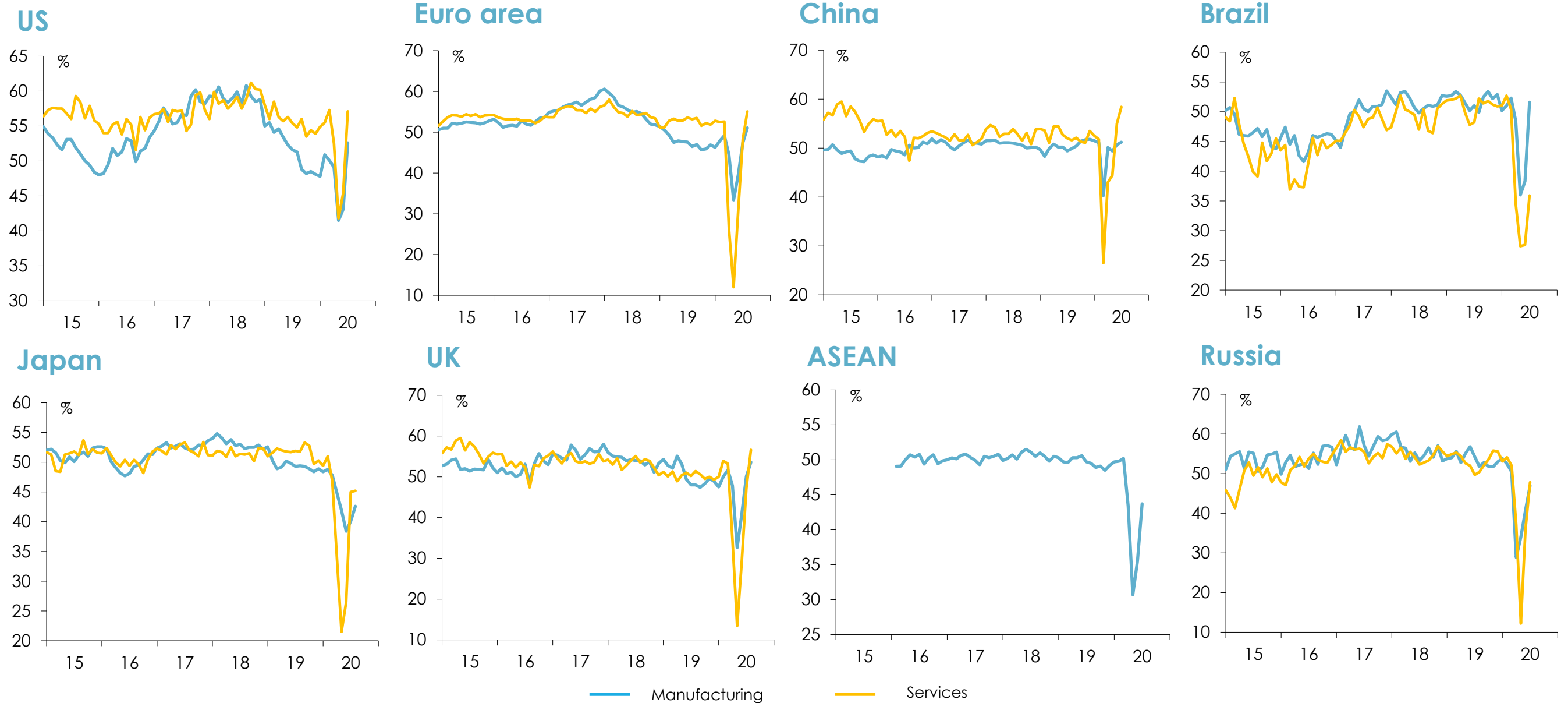


Time spent in work places



Sources: Apple Mobility Trends Reports (data up to 27th July); Google Covid-19 Community Mobility Reports (data up to 25th July).

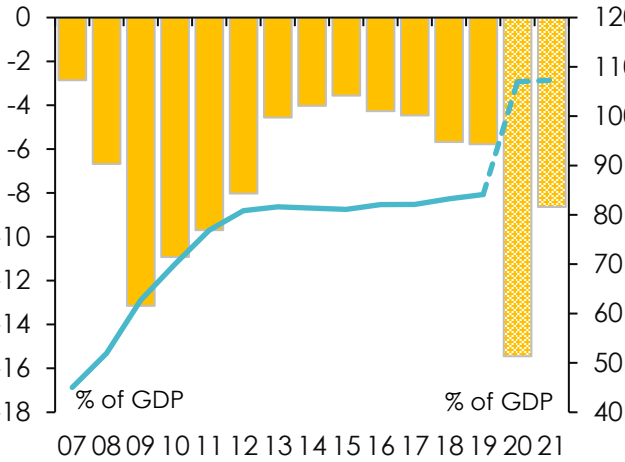
Purchasing managers' indices (PMIs) point to an ongoing rebound in both manufacturing and services in major economies since May



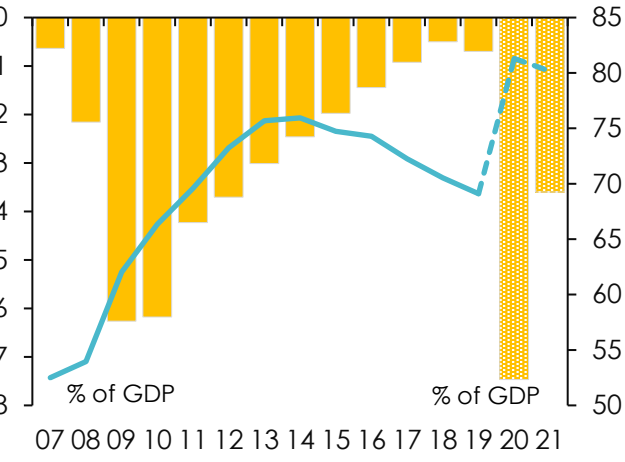
Note: Purchasing Managers' Indexes (PMIs) are derived from surveys of senior executives, who are asked to report whether various dimensions of business activity recorded an increase, decrease or no change compared with the previous month. A reading of 50 indicates an overall increase cf. the previous month, and a reading of less than 50 indicates a decrease. Latest for Japan, the euro area and the UK are July (preliminary); all others June. See also PMIs for other Asia-Pacific economies on slide 37. Sources: US Institute of Supply Management; INH Markit; Caixin; Refinitiv Datastream.

Governments around the world are doing more by way of fiscal stimulus than they did during the global financial crisis

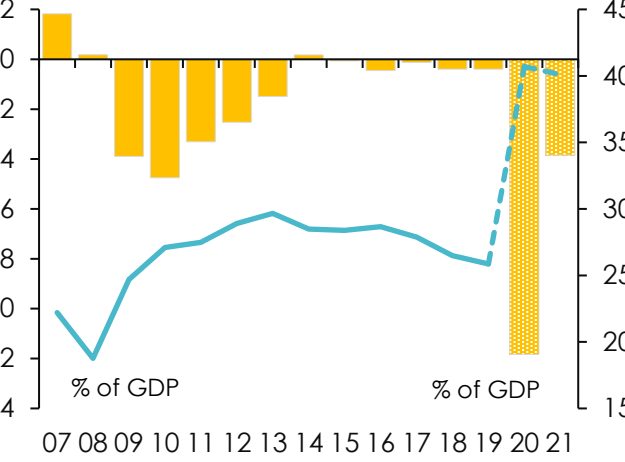
United States



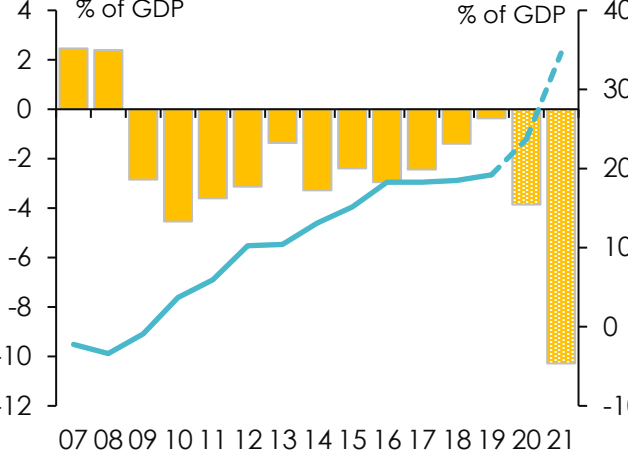
Euro area



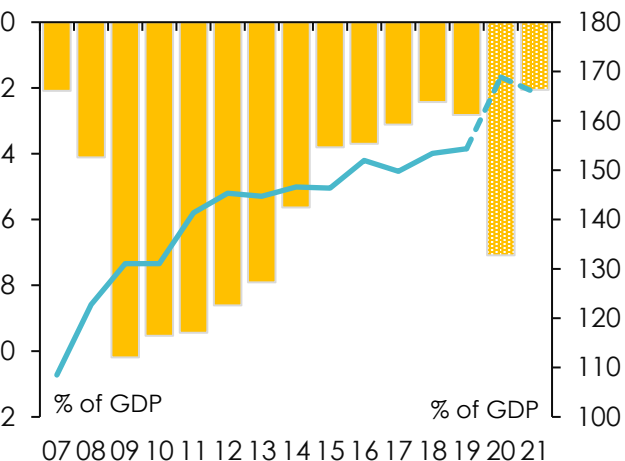
Canada



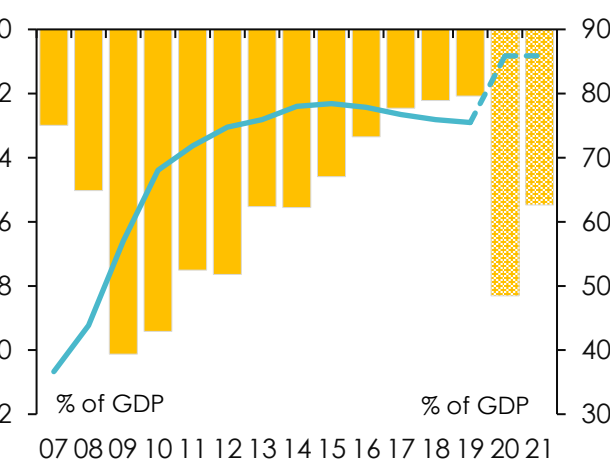
Australia



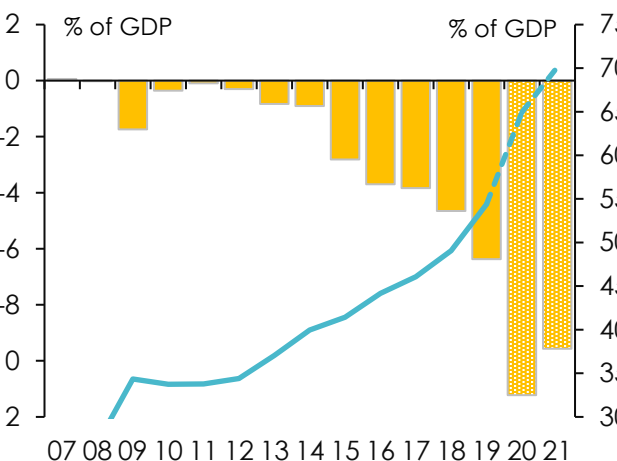
Japan



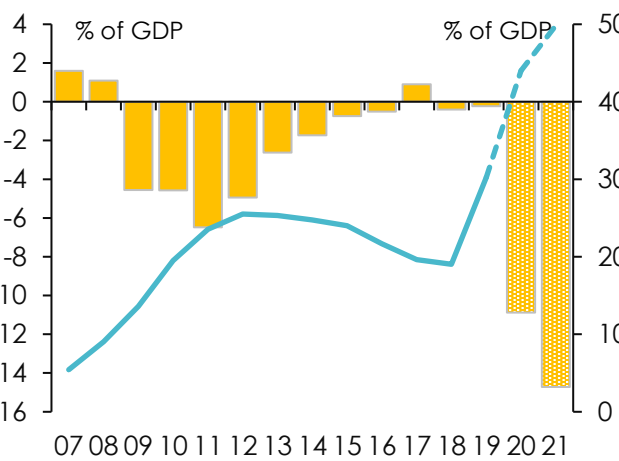
United Kingdom



China



New Zealand

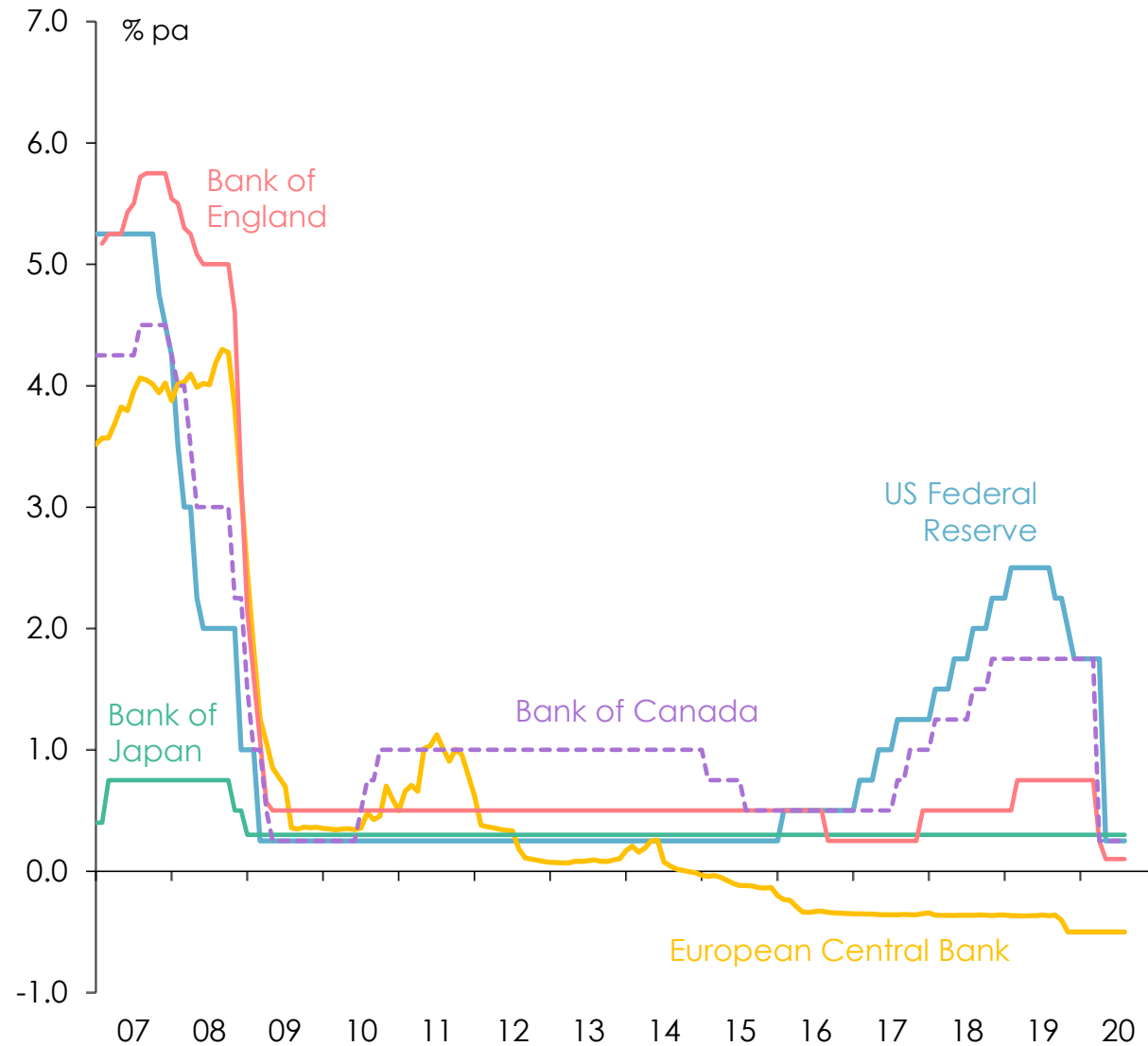


General government overall fiscal balance (left scale) General government net debt (right scale)

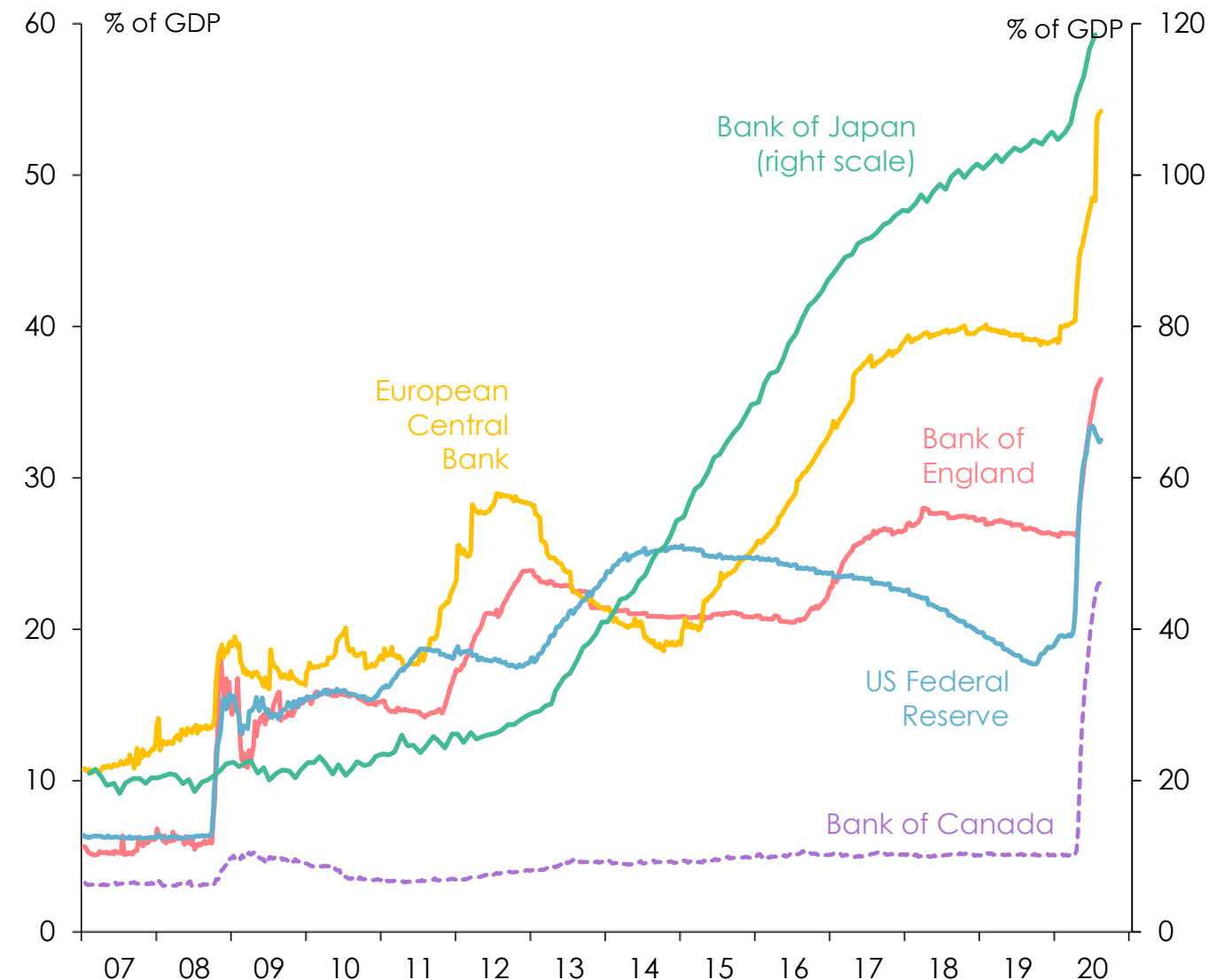
Note: UK data does not include the measures announced by the Chancellor on 8th July; China debt is gross debt, not net; Australian data are for the federal government only and are for fiscal years ended 30th June; NZ data are for fiscal years ended 31st March. Sources: International Monetary Fund, *Fiscal Monitor*, April 2020, and *World Economic Outlook*, June 2020; Australian Government, *Economic and Fiscal Update*, July 2020; New Zealand Treasury, *Budget Economic & Fiscal Update*, May 2020.

Major central banks have cut interest rates to record lows, and done more 'quantitative easing' than during the global financial crisis

Major central bank policy interest rates



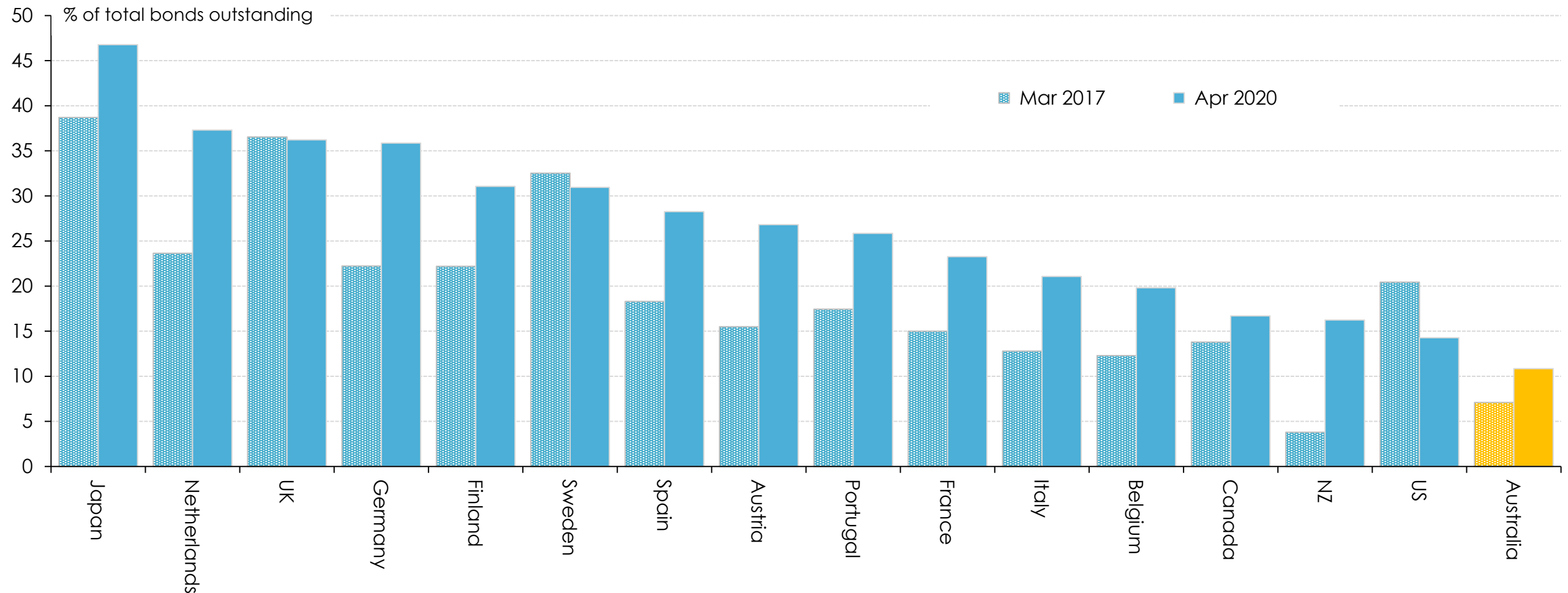
Major central bank balance sheets



Sources: US Federal Reserve; European Central Bank; Bank of Japan; Bank of England; Bank of Canada.

Central banks now hold significant proportions of total government debt in a growing number of countries

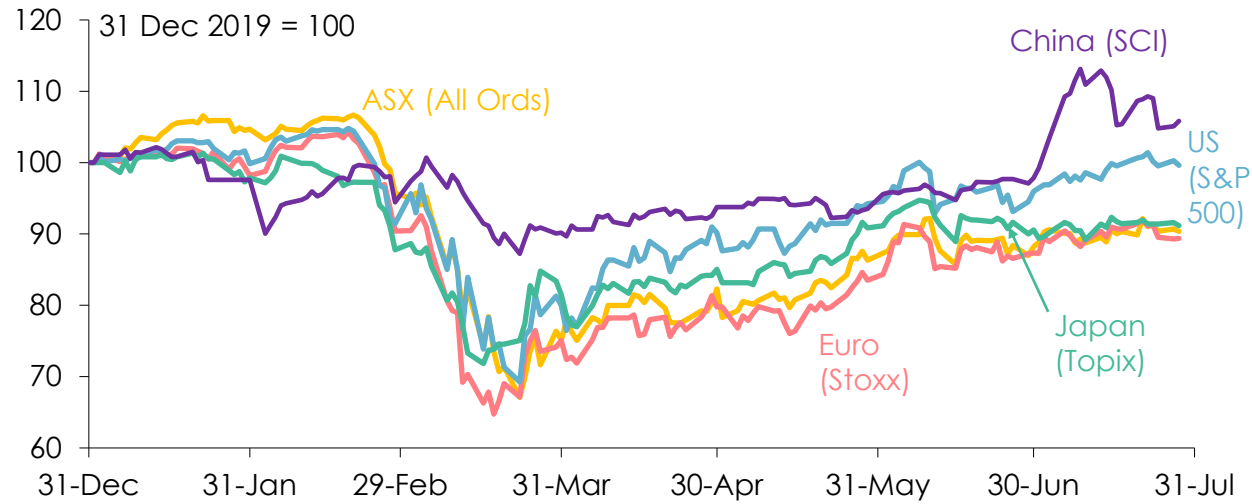
Central bank holdings of central government bonds



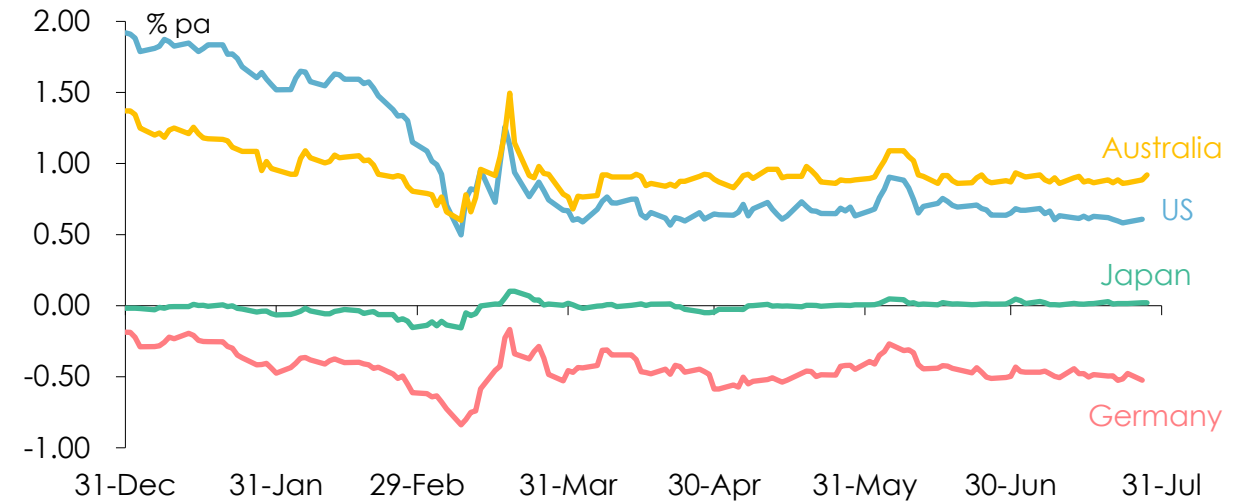
Sources: Surprisingly, the RBA does not disclose its holdings of Australian Government bonds in its weekly balance sheet statement (see RBA Statistical Table A1. Hence the figure shown here for Australia at March 2017 was derived from ABS *Finance and Wealth*, and that for April 2020 by adding to RBA holdings as per the December 2019 issue of *Finance and Wealth*, disclosed RBA purchases of Australian Government bonds up to end-April, divided by the amount of Australian Government securities outstanding disclosed in the Government's *Monthly Financial Statement*. The figures for RBNZ holdings of NZ government securities are published in Table r1 on the RBNZ's website while figures for total NZ government securities outstanding are in Table D30. All others are from OECD, *Economic Outlook* No. 107 (June 2020) and No. 104 (June 2017).

Central bank actions helped prevent the financial markets from seizing up in the second half of March

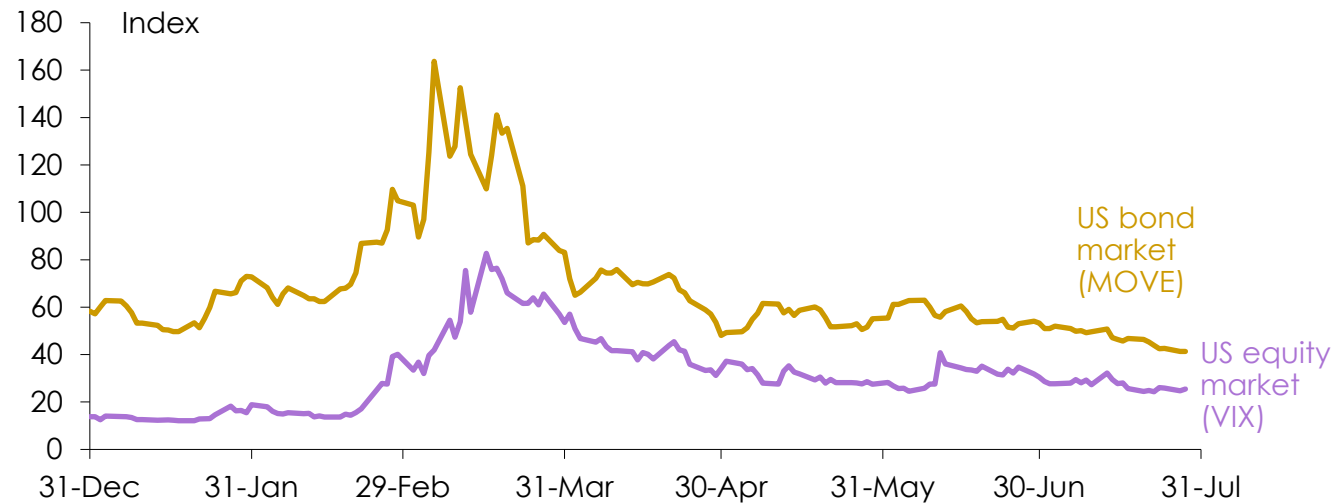
Stock markets



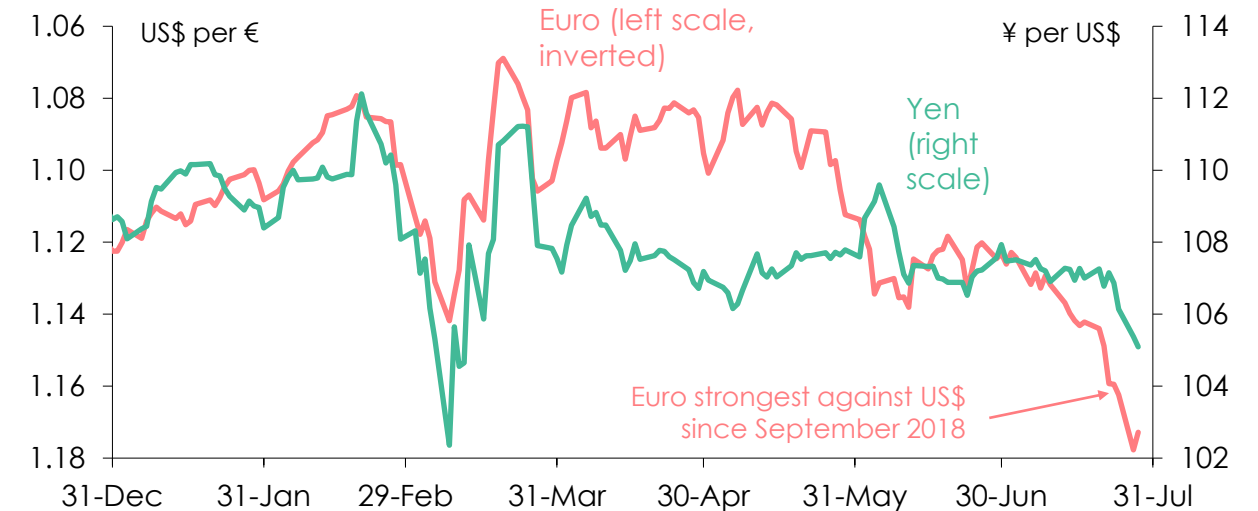
10-year bond yields



Measures of market volatility

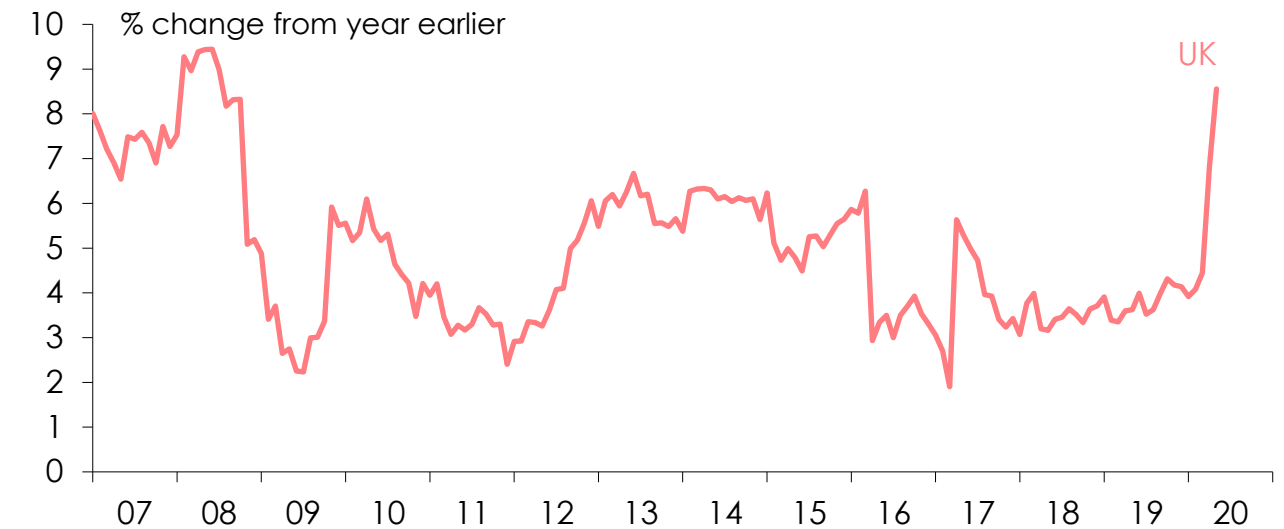
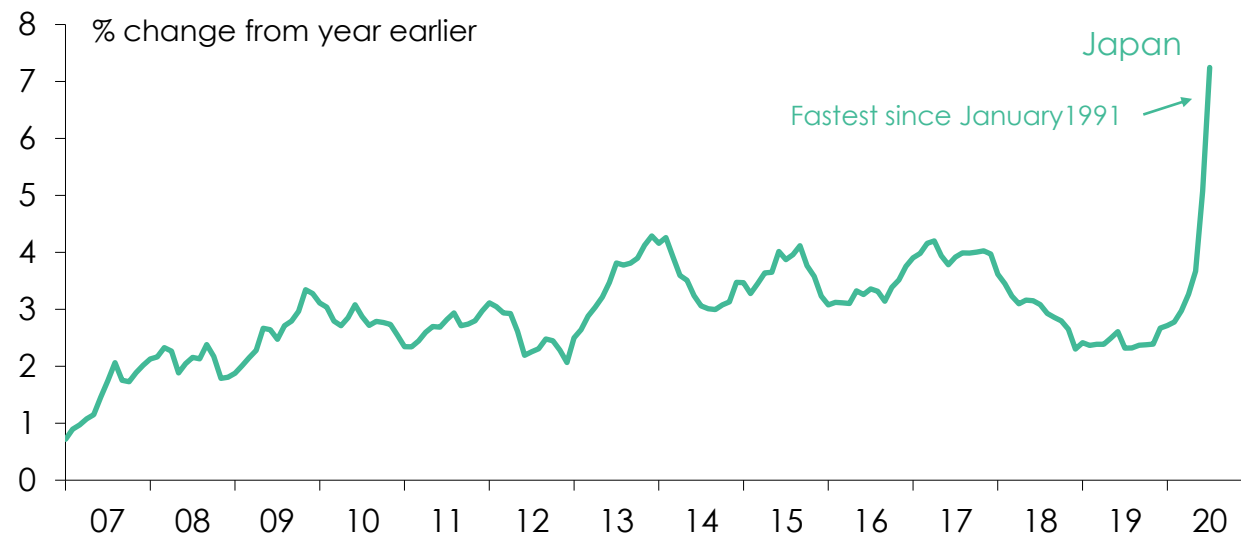
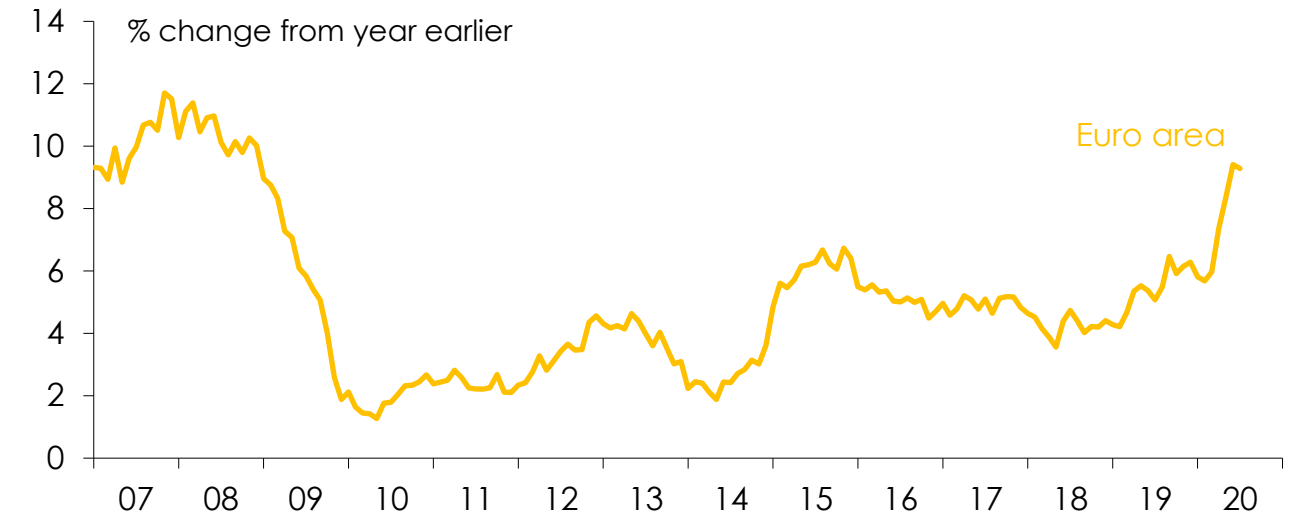
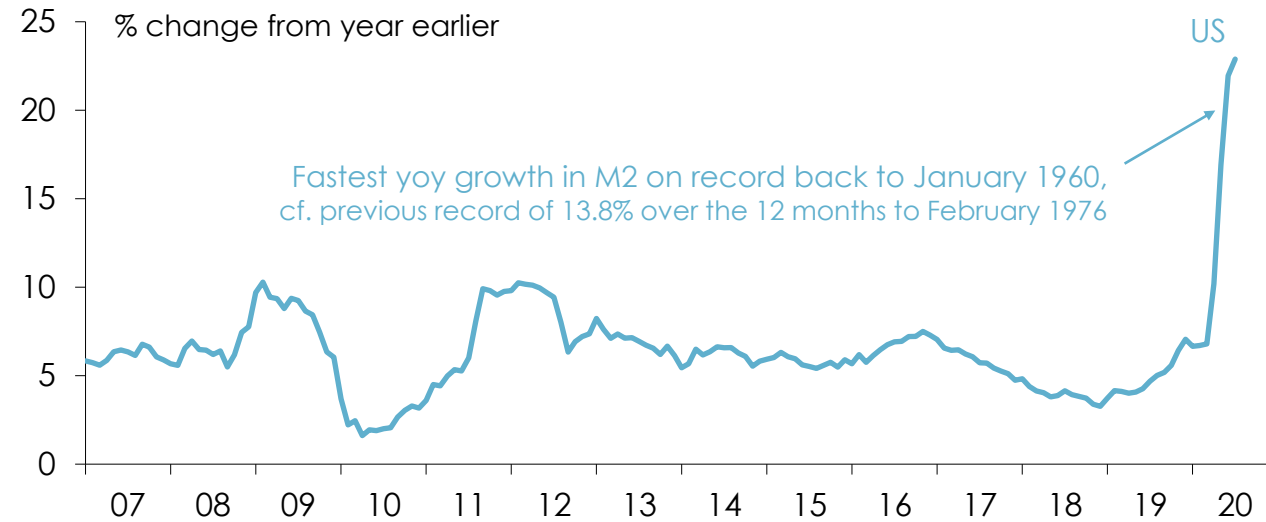


US dollar vs euro and yen



'Quantitative easing' has prompted a more rapid acceleration in money supply growth than it did during the global financial crisis ...

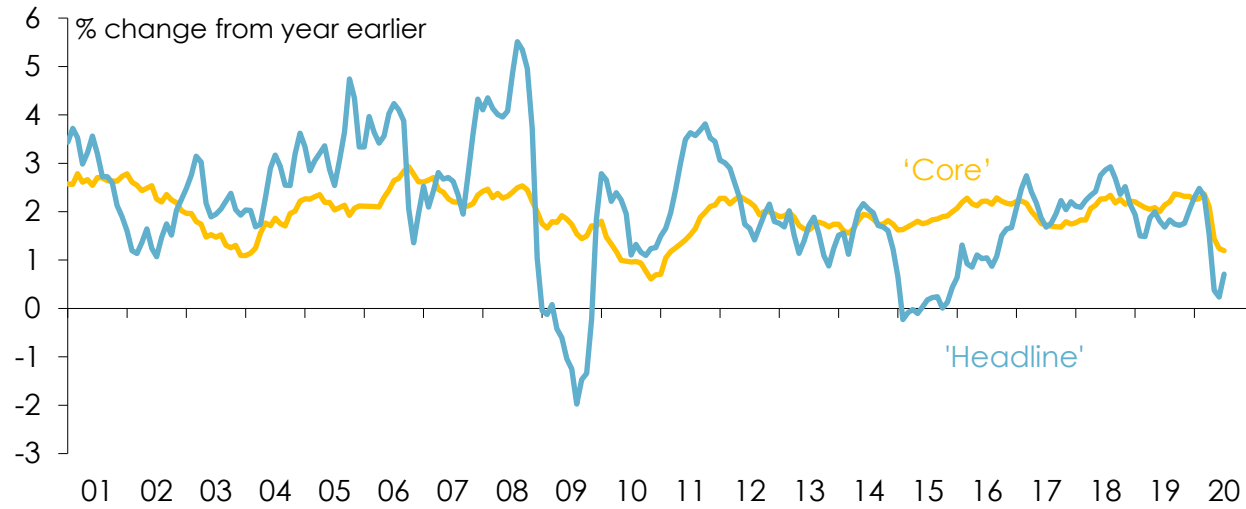
M2 money supply growth



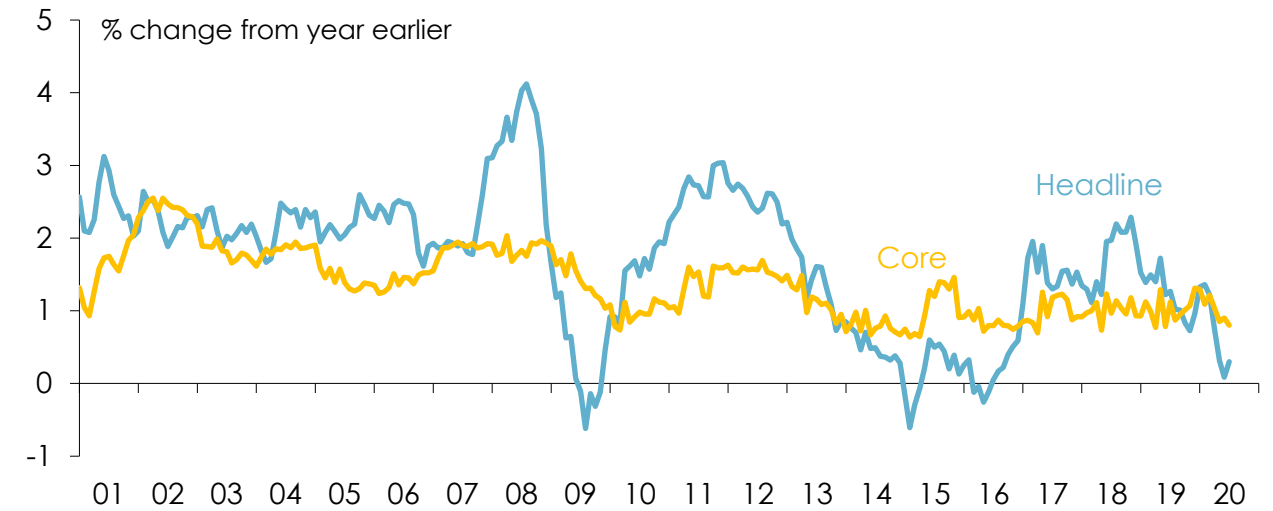
Note: Japan is M2+CDs; UK is M4. Sources: US Federal Reserve; European Central Bank; Bank of Japan; Bank of England.

...but so far at least, inflation has been falling rather than rising, even discounting the impact of lower oil prices

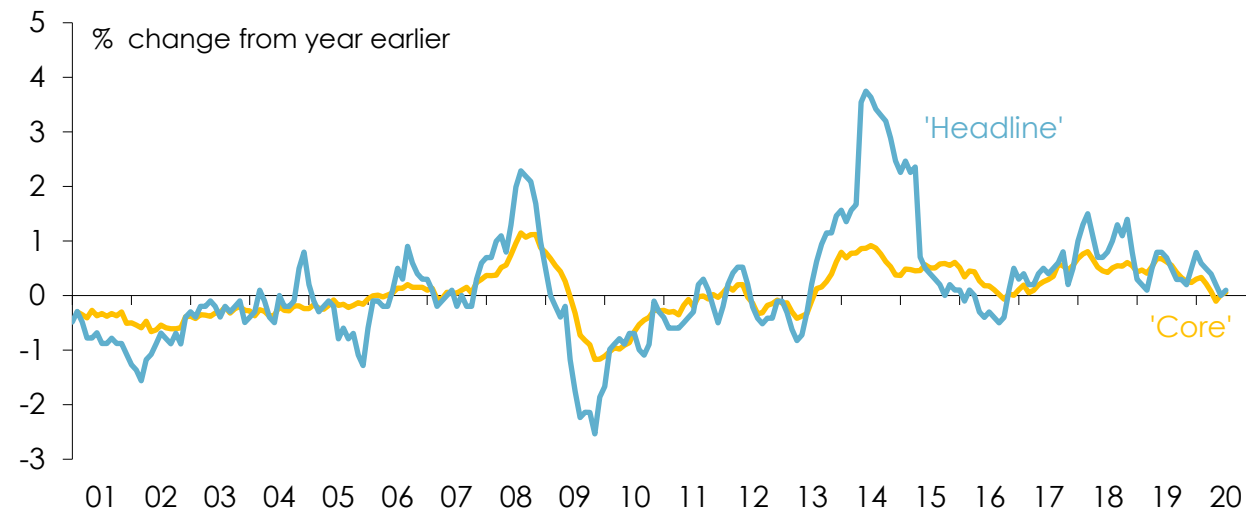
'Headline' and 'core' inflation - US



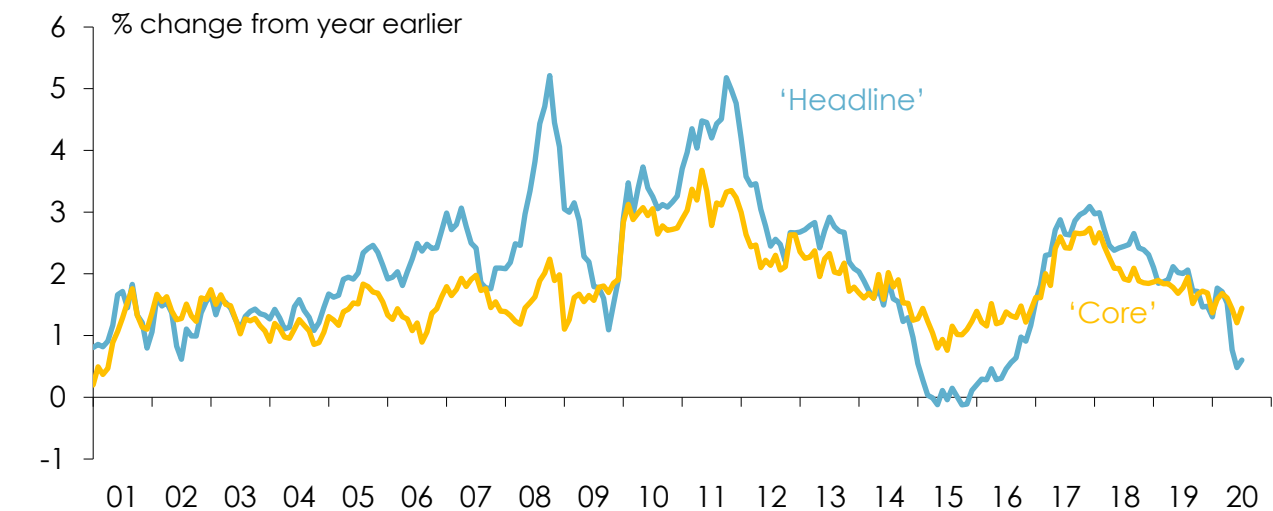
'Headline' and 'core' inflation – Euro area



'Headline' and 'core' inflation - Japan



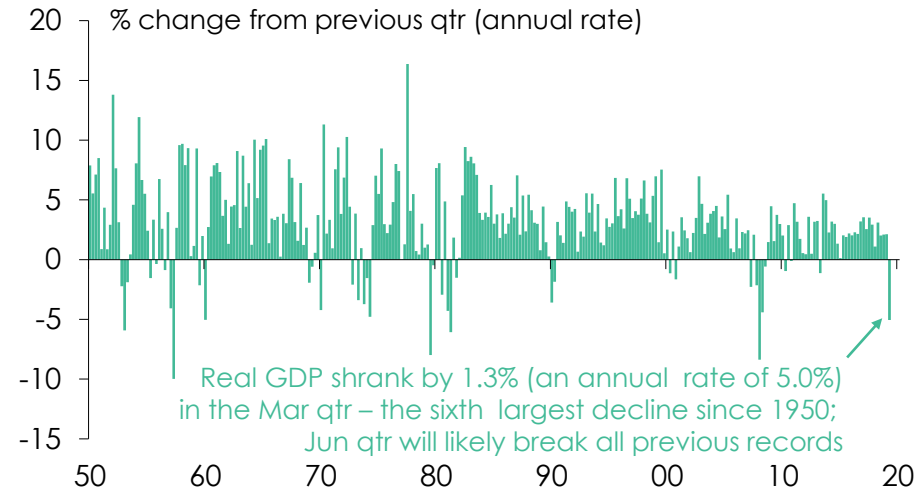
'Headline' and 'core' inflation – UK



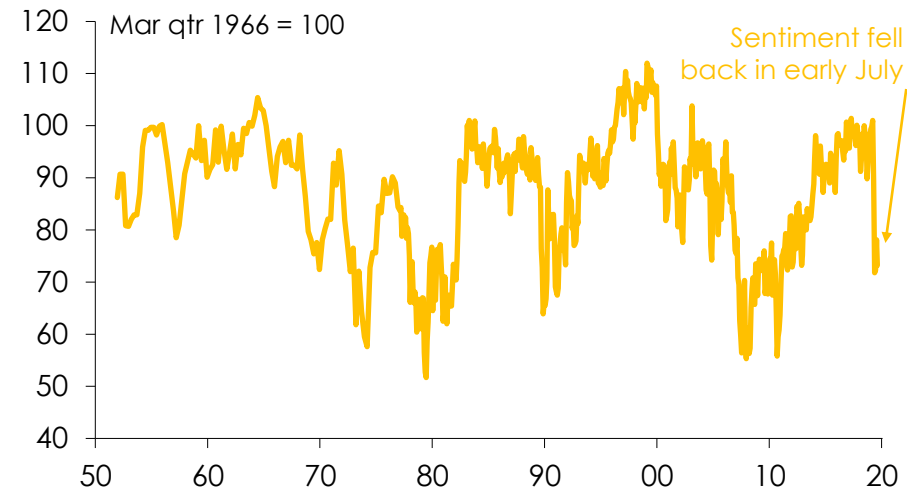
Note: 'Core' inflation is the CPI excluding food & energy in the US; excluding food, energy, alcohol & tobacco in the euro area; and excluding energy & seasonal foods in the UK. The 'core' inflation measure for Japan is the weighted median CPI calculated by the Bank of Japan. Sources: US Bureau of Labor Statistics; Eurostat; Statistics Bureau of Japan; Bank of Japan; UK Office for National Statistics.

The US economy has experienced its sharpest contraction since the 1930s, but there are increasing signs that a rebound began in May

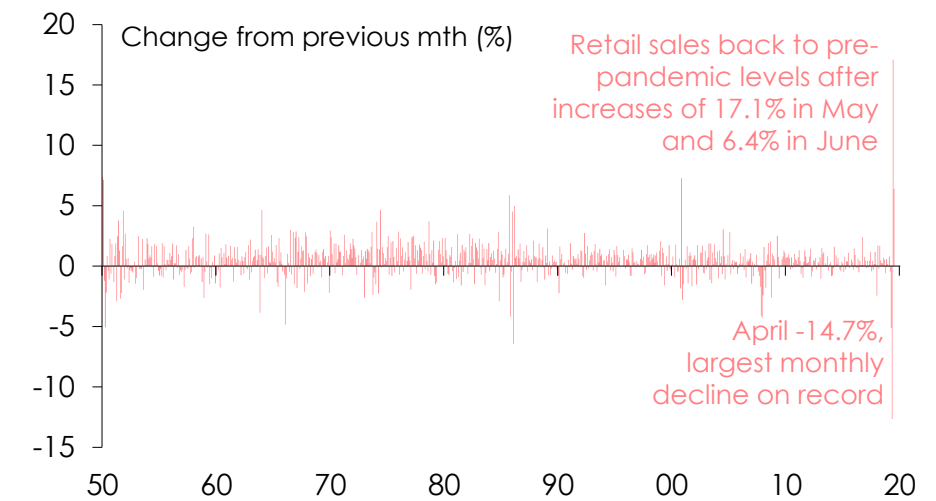
Real GDP



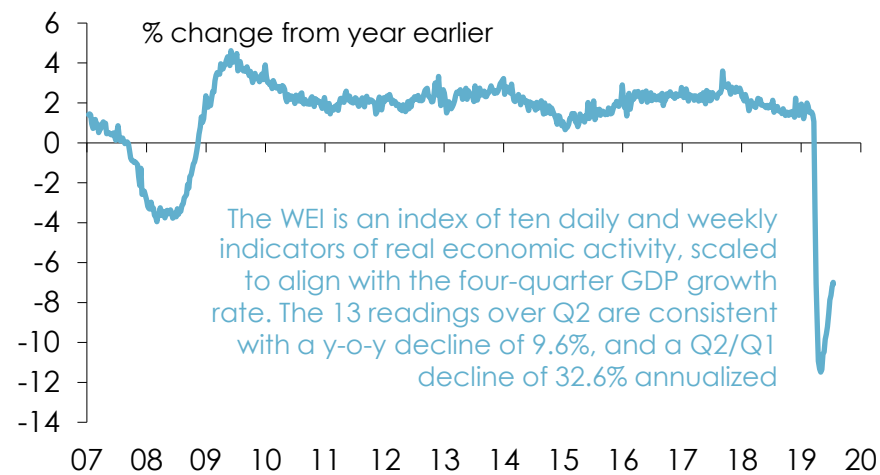
Consumer sentiment



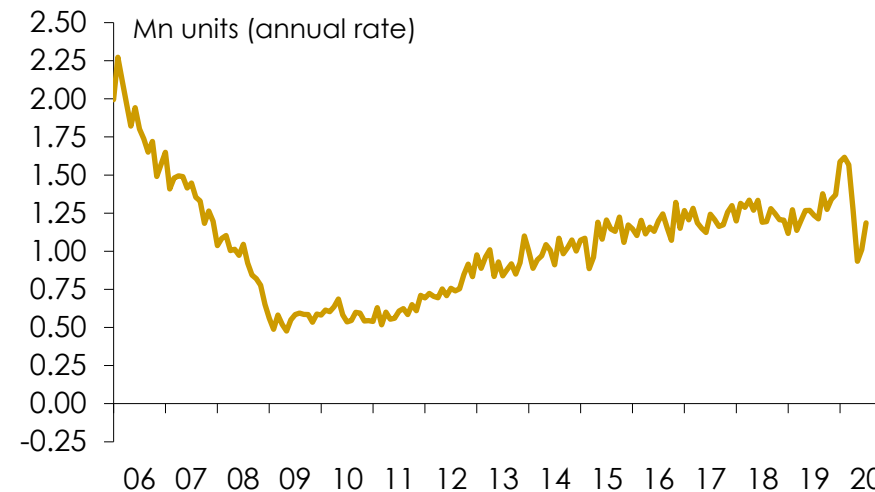
Retail sales



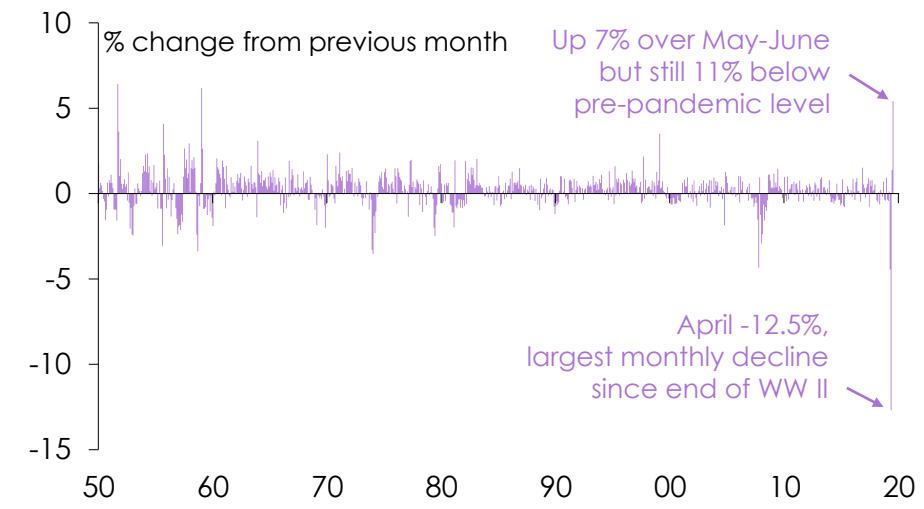
NY Fed weekly economic index



Housing starts

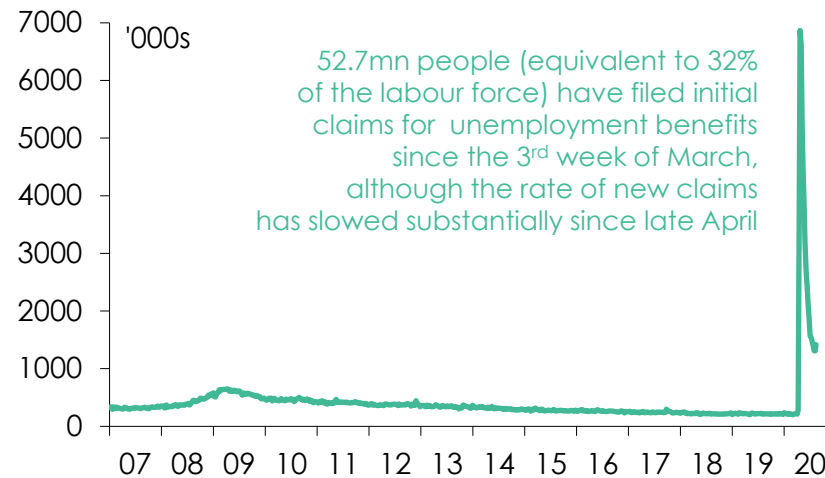


Industrial production

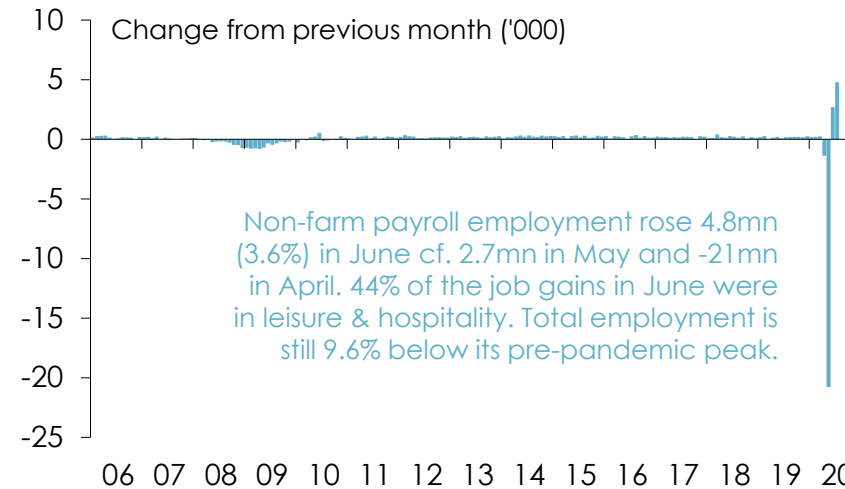


The impact on the US labour market has been particularly severe – although employment rose, and unemployment fell, in May and June

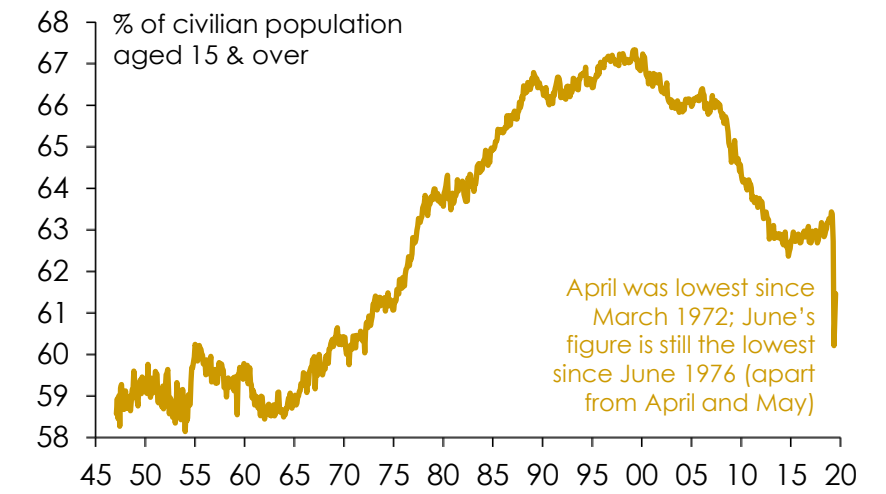
Unemployment benefit claims



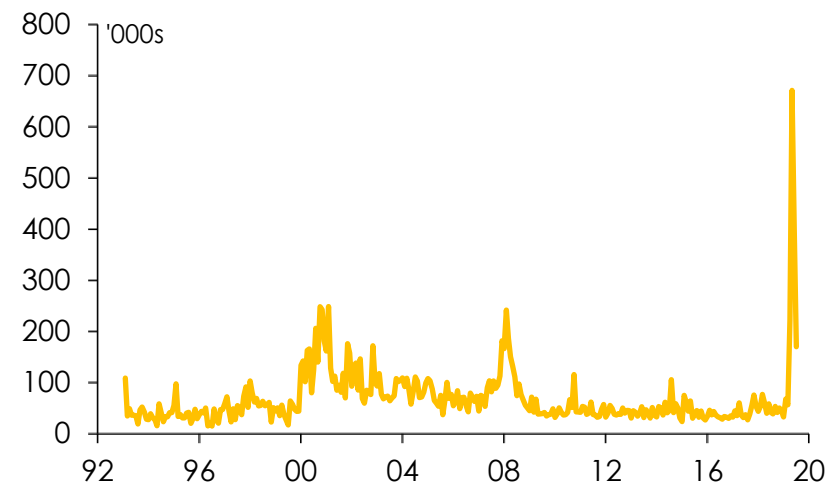
Non-farm payroll employment



Labour force participation rate



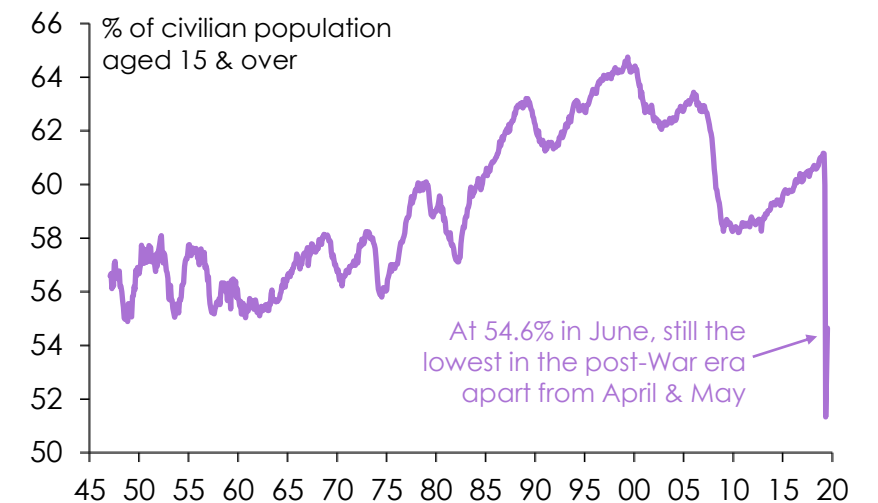
Layoff announcements



Unemployment rate



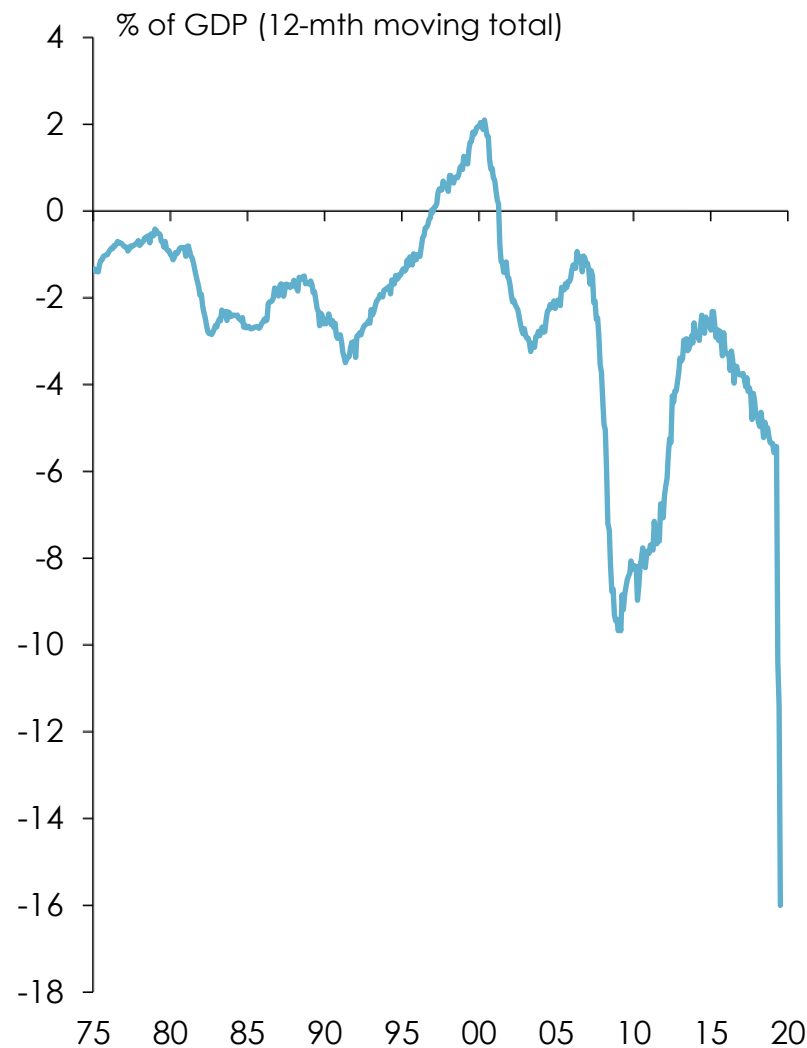
Employment to population ratio



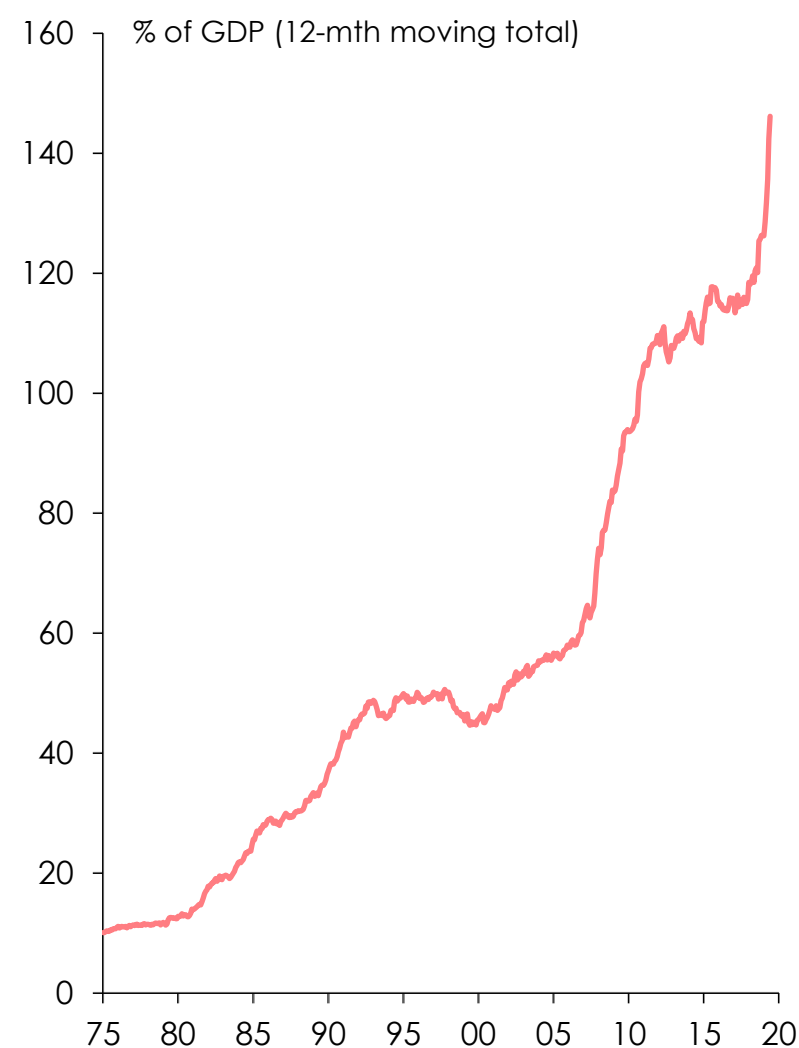
Sources: US Department of Labor; Challenger, Gray & Christmas; US Bureau of Labor Statistics; National Bureau of Economic Research Macro History database.

The US budget deficit has blown out dramatically since the end of March, reaching 16% of GDP in the 12 months ended June

US Federal budget deficit



US gross Federal debt

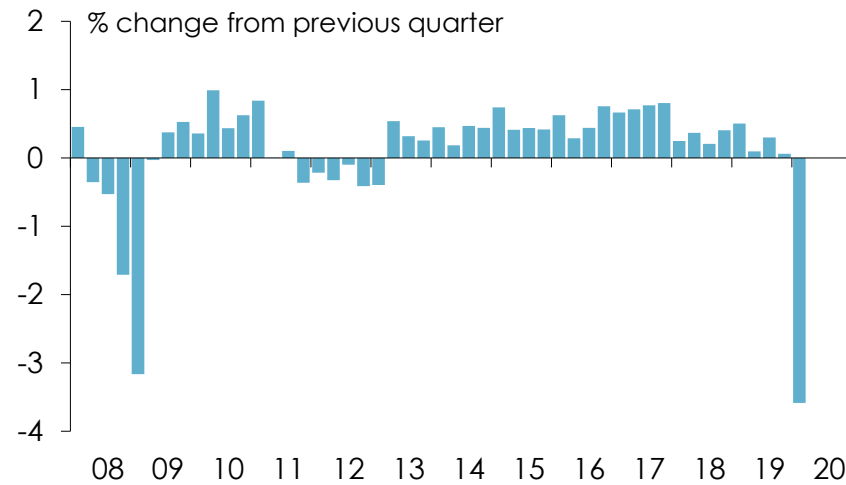


- ❑ The US federal budget deficit widened from US\$582bn (3.3% of GDP) in 2016 (Obama's last year in office) to US\$1 trn (5.4% of GDP) in 2019, while gross federal debt rose from US\$20.4 trn (115% of GDP) to \$24.1trn (126% of GDP)
- ❑ In March, the Congressional Budget Office forecast the deficit would remain above US\$1trn every year over the next decade, reaching US\$1.7 trn (5.6% of GDP) by 2030
- ❑ The budget deficit for April, May and June amounted to US\$2.0trn (reflecting the impact of Covid-19 related measures), bringing the 12-month moving total to US\$3.0 trn (16.0% of GDP), cf. a peak of 9.7% of GDP during the GFC (and the largest since 20.8% of GDP in FY 1945)
- ❑ Gross federal debt increased by US\$727 bn to US\$28.7 trn (154% of GDP)

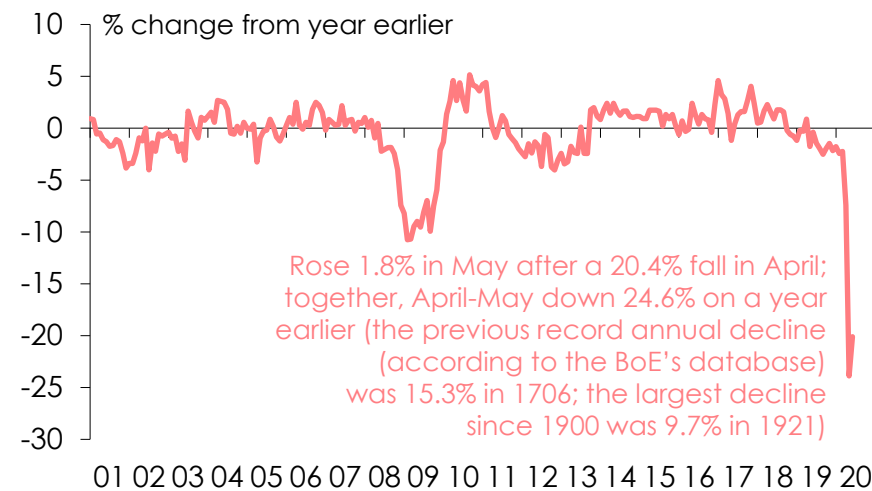
Note: The measure of US gross federal debt is at market value. Sources: US Treasury Department; Federal Reserve Bank of Dallas; US Bureau of Economic Analysis; US Congressional Budget Office; Corinna.

Europe is also experiencing a sharp downturn although unemployment probably won't rise as much as it has in the US

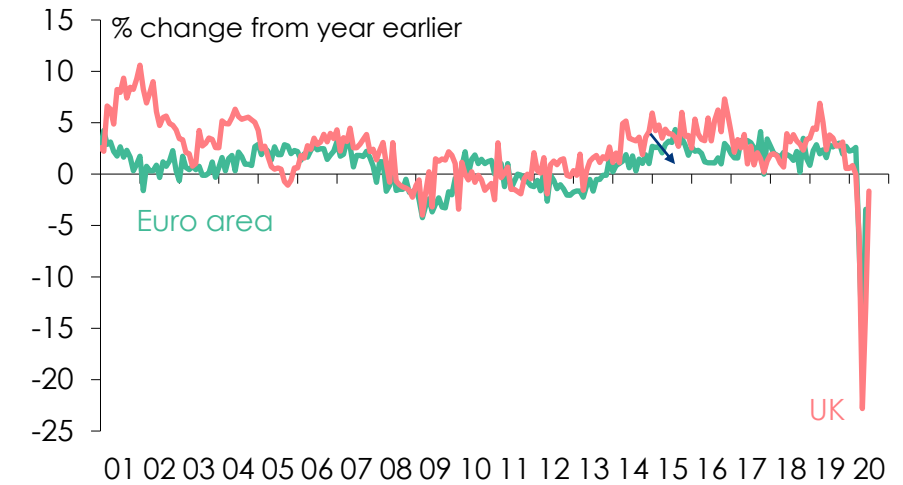
Euro area real GDP



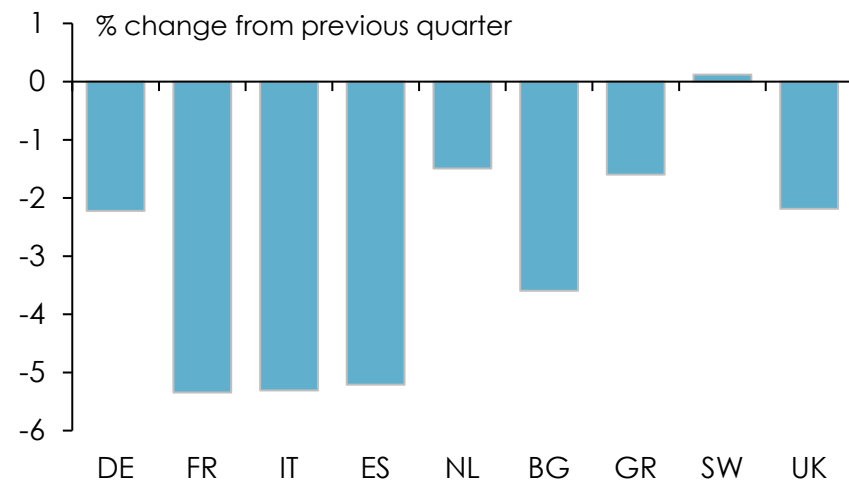
UK monthly GDP



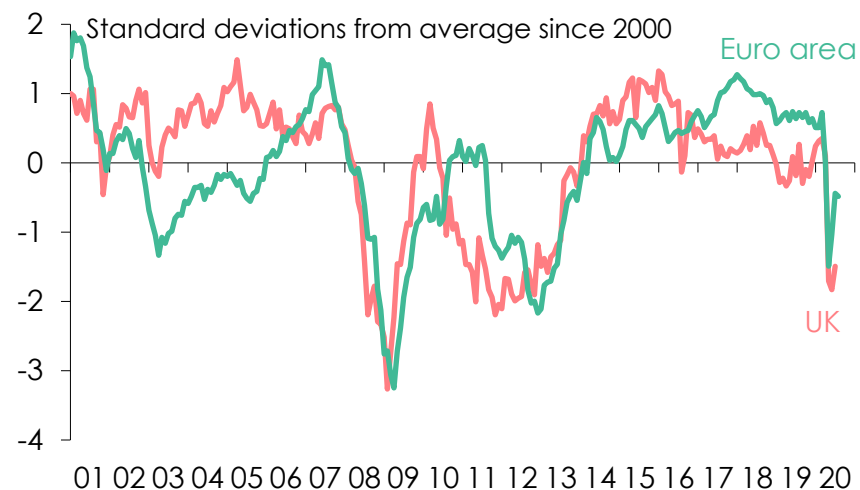
Retail sales volume



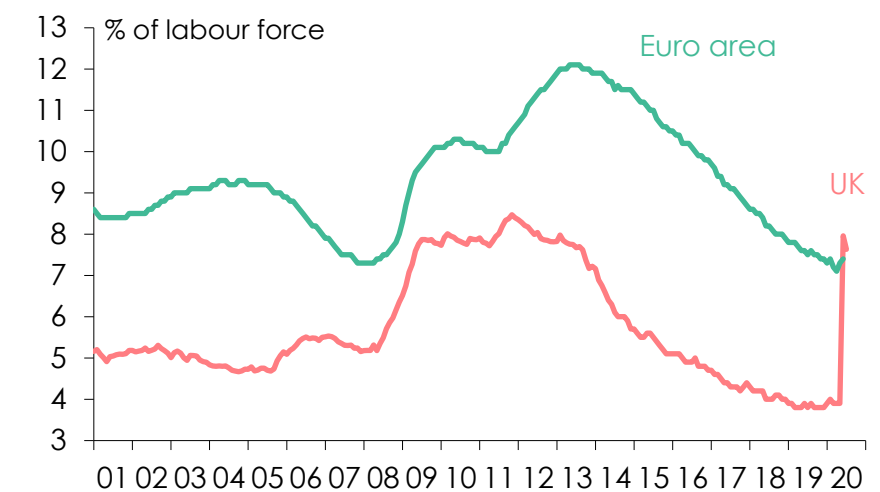
March quarter GDP by country



Consumer confidence



Unemployment

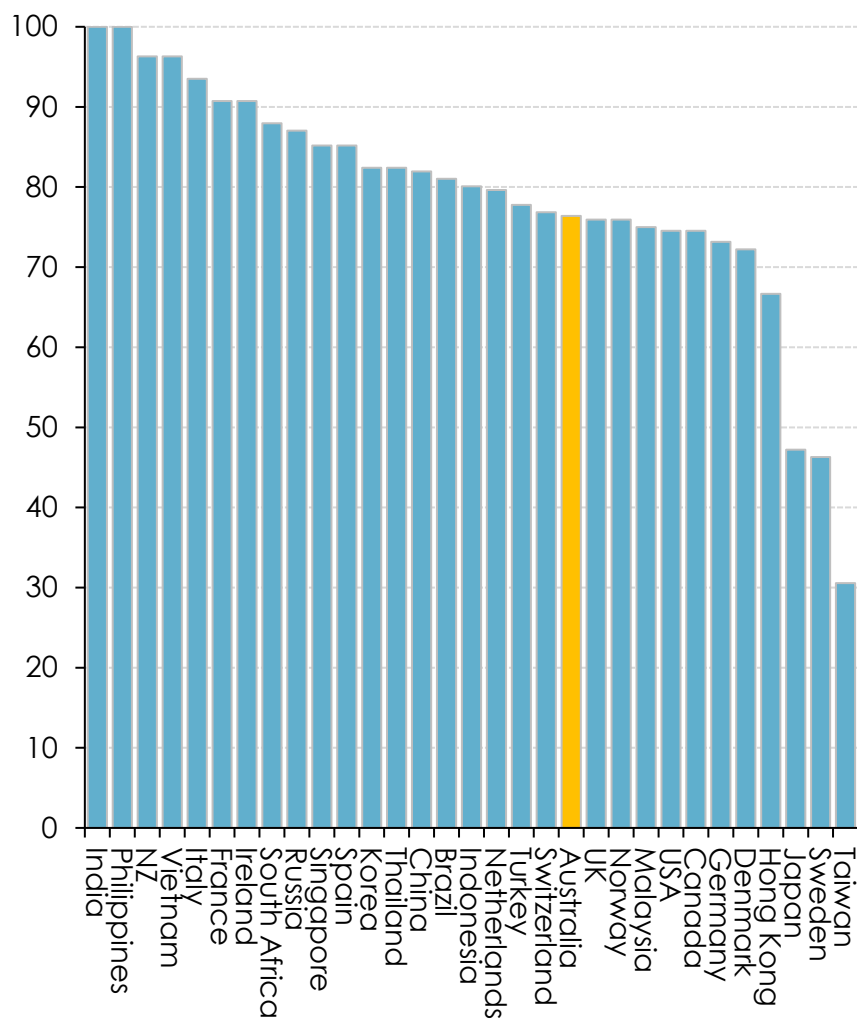


Sources: Eurostat; UK Office for National Statistics; Confederation of British Industry. The UK unemployment rate is published as a 3-month moving average; the most recent observation (for May) is derived by adding to the 'claimant count' unemployment rate the average margin between that rate and the conventionally defined unemployment rate over the preceding 12 months.

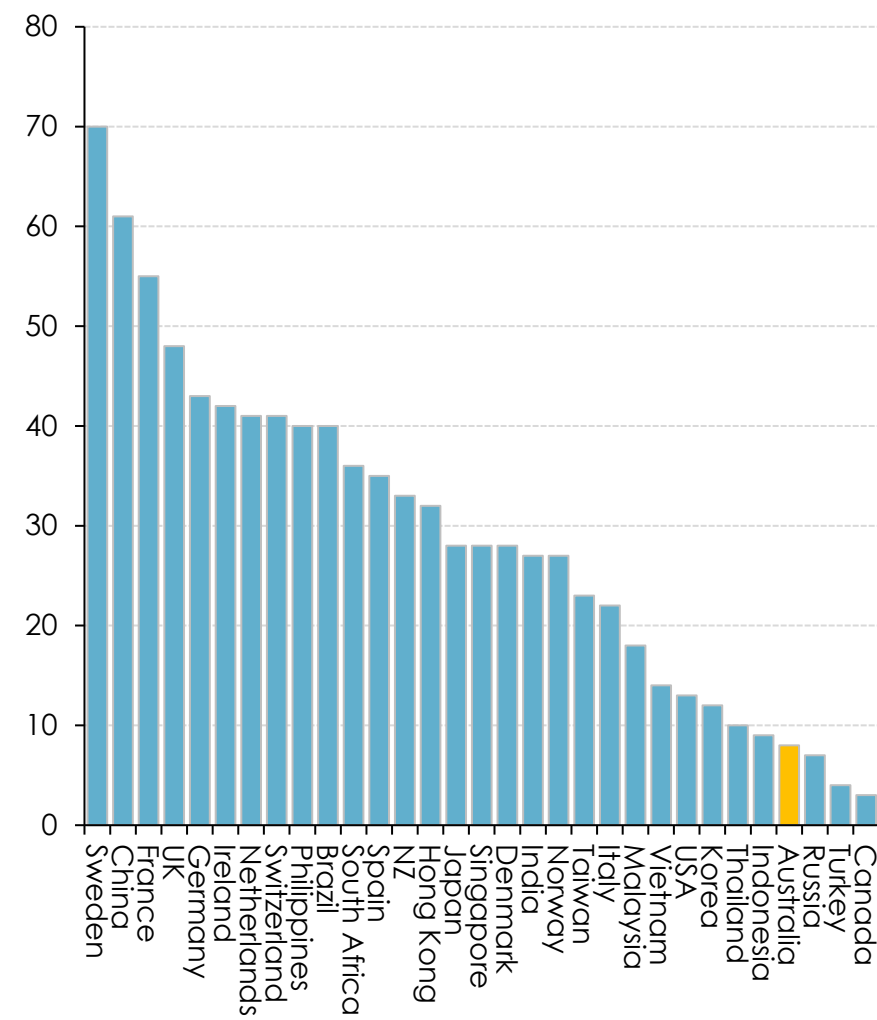
The Australian economy

Australia's Covid-19 restrictions have been, on average, less stringent than in most other 'advanced' economies, or other economies in our region

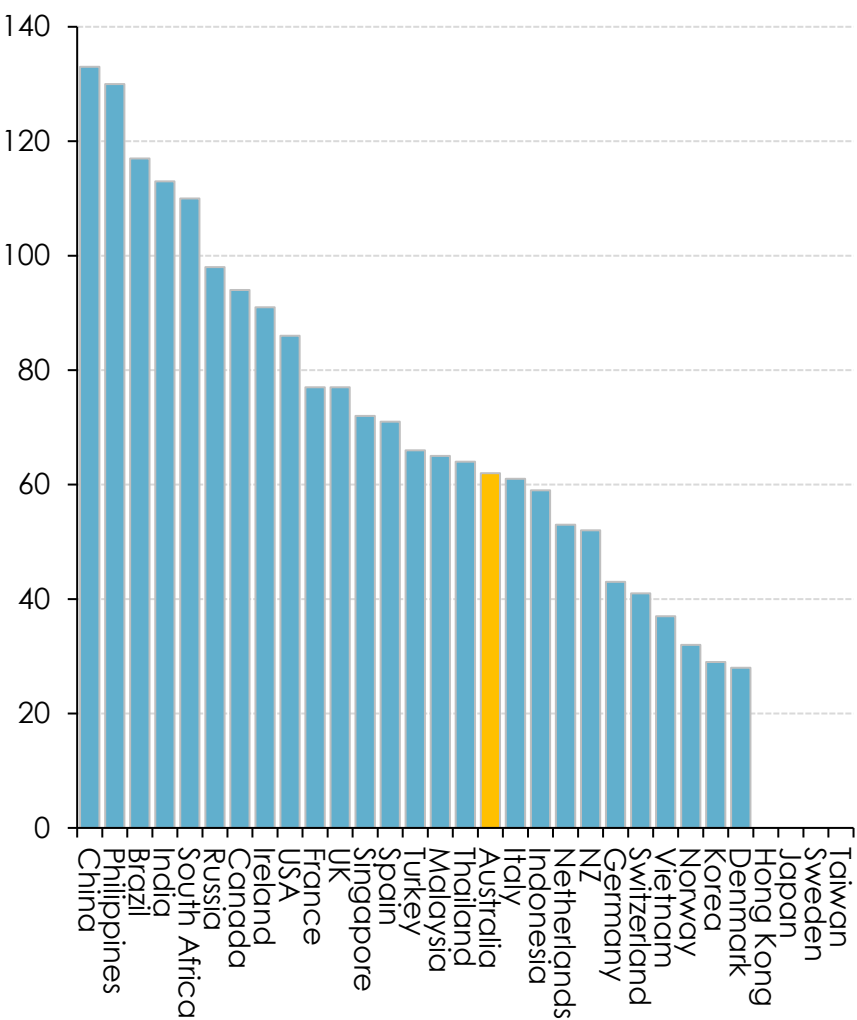
Highest level of restrictions imposed



Number of days restrictions at highest level



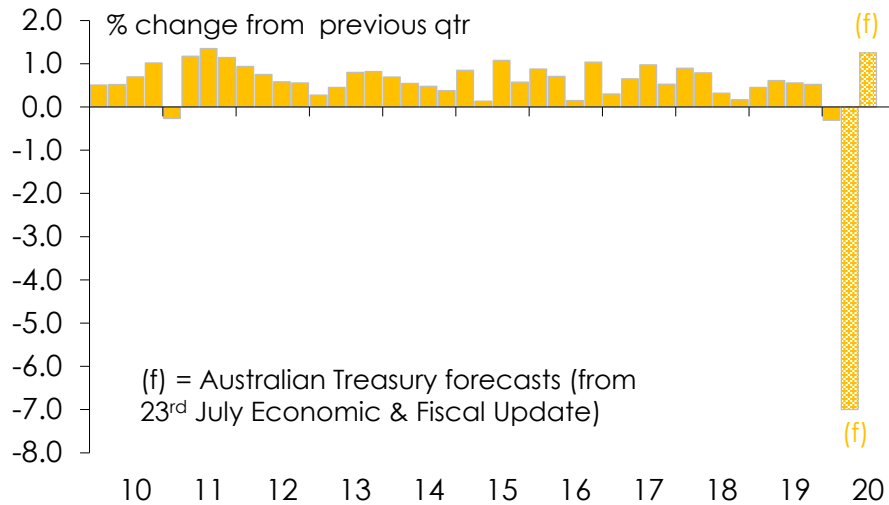
Number of days restrictions above 70 on Oxford index



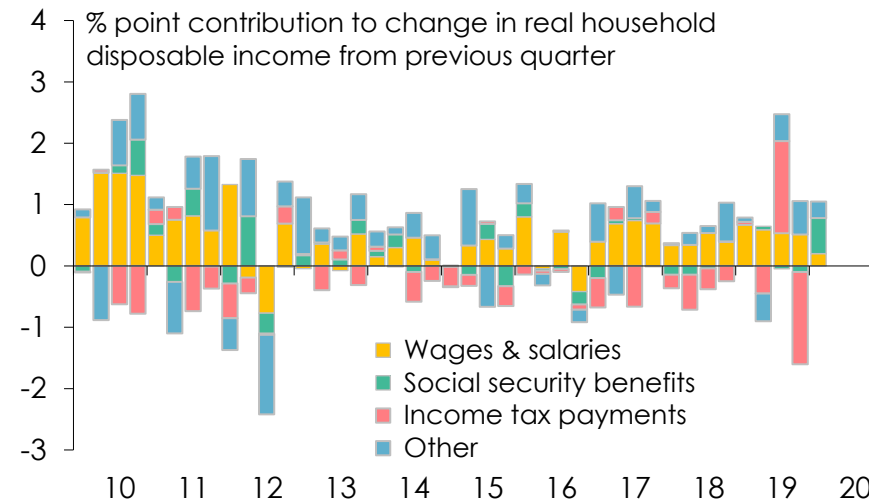
The Oxford COVID-19 Government Response Tracker collects publicly available information on 11 indicators of government response including school and workplace closures, public events cancellations, restrictions on public gatherings, stay at home requirements, public transport closures, domestic and international travel restrictions, public information campaigns, testing and contact tracing. Source: Blavatnik School of Government, Oxford University. Data up to 16th-22nd July.

In Australia GDP declined in Q1 for the first time in 9 years, reflecting the impact of bushfires and 'social distancing' restrictions on private demand

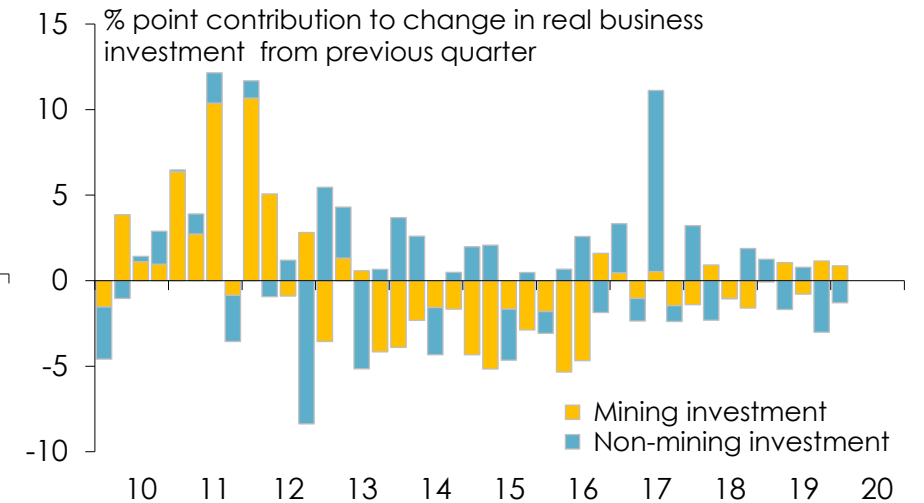
Quarterly change in real GDP



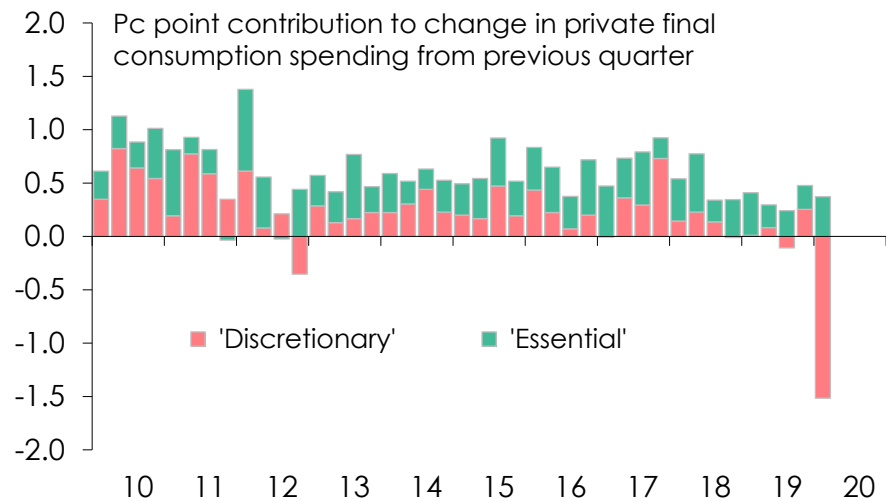
Household disposable income



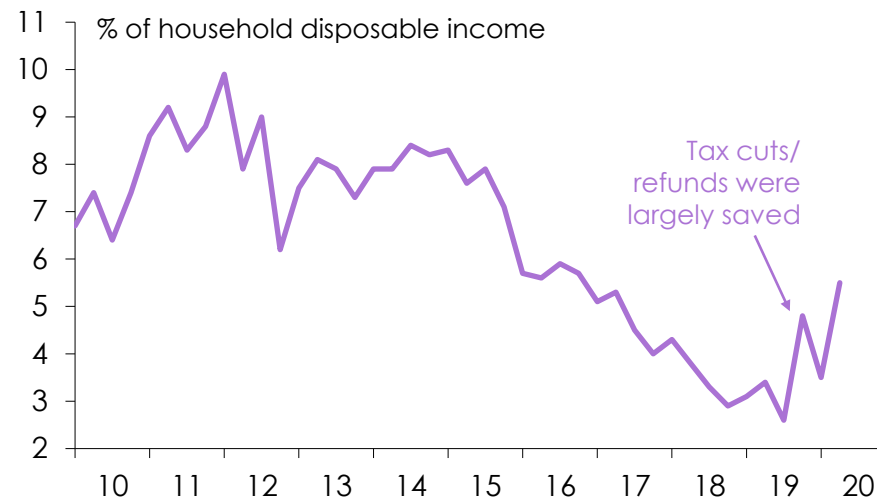
Business investment expenditure



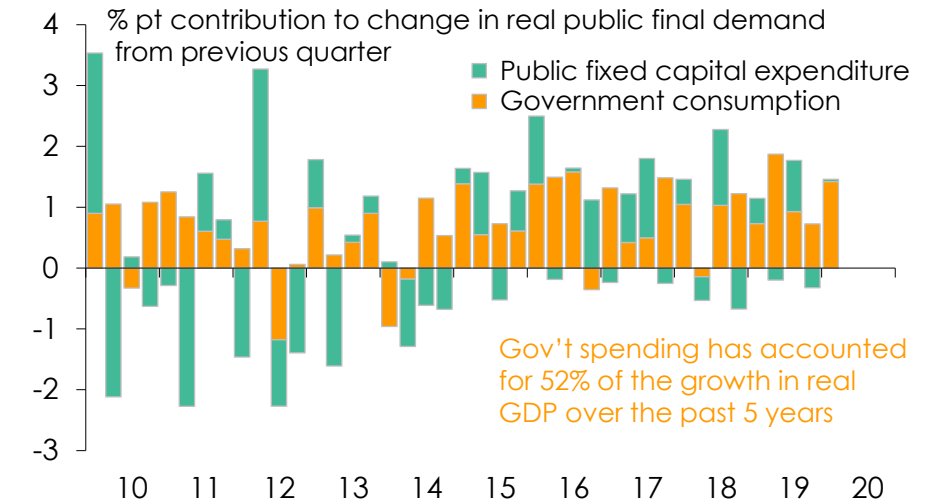
Household consumption expenditure



Household saving rate



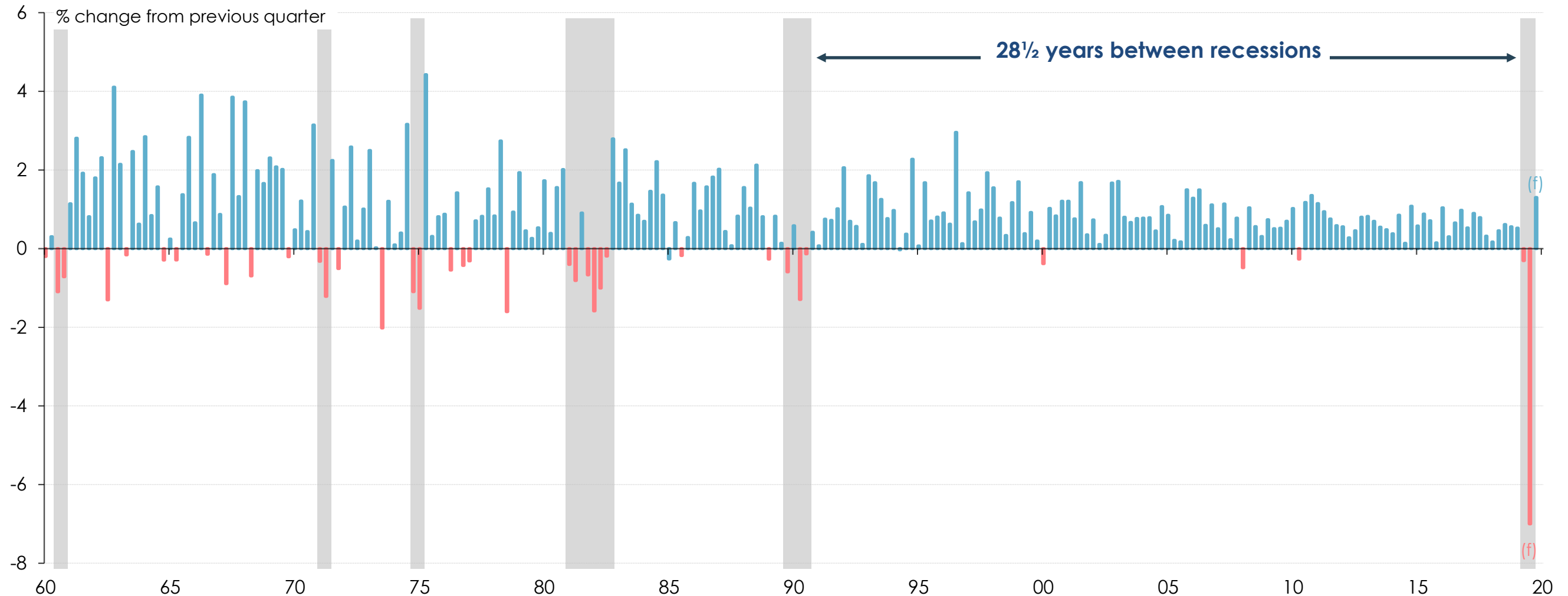
Public expenditure



Note: 'Essential' household consumption expenditure comprises food; rent & other dwelling services; electricity, gas & other fuel; operation of vehicles; rail, bus & taxi services; communications; health; education; and insurance & other financial services. Components of household disposable income are deflated by the implicit price deflator of household final consumption expenditure. Source: ABS; Australian Treasury.

Australia's record-breaking run of almost 30 years without a recession has come to an end

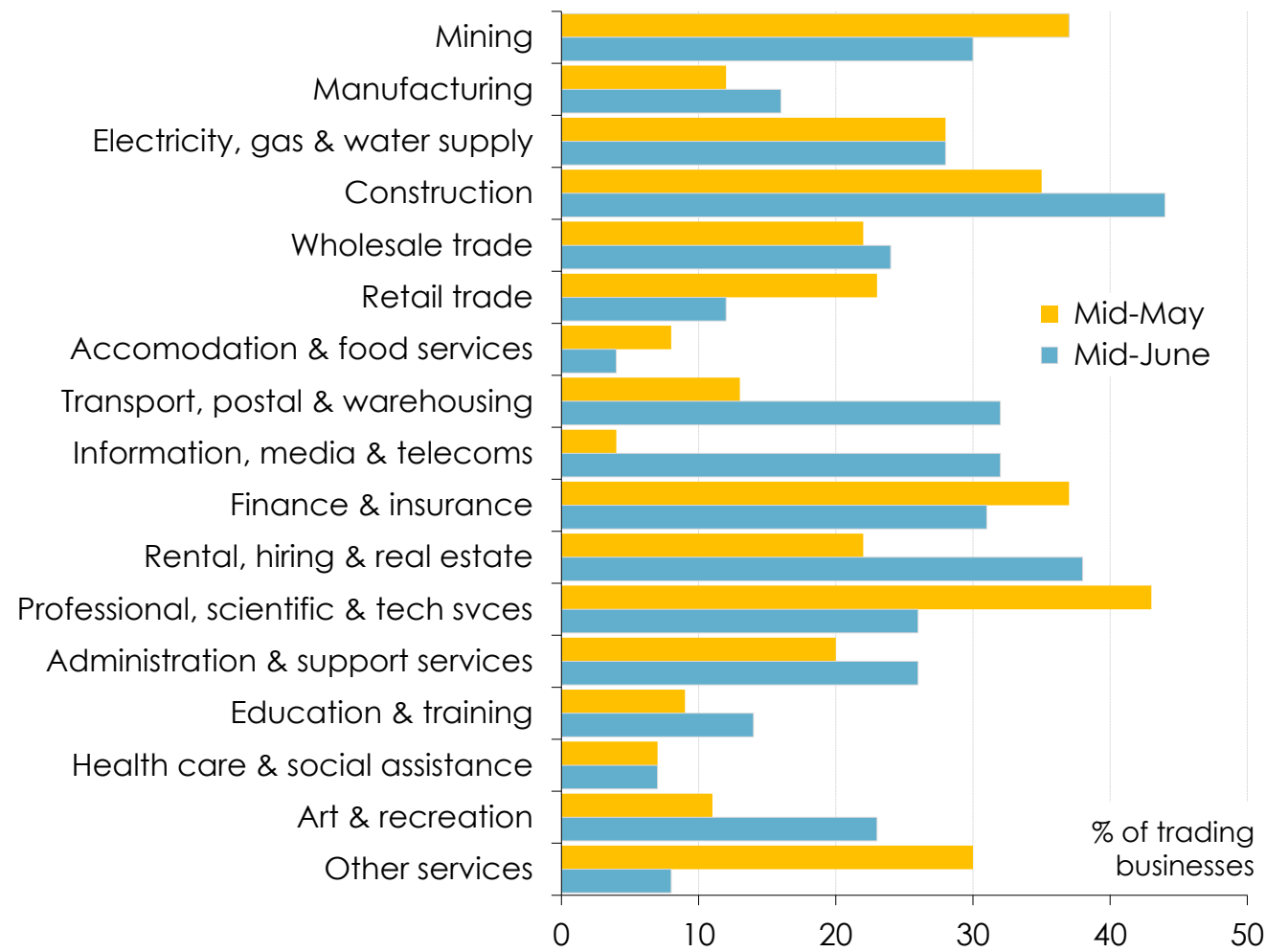
Quarterly growth in Australian real GDP, 1960-2020



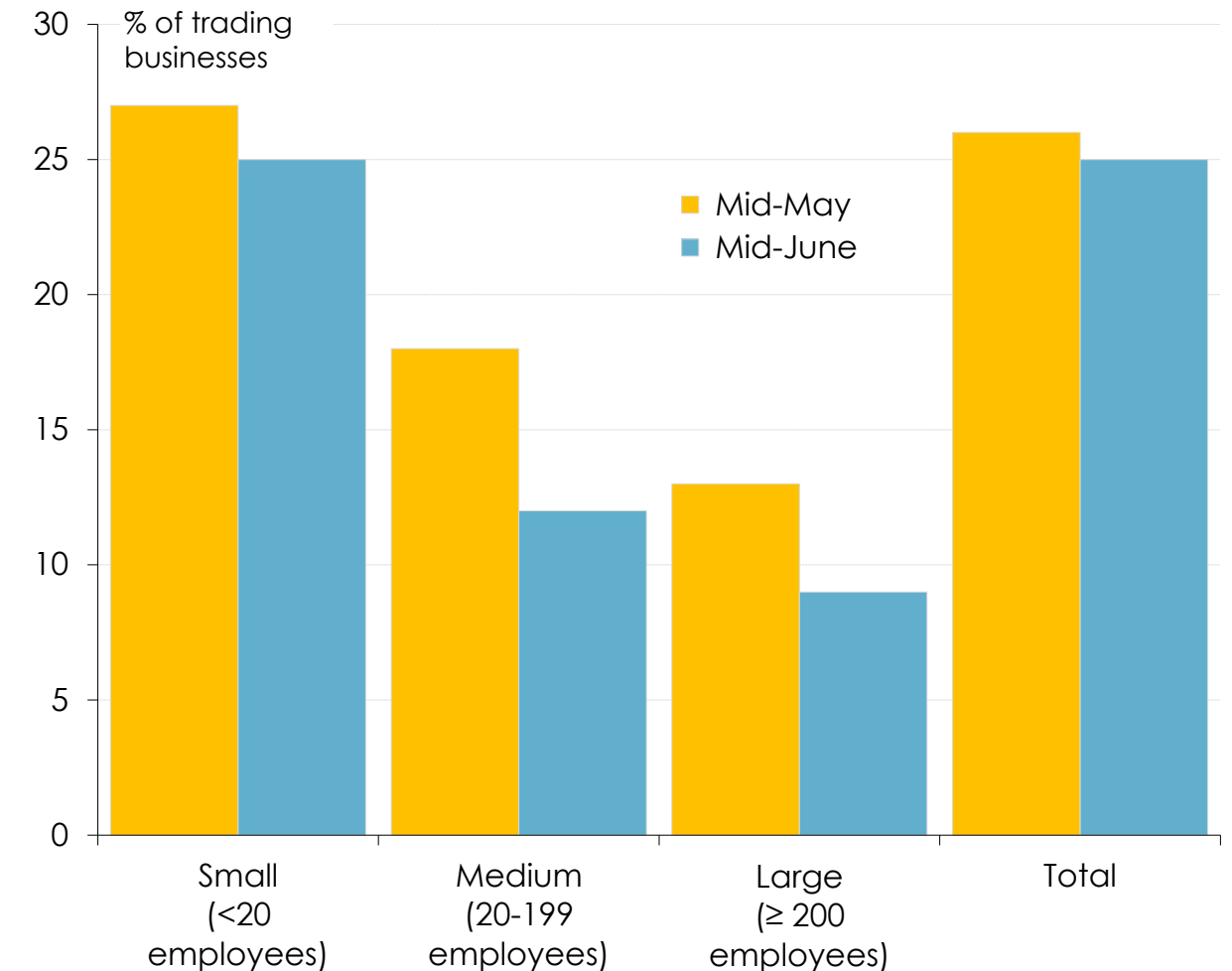
Note: Shaded areas denote recessions. (f) denotes Australian Treasury forecasts (for more detail see slide 93).
Sources: ABS; Australian Treasury, *Economic and Fiscal Update*, 23rd July 2020.

Three-quarters of businesses are still operating under 'modified conditions' – with fewer large business operating as 'normal' than small ones

Proportion of 'trading businesses' which are operating 'as normal' – by industry



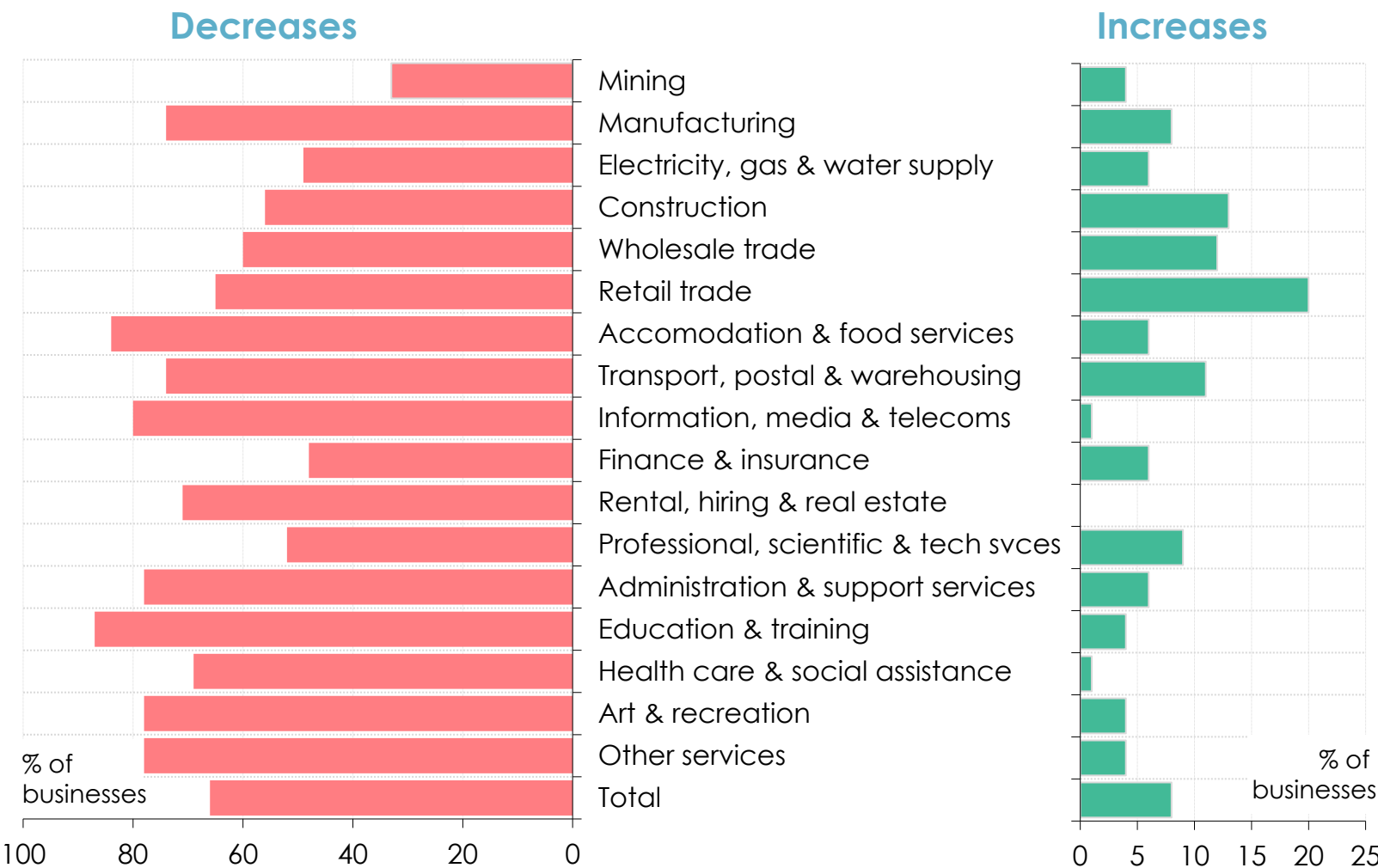
Proportion of 'trading businesses' which are operating 'as normal' – by size



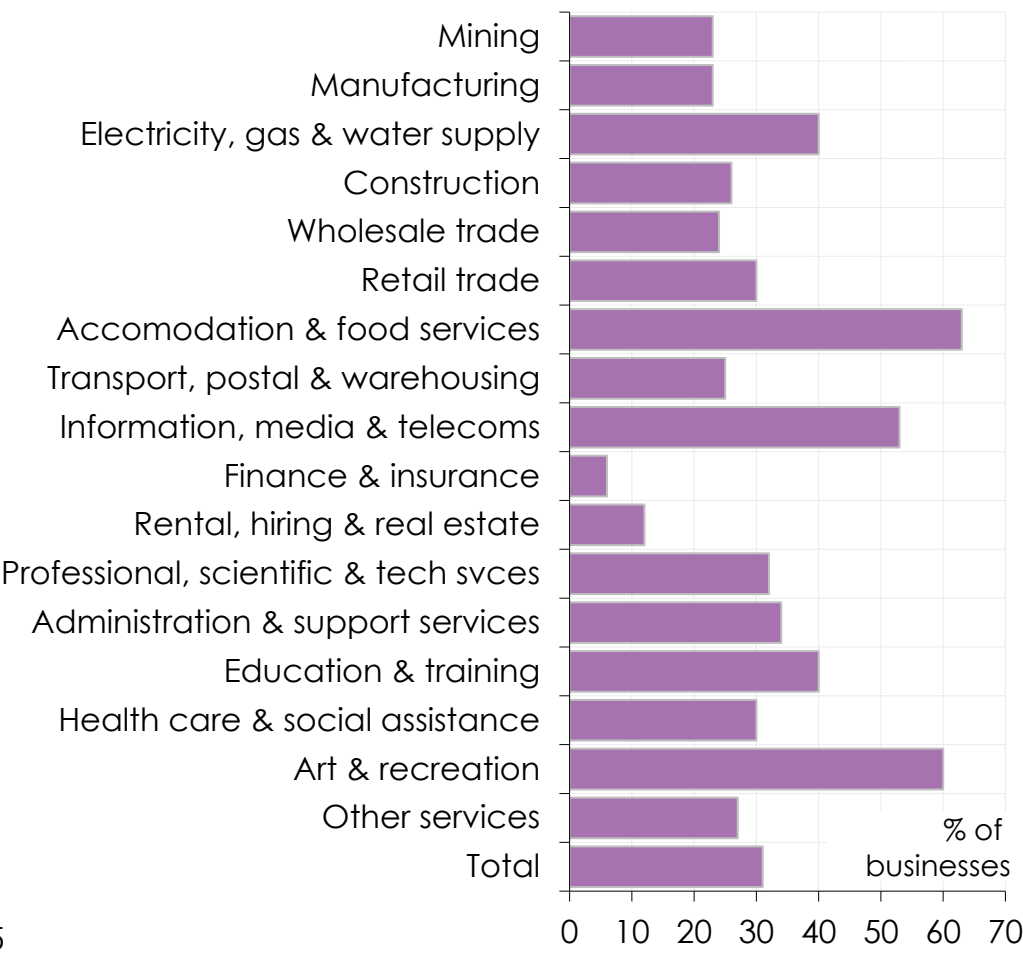
Source: ABS Business Indicators, Business Impacts of COVID-19, May 2020 (based on survey conducted between 13th and 22nd May) and June 2020 (based on survey conducted between 10th and 17th June).

Two-thirds of all businesses reported lower revenue in June compared with June last year – and 30% of them reported declines of more than 50%

Proportion of businesses reporting decreases or increases in revenue in June 2020 cf. June last year, by industry



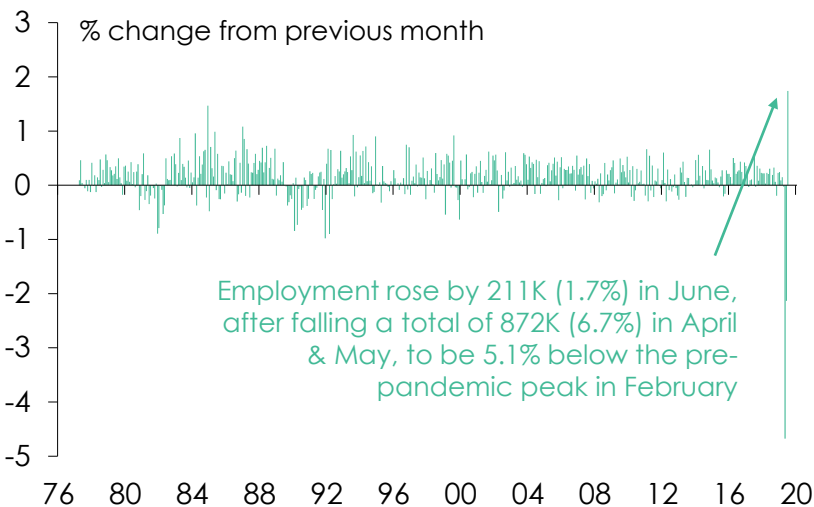
Businesses with revenue decreases of 50% or more in June cf. June last year, as a pc of businesses with lower revenue



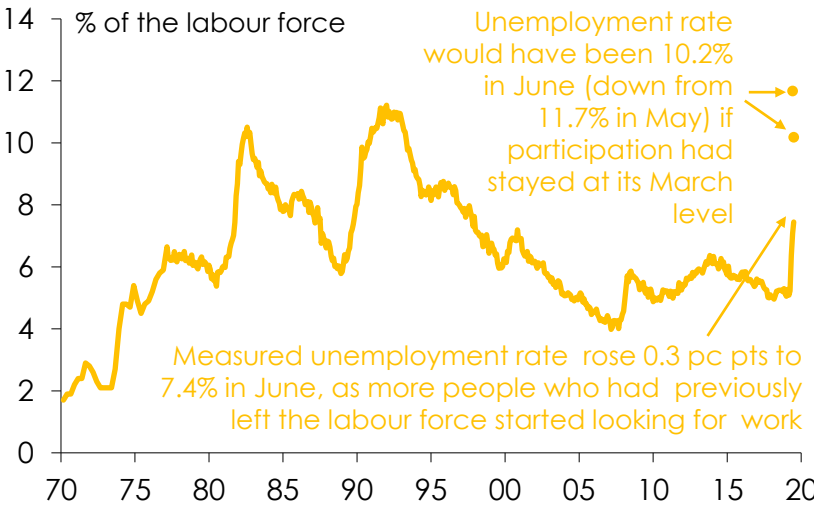
Source: ABS Business Indicators, Business Impacts of COVID-19, June 2020 (based on survey conducted between 10th and 17th June).

211,000 (24%) of those who lost their jobs in March-April are now back at work, while another 70,000 started looking for work

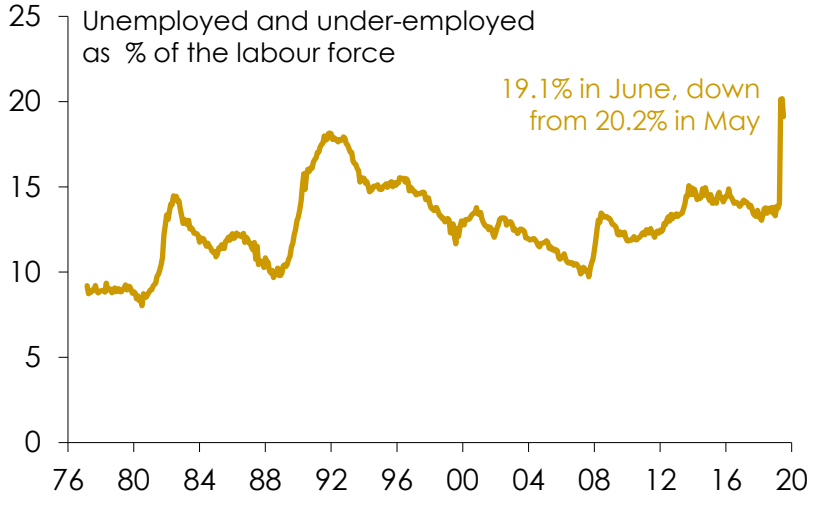
Employment



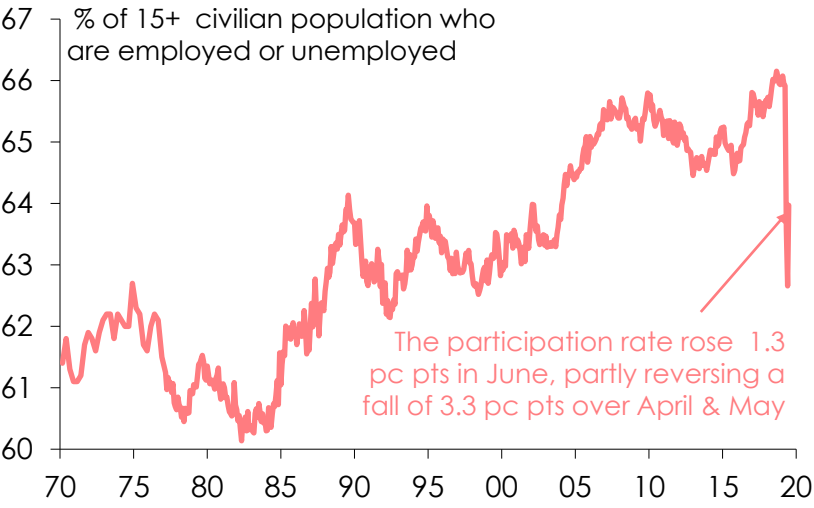
Unemployment rate



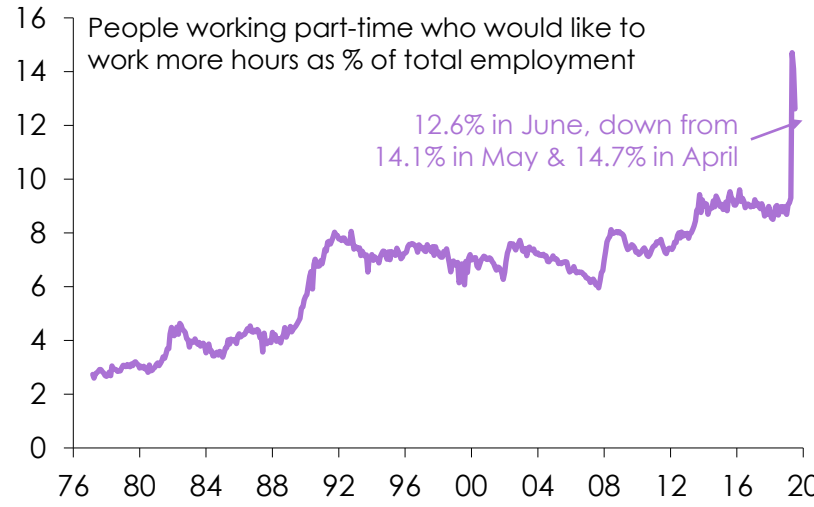
'Under-utilization' rate



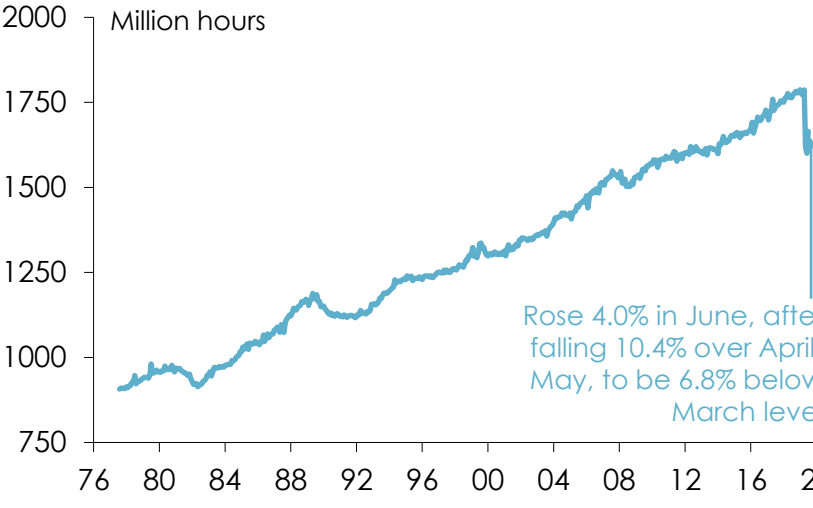
Labour force participation rate



Under-employment ratio



Total hours worked

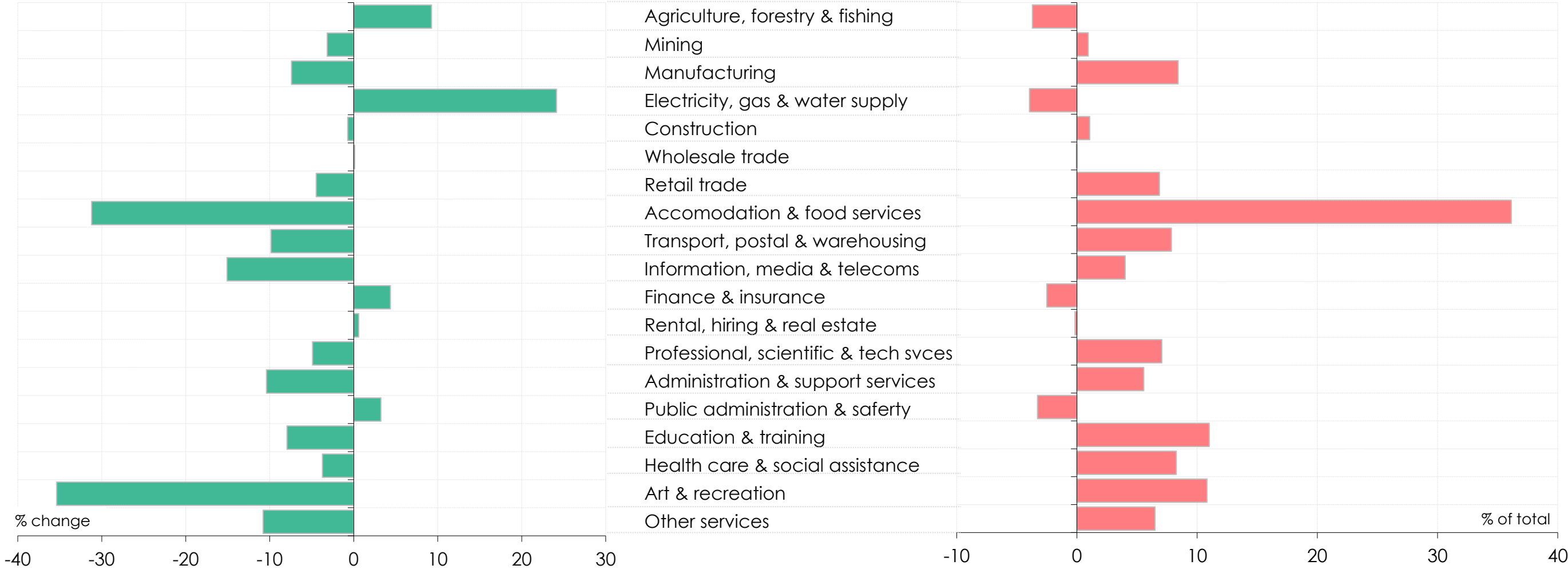


Note: The ABS classifies people on JobKeeper who worked zero hours in the survey week as 'employed'. Had it not done so, the unemployment rate in May would have been 9.5% (down from 11.7% in April). The 'under-employment ratio' is the percentage of employed persons who are working fewer hours than they are willing and able to work. The 'under-utilization rate' is the proportion of the labour force who are unemployed or underemployed. Source: ABS. July data will be released on 13th August.

58% of total job losses between February & May were in accommodation & food services, education & training, and arts & recreation

Change in employment between February and March 2020, by industry

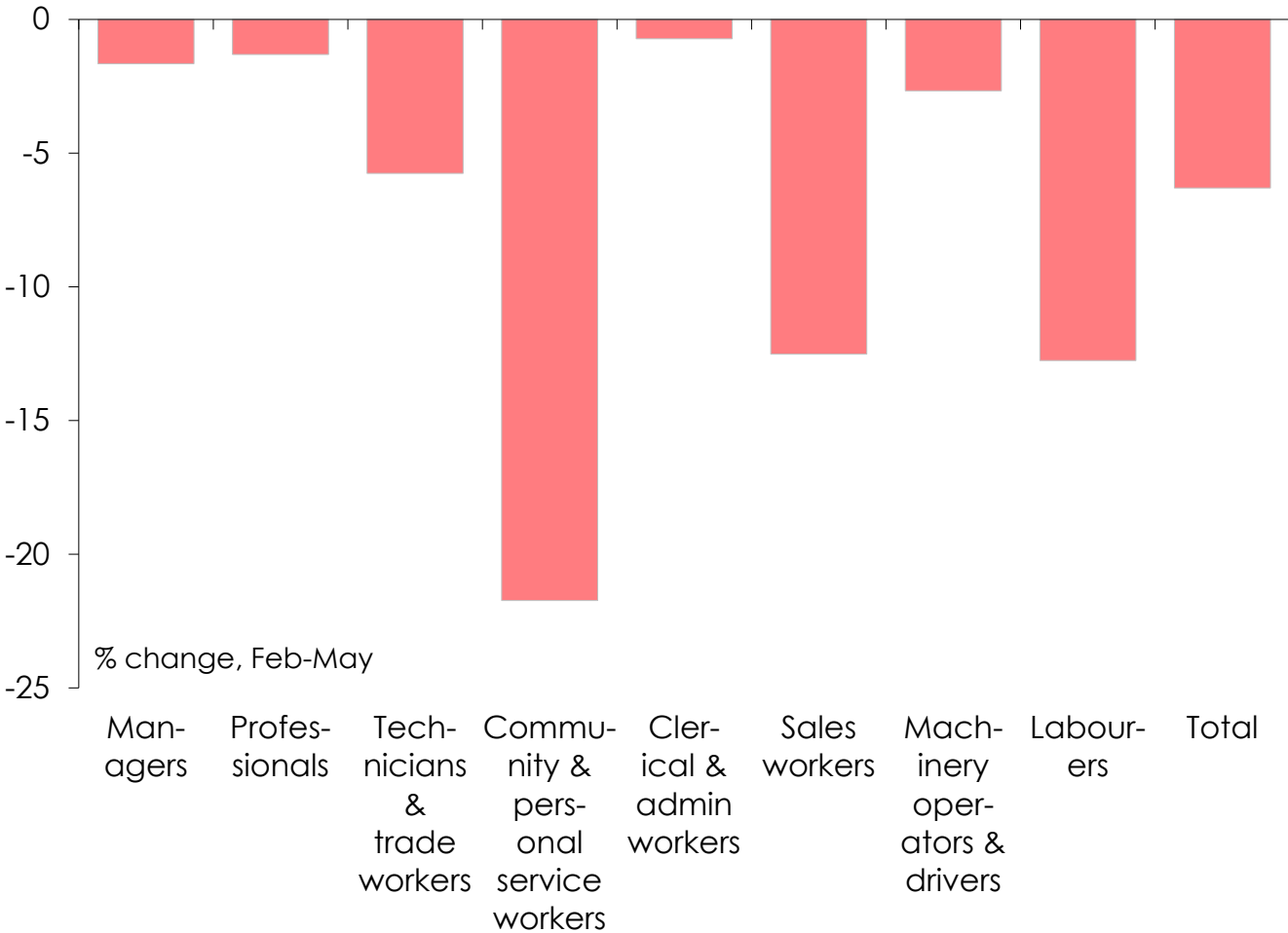
Proportion of change in total employment between February and March 2020, by industry



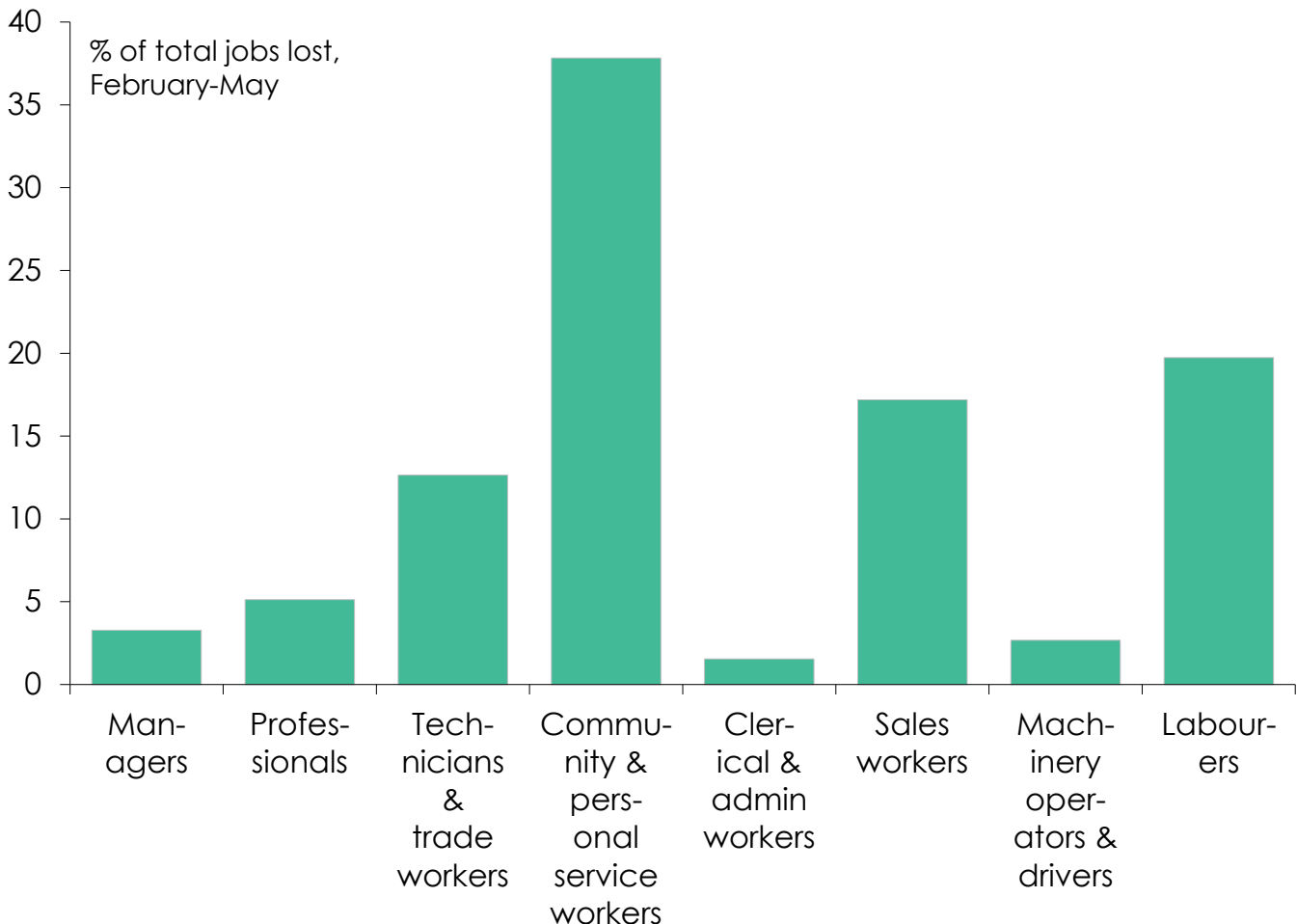
Note: The accommodation & food services, education & training, and arts & recreation services sectors accounted for 15% of total employment in February.
Source: ABS, Detailed quarterly labour force data, May 2020. August data will be released on 24th September.

Community & personal service workers, sales workers and labourers have accounted for 75% of job losses since February

Change in employment between February and March 2020, by occupation



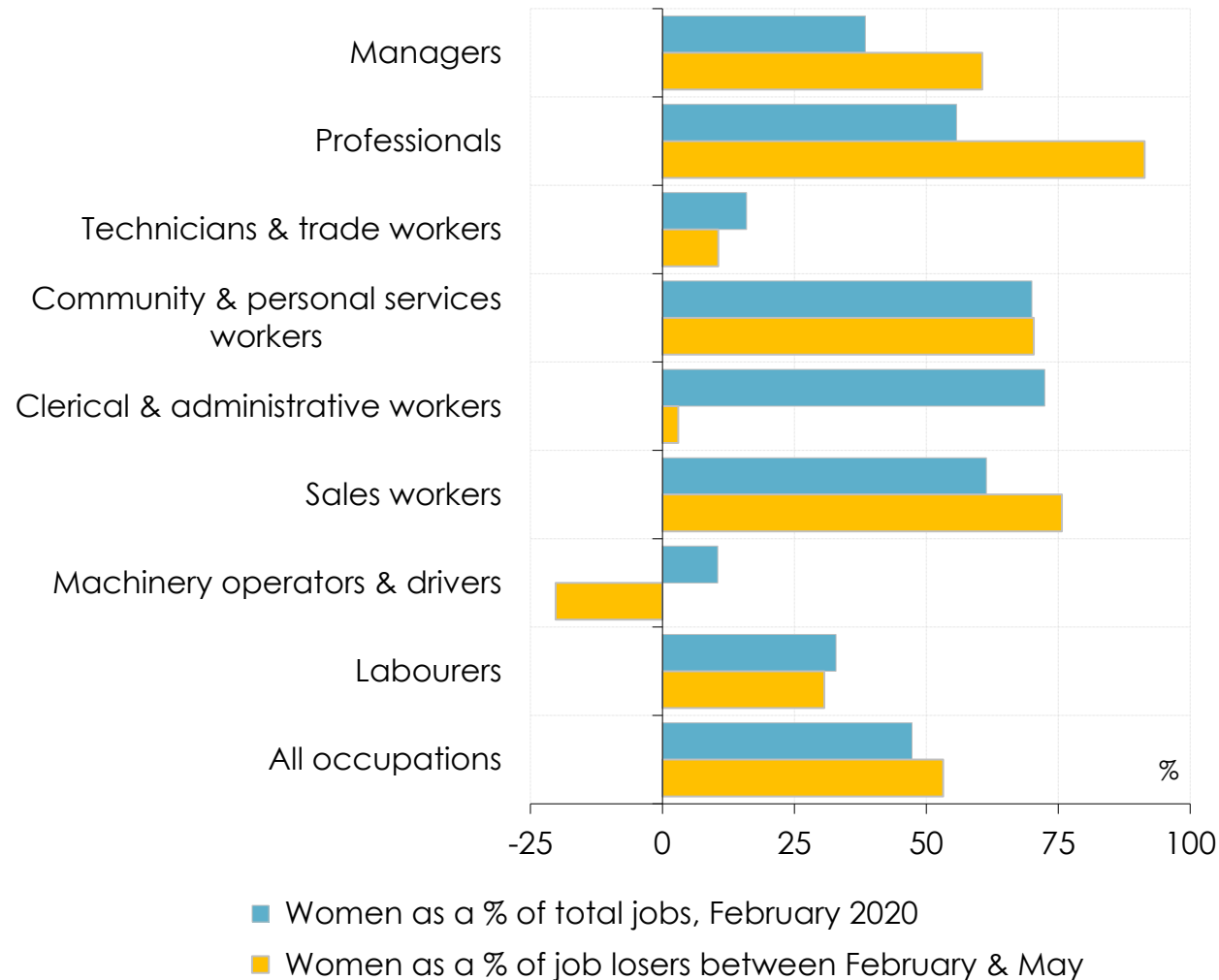
Proportion of change in total employment between February and March 2020, by occupation



Source: ABS, Detailed quarterly labour force data, May 2020.

Women bore 53% of the job losses between February & May, in part because they typically work in occupations or industries which have been hardest hit

Women's share of jobs in February, and of job losses since February, by occupation



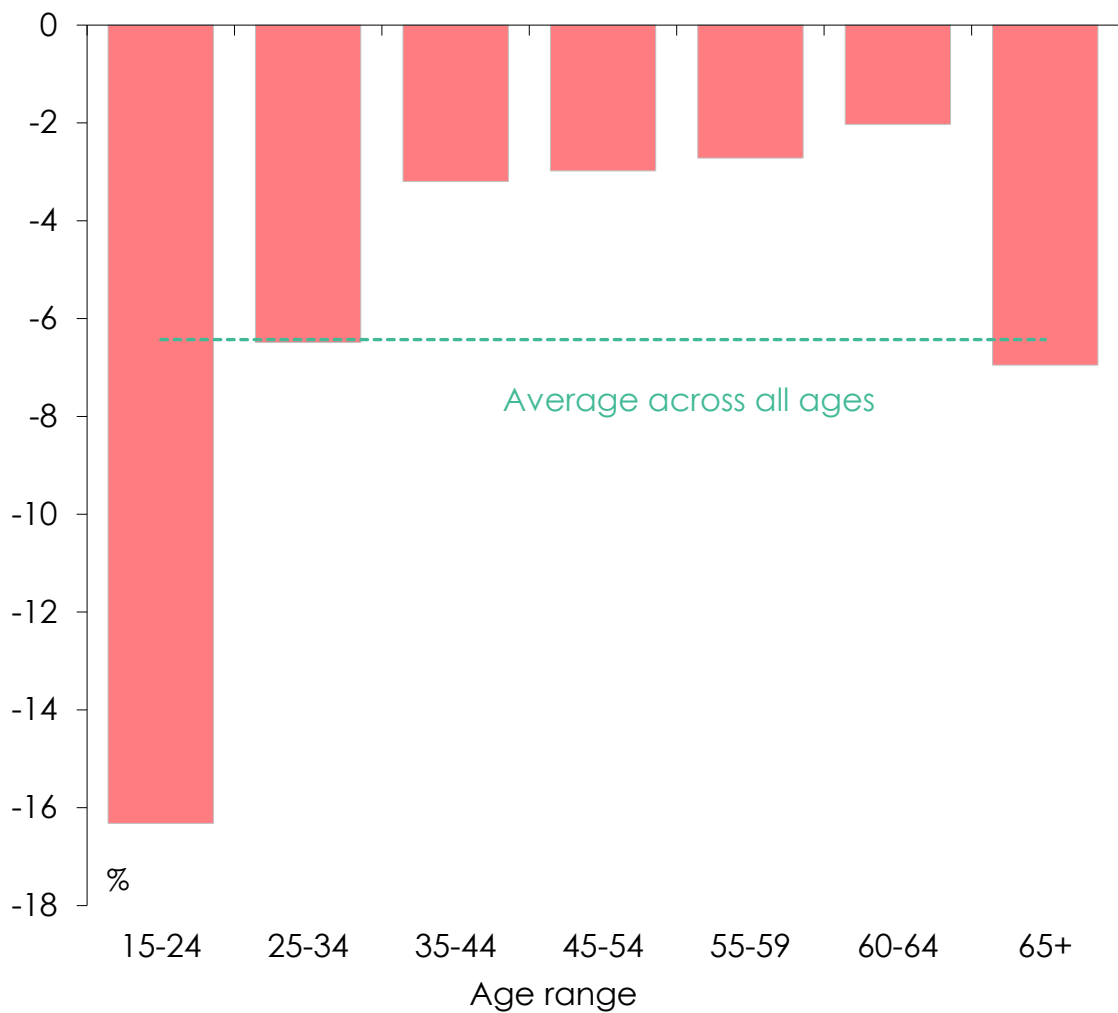
Women's share of jobs in February, and of job losses since February, by industry



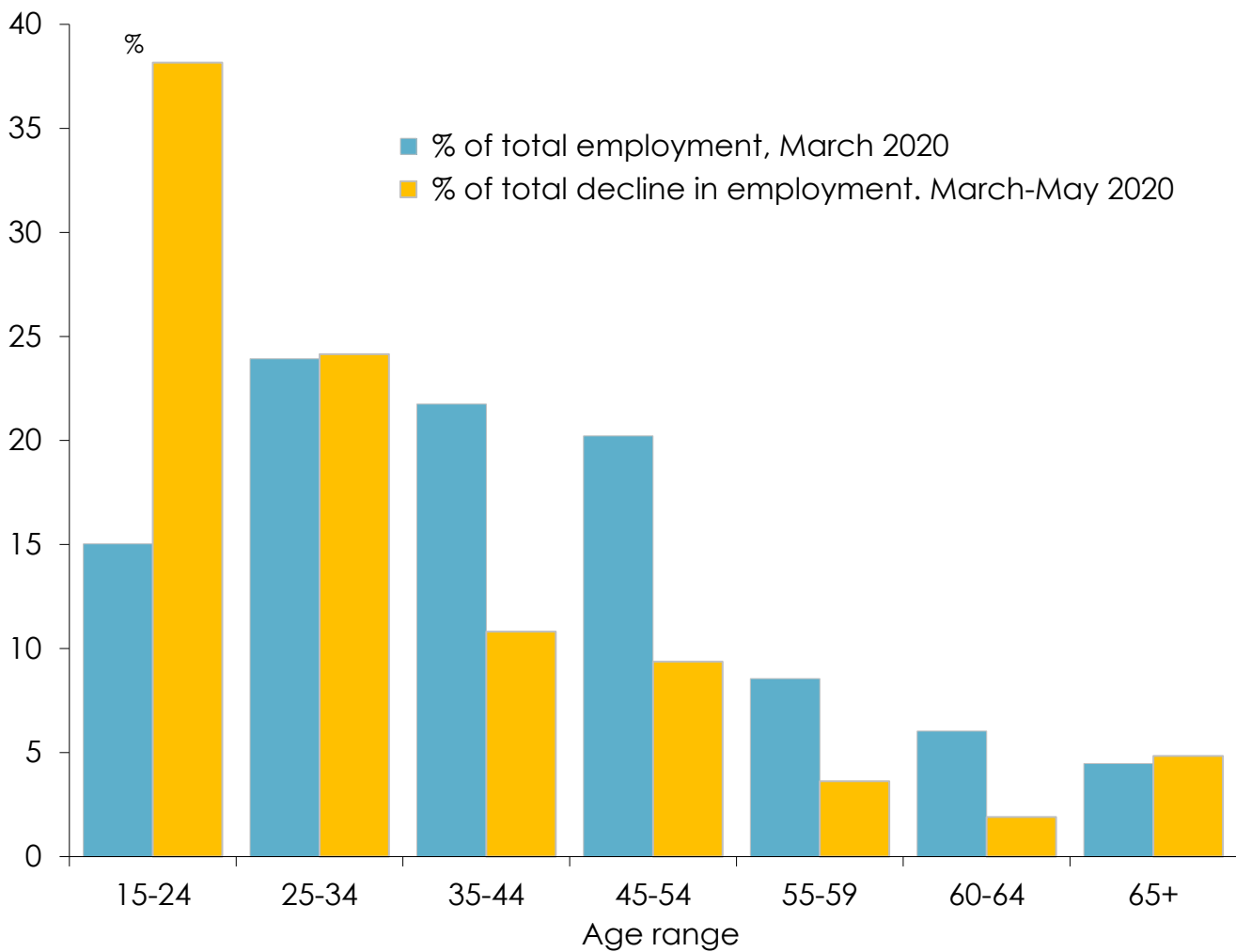
Note: Data depicted in these charts are not seasonally adjust. "nm" = "not meaningful", because employment of women in the industry thus marked either increased between February and May 2020; or fell despite total employment in that industry rising between February and May.
Source: ABS, Detailed quarterly labour force data, May 2020. August data will be released on 24th September.

People aged 15-24 accounted for 15% of total pre-pandemic employment but have experienced 38% of the jobs lost since March

Change in employment, March-May 2020, by age range



Share of total job losses between March and May 2020 and share of total employment in March, by age group



Source: ABS detailed monthly labour force data, May 2020; Corinna. August data will be released on 24th September.

The June unemployment rate would have been 11½% if people working zero hours and those who dropped out of the labour force were counted

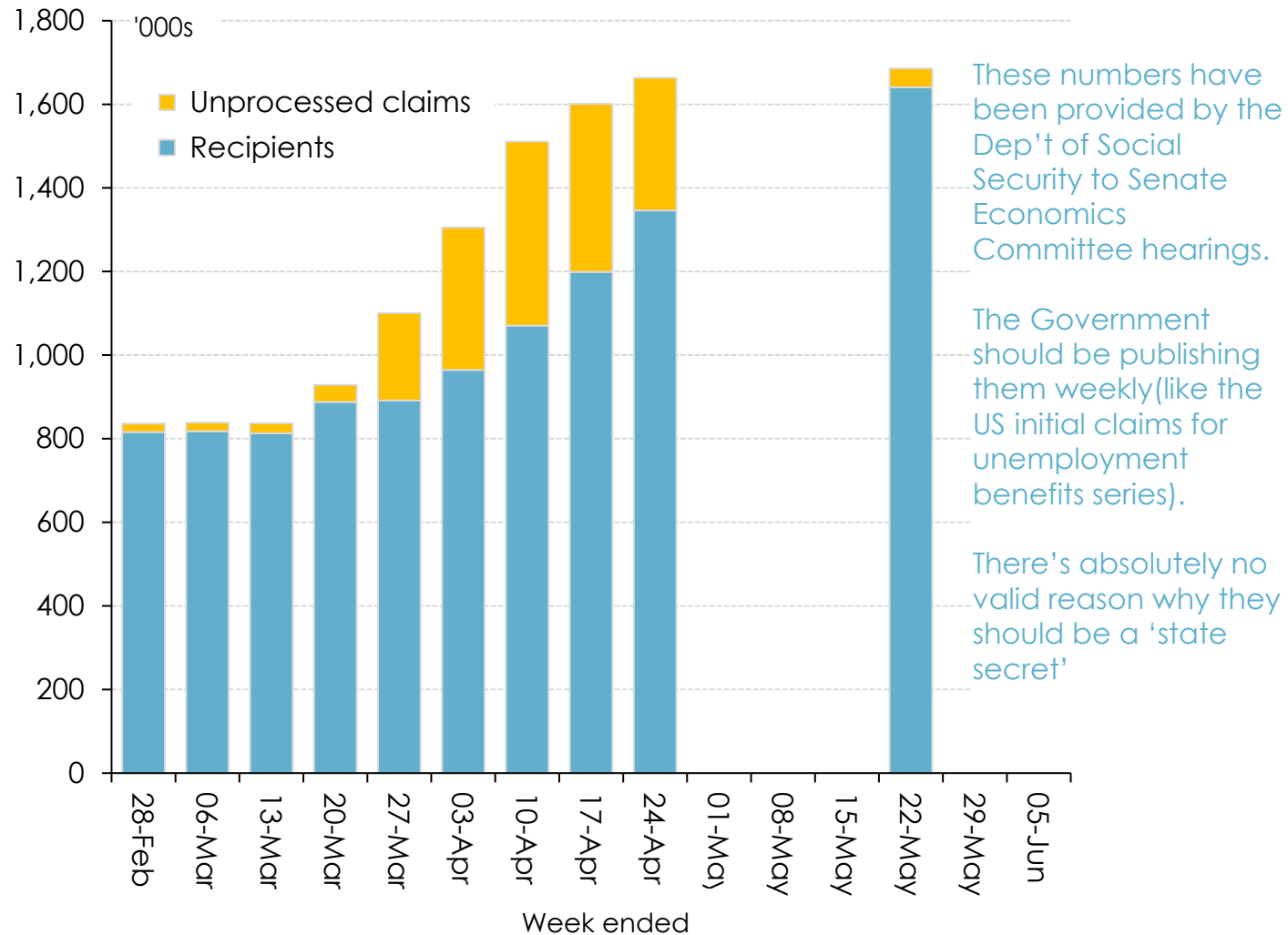
Alternative measures of unemployment



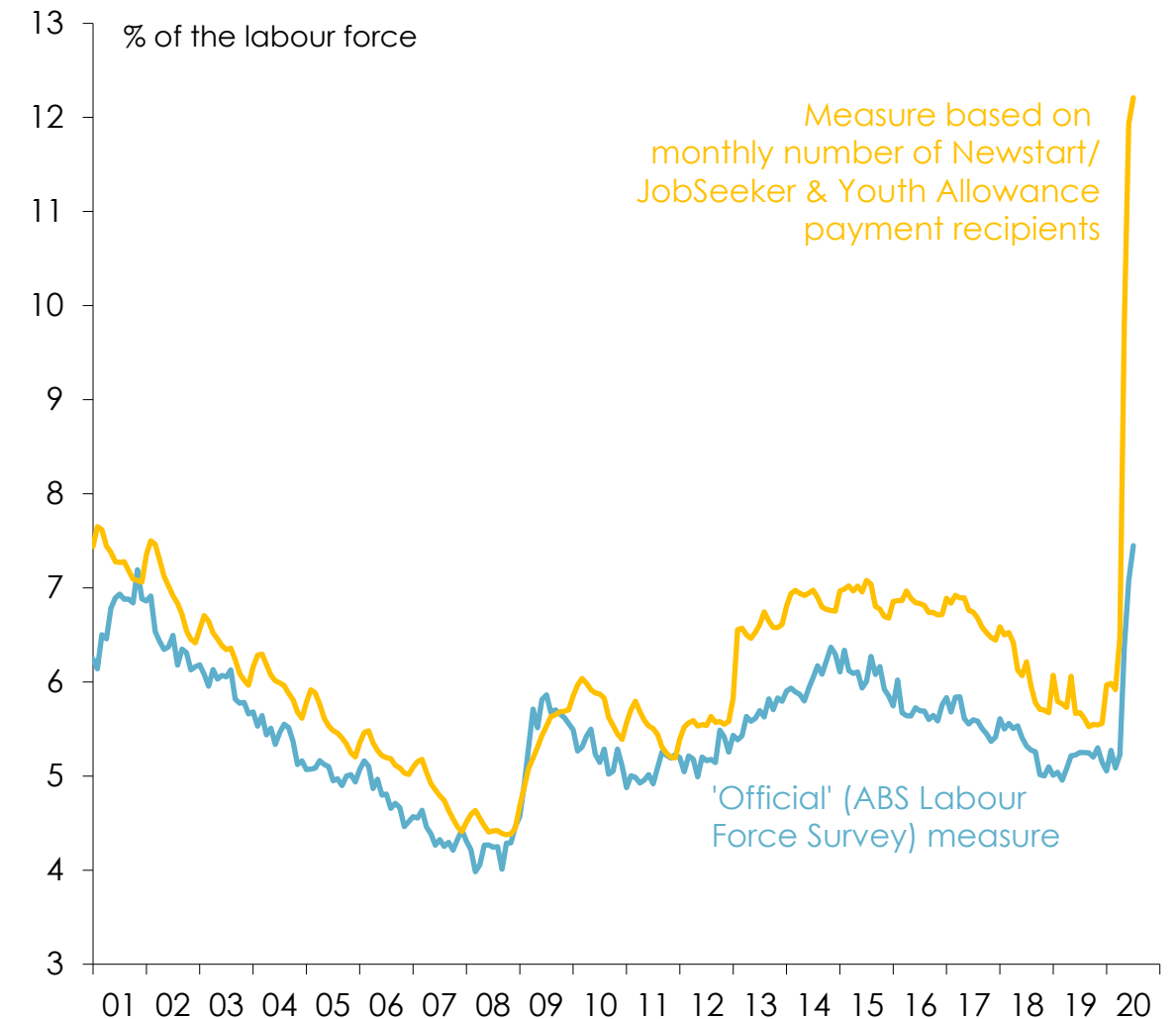
- ❑ The Government's JobKeeper program pays eligible employers a subsidy of \$1500 per fortnight for each eligible employee kept on the payroll between 30 March and 27 September
- ❑ Eligible employers are those with
 - annual turnover of <\$1bn whose turnover has fallen by >30%
 - annual turnover of >\$1bn (other than major banks) whose turnover has fallen by >\$1bn
 - registered charities whose turnover has fallen by >15%
- ❑ Eligible employees are Australian citizens who are (or were at 1 March) permanent full- or part-time employees, or casuals who had at least 12 months 'regular employment'
- ❑ For labour force survey purposes the ABS classifies people being paid through JobKeeper as 'employed' – even if they have been stood down, or worked no hours during the survey week
 - in the US and Canada, such people are classified as unemployed
- ❑ If these people, and those who've dropped out of the labour force since March, were counted as unemployed, then the unemployment rate in June would have been 11.5% - down from 14.0% in May and 14.9% in April

The measured unemployment rate is understating the 'true' extent of job losses

Number of people receiving or seeking Newstart/JobSeeker or Youth Allowance payments



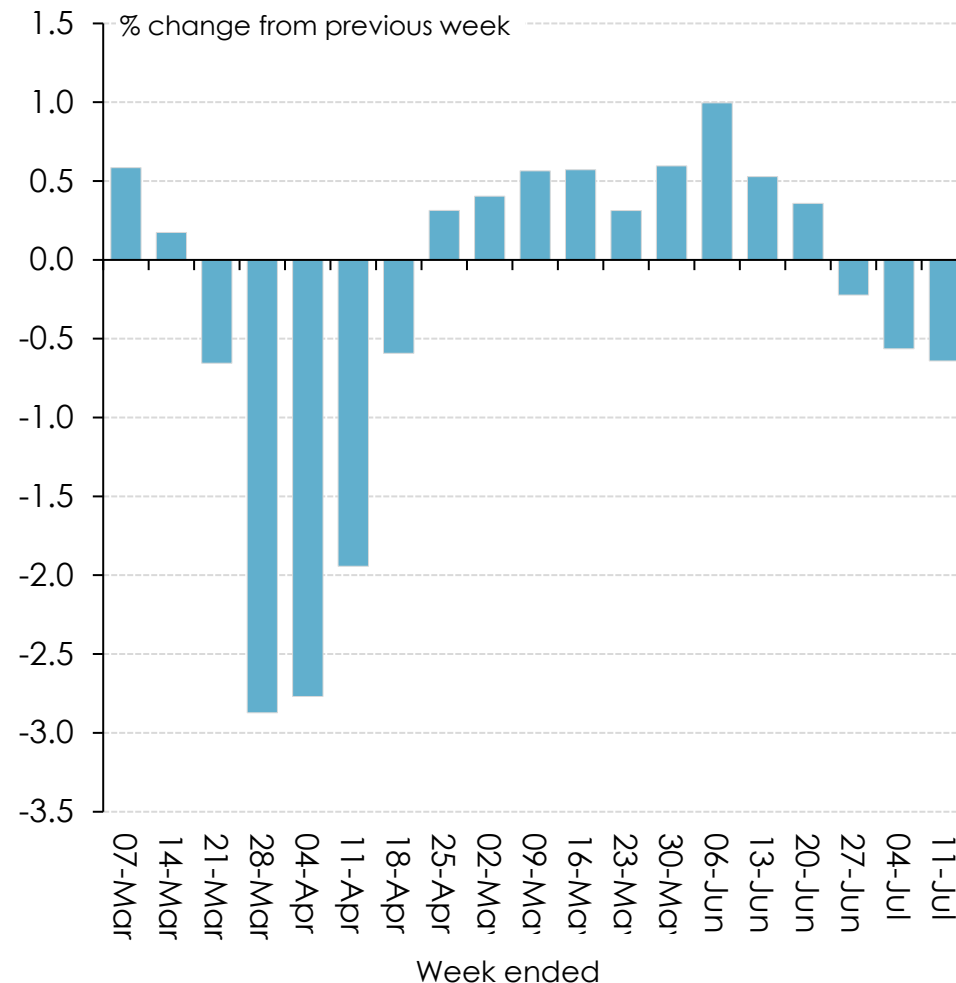
Alternative measures of the 'unemployment rate'



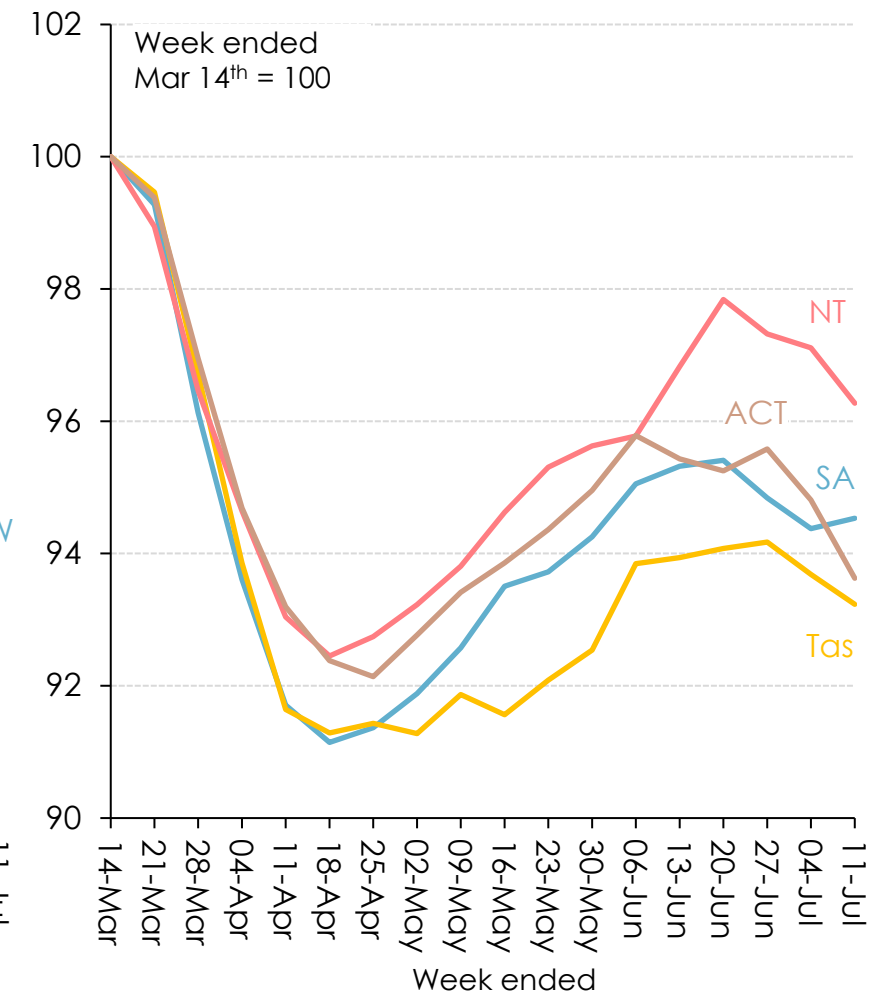
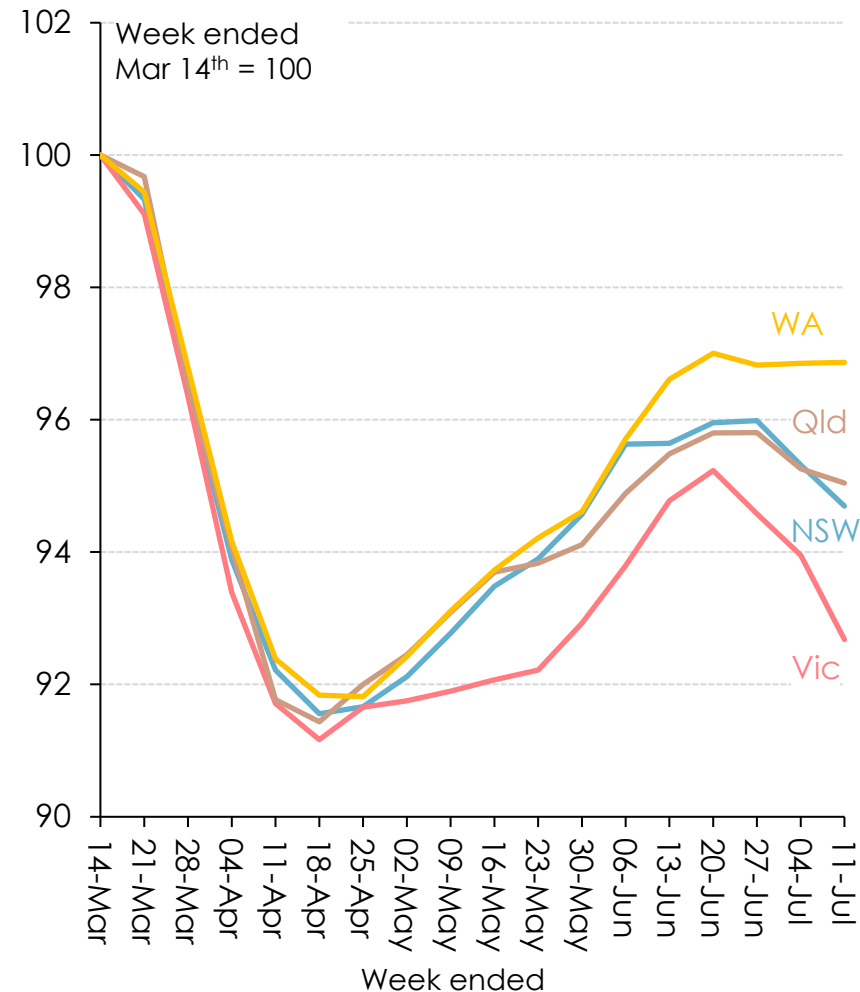
Sources: Department of Social Security; ABS. Note: Youth Allowance recipients excludes full-time students. Number of Newstart/JobSeeker and Youth Allowance recipients is not seasonally adjusted. Latest (monthly) data is for June 2020.

The recovery in payroll employment stalled and went into reverse from late June through mid-July – partly, but not only, because of Victoria

Weekly change in number of payroll jobs



Payroll jobs by State & Territory



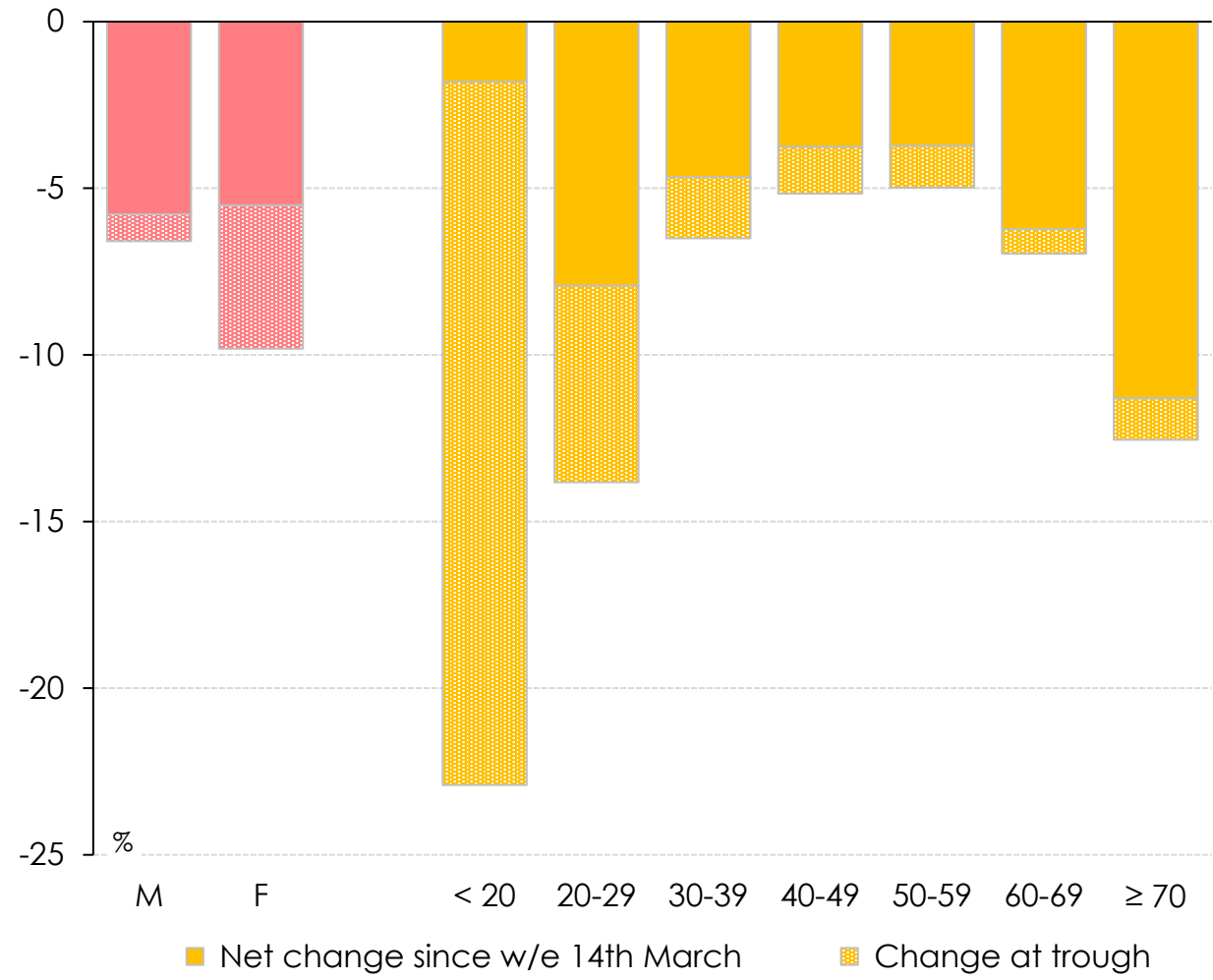
Source: ABS. Data refers to the number of payroll jobs at businesses participating in the Australian Taxation Office's Single Touch Payroll system, which covers 99% of employers with 20 or more employees and about 71% of smaller employees. People with two or more jobs (about 6% of the total) are double-counted; employers and the self-employed are not included. Data are not seasonally adjusted (so at least some of the week-to-week variations could be due to 'normal' seasonal factors). Data for weeks up to week ended 25th July will be released on 11th August.

Victoria and Tasmania continue to have experience the largest net job losses – but it's no longer true that women and teenagers have

Net change in the number of payroll jobs since the week ended 14th March, by state and territory



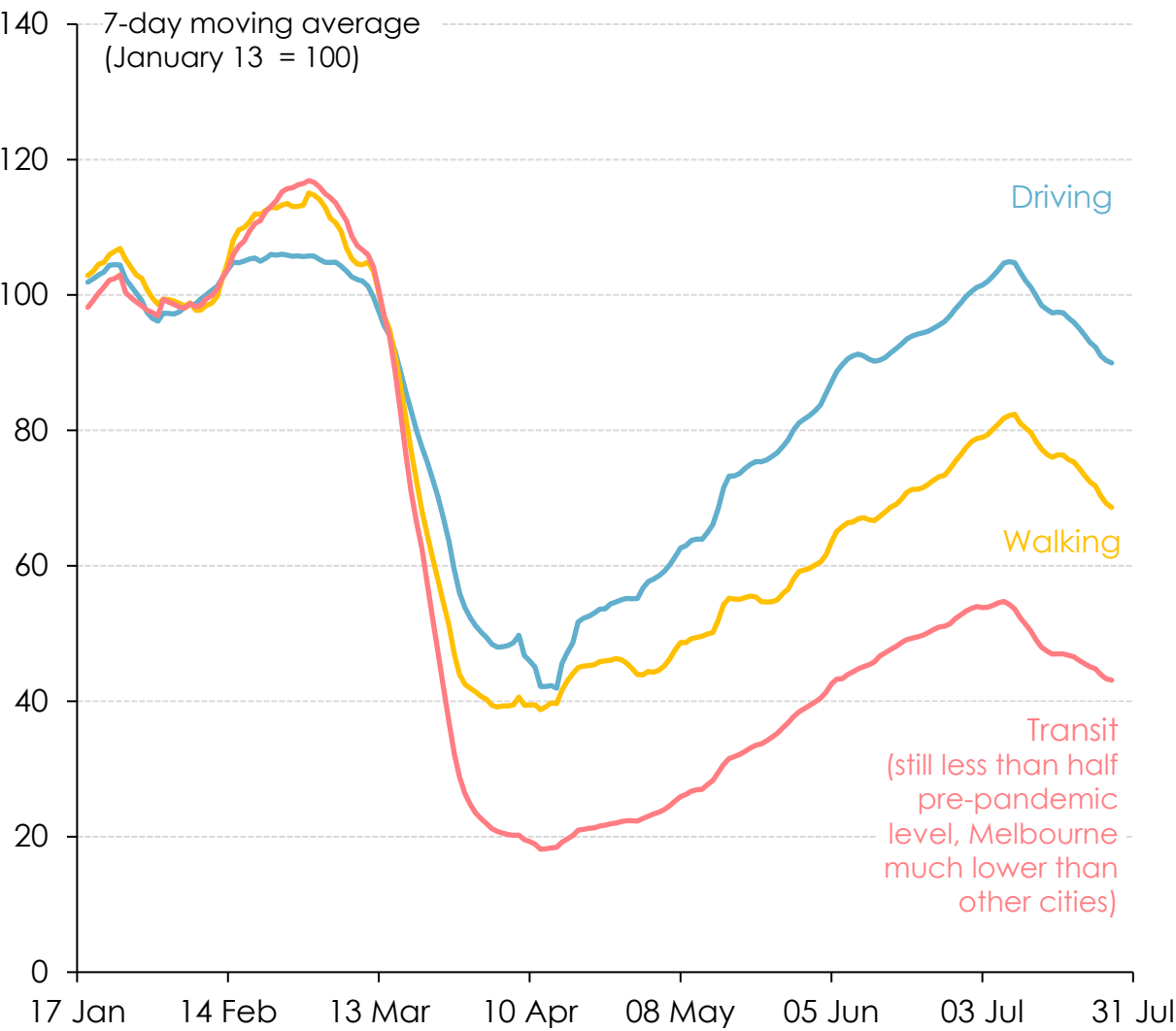
Net change in the number of payroll jobs since the week ended 14th March, by gender and age group



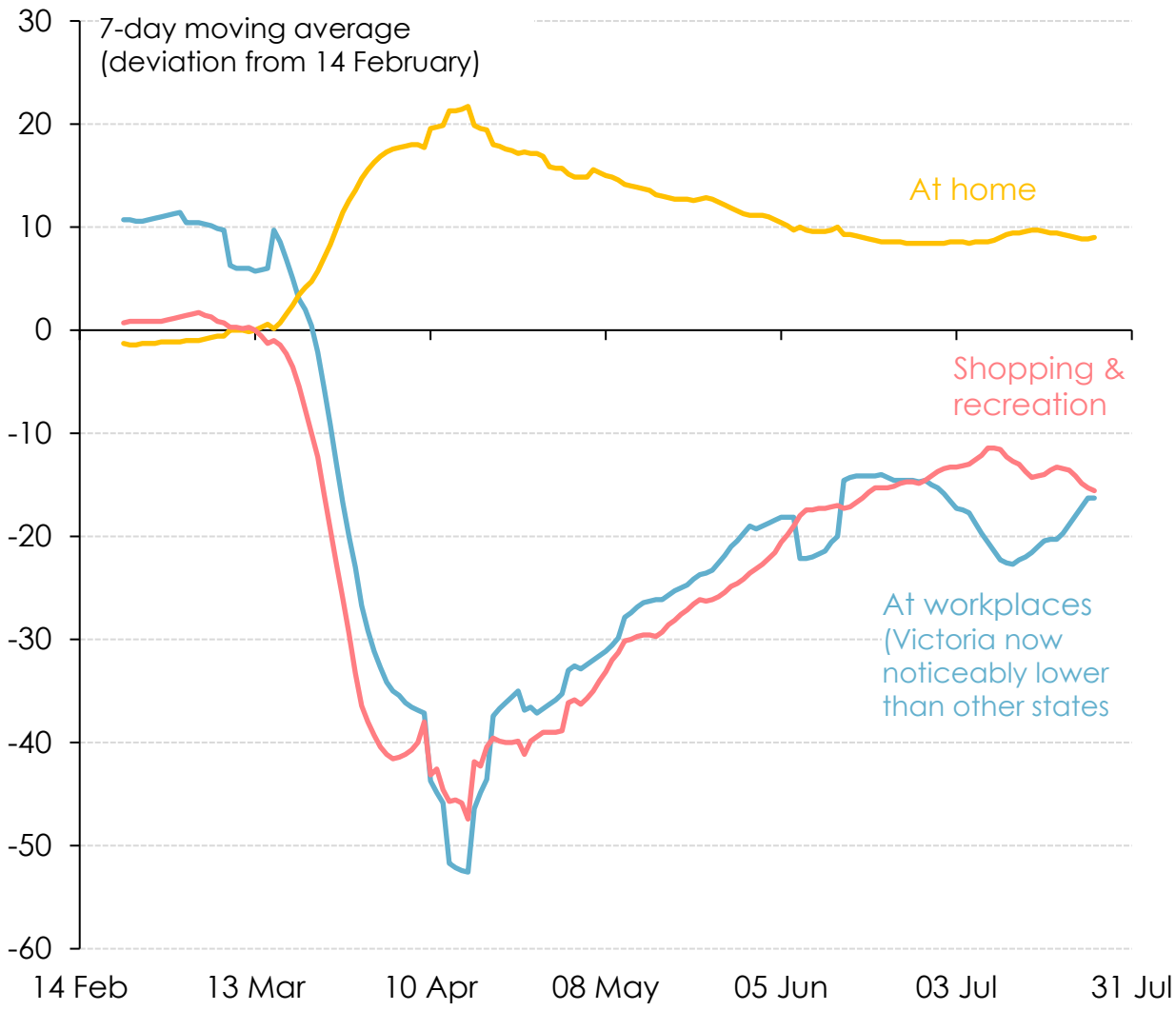
Source: ABS. Data refers to the number of payroll jobs at businesses participating in the Australian Taxation Office's Single Touch Payroll system, which covers 99% of employers with 20 or more employees and about 71% of smaller employees. People with two or more jobs (about 6% of the total) are double-counted; employers and the self-employed are not included. 'Trough' refers to the week in which payroll employment for the state/territory, gender or age group was at its lowest level since mid-March. Data for weeks up to week ended 25th July will be released on 11th August.

Australians were getting out and about more from late April onwards, but since early July have retreated a bit - especially but not only in Victoria

Time spent driving, walking and in transit



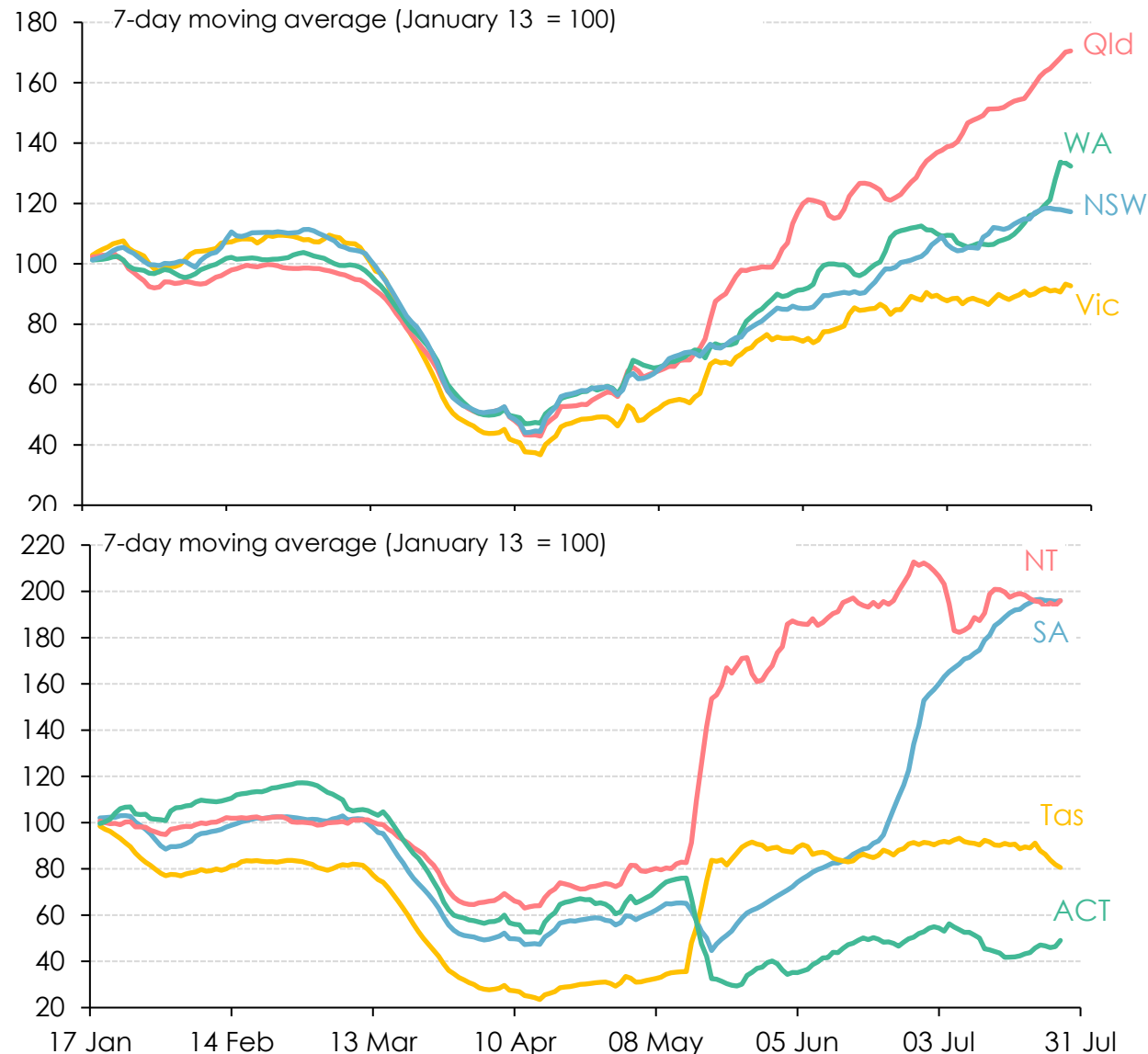
Time spent working, at home, shopping & playing



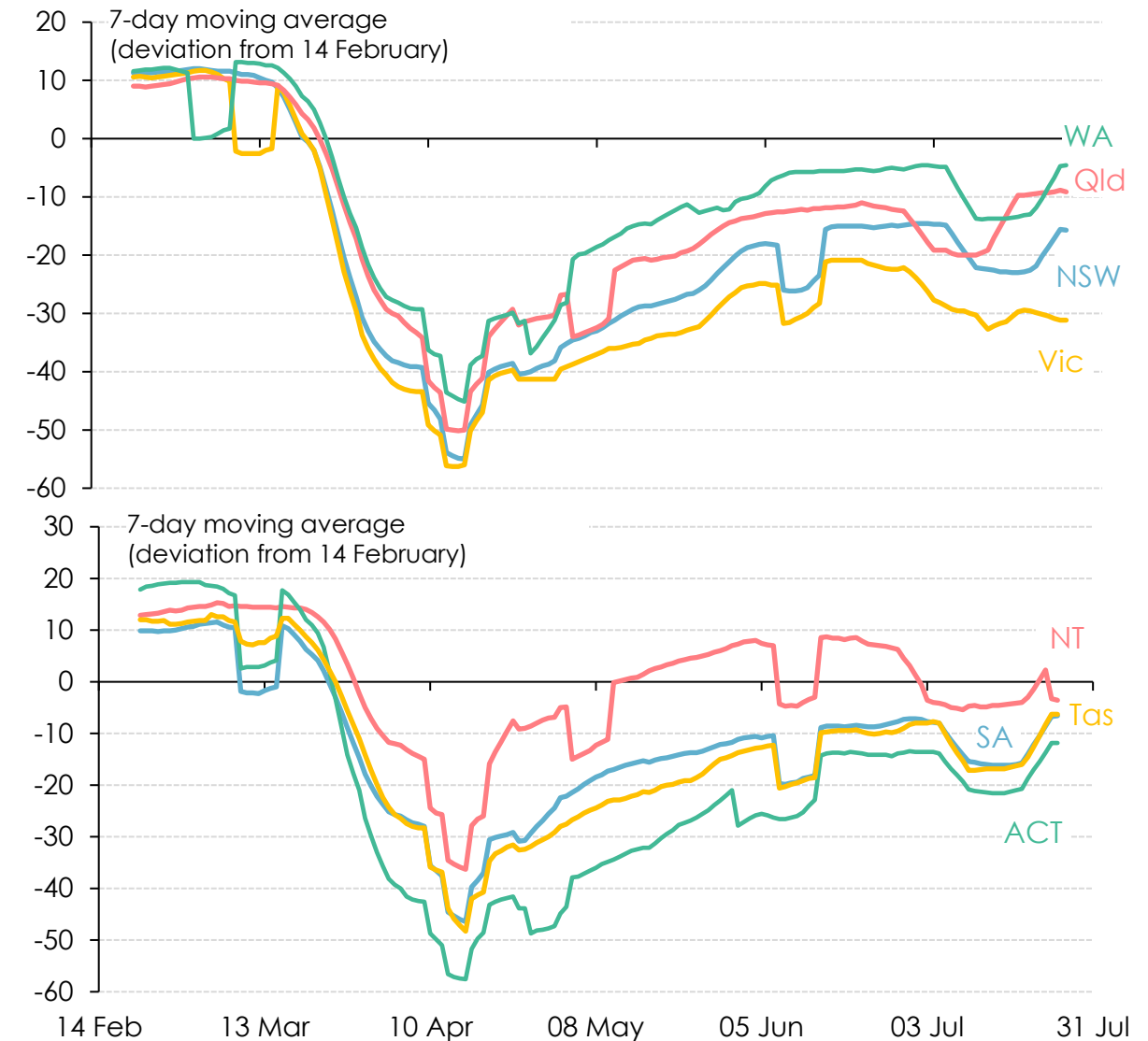
Note: 'transit' means using public transport. Sources: Apple Mobility Trends Reports (data up to 27th July); Google Covid-19 Community Mobility Reports (data up to 25th July).

Mobility data suggest Queensland, Western Australia & the NT returning to 'normal' fastest, with New South Wales & especially Victoria lagging

Time spent driving, by State and Territory

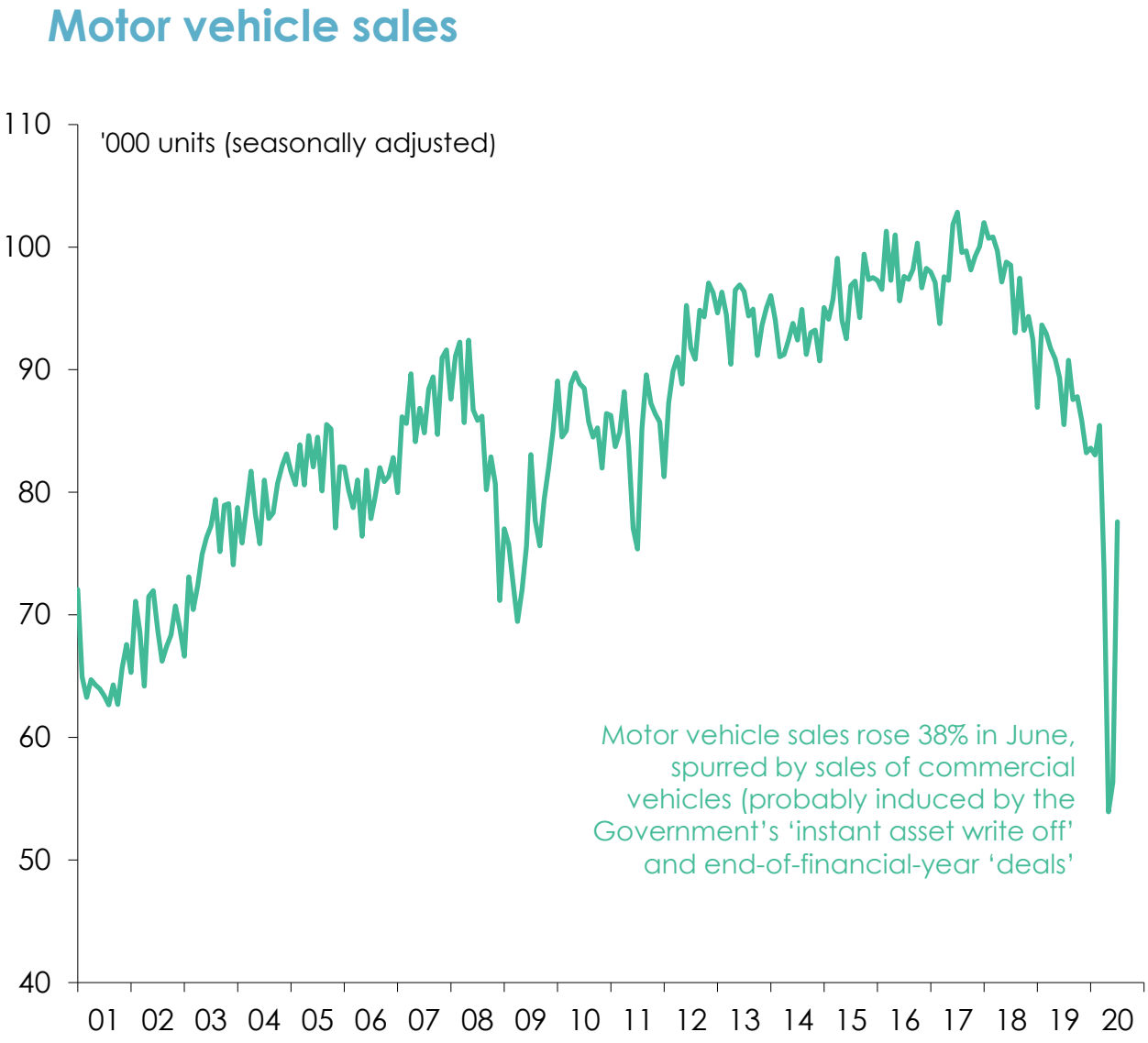
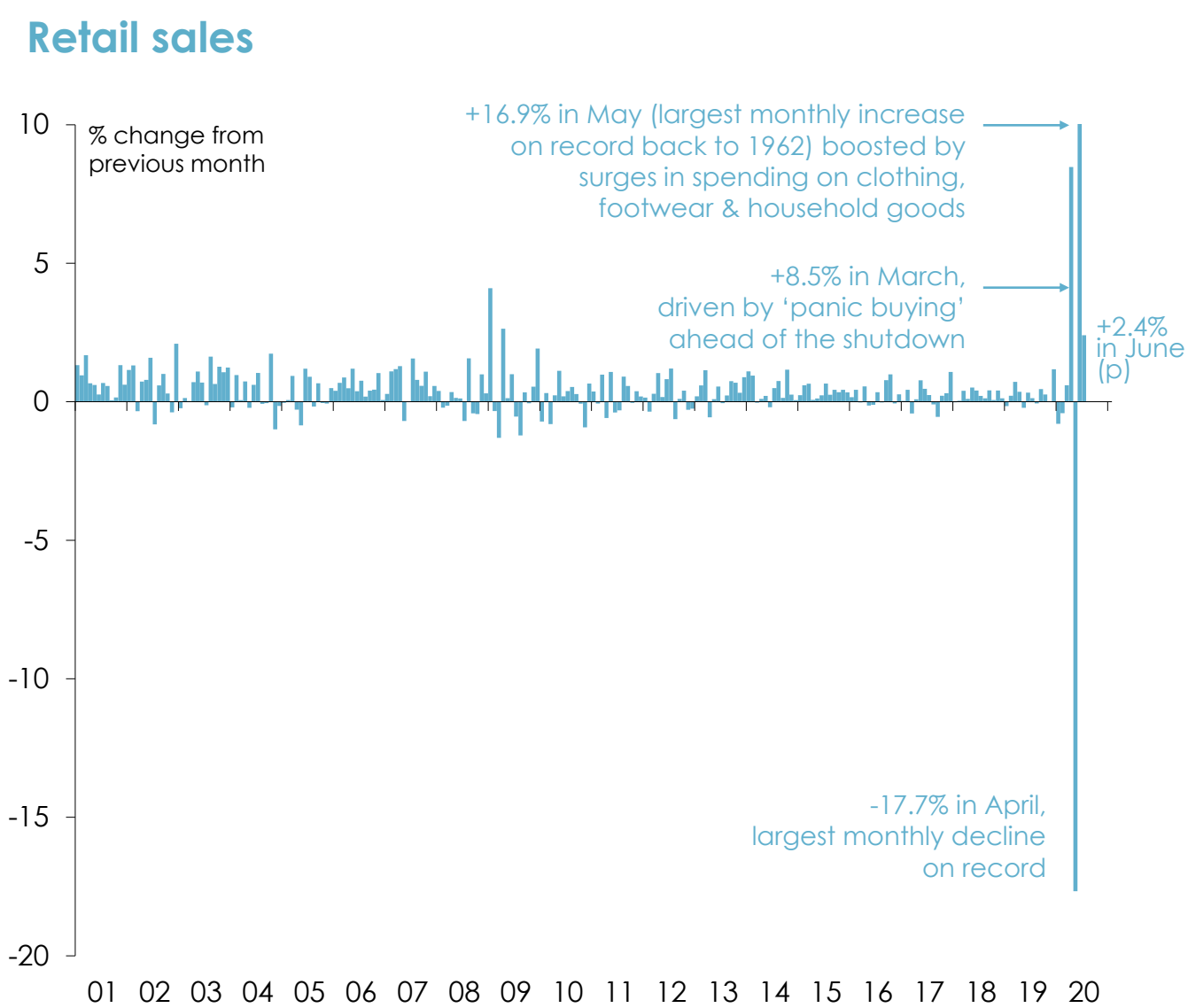


Time spent working, by State and Territory



Sources: Apple Mobility Trends Reports (data up to 27th July); Google Covid-19 Community Mobility Reports (data up to 25th July).

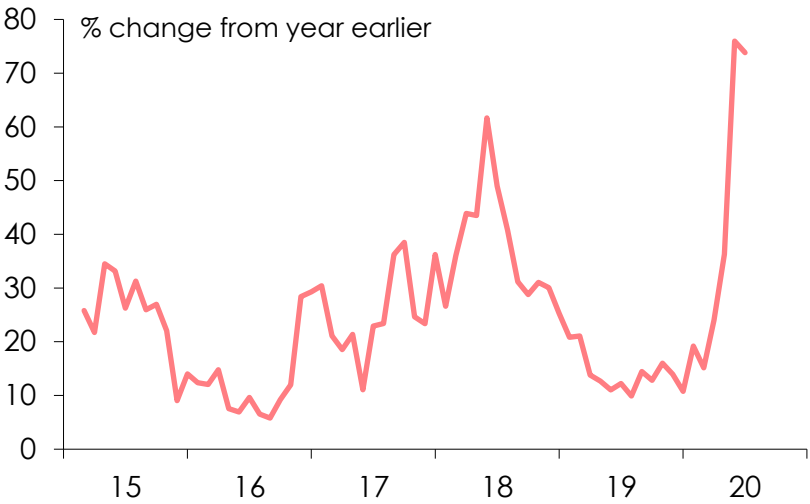
Retail sales rose another 2.3% in June after a 17% rebound in May; while vehicle sales surged in June (though still well below year-earlier levels)



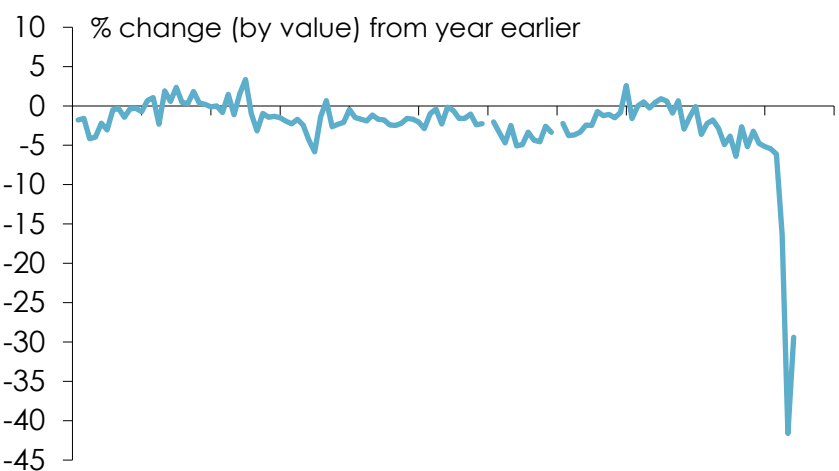
Sources: ABS; Federal Chamber of Automotive Industries VFACTS (seasonal adjustment of FCAI data by Corinna).

The pandemic and lockdown has accelerated changes in the way Australians shop, and make payments

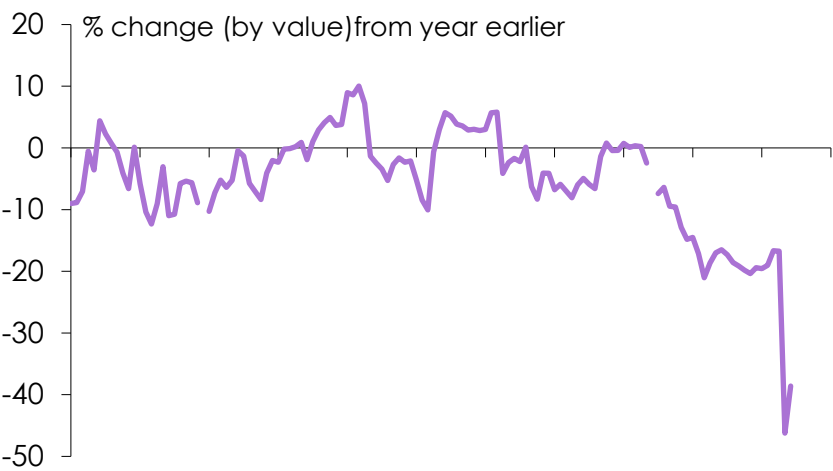
Growth in online retail sales



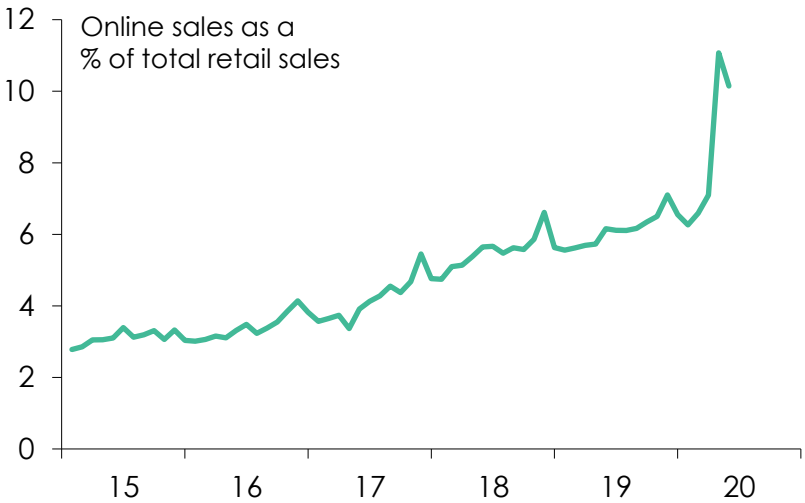
ATM cash withdrawals



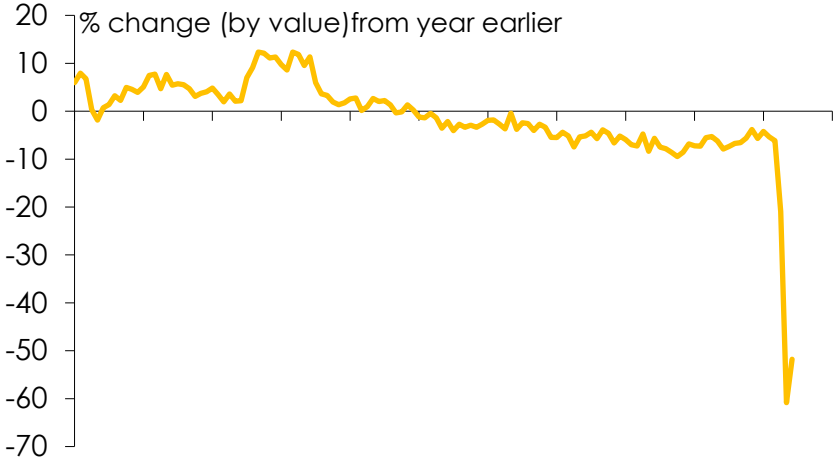
Credit card cash advances



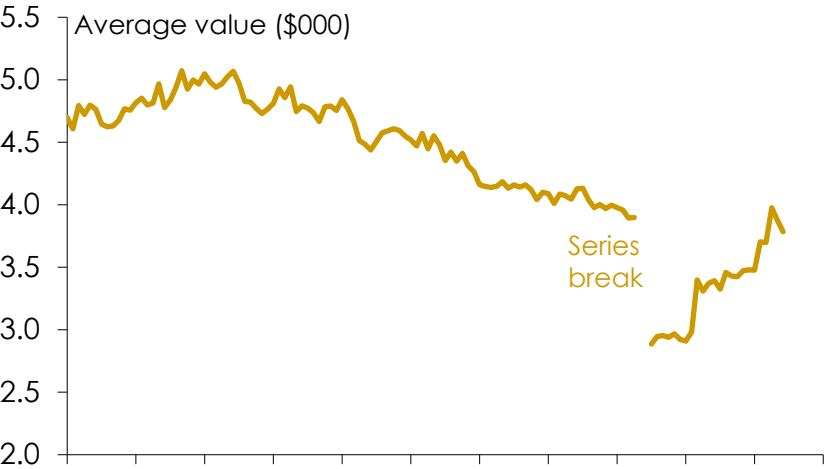
Online retail 'market share'



Debit card cash-outs



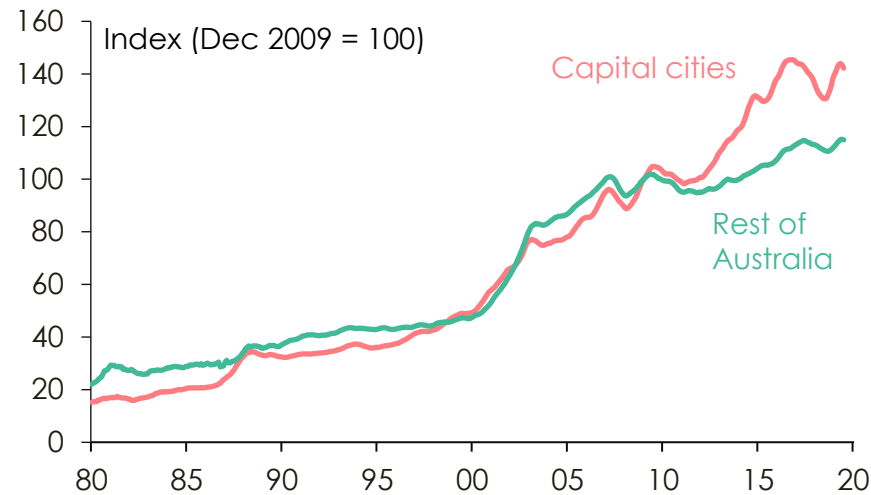
Direct entry payments



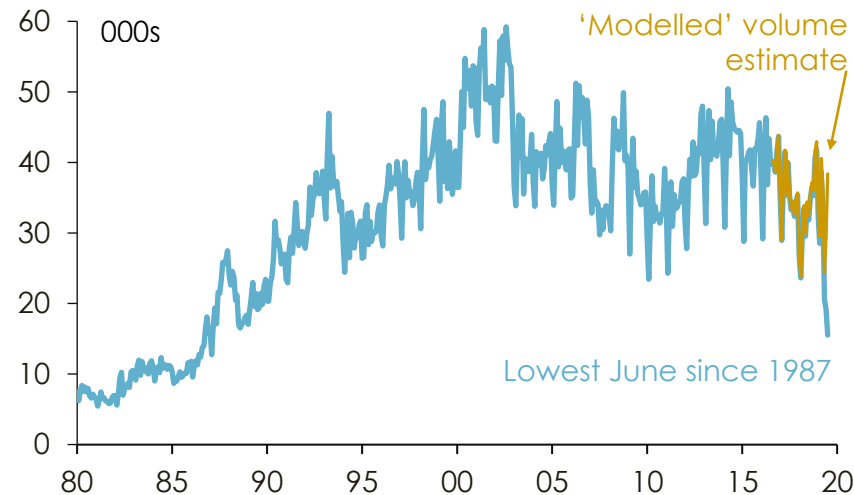
Sources: ABS; RBA. Latest data are for June.

Property prices fell by an average of 1.0% over May and June on thin volumes, largely reflecting falls in top quartile prices

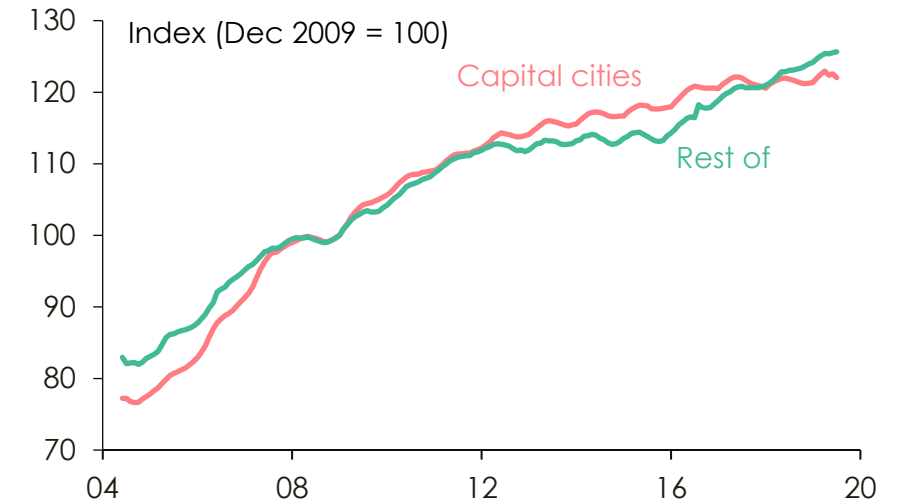
Residential property prices



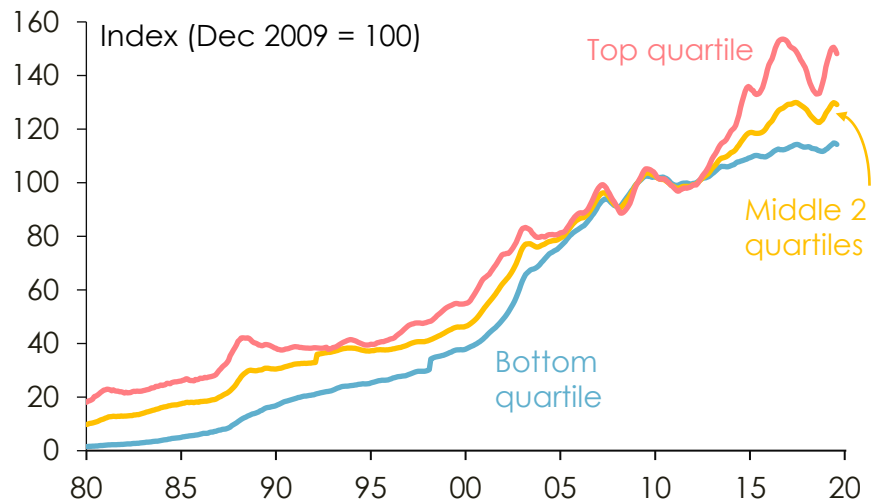
Residential property sales volumes



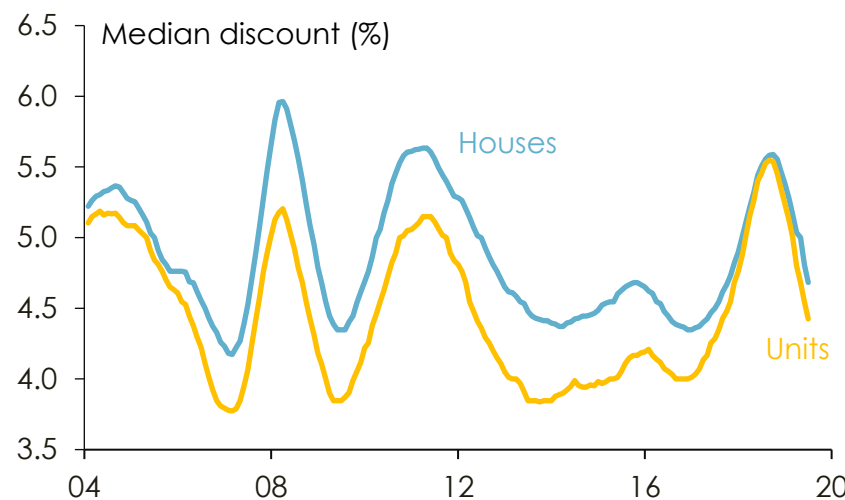
Residential rents



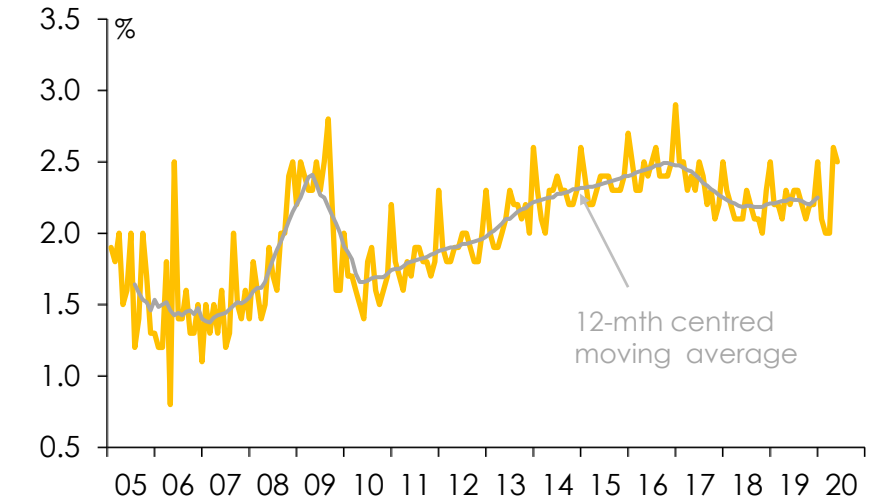
Property prices by tier



Vendor discounting



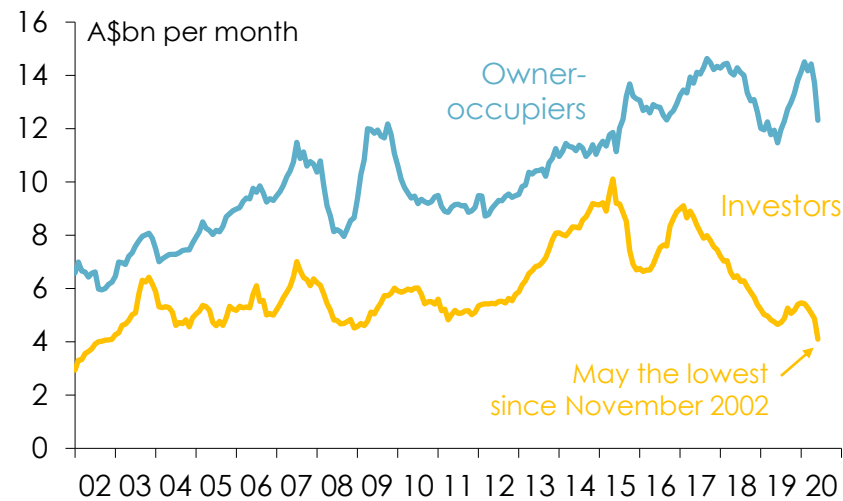
Capital city rental vacancy rates



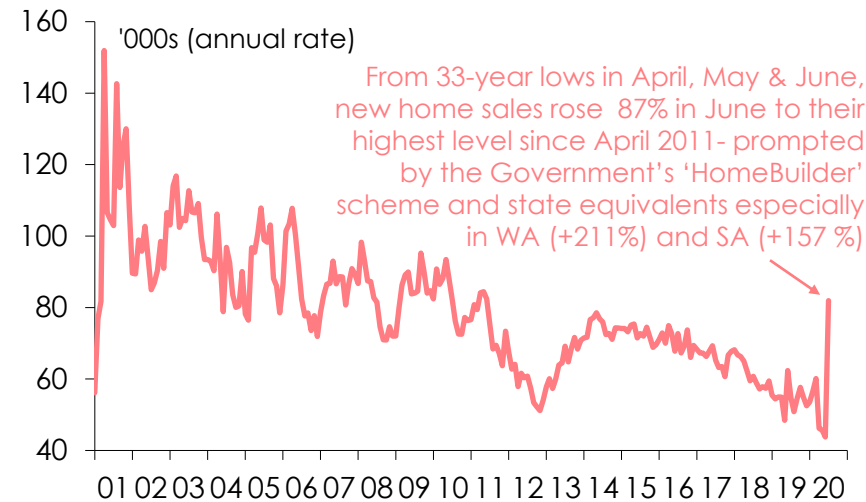
Note: The index of property prices measures the 'organic' change in underlying sales values by using a hedonic regression methodology that takes account of changes in the characteristics of properties being sold from month to month. The index of residential rents uses a similar methodology to measure the 'organic' change in underlying rents. The 'modelled' sales volume estimates seek to account for delays in receiving information on transactions that have yet to settle (which can be more than six weeks after the contract date). Latest data are for June 2020. Sources: CoreLogic; SQM Research.

Residential building activity will turn down over the next few months and longer-term will be adversely affected by sharply lower immigration

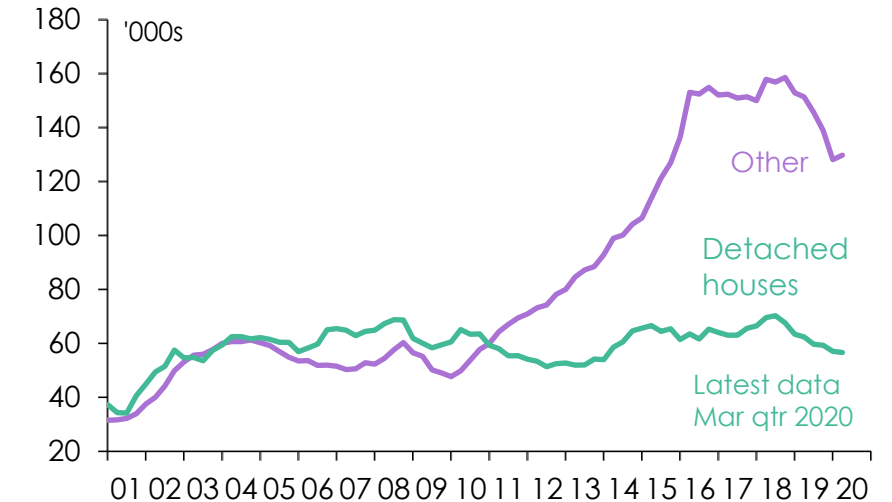
Housing finance commitments



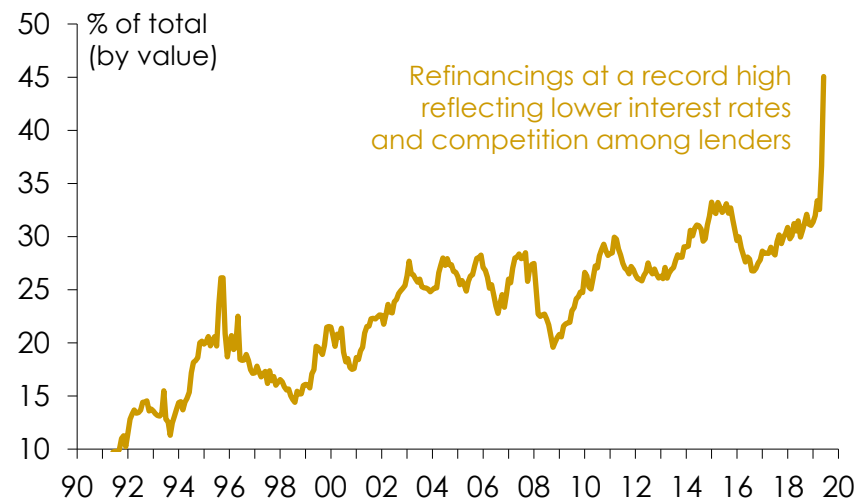
Large builders' new home sales



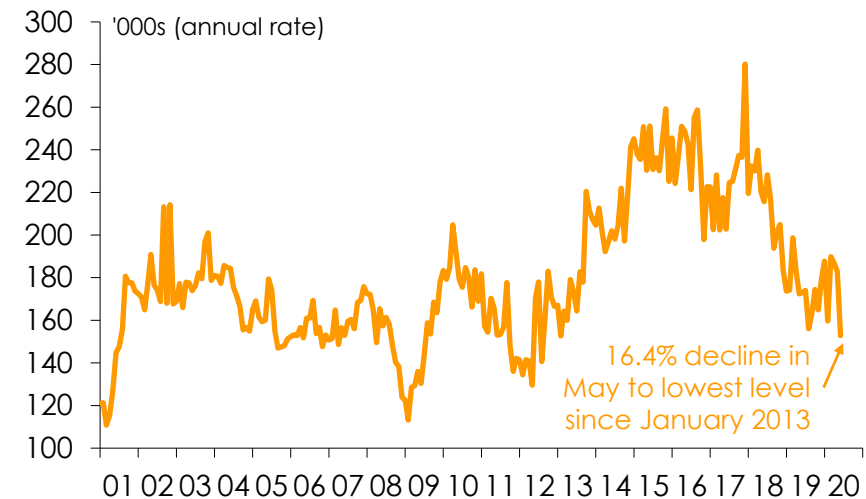
Dwellings under construction



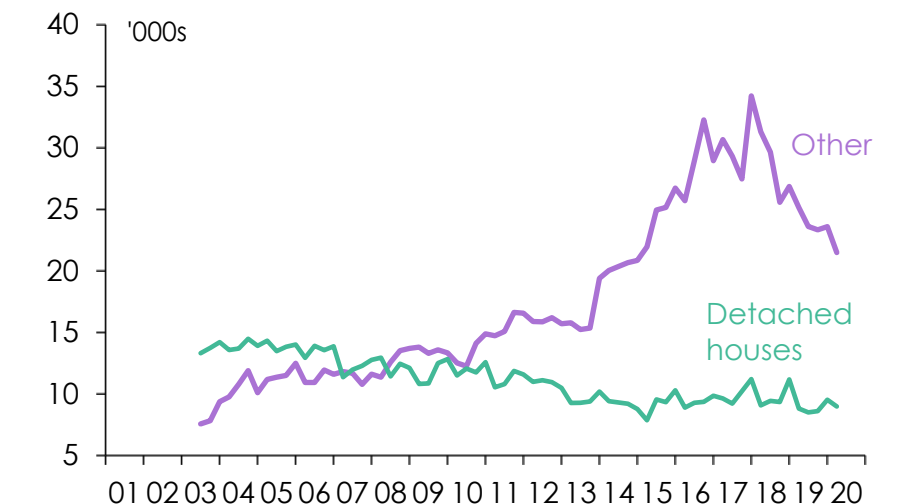
Refinancings as pc of total



Residential building approvals



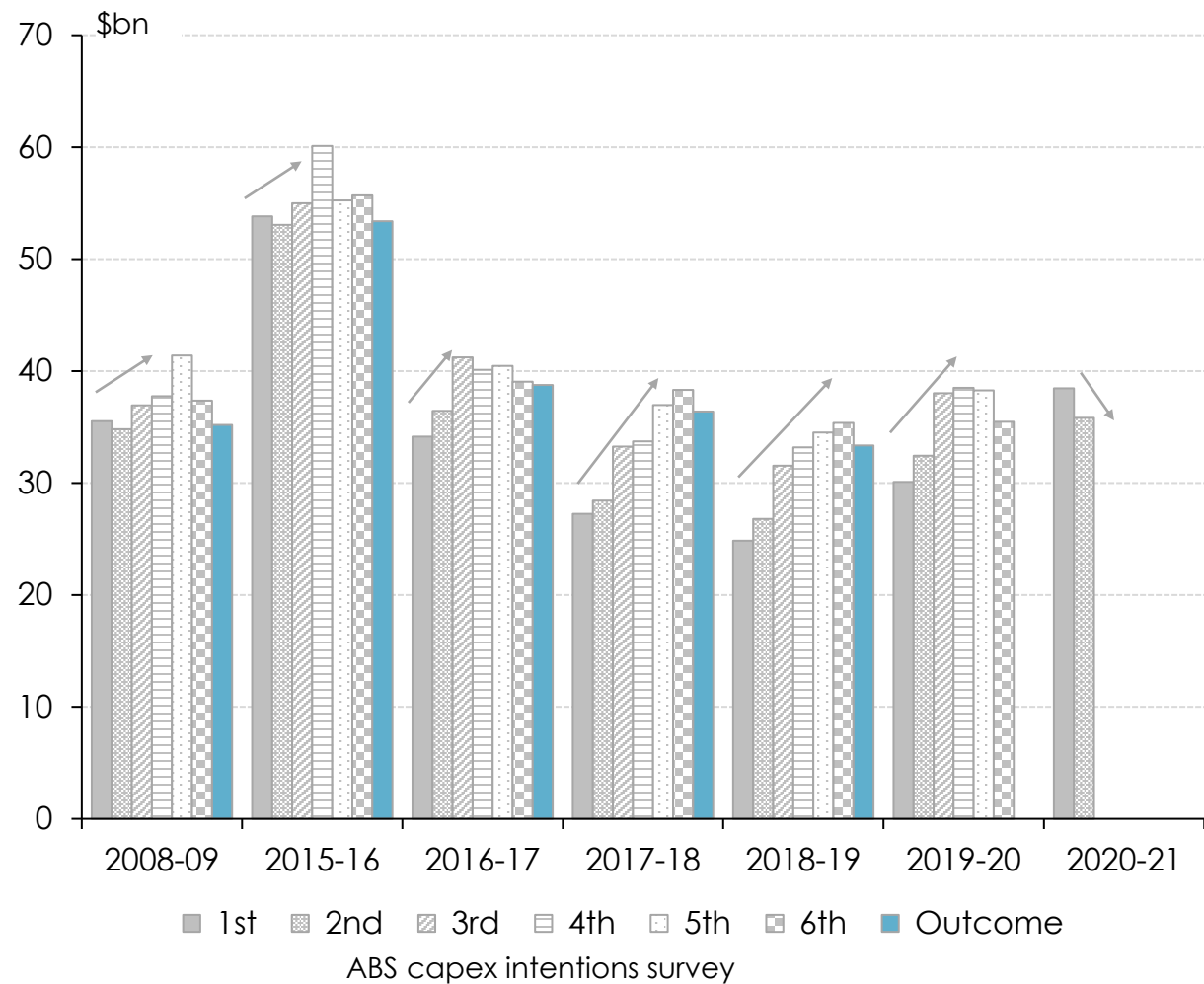
'Pipeline' of work yet to be done



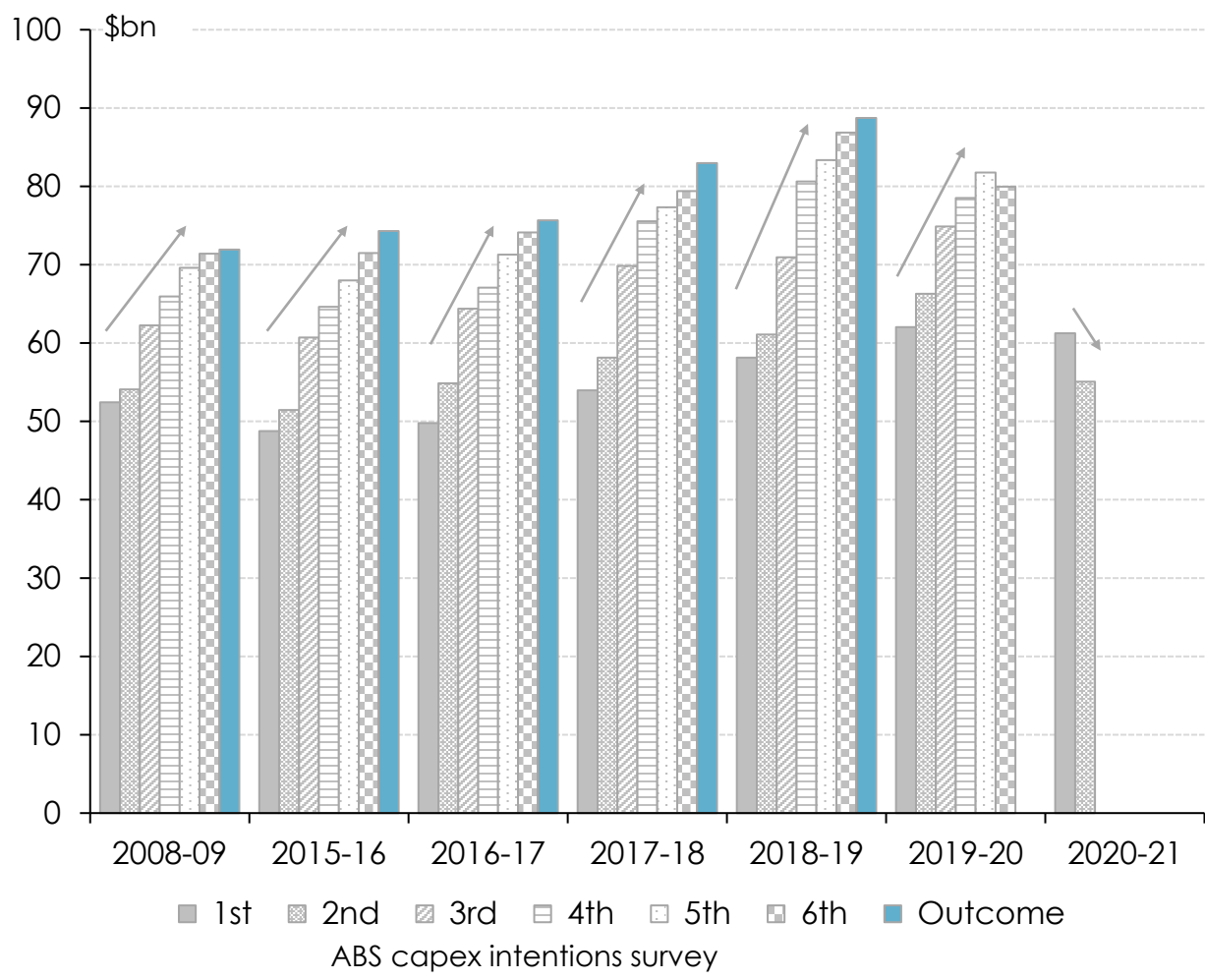
Note: 'New home sales' are of detached dwellings only and exclude small-scale builders. Sources: ABS; Housing Industry Association.

Businesses have cut back their capital expenditure intentions for 2020-21, which is unusual for this time of year

Capital expenditure intentions - mining

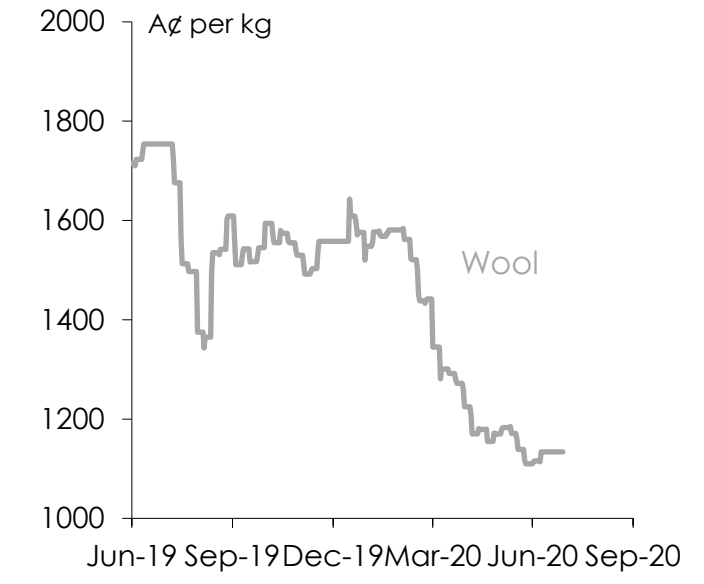
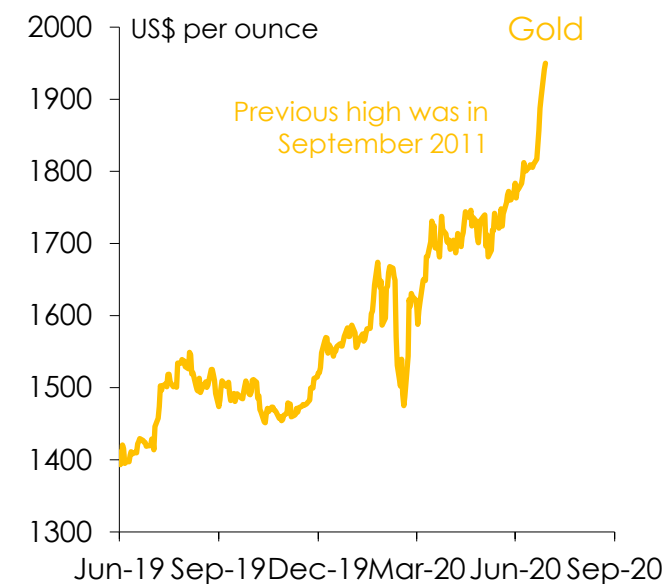
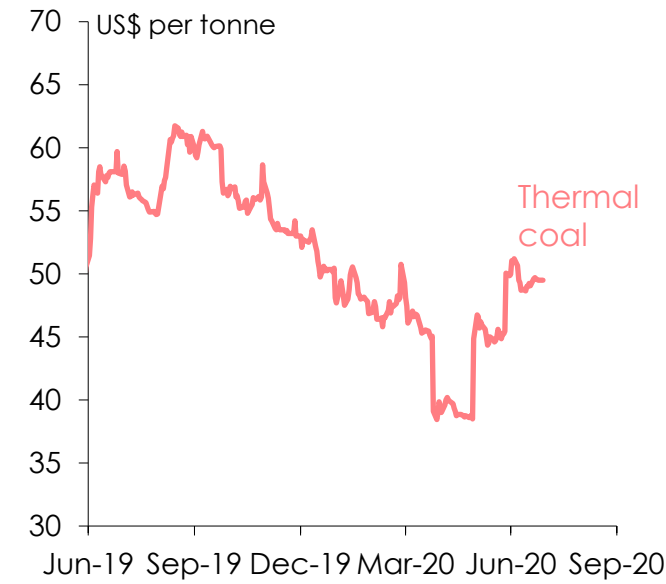
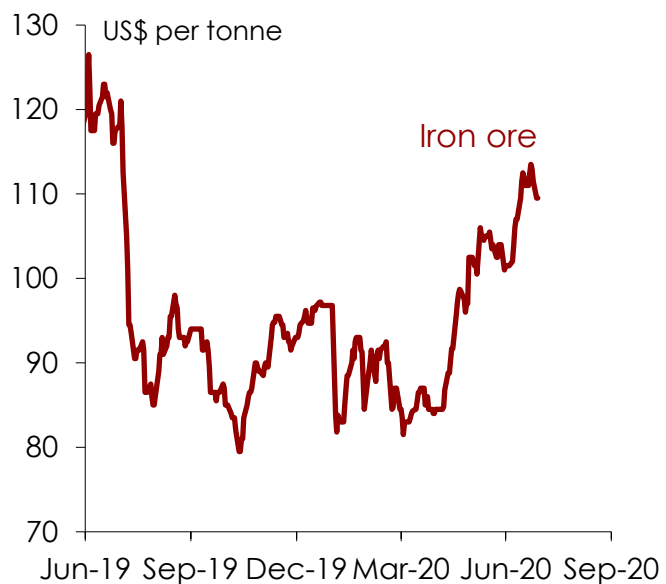
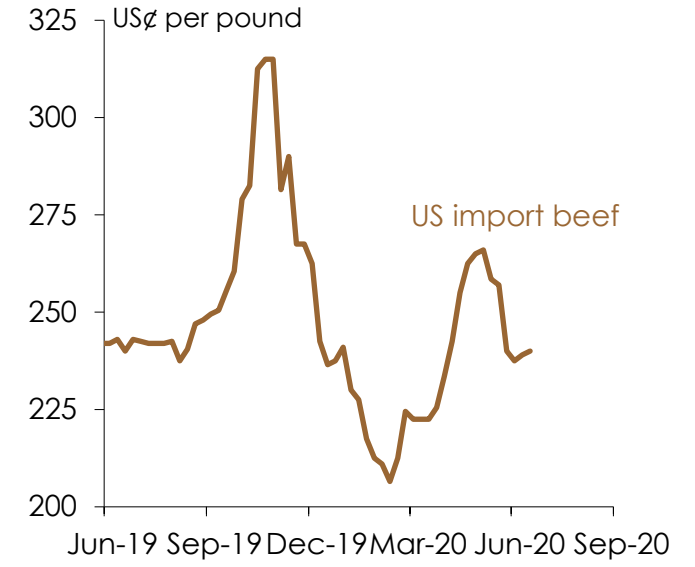
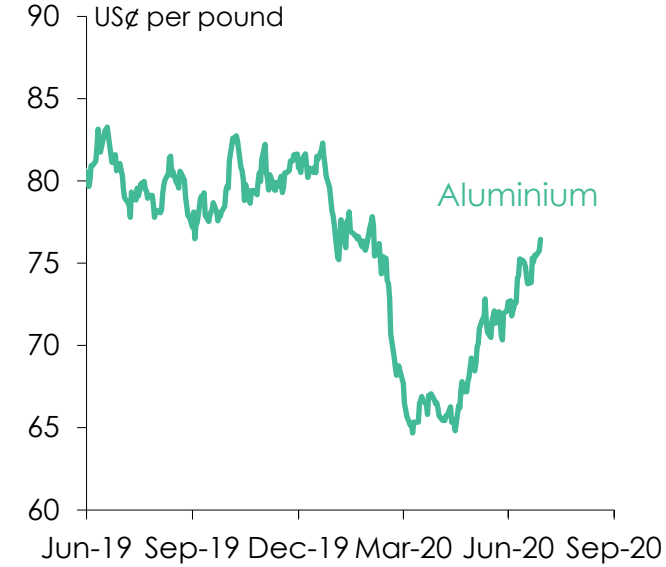
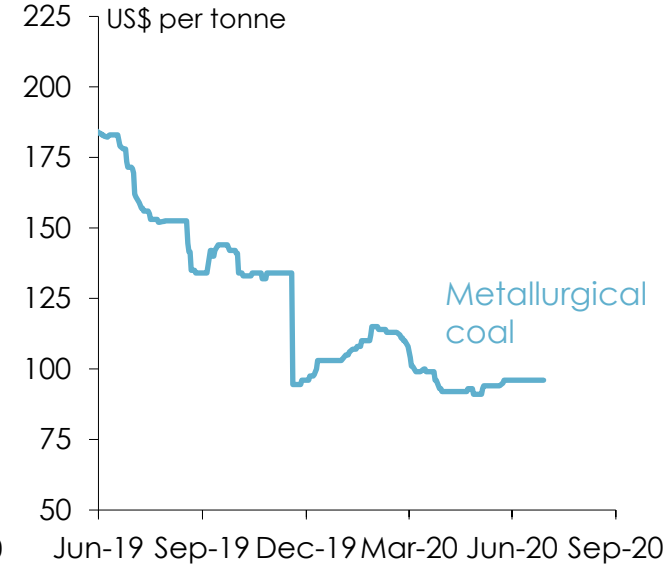
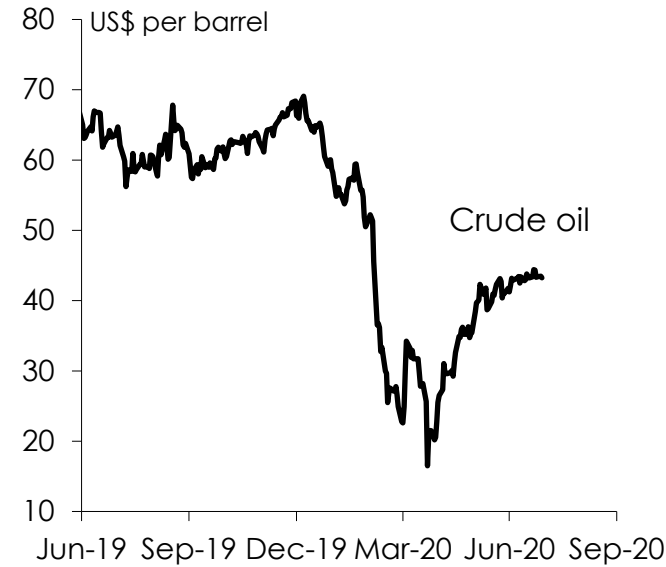


Capital expenditure intentions – non-mining



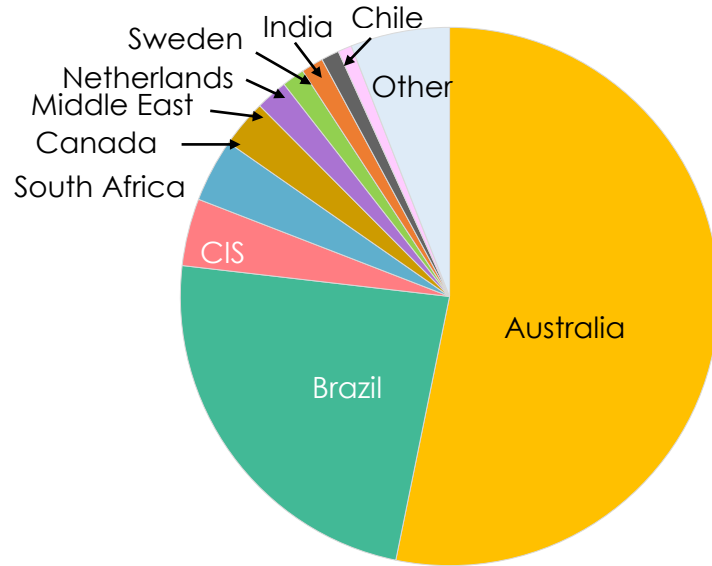
Note: The ABS conducts six surveys of business' capital expenditure intentions in respect of each financial year. The first is conducted in January & February prior to the commencement of the financial year, the second in May & June, the third in July & August of the financial year, the fourth in October & November, the fifth in January & February of the financial year, and the sixth in May & June. The outcome (actual capital expenditure in the financial year) is determined from the survey taken in July & August after the end of the financial year. The survey excludes businesses in the agriculture, forestry & fishing; and public administration and safety sectors, and also superannuation funds. The education & training, and health care & social assistance sectors have been included in the surveys since December 2019 but are not included in the above charts (to assist in comparisons). Source: ABS (next update 27th August).

Most resources commodity prices have held up well since the onset of the pandemic, but agricultural commodity prices have softened

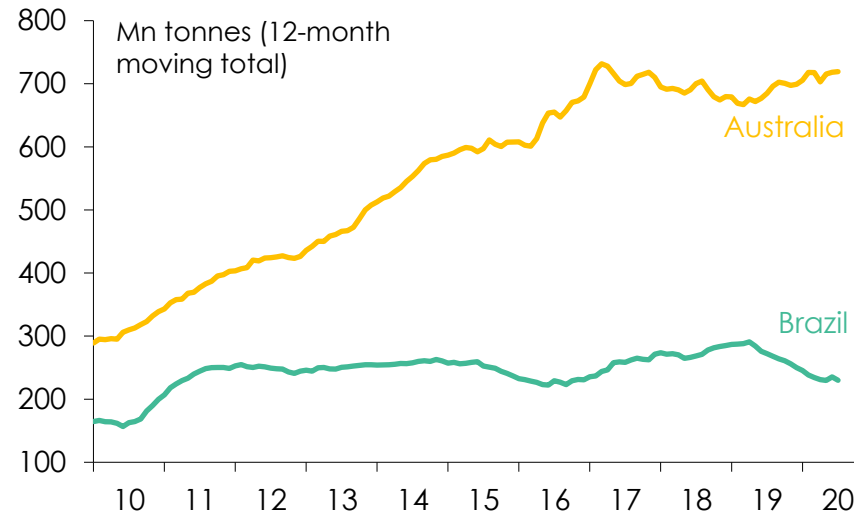


The resilience of iron ore prices stems from strong Chinese demand, declining Chinese production and constraints on Brazilian exports

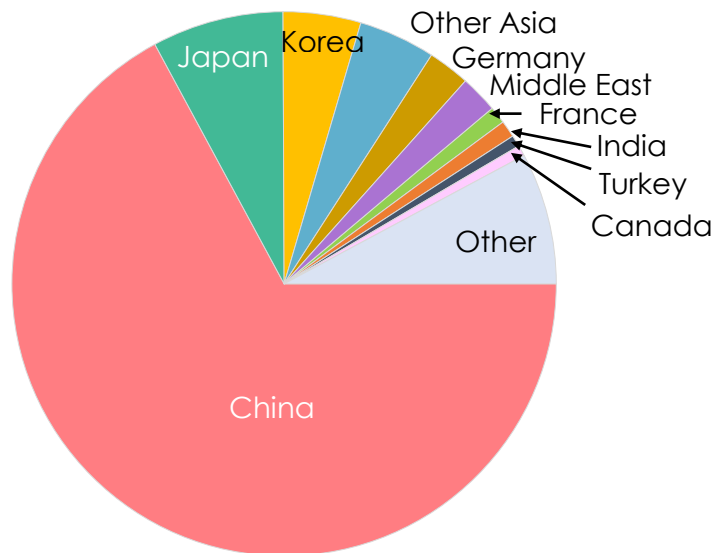
Iron ore exports, 2018



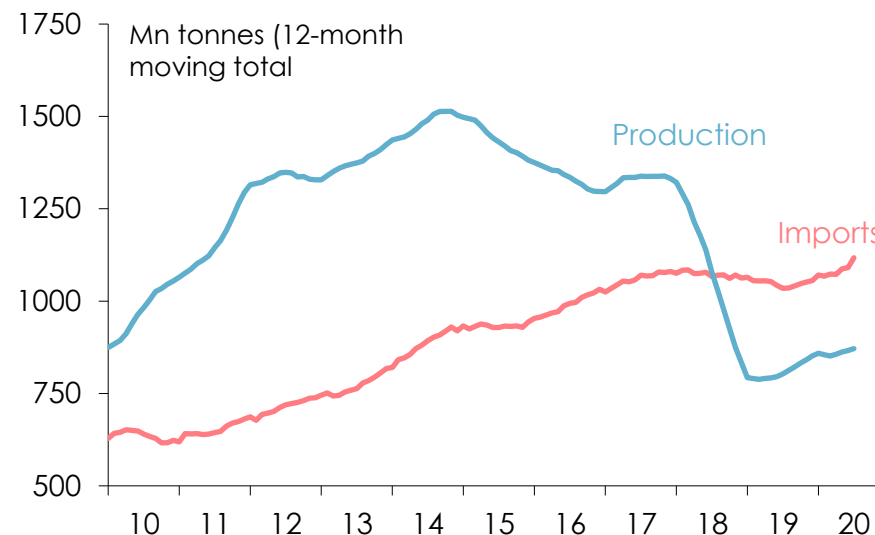
Australia & Brazil iron ore exports



Iron ore imports, 2018



China iron ore production & imports

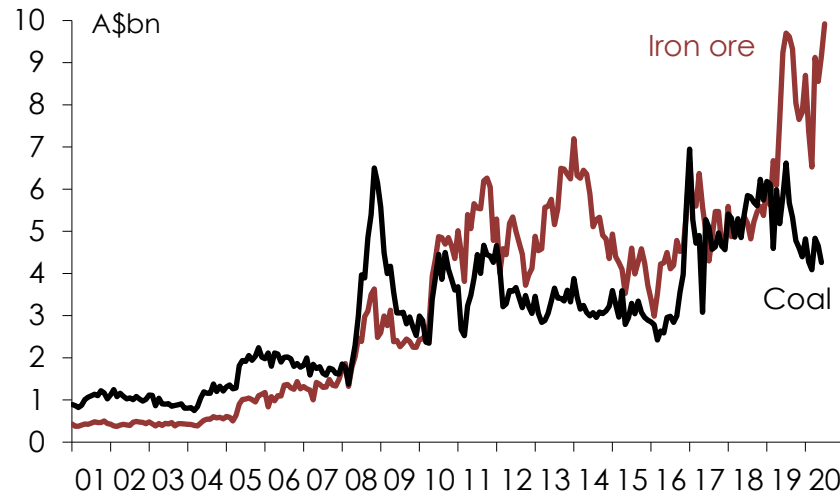


- ❑ The global seaborne iron ore trade is dominated by shipments from Australia & Brazil to China (which accounts for 53% of global steel production and 51% of steel use)
- ❑ Chinese iron ore production has fallen by more than 34% since 2017, largely because of rapidly declining quality – forcing Chinese steel mills to become more dependent on imports in response to increased demand driven by stimulus measures
- ❑ Meanwhile Brazilian production and exports have been curtailed by a series of tailing dam collapses over the past five years, and more recently by Covid-19 outbreaks at four large mine sites
- ❑ China is seeking to develop other sources especially in West Africa but this is a slow process

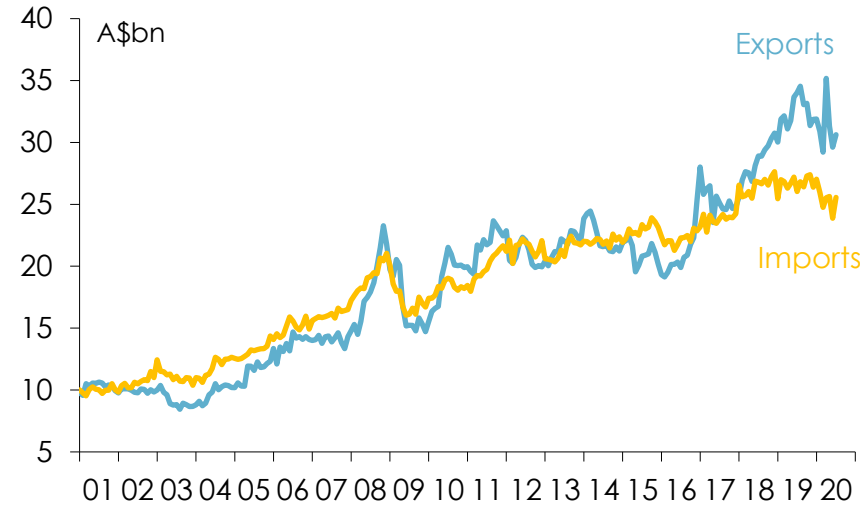
Note: Export volume data for Australia and Brazil derived by dividing export values (in US\$) from ABS and IGBE by the average US\$ price of Chinese iron ore imports.
Sources: World Steel Association; China National Bureau of Statistics; China General Administration of Customs; Refinitiv Datastream; ABS; IGBE; Corinna.

Exports of most items except iron ore have fallen since March, but that's been offset by big falls in imports, especially services & consumer goods

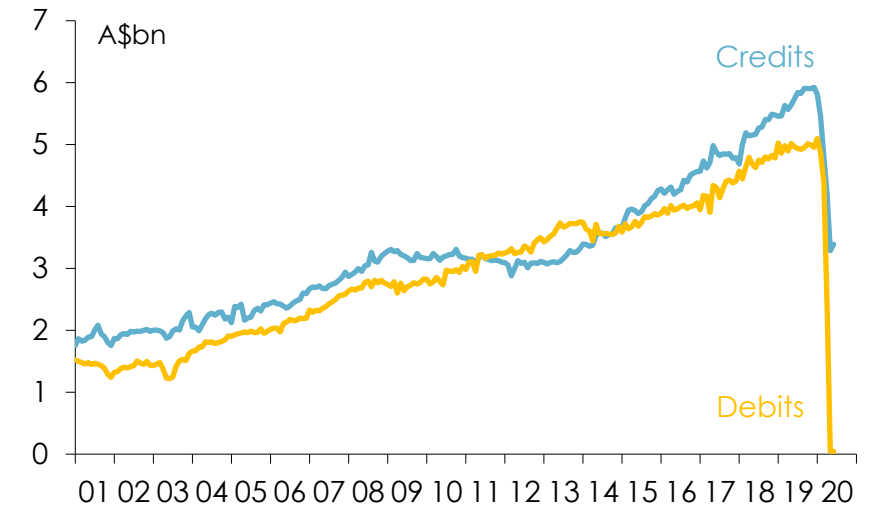
Iron ore and coal exports



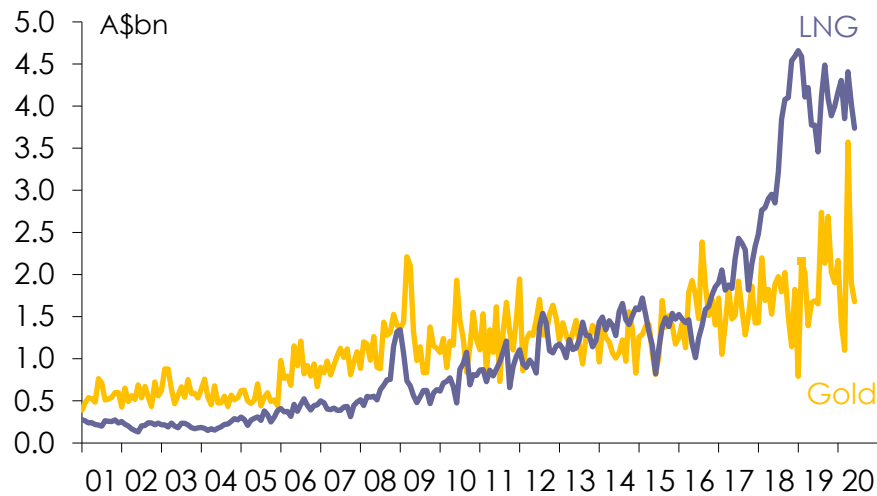
Merchandise exports and imports



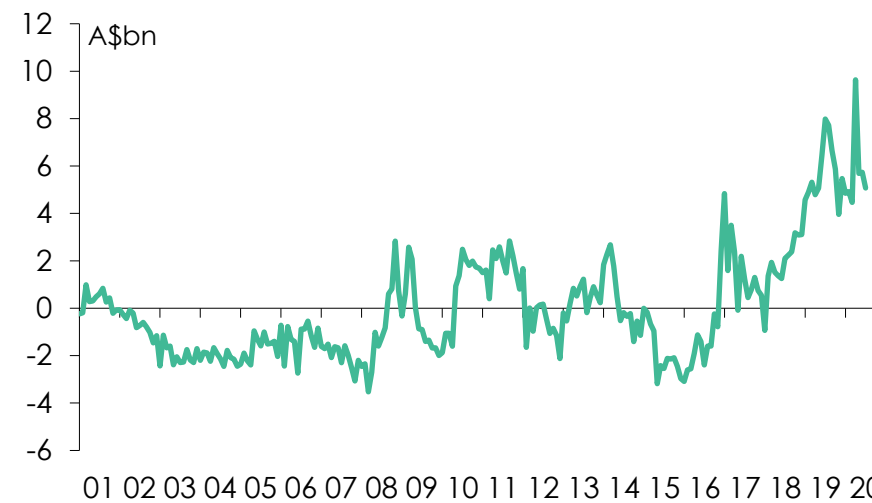
Tourism-related services trade



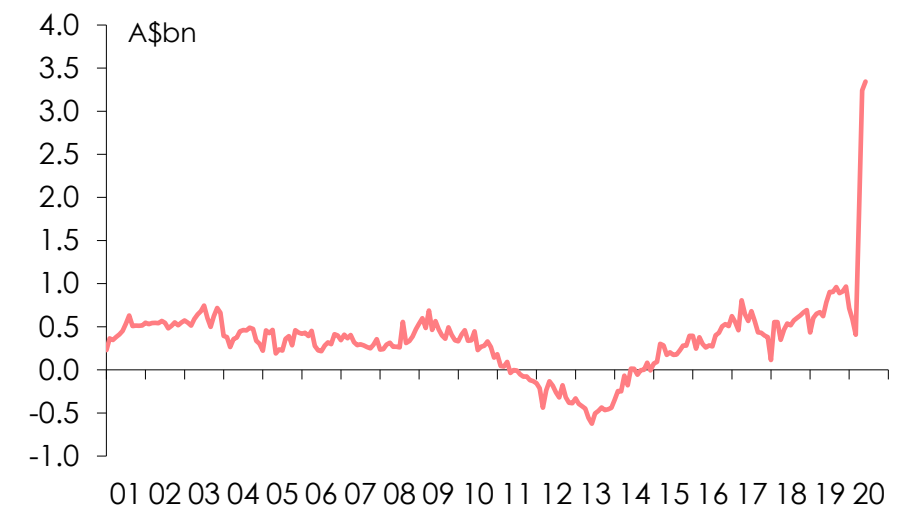
LNG and gold exports



Merchandise trade balance



Tourism services trade balance



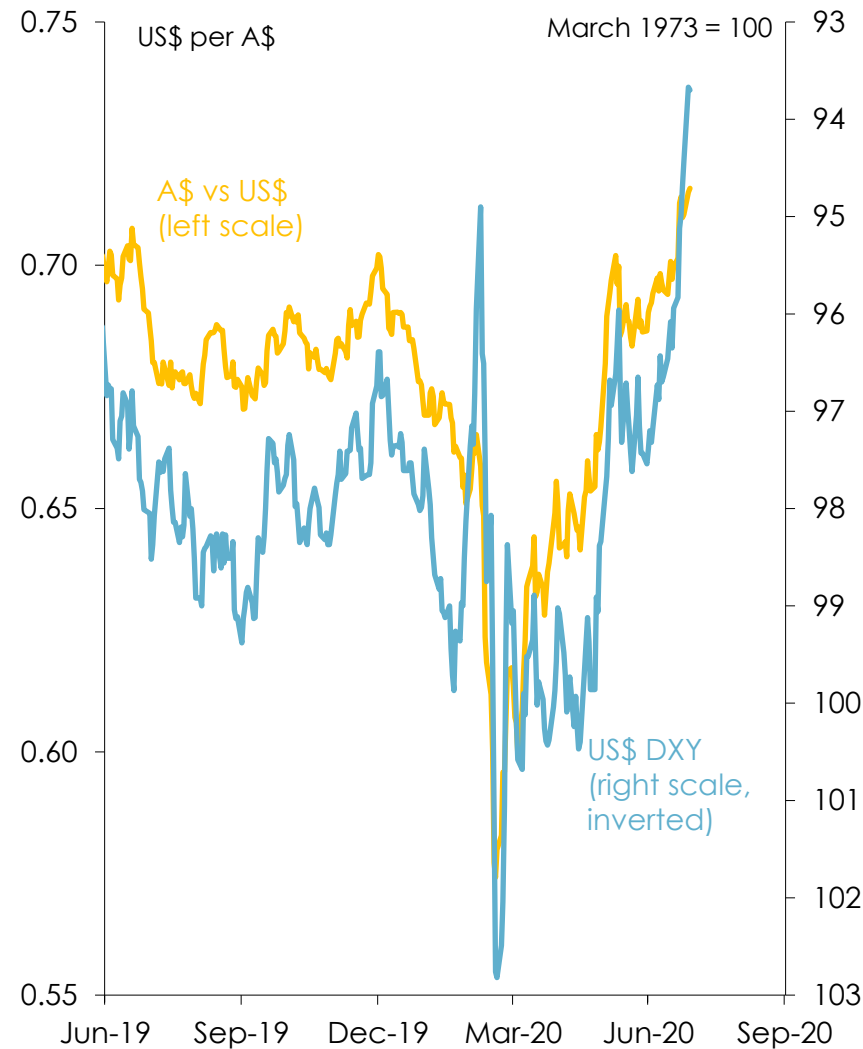
Source: ABS. Latest data are for May, except for iron ore, merchandise exports & imports and the merchandise trade balance which are preliminary June data, seas. adj. by Corinna; final June data will be released on 4th August.

The A\$ has regained all the ground it lost in February and March helped by stronger iron ore prices, a weaker US\$ and a recovery in risk appetites

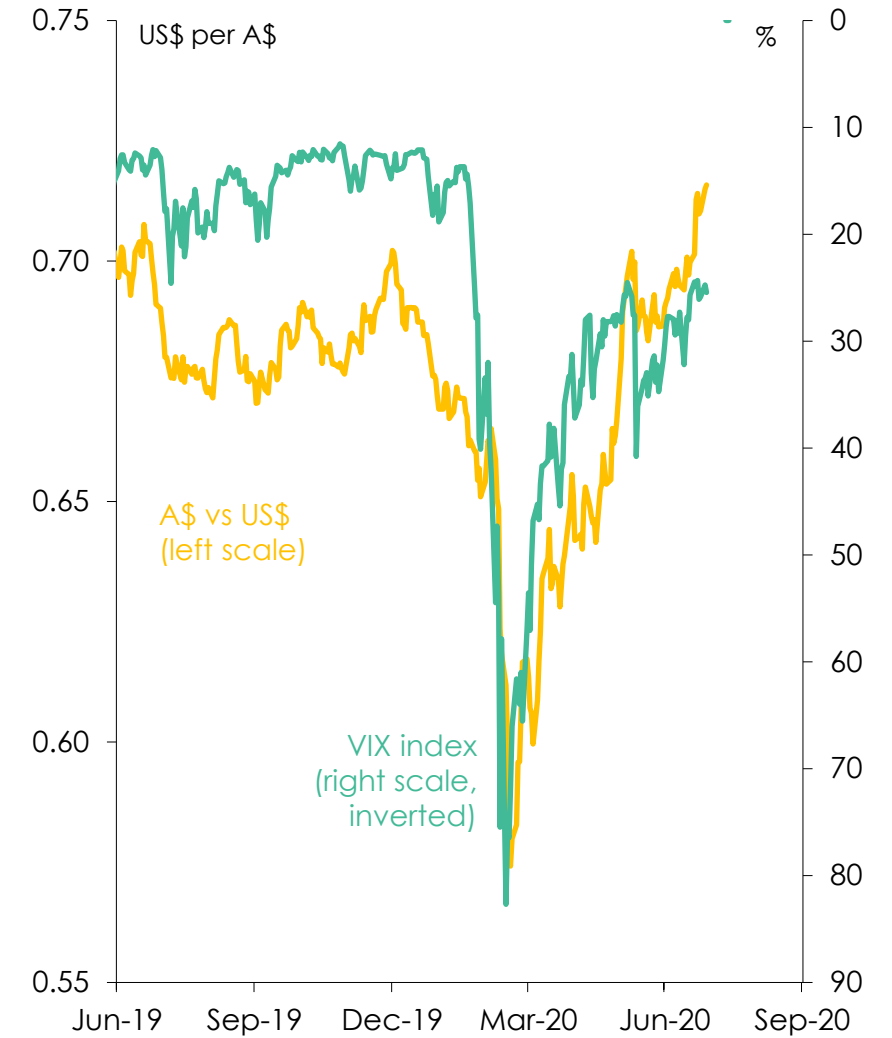
A\$-US\$ and spot iron ore prices



A\$-US\$ and US\$ trade-weighted index



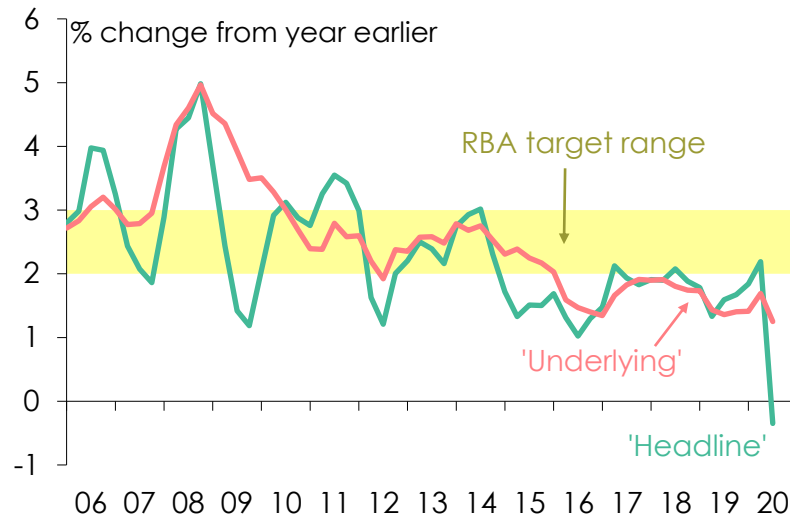
A\$-US\$ and US equity market volatility



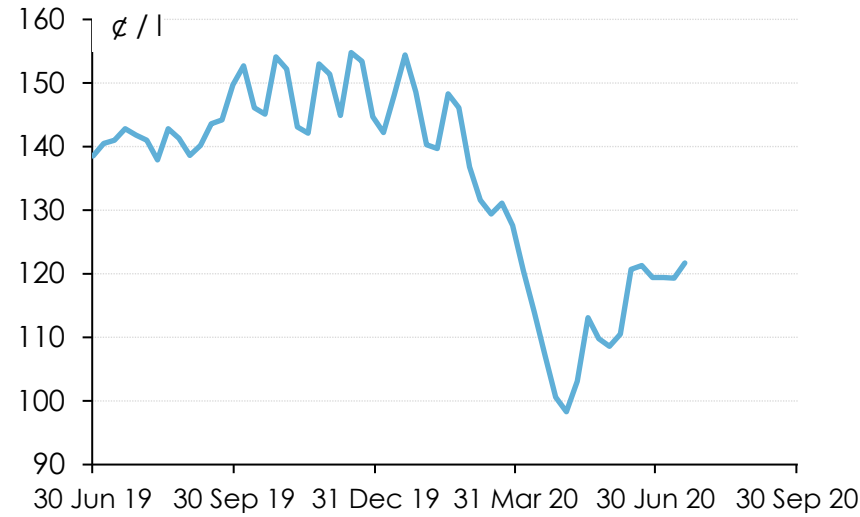
Note: The VIX index is a measure of the implied volatility of S&P500 options and is widely interpreted as an indicator of investor risk appetite or aversion.
Source: Refinitiv Datastream. Data up to 28th July.

Inflation turned negative, temporarily, in Q2 and will remain below the RBA's target until at least the second half of 2021

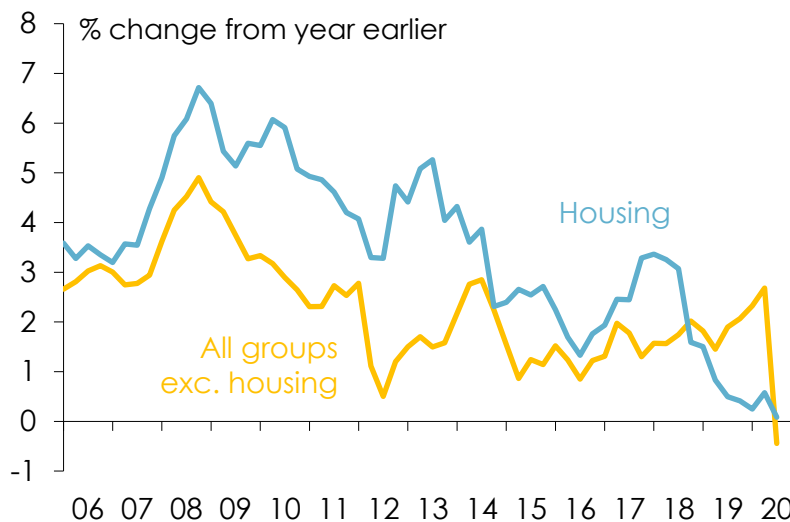
Consumer prices



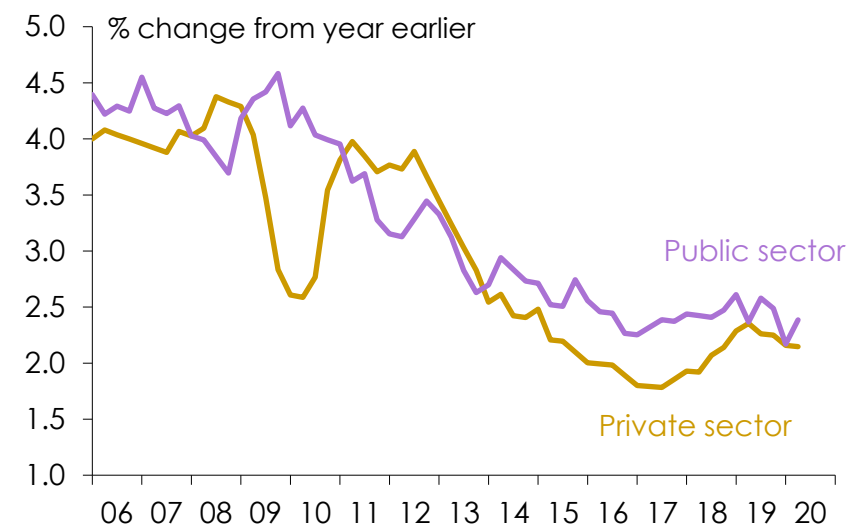
Retail petrol prices



Housing costs in the CPI



Wage price index



- ❑ The CPI fell (by 1.9%) in the June quarter, the largest quarterly decline since 1931 and only the 11th decline in 60 years
- ❑ The annual 'headline' inflation rate fell to -0.3%, the lowest since Q3 1997 (which was artificially induced by falling mortgage rates, which are no longer included in the CPI), or otherwise since Q3 1944
- ❑ The fall in the CPI in Q2 was largely due to the provision of free child care between 6th April and 28th June, which subtracted 1.1pc pts from the CPI; and a 19% fall in petrol prices, which subtracted 0.7 pc pts
 - both of these items will reverse in Q3
- ❑ 'Underlying' inflation was flat in Q2 and 1.3% from Q2 last year – it's now been below the RBA's target for more than four years
- ❑ Wages haven't been a source of price pressure for the past six years, and are unlikely to be in the next 1-2 years either (last week's Economic & Fiscal Update forecast wages growth of just 1¼% over the year to Q2 2021)

Note: 'Underlying' inflation is the average of the weighted median and trimmed mean CPIs. Wage price indices exclude bonuses.
Sources: ABS; Australian Institute of Petroleum. The September quarter (Q3) CPI will be released on 28th October.

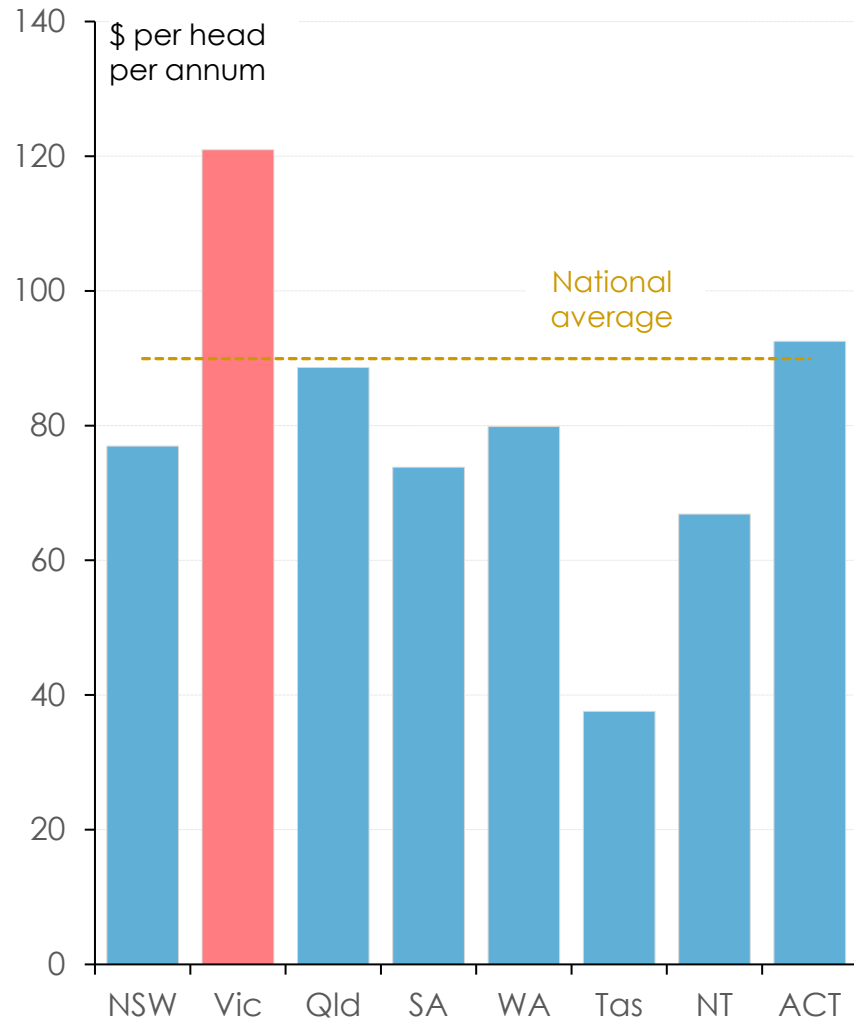
The problem with Victoria

A special look at Victoria

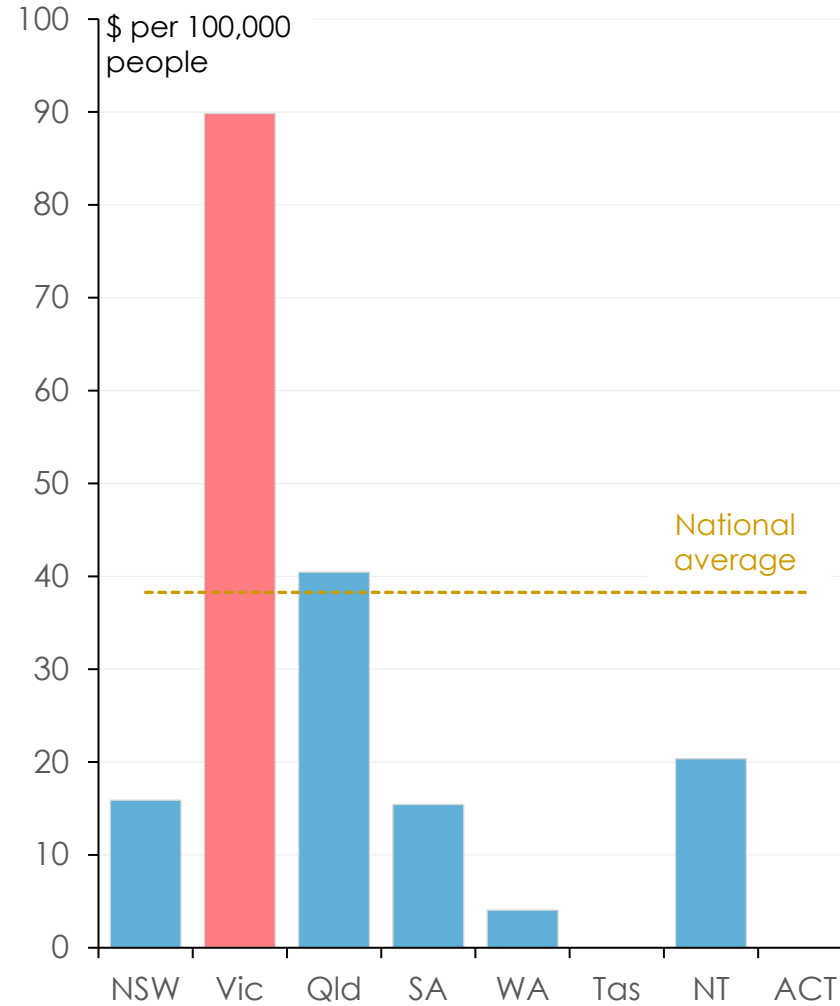
- ❑ **Victoria likes to see itself as Australia's most 'progressive' and cosmopolitan state**
 - as evidenced, for example, by being the first state to abolish the death penalty, its highest 'yes' votes of any state in the 1999 referendum on whether Australia should become a republic, or the 2016 postal plebiscite on same-sex marriage
 - and its above-average proportion of migrants, university graduates, people employed in the arts, etc
- ❑ **But Victoria has also long had an authoritarian streak**
 - as evidenced, for example, by its long-established record of fining its citizens over 50% more (per head of population) than other states and territories (see next slide)
- ❑ **Not surprisingly, therefore, Victoria adopted a stricter lockdown in response to the risks posed by Covid-19 than any other state**
 - Victoria's restrictions were stricter and broader than those in other states (except for border closures), and lasted longer
 - and Victoria was much more aggressive in fining people for breaching lockdown regulations than any other state, collecting 4½ times as much in fines per head from its citizens as all the other states and territories, on average
- ❑ **One of the principal reasons for the 'second wave' of infections being experienced in Victoria appears to have been lax enforcement of regulations at quarantine hotels for returning travellers – which in Victoria (unlike other states) was contracted out to private security firms (this is now being investigated by a judicial inquiry)**
- ❑ **Even ahead of the 'lockdown' imposed on Greater Melbourne and the adjoining Mitchell Shire from Friday this week, Victoria appeared to be lagging the national economic recovery**
- ❑ **Given that Victoria accounts for about 23% of national GDP, and greater Melbourne for about 80% of Victoria's population, but that productivity is higher in Melbourne than in regional Victoria, and based on the Australian Treasury's estimate that the national lockdown was costing \$4bn a week, the Melbourne lockdown is likely to cost at least \$800mn a week – or about 1% of (national) GDP in the September quarter**

Victoria has always been more vigilant in fining its citizens than other states – but that authoritarian approach hasn't helped it fight Covid-19

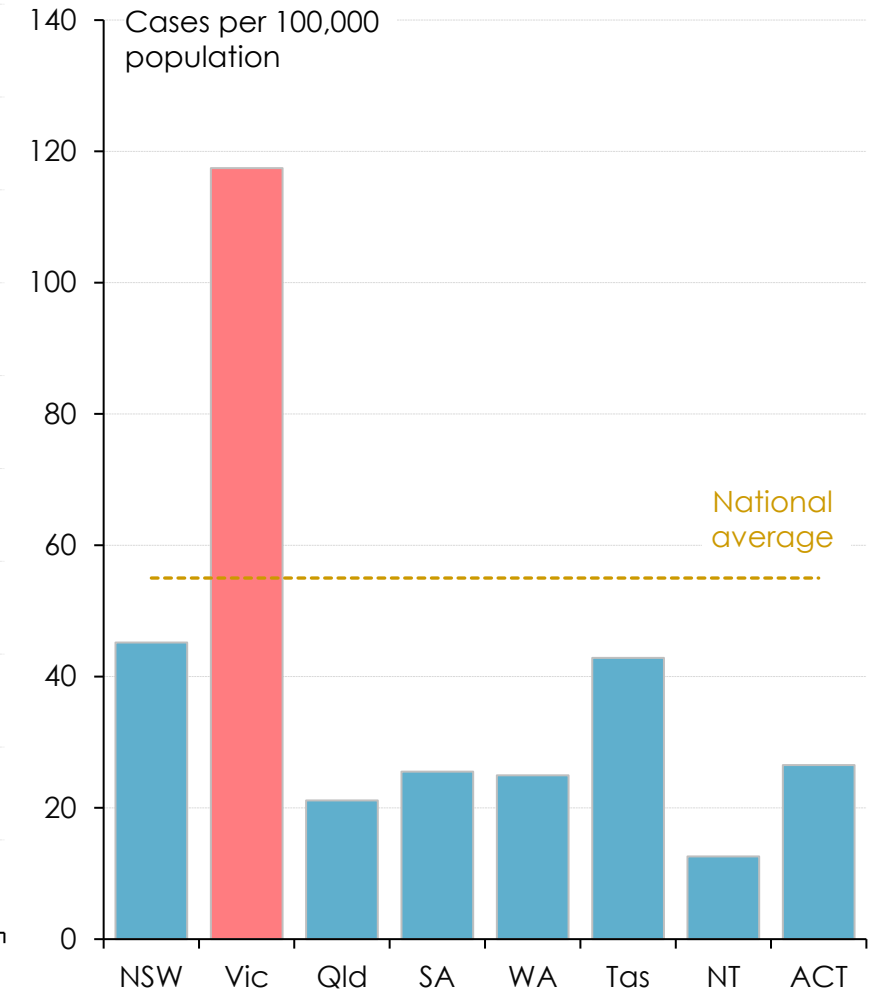
Revenue from fines per head of population, 2014-15 to 2018-19



Fines for breaches of lockdown regulations, per head



Infection rates, states and territories, as at 28th July 2020

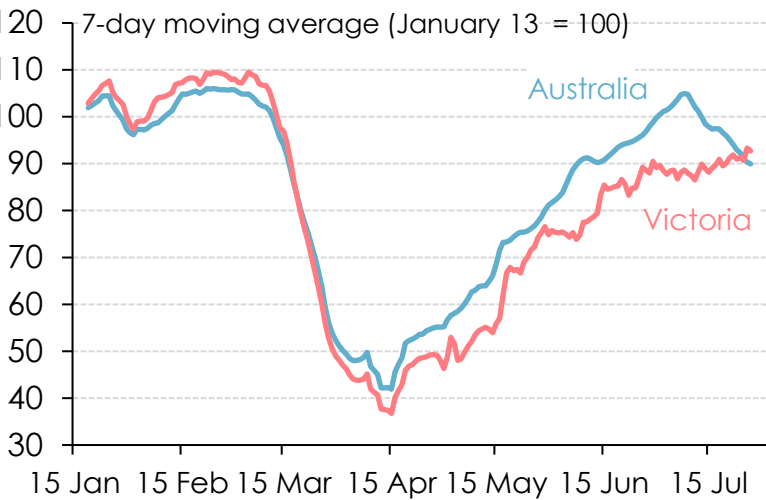


Note: fines for breaches of Covid-19 regulations are for the period between when 'stage 3' lockdowns started in late March to the last week of May.

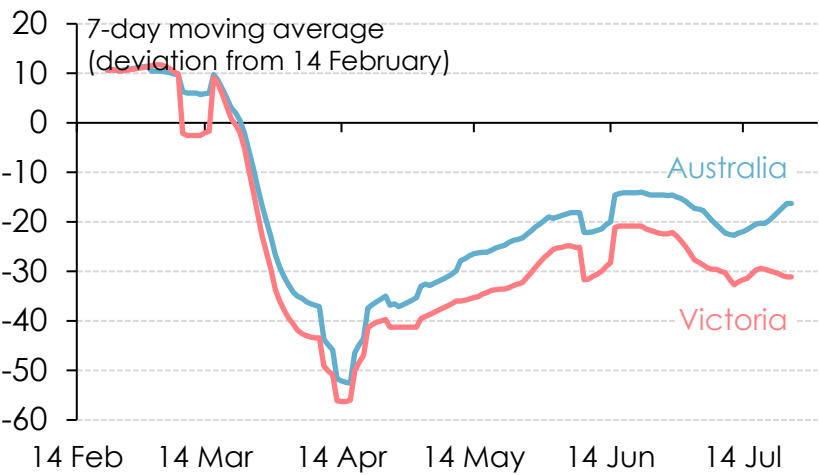
Sources: State and Territory annual financial reports and 2019-20 Mid-Year Budget Reviews; The Age, 28th May 2020; covid-19.com.au.

Victoria has been lagging the rest of Australia in emerging from lockdown – this divergence will widen over the next six weeks

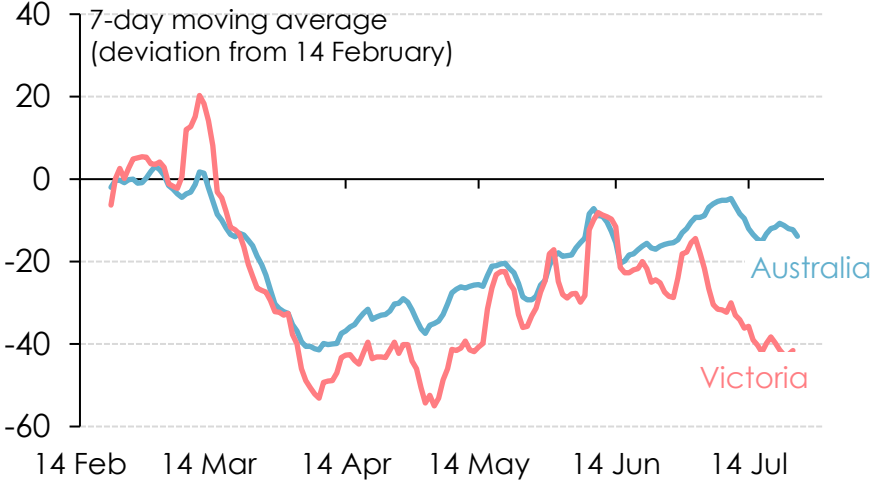
Time spent driving



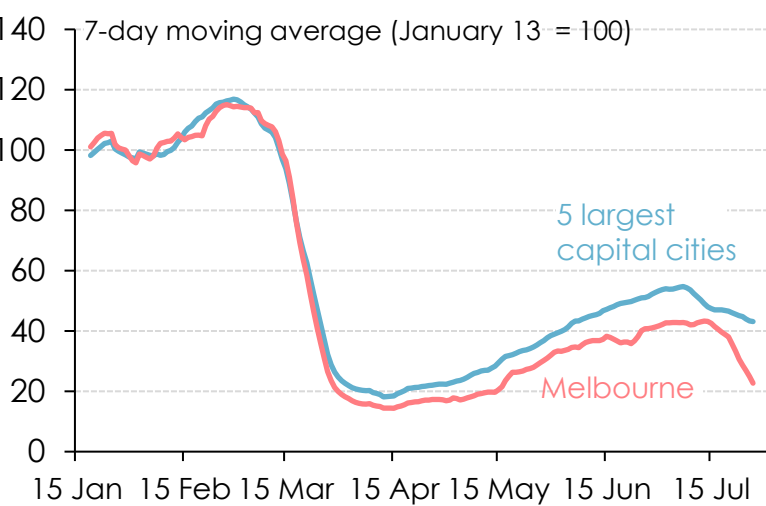
Time spent in work places



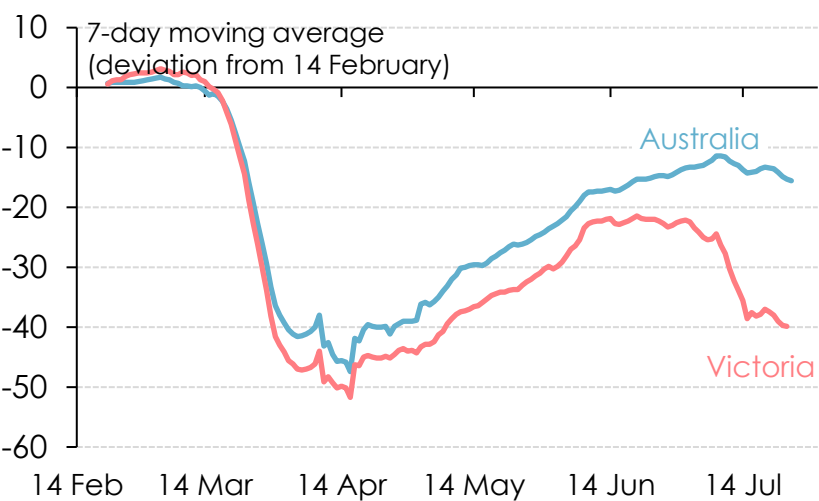
Time spent in parks



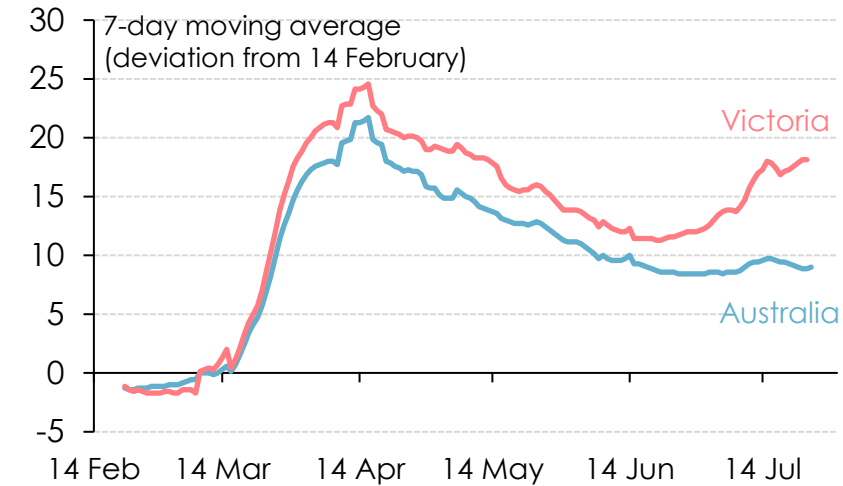
Time spent in transit



Time spent shopping

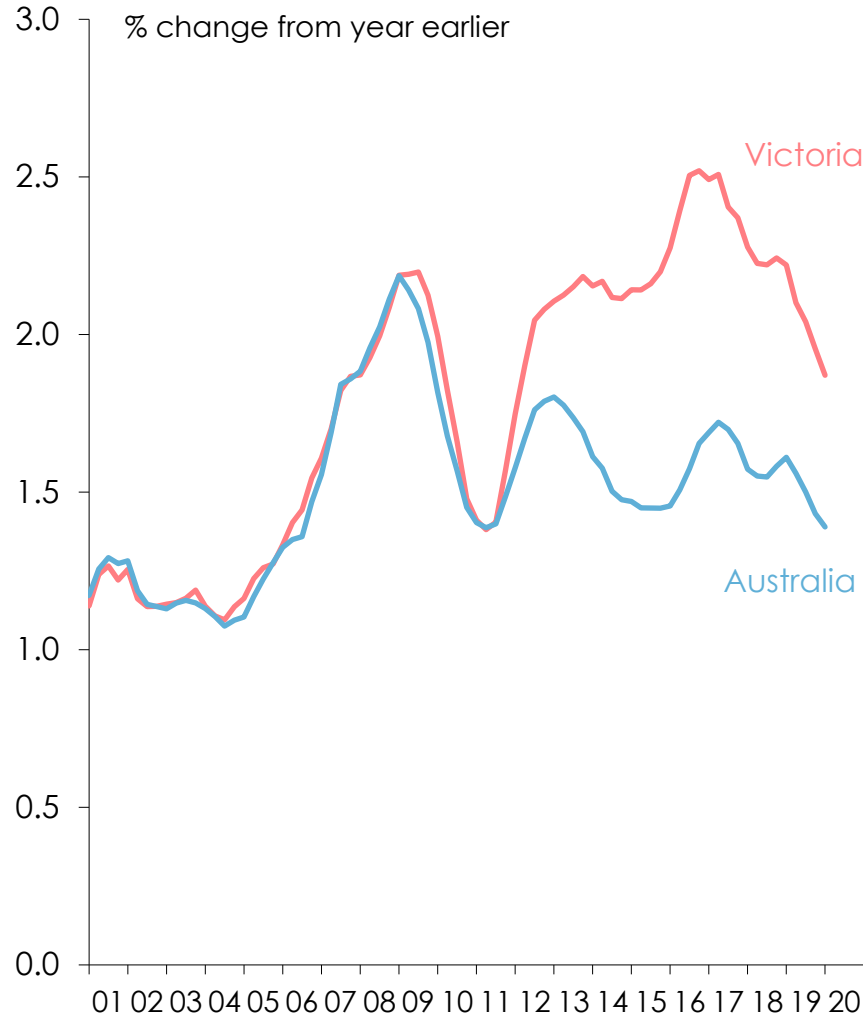


Time spent at home

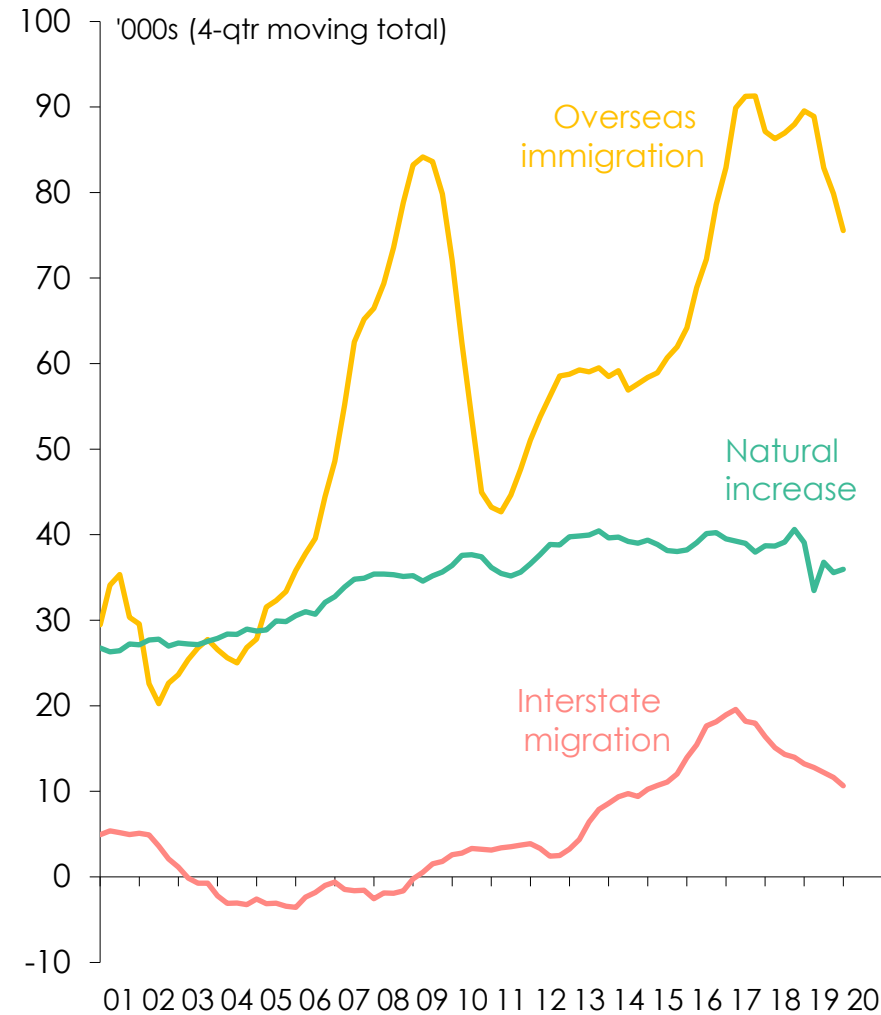


Over the past decade Victoria's economy has become increasingly dependent on population growth, through immigration ...

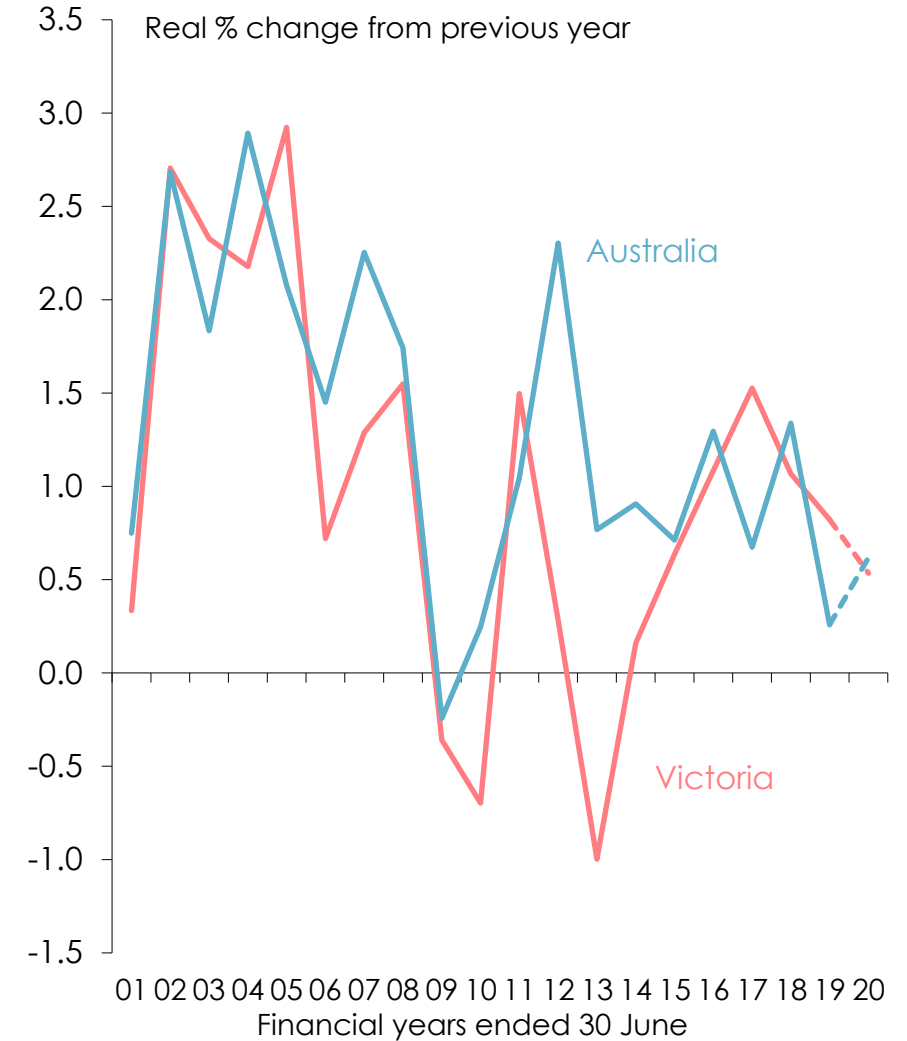
Population growth – Victoria vs national average



Sources of Victoria's population growth



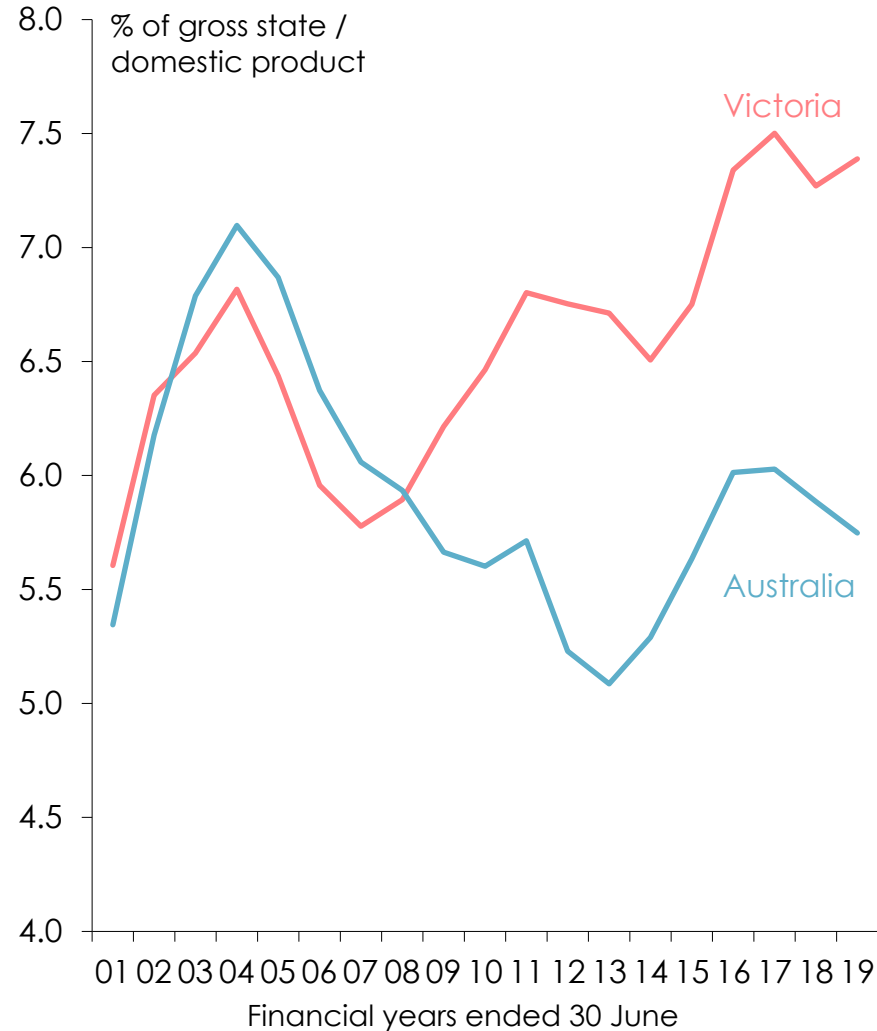
Per capita economic growth – Victoria vs national average



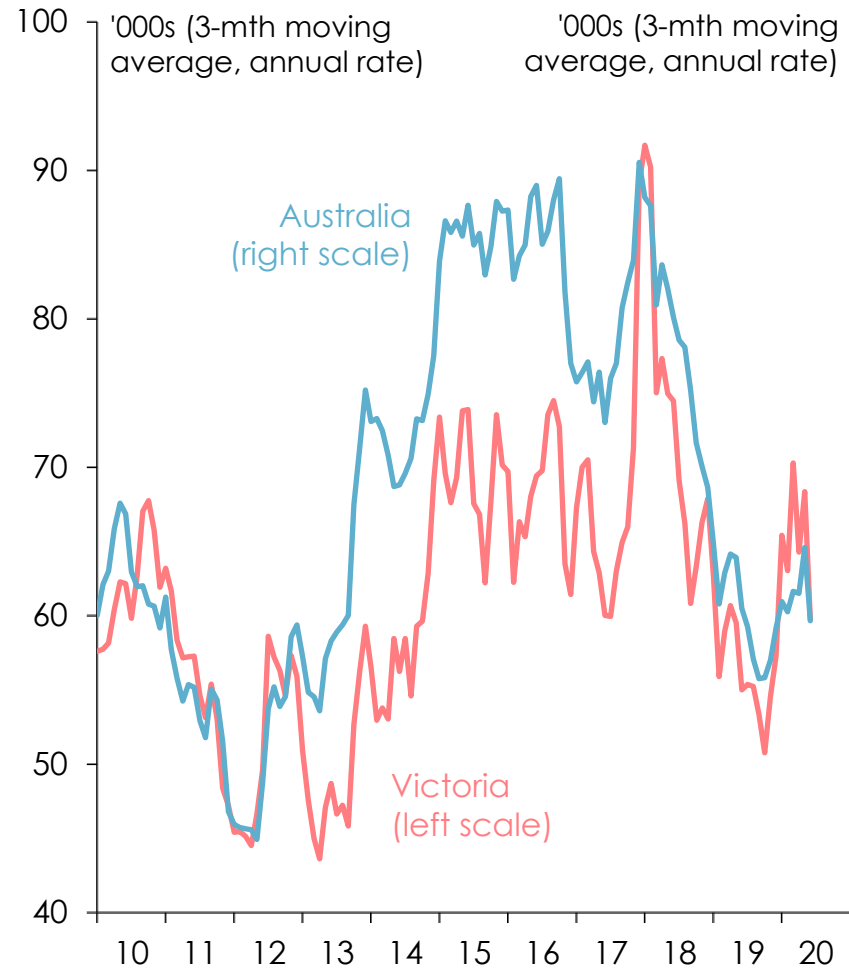
Note: 2019-20 economic growth estimates are forecasts provided in the Victorian and Australian Government mid-year budget reviews published in December 2019.
Source: ABS; Victorian and Australian Governments.

... as a result of which, it has become much more vulnerable to a downturn in housing activity than the rest of Australia

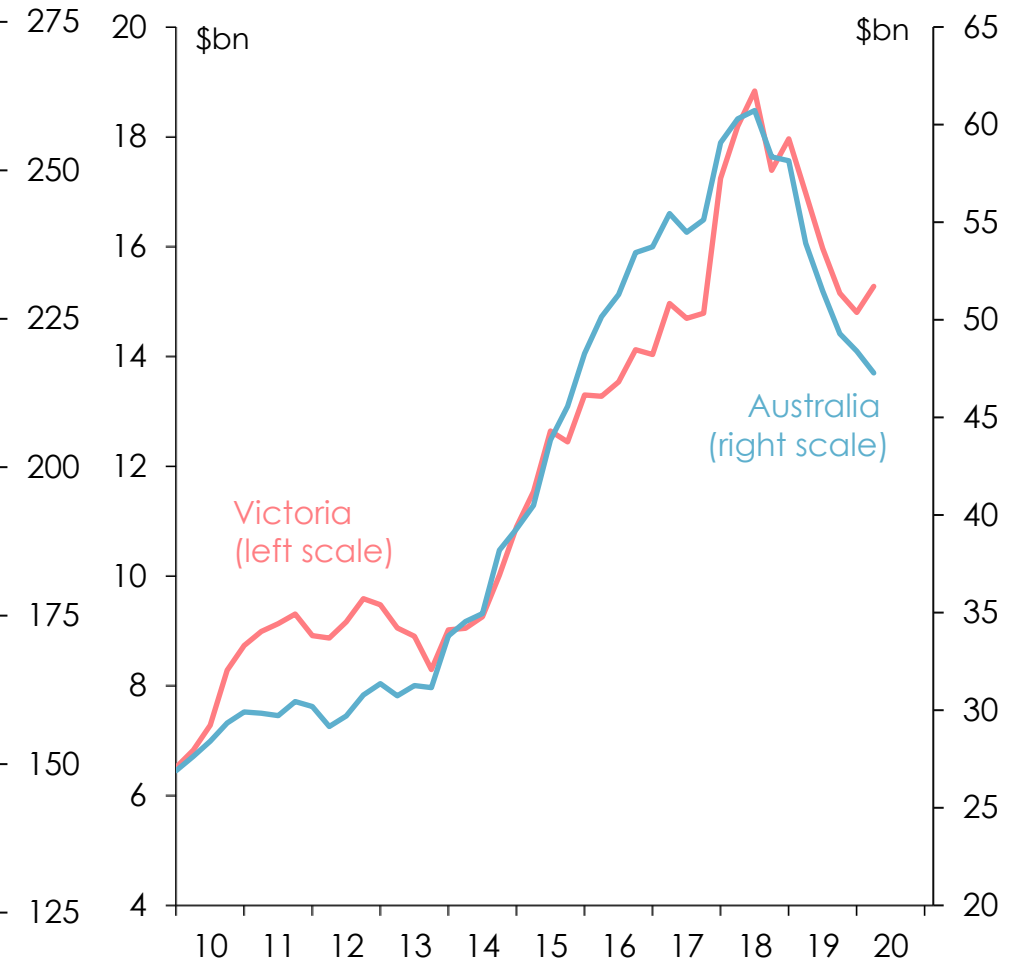
Dwelling construction as a pc of gross product



Residential building approvals

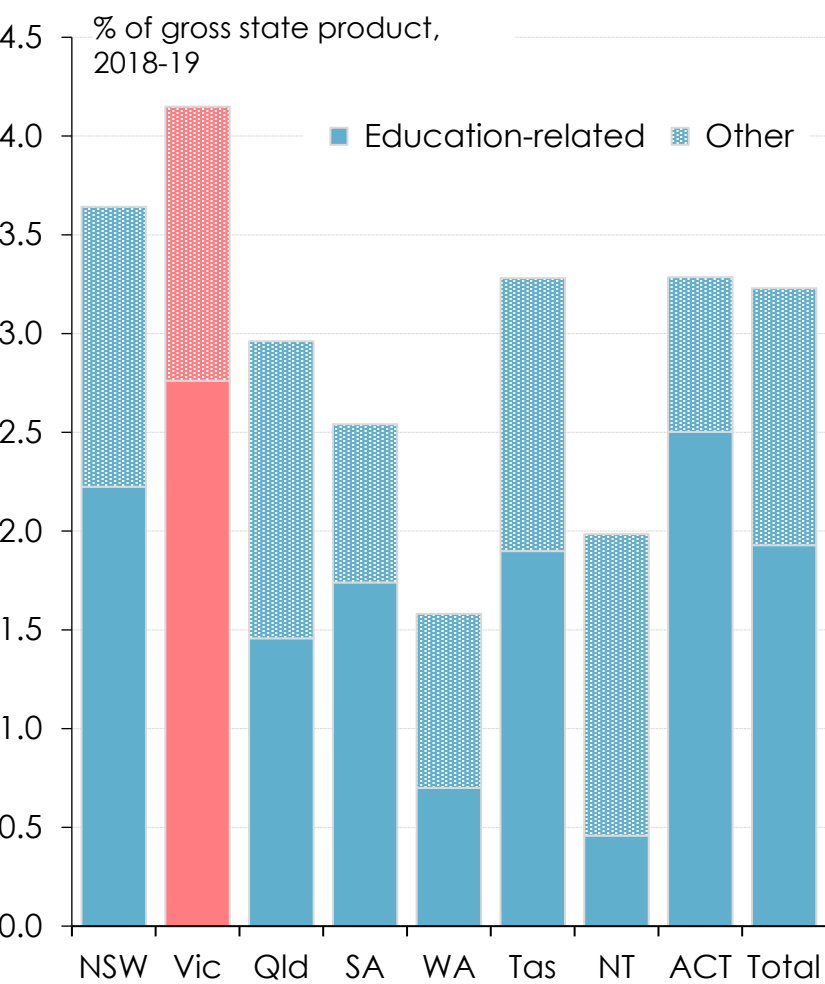


'Pipeline' of residential building work yet to be done

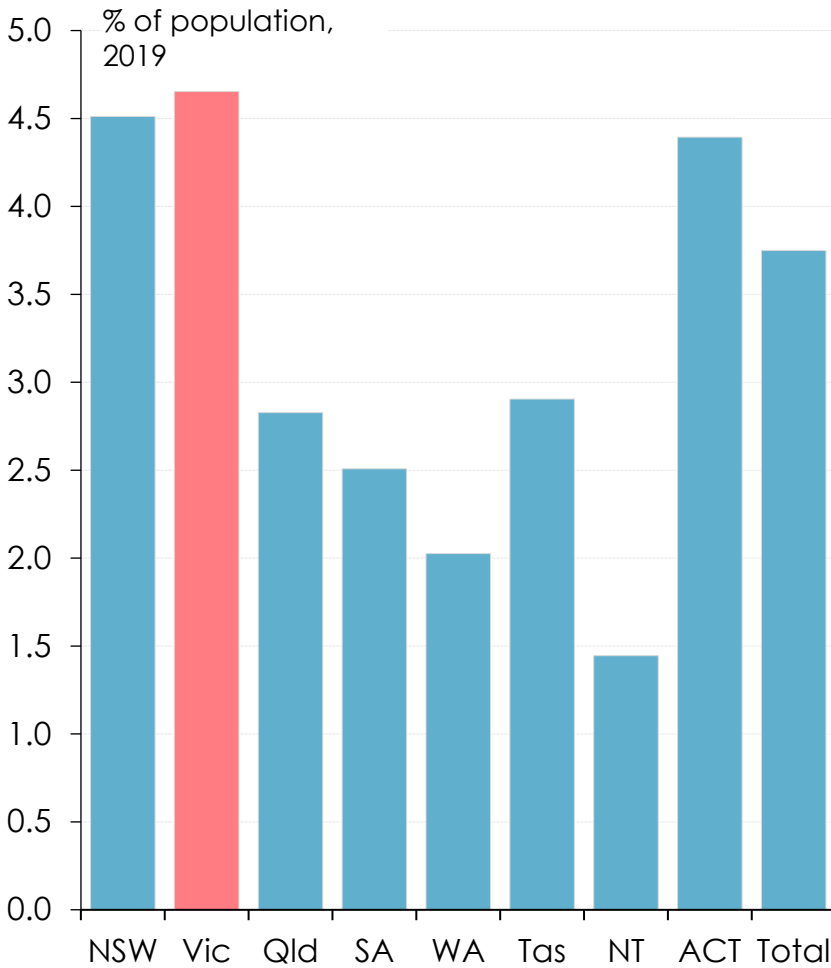


Victoria is also more dependent on foreign tourists and students than any other state or territory

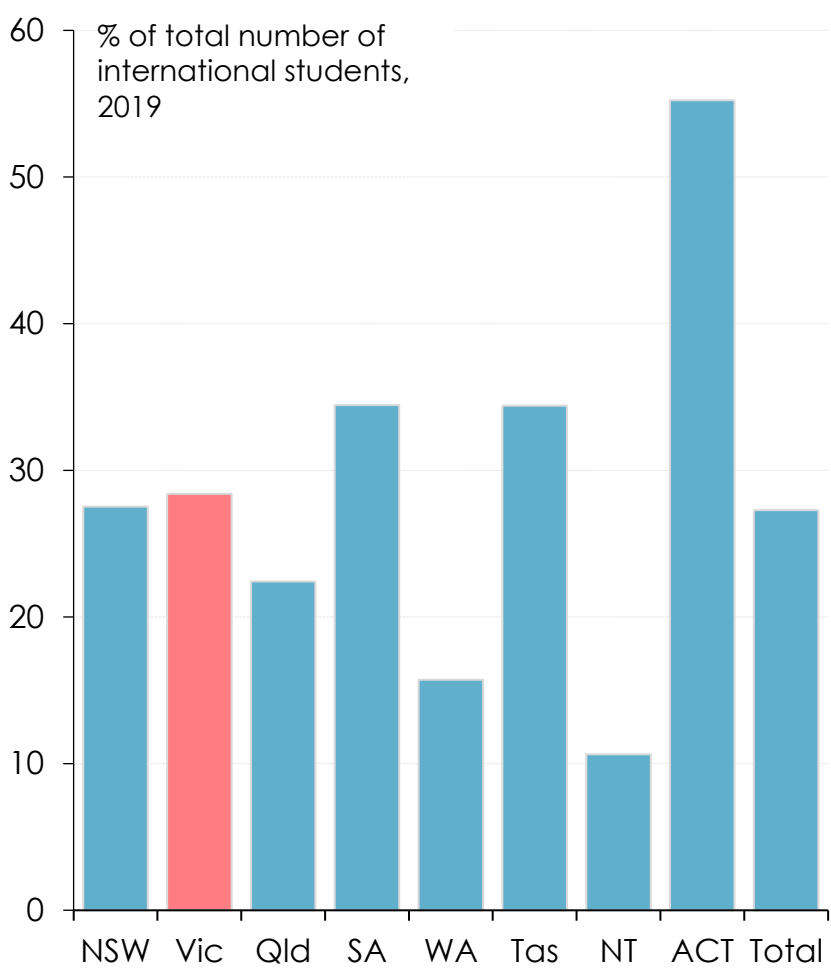
Travel services exports as a pc of gross state product, 2018-19



International students as a pc of population, 2019



Chinese students as a pc of total international students, 2019

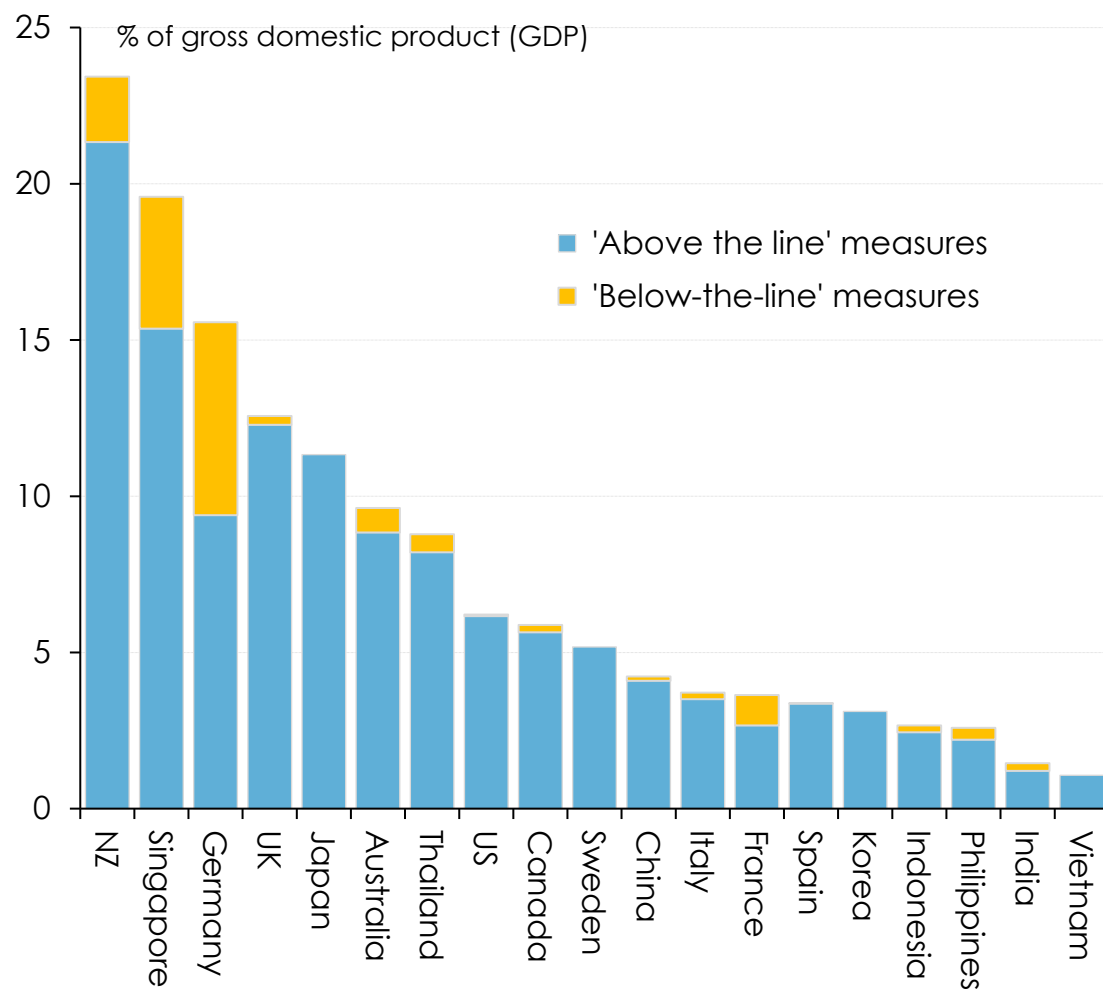


Sources: ABS; Australian Department of Education, Skills and Employment.

The Australian policy response

The Australian Government's policy measures have been large by historical and international standards

Fiscal policy responses to Covid-19 – selected 'advanced' & Asia-Pacific economies

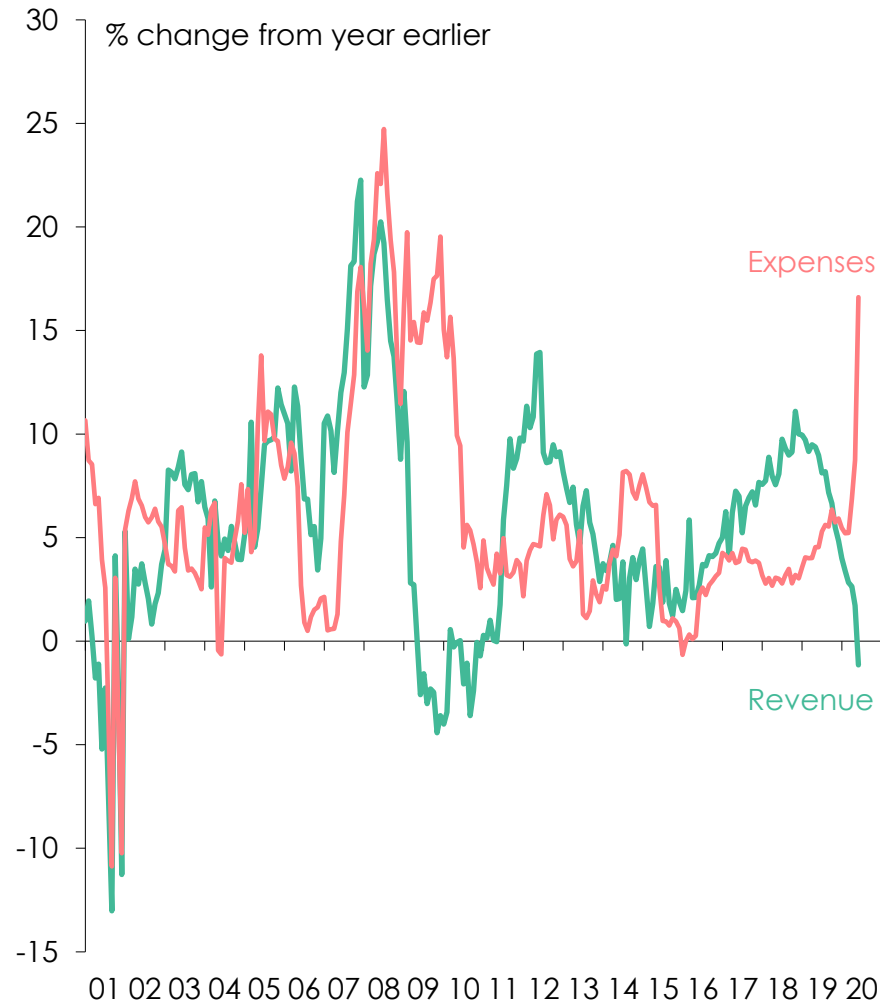


Note: 'Above the line' measures comprise additional or accelerated spending and deferred or foregone revenue. 'Below the line' measures comprise equity injections, loans, asset purchases and debt assumptions, but do not include loan guarantees or other contingent liabilities. Source: IMF, *Fiscal Monitor: Database of Country Fiscal Measures in Response to the COVID-19 Pandemic*, 24th June 2020.

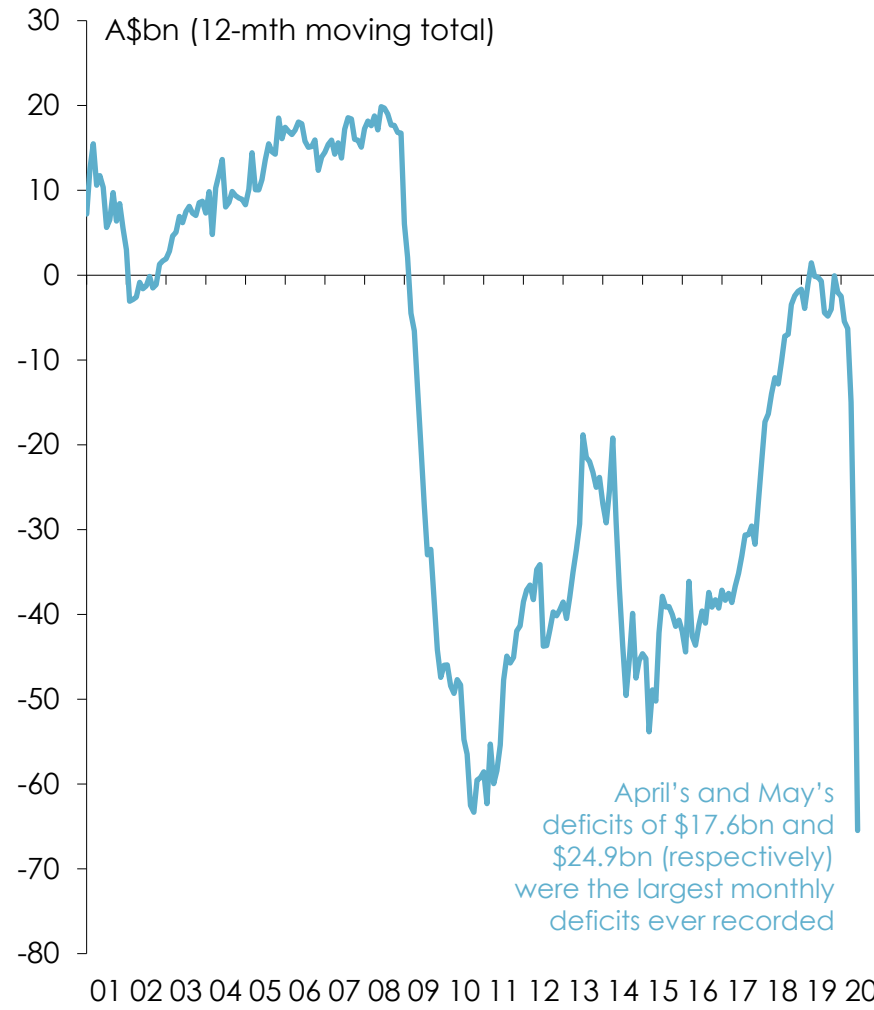
- ❑ Policy measures announced thus far by the Australian Government total \$177bn over FYs 2019-20 and 2020-21 or about 9% of one year's GDP – which is large by international standards (and double what was done during the GFC)
- ❑ Principal objectives of policy measures have been to –
 - maximize the 'survival prospects' of businesses affected by the shutdown
 - minimize the impact of the shutdown on employment
 - provide additional income support to those who lose their jobs
 - strengthen the capacity of the health care system to cope with increased demand
- ❑ Policy measures have been designed to be 'simple' to administer, and to make greatest use of existing systems rather than having to create new mechanisms
 - which has resulted in some anomalies
- ❑ Policy measures also designed to be readily 'switched off' once the need for them has passed
 - This month the Government announced the extension of 'JobKeeper' and 'JobSeeker' beyond end-September to end-March, albeit at lower payment levels

The Australian Government's 'bottom line' has begun to deteriorate sharply, and ...

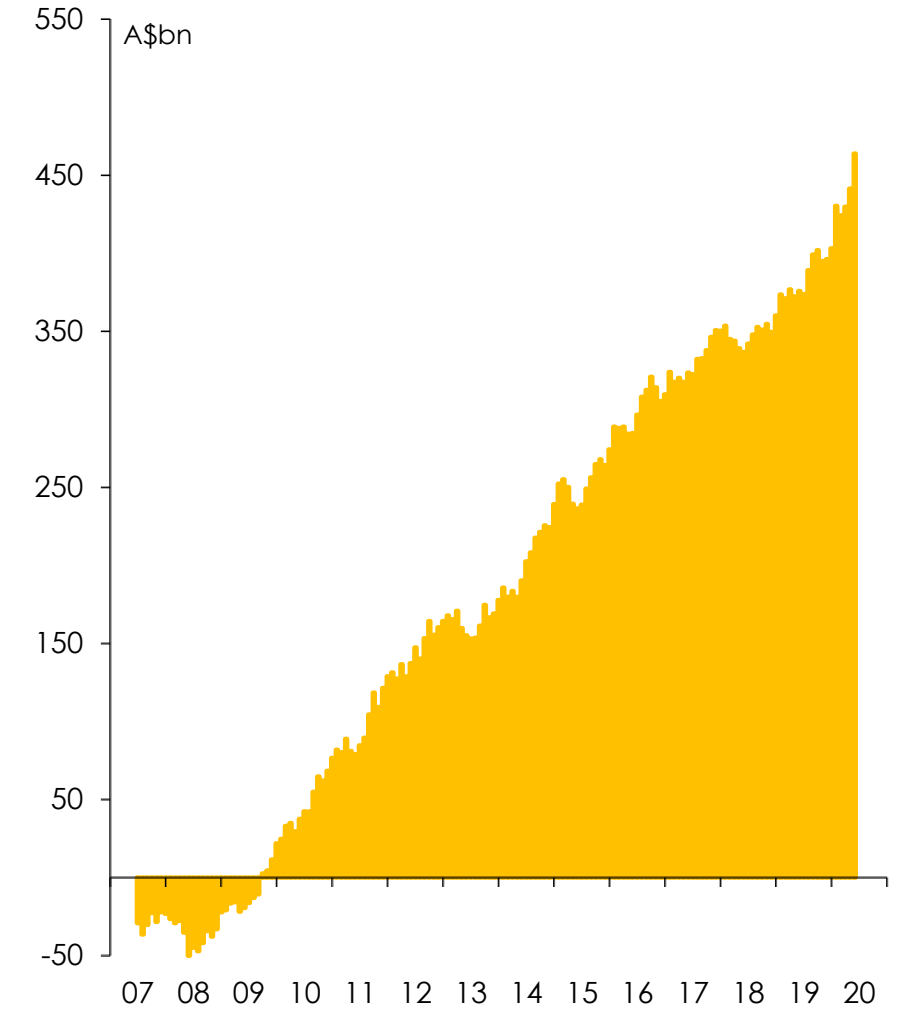
Australian Government revenue and expenses



Australian Government 'underlying' cash balance



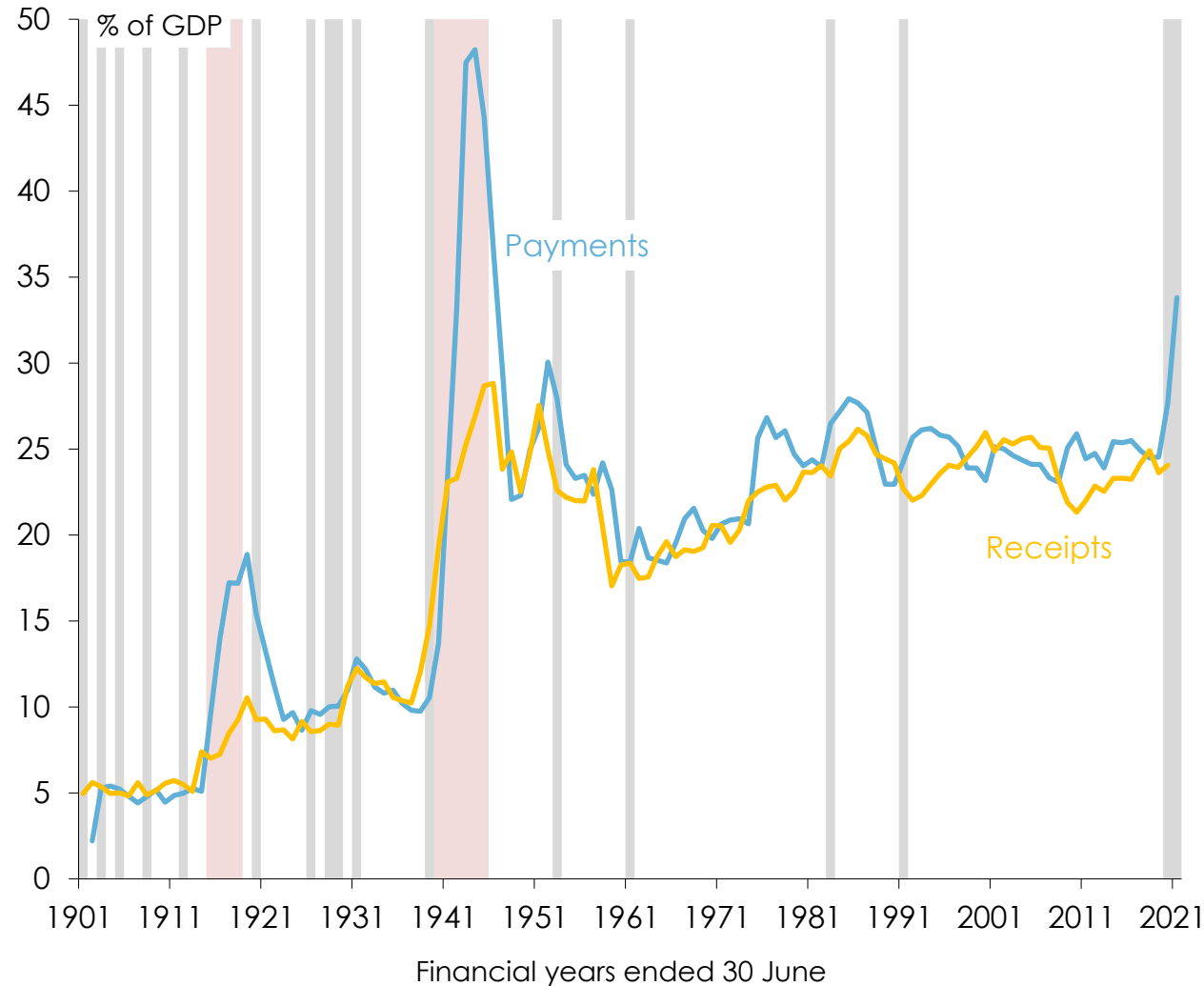
Australian Government net debt



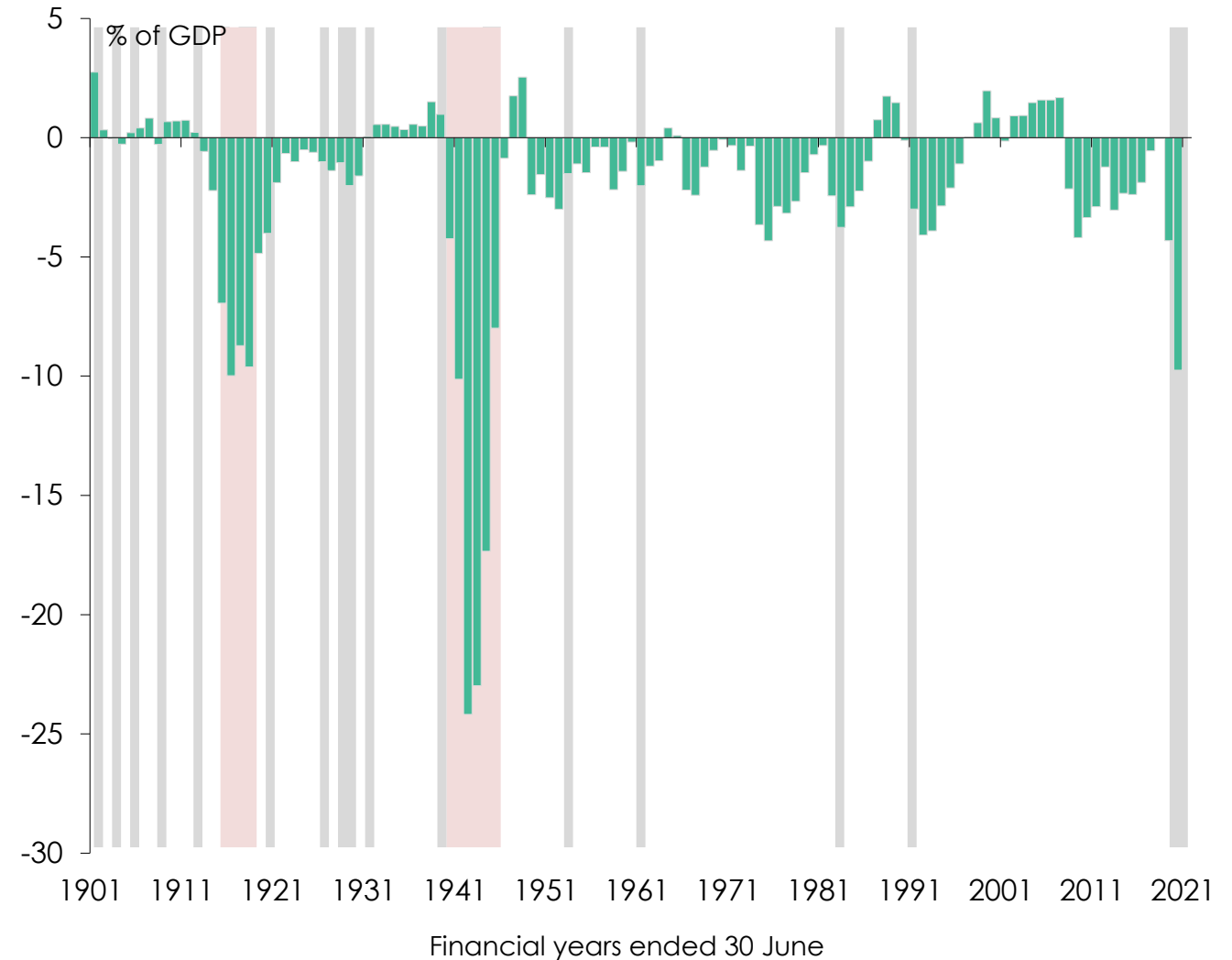
Note: Revenue and expenses are accrual accounting items. The 'underlying' cash balance is (cash) receipts minus payments, excluding transactions in financial assets for policy purposes and net earnings of the Future Fund. Net debt is total interest-bearing liabilities (government securities, deposits, loans and other borrowing) minus cash and deposits, advances paid, and (interest-bearing) loans, placements and investments. Source: Department of Finance.

... blew out to \$86bn in 2019-20, and is forecast to widen to \$185bn (9.7% of GDP) in 2020-21, the largest deficit as a pc of GDP since WW II

Australian Government receipts and payments



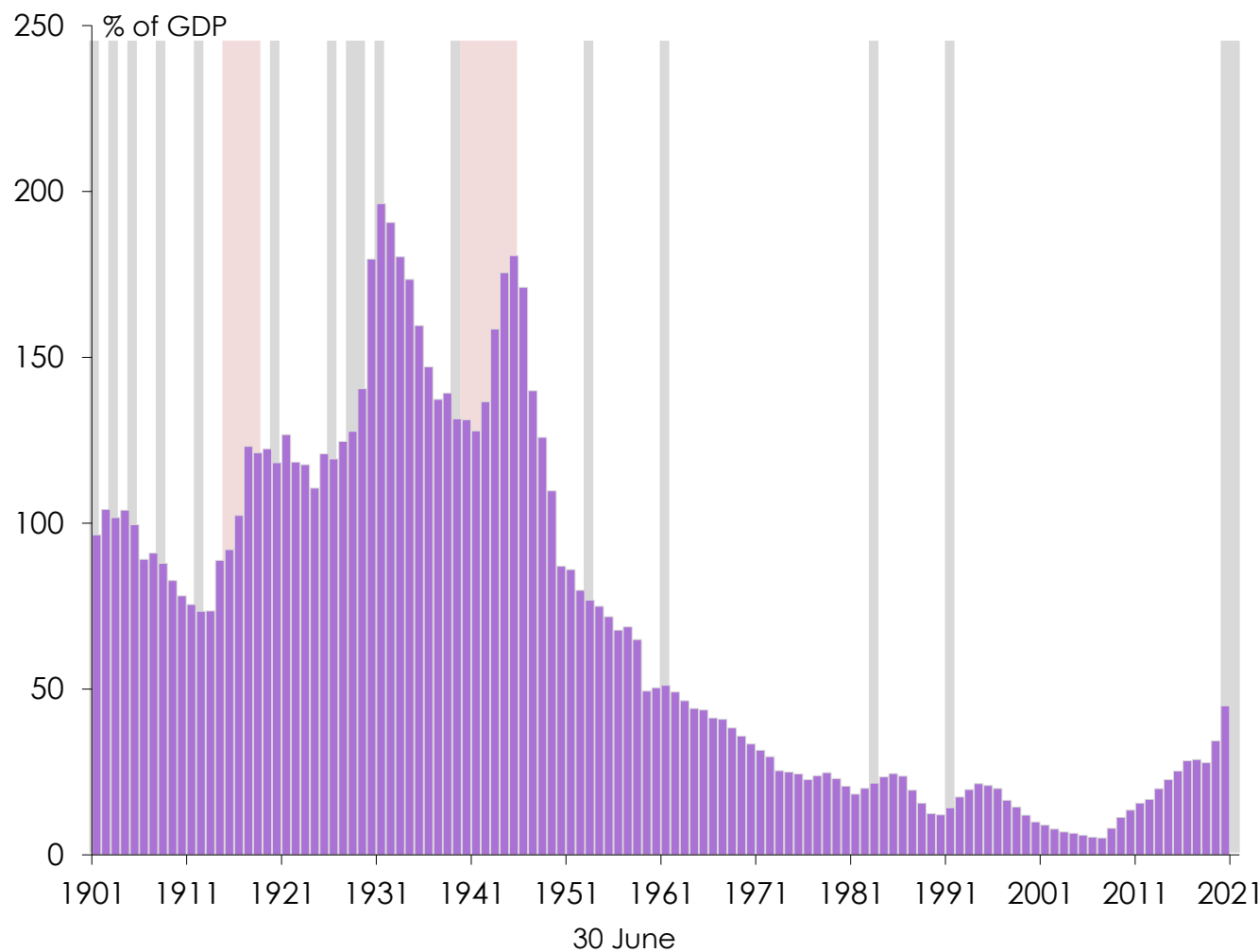
Australian Government budget deficit or surplus



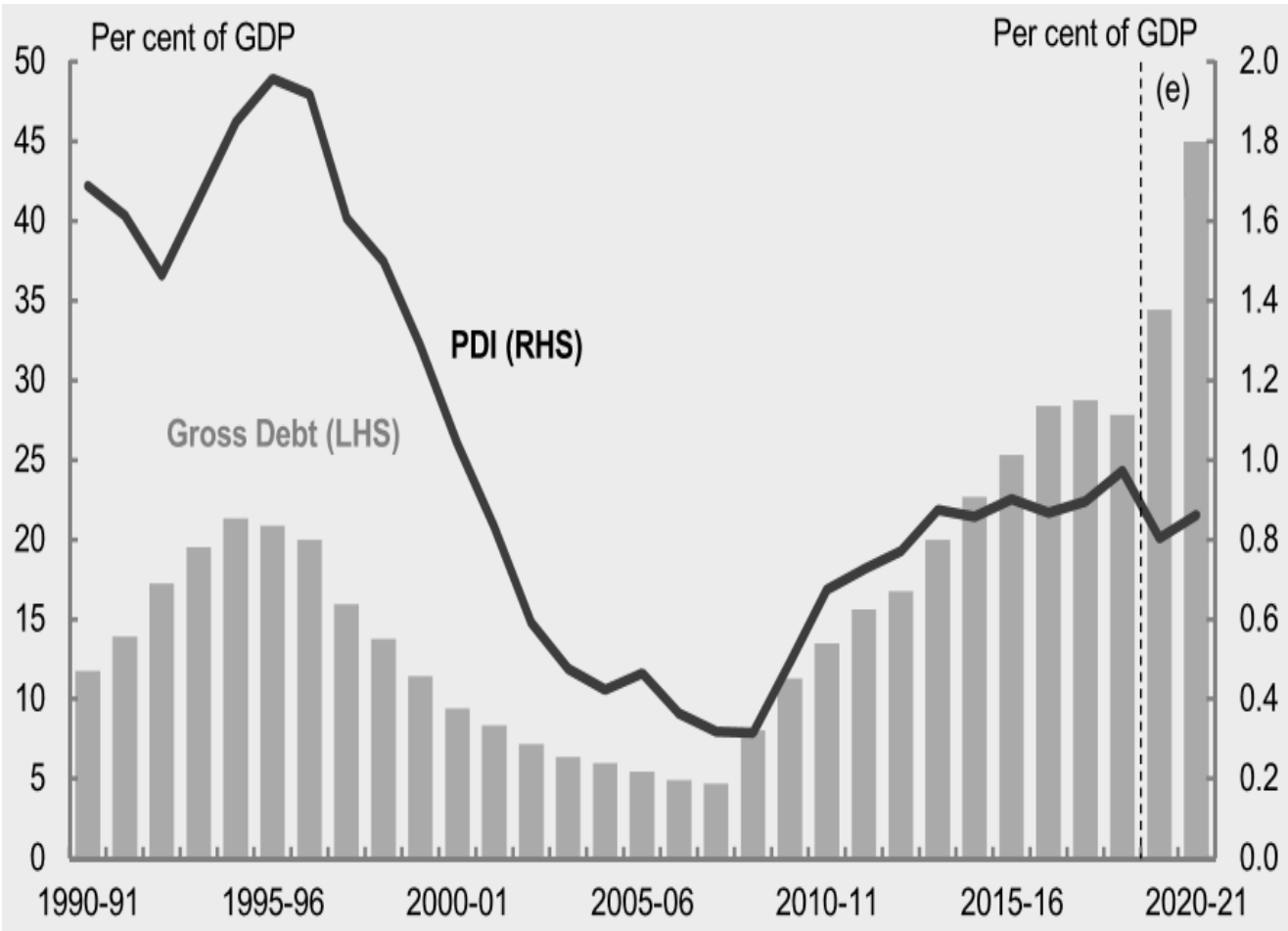
Note: Payments and the budget surplus or deficit are 'underlying' (that is, exclude 'net investments in financial assets for policy purposes') after 1989-90, when state governments became responsible for issuing their own debt, and 'headline' before that. Areas shaded in grey are fiscal years in which real GDP contracted; areas shaded in pink are World Wars I and II. Sources: Global Financial Data; Australian Government, 2019-20 Mid-Year Economic and Fiscal Outlook (December 2019) and Economic and Fiscal Update (June 2020).

There's no need for undue alarm at the level of debt which will be incurred by the Australian Government

Australian Government gross public debt



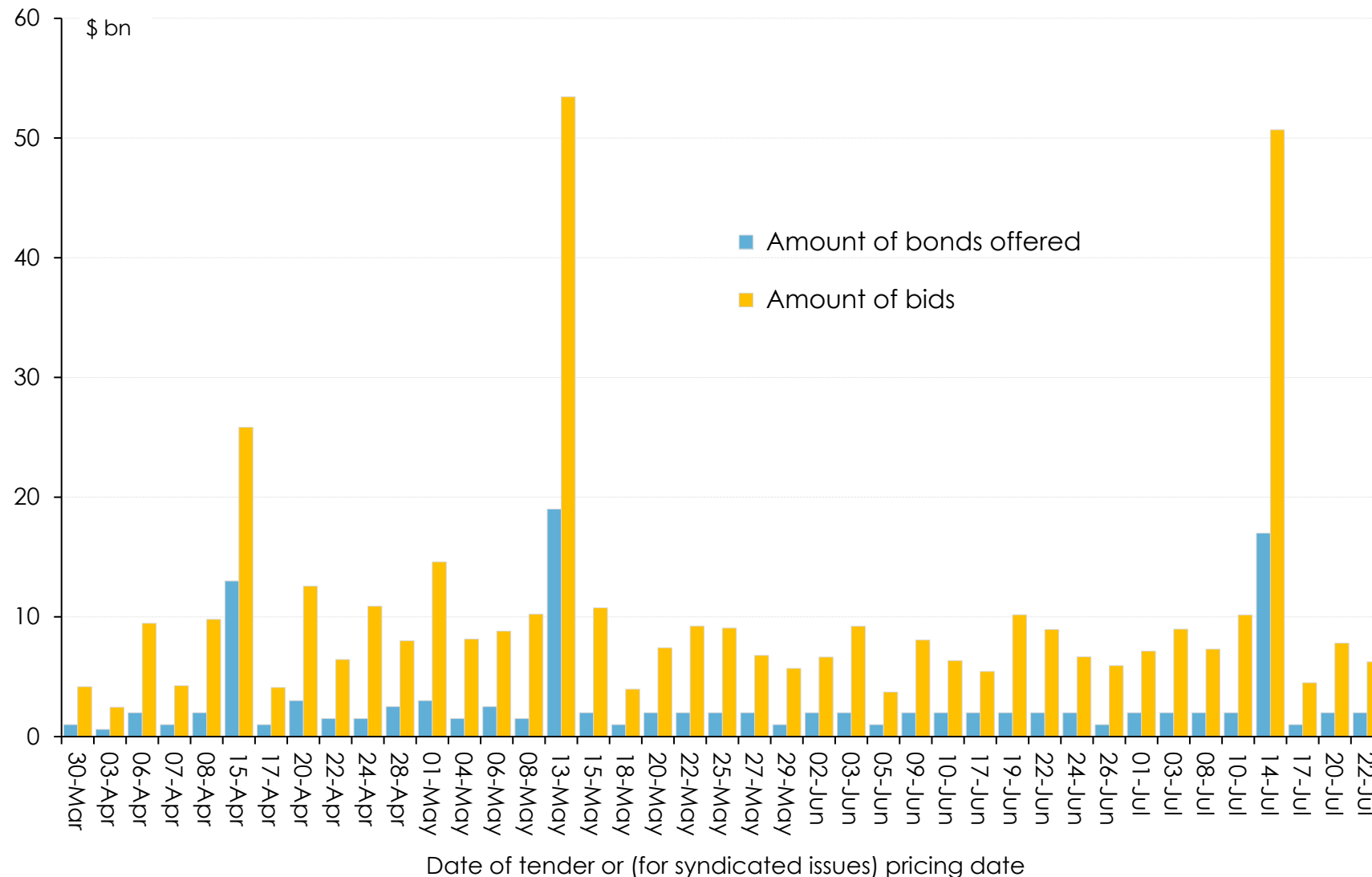
Gross public debt and public debt interest payments



Note: Areas shaded in grey are fiscal years in which real GDP contracted; areas shaded in pink are World Wars I and II. Sources: Global Financial Data; Australian Government, *Mid-Year Economic and Fiscal Outlook (MYEFO)*, December 2019, and *Economic and Fiscal Update*, June 2020; International Monetary Fund, *Fiscal Monitor*, April 2020.

The Australian Government has so far had absolutely no difficulty financing its significantly higher deficits

Australian government bond issuance since March 2020

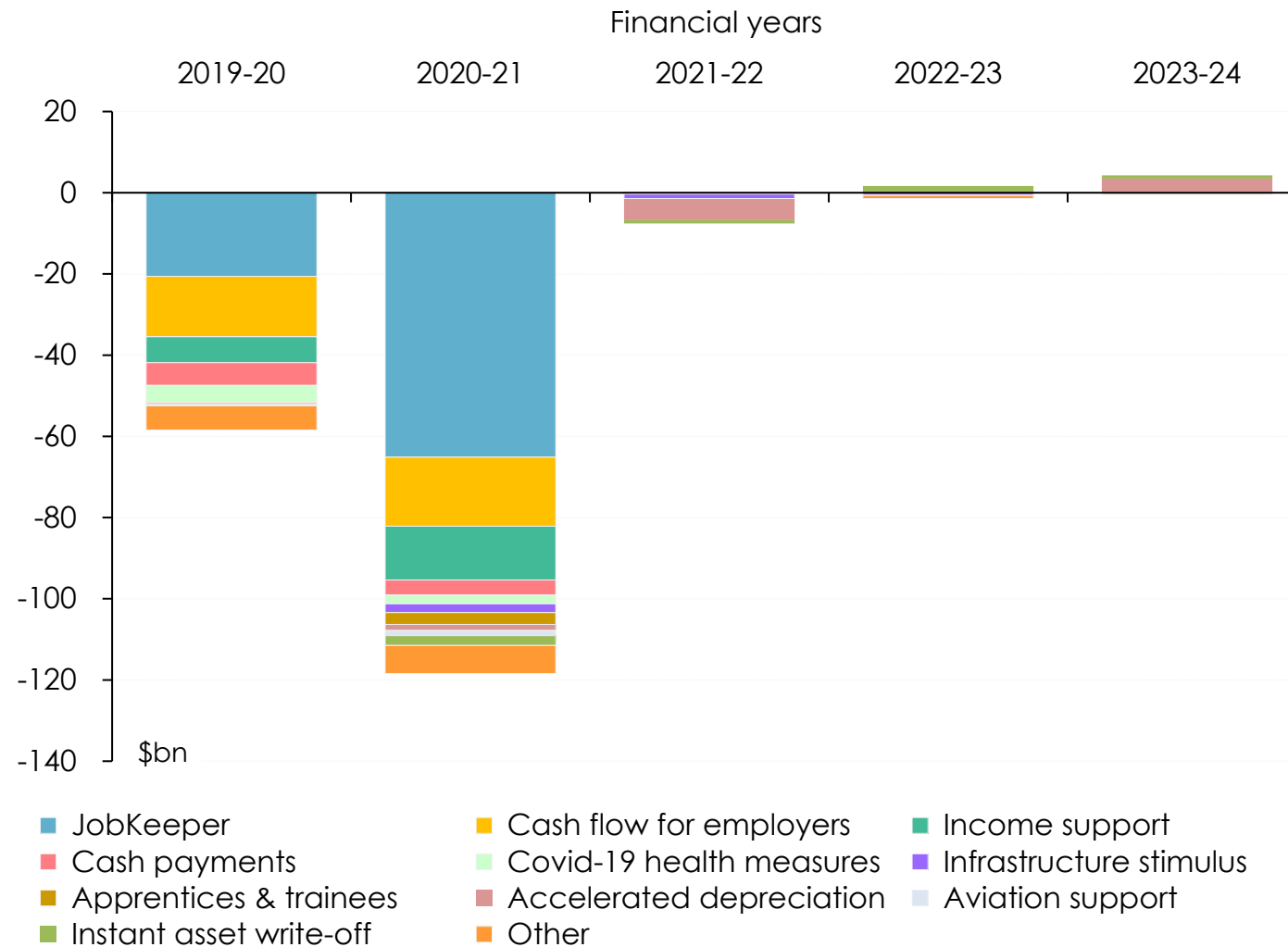


- Since 30th March, the Australian Office of Financial Management (which conducts the Government's borrowing programs) has issued \$117bn of Treasury bonds
- Based on the volume of bids received at bond tenders or for syndicated issues, the AOFM could have borrowed \$420bn (that is, 3.6 times as much as it actually accepted) – with the highest yields on unsuccessful bids averaging 34bp above the highest accepted yields
- This month, AOFM received offers worth \$50.7bn for \$17bn of 4½ year bonds carrying a coupon rate of 0.25% pa – the average yield on successful bids was 0.495%
 - 42% of the bonds were bought by banks, 27% by fund managers, 23% by hedge funds, and 8% by (foreign) central banks

Source: Australian Office of Financial Management data hub.

The Government has provided a massive fiscal stimulus during the June and September quarters, but this is set to wind back in Q4 and beyond

Impact of 'policy decisions' taken since last December on the Australian Government's 'underlying' cash balance



- ❑ 'Policy decisions' taken since last December's Mid-Year Economic & Fiscal Outlook (MYEFO) represent a discretionary fiscal stimulus equivalent to 2.9% of GDP in 2019-20 and 6.3% of GDP in 2020-21
- ❑ Treasury estimates that this fiscal support boosted by real GDP (relative to what it would have been otherwise) by $\frac{3}{4}\%$ in 2019-20, and will boost it by around $4\frac{1}{4}\%$ in 2020-21
 - and that this support prevented the loss of around 700,000 jobs, lowering the peak unemployment rate by around 5 pc points
- ❑ This week's decisions to extend 'JobKeeper', and the elevated level of 'JobSeeker' payments (albeit at lower levels) beyond end-September until the end of March (see next slide) have lowered the 'fiscal cliff' that was looming at the end of September
 - Nonetheless, as things currently stand there will still be a significant tightening of fiscal policy at the end of this and the next two quarters
- ❑ The Government will need to (and probably will) provide more fiscal stimulus in the (delayed) Budget to be presented on 6th October (see next slide)

The Treasurer has foreshadowed ‘bringing forward’ personal income tax cuts scheduled for 2022 and 2024 as a form of fiscal stimulus

Legislated personal income tax cuts

Rates from 2017-18 to 2023-24	New thresholds from 2018-19 to 2021-22	New thresholds from 2022-23 to 2023-24
Nil	Up to \$18,200 pa	Up to \$18,200 pa
19 %	\$18,201 - \$37,000	\$18,201 - \$45,000
32.5 %	\$37,001 - \$90,000	\$45,001 - \$120,000
37 %	\$90,001 - \$180,000	\$120,001 - \$180,000
45 %	Above \$180,000	Above \$180,000
Low & middle income tax offset	Up to \$1,080	-
Low income tax offset	Up to \$445	Up to \$700

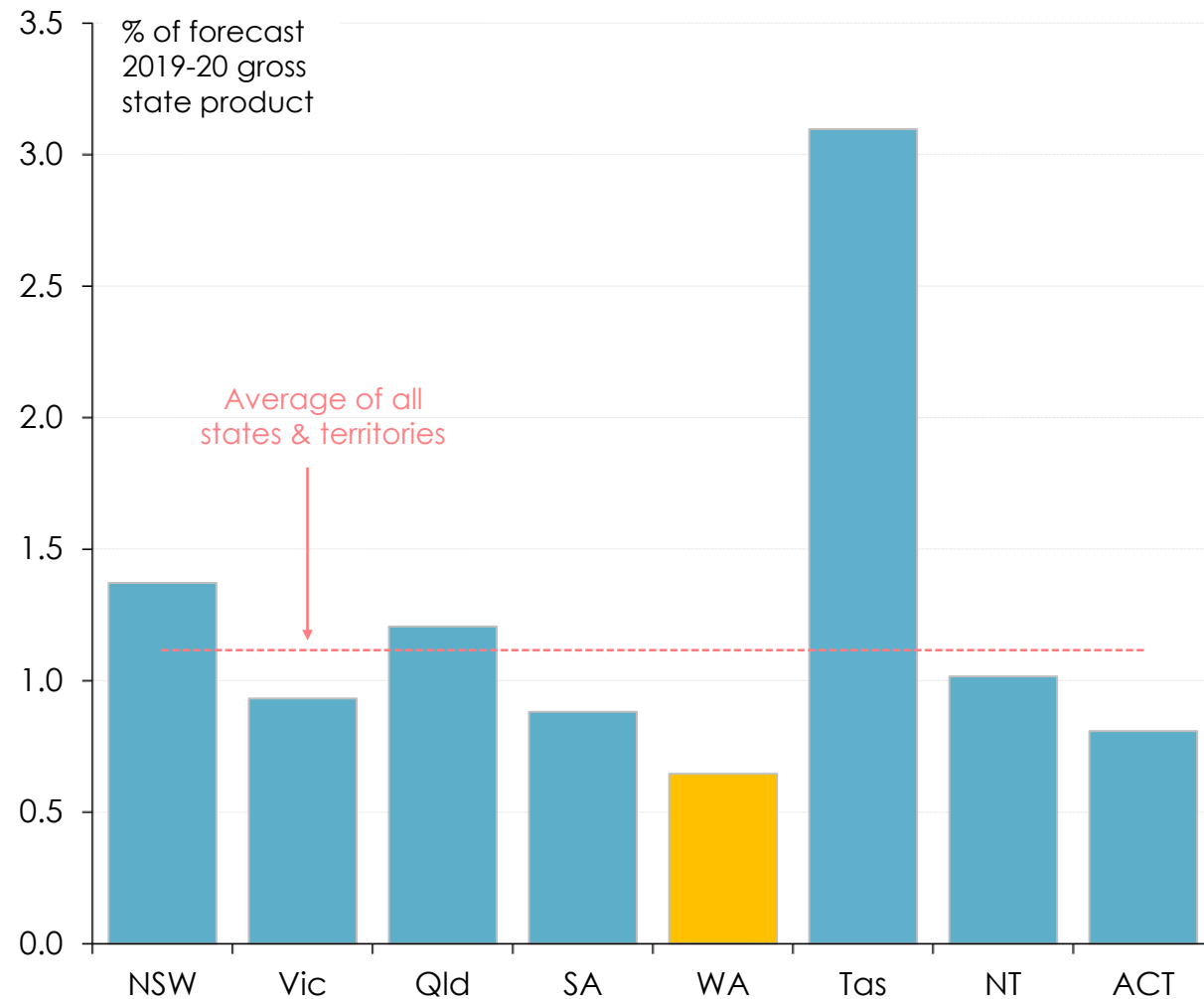
Rates from 2024-25	New thresholds from 2024-25
Nil	Up to \$18,200 pa
19 %	\$18,201 – \$45,000 pa
30 %	\$45,001 – \$200,000 pa
45 %	Above \$200,000 pa
Low income tax offset	Up to \$700

Source: Australian Government, 2019-20 Budget Paper No. 1, *Budget Strategy and Outlook*, April 2019.

- ❑ This week the Government announced extensions to its (wage subsidy and income support schemes
 - ‘JobKeeper’ will be extended from 28th September to 28th March 2021, but fortnightly payments will step down from \$1500 to \$1200 (or \$750 for people working < 20 hrs per week before 1st March 2020) from 28th September, and then to \$1,000 (\$650 for part-time workers) from 4th January
 - the ‘Coronavirus Supplement’ paid to JobSeeker recipients (and some others) will be extended beyond 27th September until 31st December, but at a lower fortnightly rate of \$300 (cf. \$550 currently) – although recipients will be allowed to earn \$300/fortnight (cf. \$200 currently)
- ❑ Treasurer Josh Frydenberg has foreshadowed bringing forward the personal income tax cuts currently legislated to come into effect on 1st July 2022, as a way to ‘boost aggregate demand, boost consumption [and] put more money in people’s pockets’
- ❑ These were estimated to ‘cost’ \$4½bn (in revenue foregone) in FY2022-23 and (together with the further cuts legislated to take effect from the beginning of FY2023-2024) \$143bn over the ten years to 2029-30
 - bringing forward these tax cuts would likely provide a lift to demand and activity – but, inevitably, at least some of the boost in after-tax incomes would be saved and/or used to pay down debt (as happened with the enhanced tax refunds paid out in the Sep quarter of last year – slide 48)
 - whereas the same dollar amount spent (eg) on infrastructure, or on cash handouts to low-income earners who don’t pay tax, would boost demand by a larger amount

There's been considerable difference in the size of state and territory governments' fiscal responses to Covid-19

State & territory Covid-19 support and response measures as a pc of gross state product



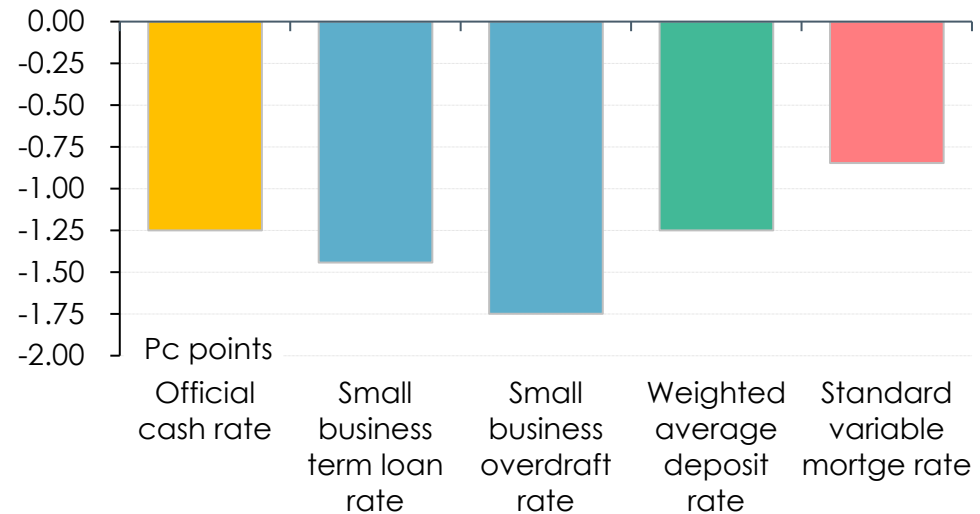
Voter approval of state premiers' handling of Covid-19



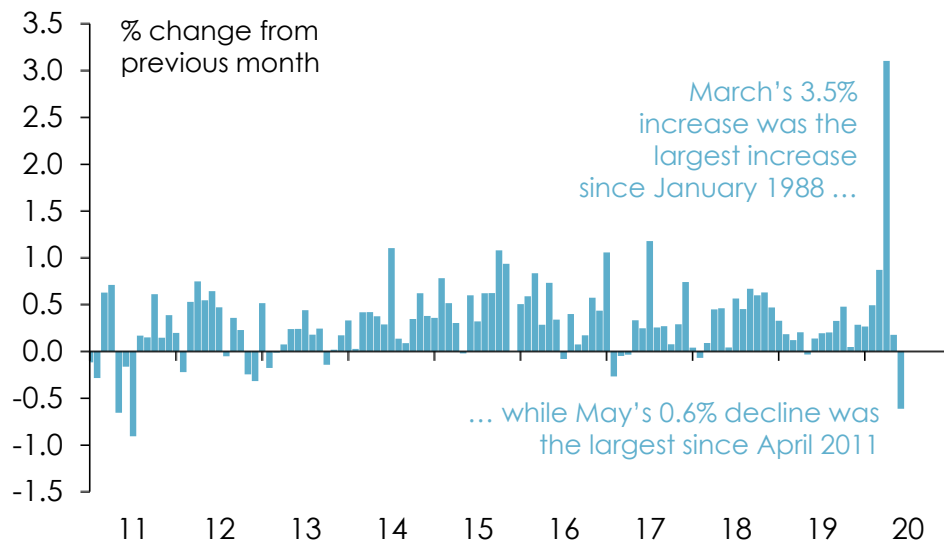
Sources: National Australia Bank, *State Economic Overview*, April 2020; Newspoll in *The Australian*, 30th June 2020.

For now at least, banks are 'part of the solution', not 'part of the problem'

Changes in interest rates since June 2019



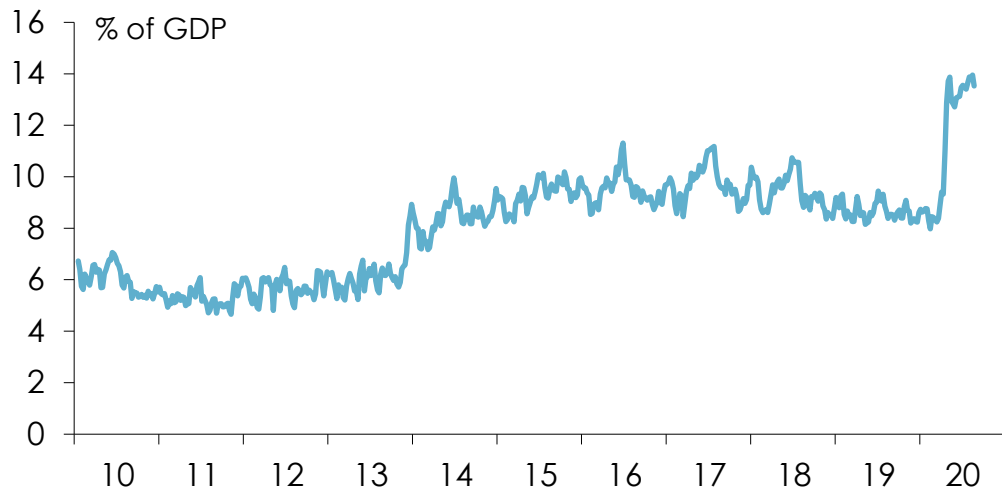
Business credit outstanding



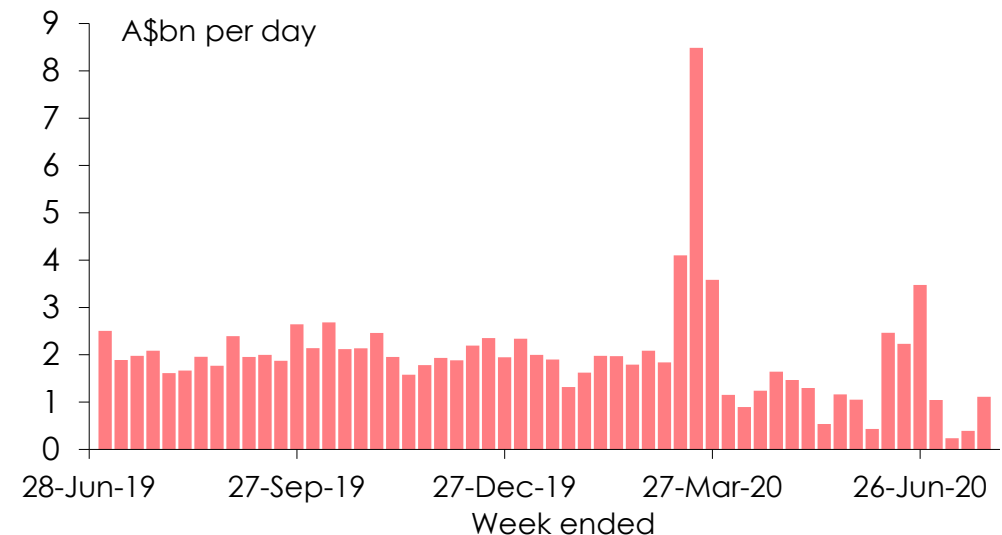
- ❑ Banks have cut interest rates on small business loans by more than the official cash rate since June last year (when the RBA started cutting rates again)
- ❑ Banks have extended 'repayment holidays' of up to six months to business and home mortgage borrowers who request it (about 13% of mortgages and 20% of SME loans)
 - although it is important to note that under these arrangements interest payments are deferred and capitalized, not foregone
- ❑ These 'repayment holidays' are due to expire at end-September, but banks this week announced that they would be extended for up to four months for those customers who were still experiencing difficulties but have good prospects of eventually repaying
- ❑ Major banks have cut or deferred dividends
- ❑ At end-2019, the Australian banking system had a Common Equity Tier 1 capital ratio of 11.3% of risk-weighted assets - well above the 10.5% required for major banks since 2017
 - APRA will allow banks CET1 ratios to drop below the 2017 requirements during the Covid-19 period provided they remain above other minimum prudential capital requirements
- ❑ Banks may be hit by increased loan impairment charges after 30th September

With official interest rates as low as they can go, the RBA has implemented a range of 'quantitative' monetary policy measures

Reserve Bank assets as a pc of GDP



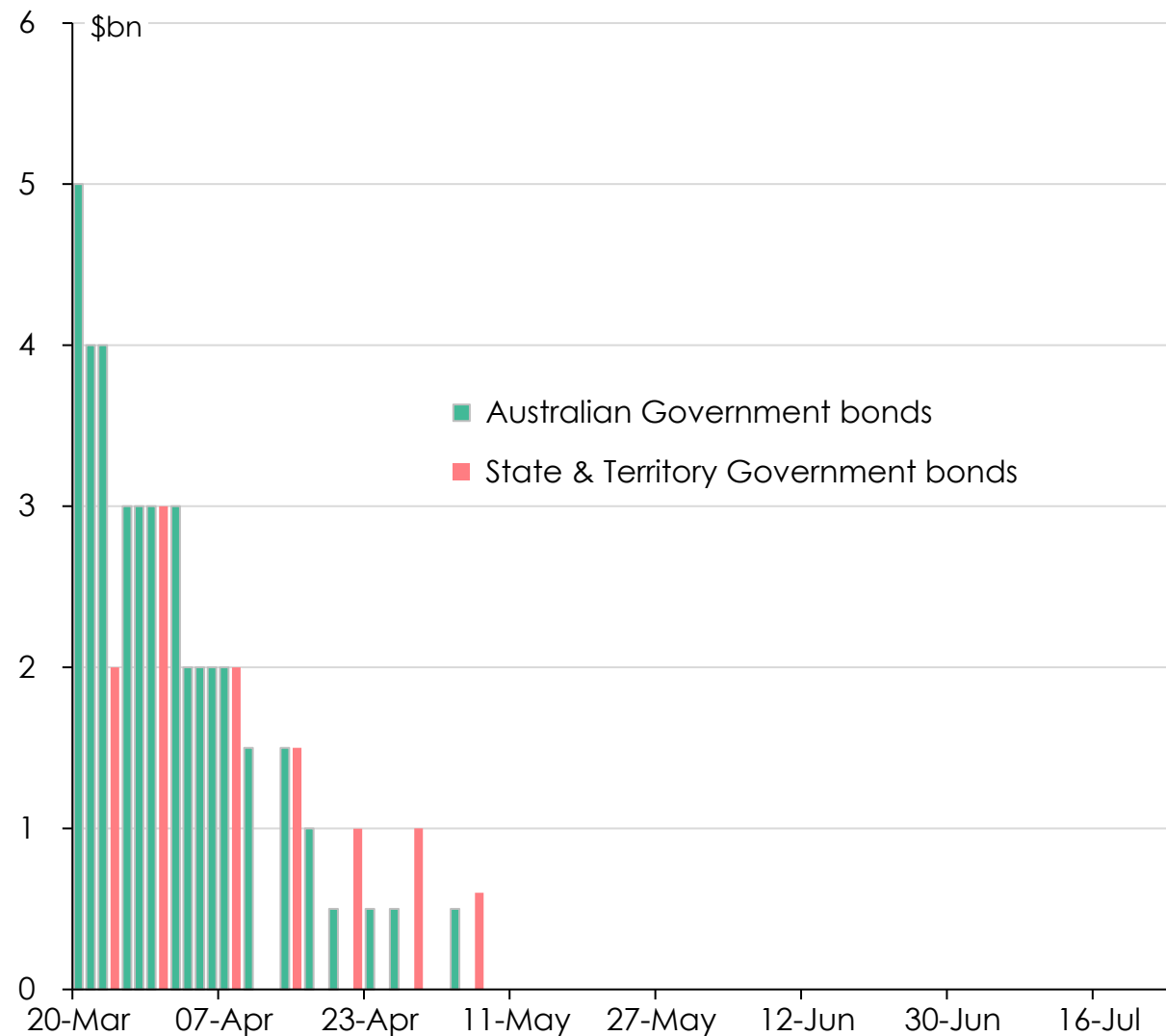
Reserve Bank daily repo transactions



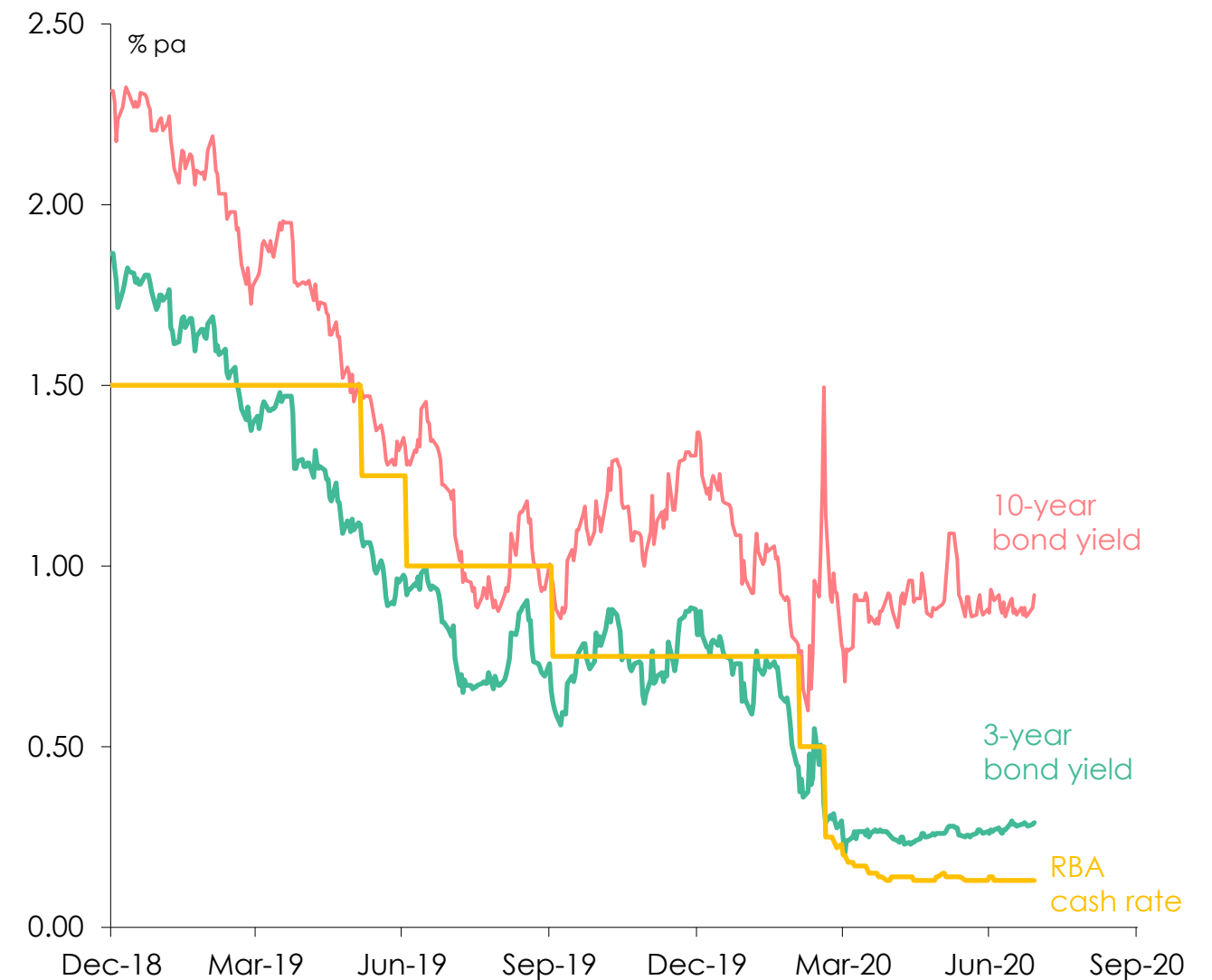
- ❑ **The RBA again left its cash rate target at 0.25% this week**
 - the RBA has committed to keeping it at this level 'until progress is made towards full employment' and 'it is confident inflation will be sustainably within the 2-3% target band'
 - RBA has 'no appetite' for negative rates
- ❑ **RBA has committed to purchase bonds in the secondary market with a view to keeping the 3-year yield at 0.25%**
 - to date RBA bond purchases amount to \$50bn (~ 2½% of GDP)
 - the RBA hasn't purchased any bonds since 6th May (but is prepared to 'scale up' these purchases again 'if necessary')
 - RBA assets are now equivalent to 14% of GDP (cf. BoC 23%, US Fed 33%, BoE 36%, ECB 54%, BoJ 119% - see slide 24) and RBNZ 17.5%
- ❑ **RBA provided additional liquidity through 'open market operations' to prevent disruption of credit markets in March**
 - RBA repo transactions averaged just over \$1 bn a day since the beginning of April (except for the last two three weeks of the 2019-20 financial year), down from peak of almost \$8½ bn a day in 3rd week of March
- ❑ **'Term Funding Facility' to provide up to \$90 bn at 0.25% pa to lending institutions for increased lending, especially to businesses with annual turnover of less than \$50 mn**
 - to date \$24.8 bn has been provided through this facility

The RBA is targeting the 3-year bond yield at 0.25% pa – and hasn't needed to purchase bonds since 6th May in order to keep it there

RBA open market bond purchases



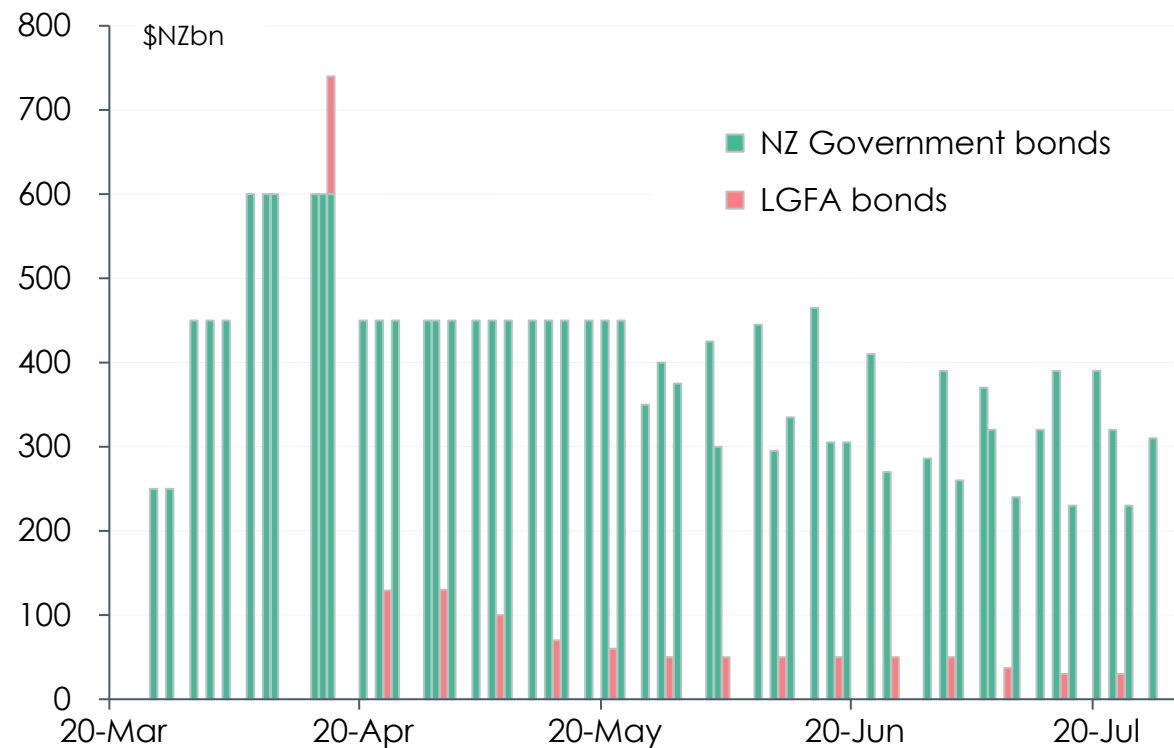
Interest rates



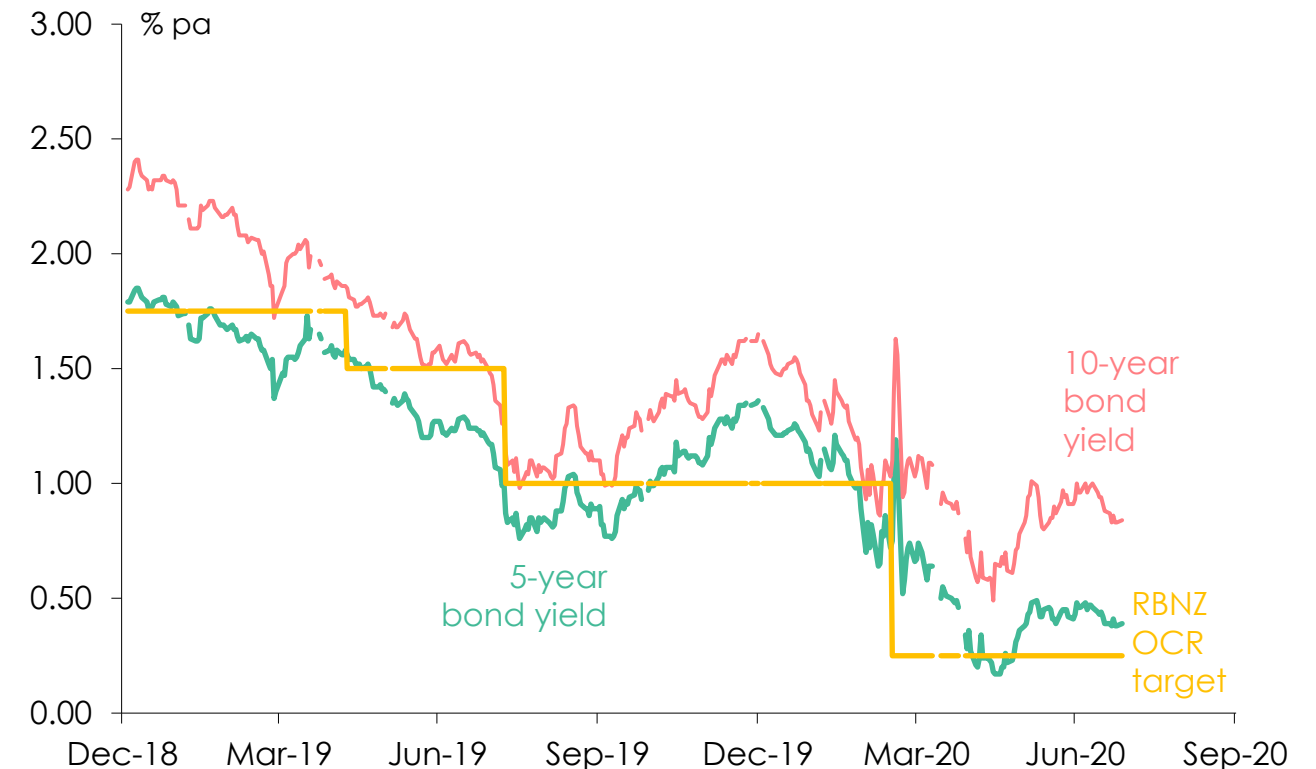
Source: Reserve Bank of Australia. Data up to 28th July.

The RBNZ's 'QE' program has been larger than the RBA's, but less successful in stabilizing bond yields

RBNZ open market bond purchases



New Zealand interest rates`

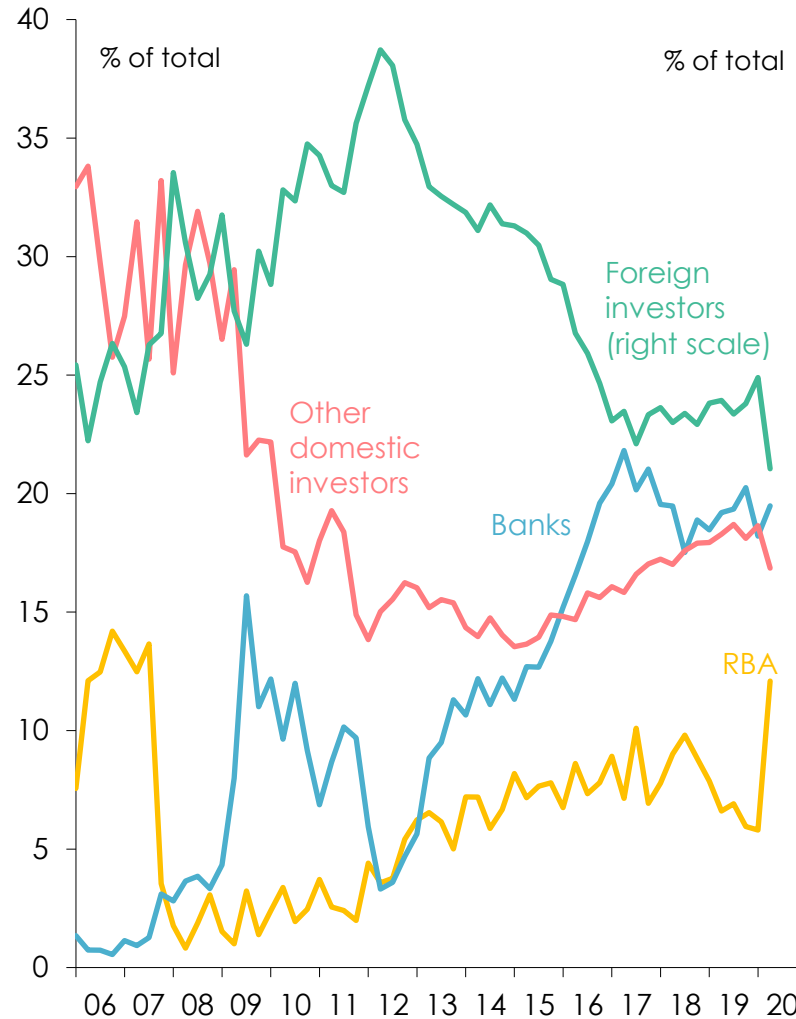


- ❑ RBNZ has adopted an ECB-style QE program, establishing a Large Scale Asset Program initially set at \$NZ33bn (10½% of GDP), since increased to \$60bn (19% of GDP)
- ❑ Since 25th March RBNZ bond purchases have amounted to \$NZ22.3 bn (7.2% of GDP) – but have been less successful than the RBA's in stabilizing medium-term bond yields
- ❑ The RBNZ has asked banks to prepare operationally for the possibility of negative interest rates

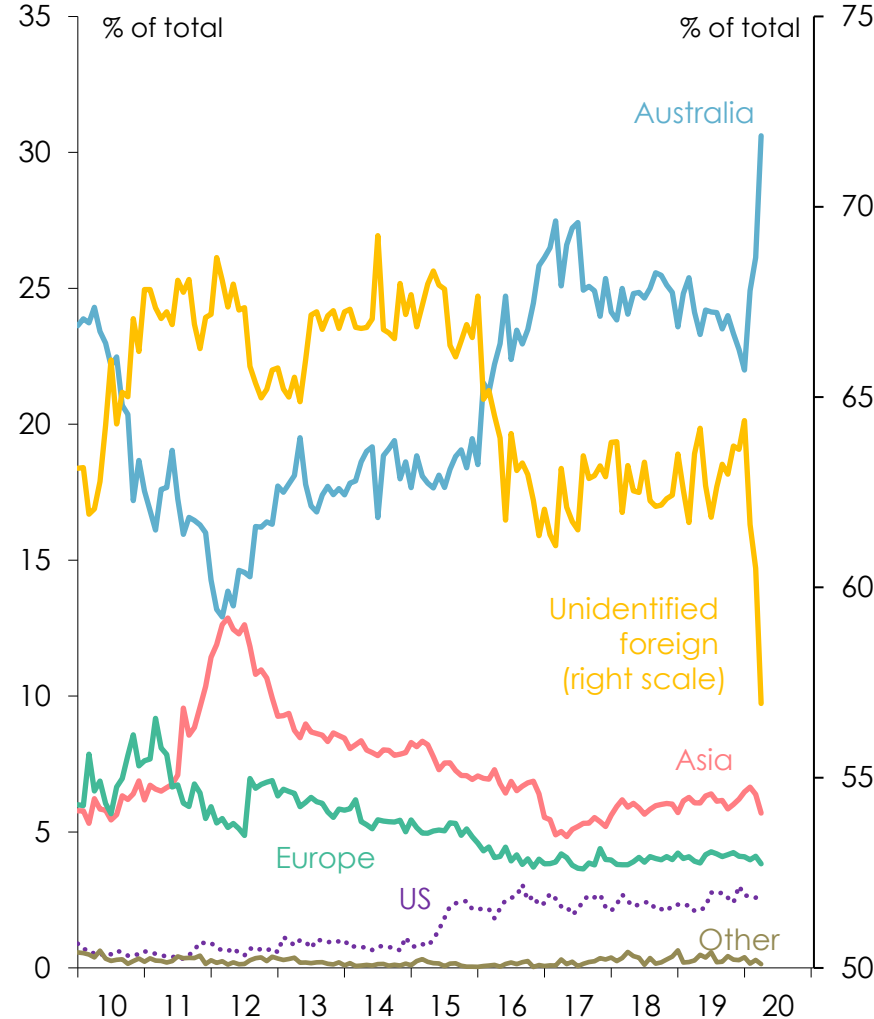
Note: LGFA = Local Government Financing Authority. Source: Reserve Bank of New Zealand. Data up 28th July.

The RBA in effect more than absorbed the increase in Commonwealth and State debt, and sales by foreign investors, during the March quarter

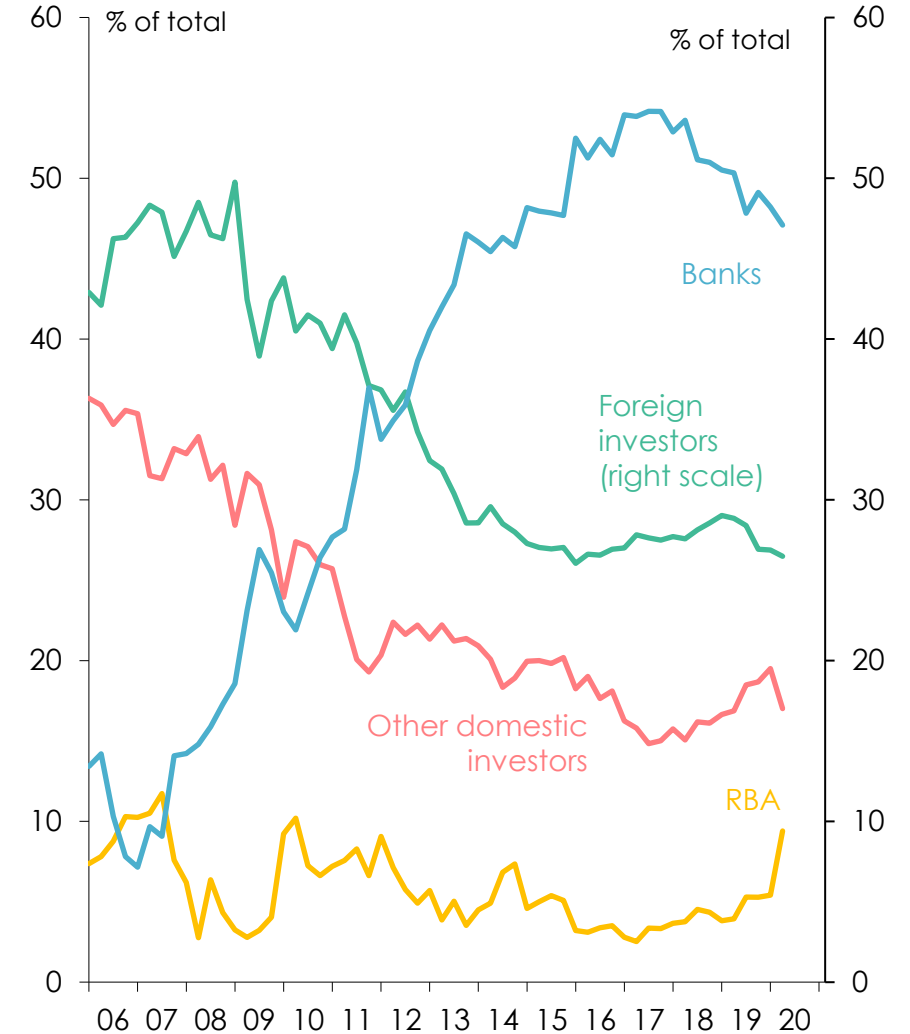
Holder of Australian Government bonds



Nationality of Australian Government bond holders



Holder of State and Territory Government bonds



Sources: ABS (Finance & Wealth Accounts); Australian Office of Financial Management. June quarter data will be released on 24th September.

The RBA Governor has again ruled out negative interest rates - and the application of 'modern monetary theory'

- ❑ **Speaking yesterday, Governor Lowe said “negative interest rates in Australia are extraordinarily unlikely”**
 - “They can cause stresses in the financial system that are unhelpful for the supply of credit. They can also encourage people to save more, rather than spend more, so they can be counter-productive from that perspective too”
- ❑ **Governor Lowe also dissed ‘modern monetary theory’ (MMT) – though without referring to it by name**
 - “For some, this idea is seen as a way of avoiding financing constraints – it is seen as holding out the offer of a free lunch of sorts”
 - “The reality, though, is there is no free lunch. The tab always has to be paid and it is paid out of taxes and government revenues in one form or another”
- ❑ **How ‘the tab is paid for’ depends, according to Governor Lowe, on ‘the arrangements in place’**
 - if money-financed government spending was “successful in stimulating the economy” and started to push inflation up, and interest rates weren’t raised to counter that, the tab would be paid “through the inflation tax that the community pays”
 - if the government were to pay the IOU issued to the central bank along with any accumulated interest at some point, “this repayment would need to be funded by future taxes”
 - if the IOU was not interest-bearing and wasn’t repaid, “the central bank would start accumulating losses as the interest rate it paid on its deposit liabilities increased and there was no offsetting income” which “would lead to a decline in dividends to the government and possibly a future recapitalization of the central bank” both of which “have to be funded through tax revenue”
 - or, if the general level of interest rates were raised to counter inflation, but the low rate on deposits at the central bank maintained, that “would effectively amount to a tax on the banking system”
- ❑ **Governor Lowe also addressed the proposal by Stanley Fischer et al that monetary financing of budget deficits could be ‘welfare enhancing’ when governments are unable to borrow ‘on reasonable terms’ and conventional monetary policy options have been exhausted, provided that the central bank (rather than the government) determined the amount of monetary financing and the conditions under which it is provided**
 - “there are likely to be very significant challenges in maintaining this type of safeguard over time”
 - and in any case this “is not relevant to the situation we face in Australia”

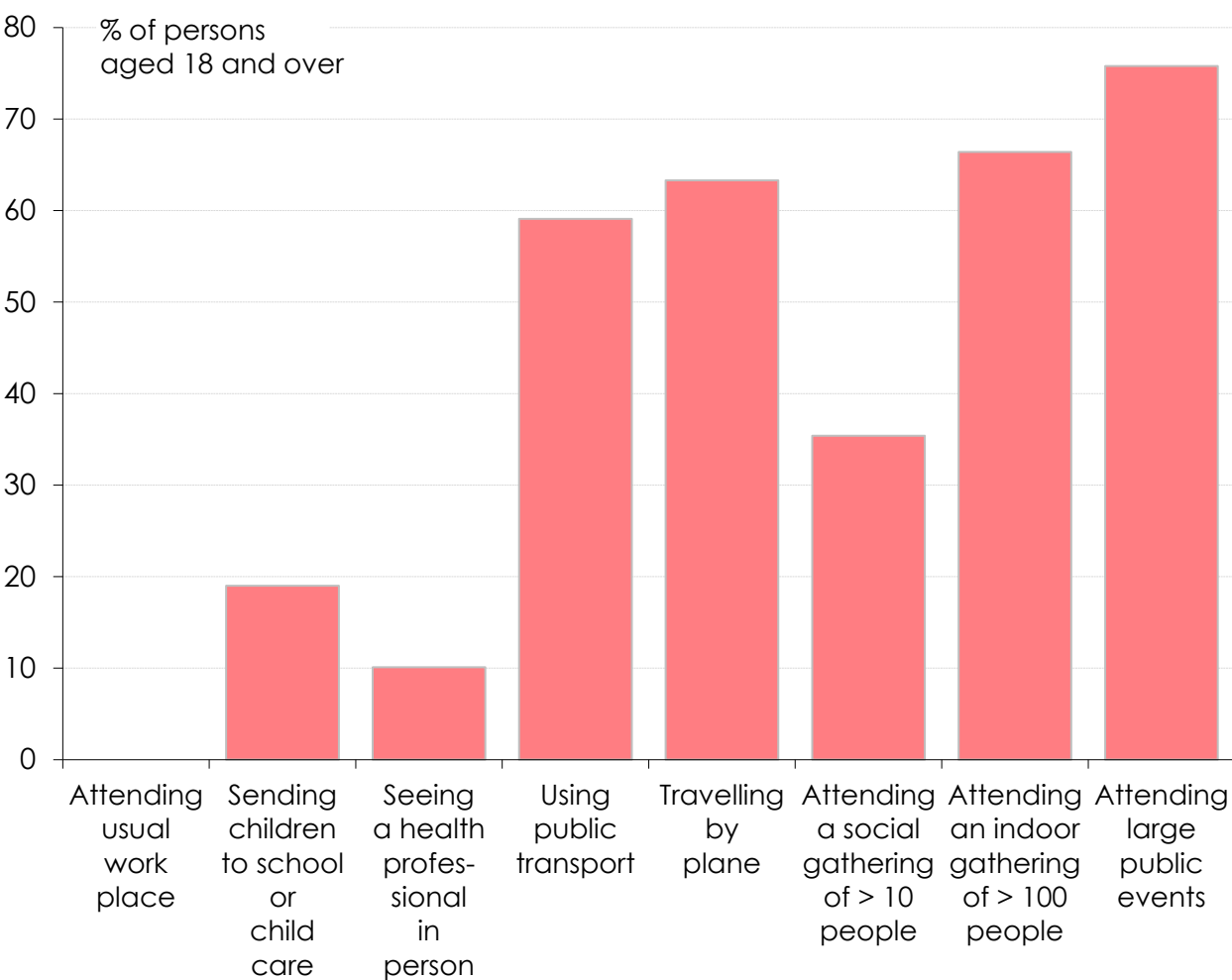
The outlook for the Australian economy

The path out of the current downturn will be more gradual than the path into it was

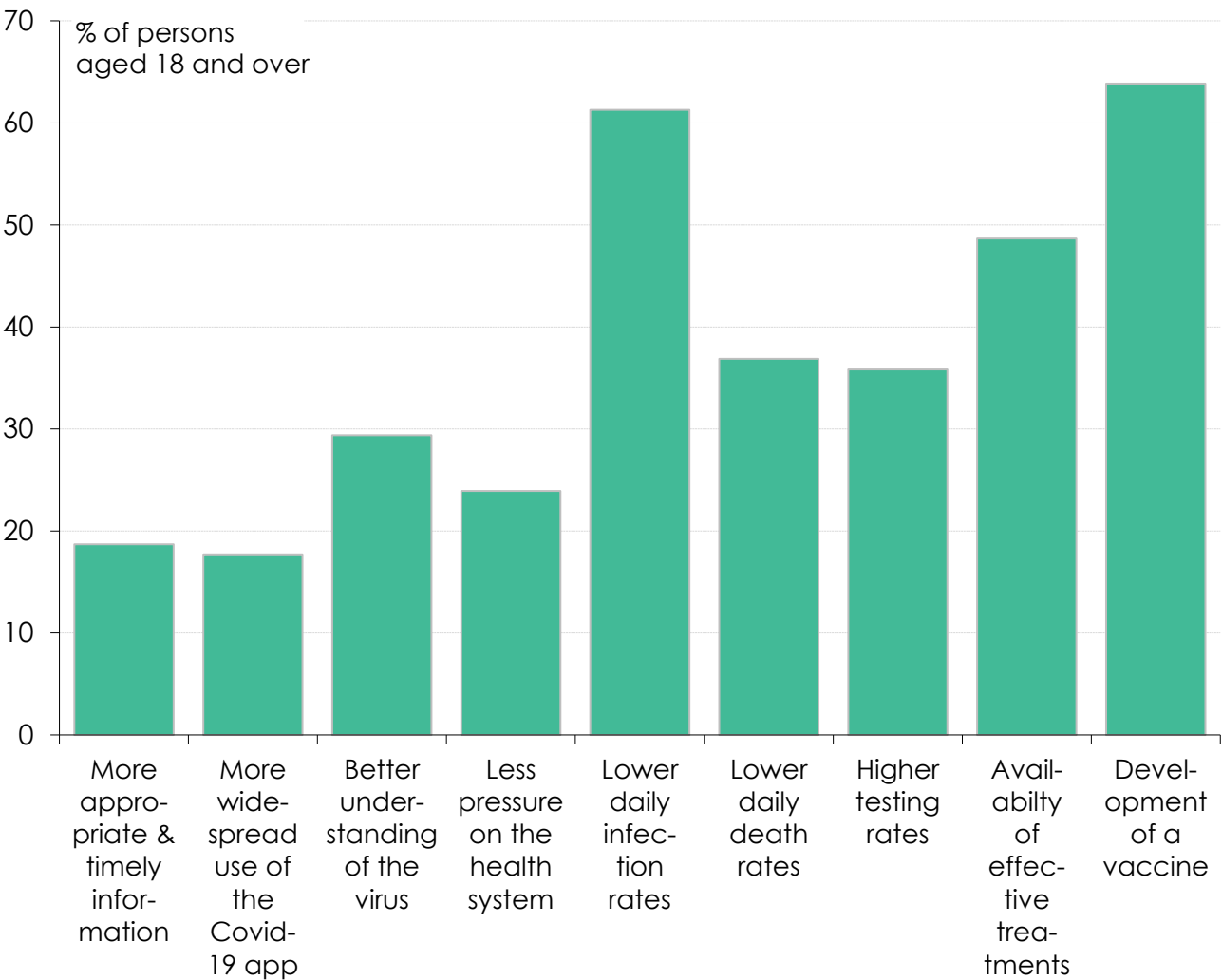
- ❑ **‘Social distancing’ requirements will be relaxed gradually rather than ‘all at once’**
 - new health and safety regulations will likely limit the number of employees and customers who can be ‘on premises’ (which may make it uneconomic for some businesses to re-open until restrictions are relaxed)
 - and many people may remain wary of exercising all of their newly-regained ‘freedoms’

Australians seem likely to continue to be wary of travel and large gatherings, at least until a vaccine for Covid-19 is developed

Proportion of adults feeling ‘uncomfortable’ with selected activities as restrictions are eased



Actions that would improve people’s comfort with activities as restrictions are eased



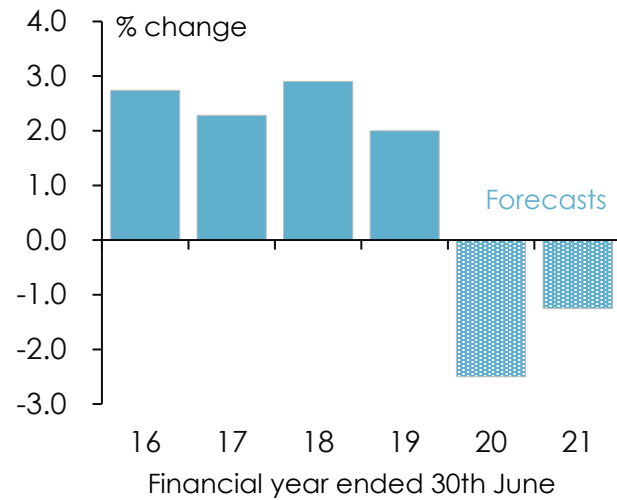
Source: ABS, Household Impacts of Covid-19 Survey, 26th-29th May (published 15th June).

The path out of the current downturn will be more gradual than the path into it was

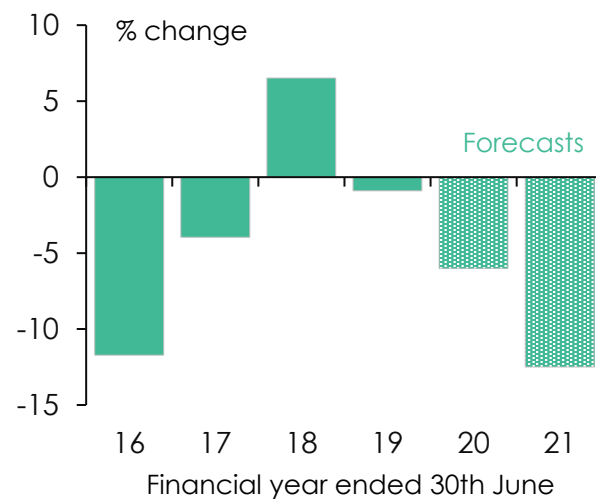
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 - and many people may remain wary of exercising all of their newly-regained ‘freedoms’
- ❑ **‘At least some businesses won’t have survived the shutdown period, and many of those which do will not immediately return to pre-outbreak levels of employment**
 - so employment will remain below pre-outbreak levels for some time rather than ‘snapping back’ quickly
 - and those returning to work may work reduced hours (compared with pre-outbreak) for some time
- ❑ **The recovery in household spending is likely to be gradual, rather than rapid**
 - if the recovery in employment is only gradual, so too will be the recovery in household disposable income
 - most households will have run down discretionary savings to at least some extent, as well as having their superannuation balances depleted by market movements and/or withdrawals – and so will likely want to rebuild savings
 - households with mortgages who have deferred repayments will face higher or longer mortgage repayments, constraining their spending capacity to some extent
 - household spending may also be affected by ‘negative wealth effects’ from lower property prices
- ❑ **There is some risk of a ‘setback’ when government support programs come to an end (nearly all of them at the end of September), or if restrictions on the movement or gathering of people have to be re-imposed**
- ❑ **International borders (except perhaps with NZ) will likely remain closed until a vaccine is widely available – which is in turn likely to be at least 12 months away**
 - implying that there will be no near-term recovery in international tourism or international education
- ❑ **Businesses are likely to be very hesitant about investment spending for an extended period (with some exceptions)**

Treasury's forecasts paint a grim picture of the Australian economy in 2020-21 – though not as bleak as seemed likely two months ago

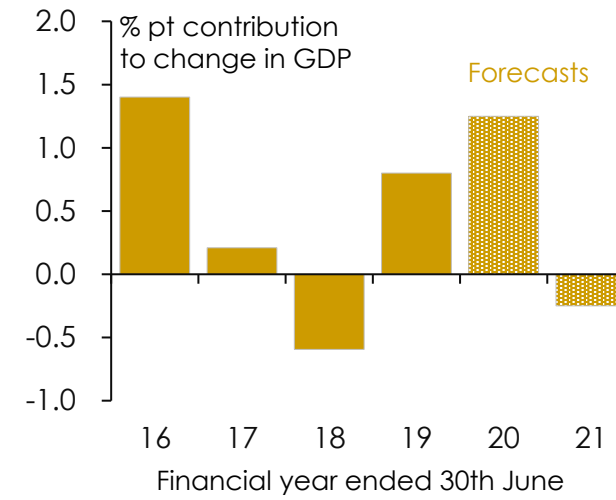
Household consumption



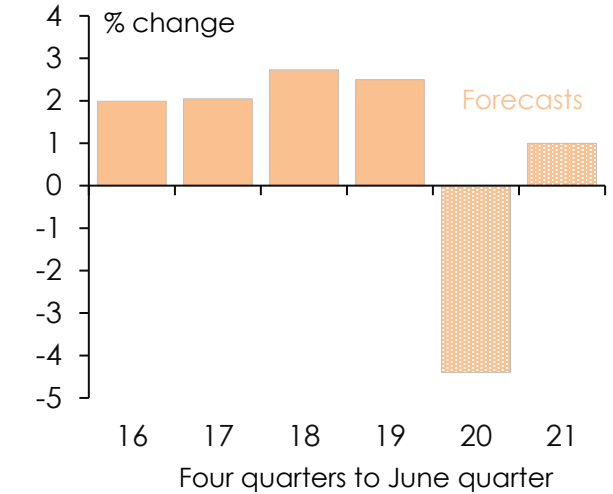
Business investment



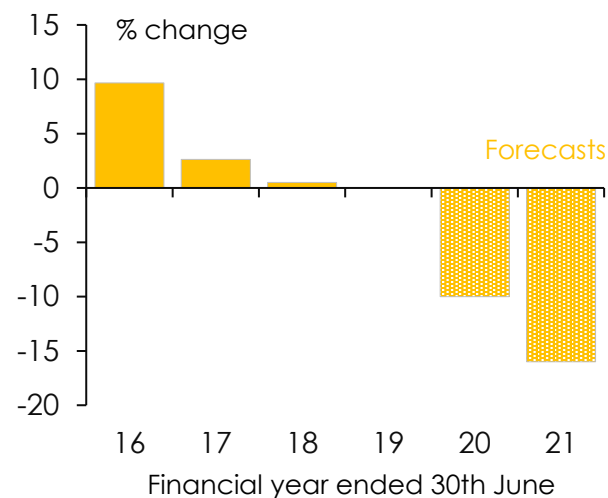
Net exports



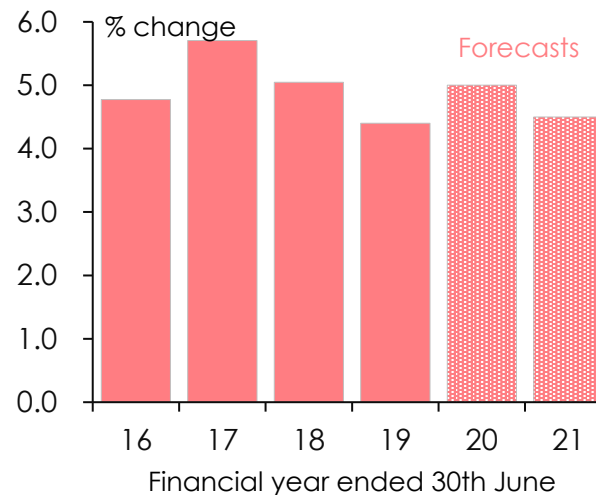
Employment



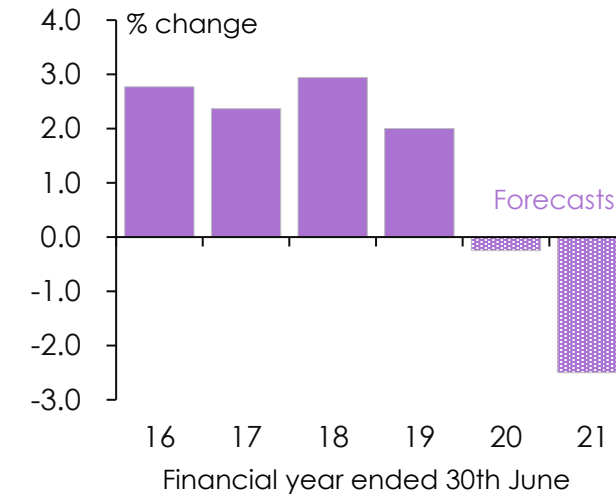
Dwelling investment



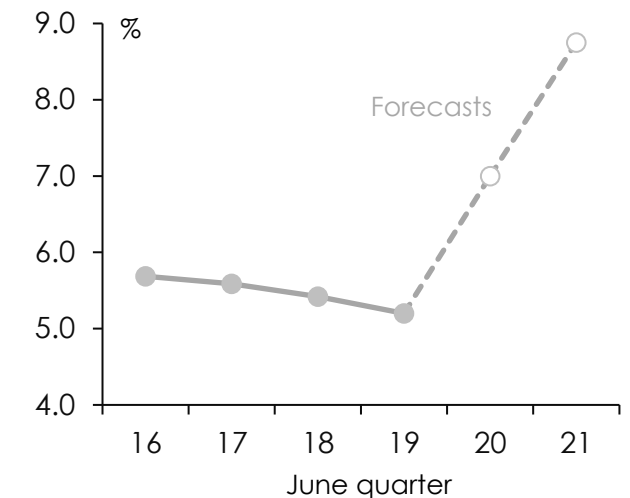
Public spending



GDP



Unemployment rate



Note: Business investment and public spending exclude transactions in second-hand assets. Employment growth is June quarter on June quarter; unemployment rate is June quarter. Assumptions include current restrictions in Melbourne ending after 6 weeks, no further restrictions imposed, and other restrictions being eased in line with the '3-step process' outlined by the Government on 8th May. Net overseas migration assumed to fall from 232K in 2018-19 to 154K in 2019-20 and 31K in 2020-21; international travel bans lifted from 1st January 2021; the iron ore price falling to US\$55/t FoB by end-2020; metallurgical and thermal coal prices remaining at US\$110/t and \$54/t FoB respectively; and the A\$ remaining at around US\$69¢. Sources: ABS; Australian Treasury, *Economic and Fiscal Update*, 23rd July 2020.

The factors which helped us achieve almost 30 years of continuous economic growth may not be so helpful in the post-Covid environment

Australia's record-breaking run of almost 30 years without two or more consecutive quarters of negative real GDP growth owed a lot to four factors -

❑ Population growth

- Australia's population grew at an average annual rate of 1.5% pa over the 19 years to 2019, compared with 0.6% pa for all 'advanced' economies
- net immigration accounted for 58% of this growth – ie, in the absence of immigration Australia's population would have grown by only 0.7% per annum, on average, and would have aged more rapidly

❑ Our unusual (for an 'advanced' economy) economic relationship with China

- China's rapid economic growth, industrialization and urbanization significantly boosted both the volumes and prices of many of our commodity exports, under-wrote the post-GFC mining investment boom, pushed down the prices of many of the things which we import, and contributed significantly to the growth of our tourism and education sectors
- By contrast, China's rapid economic growth undermined the competitiveness of manufacturing industries which account for a much larger share of most other 'advanced' economies, put downward pressure on the prices of their exports and put upward pressure on the prices of commodities which they import

❑ The 'housing boom'

- Australia's 'housing boom' started earlier (mid-1990s) and ended later (2017, rather than 2007-08) than in most other 'advanced' economies (some – such as Japan, Italy and France – didn't have a housing boom at all)
- the two-way interaction between rising house prices and rising household debt underwrote stronger growth in household consumption spending, for longer, than would have occurred otherwise

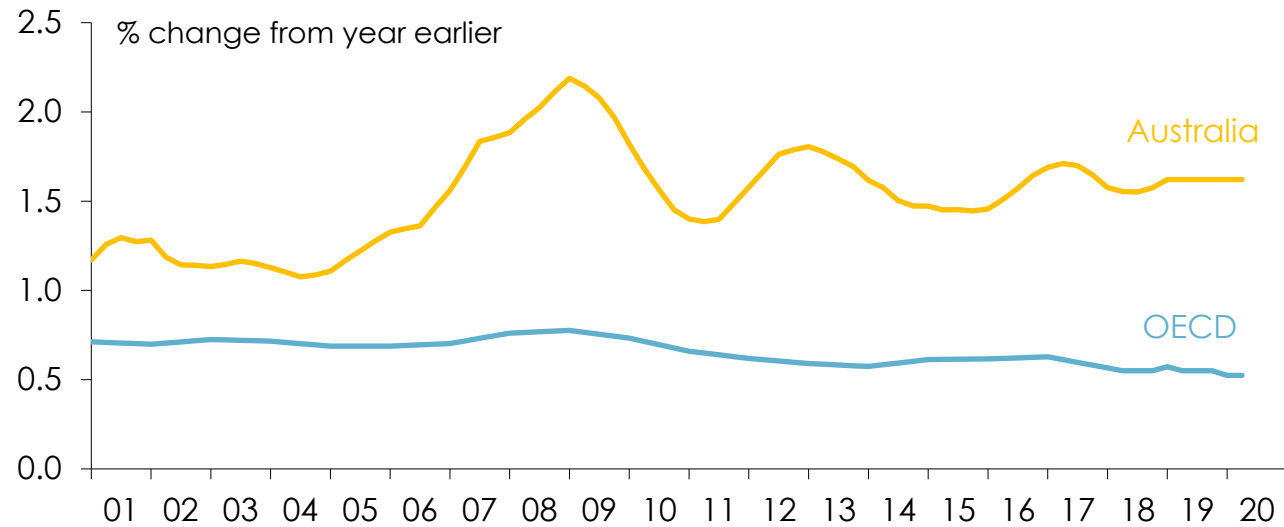
❑ (Mostly) good macro-economic policy – especially by comparison with other 'advanced' economies

- although we haven't done nearly as well as we once did on the micro-economic front (especially with regard to productivity)

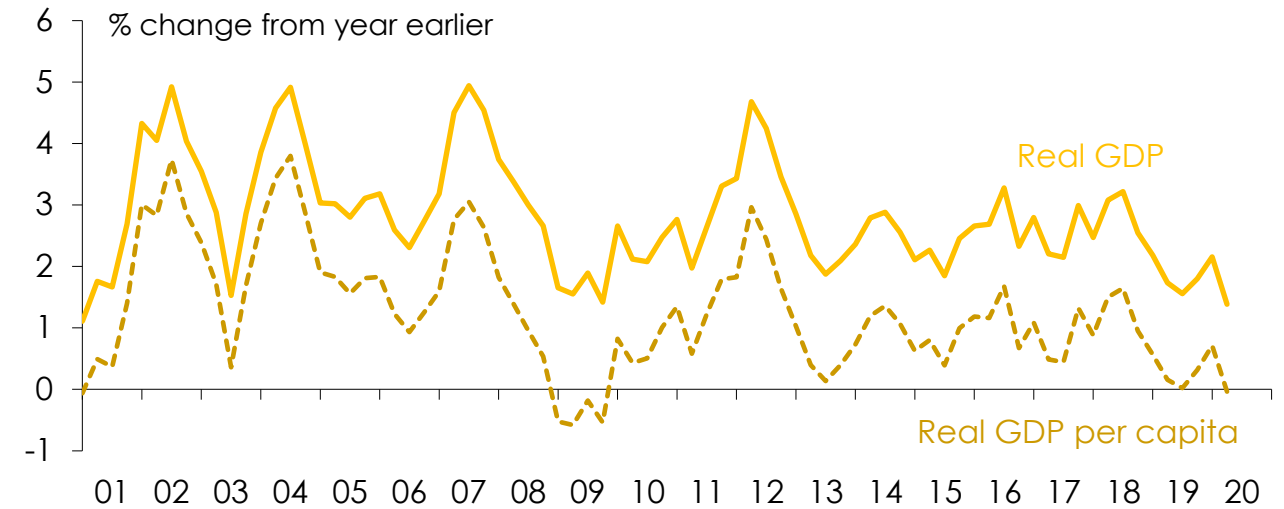
The first three of these are likely to be of less assistance from now on

Australia's above-average economic growth over the past 20 years owes a lot to above-average population growth: that's about to change

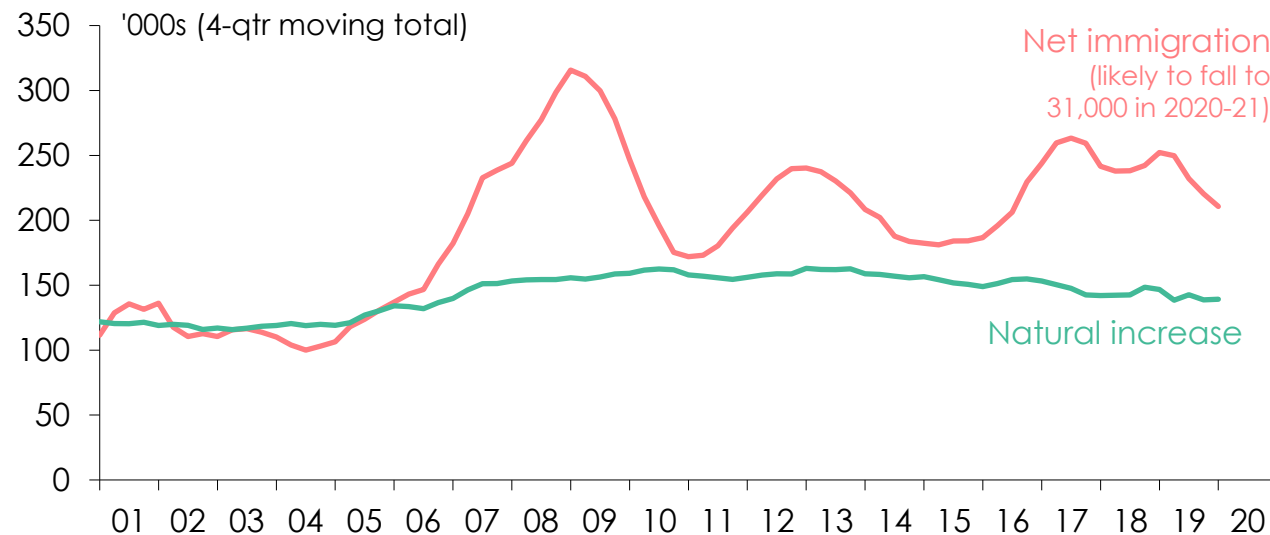
Australia and OECD population growth



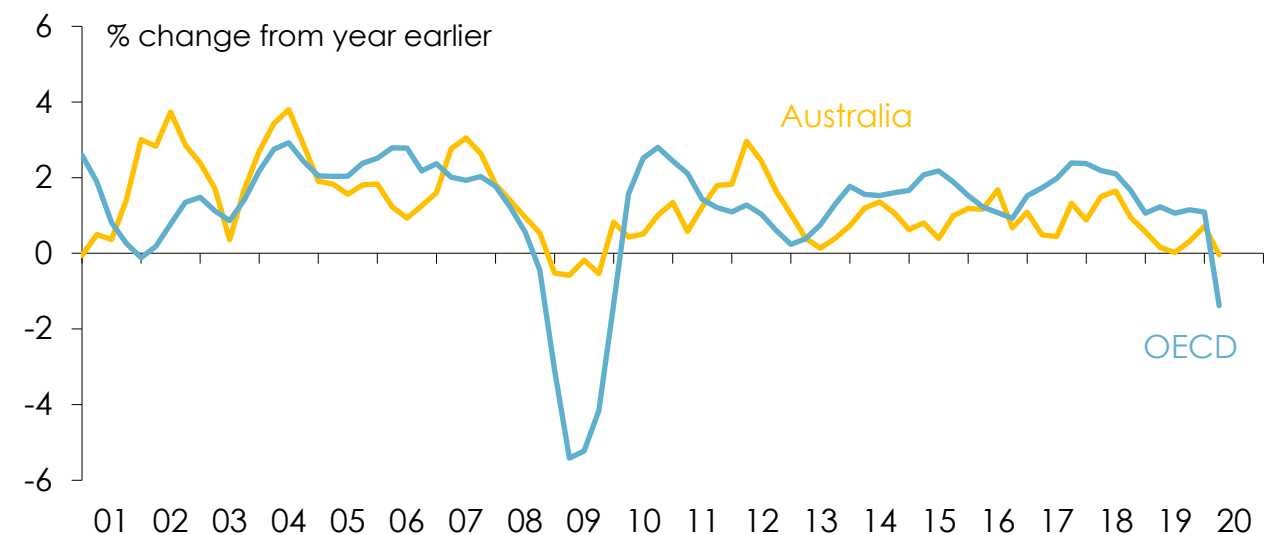
Australian GDP and per capita GDP growth



Sources of Australia's population growth



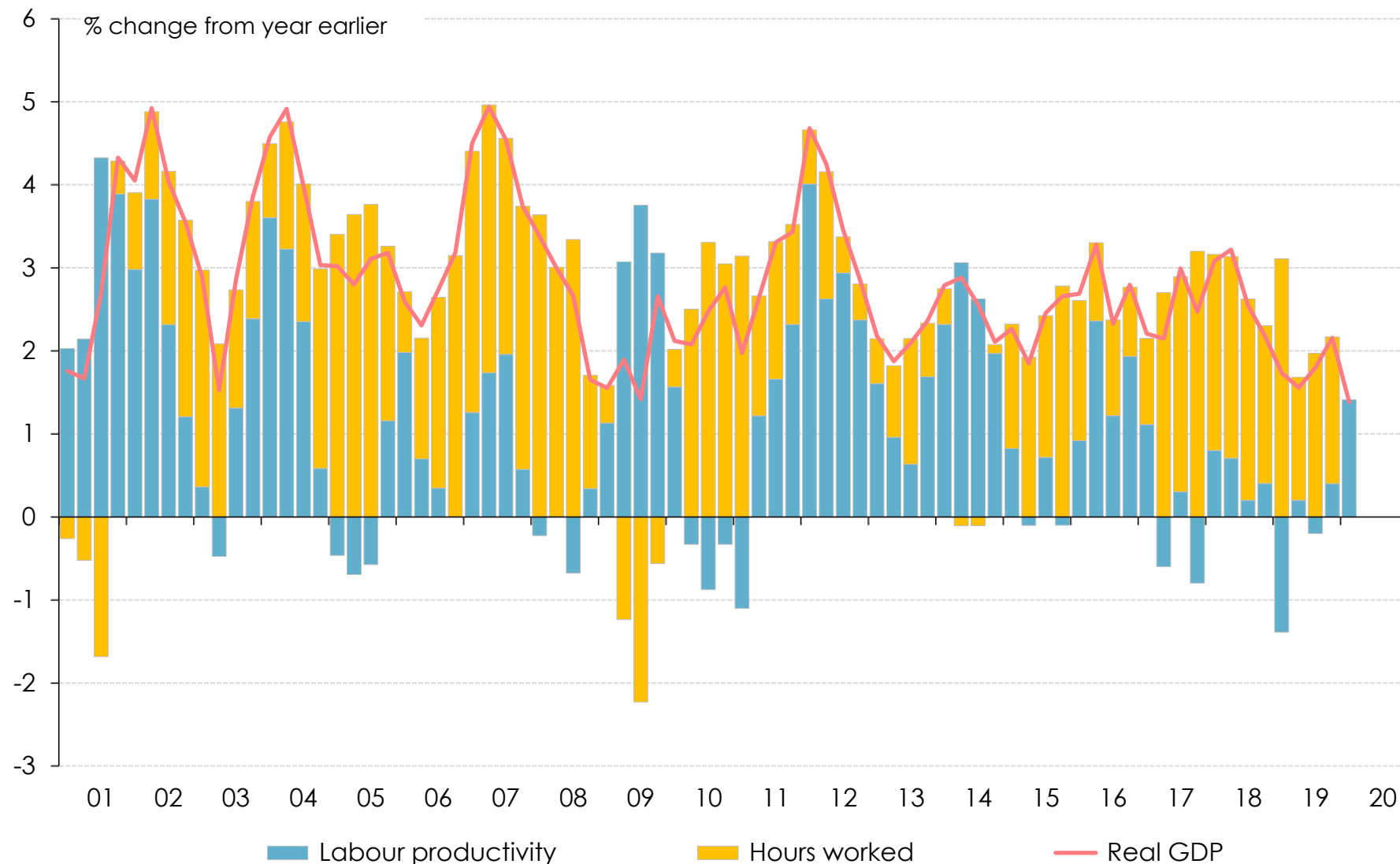
Australia and OECD per capita real GDP growth



Sources: ABS; OECD.

Australia has come to rely much more heavily on increased labour input to drive economic growth in recent years – we can't keep doing that

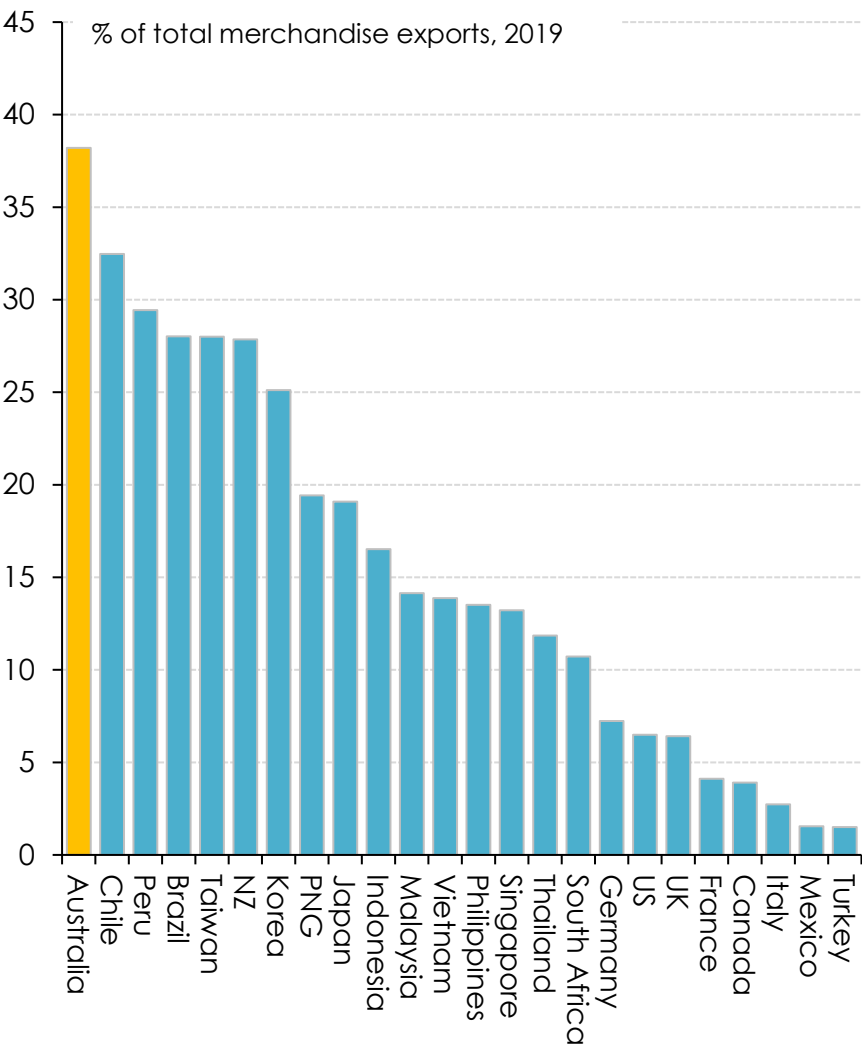
Labour input and labour productivity contributions to Australian real GDP growth



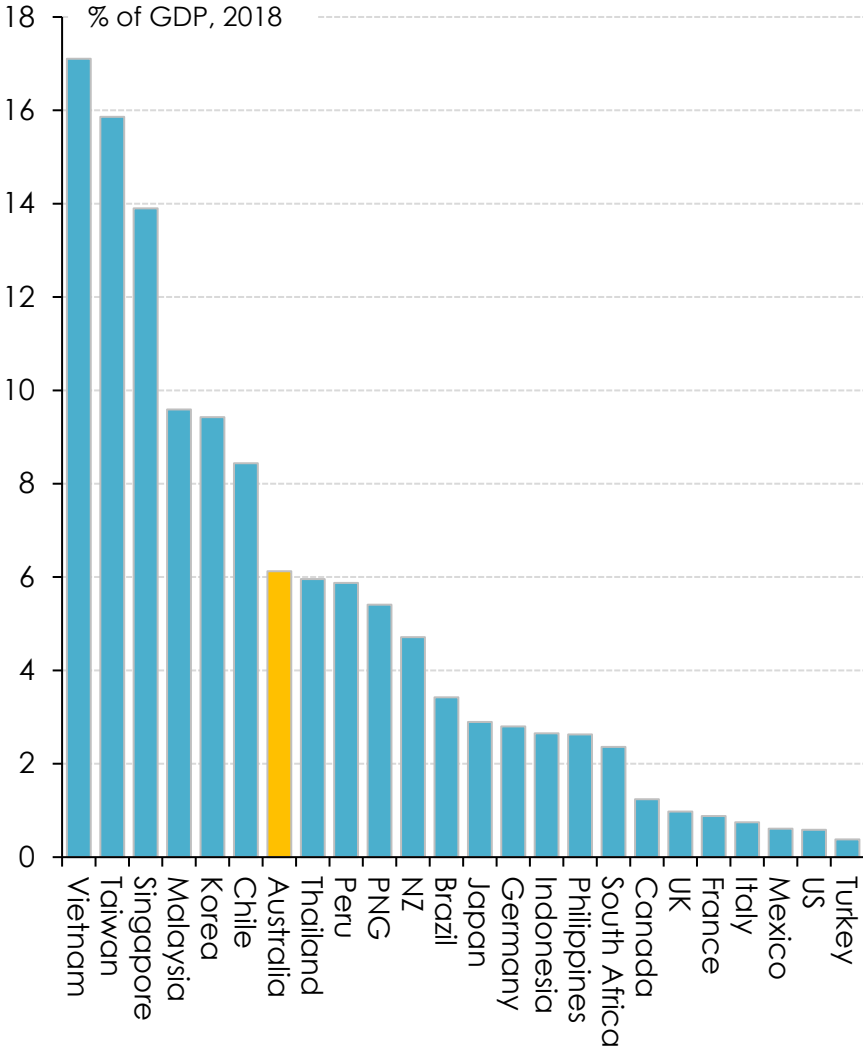
- ❑ Over the past five years, 72% of Australia's real GDP growth has come from increased labour input, and only 28% from labour productivity growth
- ❑ By contrast, between the end of the early 1990s recession and the onset of the global financial crisis, 46% of Australia's real GDP growth came from increased labour input and 54% from productivity growth

Australia has benefited enormously from its economic relationship with China over the past 25 years, but will that continue to be the case?

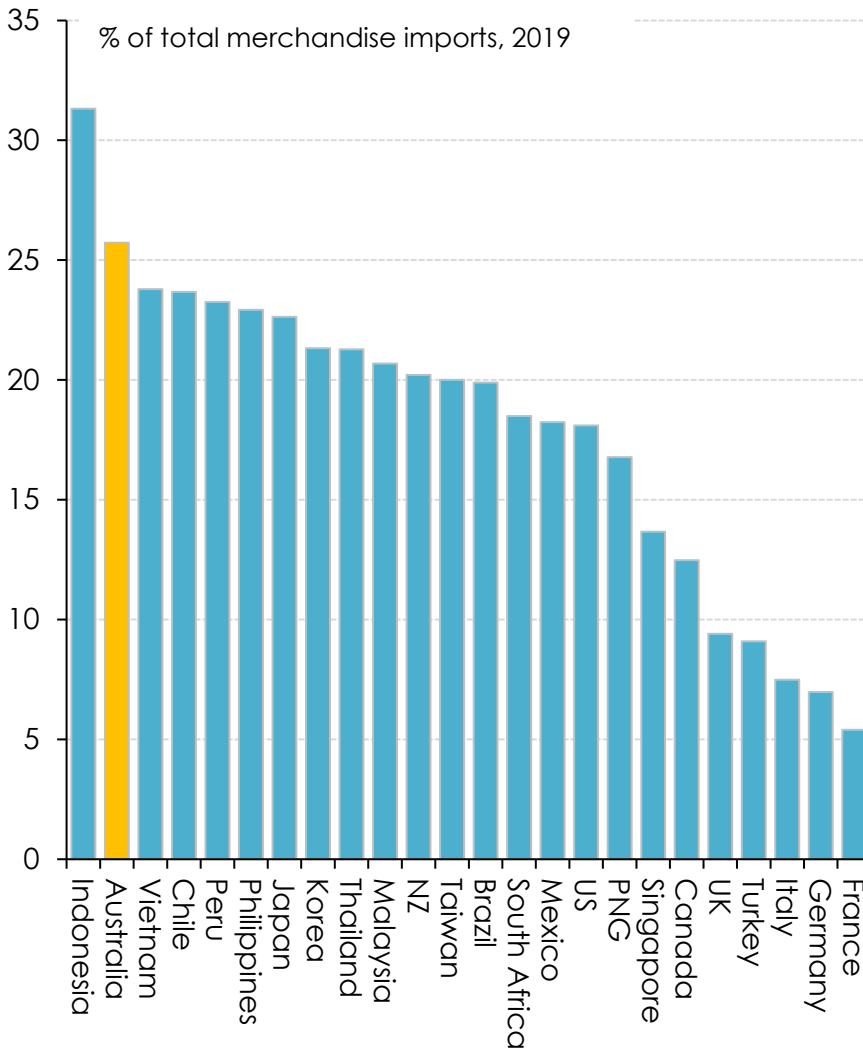
Merchandise exports to China as a pc of total



Merchandise exports to China as a pc of GDP



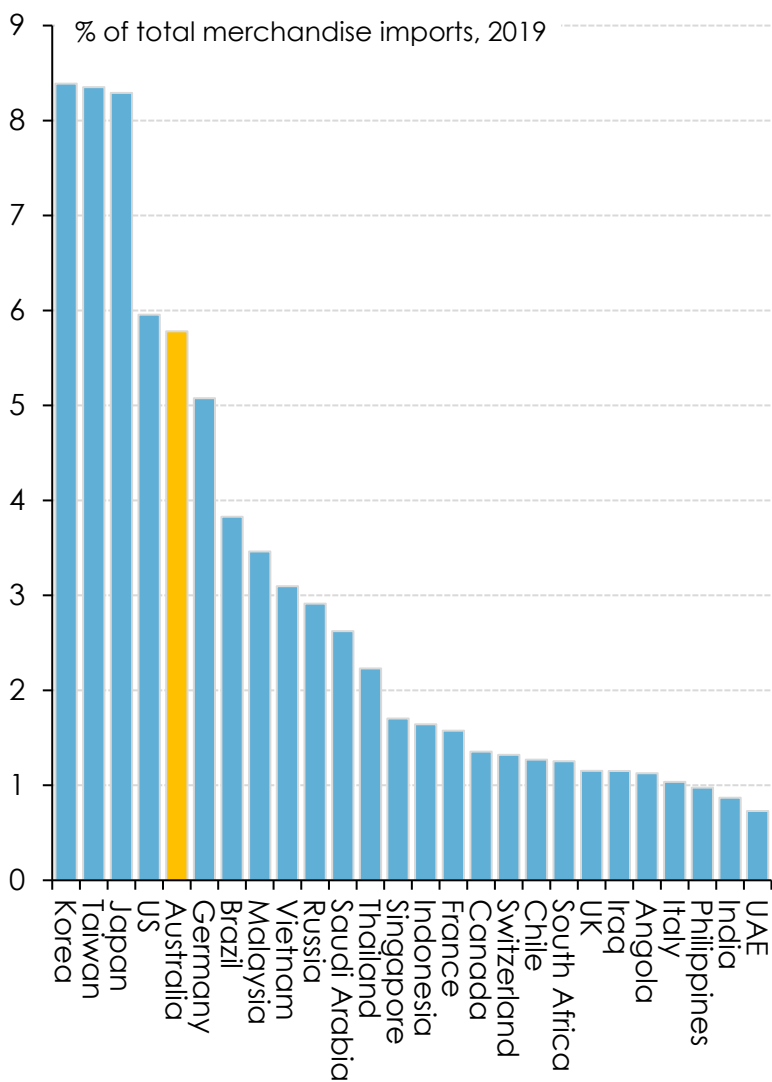
Merchandise imports from China as a pc of total



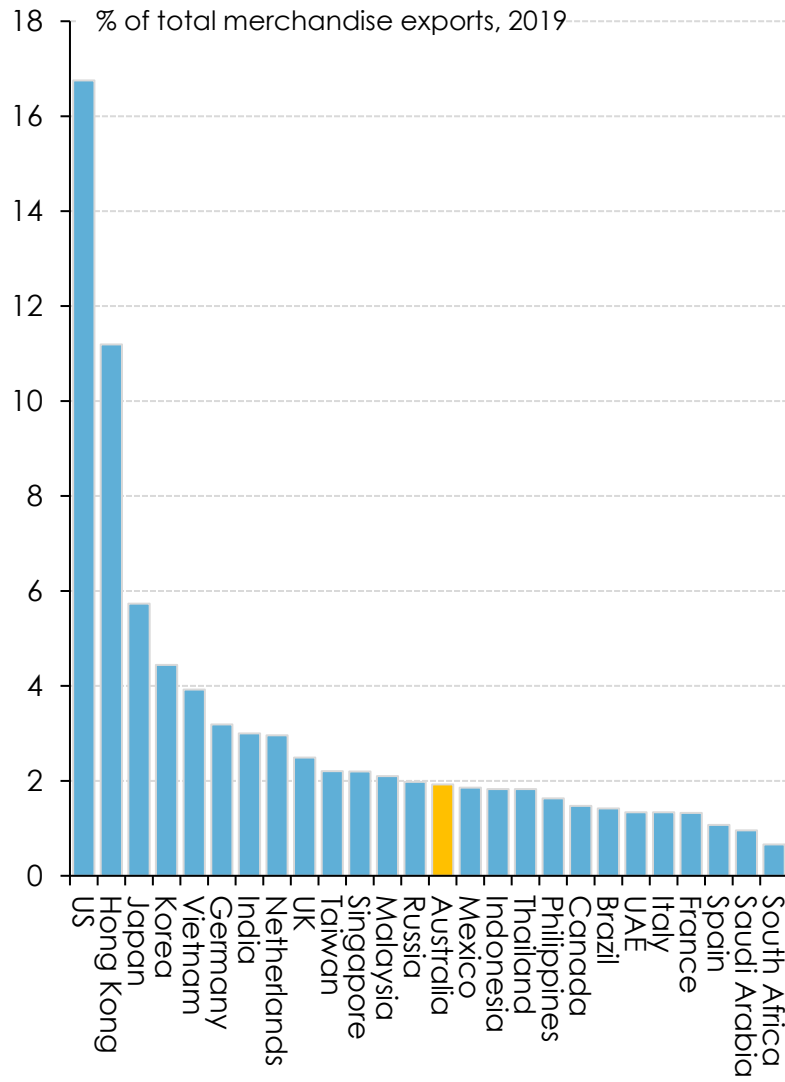
Sources: IMF, Direction of Trade Statistics; Taiwan Ministry of Economic Affairs, Bureau of Foreign Trade.

Australia is China's 5th biggest source of imports (of goods), 14th biggest export market, and has the 2nd-largest bilateral trade surplus with China

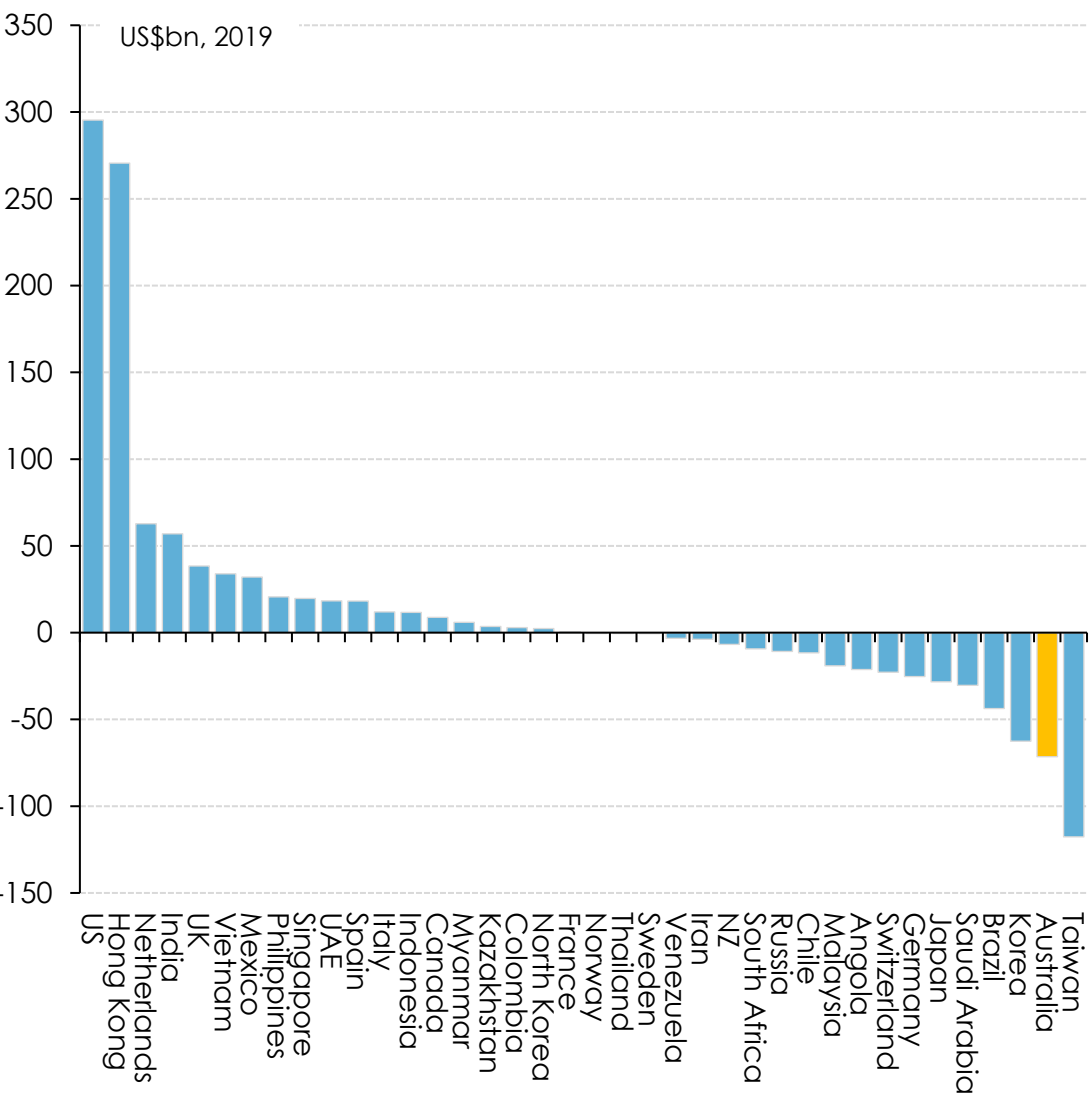
China's sources of imports



China's export destinations



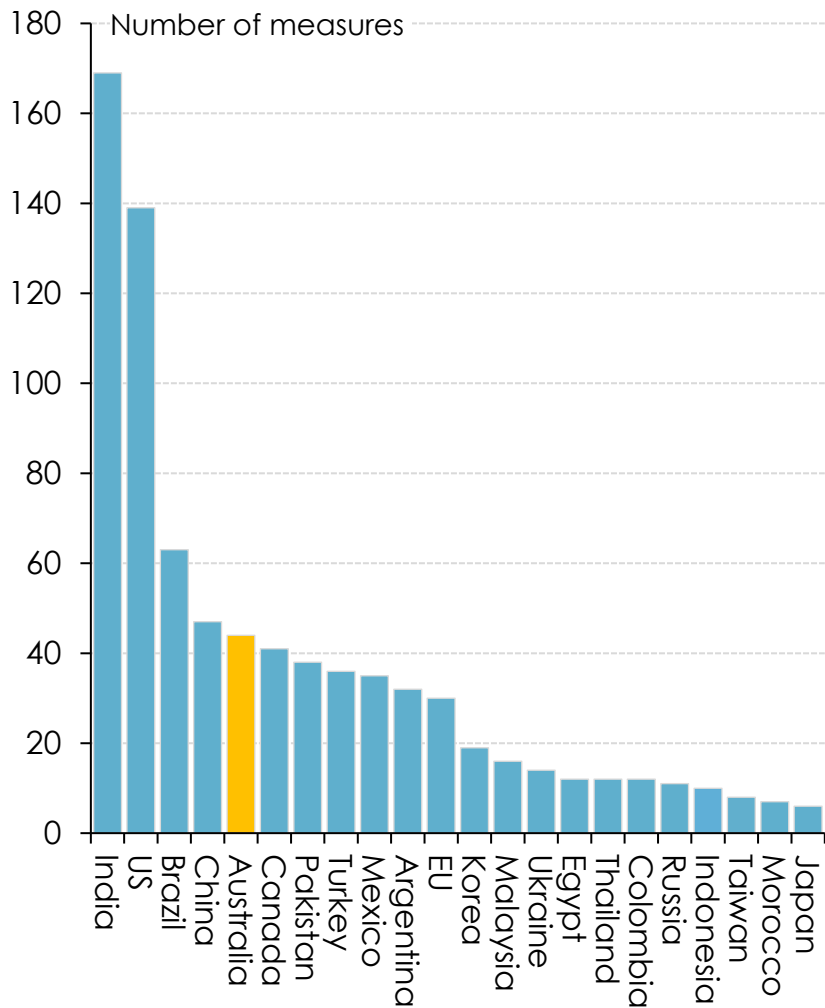
China's bilateral merchandise trade balances



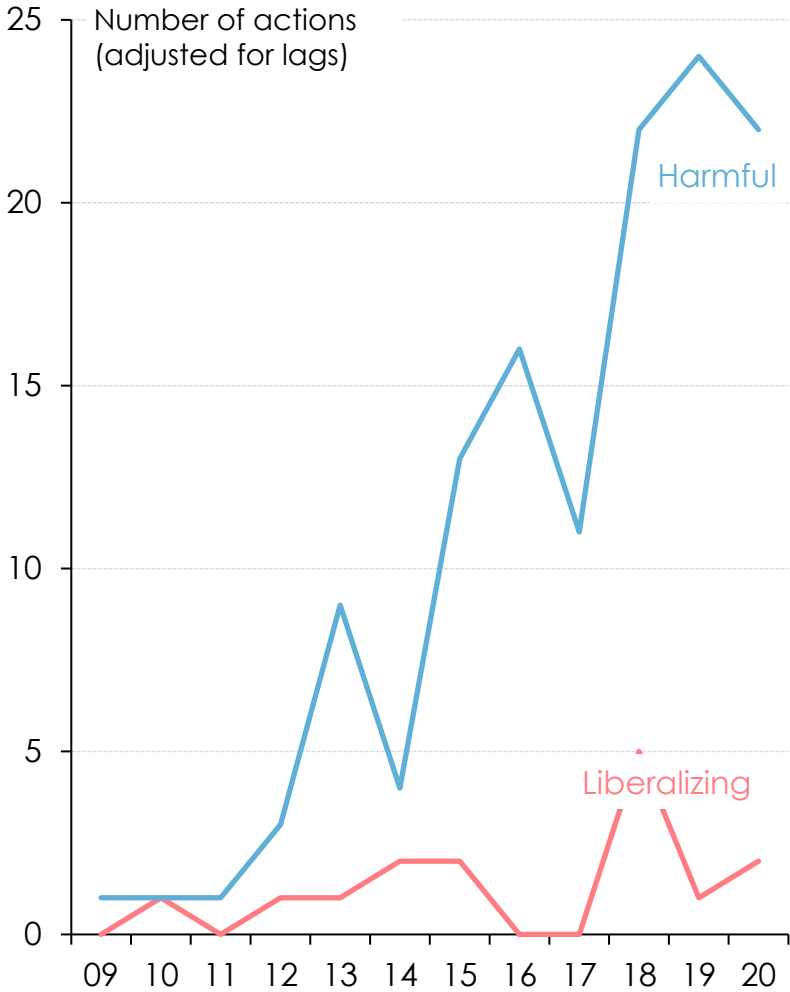
Source: International Monetary Fund, Direction of Trade Statistics.

China's threats against Australian exports of barley, beef, coal, tourism and education aren't justified, but we aren't complete innocents either

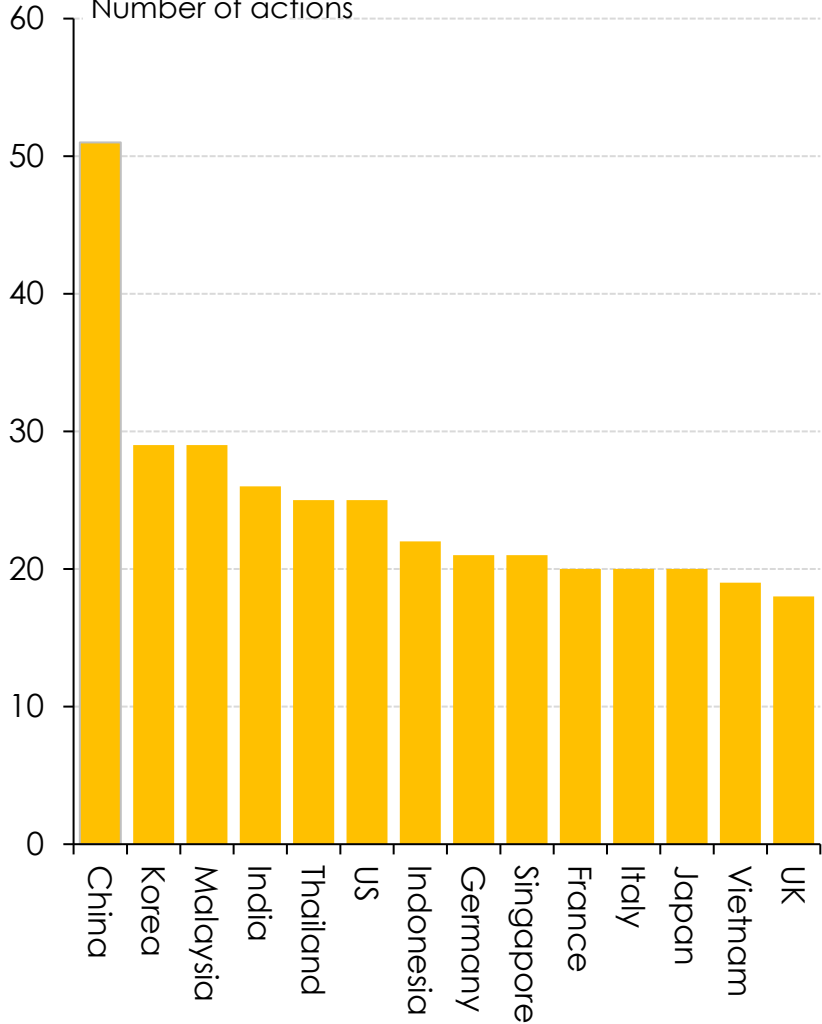
Number of anti-dumping measures imposed, 2015-19



Australian trade policy measures since 2009



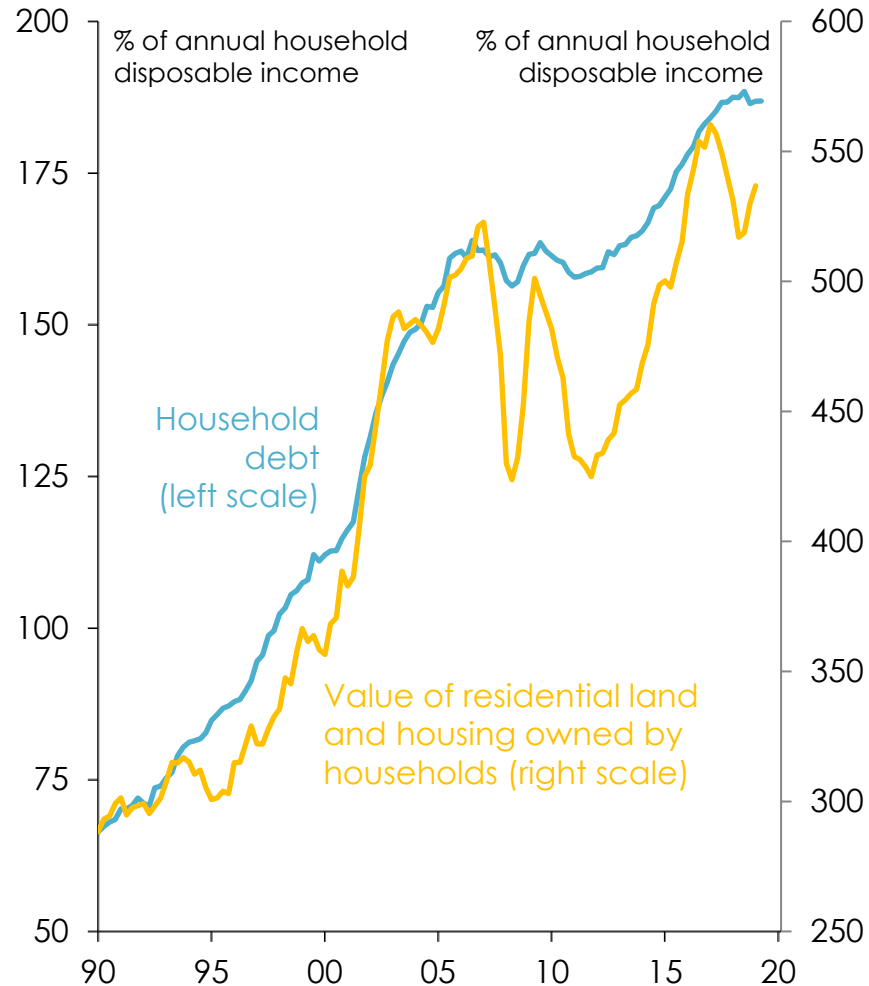
Countries adversely affected by 'harmful' Australian trade actions



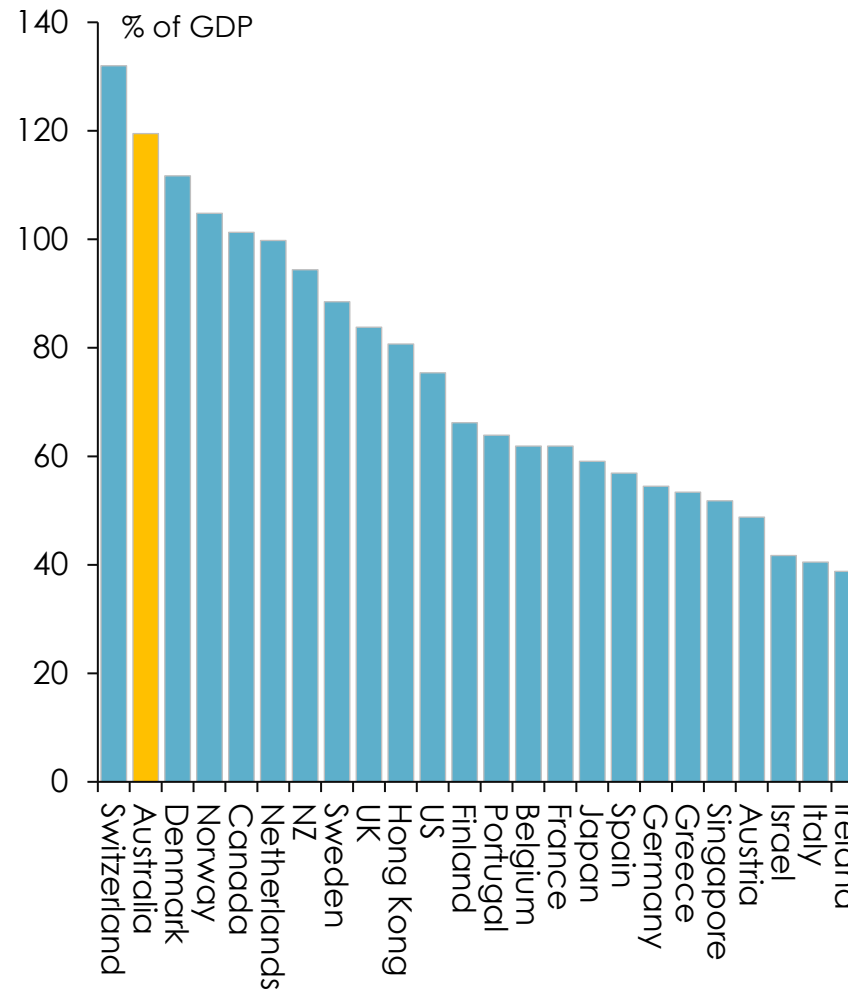
Sources: World Trade Organization; Global Trade Alert (data up to 20th July).

Rising property prices and household debt are unlikely to underpin Australian economic growth as they have done for most of the past 30 years

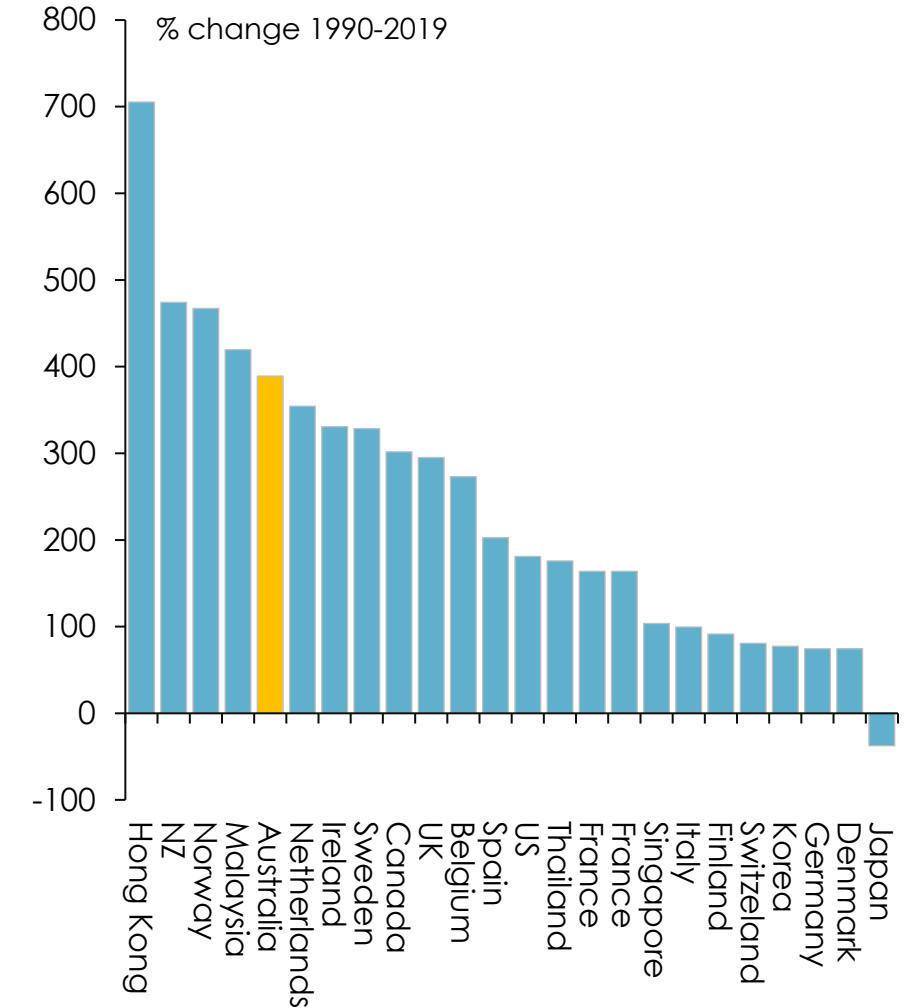
Australian housing wealth and household debt



Household debt as a pc of GDP, December 2019



Increase in residential property prices, 1990-2019



Note: Singapore property price increase is from March quarter 1999. Sources: ABS; Bank for International Settlements.

Some other possible longer-term consequences of the pandemic

- ❑ **An accelerated retreat from 'globalization'**
 - prompted by mistrust of international supply chains and desire for greater self-sufficiency in 'essential' products
 - greater government control over movement of people and capital across international borders likely to persist
- ❑ **Greater expectations of government**
 - having done things previously considered 'unthinkable' during this downturn, governments may be expected to do more during future downturns
 - there may be heightened demand for hitherto unprecedented government intervention to address other issues (for example climate change)
- ❑ **A reduced role for (conventional) monetary policy in managing economic cycles**
 - implying a greater role for fiscal policy (or, alternatively, bigger and perhaps more frequent cycles)
- ❑ **Changes in ways of working**
 - at least some employers and employees are likely to maintain the option of (or preference for) 'working from home'
 - possible implications for demand for commercial office space
- ❑ **Diminished use of mass transit (see slide 64)**
- ❑ **Accelerated decline in the use of cash for transactions (see slide 68)**
- ❑ **Re-think of relationships with China**
 - especially challenging for Australia given our unusual (for an 'advanced' economy) economic relationship with China
- ❑ **Erosion of respect for US leadership and competence**
 - unless Trump loses the November election and Biden can reverse the damage done to perceptions of US credibility, competence and commitment

For more on how Covid-19 is affecting
Asian economies, join me on Friday
at 5pm AEST

Go to www.bettercallsaul.com.au for details

You can also subscribe to a weekly update
of these and other charts

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