

Summary:

- **The Australian economy bounced strongly towards the end of last year;**
- **And there are good signs ahead for this year;**
- **Further Government and RBA assistance will be required. And it will be delivered;**
- **Increasing population and productivity growth will be important in coming years.**

The Australian economy was a lot stronger than expected in the December quarter. And a lot better than what most other economies have managed to deliver. The impact of the virus did not impact the economy evenly. Some industries struggled. Some did well.

If the virus news remains good so should the economic news. Home builder order books are bulging. There will be plenty of infrastructure work to be done in coming years. Tax incentives have led to many firms buying equipment. Export prices are high, helped by booming demand for commodities (notably iron ore). A growing number of firms are finding it tough to find skilled labour.

The big unknown is how much of the 'saving mountain' that households have built up over the past year will be spent. Consumers are spending more. But they have yet to indicate they are about to embark on a spending binge.

Government economic response has had three stages. The first was to support household and business incomes during the big economic hit. This was an unqualified success. Household incomes rose at their strongest pace in years at the same time as overall national income fell.

The second stage is to support a return to decent economic growth. The gathering economic momentum means most of the economy should be able to cope with a step-down in government income support. Some sectors of the economy are continuing to find the going tough. They are likely to require further support.

Stage three is to focus on how to boost long-term growth. Population growth was one of the few things pushing the economy forward and that has slowed to virtually a standstill. A return to the pre-COVID pace of population growth will therefore be important. But the big prize is what Governments can do to boost productivity growth. Firms are doing their bit by increasing their spending on digitisation.

Australia did Ok

The Australian economy was a lot stronger than expected in the December quarter. A key reason was that Victoria was again open for business (where domestic demand was up almost a whopping 7%). The bounce of over 3% in the quarter meant that the economy 'only' fell a bit over 1% for the year. Not good. But a lot better than what had been forecast just a few months earlier. And a lot better than what most other economies have managed to deliver.

Business and household incomes fell reflecting the ratcheting down of JobKeeper and JobSeeker support, as well as the modest pace of wages growth. But households were happy to spend, with more shops open and having squirrelled away plenty of nuts for a rainy day.

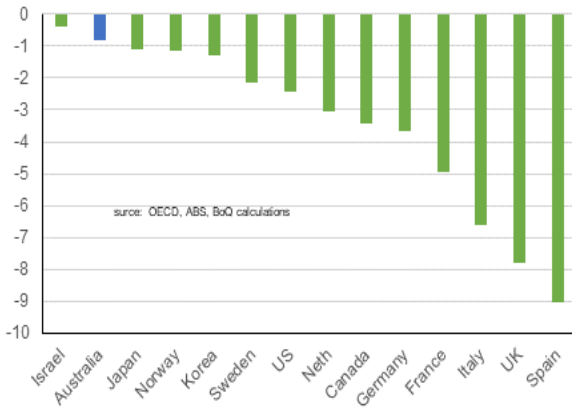
ECONOMIC UPDATE

PETER MUNCKTON – CHIEF ECONOMIST
WEEK ENDING 12TH MARCH 2021



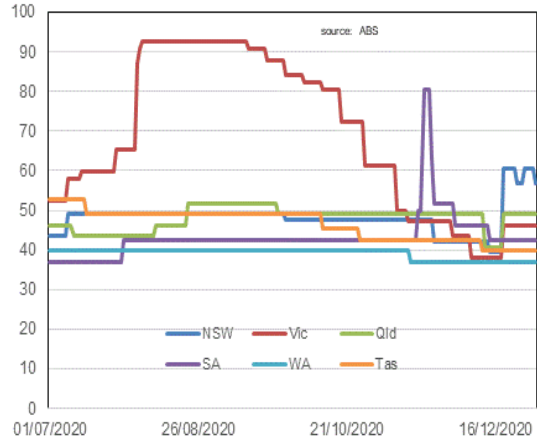
Australia had a tough economic year. Most other countries had it tougher.

Selected OCED country Q4 GDP growth (annual % change)



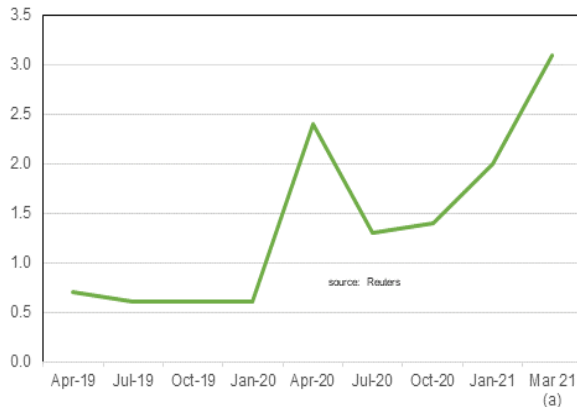
Government policy in Victoria notably impacted economic performance last year.

State COVID stringency Index



GDP growth in Q4 turned out to be a lot stronger than has been forecast.

Q4 2020 GDP forecasts (annual % change)



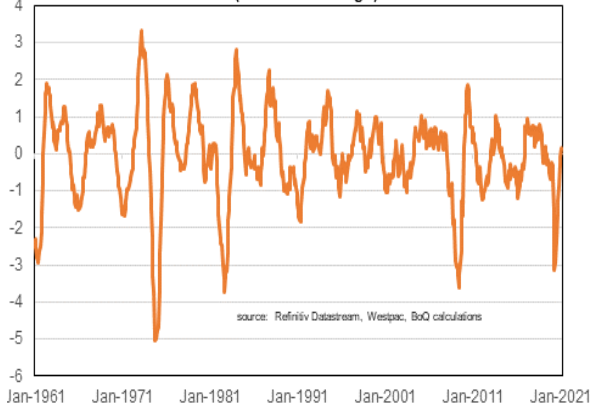
Less households are looking to pay down debt.

Proportion of households use savings to repay debt



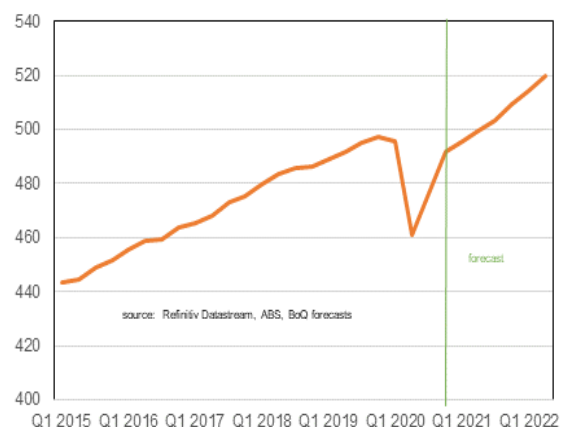
The forward economic indicators are looking increasingly positive.

Leading economic indicator for Australia (annual % change)



It certainly looks like a 'V'.

Australia GDP (quarterly levels, \$Ab)



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The impact of the virus did not impact the economy evenly. Transport (particularly Air Travel), Arts and Recreation and Accommodation and Food Services all had tough years. JobKeeper (and other income support programs) helped. But there is only so much that can be done if no one wants to (or can) catch a plane or stay in a hotel.

But not all sectors struggled. Better weather and few COVID problems means that most farmers had a bumper 2020. Consumers stuck at home and not being able to go to the movies meant that they had plenty of cash that could go the way of wholesalers and retailers. There was plenty of work for the Government to do.

The health sector did grow over the year. But at a rate well under its usual pace with COVID making patients reluctant to get stuck in waiting rooms. Iron ore mining had a good 2020 powered by strong demand from China. But its economic contribution was down in Q4 due to weather disruptions. The coal sector faced challenges from falling global demand (including from China).

Australian sector economic performance in 2020

(annual % change)

Very weak	Weak
Air Transport (-87%)	Computer Services (-4%)
Rail Transport (-19%)	Oil and gas (-4)
Admin Services (-14%)	Property Services (-4%)
Accom and Food Services (-13%)	Water (-4%)
Transport Services (-13%)	Rental Services (-3%)
Coal (-12%)	Electricity (-3%)
Arts and Recreation (-8%)	Building construction (-2%)
Construction Services (-8%)	Heavy construction (-1%)
Other Services (-7%)	Mining Exploration (0%)
Chemical Manufacturing (-6%)	Machinery manufacturing (0%)
Food Manufacturing (-6%)	
Modest	Strong
Other IT/media 2%	Agriculture (22%)
Health (2%)	Forestry/fishing (8%)
Iron Ore (2%)	Retail trade (6%)
Telco Services 2%	Government (6%)
Other Finance 1%	Gas (5%)
Education (1%)	Road transport (5%)
Other mining (1%)	Wholesale Trade 4%
Other manufacturing (0%)	Metal manufacturing (4%)
	Other professional services (4%)
	Finance (4%)

The outlook is increasingly encouraging

Most economic downturns are caused by economic factors (such as interest rates or debt being too high). This was an unusual economic recession (caused by a significant health problem) that required unusual Government responses. Historically Governments have limited people movement between countries, regions or even cities to reduce the spread of a pandemic. The unusual response this time is that technology has allowed (particularly in developed countries) the implementation of 'lockdowns' to limit people movement within cities.

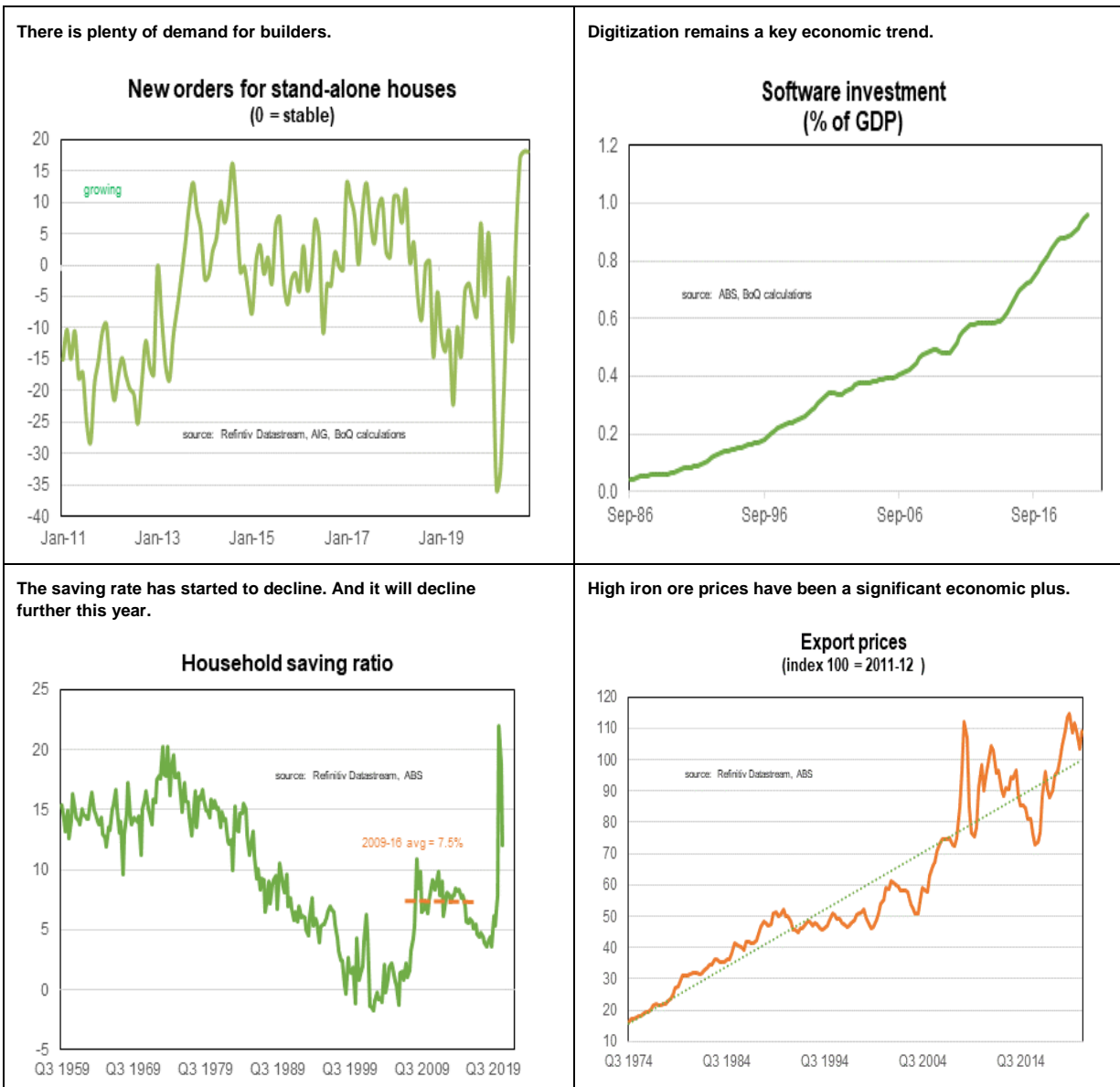
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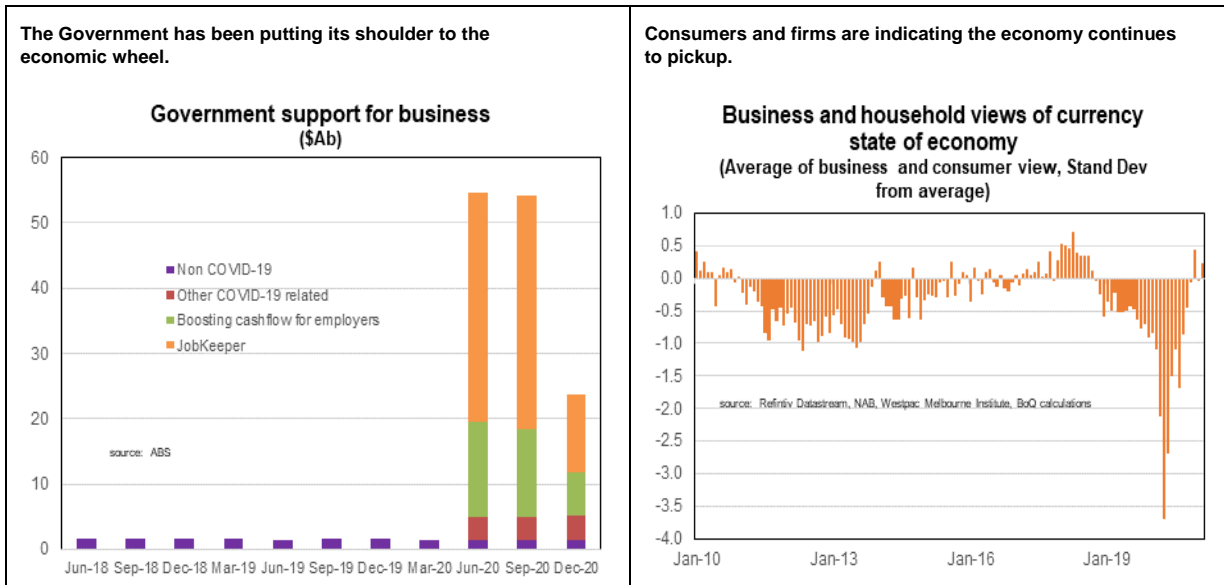
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Even without Government-mandated restrictions economic growth would have been weak. Fear of the virus would have limited people movement and made them less likely to spend. And why the vaccine is a game-changer. Restrictions though will remain in place for a while, at least until a large proportion of the domestic and global population gains immunity. And after the size of the scare that we have had consumer and business confidence might take a while to fully recover.

If the virus news remains good so should the economic news. Home builder order books are bulging. There will be plenty of infrastructure work to be done in coming years. Tax incentives has led to many firms buying equipment. Export prices are high, helped by booming demand for commodities (notably iron ore). The index of leading economic indicators is pointing northward. A growing number of firms are finding it tough to get the find skilled labour.

The big unknown is how much of the 'saving mountain' that households have built up over the past year will be spent. Certainly households are now saving less (helped by the fact they can go out and buy a coffee). And low interest rates means they feel less inclined to pay down debt. Saving rates will almost certainly decline further this year. Consumers though are not yet indicating they are ready to go on a spending binge.





Government actions

In addition to the health responses Government actions have been an important reason for the (relatively) strong performance of the Australian economy. The response has had three stages. The first was to support household and business incomes during the big economic hit. They did this through JobKeeper and enhanced JobSeeker, minimising tax payments, providing rent and interest rate holidays (in agreement with banks and landlords) and putting the insolvency regime on ice.

Stage one was an unqualified success. Household incomes rose at their strongest pace in years at the same time as overall national income fell. The rise in the unemployment rate has been well below that expected by most forecasters.

The second stage is to support a return to decent economic growth. The federal and all the state governments put in place programs to boost economic growth in their most recent budgets. These include HomeBuilder, tax incentives to invest (and employ) and bigger infrastructure plans. The economic benefits will be partially offset by a reduction of income support programs (end of JobKeeper, scaled down JobSeeker, end of interest rate and rent payment holidays).

The gathering economic momentum means most of the economy should be able to cope with a step-down in government income support. But some sectors of the economy are continuing to find the going tough (such as the accommodation sector in Cairns). They are likely to require further government support (particularly while restrictions remain in place). And they are likely to get it.

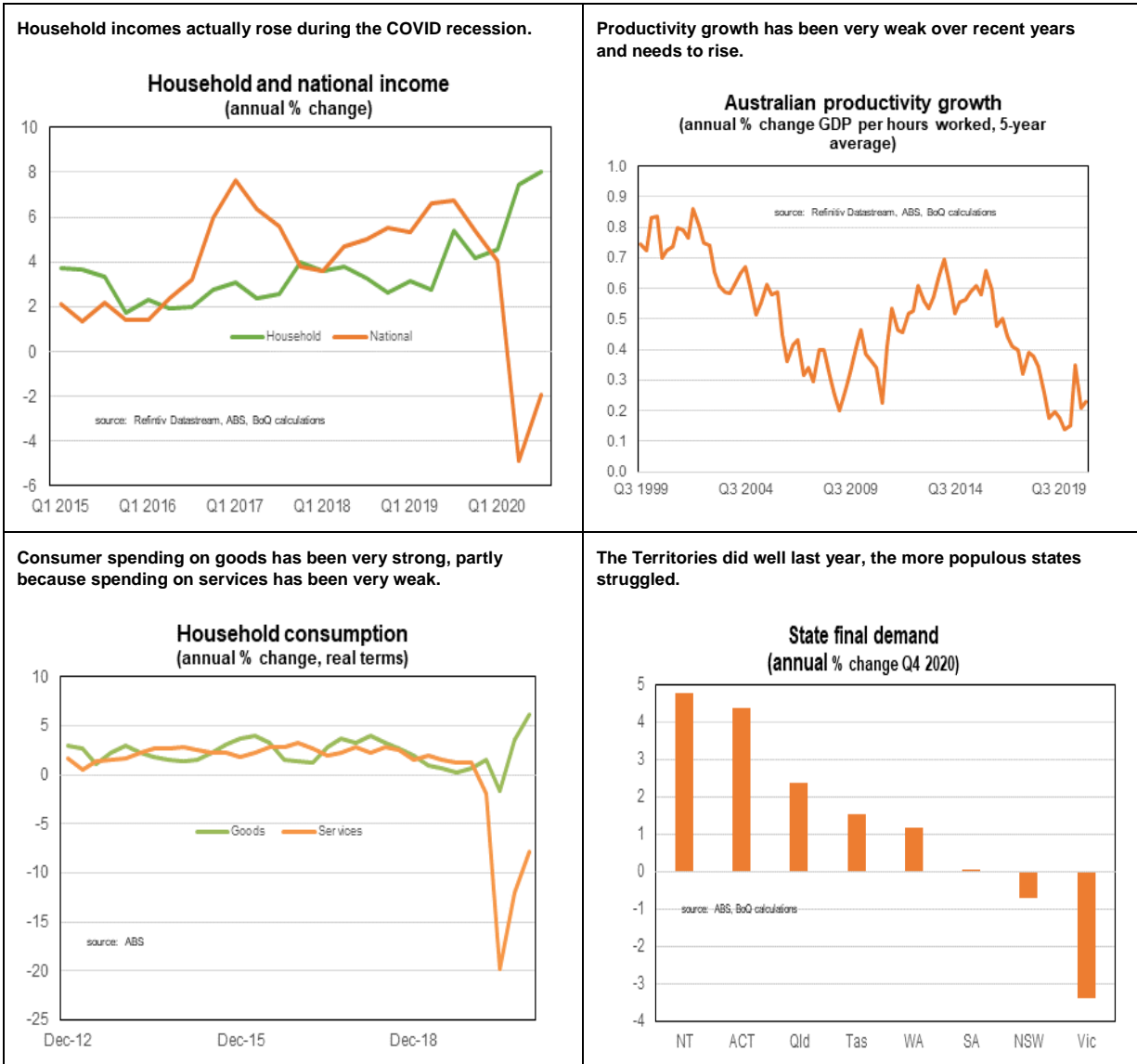
Stage three is to focus on how to boost long-term growth. After all the pre-COVID economy was hardly humming along. Population growth was one of the few things that had been pushing the economy forward and that has slowed to virtually a standstill. A return to the pre-COVID pace of population growth will therefore be important. Not the least because strong immigration growth helped minimise concerns about an aging population.

But the big prize is what Governments can do to boost productivity growth. As a famous economist once said, in the short term productivity growth is variable but it is everything in the long run. Firms are doing their bit by increasing their spending on digitization (also driven by changes in consumer behaviour post COVID). And a couple of tax changes by state governments (shift from stamp duty to land tax in NSW and a road tax in Victoria and South Australia) will be worth watching.

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There are global developments that might influence the direction of productivity growth. The potential shift from one global technology standard to different standards for a China and US sphere would be a productivity negative. The UK Government has indicated that to pay for the big run up in Government debt they will raise the corporate tax rate. It will be interesting to see how many other governments follow.



Overall, the Australian economy did better in 2020 than thought possible during the peak of the pandemic worries. It increasingly looks to be the case that this year will be a good one for the domestic economy. Good luck with the progress of the virus will be important. Increased confidence to spending by firms and consumers will be a big plus.

The Australian economy has achieved its big bounce after the COVID plunge. Growth rates won't be as strong from here over the next few quarters. But it looks increasingly like they will still be pretty good.

We live in interesting times.

Regards,

Peter Munckton
Chief Economist