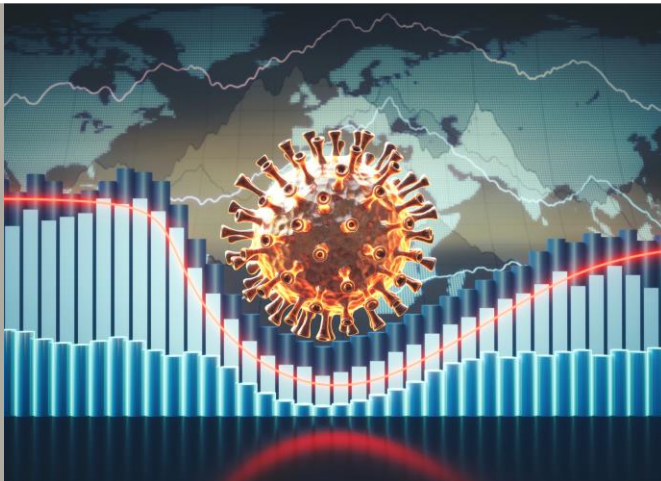




RESEARCH PAPER

2020, an unforgettable year: Australia's macro-economic journey



March 2021

The Centre for International Economics is a private economic research agency that provides professional, independent and timely analysis of international and domestic events and policies.

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Abbreviations

ABS	Australian Bureau of Statistics
AOFM	Australian Office of Financial Management
GDP	Gross Domestic Product
ESAs	Exchange Settlement Accounts
MPC	Marginal Propensity to Consume
MYEFO	Mid-year Economic and Fiscal Outlook
RBA	Reserve Bank of Australia

Executive summary

Australia's macroeconomic landscape experienced a turbulent 2020, following two major exogenous shocks; severe bushfires and COVID-19 associated restrictions on large gatherings and other containment measures that limit economic activities. At its lowest point, Australia entered its first recession in over 30 years. However, the latter part of 2020 saw a quick economic recovery, following the easing of public health measures.

This paper summarises Australia's 2020 economic journey by discussing key macro-economic timeseries data for:

- Gross Domestic Product (GDP)/output
- consumption
- investment
- government expenditure, and
- employment.

1 Australia's 2020 macroeconomic journey

GDP/output

Real GDP

The Australian economy was undoubtedly impacted by the COVID-19 pandemic, with real gross domestic product (GDP) contracting by (chart 1.1):

- 0.3 per cent in the 2020 March quarter, and
- a record 7 per cent in the 2020 June quarter.

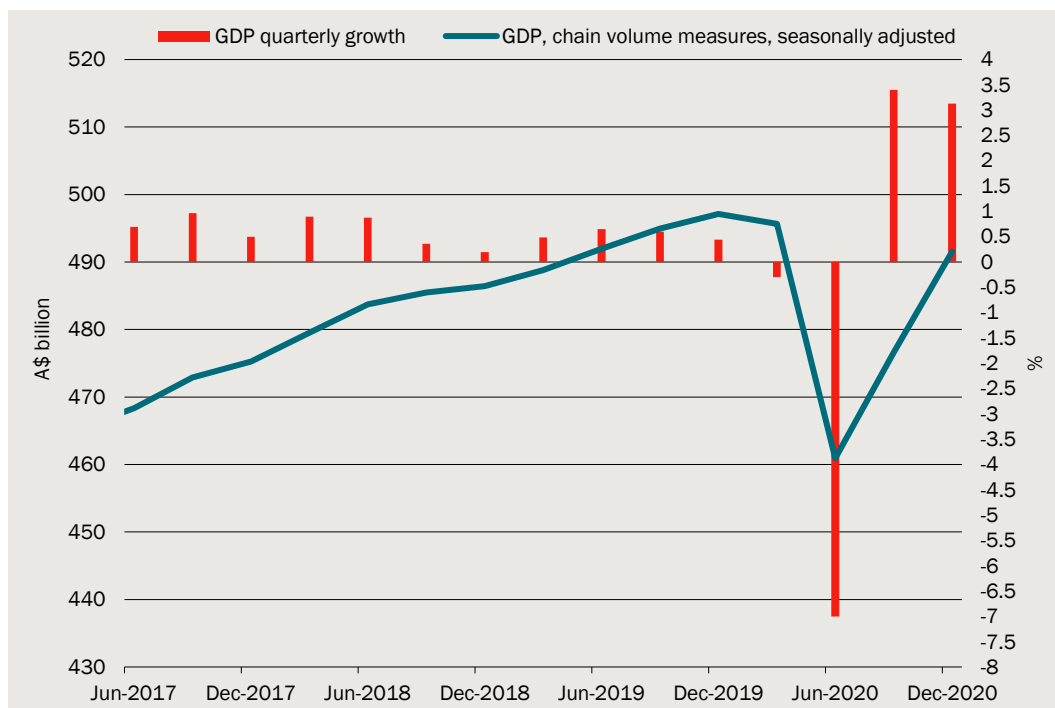
These consecutive quarter falls officially confirmed Australia's first recession in 30 years.

However, Australia experienced a quick turnaround, with real GDP expanding by:

- 3.4 per cent in the 2020 September quarter, and
- 3.1 per cent in the 2020 December quarter.

Overall, GDP fell 1.1 per cent over 2020.

1.1 Australian Real GDP 2017-2020



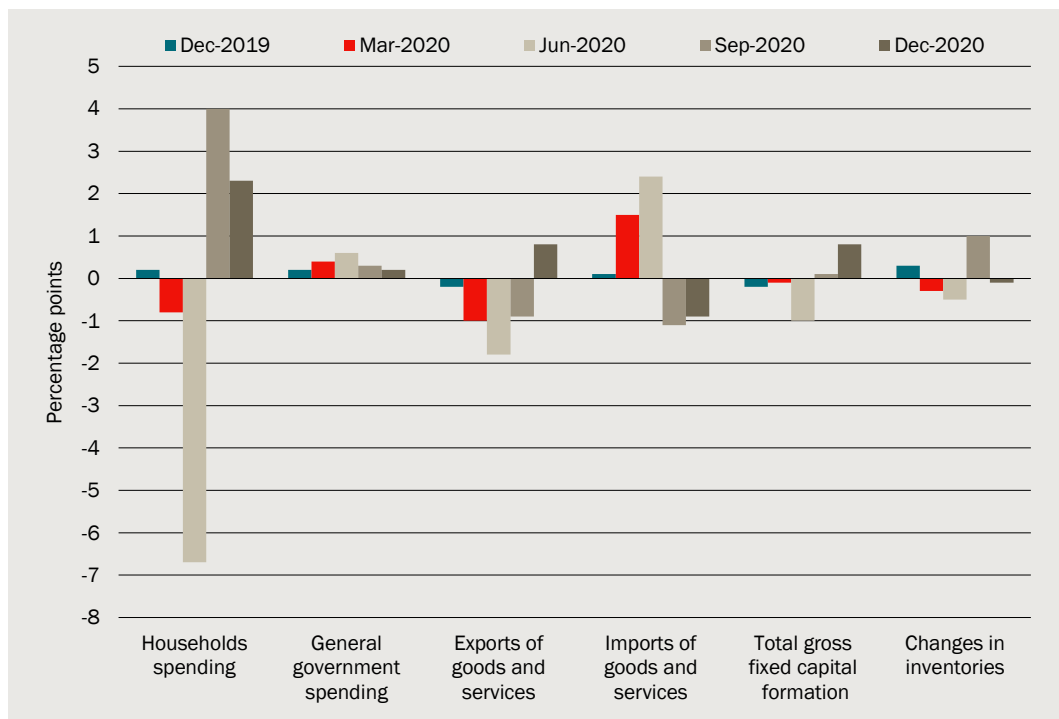
Note: Real GDP, seasonally adjusted is presented against left axis. Real GDP quarterly percentage change is presented against right axis.

Data source: Australian Bureau of Statistics 2021, cat. No.5206.0 Australian National Accounts: National Income, Expenditure and Product: Table 1. Key National Accounts Aggregates, March, <https://www.abs.gov.au/statistics/economy/national-accounts/australian-national-accounts-national-income-expenditure-and-product/latest-release>

Chart 1.2 shows:

- Household spending:
 - reduced GDP with sustained declines in the March 2020 and June quarters, due to social distancing restrictions and travel bans, and
 - increased GDP with a strong turnaround in the September and December quarters.
- Government expenditure:
 - has supported GDP growth over the course of 2020, with the introduction of several economic stimulus and support packages to households and businesses on bushfire relief and economic responses to COVID-19 in the March 2020 quarter and continued in the subsequent quarters.
- Investment:
 - weighed down GDP in the March and June quarters, associated with COVID-19 containment measures and market uncertainty, and
 - supported GDP growth in the September, and especially the December quarter, with an improvement to both household and business investment.
- Exports of goods and services:
 - weighed down GDP, over the March, June, and September quarters, attributed to travel restrictions on overseas arrivals impacting education and tourism, and
 - supported GDP growth in the December 2020 quarter, following an improvement in the terms of trade, off the back of higher export prices, particularly for iron ore.

1.2 Contributions to GDP growth



Note: The positive contribution of imports to GDP reflect that imports fell more sharply than exports, resulting in a positive net export.

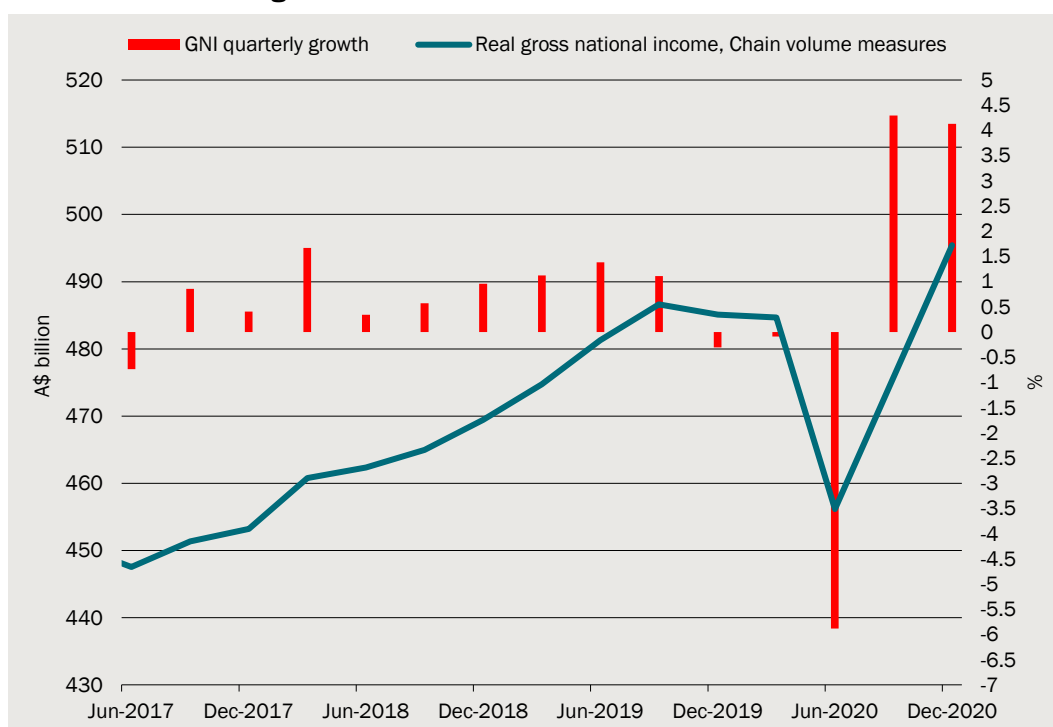
Data source: Australian Bureau of Statistics cat. No.5206.0

Gross national income

Gross national income, formerly called gross national product, represents income derived from wage and salary, government payments, compensations, superannuation, interests, rents, profits and dividends and reflects Australian economic well-being. Like GDP, Gross national income (chart 1.3):

- suffered a significant fall in the June 2020 quarter, despite the introduction of government support measures for households and businesses.
 - The initial payment of the temporary cash flow support accrued to financial distressed businesses in March and continued through the June 2020 quarter. However, the government measures were not enough to offset the loss of income from reduced employment and business activity, leading to an overall decline of 5.8 per cent in the June 2020 quarter.
- experienced a resurgence in the September and December quarters, fuelled by mining operating surplus linked to higher iron ore prices, the consumer expenditure turnaround and increased wages from improved hours worked.

1.3 Australian real gross national income 2017-2020



Note: Real GNI, seasonally adjusted is presented against left axis. Real GNI quarterly percentage change is presented against right axis.

Data source: Australian Bureau of Statistics cat. No.5206.0

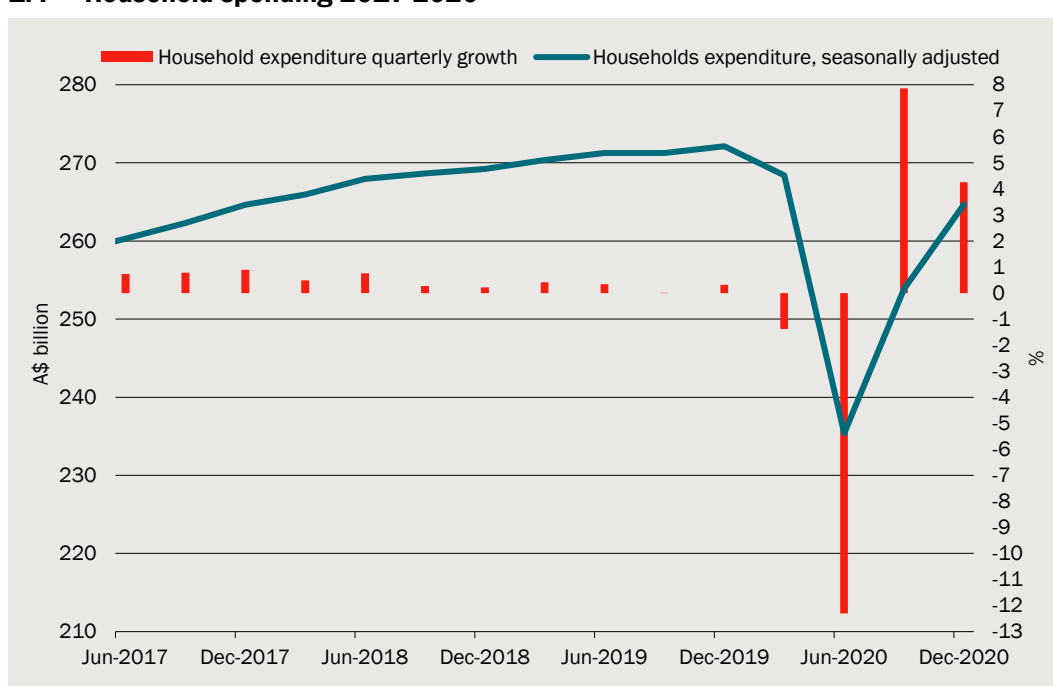
Consumption

Household spending experienced an unprecedented dramatic fall and then subsequent recovery, in 2020. Household spending (chart 1.4):

- fell 1.4 per cent in the March 2020 quarter, with a further deterioration of 12.3 per cent in the June 2020 quarter, and
- increased 7.8 per cent in the September quarter and a further 4.2 per cent increase in the December quarter.

The four most recent quarterly household consumption movements dwarf recorded historical quarterly changes. The previous largest Australian quarterly household expenditure fall was 1.9 per cent in 1975 and the previous largest increase was 3.3 per cent in 1962.

1.4 Household spending 2017-2020



Data source: Australian Bureau of Statistics cat. No.5206.0.

The March quarter decrease in household spending is attributable to a 2.4 per cent fall in services consumption, partly offset by an increase in goods consumption of 1.0 per cent.¹ The further deterioration of household expenditure in the June 2020 quarter is due to the continued fall in service expenditure (decreased by 17.6 per cent), combined with a 2.8 per cent fall in goods expenditure.² The 2020 September and December quarter household consumption increases are attributed to a rebound in goods and services

¹ ABS 2020, '5206.0 - Australian National Accounts: National Income, Expenditure and Product, Mar 2020: Household consumption behaviour in response to COVID-19'
<https://www.abs.gov.au/AUSSTATS/abs@.nsf/Latestproducts/5206.0Main%20Features70Mar%202020?opendocument&tabname=Summary&prodno=5206.0&issue=Mar%202020&num=&view=>

² ABS 2020, '5206.0 - Australian National Accounts: National Income, Expenditure and Product, June 2020,'
<https://www.abs.gov.au/ausstats/abs@.nsf/Latestproducts/5206.0Main%20Features3Jun%202020?opendocument&tabname=Summary&prodno=5206.0&issue=Jun%202020&num=&view=>

consumption, post COVID-19 lockdowns, with consumers reverting back to pre-pandemic buying preferences.

Fluctuating consumer preferences

Chart 1.5 shows quarterly household consumption changes from the June 2019 to December 2020 quarter. As COVID-19 associated restrictions and uncertainty increased in the March and June 2020 quarters, consumers substituted to goods and services that:

- can be consumed in private settings and/or without the need for close social contact,
 - communications
 - ... 2.1 and 1.6 per cent in increase in the March and June quarters respectively
 - household equipment
 - ... 1.3 and 9.7 per cent in increase in the March and June quarters respectively
 - electricity, gas and fuel
 - ... 4.4 per cent in increase in the June quarter
- are durable or non-perishable
 - food
 - ... 5.6 per cent increase in the March quarter
 - alcohol
 - ... 2.9 per cent increase in the March quarter
 - ... 13.1 per cent increase in the June quarter

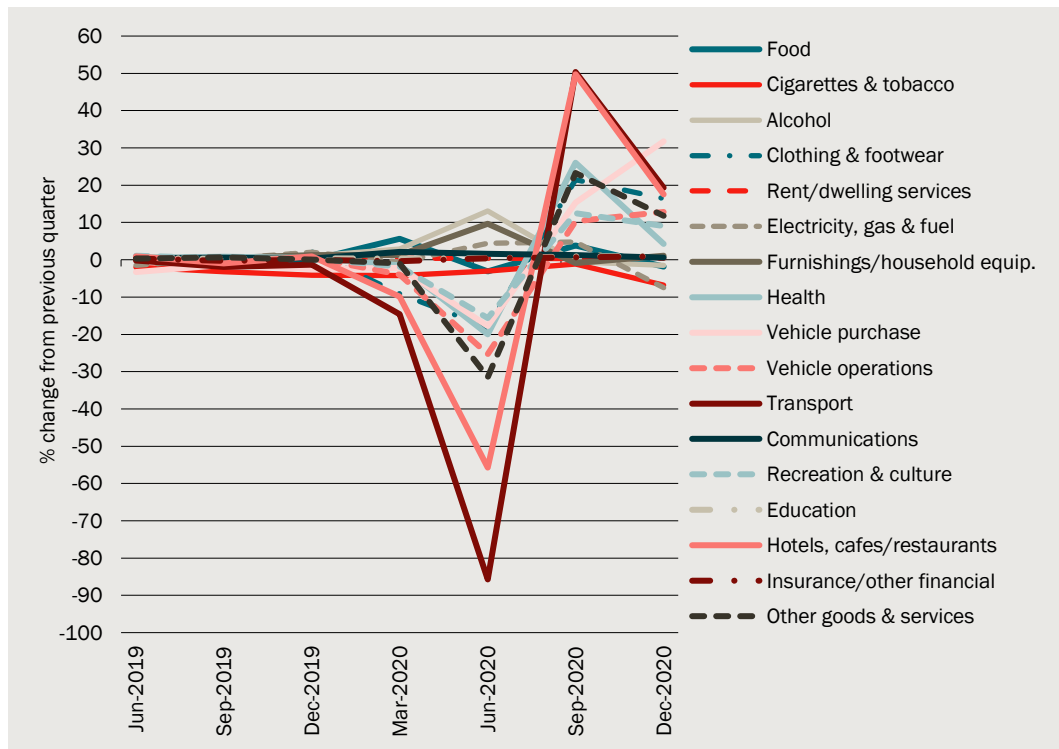
Conversely, consumers significantly reduced their consumption of:

- transport services
 - 14.6 per cent reduction in the March quarter
 - 85.7 per cent reduction in the June quarter
- hotels, cafes and restaurants
 - 9.9 per cent reduction in the March quarter
 - 55.7 per cent reduction in the June quarter
- clothing and footwear
 - 9.1 per cent reduction in the March quarter
 - 18.1 per cent reduction in the June quarter
- recreation and cultural services
 - 1.8 per cent reduction in the March quarter
 - 15.6 per cent reduction in the June quarter, and
- health services
 - 1.5 per cent reduction in the March quarter
 - 20 per cent reduction in the June quarter.

However, these consumption trends were reversed post strict COVID-19 lockdowns, with non-durable, leisure, recreation and transport services experiencing a surge in demand. For example, 2020 September and December quarter consumption dramatically increased for:

- Vehicle purchases (15.3 per cent and 31.8 per cent respectively)
- Health (26 per cent and 4.3 per cent respectively)
- Clothing and footwear (21.5 per cent and 16.4 per cent respectively)
- Transport (50.4 per cent and 19.3 per cent respectively)
- Hotels, cafes and restaurants (49.8 per cent and 17.5 per cent respectively), and
- Recreation & culture (12.5 per cent and 9.1 per cent respectively).

1.5 Quarterly household consumption percentage changes by type 2019-2020



Data source: Australian Bureau of Statistics cat. No.5206.0

Household saving ratio

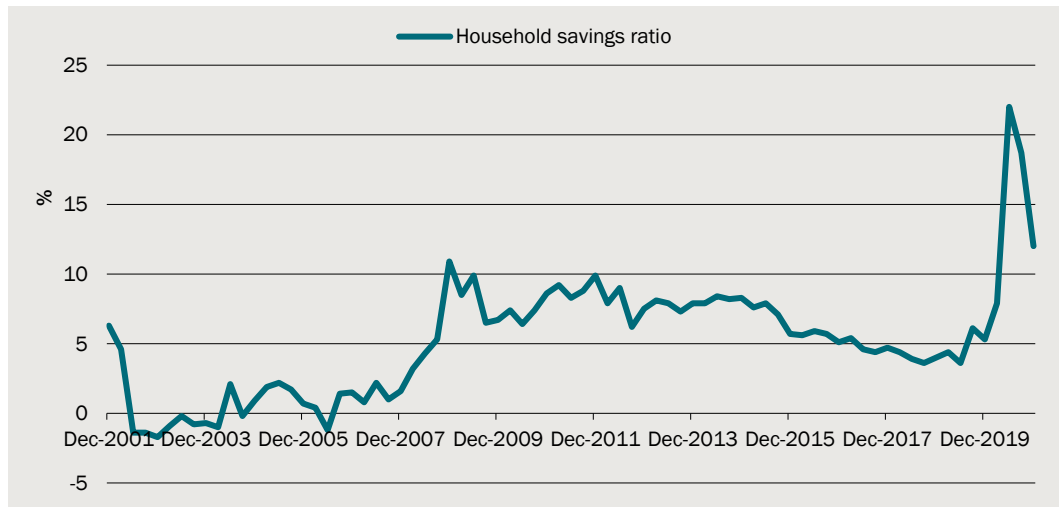
The September and December 2020 quarter surge in household expenditure was in part possible due to the sharp increase in the household savings ratio³, which peaked at 22 per cent in the June 2020 quarter, a level not seen since 1975 (chart 1.6).

The increased household saving ratio was driven by a 42 per cent increase in social assistance benefits to lower income households. This is a product of:

- additional COVID-19 support payments to existing welfare payment recipients, and
- an increase in the number of individuals who receive social welfare payments.

³ The ratio of household net saving to household net disposable income. Household net saving is calculated as household net disposable income, less household final consumption expenditure. Household net disposable income is calculated as household gross disposable income less household consumption of fixed capital.

1.6 Household saving ratio



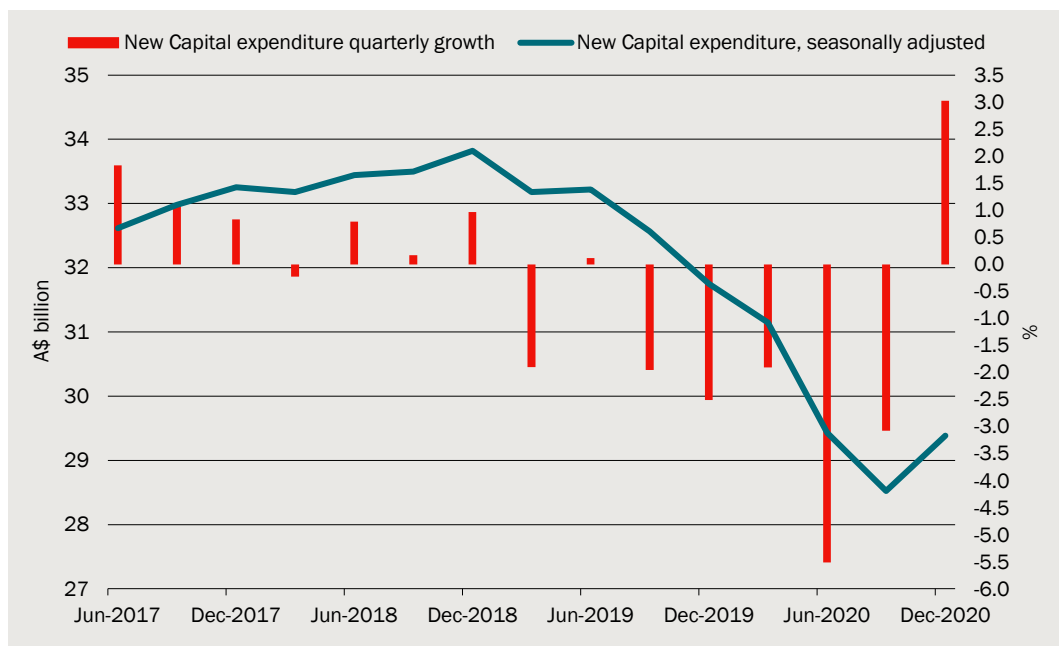
Data source: ABS 2020, 5206.0 - Australian National Accounts: National Income, Expenditure and Product, December 2020, <https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/5206.0Mar%202020?OpenDocument>

Investment

New Investment

Total new capital expenditure has been in successive decline since the December 2018 quarter, with the June and September 2020 quarters associated with the most dramatic declines of 5.5 per cent and 3.1 per cent respectively (chart 1.7). However, the December 2020 quarter saw the first positive movement in capital expenditure in two years (3 per cent).

1.7 New capital expenditure 2017-2020



Data source: Australian Bureau of Statistics cat. No.5625.0

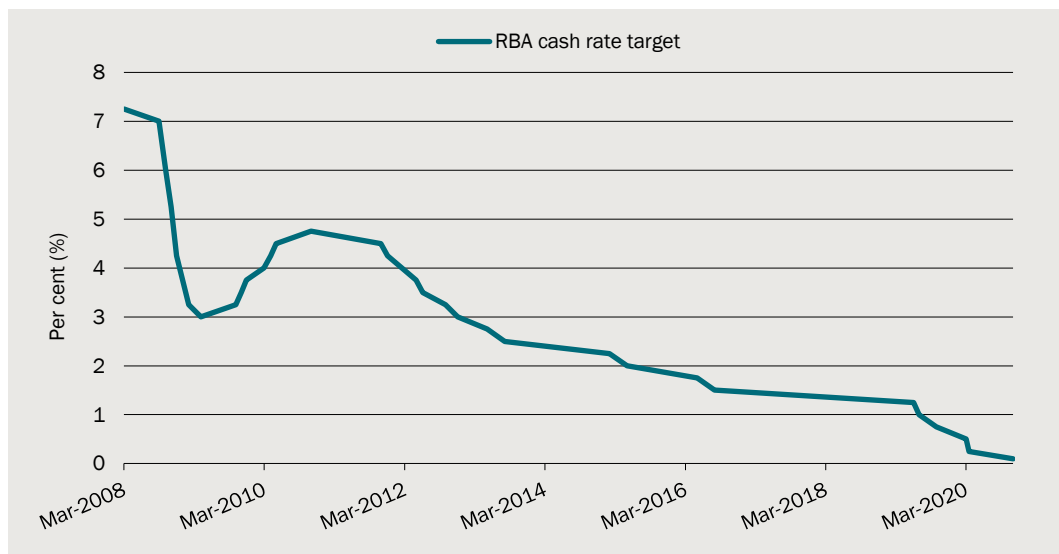
The ABS attribute the December 2020 quarter increase in new capital expenditure to:

- private investment in:
 - new machinery and equipment
 - ownership transfer costs, and
 - dwellings, and
- public investment in by state and local general government.⁴

Expansionary monetary policy

The Reserve Bank of Australia (RBA) has been undertaking expansionary monetary policy in recent years, prior to COVID-19, to stimulate private investment. The RBA further lowered its target cash rate by 0.25 basis points in March 2020, then a further 15 basis points in November 2020, as a result of the COVID-19 associated economic slowdown. The cash rate now sits at an historic low of 0.10 per cent (chart 1.8).

1.8 RBA cash rate target



Data source: RBA 2020, Statistical Tables: Monetary Policy Changes – A2, <https://www.rba.gov.au/statistics/tables/#interest-rates>

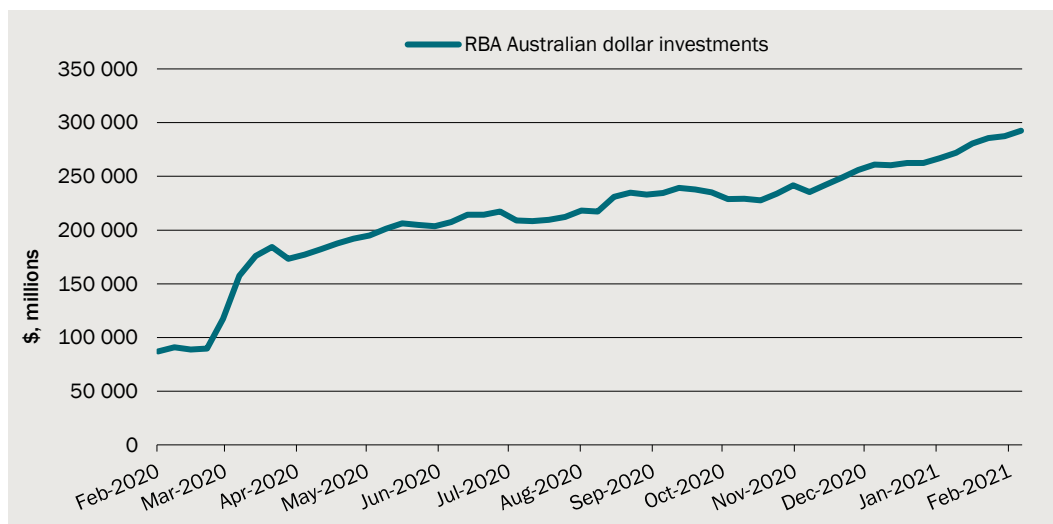
Further, the RBA also increased the supply of liquidity to the banking system by scaling up its open market operations⁵ and purchasing government bonds in secondary markets,

⁴ ABS 2021, '5206.0 - Australian National Accounts: National Income, Expenditure and Product, Mar 2020: Quarterly estimates of key economic flows in Australia, including gross domestic product (GDP), consumption, investment, income and saving' <https://www.abs.gov.au/statistics/economy/national-accounts/australian-national-accounts-national-income-expenditure-and-product/latest-release>

⁵ RBA repurchase agreements and outright transactions in short-dated Commonwealth Government securities. Refer to RBA 2003, 'The Reserve Bank's Open Market Operations', June 2003, <https://www.rba.gov.au/publications/bulletin/2003/jun/pdf/bu-0603-1.pdf>

in response to COVID-19 induced financial market uncertainty.⁶ RBA Australian dollar investments have increased 226 per cent over the period 1 March to 24 February 2021 (chart 1.9).

1.9 RBA Australian dollar investments



Data source: RBA 2020, Statistical Tables: Reserve Bank of Australia Liabilities and Assets – Summary – A1, <https://www.rba.gov.au/statistics/tables/>

The increased RBA balance sheet is intended as a broad package to further support Australia's economic recovery. In November 2020, the RBA committed to the purchase of \$100 billion of government bonds of maturities of 5 to 10 years over a six-month period.⁷ The RBA further committed to purchase an additional \$100 billion of Australian Government and State/Territory bonds when the current bond purchase program is completed in April 2021, at an expected rate of \$5 billion a week.⁸

The increased financial liquidity is evident with a 402 per cent increase in Exchange Settlement accounts⁹ between early March 2020 and late February 2021. Exchange Settlement account balances were slowly declining over the period April to November 2020, but have since dramatically increased over the period November 2020 to February 2021 (chart 1.10).

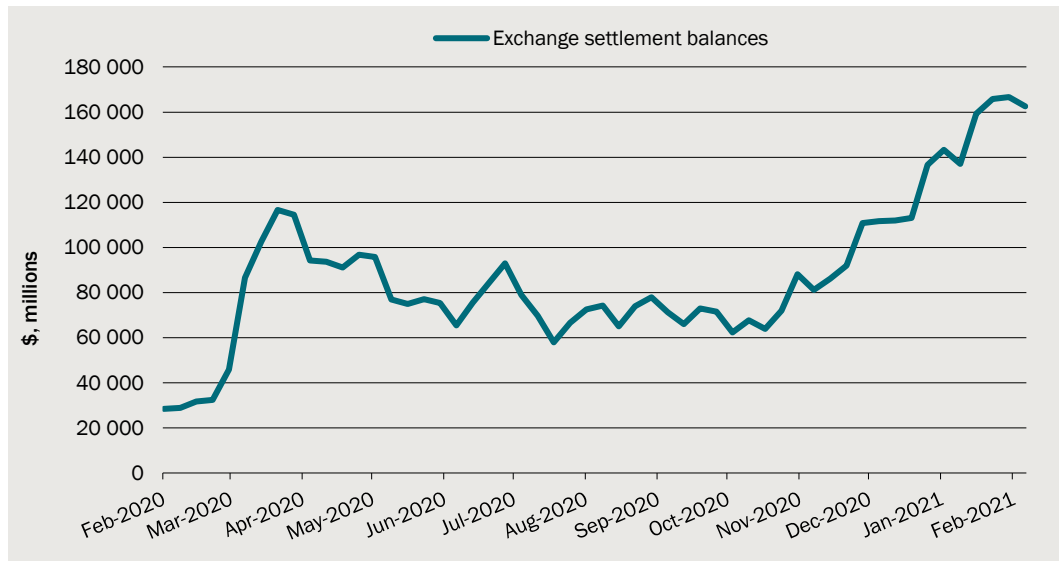
⁶ Kent, C 2020, 'The Reserve Bank's Operations – Liquidity, Market Function and Funding,' address to KangaNews, RBA, 27 July 2020, <https://www.rba.gov.au/speeches/2020/sp-ag-2020-07-27.html>

⁷ RBA 2020, 'Statement on Monetary Policy – November 2020: Overview', <https://www.rba.gov.au/publications/smp/2020/nov/overview.html>

⁸ RBA 2021, 'Statement on Monetary Policy – February 2021: Overview', <https://www.rba.gov.au/publications/smp/2021/feb/overview.html>

⁹ Exchange Settlement Accounts (ESAs) are the means by which providers of payments services settle obligations that have accrued in the overnight clearing process. Refer to [https://www.rba.gov.au/payments-and-infrastructure/esa/#:~:text=Exchange%20Settlement%20Accounts%20\(ESAs\)%20are,ESA%20and%20the%20application%20process](https://www.rba.gov.au/payments-and-infrastructure/esa/#:~:text=Exchange%20Settlement%20Accounts%20(ESAs)%20are,ESA%20and%20the%20application%20process)

1.10 Exchange settlement balances

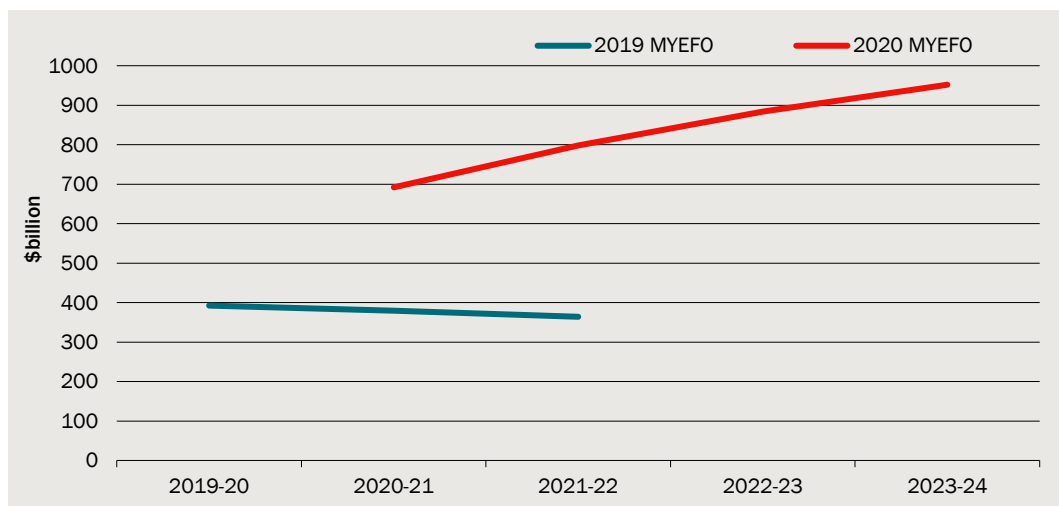


Data source: RBA 2020, Statistical Tables: Reserve Bank of Australia Liabilities and Assets – Summary – A1, <https://www.rba.gov.au/statistics/tables/>

Government expenditure

Chart 1.11 shows the projected Australian Government net debt forecast in the December 2019 MYEFO (teal line) and the 2020 MYEFO (red line).

1.11 Projected Australian Government net debt



Data source: Australian Government 2019, 'Budget 2019-20: Mid-Year Economic and Fiscal Outlook – Part 4 Debt Statement', p. 66, <https://budget.gov.au/2019-20/content/myefo/index.htm>; Australian Government 2019, 'Mid-Year Economic and Fiscal Outlook 2019-20, Appendix B Table B1: Estimates of Australian Government general government sector expenses by function and sub-function', p. 298, December 2019, https://budget.gov.au/2019-20/content/myefo/download/MYEFO_2019-20.pdf?2; Australian Government 2020, 'Mid-Year Economic and Fiscal Outlook 2020-21, Debt Statement, Table 4.7: Net Debt - reconciliation from the 2020-21 Budget to the 2020-21 MYEFO', <https://budget.gov.au/2020-21/content/myefo/index.htm>

The 2020 MYEFO statement forecasts the Australian Government's net debt to increase from \$691.9 billion (34.5 per cent of GDP) in 2020-21, to \$951.7 billion (43 per cent of GDP) in 2023-24. The 2020 MYEFO net debt forecasts are significantly higher than the

2019 MYEFO forecasts, made only 12 months earlier, following large scale COVID-19 Government assistance measures.¹⁰ Specifically:

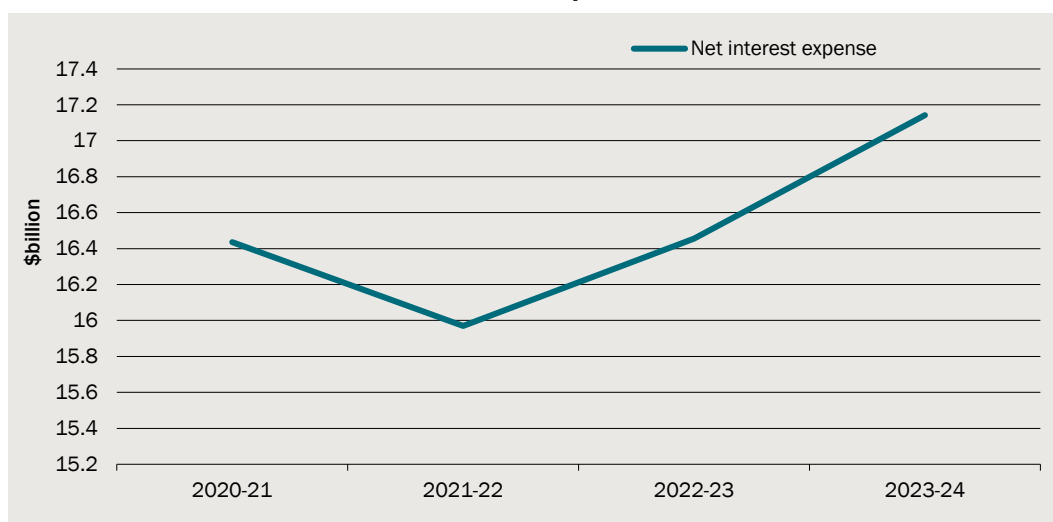
- the 2020-21 forecast net debt stated in MYEFO 2020 is 82.5 per cent higher than the \$379.2 billion net debt forecast in MYEFO 2019, and
- the 2021-22 forecast net debt stated in MYEFO 2020 is 119.1 per cent higher than the \$364.5 billion net debt forecast in MYEFO 2019.

In short, in the 12 months between December 2019 and December 2020, the forecast Australian Government net debt:

- has approximately doubled, and
- is anticipated to increase over the forward estimates, instead of decline as previously forecast.

Chart 1.12 shows the Australian Government's net interest expense.

1.12 Australian Government's net interest expense



Note: Net interest expense is equal to the difference between interest expenses and interest income

Data source: Australian Government 2020, 'Mid-Year Economic and Fiscal Outlook 2020-21, Debt Statement, Table 4.9: Interest expense, interest income and net interest expense, <https://budget.gov.au/2020-21/content/myefo/index.htm>

In line with increasing net debt, the Australian Governments net interest expense is forecast to increase from \$16.4 billion in 2020-21, to \$17.1 billion in 2023-24, which is 0.8 per cent of GDP.

¹⁰ For further details of Australian and State/Territory Government COVID-19 support measures, refer to CIE 2020, 'The impact of COVID-19 on Australia's economic landscape,' <https://www.thecie.com.au/publications-archive/the-impact-of-covid-19-on-australias-economic-landscape>.

Employment

Australia's unemployment rate peaked at 19 year high of 7.5 per cent in July 2020. The unemployment rate has since reduced to 6.4 per cent in January 2021, equivalent to the previous peak in July 2015 (chart 1.13).

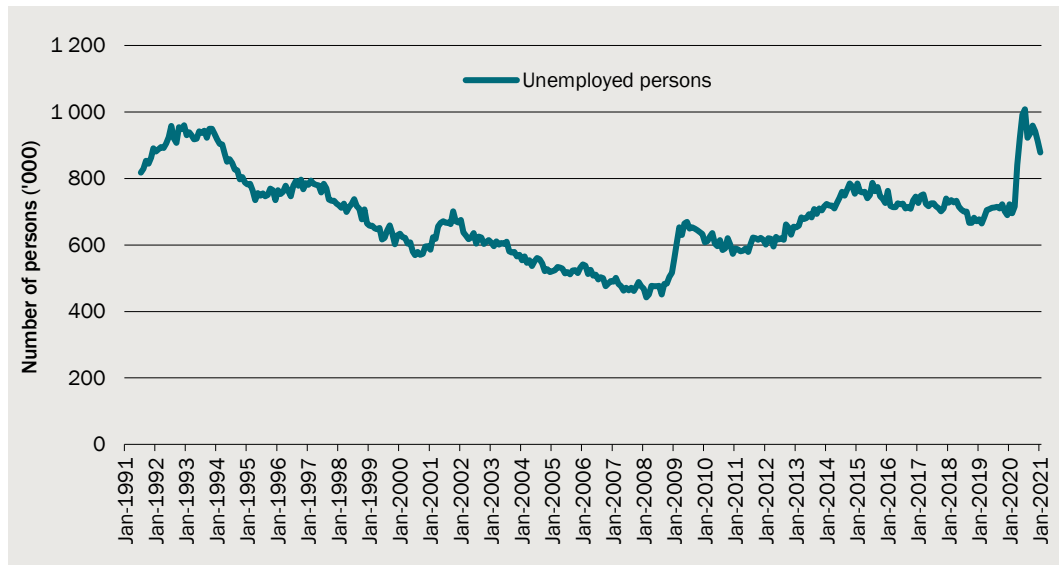
1.13 Unemployment rate



Data source: ABS 2021, Labour Force, Australia, <https://www.abs.gov.au/statistics/labour/employment-and-unemployment/labour-force-australia/latest-release>

The July 2020 unemployment rate represented 1 million unemployed persons, the highest number recorded since the early 1990's recession (chart 1.14). At the end of 2020, 878 000 Australians were estimated to be unemployed.

1.14 Unemployed persons



Data source: ABS 6202.0 - Labour Force, Australia, January 2021

2 Conclusion

2020 truly was a tumultuous time for the Australian economy. First, experiencing two exogenous shocks in the form of bushfires and COVID-19, which in turn increased market uncertainty. A sharp economic downturn eventuated but was quickly followed by a strong resurgence. In numbers:

- GDP fell by a record 7 per cent in the 2020 June quarter, followed by the sixth (3.4 per cent) and ninth largest (3.1 per cent) quarterly growth in recorded history
- household spending fell a record 12.3 per cent in the June 2020 quarter, followed the largest recorded quarter increase of 7.8 per cent in the September quarter and a further 4.2 per cent increase (the second largest on record) in the December quarter
- consumer preferences changed quickly and dramatically, including:
 - 13.1 per cent increase quarterly increase in alcohol consumption for the June quarter
 - 85.7 per cent reduction in transport services for the June quarter
 - 49.8 per cent increase in hotels, cafes and restaurants in the September quarter, and
 - 31.8 per cent increase in vehicle purchases for the December quarter.
- the household saving ratio increased to a 45 year high of 22 per cent in the June 2020 quarter, and
- Australia's unemployment rate peaked at 19 year high of 7.5 per cent in July 2020, representing 1 million unemployed persons, but has improved to 6.4 per cent in January 2021, or 878 000 unemployed Australians.

In response, the RBA and Australian Government initiated unprecedented expansionary monetary and fiscal policies respectively.

The RBA:

- lowered the cash rate to an historic level of 0.10 per cent
- increased its Australian dollar investments over 200 per cent, and
- experienced an increase of over 402 per cent to the total Exchange Settlement account balance.

The Australian Government:

- doubled its forecast net debt to \$951.7 billion (43 per cent of GDP) in 2023-24, and
- abandoned budget surpluses for the foreseeable future.



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