

'THE NEXT BIG RISKS' – INSIGHTS ON THE ECONOMIC AND FINANCIAL OUTLOOK

PRESENTATION TO THE INSTITUTE OF INTERNAL AUDITORS
AUDIT & RISK COMMITTEE FORUM

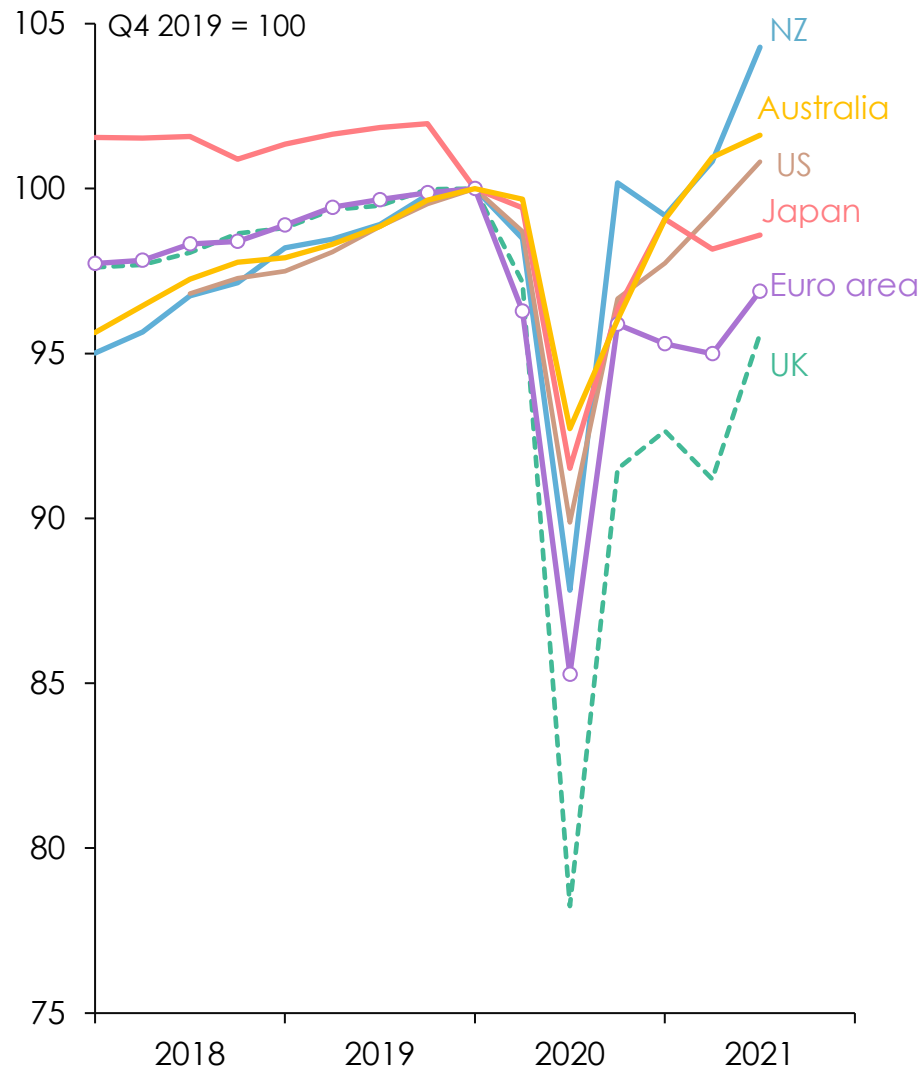
28TH OCTOBER 2021

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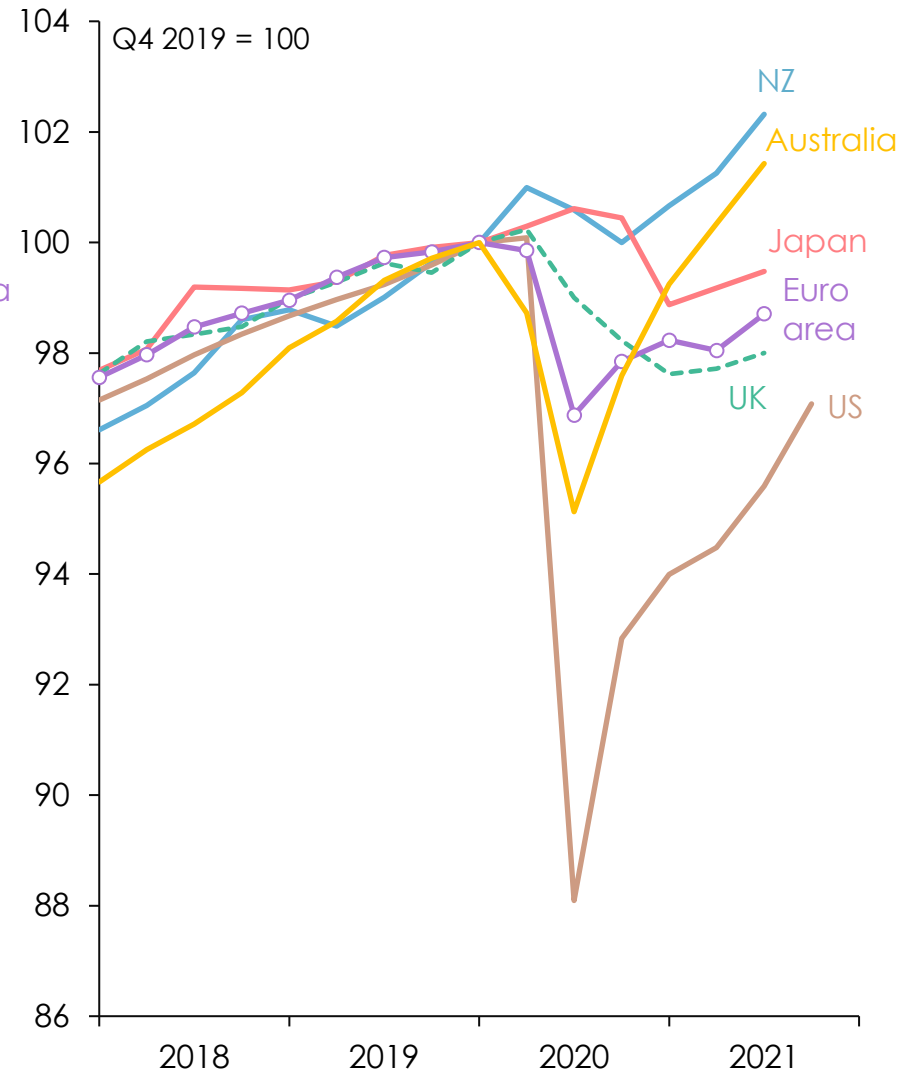
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Australia's recession wasn't as severe as, and its recovery has been stronger than, most other 'advanced' economies

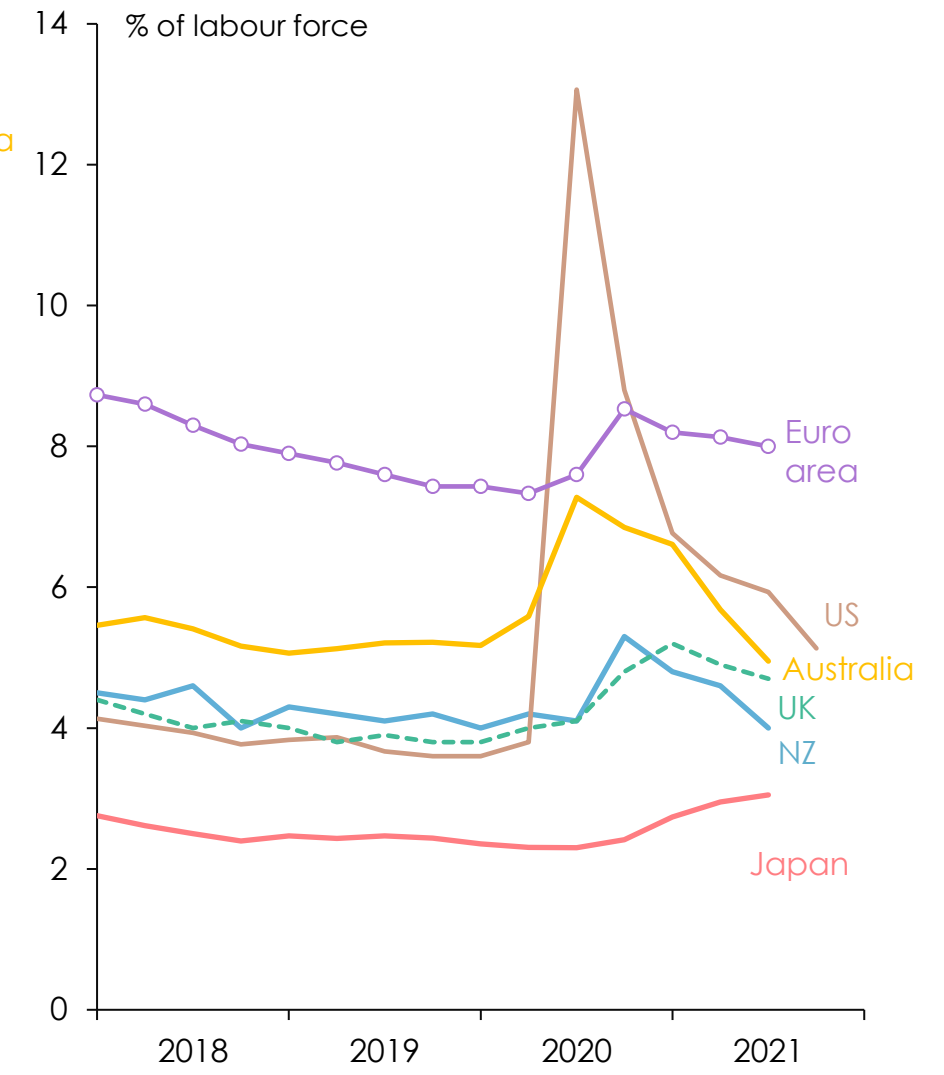
Level of real GDP



Employment



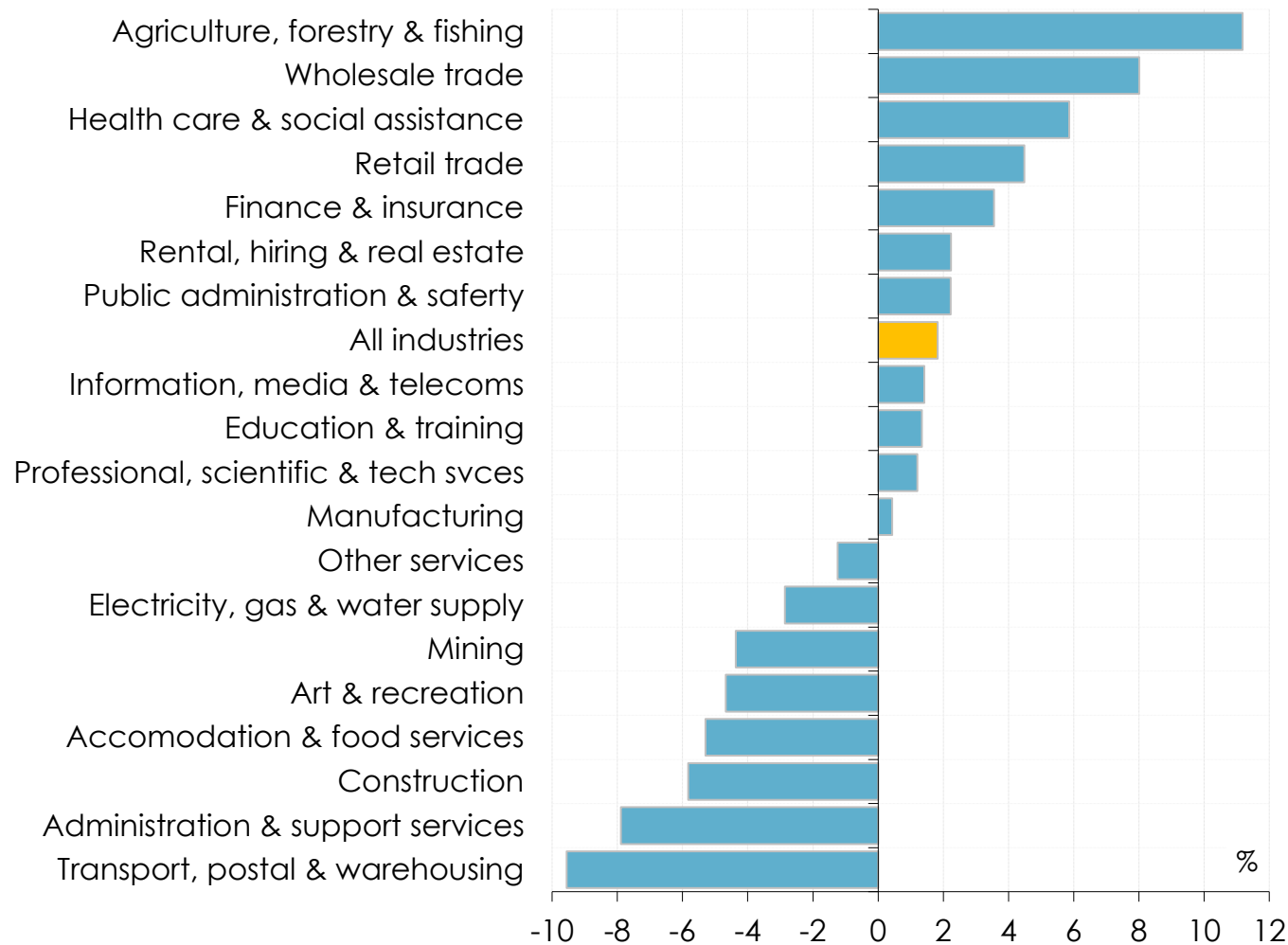
Unemployment



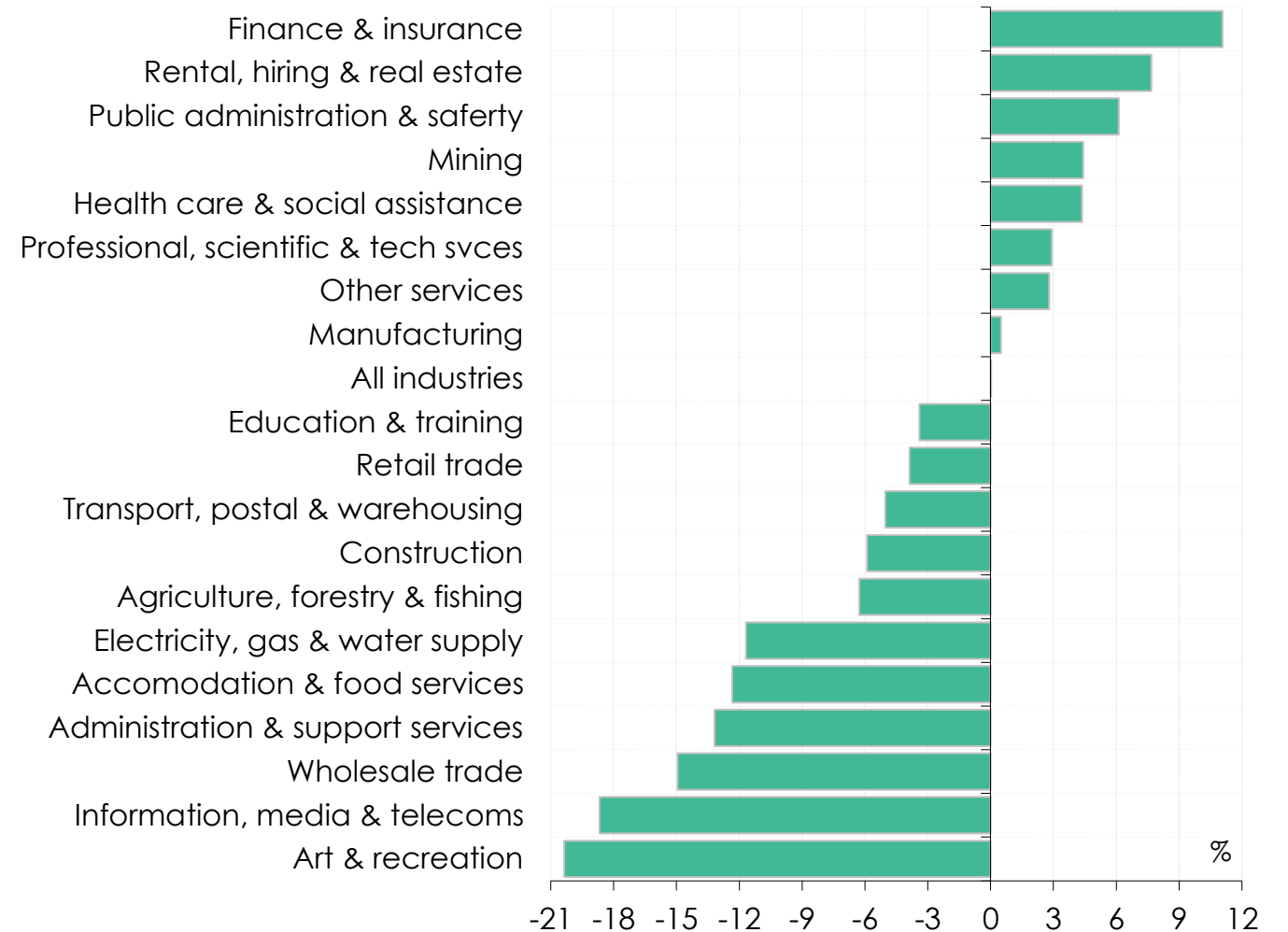
Sources: [ABS](#) ; [Statistics NZ](#) ; US [Bureau of Economic Analysis](#) and [Bureau of Labor Statistics](#); Japan [Cabinet Office](#) and [Statistics Bureau of Japan](#); [Eurostat](#); and UK [Office for National Statistics](#); Corinna.

Though stronger-than-expected overall, the recovery in economic activity and employment has been very uneven across sectors

Q2 2021 real gross value added by industry – change from pre-pandemic peak



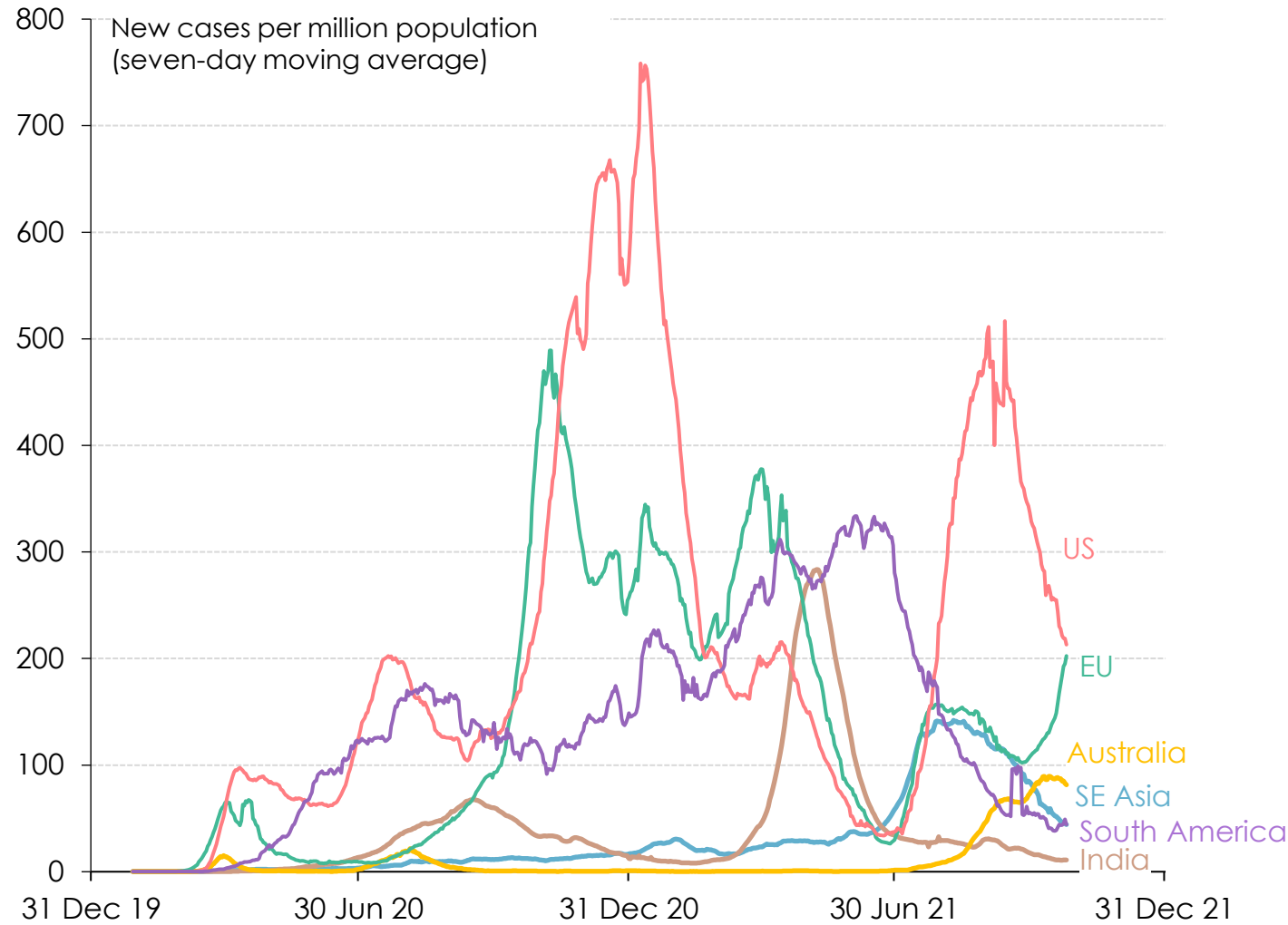
Q3 2021 employment by industry – change from pre-pandemic peak



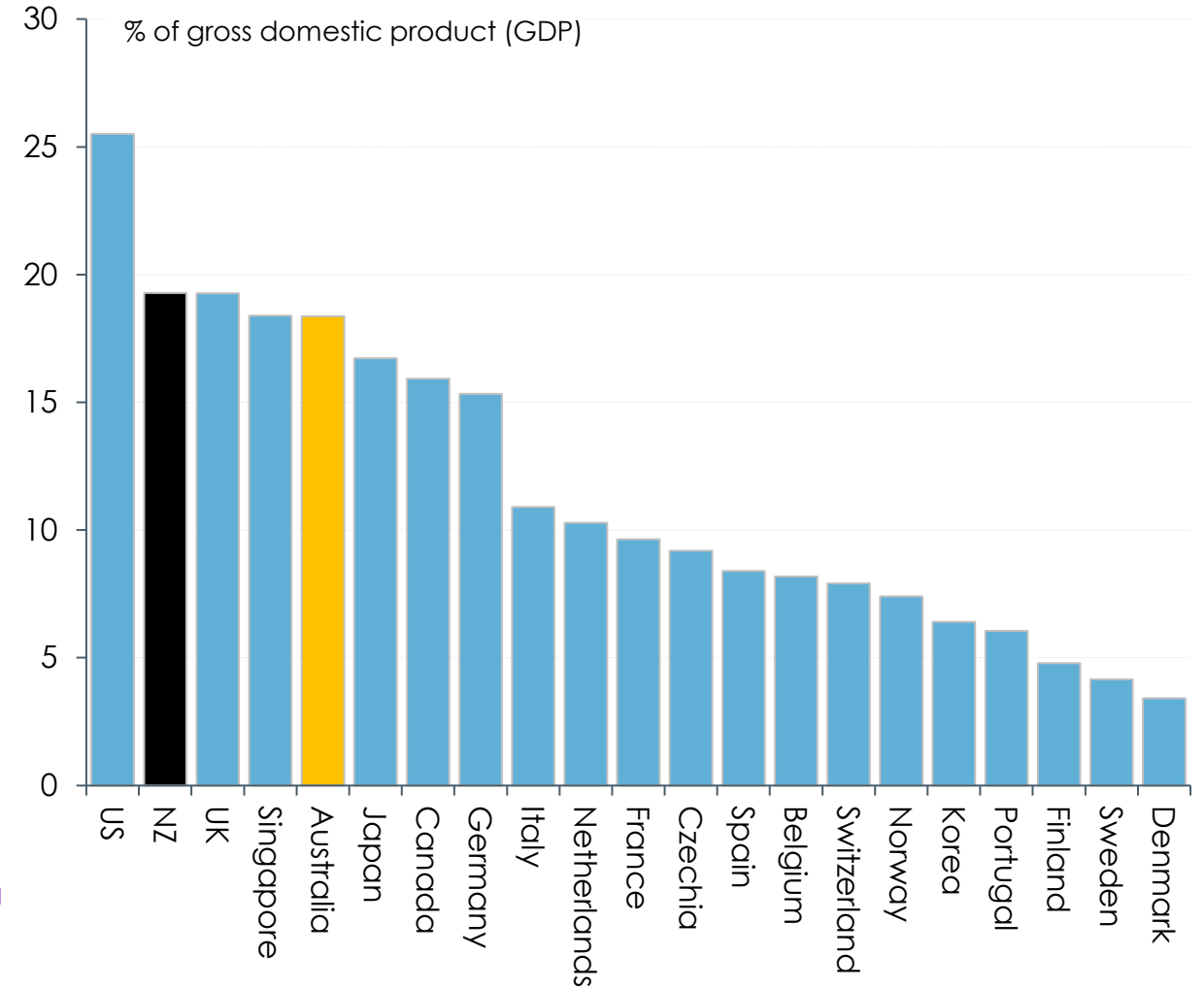
Sources: ABS, [Australian National Accounts: National Income, Expenditure and Product](#), June quarter 2021; and [Labour Force, Australia, Detailed](#), August 2021.

Up until very recently Australia has done a better job than most others of suppressing the virus – and governments have provided more fiscal support

New covid-19 infections per million population, Australia compared with other countries and regions



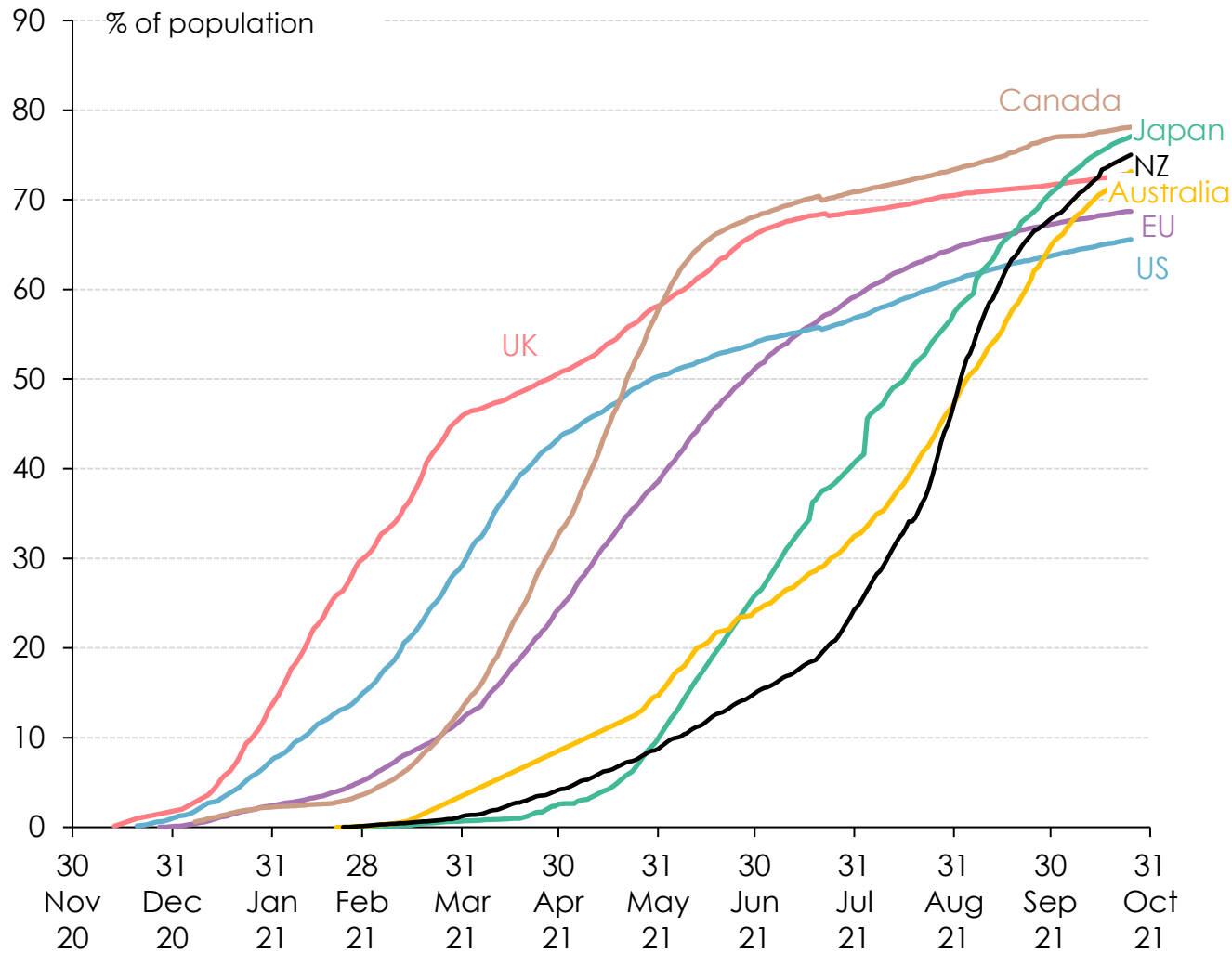
Fiscal policy responses to Covid-19 – selected 'advanced' economies



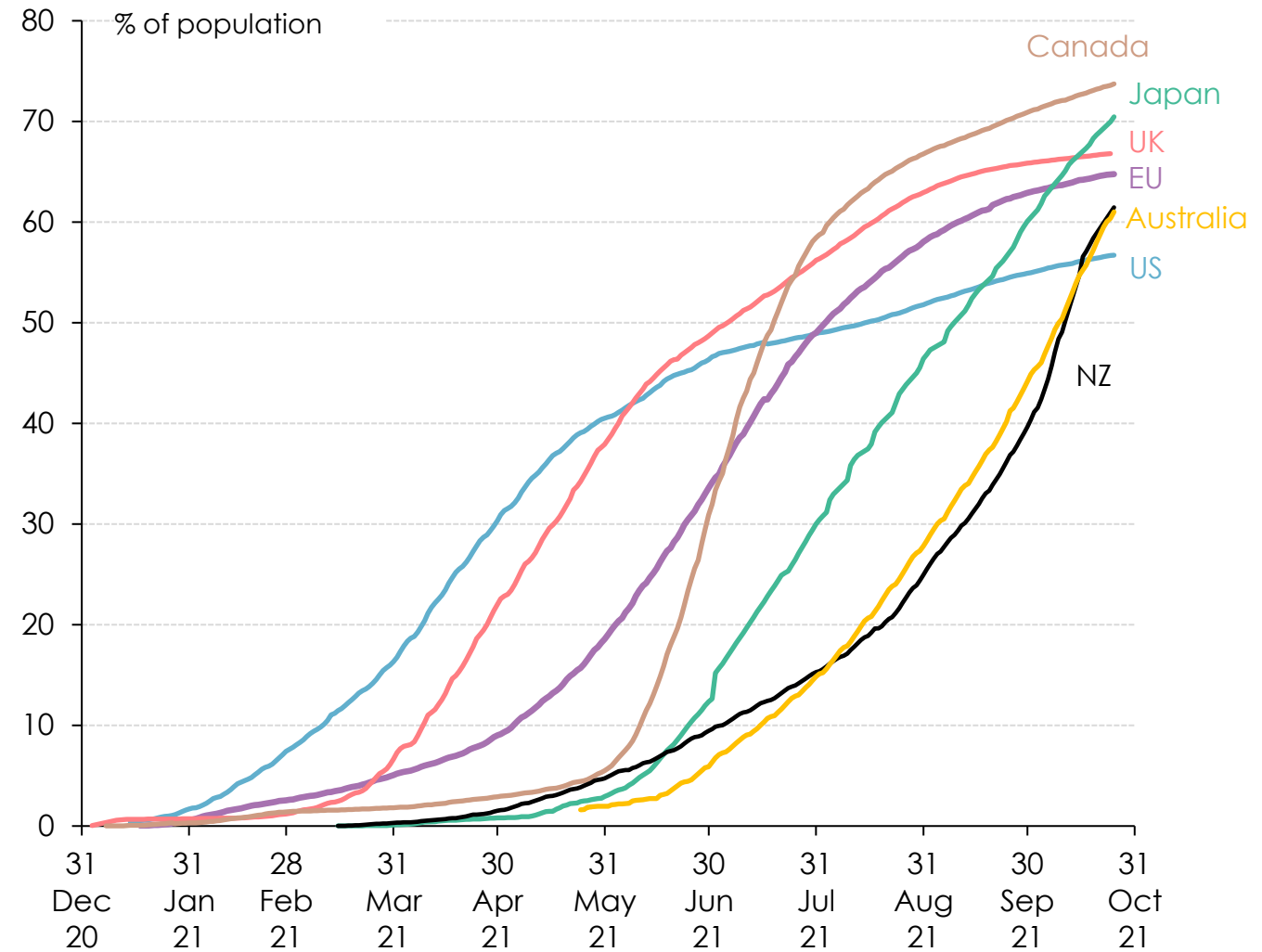
Sources: University of Oxford, [Our World in Data](#) (data up to 25th October); IMF, [Fiscal Monitor Database of Country Fiscal Measures in Response to the COVID-19 Pandemic](#), October 2021 (data up to 27th September: excludes loan guarantees and other 'below-the-line' measures); Corinna.

Australia (initially and for quite some time) didn't do nearly so well in pursuing the alternative (and less costly) strategy of vaccinations

Percentage of major 'advanced' economies' populations who have had one vaccine shot



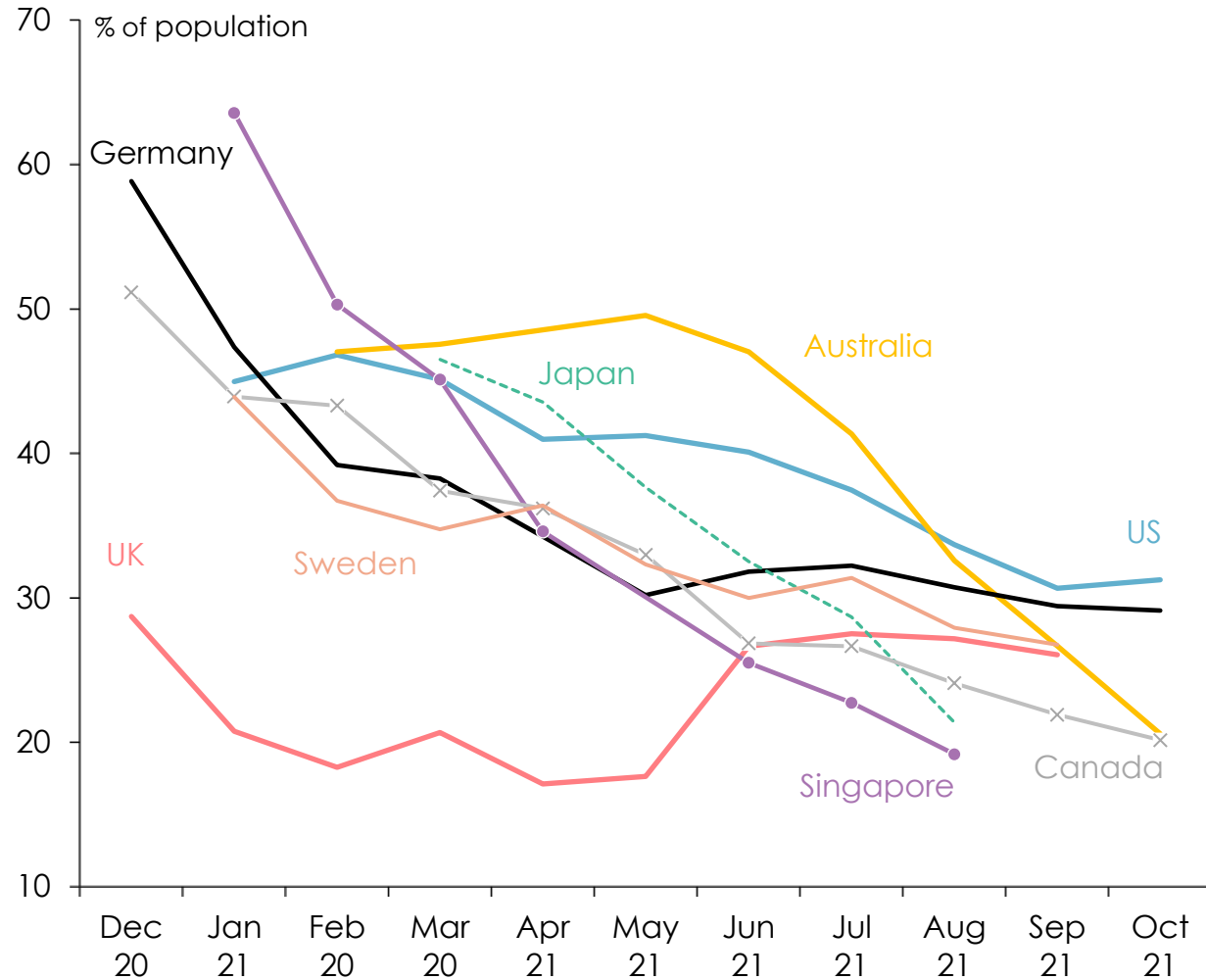
Percentage of major 'advanced' economies' populations who have had two vaccine shots



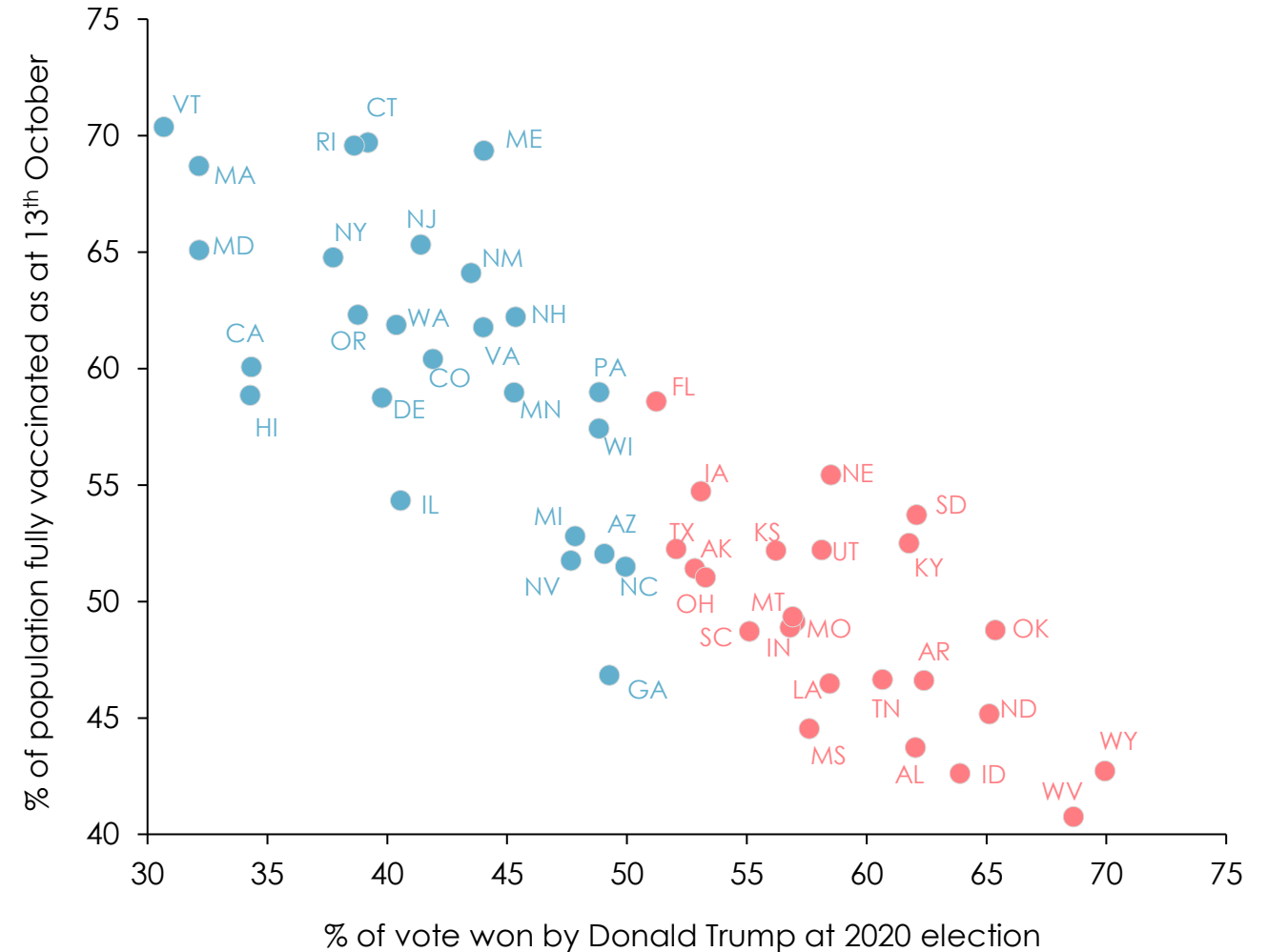
Note: Data up to 25th October. Source: [Our World in Data](#); [Coronavirus \(COVID-19\) Vaccinations](#).

Until recently Australia had one of the highest rates of vaccine hesitancy in the 'developed' world – and the Government did nothing about it

Covid-19 vaccine hesitancy, selected 'advanced' economies



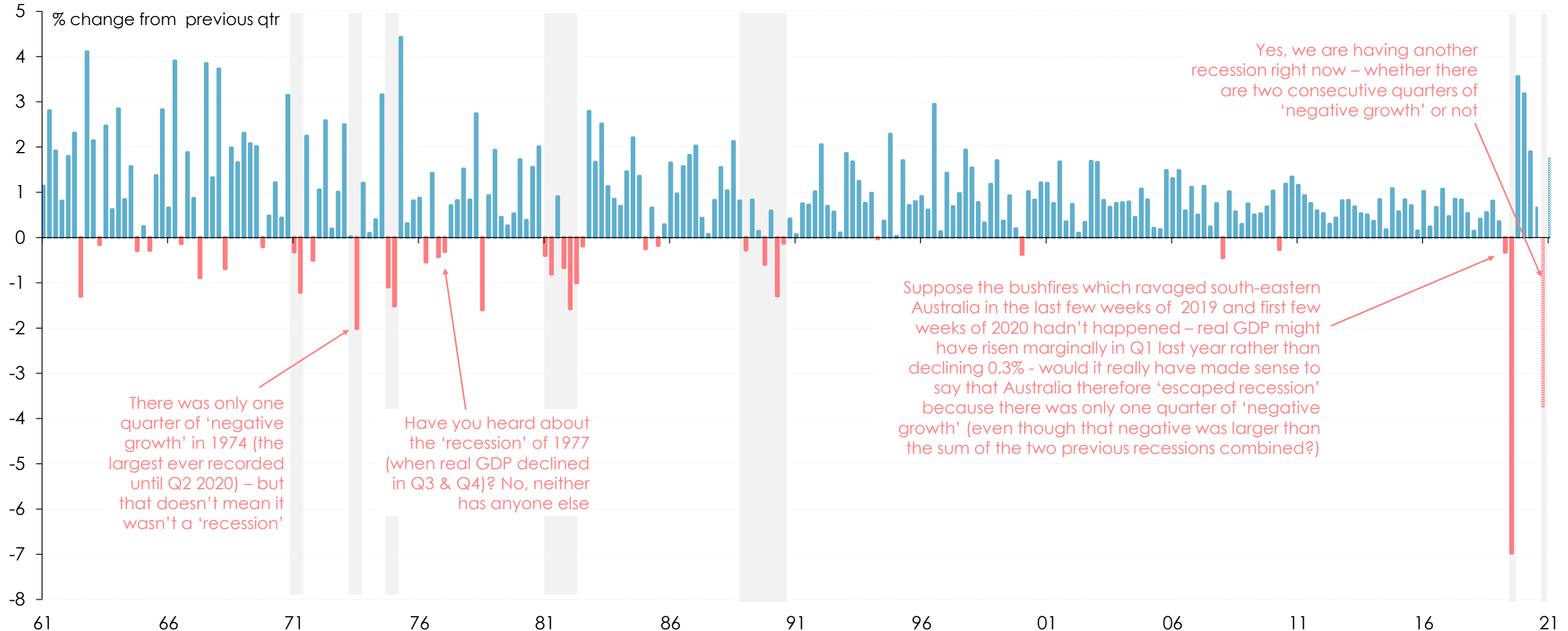
Vaccination rates by US states vs vote for Trump at last November's presidential election



Sources: Imperial College London and YouGov, [Covid 19 Behaviour Tracker Data Hub](#); [The Cook Political Report](#); [Our World in Data](#); Corinna.

Australia has had a second recession (albeit a very short one) as a result of the lockdowns in NSW, Victoria and the ACT

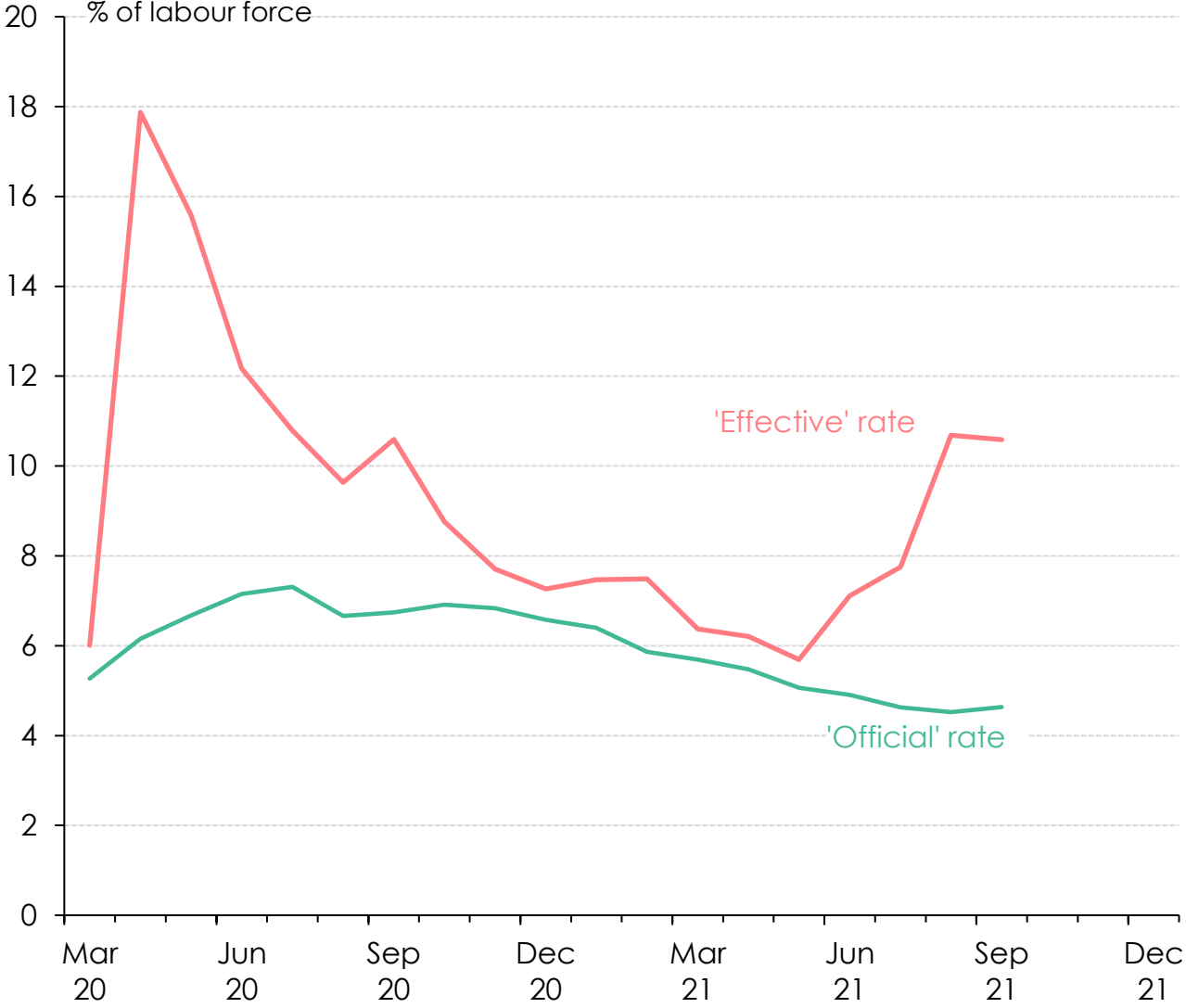
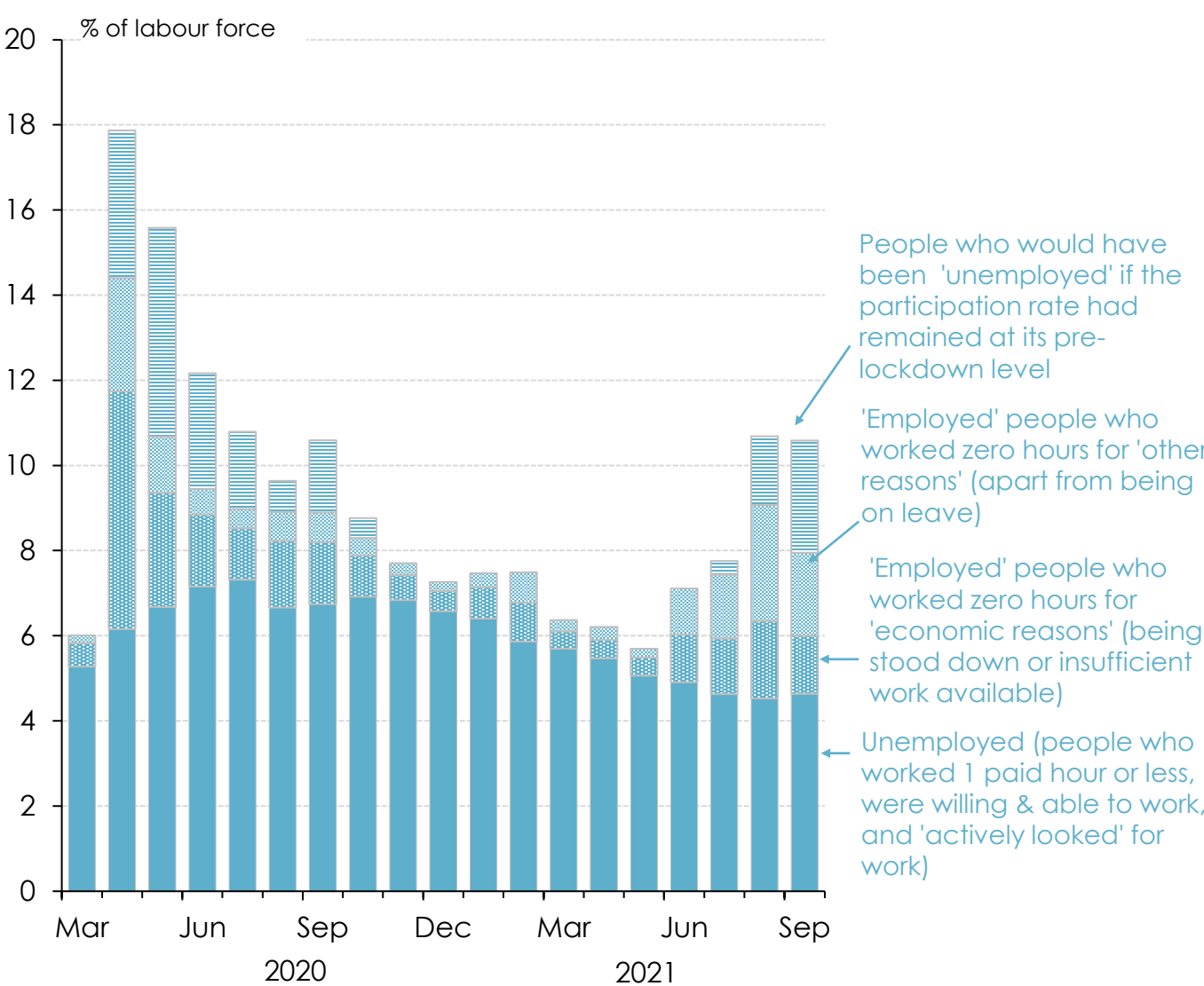
Quarterly growth in Australian real GDP, 1961-2021



Note: Shaded areas denote recessions. Source: ABS, [Australian National Accounts: National Income, Expenditure and Product](#), March quarter 2021.

The 'effective' unemployment rate dropped 0.1 pc pt to 10.6% in September - well above May's low of 5.7% - but should fall over the next few months

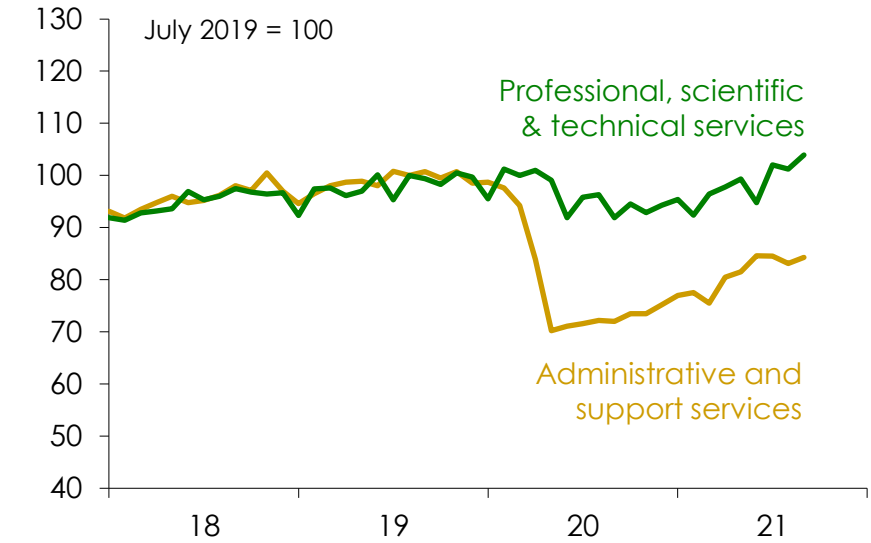
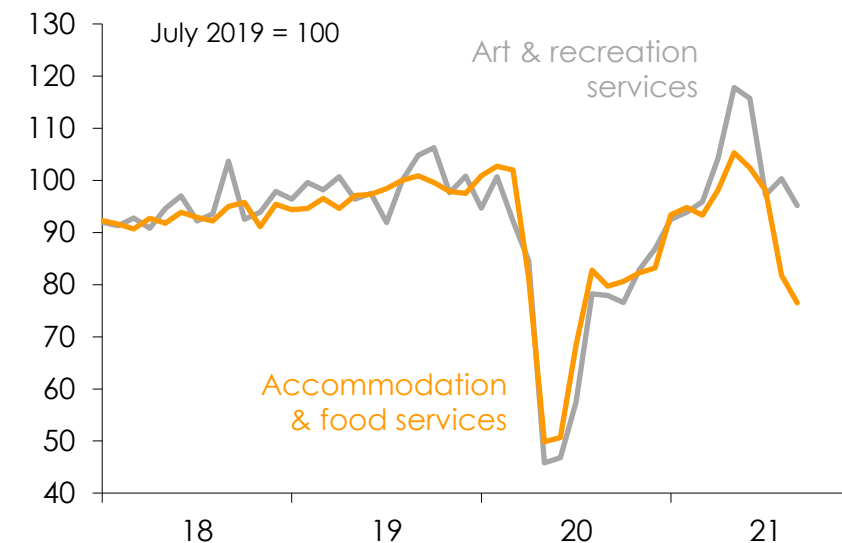
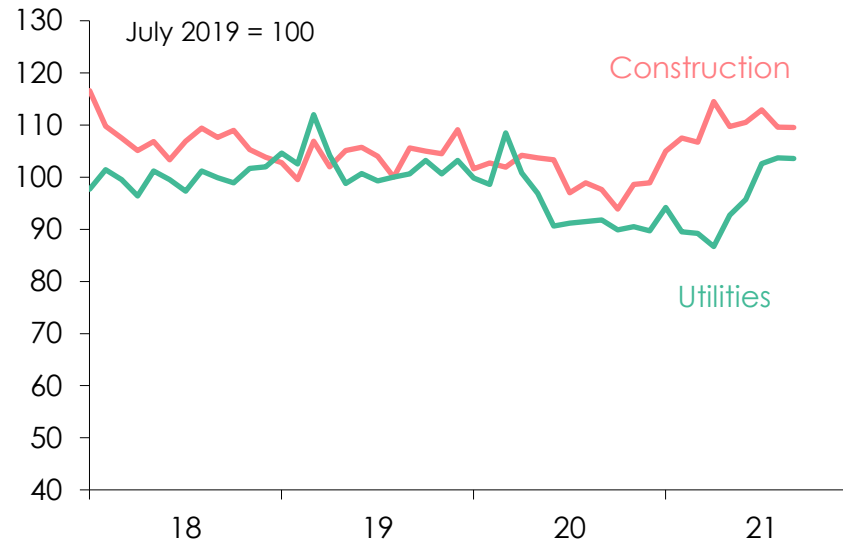
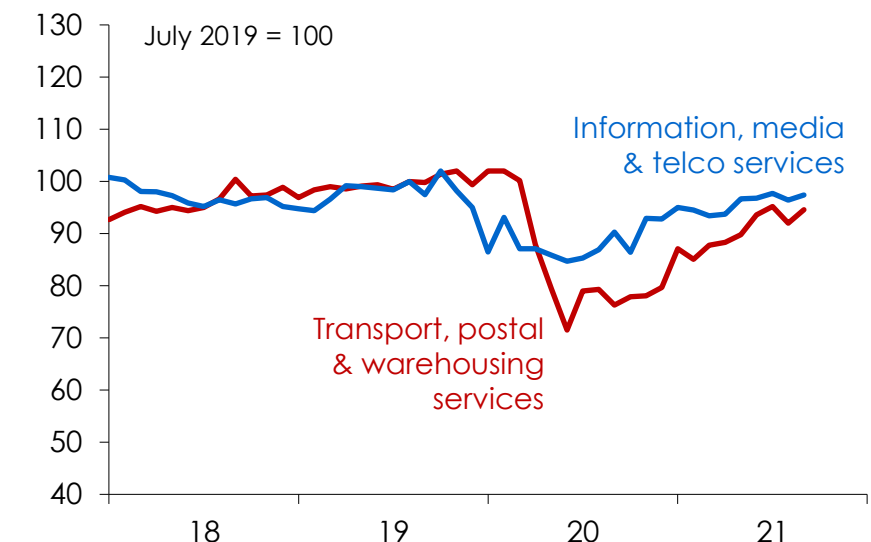
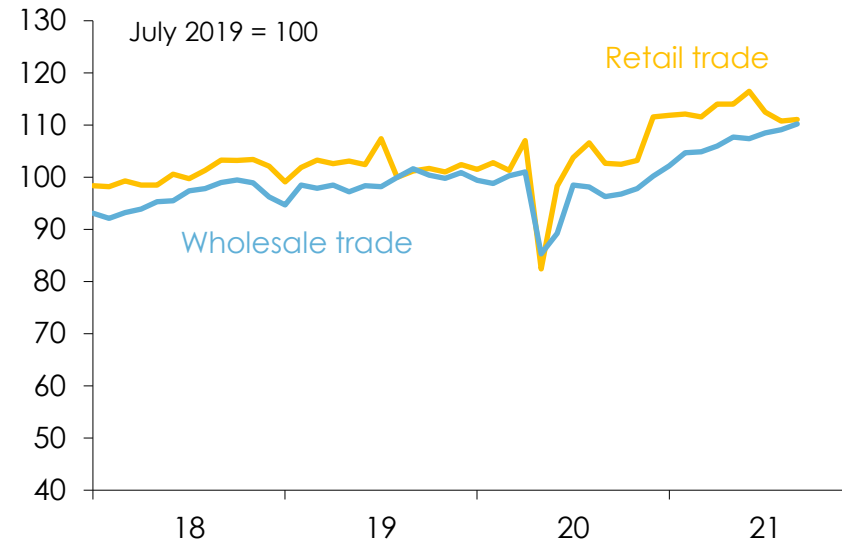
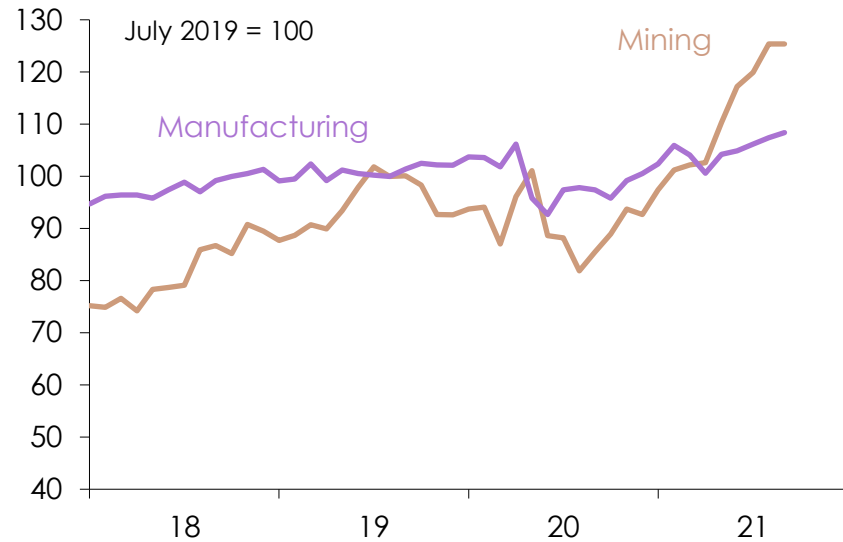
Alternative measures of unemployment



Source: ABS, [Labour Force, Australia](#), September 2021.

The ABS' new business turnover indicator shows that the same sectors have been hardest hit during the recent lockdowns in NSW & Victoria

Indicators of business turnover, by industry

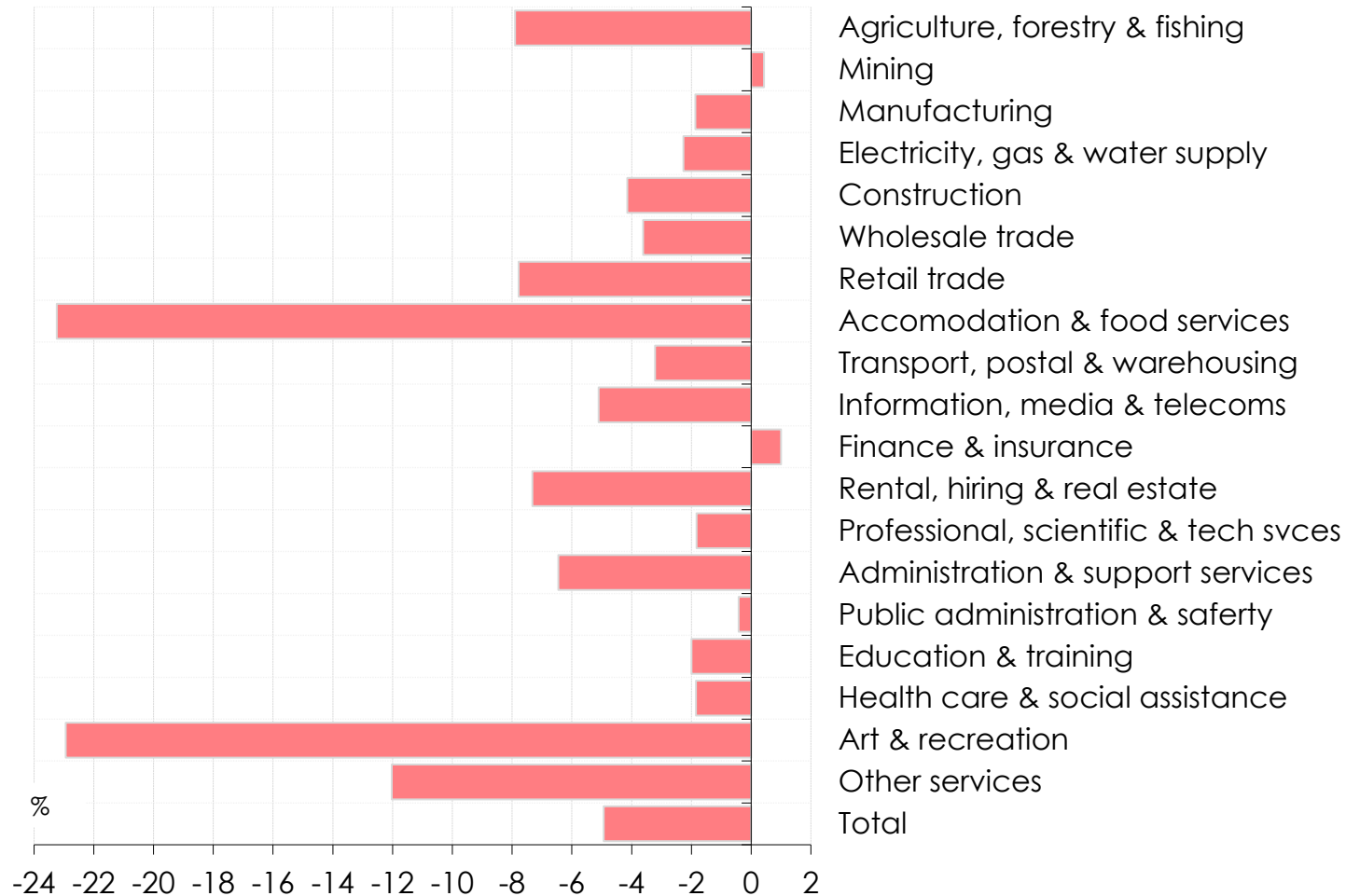


Note: The turnover indicators are derived from the Business Activity Statements submitted to the Australian Taxation Office by all businesses with an annual GST turnover of \$20mn or more (together with a proportion of smaller businesses which voluntarily report monthly). Source: ABS, [Monthly Business Turnover Indicator](#), August 2021. September data will be released on 10th November.

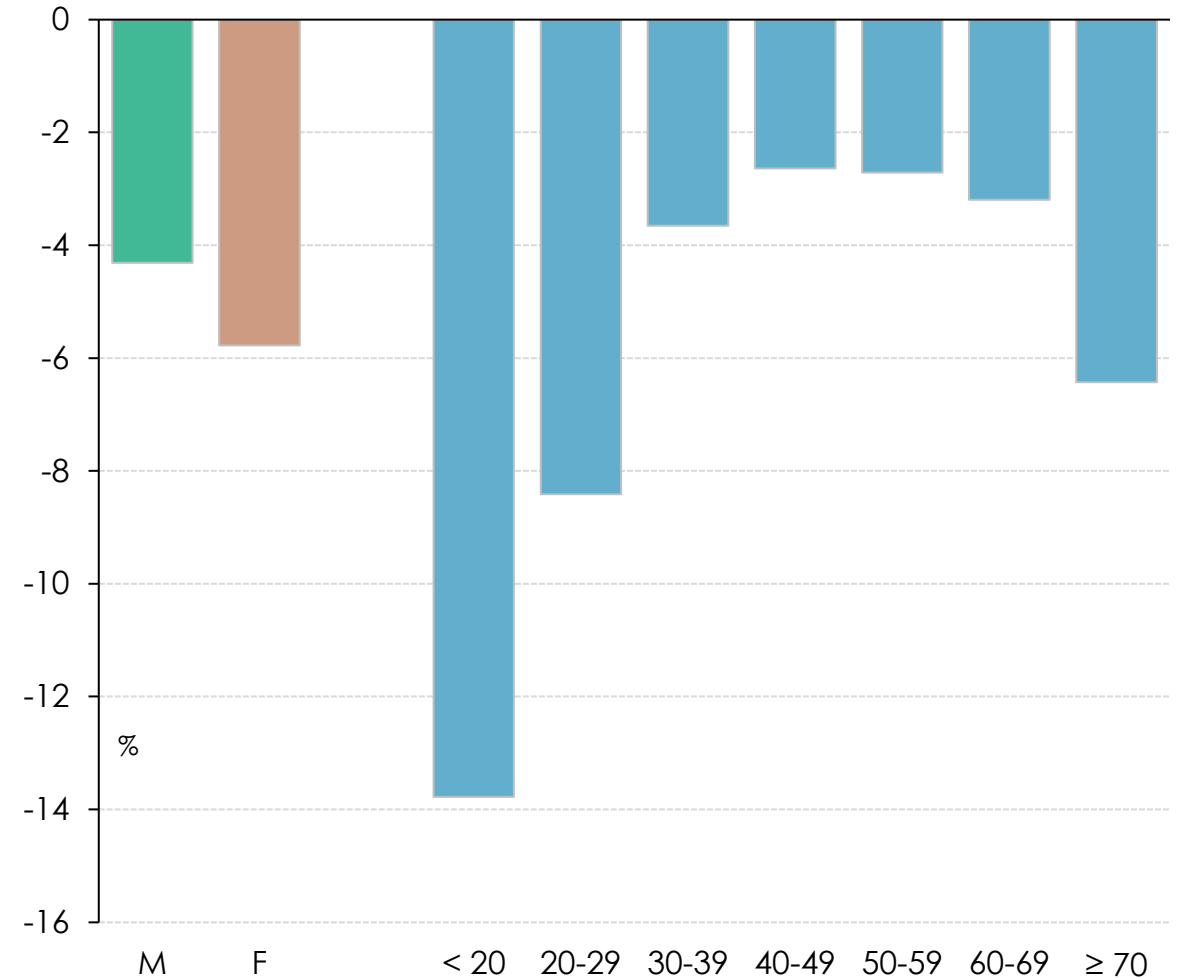
Job losses have been concentrated among the same industries, and the same groups of people, as during last year's lockdowns

Change in payroll jobs between week ended 3rd July and week ended 11th September

By industry



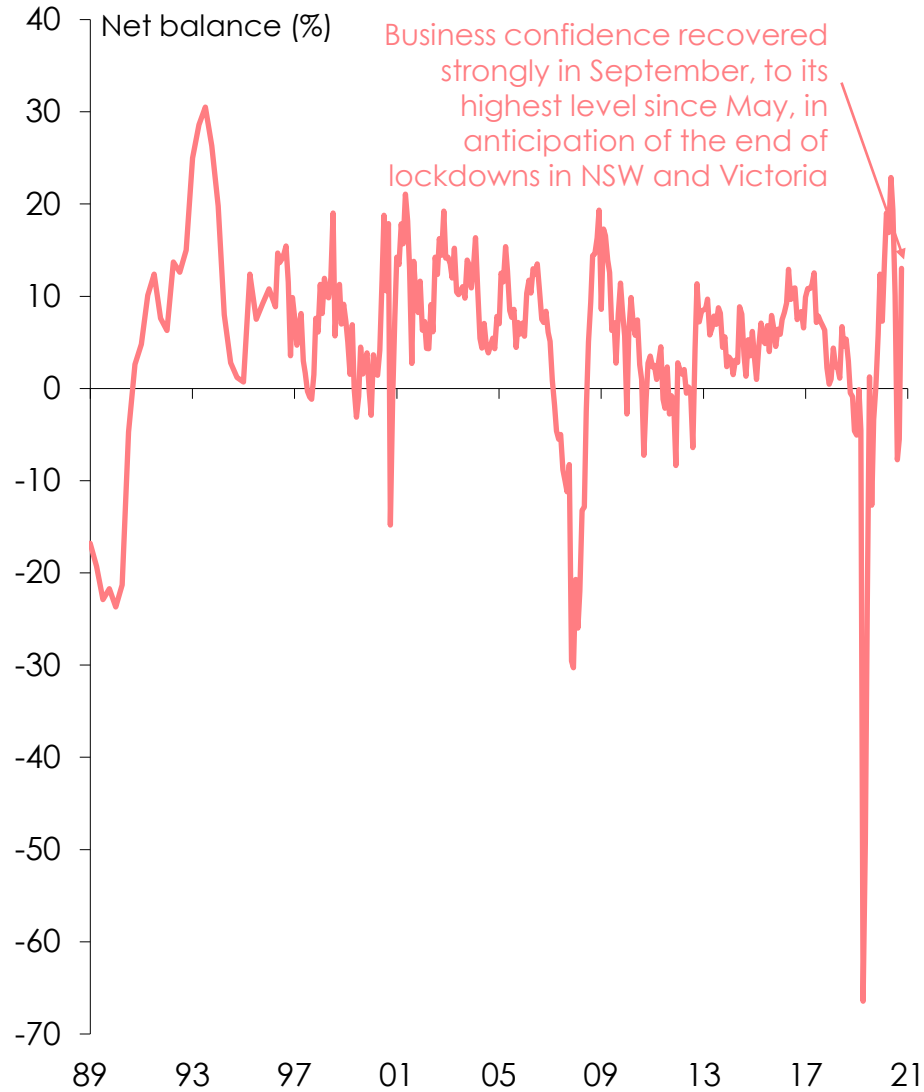
By gender and age



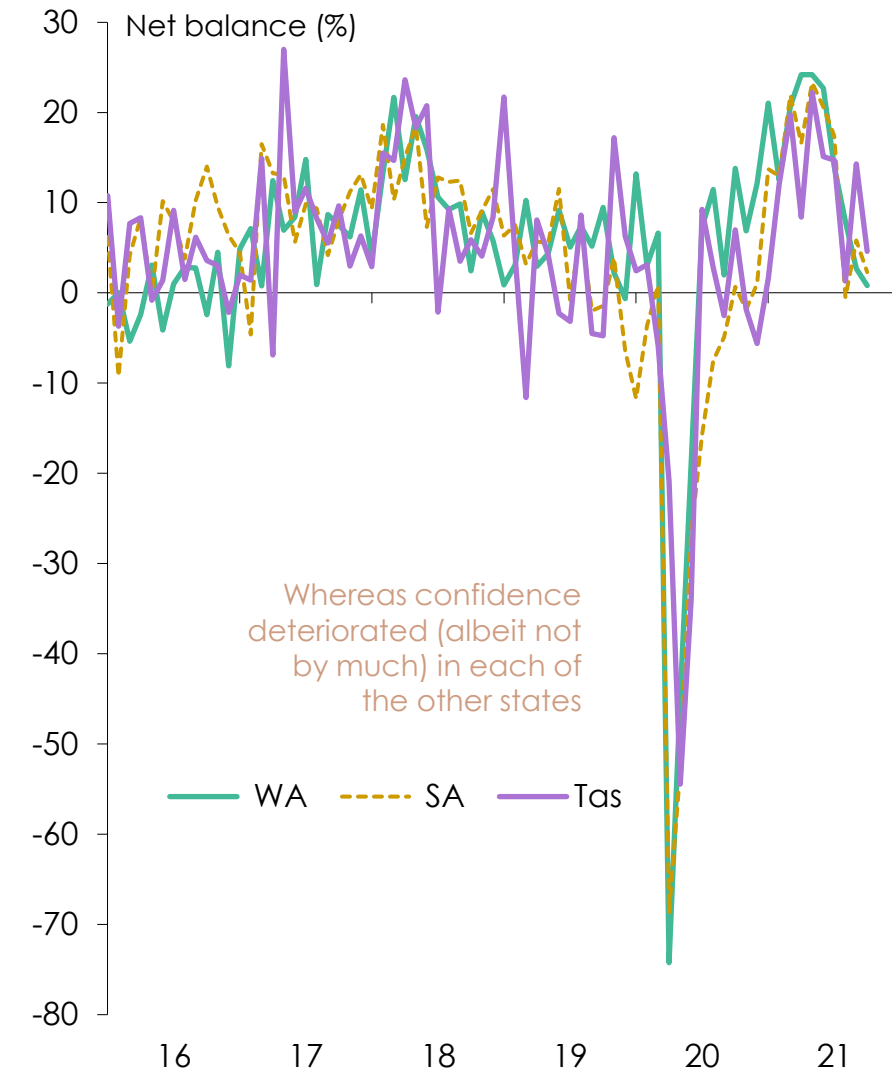
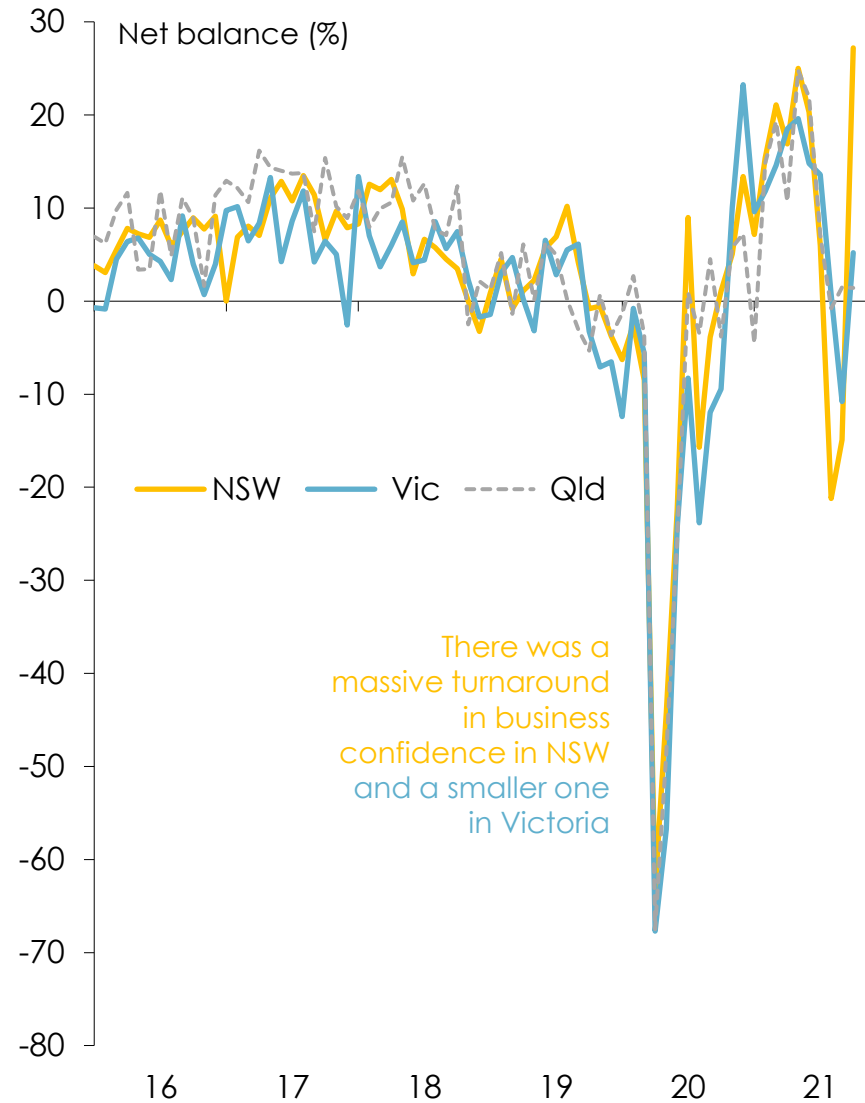
Source: ABS, [Weekly Payroll Jobs and Wages in Australia](#). Data refers to the number of payroll jobs at businesses participating in the Australian Taxation Office's Single Touch Payroll system, which covers 99% of employers with 20 or more employees and about 71% of smaller employees. People with 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); and the two most recent weeks are subject to (what have often been large) revisions.

Business confidence has rebounded, especially in NSW, in anticipation of the lockdowns ending

Business confidence

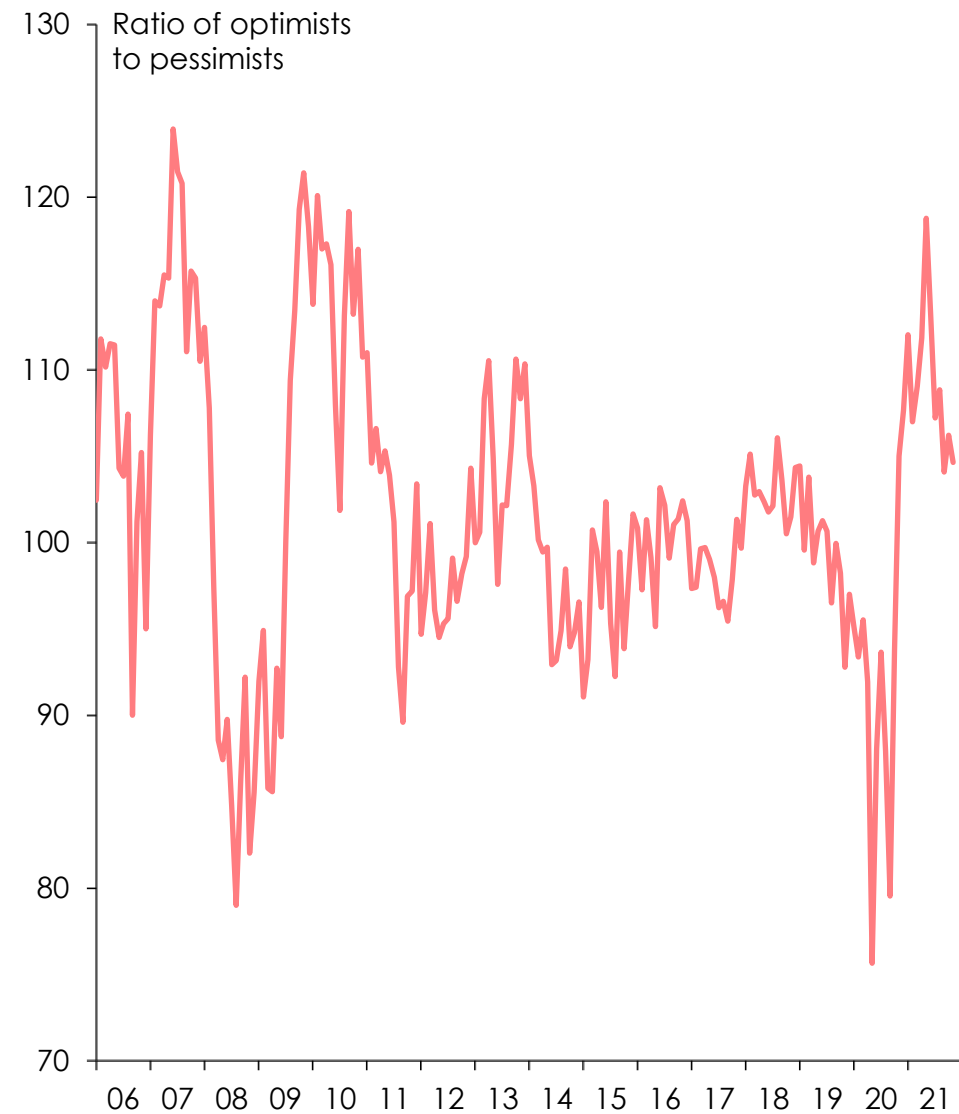


Business confidence, states and territories

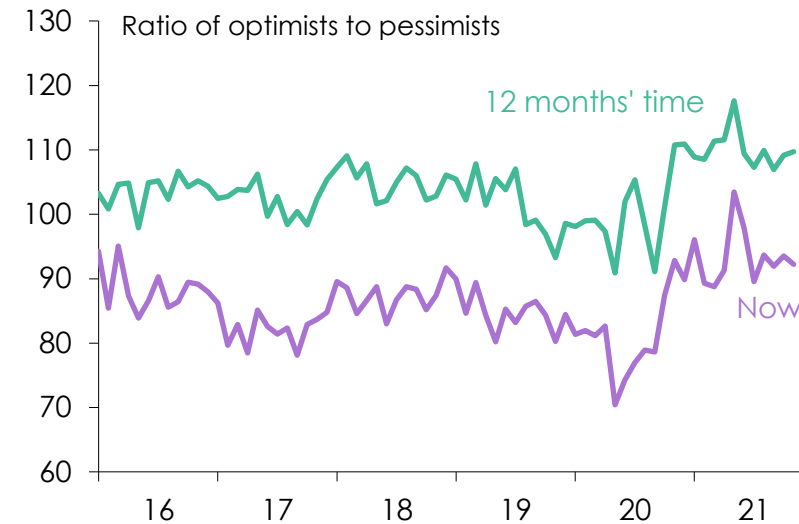


Consumer confidence has held up better than business confidence

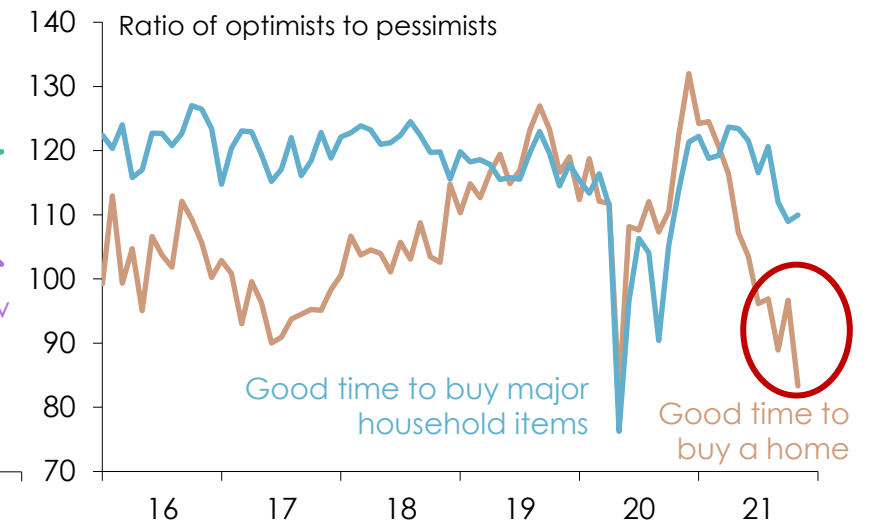
Consumer confidence index



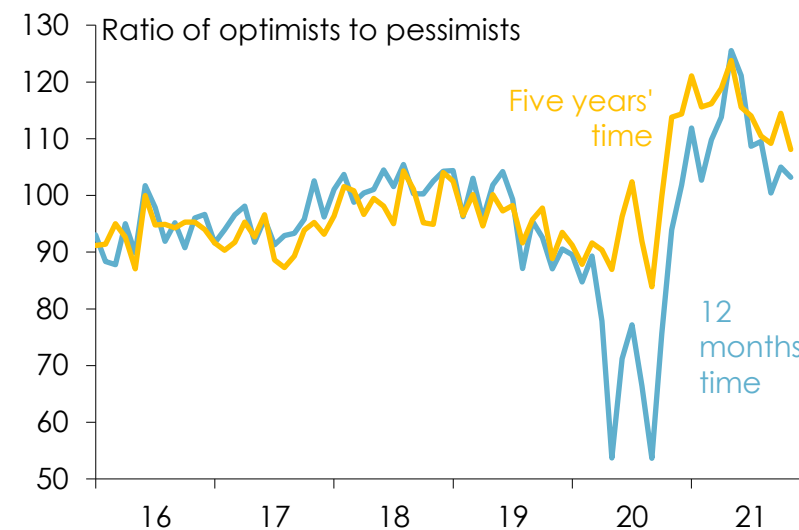
Household finances assessment



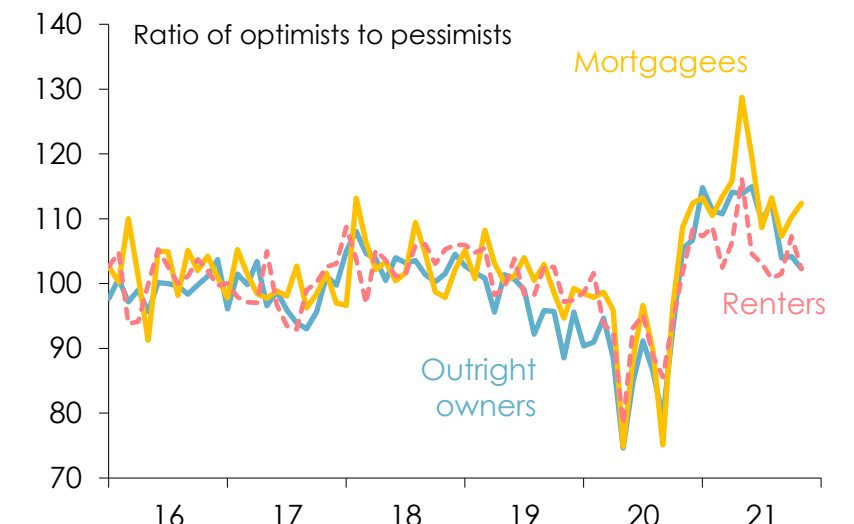
Buying conditions assessment



Economic conditions assessment

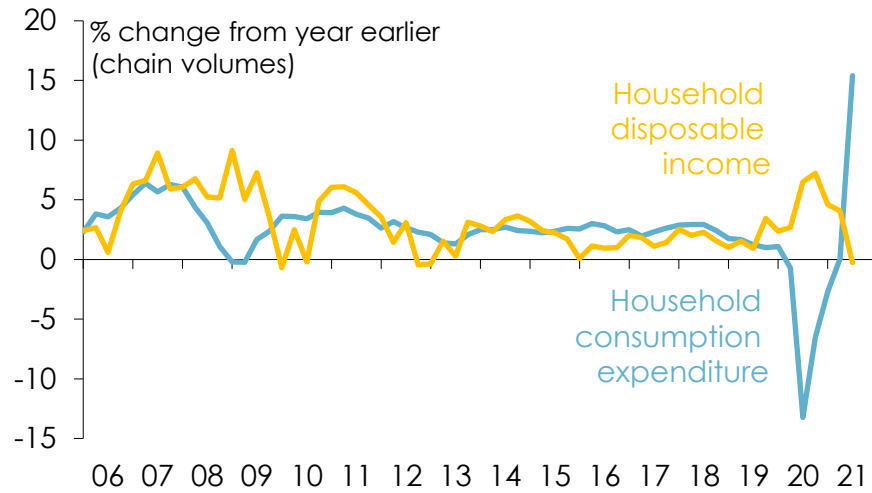


Confidence by housing tenure

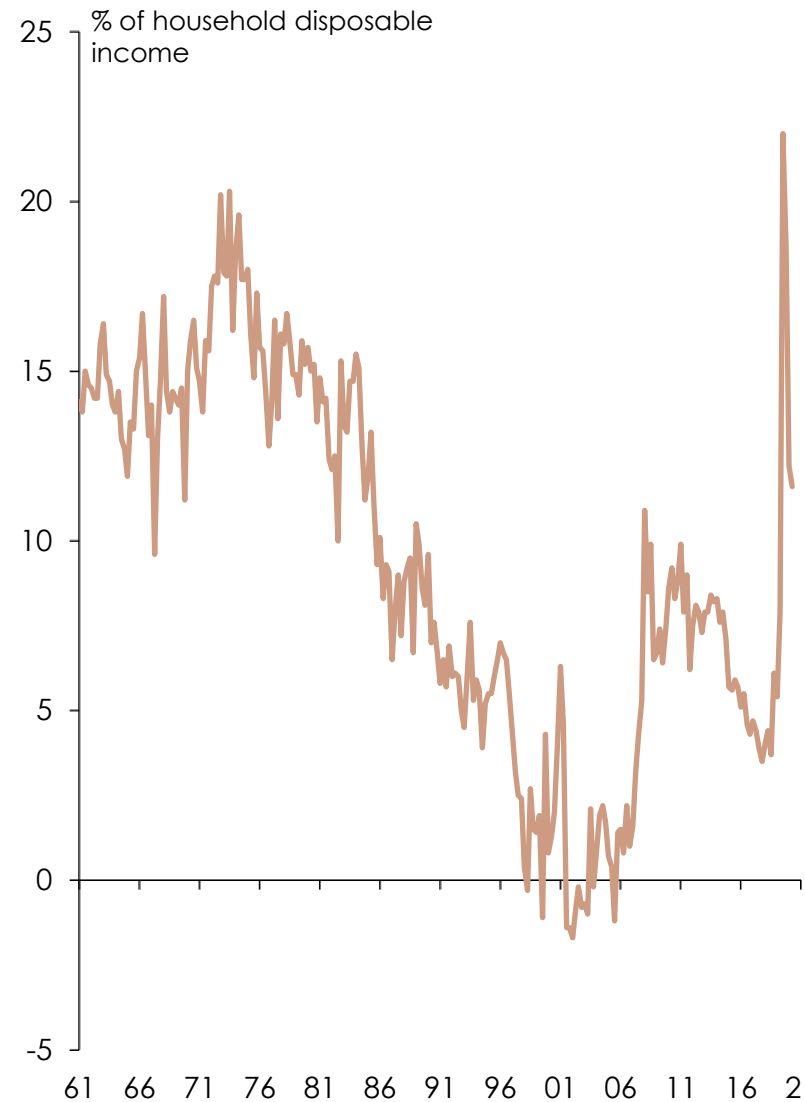


Household incomes have been supported by government payments, but spending has been curtailed, so households have lots of savings to spend

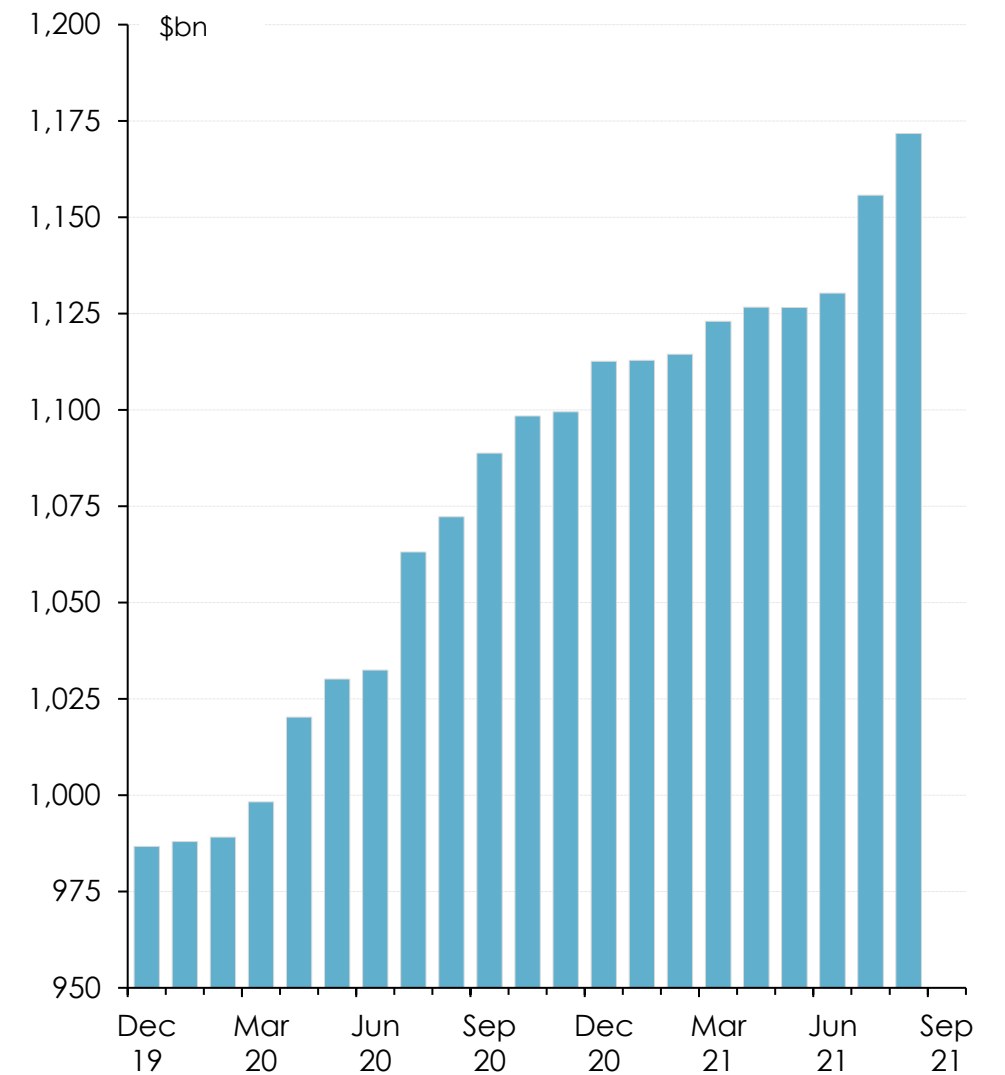
Household income and spending



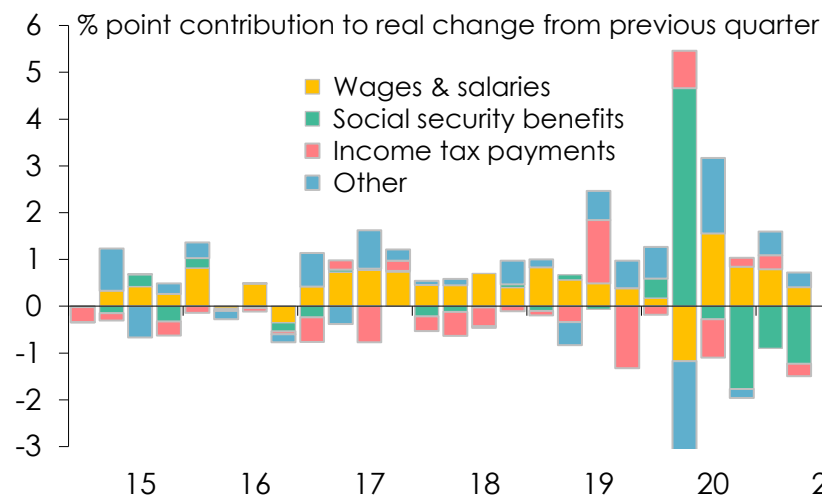
Household saving ratio



Household bank deposits



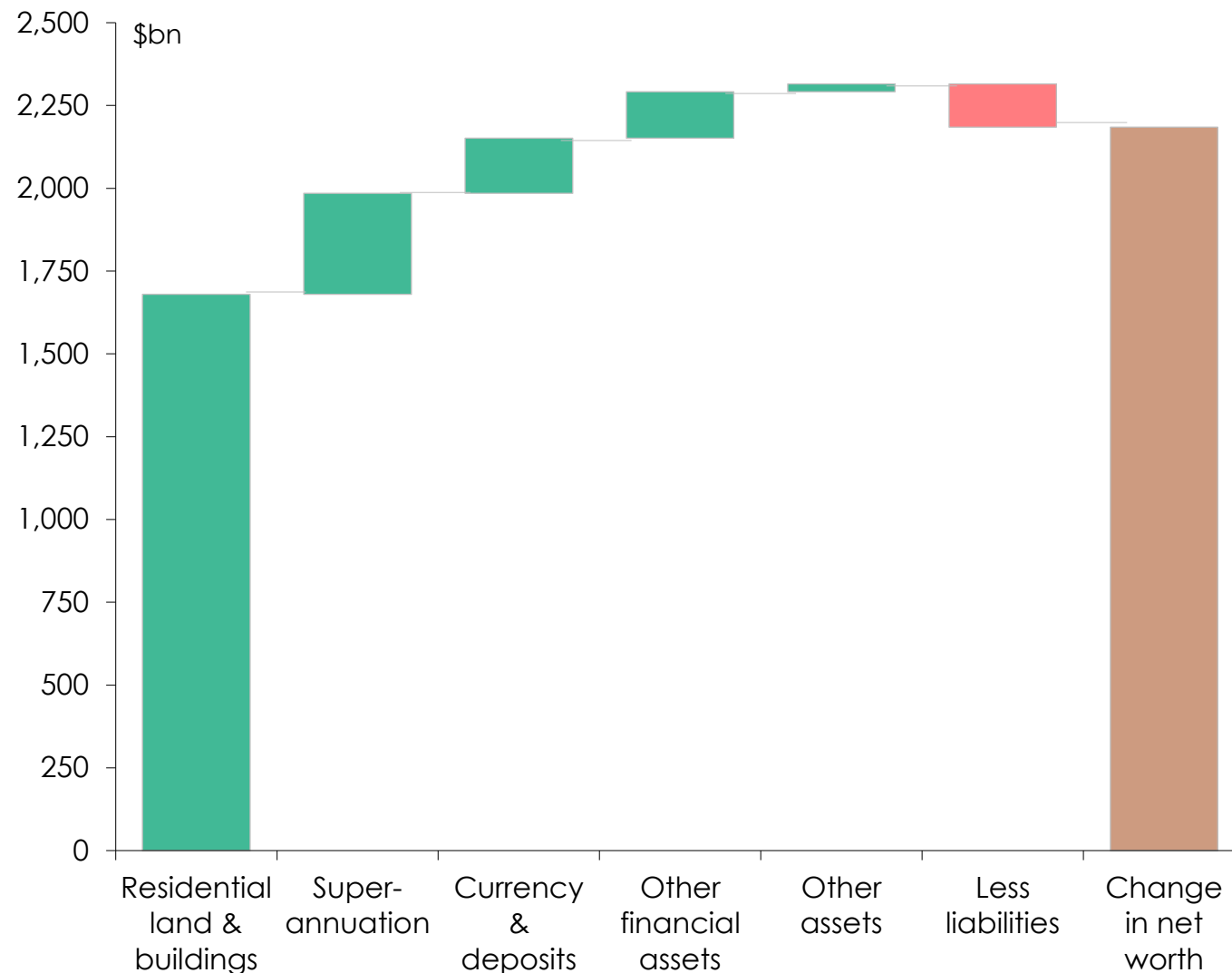
Sources of household income



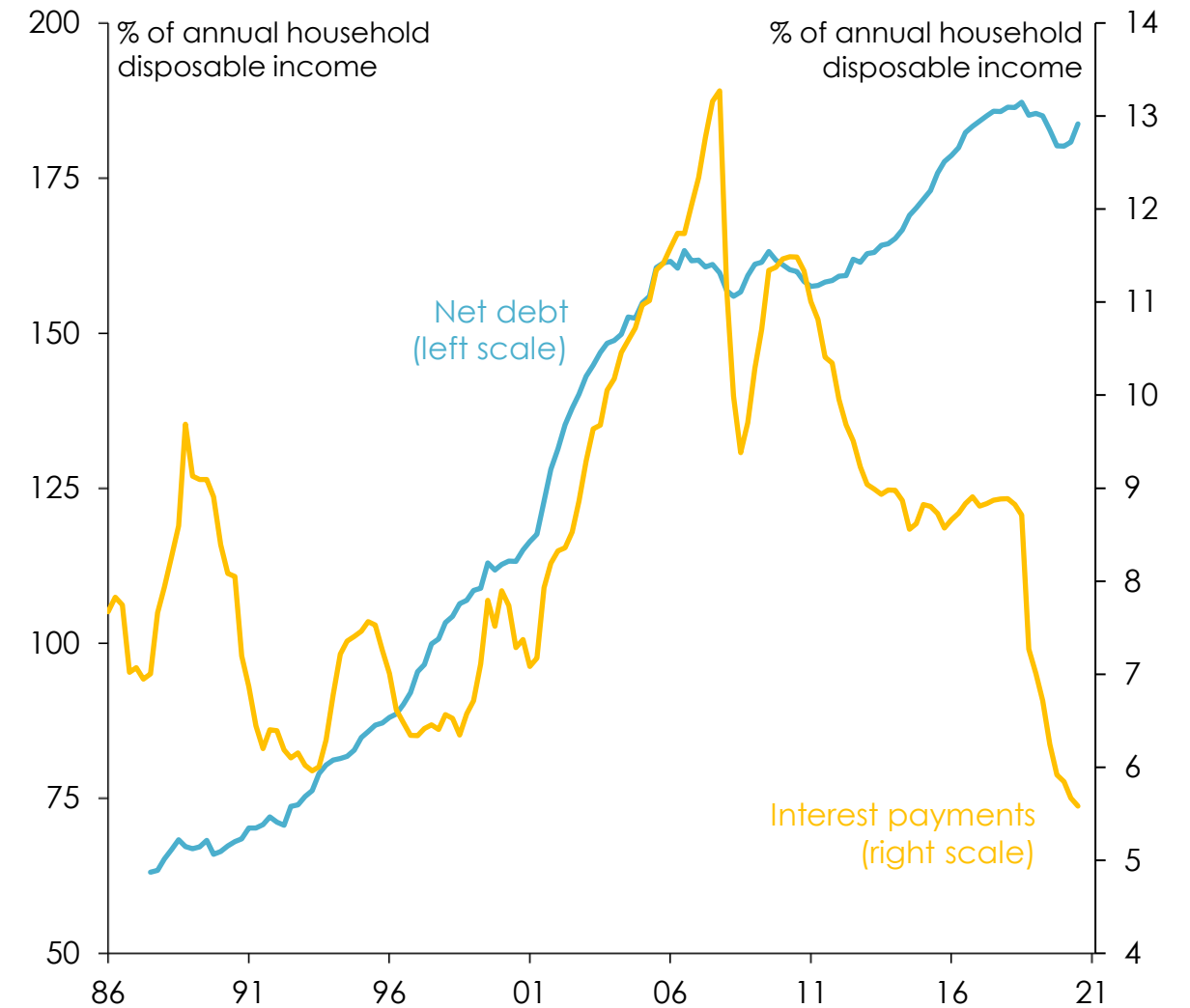
Sources: ABS, [Australian National Accounts: National Income, Expenditure and Product](#), March quarter 2021; Australian Prudential Regulation Authority, [Monthly Authorised Deposit-taking Institution Statistics](#).

Household net worth has risen by \$2.2trn (19½%) since the end of 2019, while debt service payments have fallen as a pc of income

Sources of gains in household net worth, Q4 2019 to Q2 2021



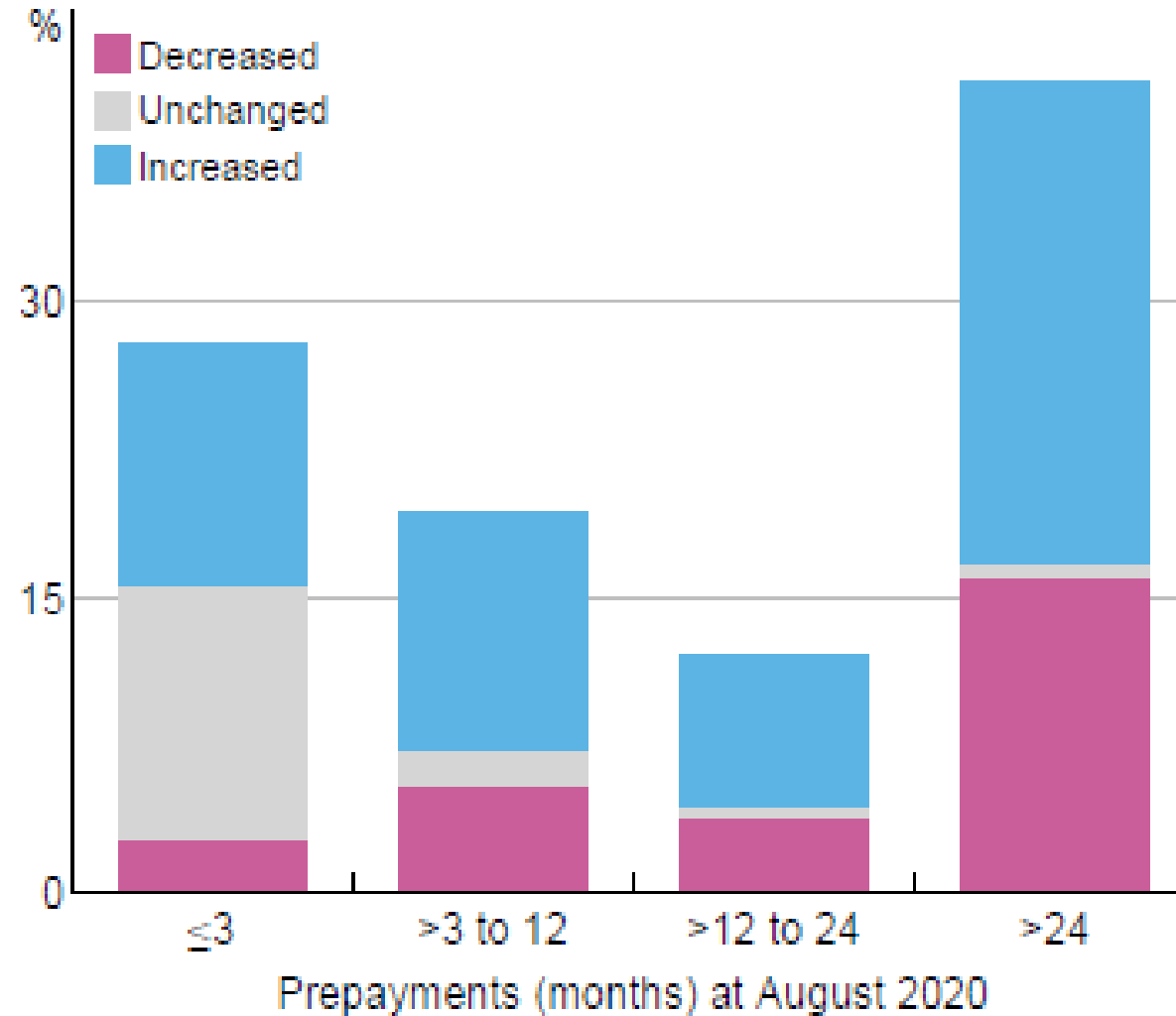
Household net debt and interest payments as a percentage of disposable income



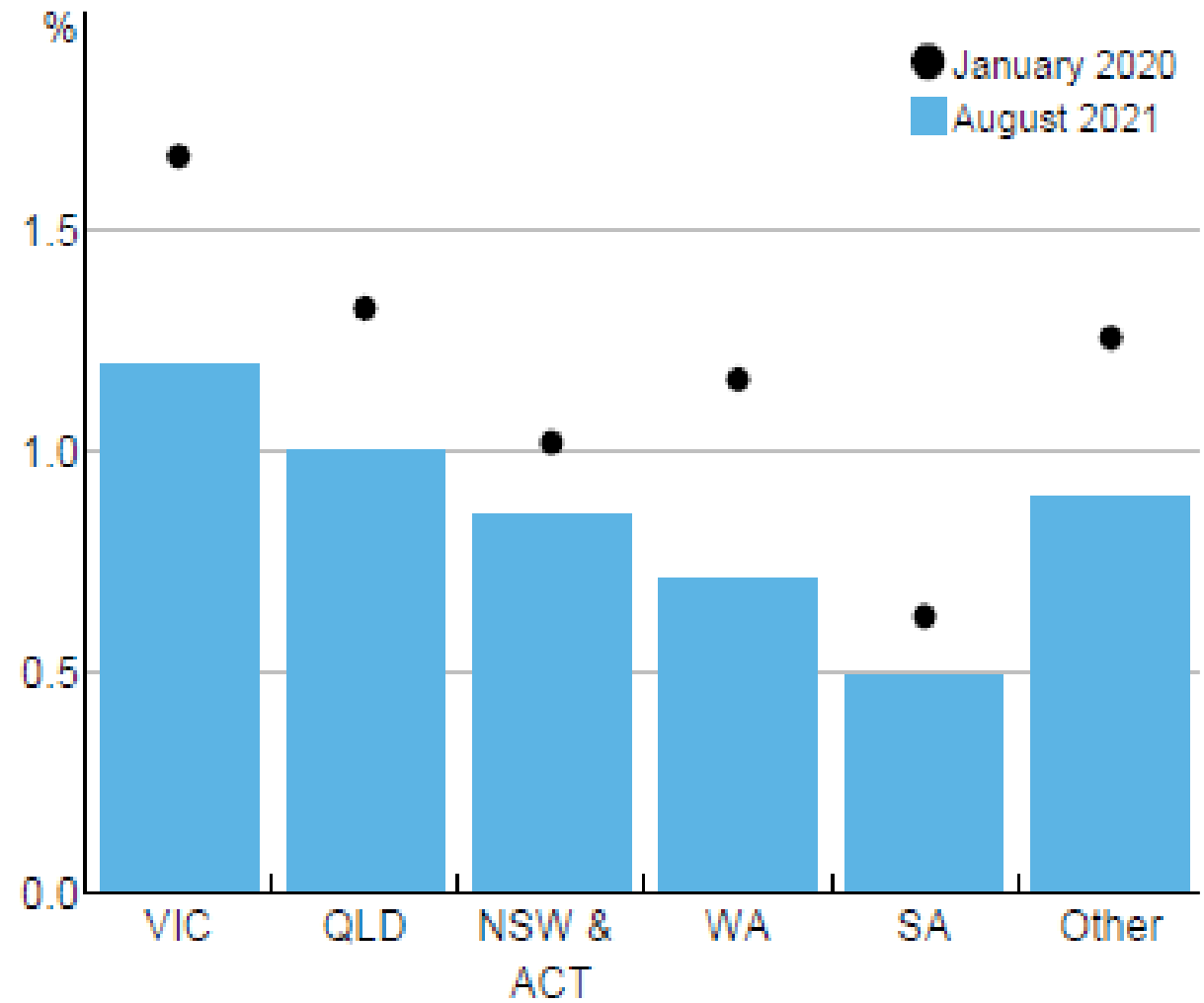
Sources: ABS, [Finance and Wealth Accounts](#), June quarter 2021; RBA, [Statistical Tables](#) E1 & E2.

Most mortgage borrowers have been using high savings and low interest rates to increase their pre-payments of principal

Change in housing loan pre-payments over the twelve months to August 2021



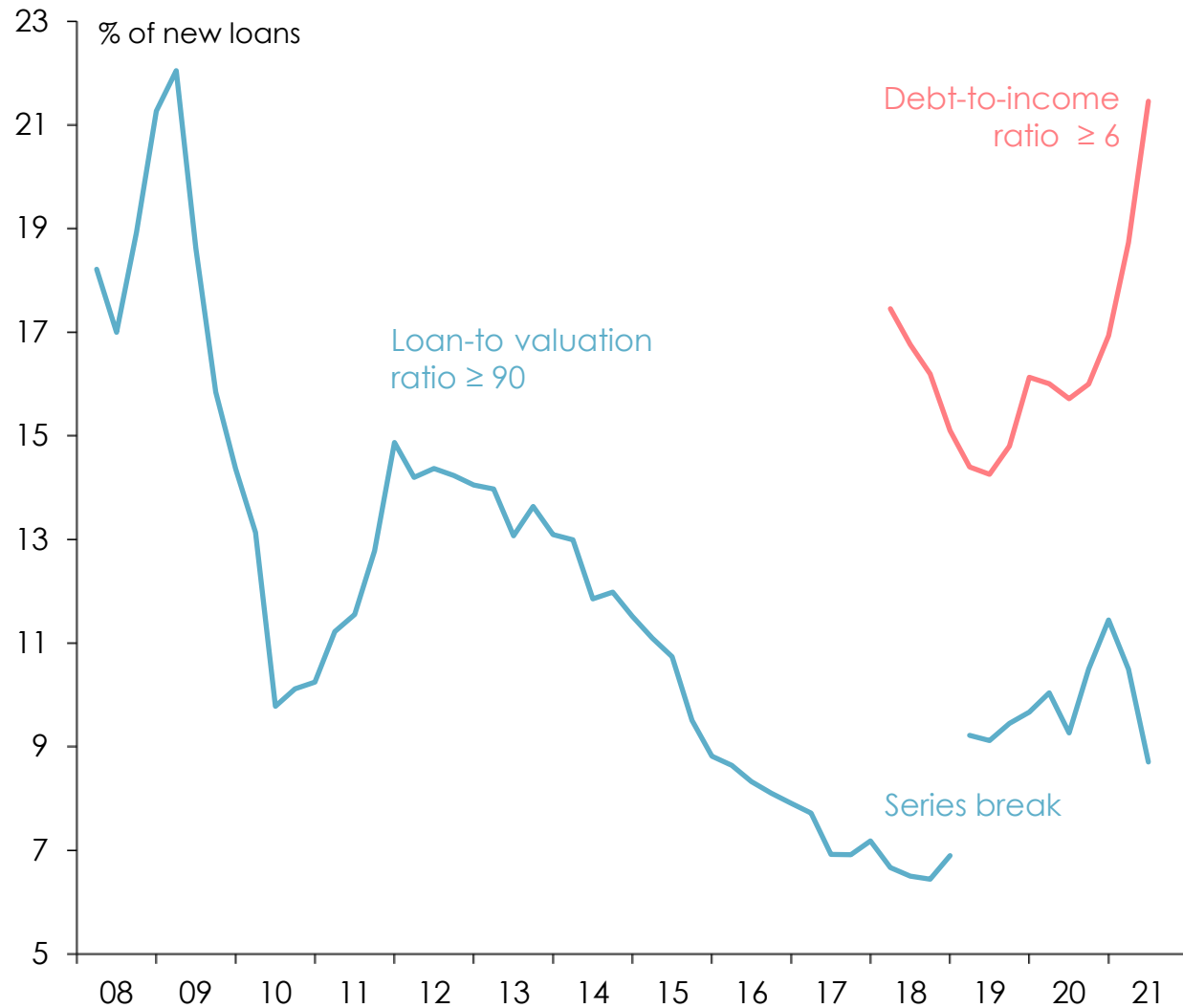
Owner-occupier mortgage borrowers with high DTI ratios and low pre-payment 'buffers'



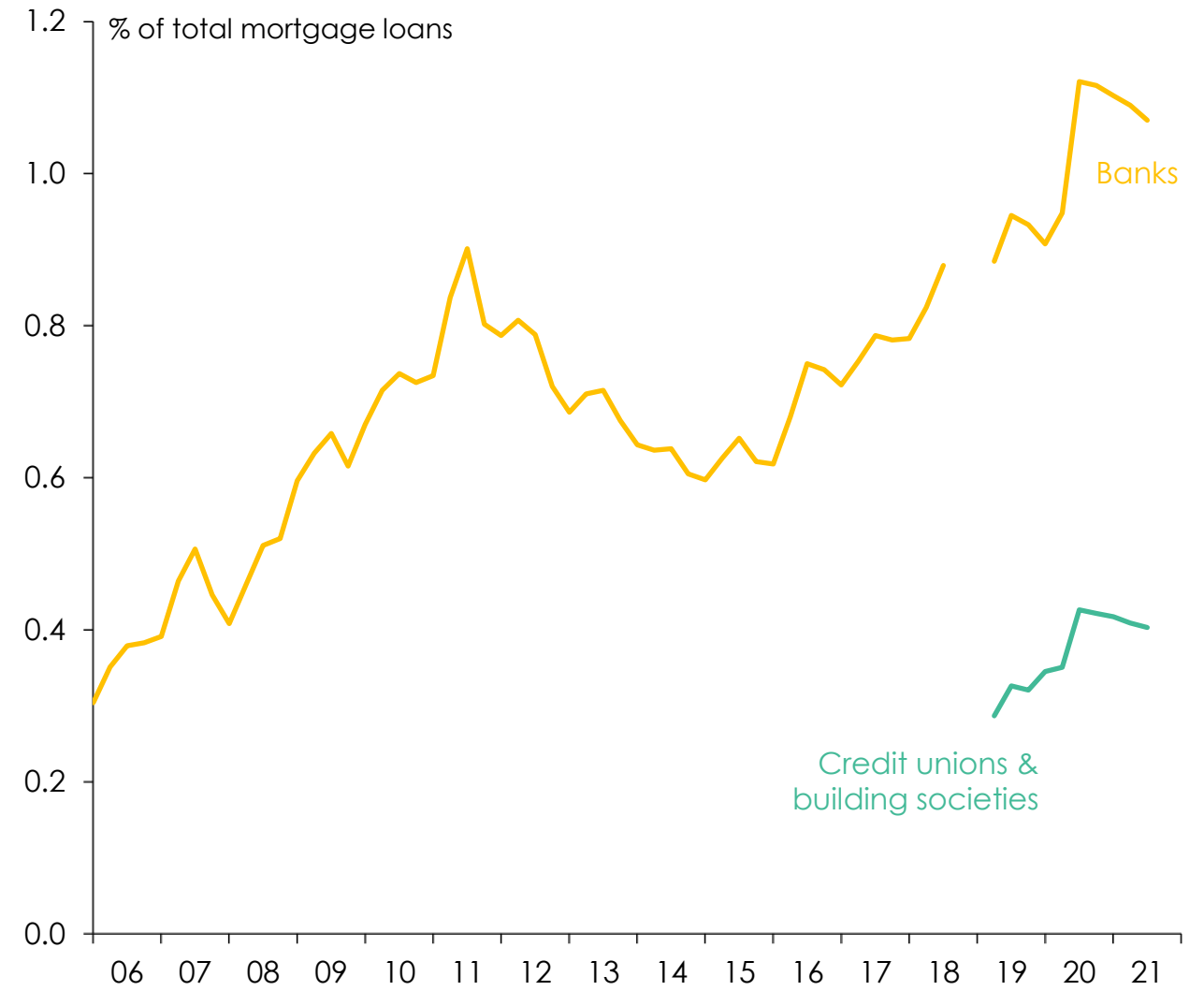
Note: Pre-payments are measured in months of repayments and expressed as a share of loans (excluding fixed-rate and investor loans. 'High debt and low buffer' households are those with a DTI > 6 and less than one month of pre-payments. Source: Reserve Bank of Australia, [Financial Stability Review](#), 8th October 2021.

Mortgage lending standards have deteriorated somewhat over the past two years – but so far, loan quality hasn't

Characteristics of new mortgage loans

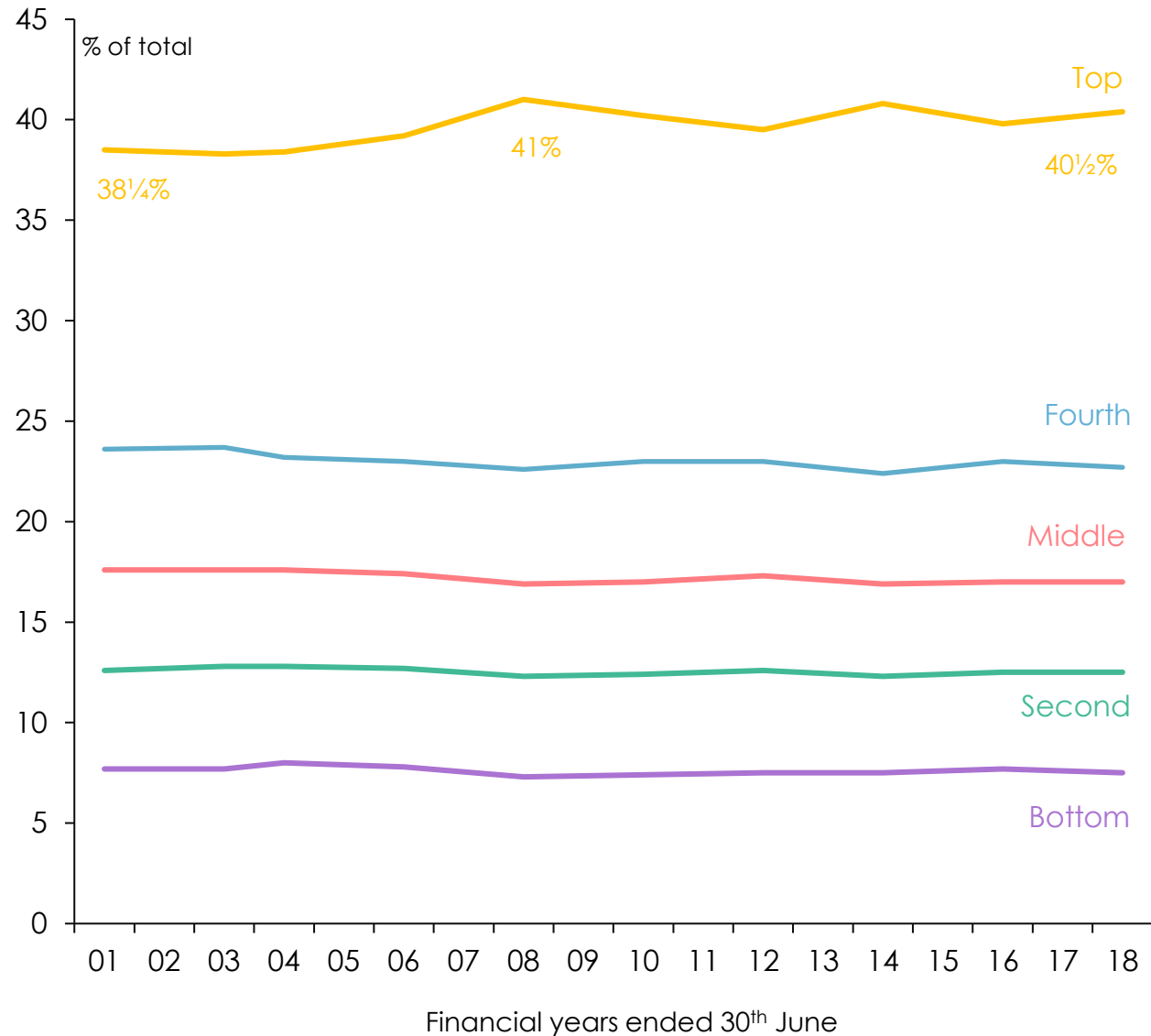


Non-performing mortgage loans

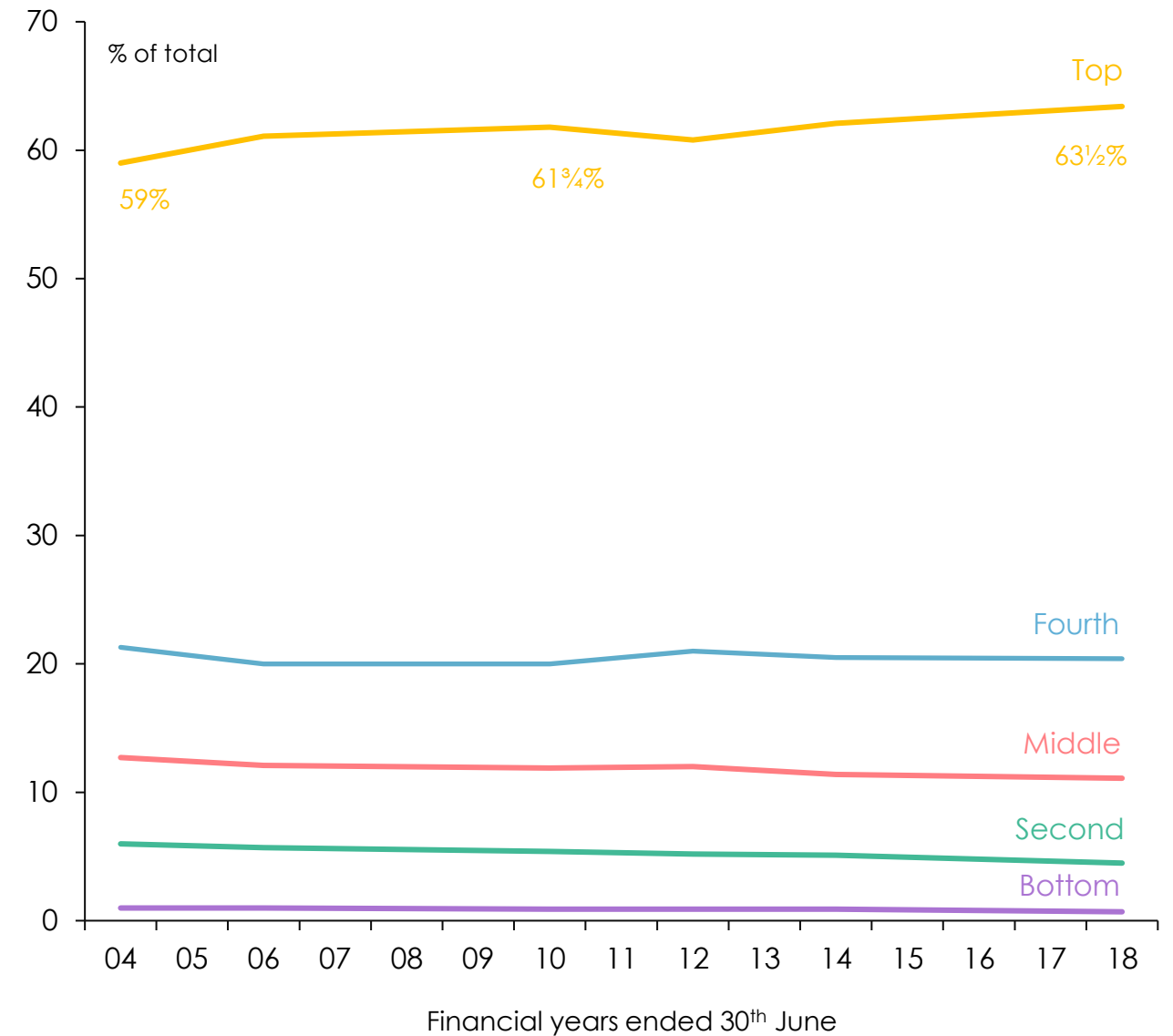


The rich have gotten a bit richer over the past twenty years – but not by a lot

Income distribution by income quintiles



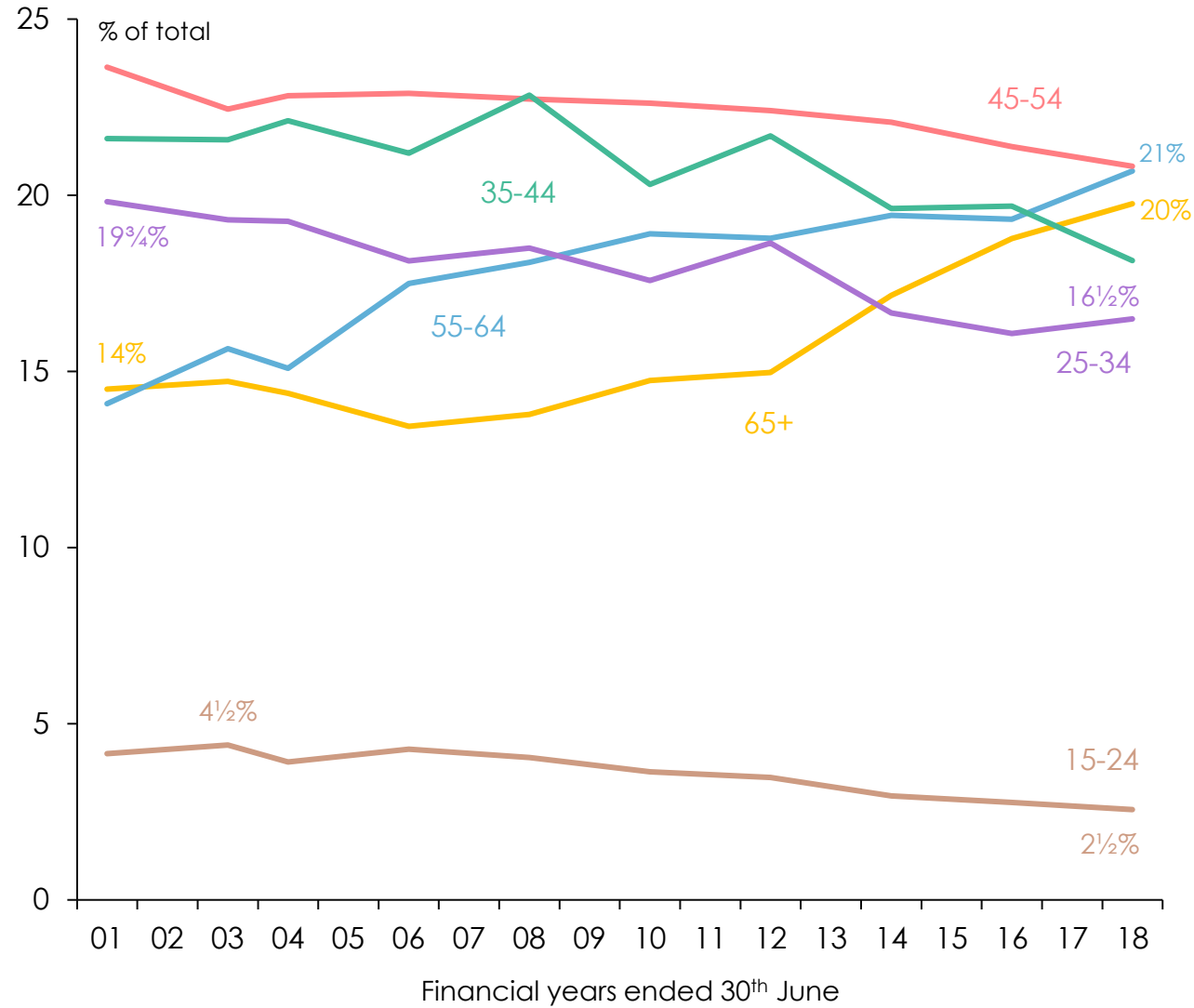
Wealth distribution by wealth quintiles



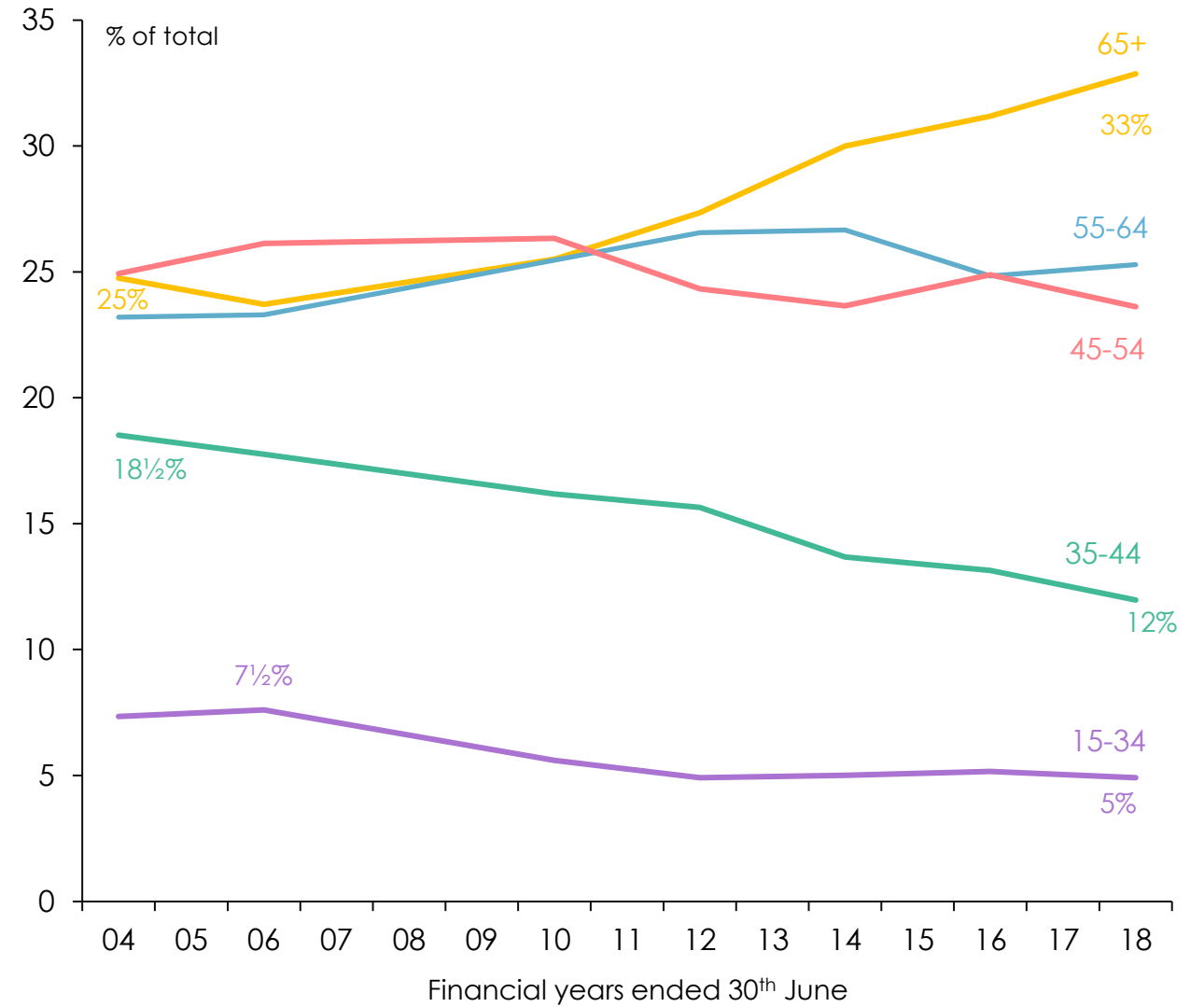
Note: 'income' is 'equivalized disposable household income' which takes account of differences in the number of people living in different households. 'Quintiles' are '20% slices' of households ranked by income. Sources: ABS, [Household Income and Wealth, Australia, 2017-18](#).

What is more striking is how much richer the old have become, (mostly) at the expense of young adults

Income distribution by age cohorts



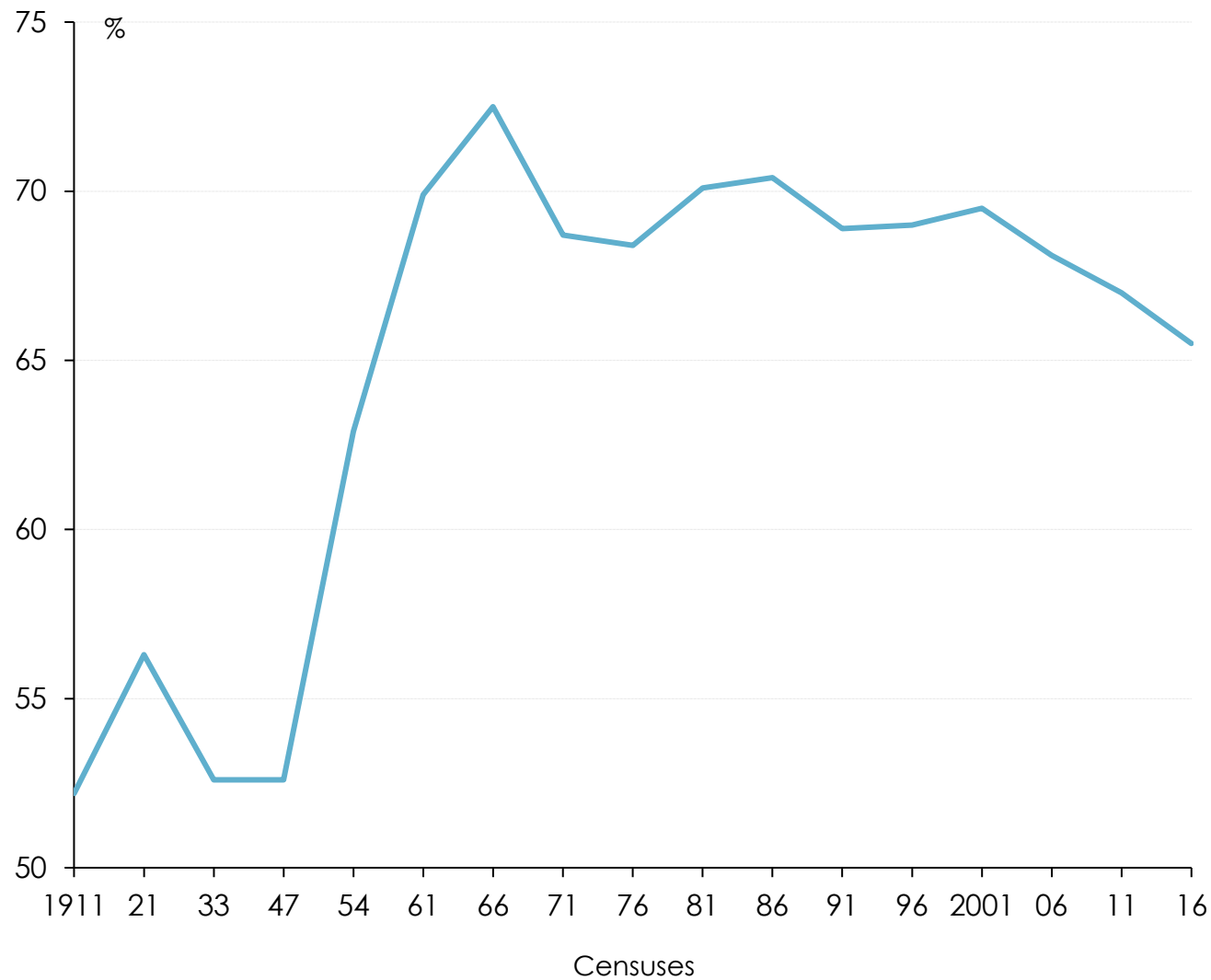
Wealth distribution by age cohorts



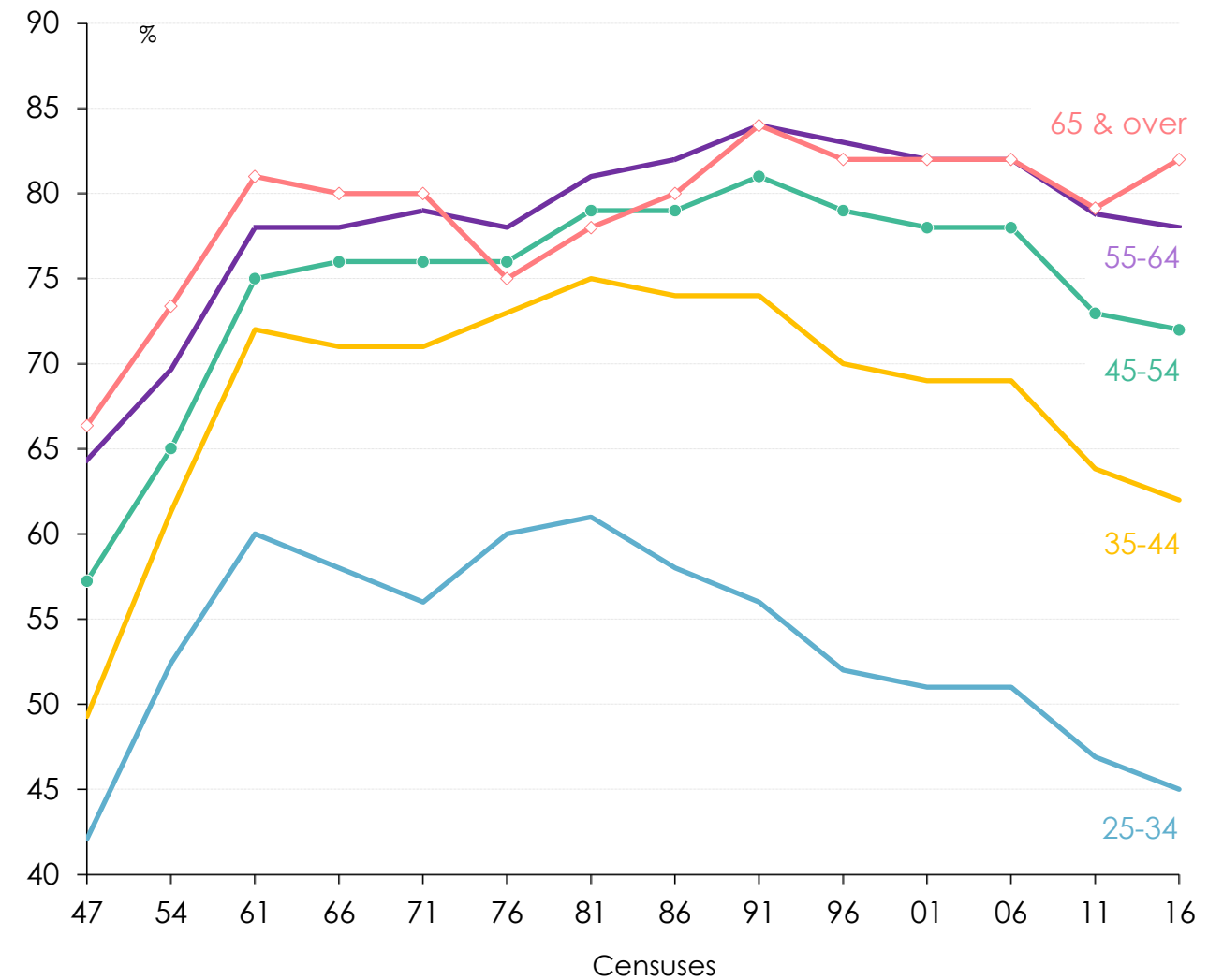
Note: 'income' is 'equivalized disposable household income' which takes account of differences in the number of people living in different households. The percentage of households 'headed' by people aged 65+ has risen from 20% in 2000-01 to 24% in 2017-18; the percentage 'headed' by people aged 15-34 has declined from 23.5% to 19.5% over the same period. Sources: ABS, [Household Income and Wealth, Australia](#), 2017-18.

The home ownership rate at the 2016 census was the lowest since 1954 – and for some age groups it was the lowest since 1947

Overall home ownership rates at Censuses



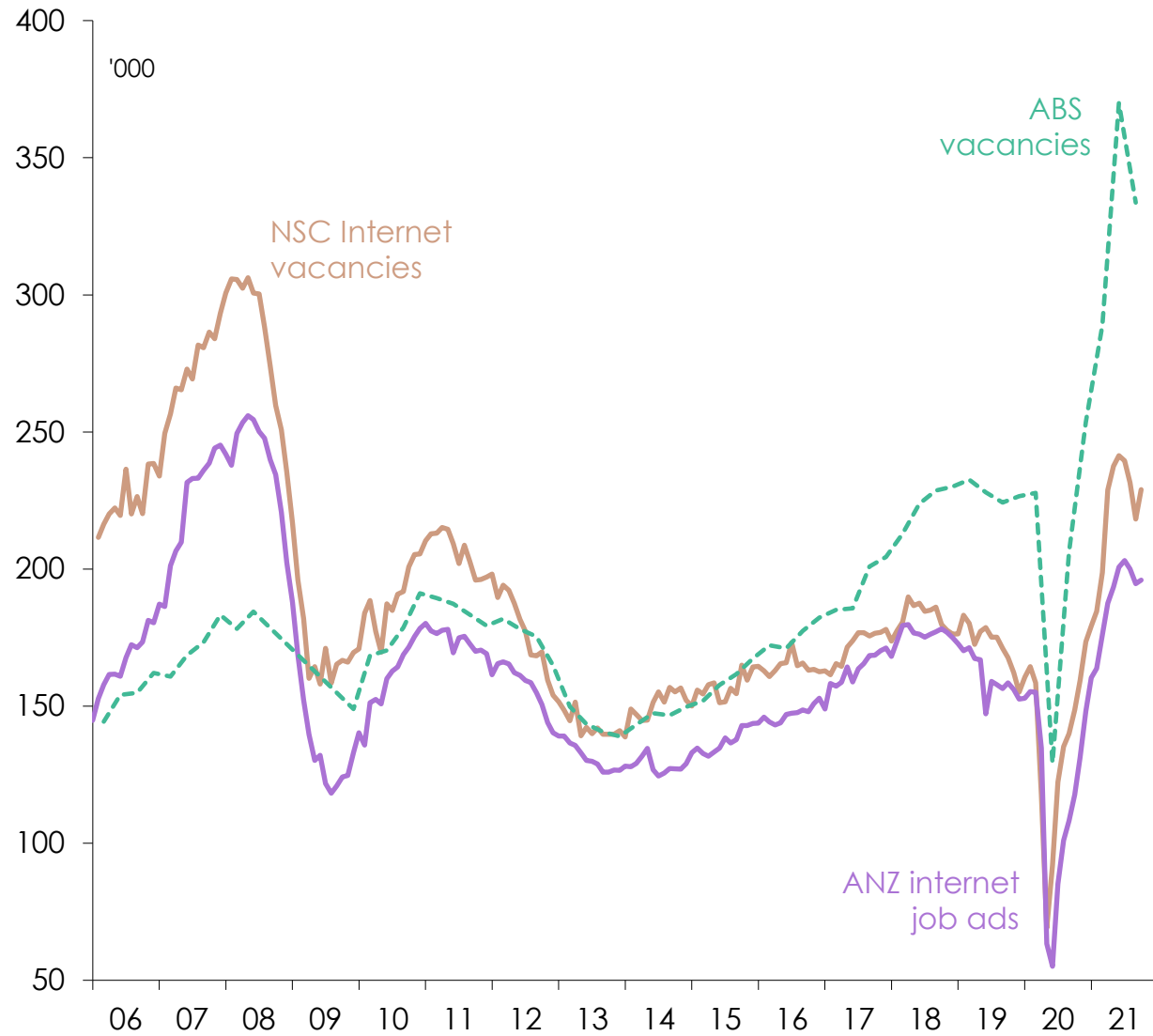
Home ownership rates by age group



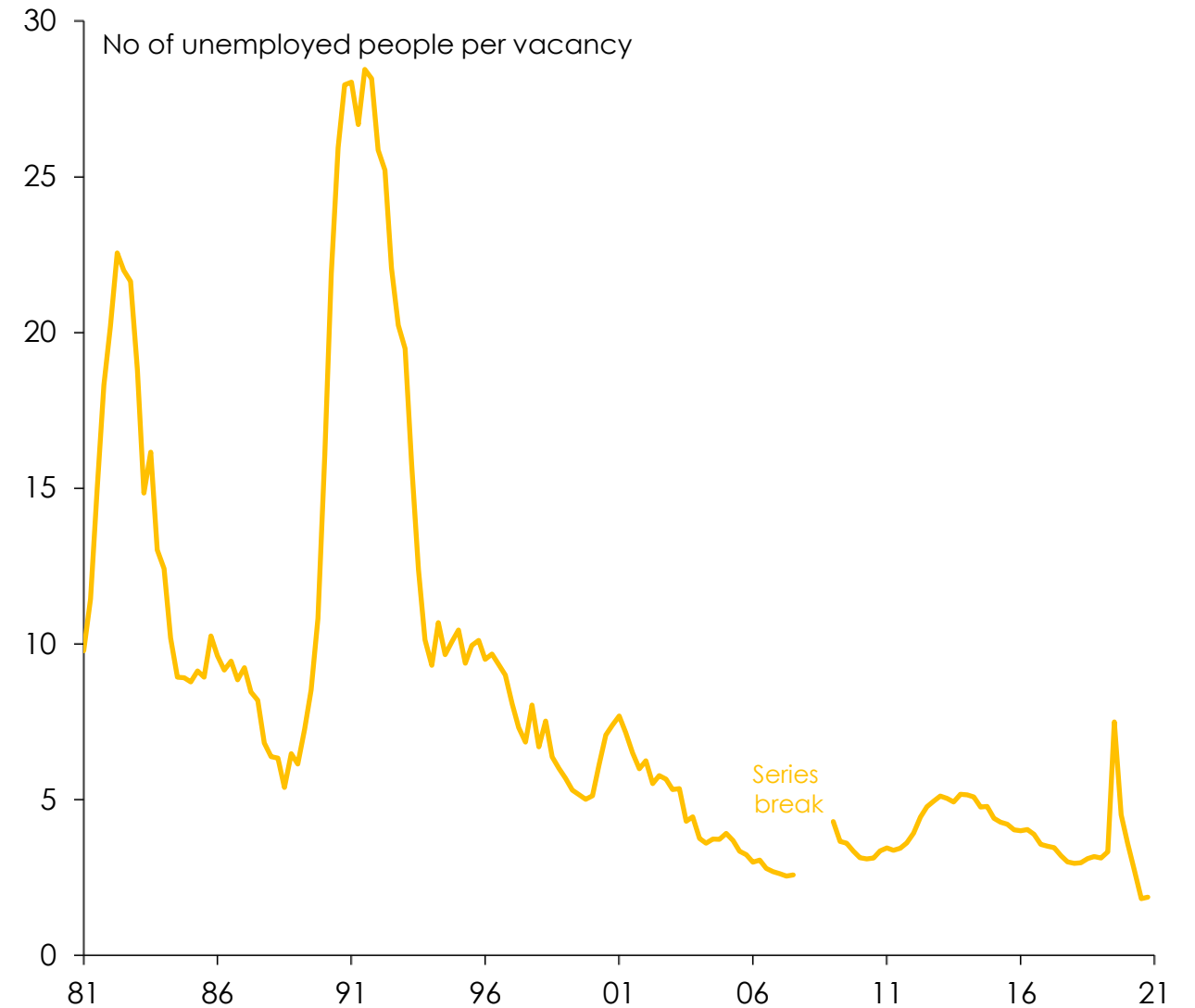
Sources: ABS, [Census of Population and Housing: General Community Profile, Australia, 2016](#) and [Historical Census Data](#); Judith Yates, "[Explainer: what's really keeping young and first home buyers out of the housing market](#)", *The Conversation*, 12th August 2015,

Employment should recover quite quickly given the high level of vacancies and the lack of competition for jobs from migrants

Measures of job vacancies

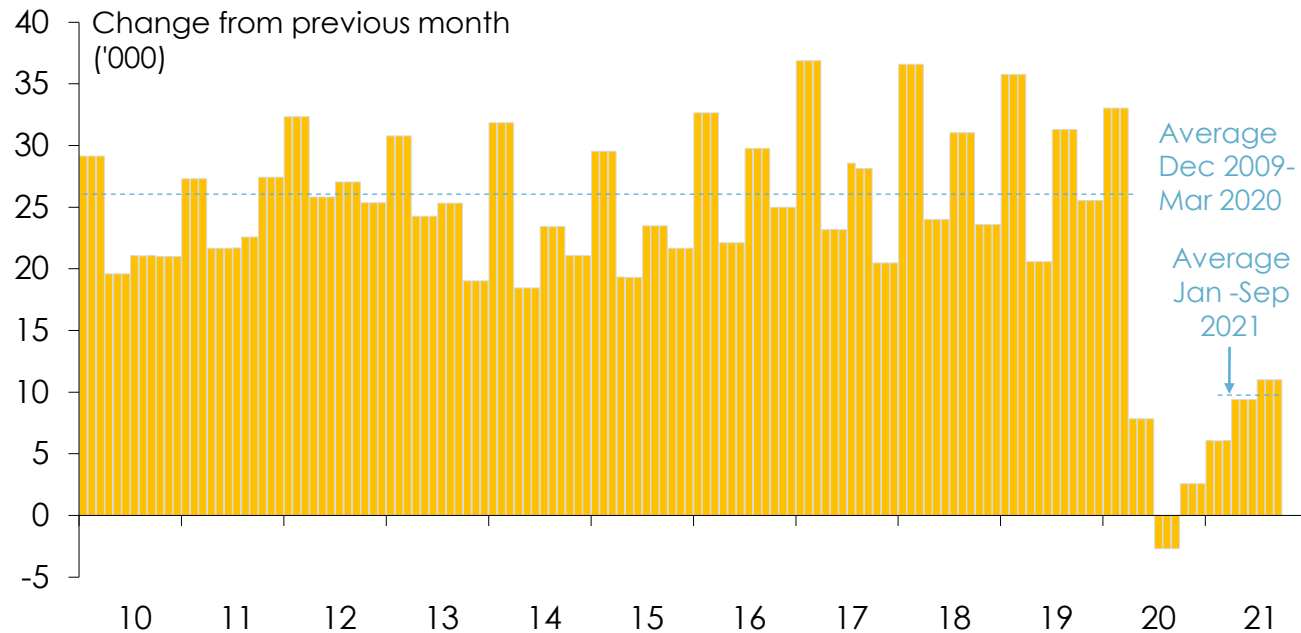


Ratio of unemployed people to job vacancies



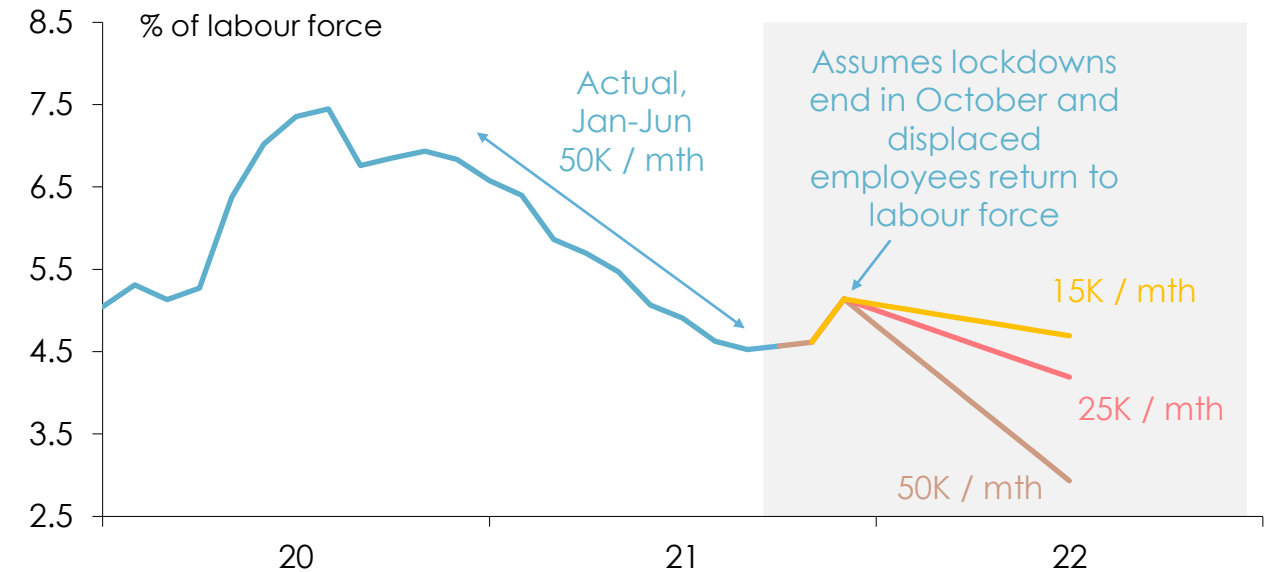
The unemployment rate could fall more quickly, and further, than expected depending on how long before immigration picks up again

Monthly growth in civilian working-age population



- ❑ Over the decade prior to the onset of Covid-19, the civilian working-age population (people aged 15 and over) grew by an average of 26K a month – meaning that 16½K new jobs a month, on average, were required to keep the unemployment rate constant (assuming an unchanged participation rate)
- ❑ But so far this year, the working-age population has risen by an average of just under 10K a month – which means that anything more than 6½K new jobs a month will result in a fall in the unemployment rate, all else being equal

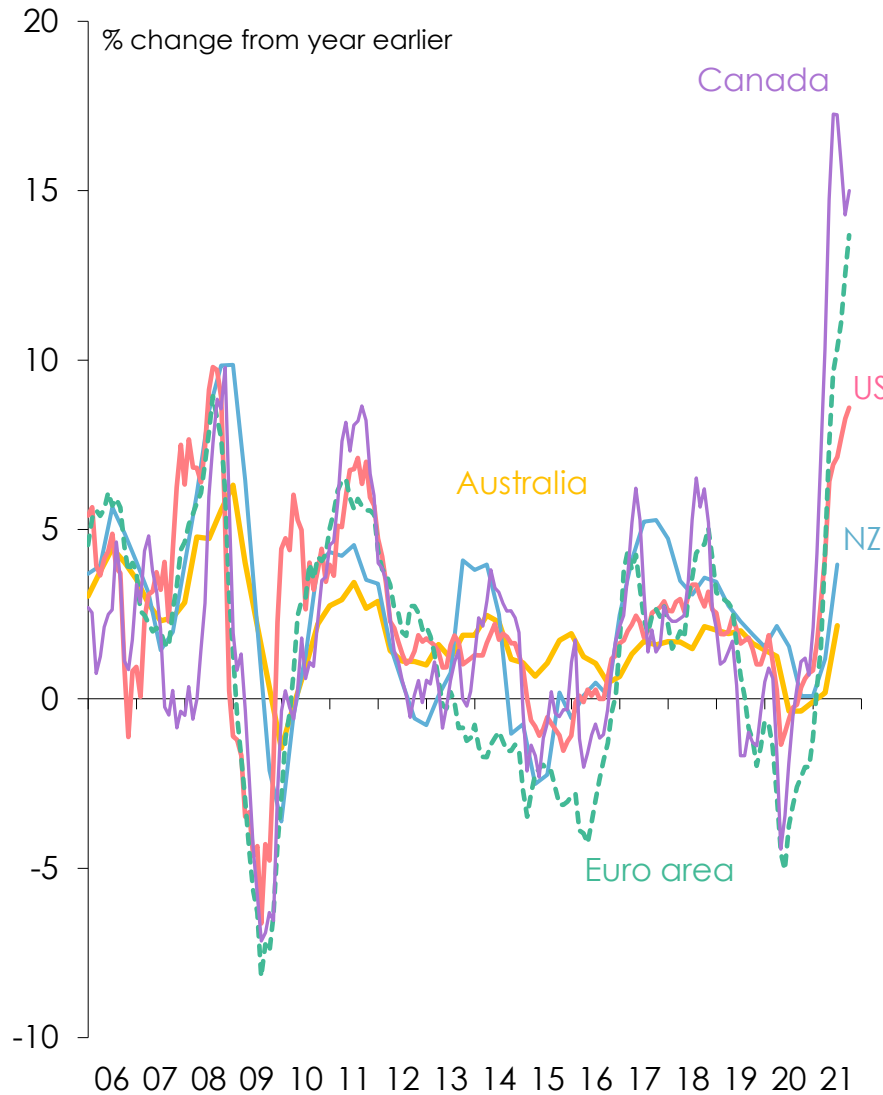
Unemployment rates for alternative rate of jobs growth



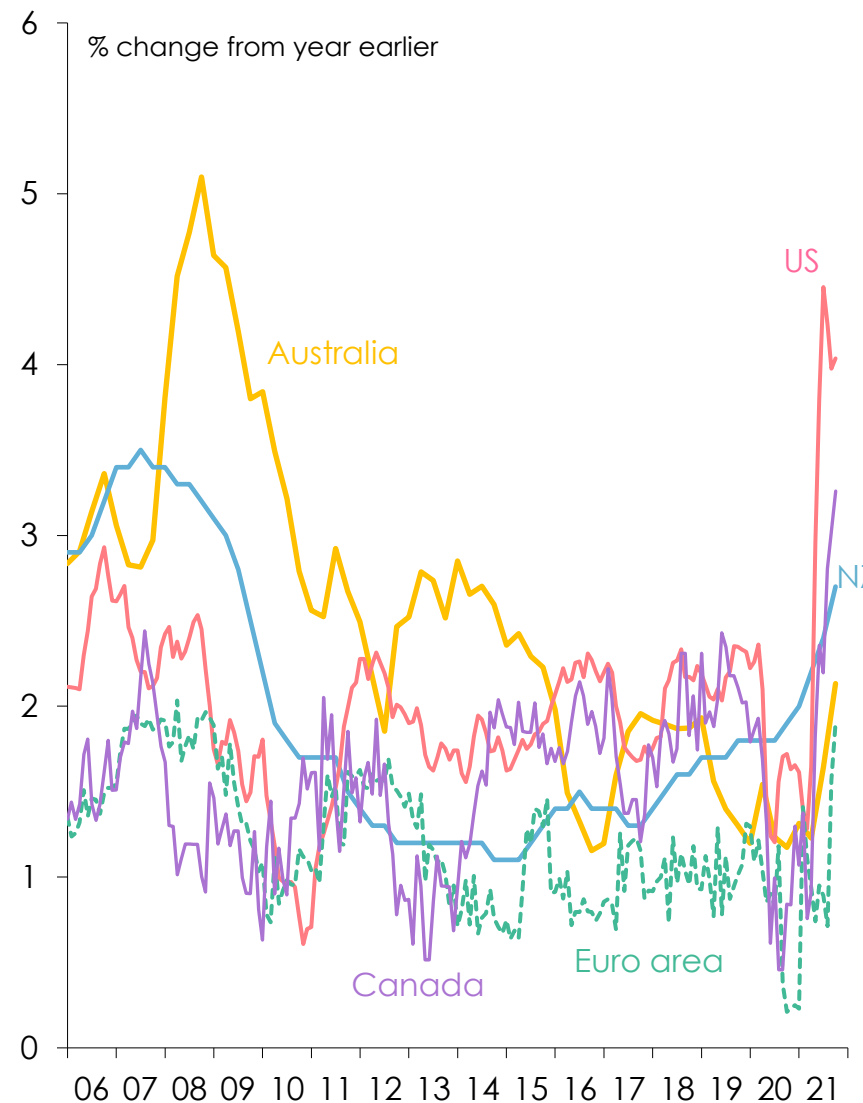
- ❑ Assuming the working-age population grows at the same rate as it has over the first nine months of 2021, and that lockdowns end by end-October, with people displaced from work during lockdowns returning to the labour force by November – if employment then grows at the same rate as in January-June, the unemployment rate would be down to less than 3% by June next year
- ❑ Even if employment grows by half what it did between January and June, the unemployment rate would be down to almost 4% by next June

Australia isn't seeing as much inflationary pressures as other 'advanced' economies – but 'underlying' inflation is now back in the 2-3% target range

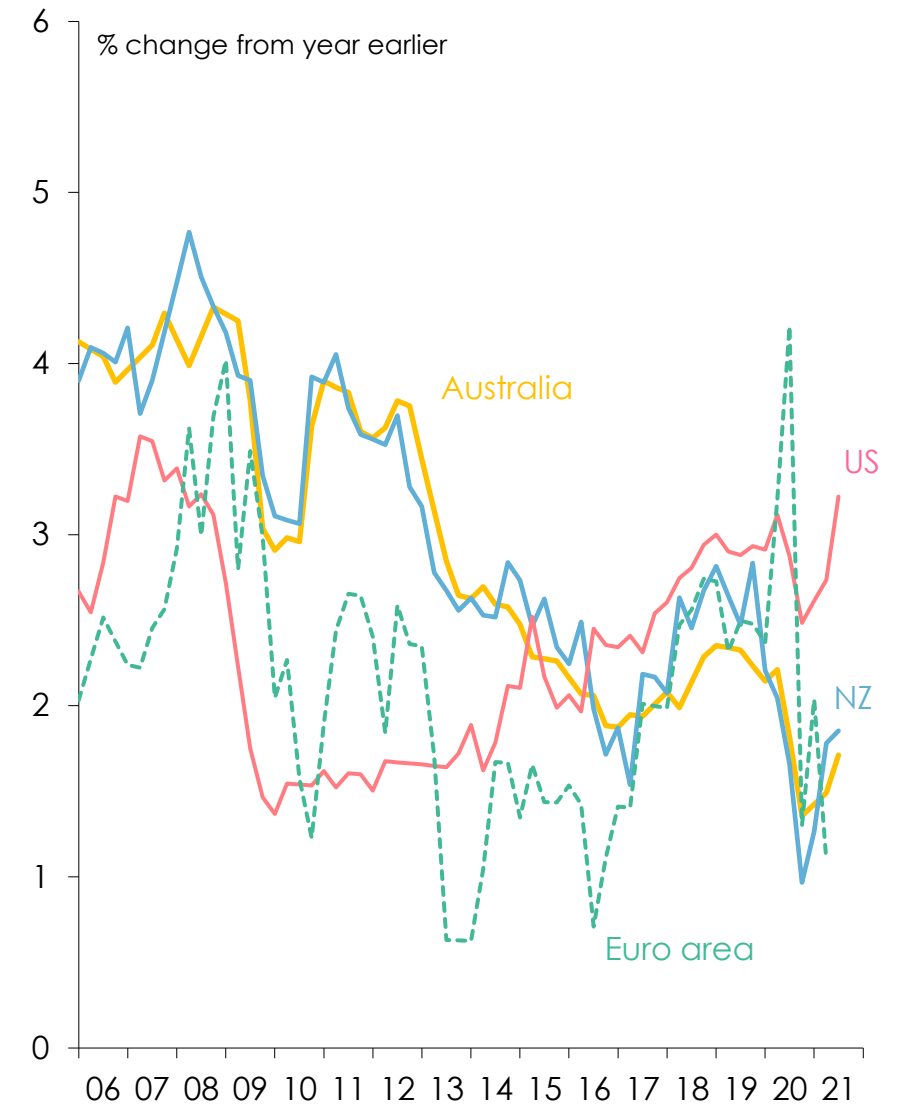
Producer prices



'Underlying' consumer prices



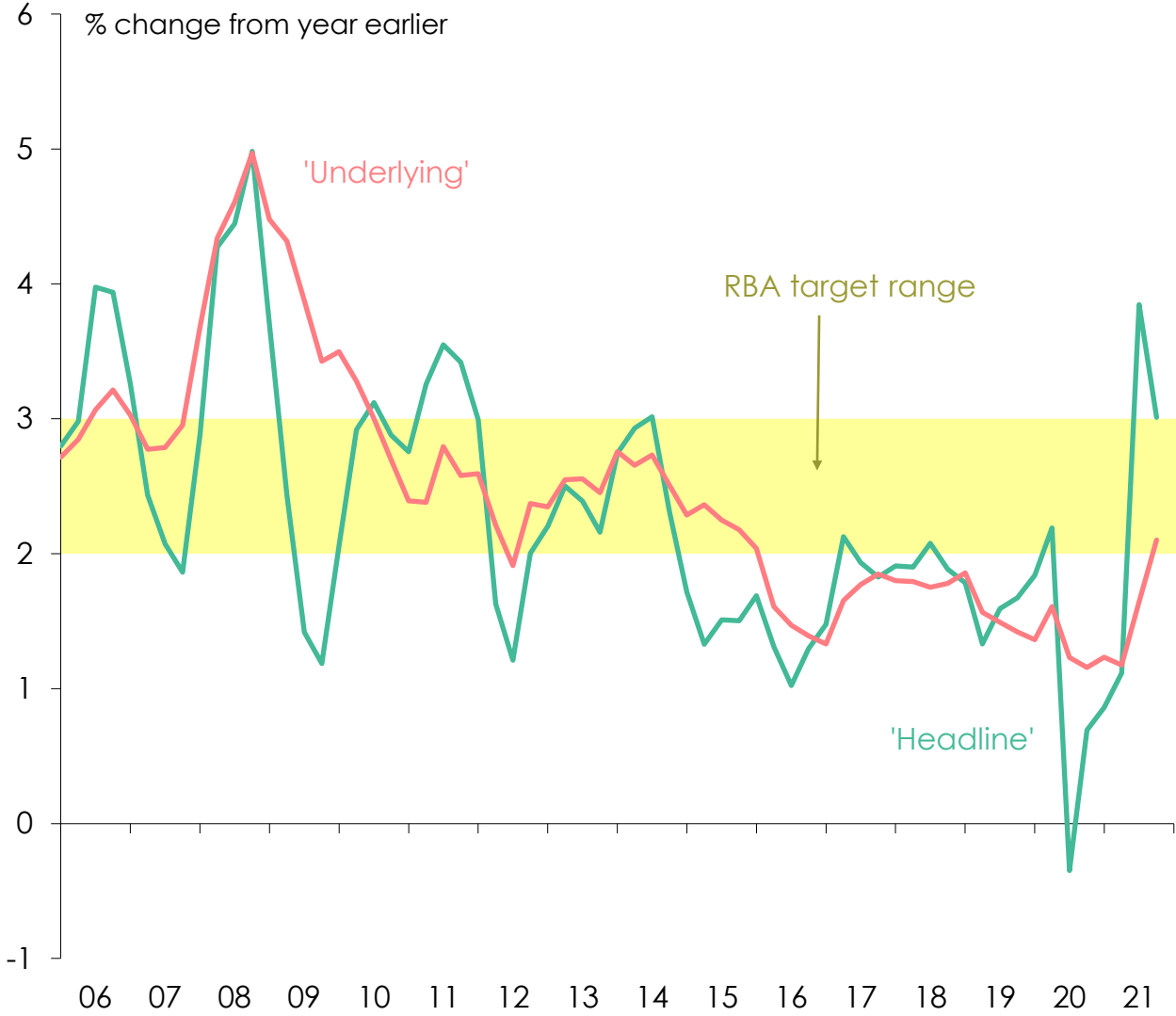
Wage costs



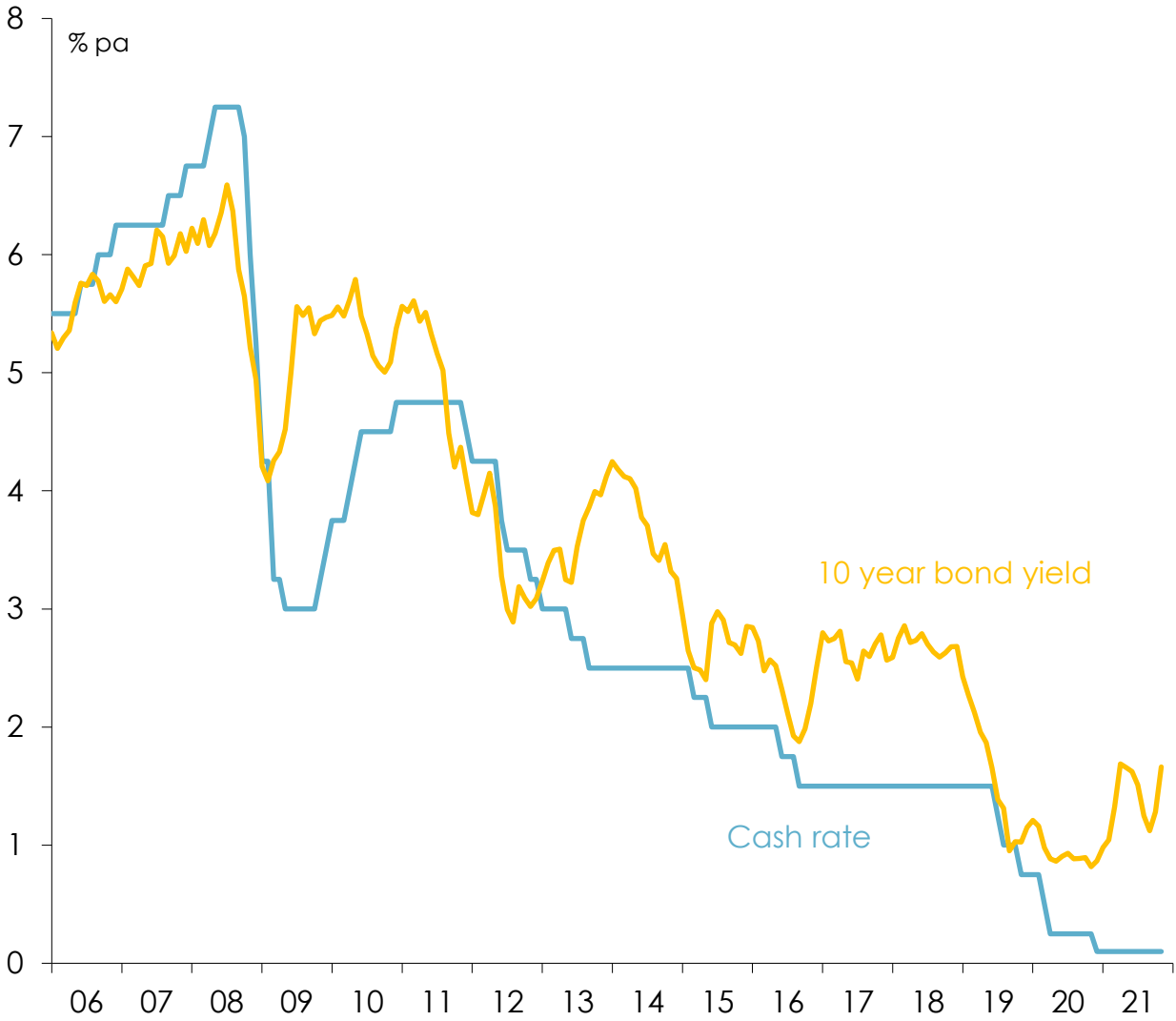
Note: 'Underlying' consumer prices are, for Australia, the trimmed mean; for New Zealand, the RBNZ's 'sectoral factor model'; and for the US, euro zone and Canada, the CPI excluding food and energy. Sources: [ABS](#); [Statistics NZ](#); [US Bureau of Labor Statistics](#); [Eurostat](#); [Statistics Canada](#).

'Underlying' inflation may be 'sustainably' back in the RBA's 2-3% target range before 2024: in which case interest rates might starting rising in 2023

Consumer prices



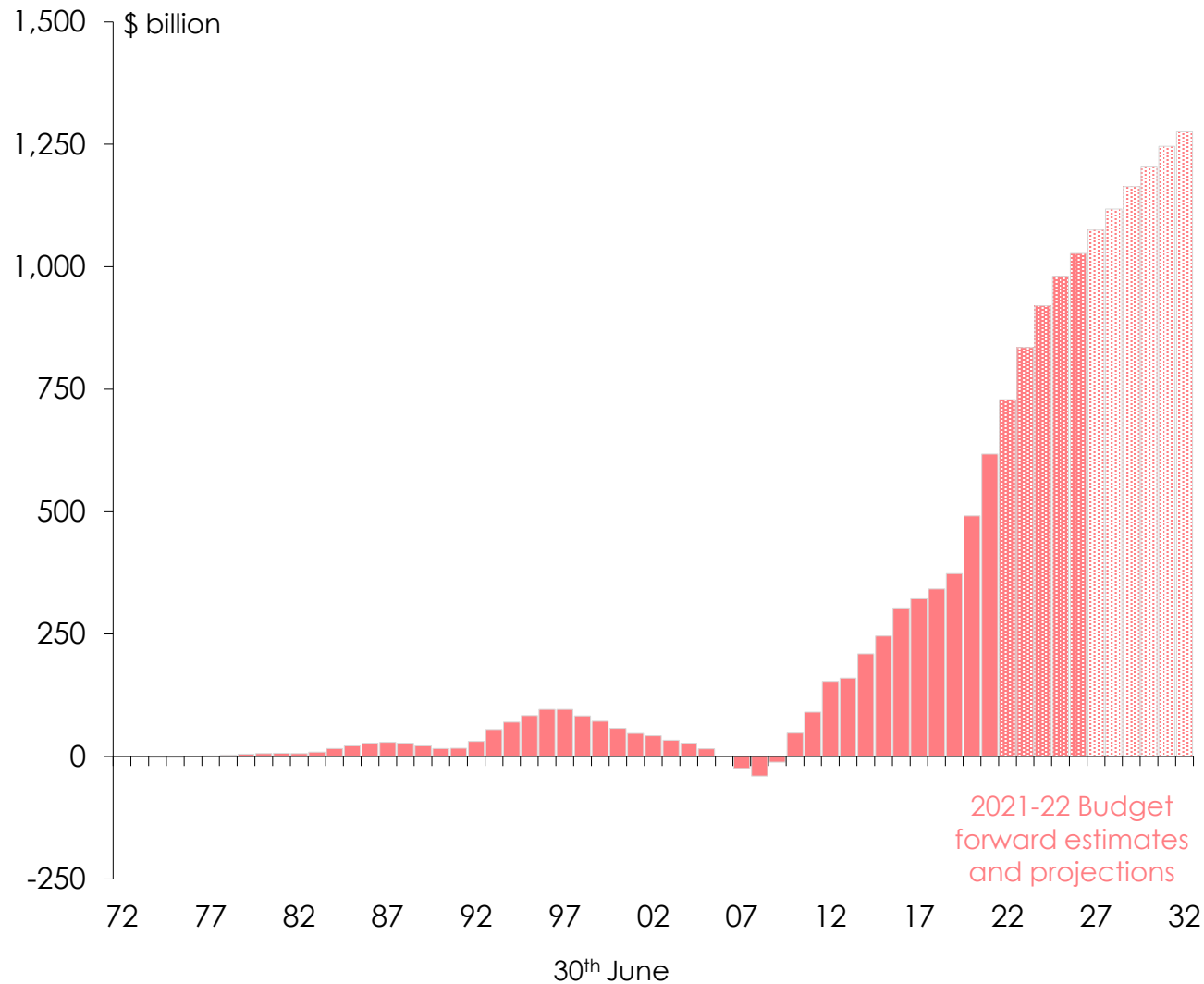
Interest rates



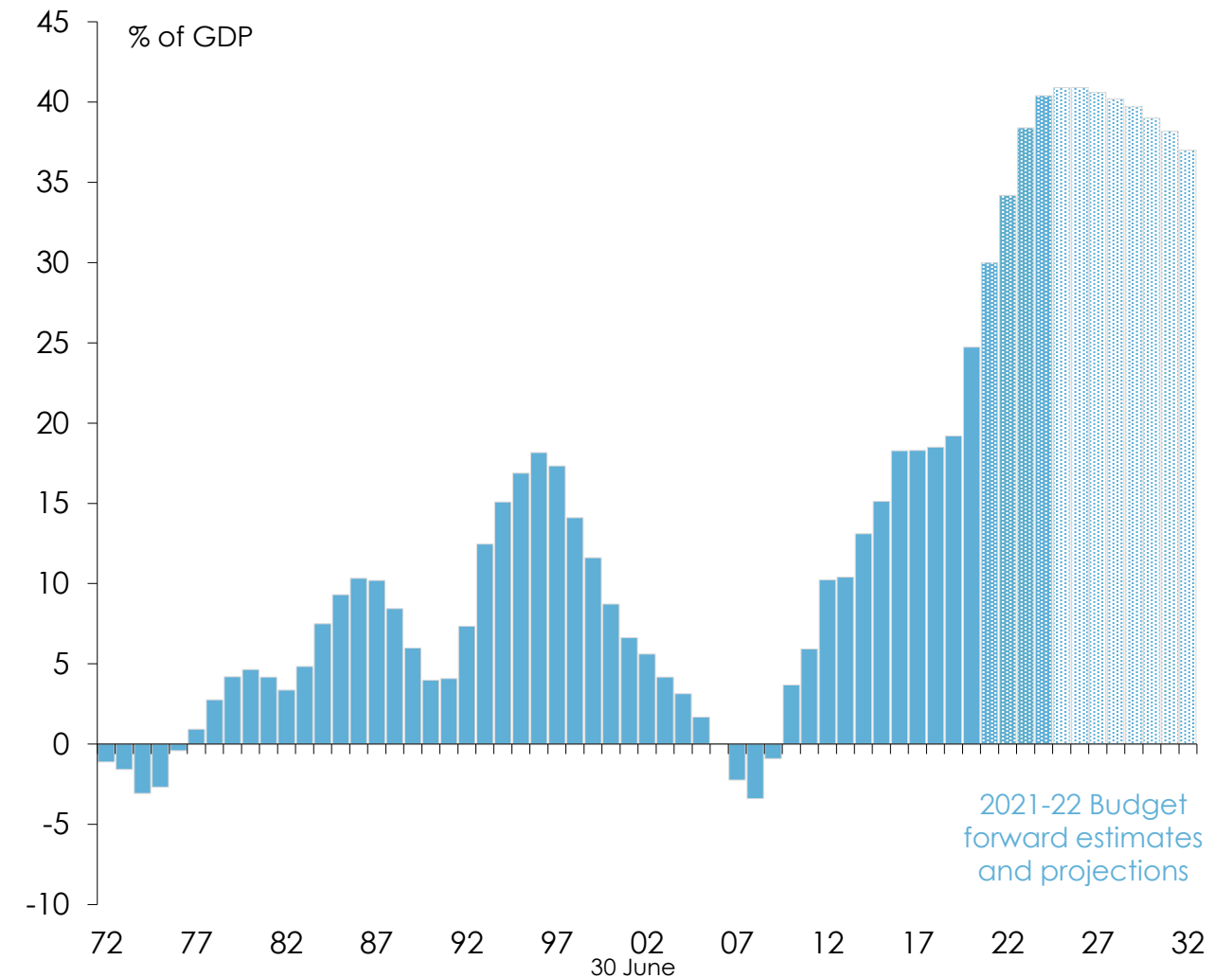
Note: 'Underlying' inflation is the average of the weighted median and trimmed mean CPIs. Sources: ABS, [Consumer Price Index, Australia](#); Reserve Bank of Australia, [Statistical Tables F1 and F2](#).

The Australian Government does now have a lot of debt, by historical standards

Commonwealth Government net debt



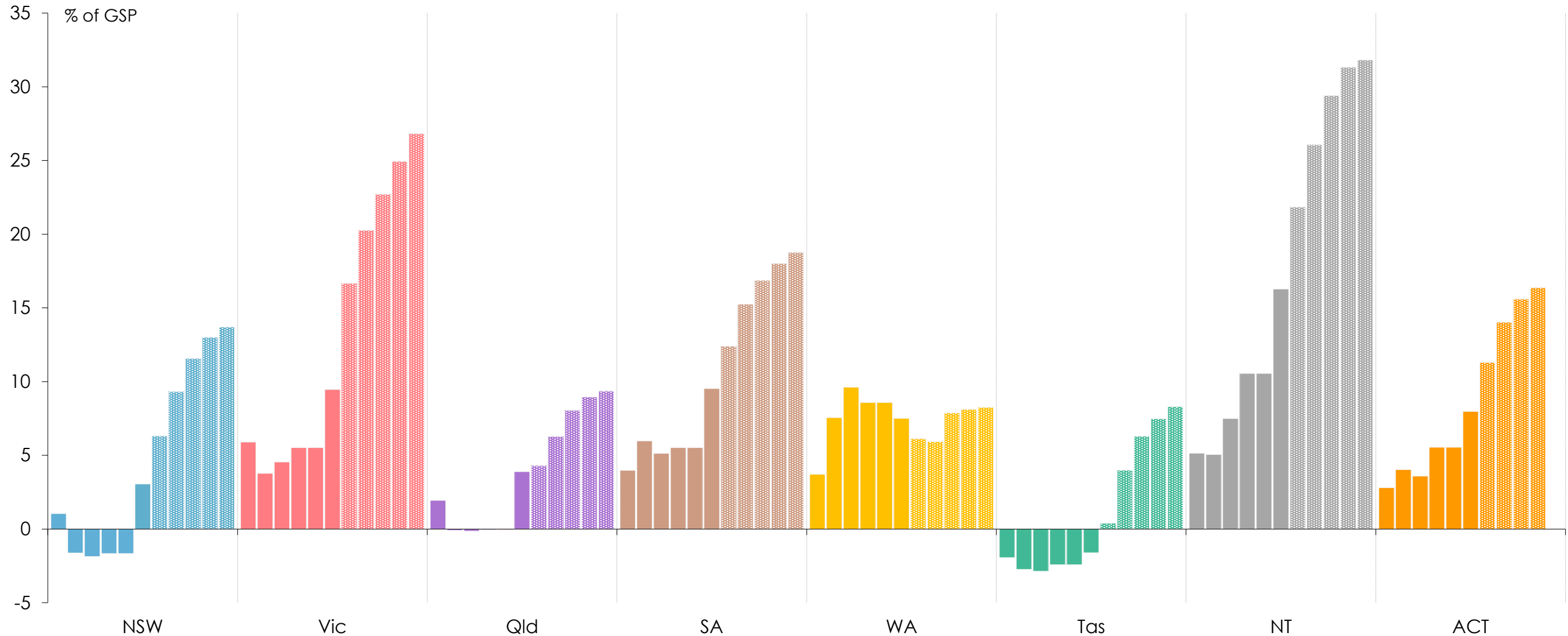
Net debt as a percentage of GDP



Note: 'Net debt' is the interest-bearing liabilities (mainly government bonds) less the sum of selected financial assets (cash and deposits, advances paid and investments, loans and placements). Source: Australian Government, [2021-22 Budget Paper No. 1 - Budget Strategy and Outlook - Statement 11](#).

So do most state and territory governments – especially Victoria and the Northern Territory

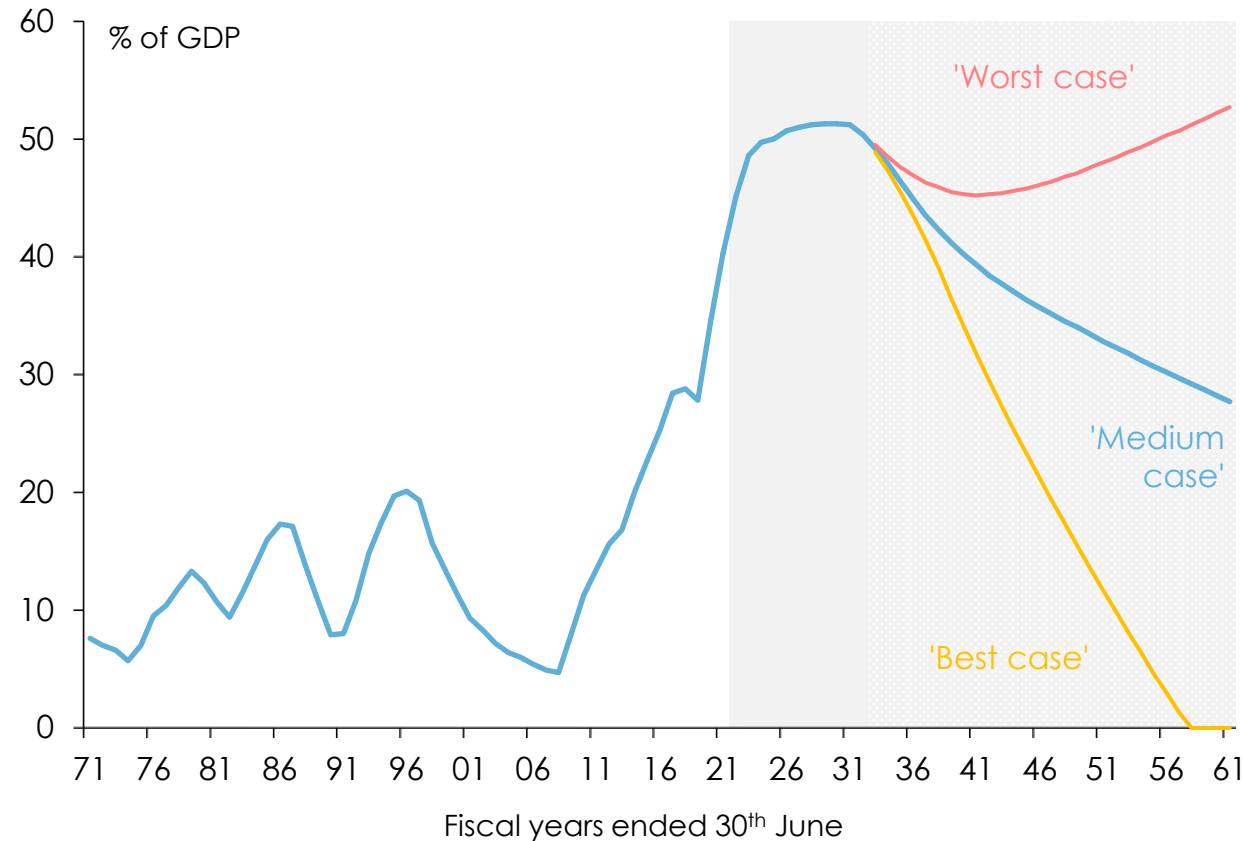
State and Territory Government net debt, 2014-15 to 2024-25



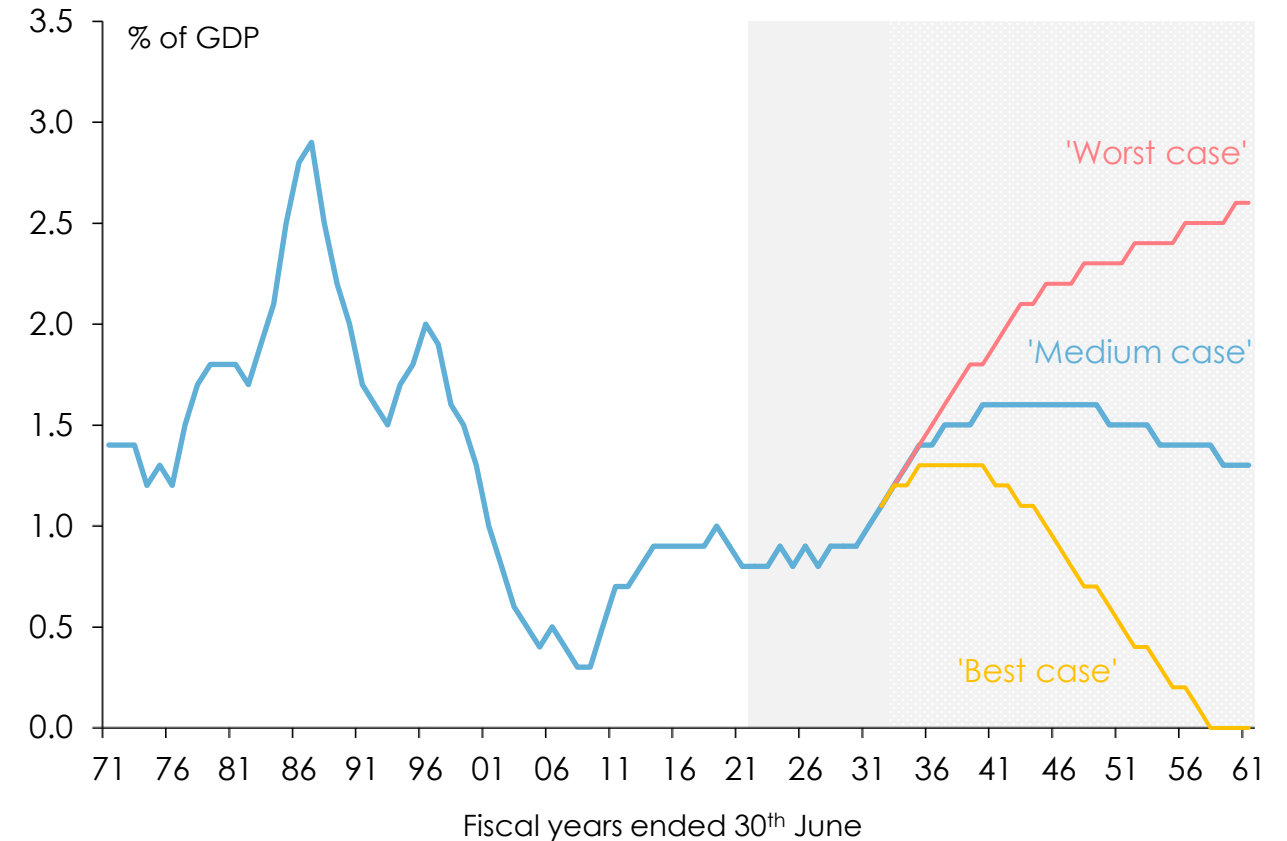
Note: 'Net debt' includes the debt of state and territory public non-financial enterprises (GBEs). Sources: State and Territory Budget Papers.

Analysis by the Parliamentary Budget Office suggests the debt which the Government has incurred is sustainable under a wide range of scenarios

PBO projections of Commonwealth Government gross debt



PBO projections of Commonwealth Government interest payments

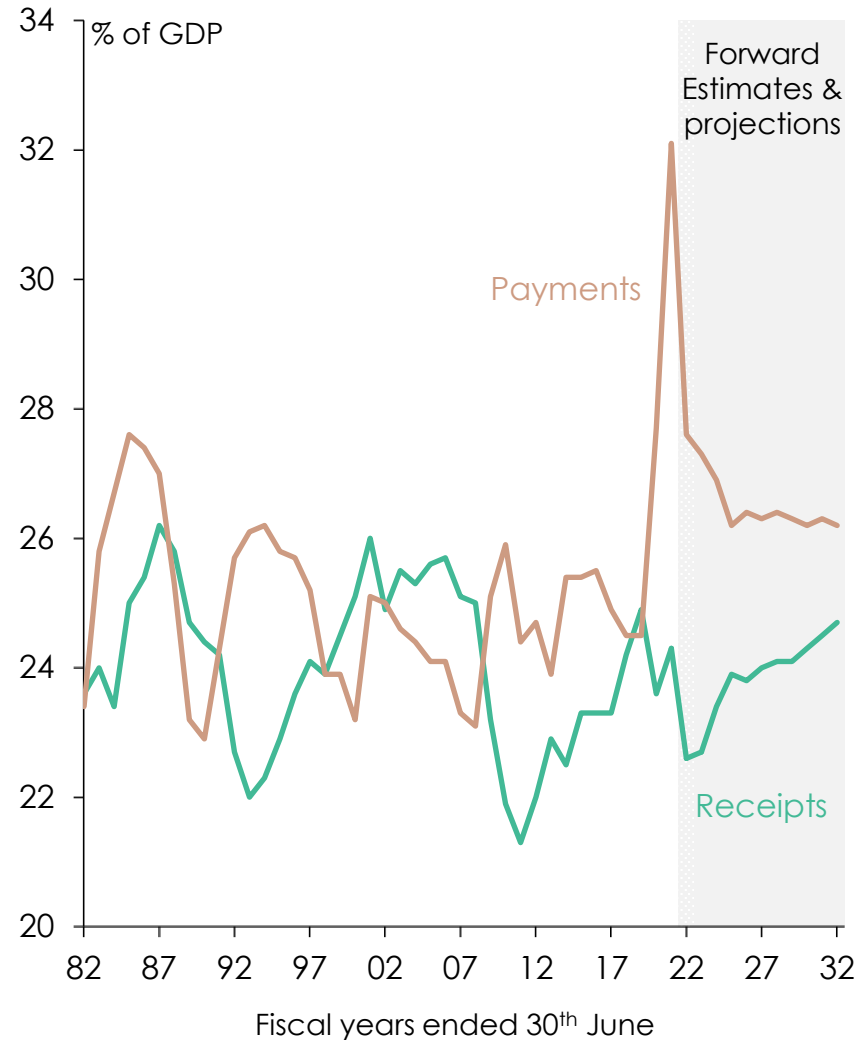


- ❑ The PBO derived projections of gross debt and interest payments over the next 40 years based on 27 combinations of different assumptions about economic growth, interest rates and the budget balance
- ❑ Under all of these scenarios (even the 'worst case'), both total debt and debt-servicing costs remain within the bounds of historical experience

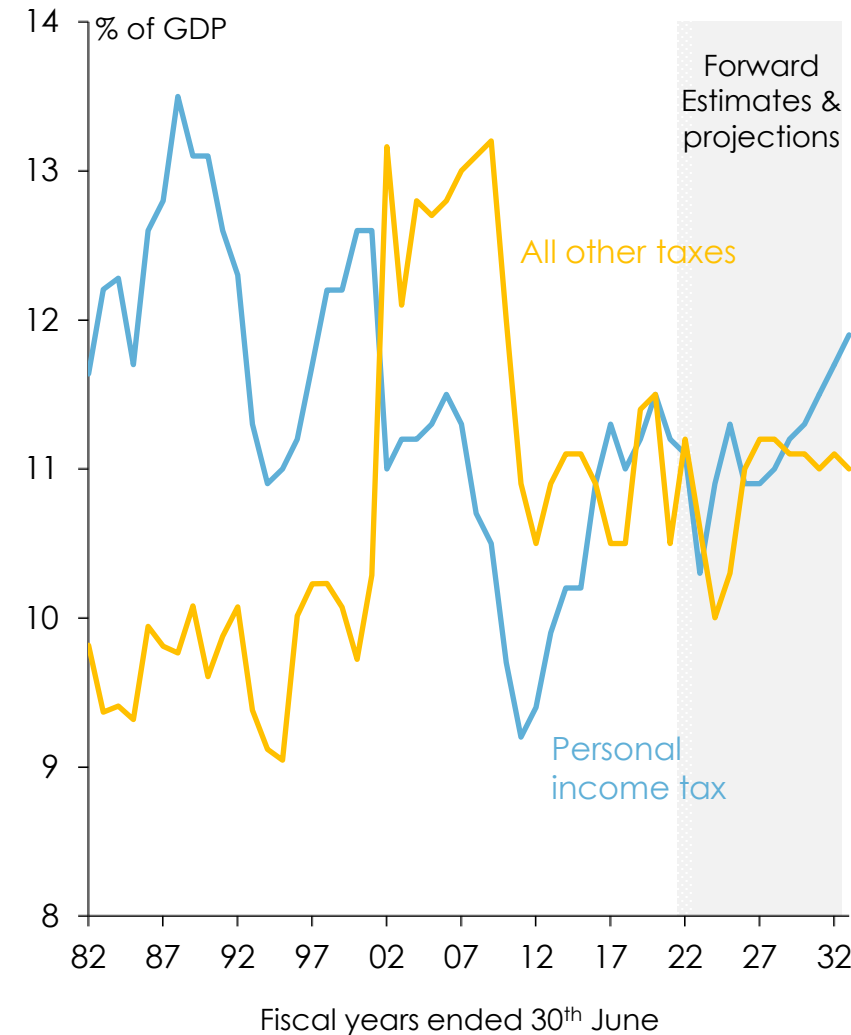
Source: Parliamentary Budget Office, [Beyond the Budget: Fiscal outlook and scenarios](#), 21st September 2021.

Australia's problem is that the Government will be relying solely on rising personal income tax collections to keep the deficit on a declining path

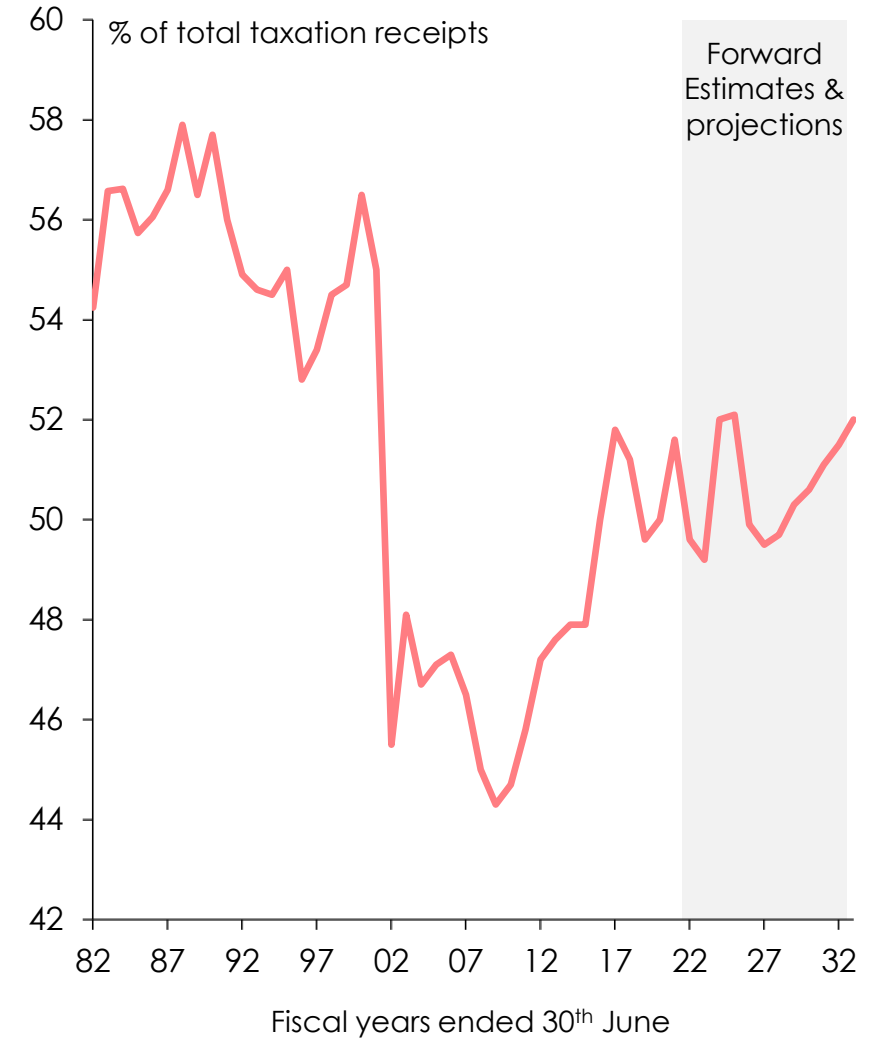
Commonwealth Government receipts and payments



Personal income tax and other tax receipts as pc of GDP

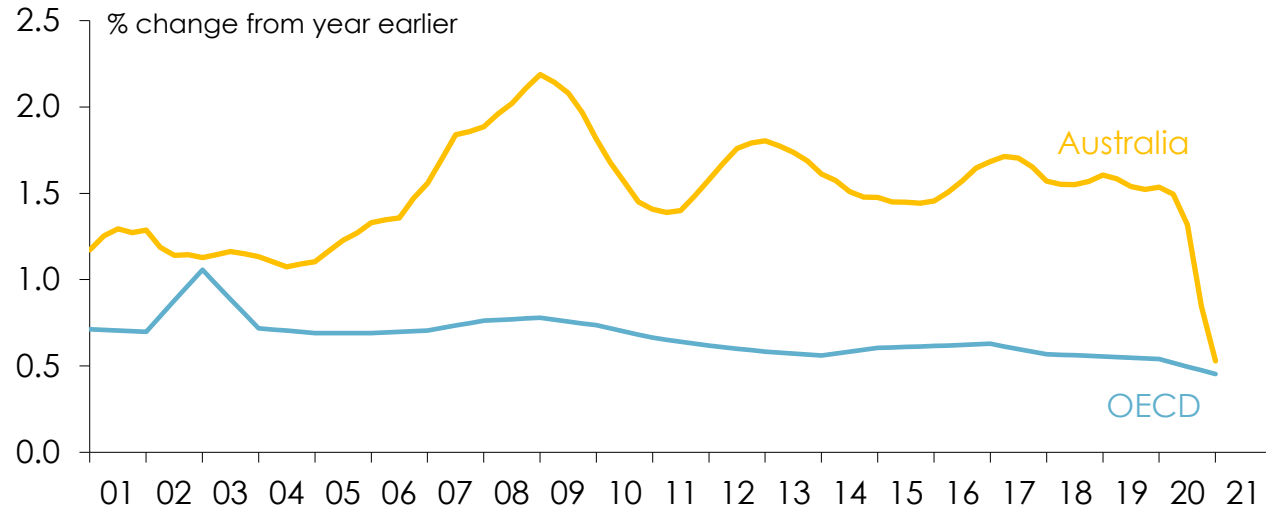


Personal income tax receipts as a pc of total tax receipts

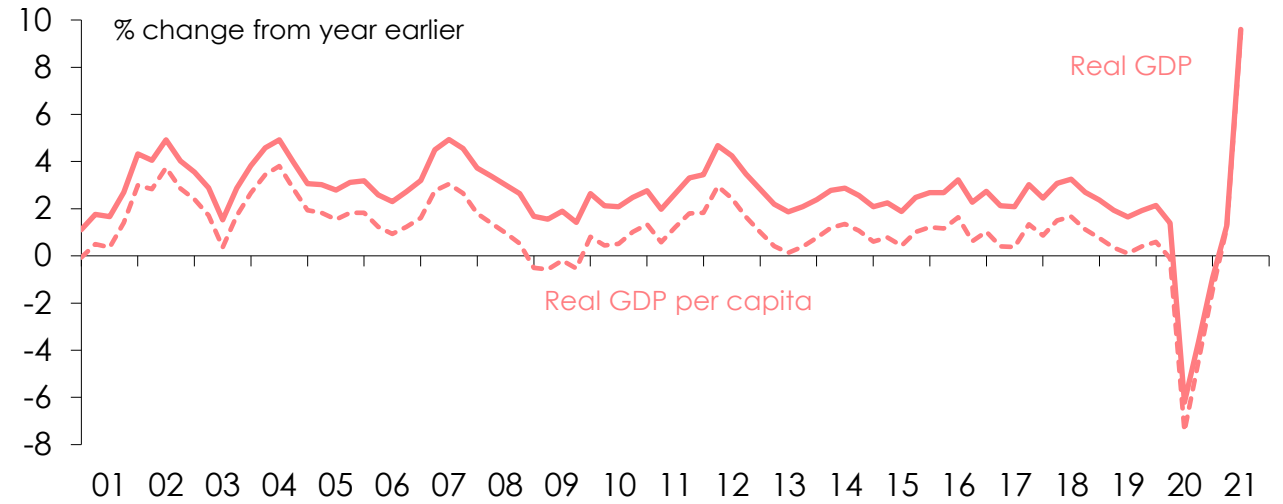


Australia's above-average economic growth over the past 20 years owes a lot to above-average population growth: that's now changed

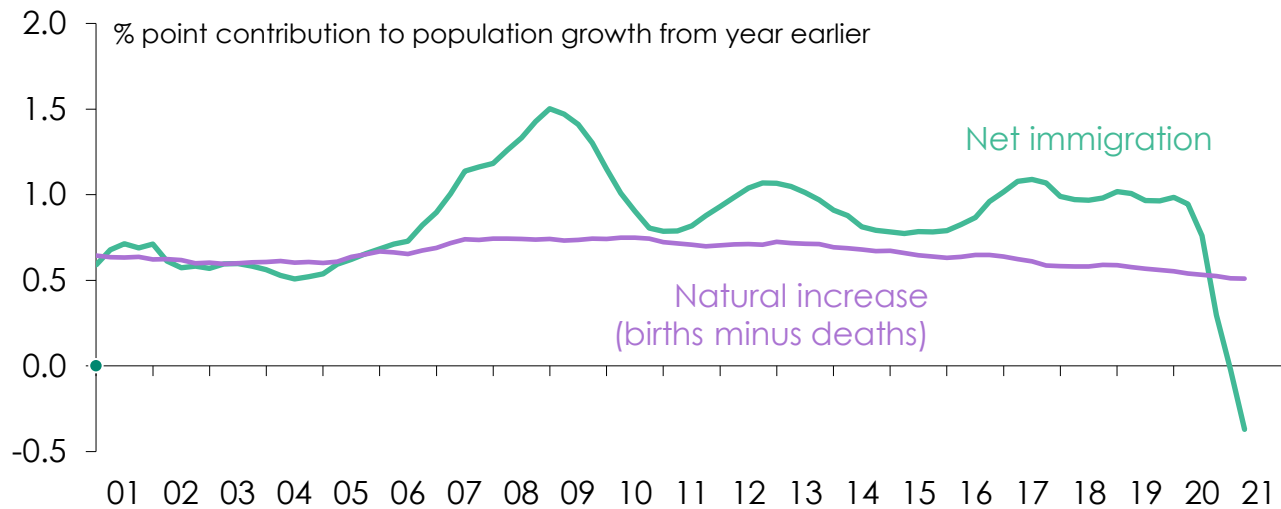
Australia and OECD population growth



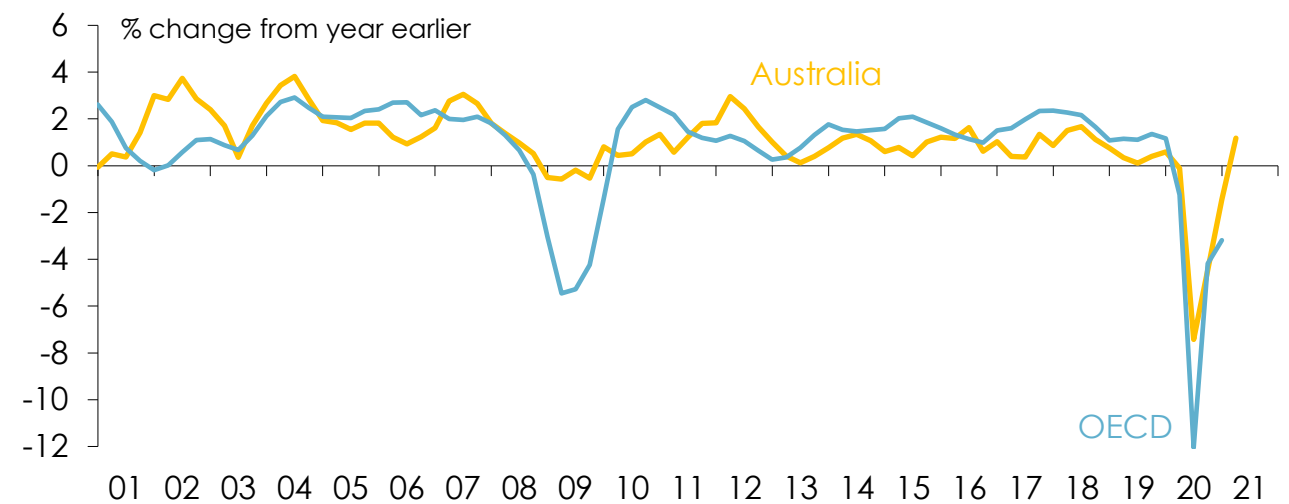
Australian GDP and per capita GDP growth



Sources of Australia's population growth

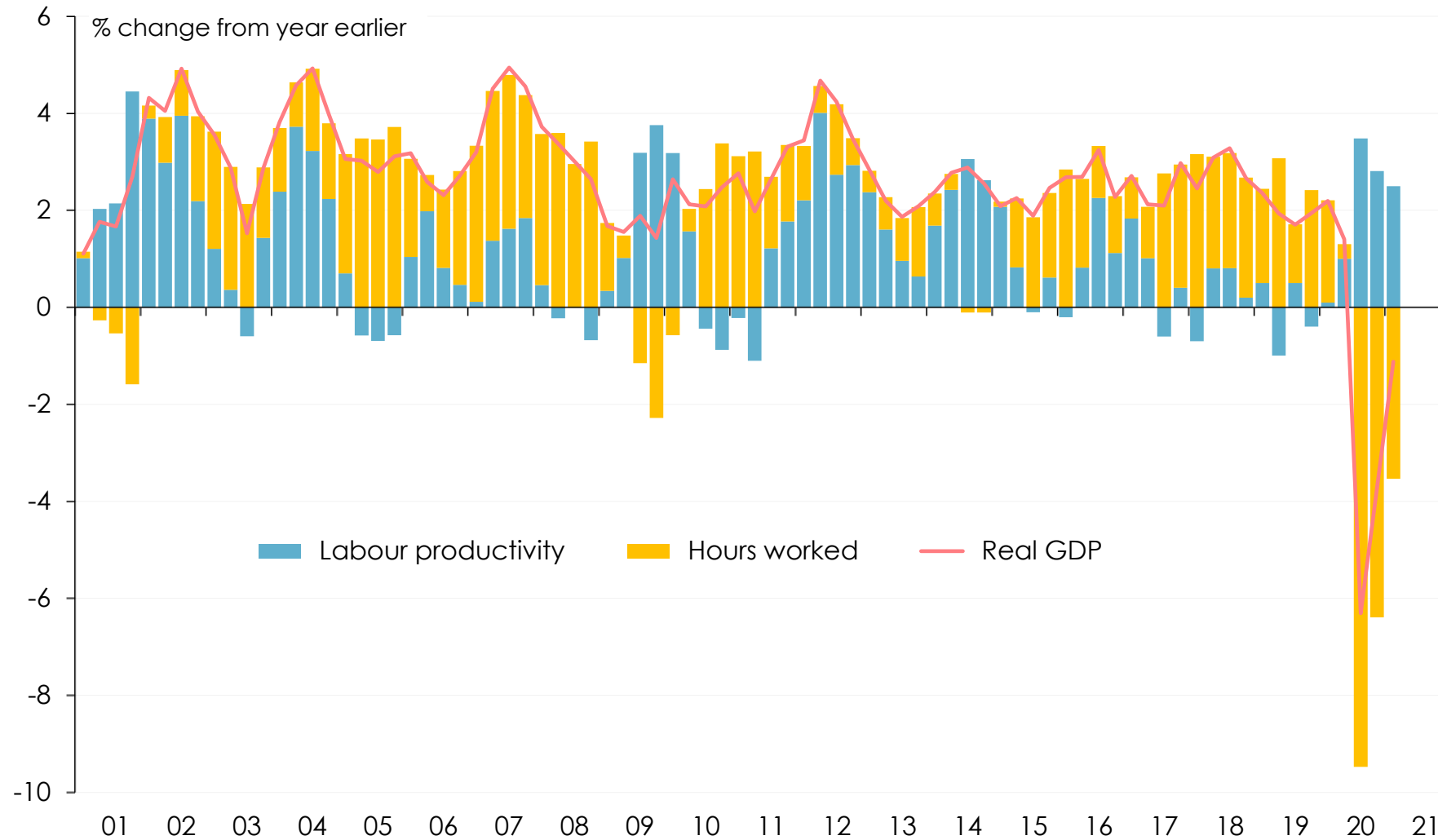


Australia and OECD per capita real GDP growth



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

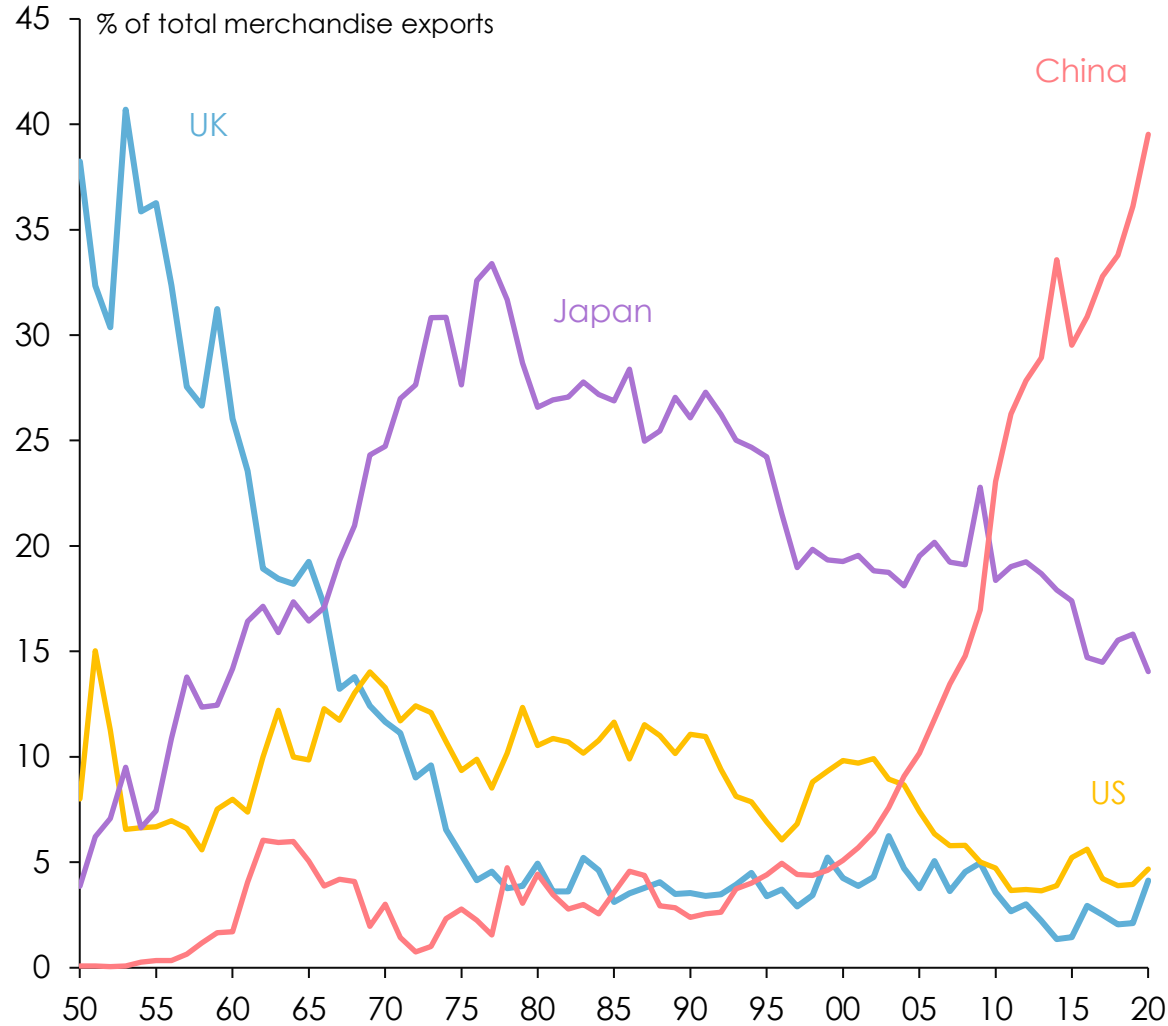
Labour input and labour productivity contributions to Australian real GDP growth



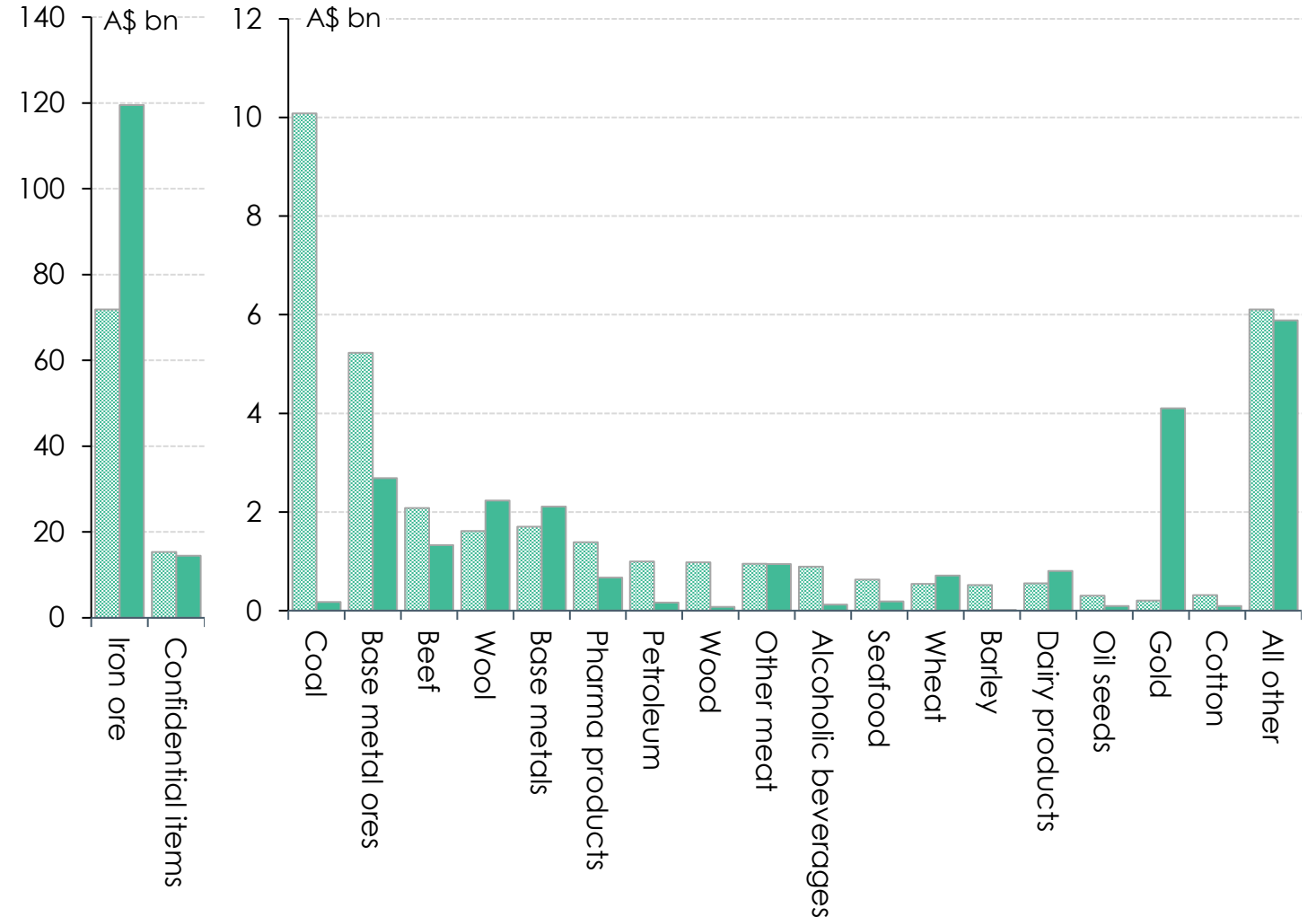
- ❑ Over the five years between the end of the 'mining boom' and the onset of the Covid-19 pandemic, 72% of Australia's real GDP growth came from increased labour input, and only 28% from labour productivity growth
- ❑ By contrast, between the end of the early 1990s recession and the onset of the global financial crisis, 46% of Australia's real GDP growth came from increased labour input and 54% from productivity growth

Australia is now more dependent on China as a market than we have been on any one country since the 1950s – and that's now not such a Good Thing

Australia's major export markets, 1950-2020



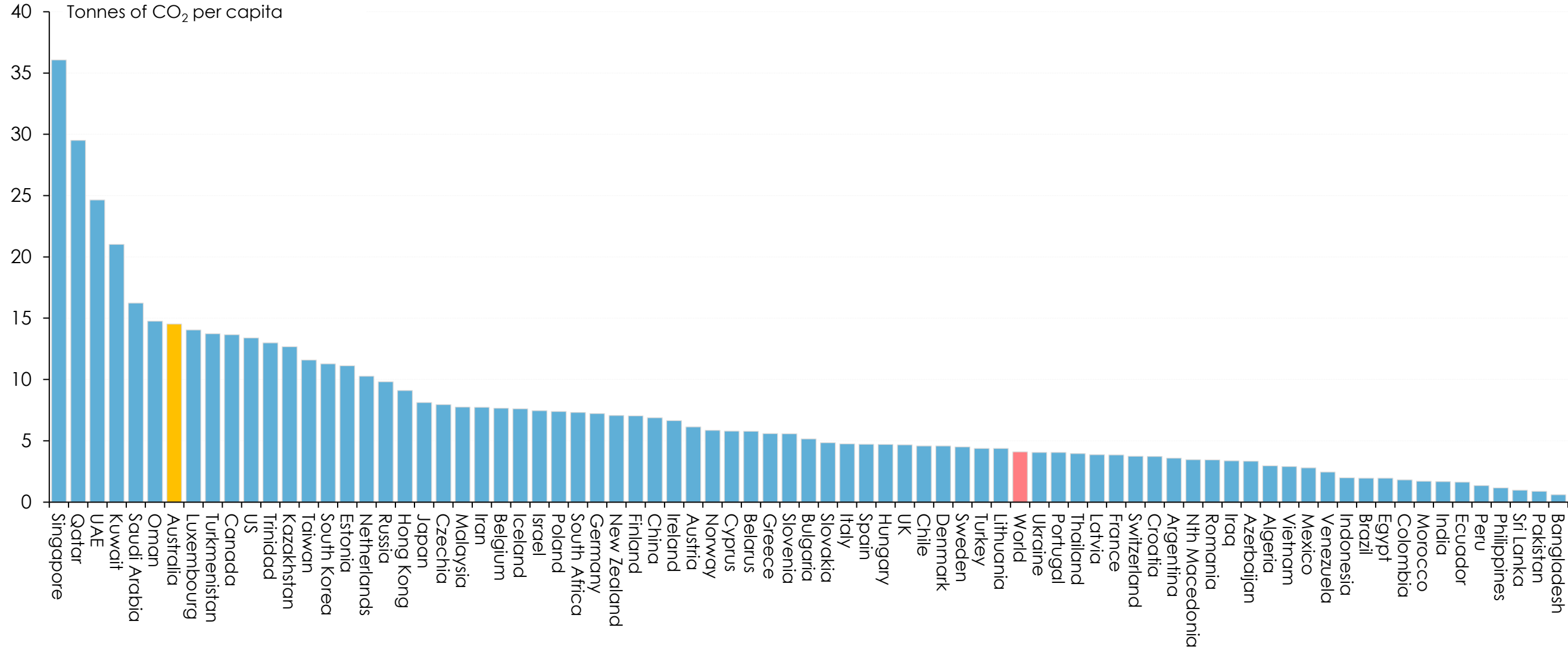
Australian exports to China, ten months to August 2021 compared with ten months to August 2020



Note: 'confidential items' includes, in particular, LNG. Sources: Australian Department of Foreign Affairs and Trade, [Historical trade and economic data](#) and [Trade Statistical Pivot Tables - Country and commodity pivot table monthly](#).

Australia risks being seen as a 'climate change pariah' with potentially adverse consequences for our trade

CO₂ emissions per capita, 2020



Sources: BP, [Statistical Review of World Energy 2021](#).

So, summing up the situation and outlook for Australia

- ❑ **Australia has had a (short and sharp) second recession during the September quarter**
 - but there should also be a strong rebound in the December quarter as NSW, the ACT and Victoria come out of lockdown
 - with the only dampening influences being that people may remain a bit more cautious than after last year's lockdowns because they know Covid will be circulating in the community; and because some spending will be done overseas
- ❑ **Employment should 'snap back' quite quickly as NSW, the ACT and Victoria emerge from lockdowns**
 - given the large number of job vacancies and the lack of competition for jobs from migrants
 - the unemployment rate could fall quite quickly especially if the Government delays re-starting immigration
- ❑ **Households' capacity to spend will be supported by the build-up in savings and increases in wealth which have accrued (contrary to initial expectations) over the past 18 months**
 - although there is some uncertainty around the distribution of those savings and wealth gains across different households
- ❑ **Australia so far isn't seeing nearly as much inflationary pressure as other 'advanced' economies**
 - and the RBA has a less demanding inflation target than most other 'advanced' economy central banks
 - so it is under as much pressure to raise interest rates as central banks in some other economies
- ❑ **The RBA will probably end up starting to raise interest rates in the second quarter of 2023**
 - most mortgage borrowers are reasonably well placed to cope with (modestly) higher interest rates, but some will struggle
 - there will also likely be an increase in small business insolvencies as cash resources are exhausted
- ❑ **There has to be a federal election some time before late May next year – most likely in early March**
- ❑ **Fiscal policy is likely to be tightened after the election – a fair bit of tightening will occur 'automatically'**
- ❑ **The Australian economy will likely face some 'headwinds' from slowing growth in China (as well as on-going difficulties in the political relationship), and potentially from being seen as a climate change 'pariah'**

Important information

This document has been prepared by Saul Eslake on behalf of Corinna Economic Advisory Pty Ltd, ABN 165 668 058 69, whose registered office is located at Level 11, 114 William Street, Melbourne, Victoria 3000 Australia.

Corinna Economic Advisory is a partner (with Llewellyn Consulting, of 1 St Andrews Hill, London EC4V 5BY, United Kingdom) in Independent Economics.

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