# ECONOMIC UPDATE

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## Summary


- **The headline August labour market numbers were surprisingly strong;**
- **But the underlying jobs market in the month could be better characterised as being flat;**
- **GDP growth in H2 is likely to be stronger than consensus, but that growth may not be enough;**
- **Strong Government support means that the economic impact of this pandemic might not be as severe as previous ones;**
- **The medium term structural issue of slowing population growth in an aging world economy will provide challenges.**


Payrolls data released earlier by the ABS suggested that the number of jobs declined by over 1% over the month to August. So the rise of over 100,000 in the month was a shock. A Pandemics can have substantial long-term economic consequences. It was estimated that the bubonic plague killed 30-50% of people living in Europe in the 14th century, and was a leading cause of the collapse of the feudal system. At this stage COVID looks unlikely to have the same sizeable implications as some pandemics. Unlike previous episodes Governments have provided substantial support to their economy. The one clear outcome from the pandemic is that Government spending and debt is likely to be at a higher level (relative to GDP) than it was entering the pandemic.

The cyclical response to COVID is taking place amidst the massive structural demographic story of an aging and slowing in world population growth. Until COVID the demographic outlook for Australia was not as dire. Australia's population has historically got a major boost (along with countries such as New Zealand and Canada) from immigration growth. Immigration has essentially slowed to a standstill and is the reason why population growth in Australia this year will be at its lowest growth rate since the First World War. At times the state of the economy can influence birth rates.

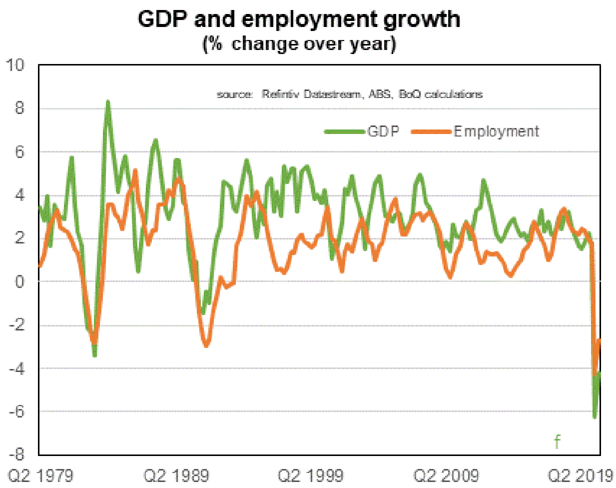
### The labour market is too good to be true

When the economic history of 2020 is written it will be about GDP growth declining by more than any time since the Great Depression. The economy started to plunge in late March as the 'first wave' appeared, and reached rock bottom in early May. The economy picked up significantly in June. Although a 'second wave' arrived in July the economy still had a decent month.

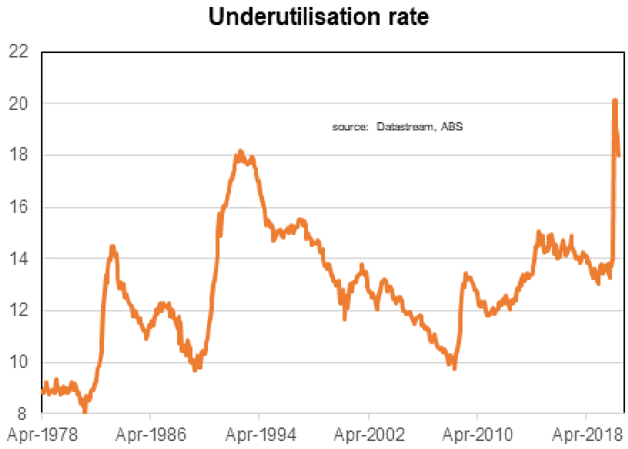
Given the extent of the lockdown in Victoria tougher August was expected. And certainly that was the message coming from the business and consumer surveys. But not from the headline labour market data. Payrolls data released earlier by the ABS suggested that the number of jobs declined by over 1% in the month to August. So the rise of over 100,000 in the month was a shock. So was seeing that the unemployment rate fell to 6.8% (from 7.5%). And that the participation rate rose.

But the old saying of being too good to be true comes to mind. The ABS reported a remarkable rise of over 50,000 sole traders in the month. Possibly that reflects an extraordinary spontaneous rise in the entrepreneurial spirit, although

On historical grounds the fall in recorded jobs has been modest given the weakness of the economy.




But it has been big enough to see a sharp rise in worker underutilisation.




There is a divergence between business and consumers views on the labour market.


There are a lot fewer jobs ads around.

## The long run implications of pandemics

Recently three economists from the San Francisco Federal Reserve[1] wrote a paper on the long-term economic implications of pandemics. A lot of the discussion about that topic revolves around what happened following the Spanish Flu of 1918-19. While there are similarities between then and now (not the least the timing of the virus 'waves') the problem is that events could be influenced by factors specific to that time (eg, that the Spanish Flu followed the end of World War I).

The bottom line of the analysis was that pandemics can have substantial long-term economic consequences. They reduce the size of the workforce (because workers have died), reducing the need for investment (because there are less workers to use that investment). The result is that productivity (and therefore GDP per person) growth is lower.

It was estimated that the bubonic plague killed 30-50% of people living in Europe in the 14th century, and was a leading cause of the collapse of the feudal system (the large number of deaths provided workers with more bargaining power). The arrival of the Spanish to the Americas in the 16th century led to the spread of smallpox (as well as measles and plague) that (according to History.com) in some parts of America wiped out 90% of indigenous people.

The Justinian Plague in the 6th century led to the death of over 25% of world population and has been credited with bringing the end of the Roman Empire. And the plague that hit Athens in 430 BC (said to be Typhoid Fever) was thought to have killed two thirds of the city population and led to the defeat of Athens by the Spartans.

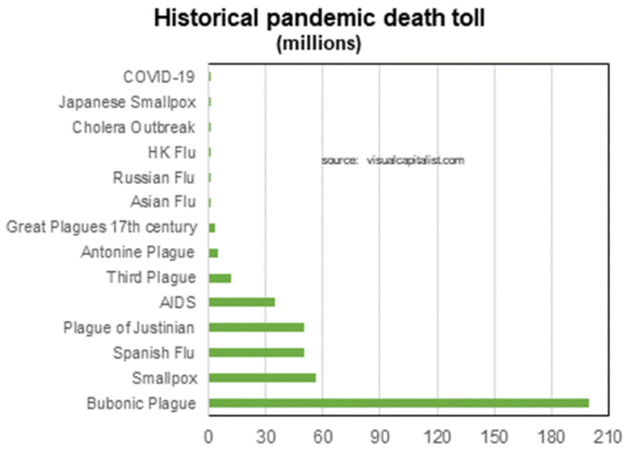
At this stage COVID looks unlikely to have the same sizeable implications as the above pandemics. The death toll is lower (particularly when measured relative to the size of the global population). And while it is a society tragedy that so many older people have lost their lives, the economic consequences are not as severe if mortality rates had been more evenly spread across age groups.

But investment has fallen as it has done prior to previous pandemics (and saving has risen substantially as it often does as recessions are about to hit). Unlike previous episodes Governments have provided substantial support to their economy. And it looks likely that in many countries (Australia, New Zealand, China, Europe) massive fiscal stimulus will be on the cards for some time to come. Despite the political machinations, a further big fiscal boost is also likely to be forthcoming in the US.

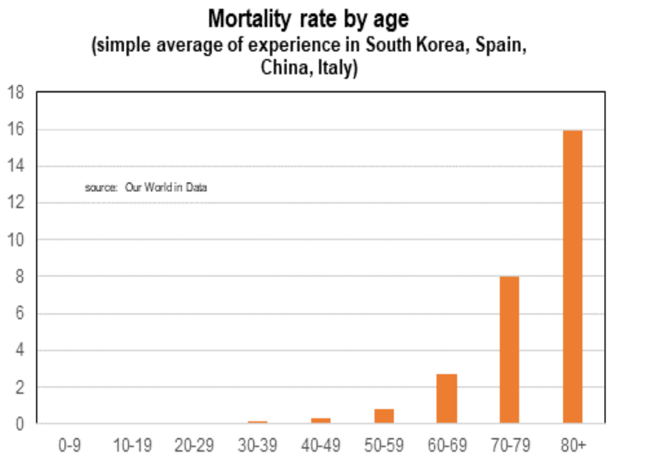
The one clear outcome from the pandemic is that Government spending and debt is likely to be at a higher level (relative to GDP) than it was entering the pandemic. At a time when private demand is very low that makes sense. And higher spending if well directed (such as on infrastructure) has the ability to boost private demand in the future. The difficult political question will be how to reduce Government spending (and debt) in the future (ideally through stronger economic growth). But that is very much a question for the future. The more important question today is whether Government's are doing enough to support the economy.

[1] '*Longer run economic consequences of Pandemics*', O. Jorda, S. Singh and A. Taylor, June 2020, San Francisco Federal Reserve Working Paper 2020-09

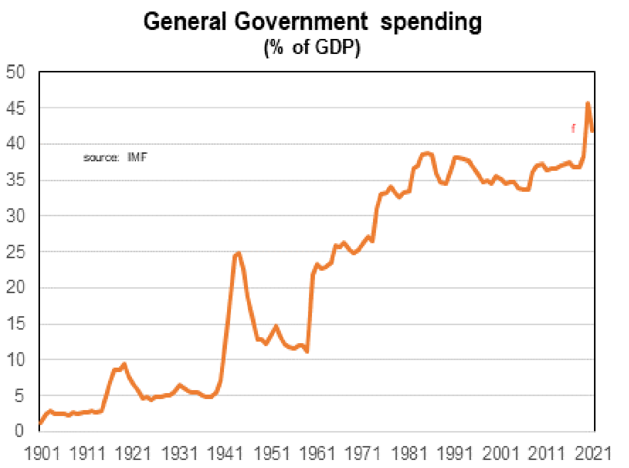
There have been several major pandemics over the course of history.



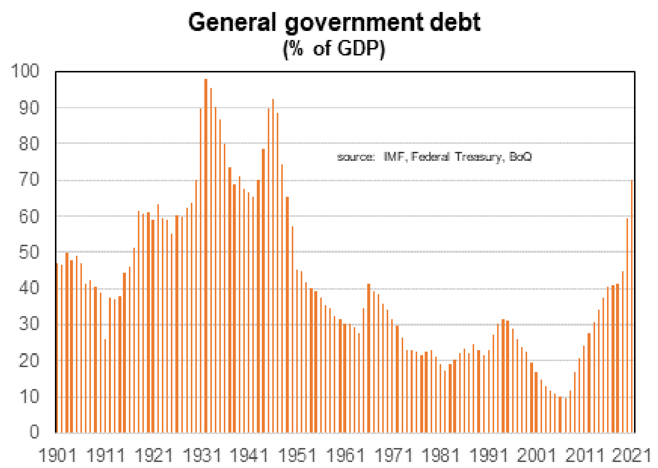

This pandemic mainly impacts the aged.




Government spending goes up following major crisis but never fully comes back down.




Government debt levels will reach their highest level since the Second World War.




## The demographic trends have not changed

Understandably the current economic focus is very much on the cyclical story of the fallout from fighting the pandemic. But that cyclical story is taking place amidst the massive structural demographic story of an aging and slowing in world population growth.

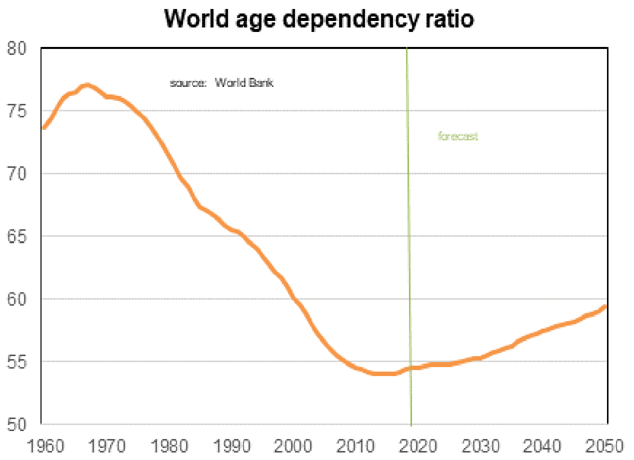
Less people means less demand for cars or trips to the cinema. Less people means less taxpayers to provide services for an aging population. This can be overcome if there is a substantial rise in productivity growth. The challenge is for Governments to be able to put in place the policies to encourage strong productivity growth to flow.

Until COVID the demographic outlook for Australia was not as dire. While natural population growth (births minus deaths) was slowing (although still higher than in most other OECD countries) Australia's population had historically got a major boost (along with countries such as New Zealand and Canada) from immigration growth. Post COVID immigration has essentially slowed to a standstill, and is the reason why population growth in Australia this year will be at its lowest growth rate since the First World War.

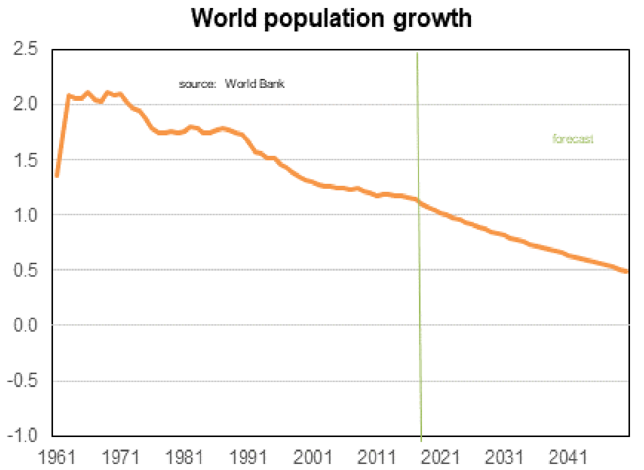
As yet there does not seem to be any political consensus about resuming any immigration growth (let alone when it may return to pre-COVID levels). Some states are talking about bringing a small number of international students. Clearly a vaccine would be a game changer. In the absence of a vaccine greater confidence in the quarantining process on a large scale would be necessary. But without those two factors immigration growth will also likely to be low next year. Thereafter it will depend upon the path of the virus (and the health response). And the performance of Australia's economy (a strong economy provides the jobs that attracts immigrants).

The state of the economy can also influence birth rates. Most clearly this happened during the Great Depression when weak economic growth made it difficult for families to afford to have more children. In recent years, changing perceptions about the medium-term outlook for the economy has coincided with the broad trend in annual birth rates. By contrast, the typically negative view that consumers had about the economy (no surprise given high inflation and unemployment) in the 1980s and 90s appeared to have little influence on birth rates.

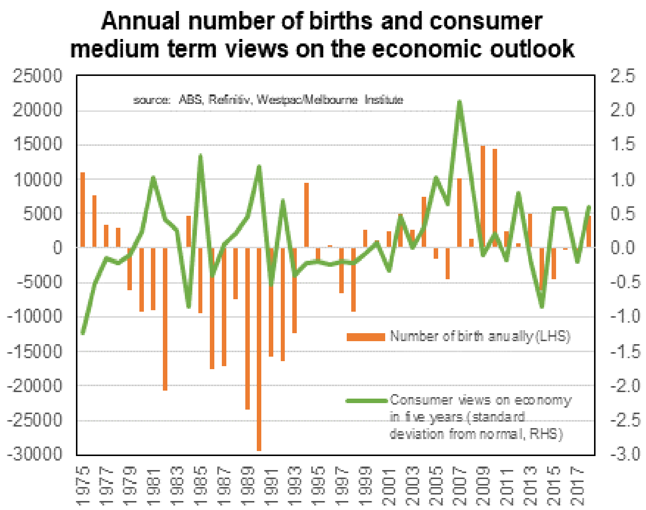
The world is getting older



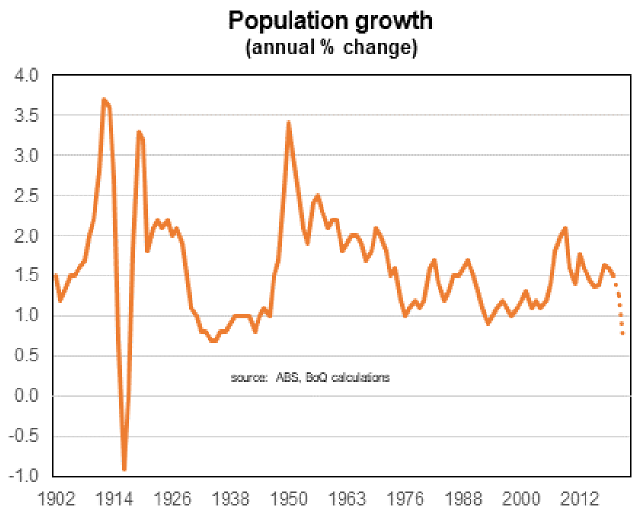

And population growth is almost certain to slow




There are time when views on the economy can influence birth rates




Population growth in Australia this year is likely to be at its slowest pace since World War One.




We live in interesting times.

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