DISCUSSION PAPER

The impact of COVID-19 on Australia's economic landscape

An economist's perspective on the challenges and opportunities for Australian businesses

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THE CENTRE FOR INTERNATIONAL ECONOMICS
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Abbreviations

ANZSIC	Australian and New Zealand Standard Industrial Classification codes
ABS	Australian Bureau of Statistics
AOFM	Australian Office of Financial Management
ESAs	Exchange Settlement Accounts
GFC	Global Financial Crises
MPC	Marginal Propensity to Consume
RBA	Reserve Bank of Australia

About this paper

This paper discusses the challenges and opportunities for Australian businesses considering the economic impact of COVID-19 and subsequent government stimulus.

The paper begins with an analysis of the Australian macroeconomic landscape post COVID-19, with a focus on GDP/output, employment, investment, consumption and government expenditure. This is followed by an evaluation of the different sectors of the economy and the unique challenges they face in the "new normal" paradigm. Lastly, the paper considers potential business opportunities for long term success, in the form of innovation, customer retention and balance sheet management.

1 Australian macroeconomic landscape post COVID-19

Australia's first COVID-19 diagnosis occurred in January 2020. This was followed by sustained growth in diagnosed cases, both domestically and internationally, over February and March. The World Health Organisation declared COVID-19 a global health pandemic in March 2020.

In response, the Australian Government, and State/Territory counterparts implemented immediate forced business closures for some industries, coupled with restrictions on large gatherings and other containment measures that limit economic activities.[1]

These public health measures were subsequently rolled back commencing May 2020, via a staged approach in line with COVID-19 associated health outcomes.[2] However, some restrictions on business activities, movement across state borders and social gatherings have been re-introduced, following increased COVID-19 cases in declared "hot spots".[3]

This has resulted in significant shocks to the Australian macroeconomic landscape. We discuss GDP/output, employment, investment, consumption and government expenditure below.

GDP/output

The Australian economy is undoubtedly impacted by the COVID-19 pandemic, with real gross domestic product contracting by 0.3 per cent in the March quarter of 2020, followed by an historical record 7 per cent fall in the June 2020 quarter (chart 1.1). These consecutive quarter falls officially confirm Australia's first recession in 30 years.

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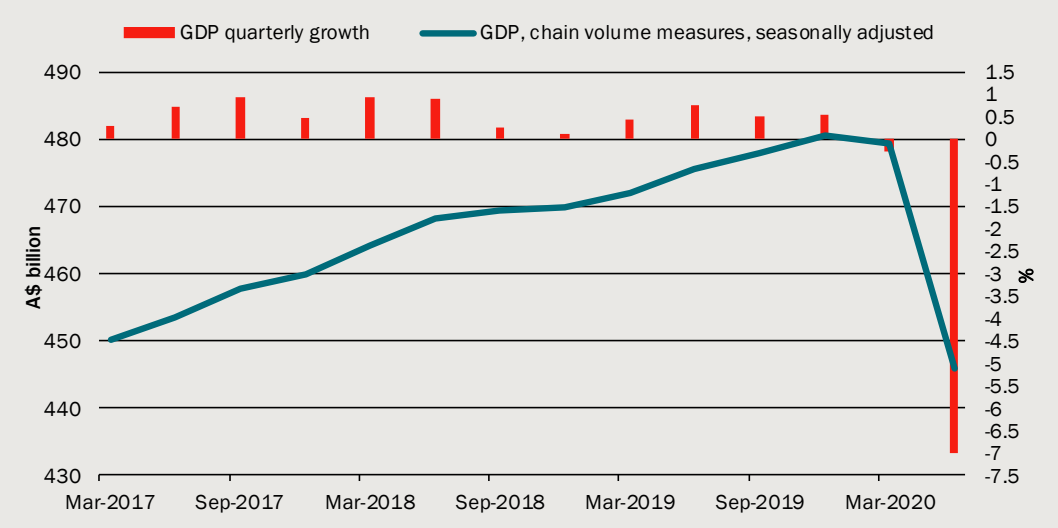
1 Prime Minister of Australia 2020, 'Press Conference – Australian Parliament House ACT Transcript', 22 March 2020, https://www.pm.gov.au/media/press-conference-australian-parliament-house-act-220320

2 Prime Minister of Australia 2020, 'Update on Coronavirus measures – Media Statement', 8 May 2020, https://www.pm.gov.au/media/update-coronavirus-measures-08may20

3 For example, Victorian Government 2020, 'Business and industry stage 4 restrictions', *Health and Human Services*, https://www.dhhs.vic.gov.au/business-industry-stage-4-restrictions-covid-19; and restricted travel between Victoria and NSW as stated in NSW Government 2020, 'Directions under the Public Health Act: What you must do under new coronavirus rules from 24 July 2020', *NSW Health*, https://www.health.nsw.gov.au/Infectious/diseases/Documents/easy-read-pho-directions.pdf

1.1 Australian Real GDP 2017-2020

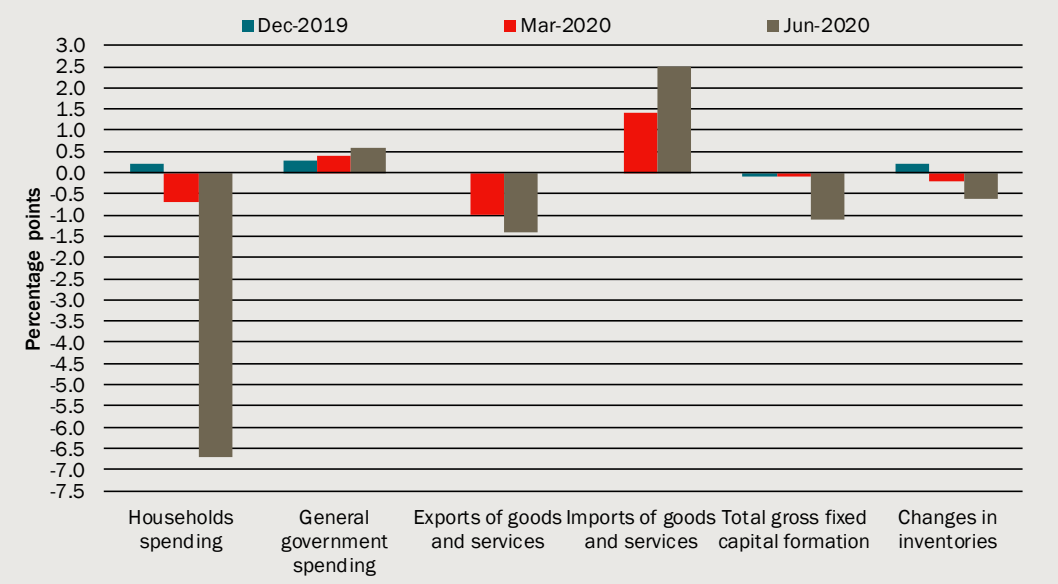


Note: Real GDP, seasonally adjusted is presented against left axis. Real GDP quarterly percentage change is presented against right axis.

Data source: Australian Bureau of Statistics 2020, cat. No.5206.0

Household spending started to decline in the March 2020 quarter and fell sharply in the June quarter, due to social distancing restrictions and travel bans. Government spending increased 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 June 2020 quarter. Exports of goods and services detracted significantly, which had been attributable to travel restrictions on overseas arrivals impacting education and tourism. The pandemic and associated containment measures continued to weigh on investment activities (chart 1.2).

1.2 Contributions to GDP growth



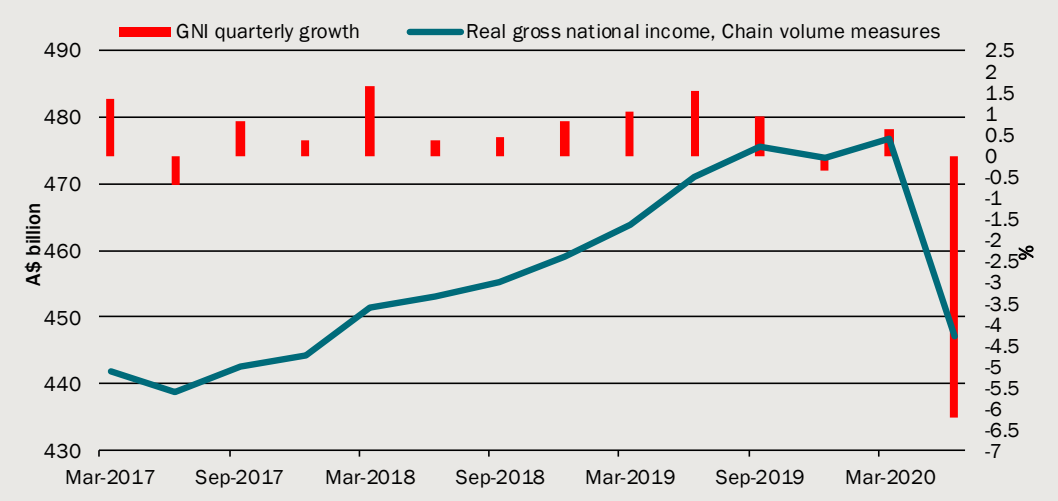
Note: The positive contribution of imports to GDP reflect that imports fell more sharply than exports, resulting in a positive net export.

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

Gross national income, 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. Gross national income had been less hit by the pandemic during the March 2020 quarter, but suffered a significant fall in the June 2020 quarter (chart 1.3).

By the end of the March quarter, timely measures to support workers, households and businesses through the difficult time were introduced. 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 6.2 per cent in the June 2020 quarter.

1.3 Australian real gross national income 2017-2020



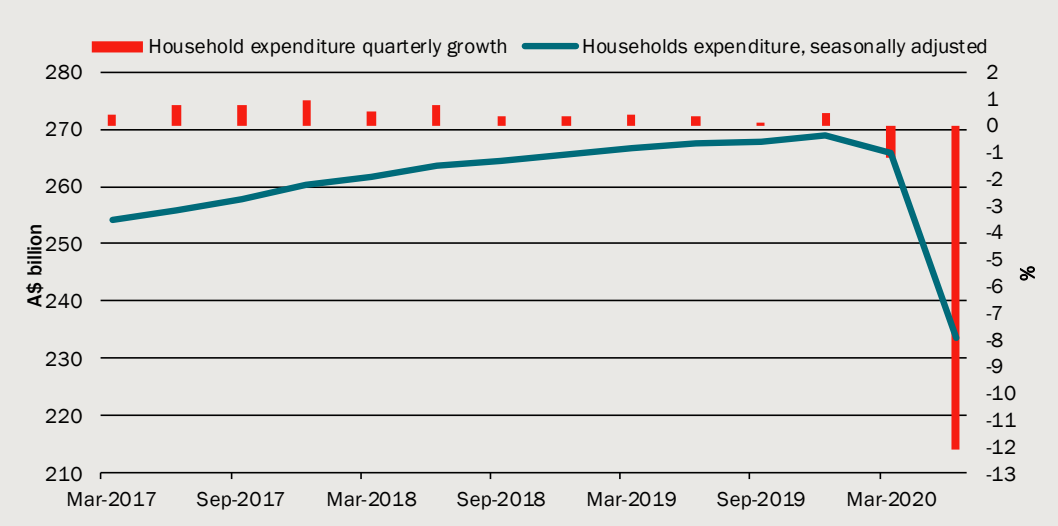
Note: Real GNI, seasonally adjusted is presented against left axis. Real GNI quarterly percentage change is presented against right axis.

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

Consumption

Household spending fell by 1.1 per cent in the March 2020 quarter, with a further deterioration of 12.1 per cent in the June 2020 quarter (chart 1.4).

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.[4] 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.[5]

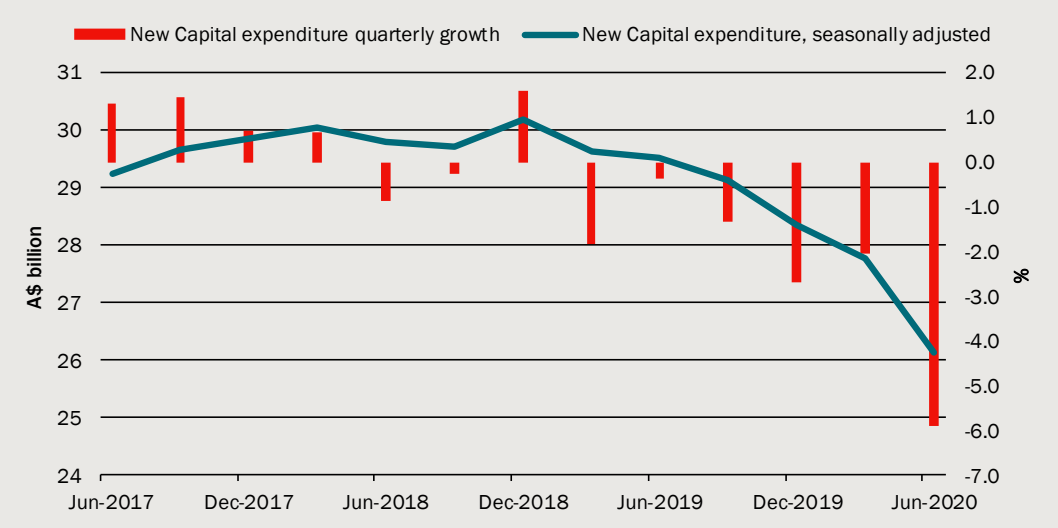
Investment

Total new capital expenditure has been in successive decline since the December 2018 quarter. However, the March and June 2020 quarters saw the most dramatic declines of 2.1 per cent and 5.9 per cent respectively (chart 1.5).

4 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=

5 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=

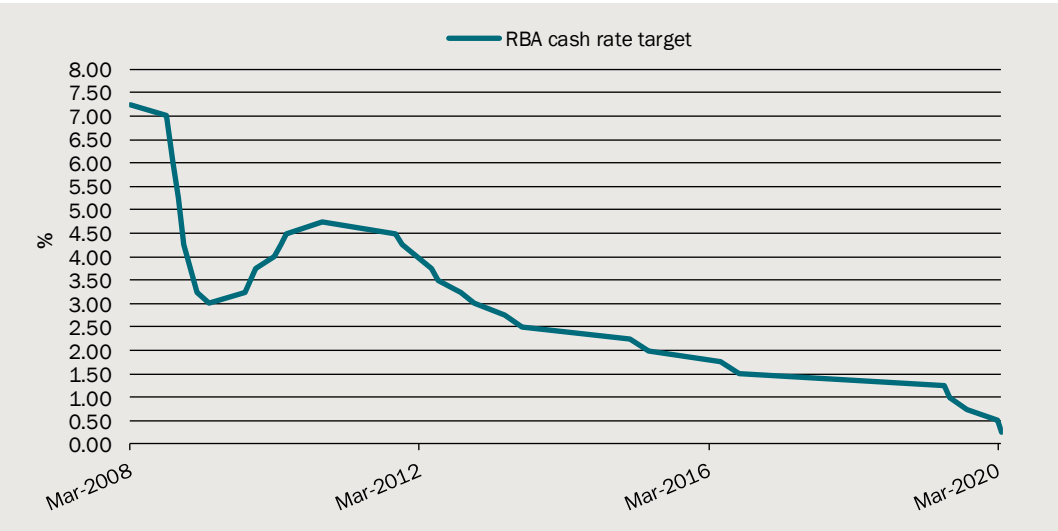
1.5 New capital expenditure 2017-2020



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

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, given the impending COVID-19 associated economic slowdown. The cash rate now sits at an historic low of 0.25 per cent (chart 1.6).

1.6 RBA cash rate target



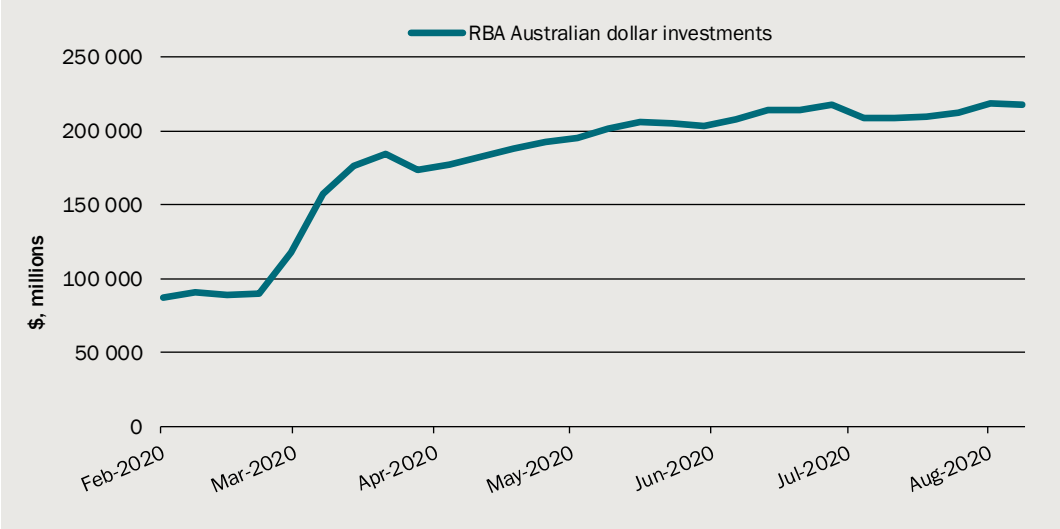
Data source: RBA 2020, Statistical Tables: Monetary Policy Changes – A2, https://www.rba.gov.au/statistics/tables/#interest-rates

Further, the RBA also increased the supply of liquidity to the banking system by scaling up its open market operations[6] and purchasing government bonds in secondary markets,

6 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.[7] RBA Australian dollar investments have increased 142 per cent over the period 1 March to 26 August 2020 (chart 1.7).

1.7 RBA Australian dollar investments



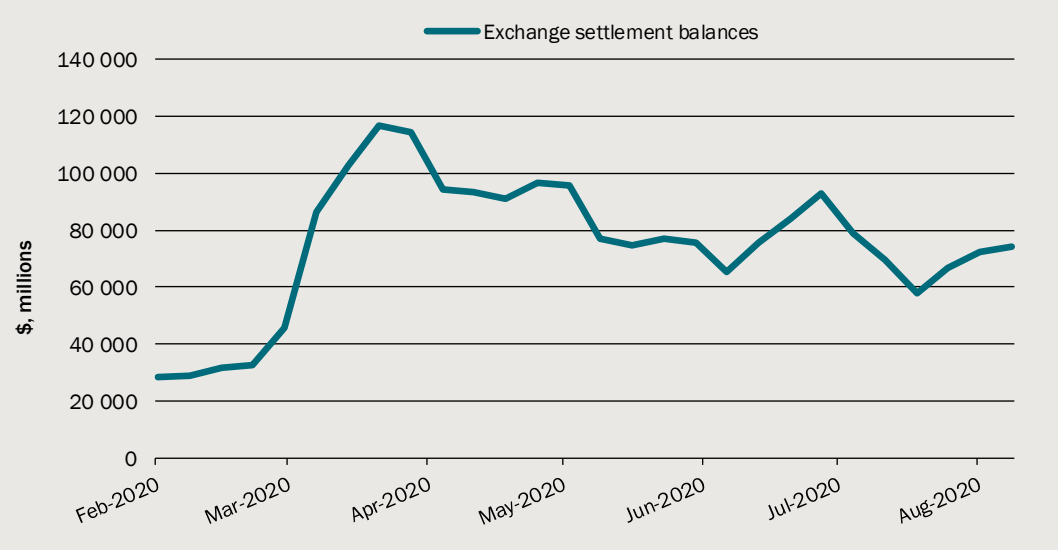
Data source: RBA 2020, Statistical Tables: Reserve Bank of Australia Liabilities and Assets – Summary – A1, https://www.rba.gov.au/statistics/tables/

The increased financial liquidity is evident with a 261 per cent increase in Exchange Settlement accounts[8] between early March and mid-April 2020. Exchange Settlement account balances have since slowly declined but are still 2.3 times higher at the end of August 2020, compared to the start of March 2020 (chart 1.8).

7 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

8 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

1.8 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

COVID-19 stimulus expenditure

The Australian Government has provided $293 billion of COVID-19 economic spending for the period 2019-20 to 2021-22. This consists of:

- $168 billion of fiscal stimulus, and
- $125 billion of balance sheet measures (table 1.9).

1.9 Australian Government COVID-19 fiscal stimulus and balance sheet measures

COVID-19 stimulus measures	2019-20	2020-21	2021-22	Total
	$, million	$, million	$, million	$, million
Fiscal stimulus				
JobKeeper payments	20 576	65 126	0	85 702
Boosting cash flow for employers	14 900	17 000	0	31 900
Income support for individuals (including Coronavirus Supplement)	5 945	11 585	-834	16 696
Payments to support household	5 601	3 727	34	9 362
Infrastructure stimulus	0	2 168	1 152	3 320
Backing business investment	0	1 500	5 200	6 700
Supporting apprentices and trainees	364	2 391	56	2 811

COVID-19 stimulus measures	2019-20	2020-21	2021-22	Total
	$, million	$, million	$, million	$, million
Temporary early access to superannuation	30	490	540	1 060
JobSeeker Partner Income Test measure	508	1 262	103	1 873
Aviation support	564	1 373	2	1 939
Increasing and extending the instant asset write-off	0	2 400	800	3 200
Relief and Recovery Fund	299	701	0	1 000
HomeBuilder Grant	0	680	0	680
Social Services (including Emergency Food Relief and support for at-risk individuals)	376	215	0	591
JobTrainer Fund — establishment	8	537	16	561
Communications, cyber safety and the arts	2	263	27	292
Child care	105	207	0	312
Other economic measures	1 167	190	-1 103	254
Fiscal stimulus total	**50 445**	**111 815**	**5 993**	**168 253**
Balance sheet support				
Government support for immediate cash flow needs of SMEs [a]				20 000
Australian Office of Financial Management – Structured Finance Support Fund				15 000
Reserve Bank of Australia – Term Funding Facility				90 000
Total balance sheet support measures				**125 000**
Total Australian government COVID-19 economic support expenditure				**293 253**

[a] Includes $90 million in concessional loans through the Arts and Entertainment Guarantee Scheme

Source: Australian Government 2020, 'Economic and Fiscal Update July 2020: Summary of key policy measures', *Treasury*, https://budget.gov.au/2020-efu/downloads/fact_sheet_overview.pdf

JobKeeper (box 1.10) formed a core component of the government's COVID-19 business and employment stimulus response, accounting for 51 per cent of fiscal stimulus.

1.10 JobKeeper

JobKeeper's objective is to temporarily offset wage costs to support businesses retain staff, continue paying them and facilitate quick businesses recommencement post COVID-19.[9] An estimated 960 000 organisations and over 3.5 million individuals are receiving job keeper payments as at July 2020.[10]

JobKeeper commenced as a pre-tax payment of $1 500 per fortnight available for the period 30 March 2020 to 27 September 2020 for eligible employees of Australian businesses that can demonstrate actual declines in GST turnover. The Australian Government has subsequently announced two extensions of the JobKeeper Payment, with two tiered rates:[11]

- Extension 1 - 28 September 2020 until 3 January 2021 (subject to proving actual GST turnover has fallen in the September 2020 quarter)
  - tier 1 rate $1 200 per fortnight (payable to those who satisfy an average weekly 20-hour work test)
  - tier 2 rate $750 per fortnight (payable to all other eligible recipients)
- Extension 2 - 4 January 2021 until 28 March 2021 (subject to proving actual GST turnover has fallen in the December 2020 quarter)
  - tier 1 rate $1 000 per fortnight (payable to those who satisfy an average weekly 20-hour work test)
  - tier 2 $650 per fortnight (payable to all other eligible recipients)

State and Territory governments have also implemented COVID-19 government assistance packages to businesses within their jurisdictions, in the form of (table 1.11):

- waiver of:
  - taxes
  - licence fees, and
  - rent on Government land
- grants to subsidise business fixed costs during imposed trading restrictions
- grants to subsidise re-opening, upscaling, or diversify operations post COVID-19 imposed restrictions, and
- subsidised re-training and upskilling.

9 Commonwealth of Australia 2020, 'Coronavirus Economic Response Package (Payments and Benefits) Rules 2020 Explanatory Statement,' https://www.legislation.gov.au/Details/F2020L00419/Explanatory%20Statement/Text

10 Australian Government 2020, 'Economic and Fiscal Update July 2020,' *Treasury*, p. 7, https://budget.gov.au/2020-efu/downloads/JEFU2020.pdf

11 Australian Taxation Office 2020, *Extension of the JobKeeper Payment*, https://www.ato.gov.au/General/JobKeeper-Payment/In-detail/Extension-of-the-JobKeeper-Payment/

1.11 State and Territories COVID-19 government assistance

State/Territory	Government assistance to businesses
New South Wales	▪ Support4Work Grant to help manage the recovery at work of an injured employee. ▪ Fee and Licence Relief ▪ Small Business COVID-19 Recovery Grant ▪ COVID-19 Tax Relief Measures ▪ Land tax relief for commercial landlords
Victoria	▪ COVID-19 Tax Relief Measures (land tax, payroll tax and liquor licencing fees) ▪ Hospitality Business Grant Program ▪ Dairy Farm Induction Program ▪ Business Support Fund – Expansion ▪ Tourism Accommodation Support Program ▪ Commercial Tenancy Relief Scheme
Queensland	▪ COVID-19 Payroll Tax Relief ▪ Coronavirus Land Tax Relief ▪ State Land Rent Relief - COVID-19 Assistance ▪ Small Business COVID-19 Adaption Grant Program ▪ Market Diversification and Resilience Grants for QLD commercial fishing, charter fishing and aquaculture businesses ▪ Tourism Lease and Licence Holder Assistance ▪ Small Business Skills Hub ▪ Fees and charges relief for tourism operators and hospitality providers
South Australia	▪ Regional Growth Fund - Strategic Business Round 2020 ▪ Financial support to hire and maintain apprentices ▪ COVID-19 Tax Relief Measures (payroll and land tax) ▪ Waiver of annual liquor licensing fees
Western Australia	▪ Payroll Tax relief ▪ International Competitiveness Co-Investment Fund ▪ Apprenticeship and Traineeship Re-engagement Incentive ▪ COVID-19 Business Recovery and Growth Round for supplier to priority industry sectors
Australian Capital Territory	▪ Economic Survival Package[a]
Northern Territory	▪ Small Business Survival Fund ▪ Business Hardship Package (relief from payroll tax, subsidised utilities, and deferred council rates) ▪ Business Improvement Grant

[a] Includes access to online business development resources, waivers for various business licensing fees, payroll tax deferrals and waivers for various industries, rental relief to tenants of ACT government owned properties and electricity rebates.

Source: https://www.business.gov.au/Risk-management/Emergency-management/Coronavirus-information-and-support-for-business/Coronavirus-state-and-territory-information-and-assistance

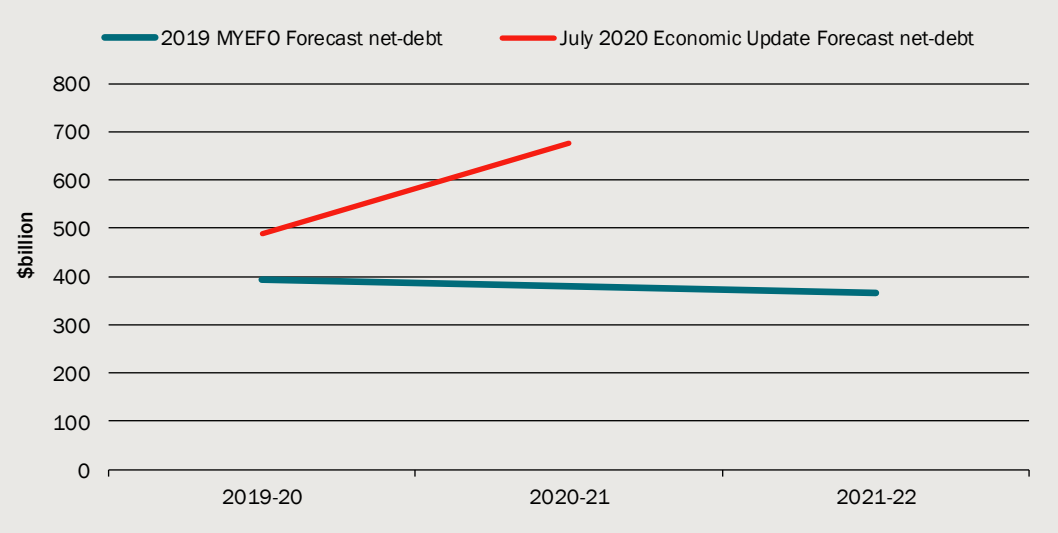
Government debt

The additional Australian Government expenditure will be paid for in the short term by issuing additional Australian Government Securities (AGS) to investors, managed by the Australian Office of Financial Management (AOFM). Long term government debt financing strategies are discussed in CIE 2020,[12] and broadly consist of:

- government asset sales
- tax increases, and
- removing tax exemptions.

Chart 1.12 shows the Australian Government's estimated net-debt post COVID-19 is forecast to be $298 billion higher in 2020-21, compared to the government's 2019 forecast released before COVID-19.

1.12 Australia's estimated net-debt before and after the Coronavirus (COVID-19) stimulus expenditure



Note: July 2020 Economic update provides forecasts for the 2019-20 and 2020-21 financial years only.

Data sources: 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, *Economic and Fiscal Update July 2020: Part 3: Fiscal outlook Table 3.1 – Budget aggregates*, p.45, https://budget.gov.au/index.htm

Prior to the COVID-19 outbreak, the Australian Government was forecasting Australia's net debt of:[13]

- $392.3 billion in 2019-20 (19.5 per cent of GDP)

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12 CIE 2020, 'How to fund the fiscal response to a global pandemic and avoid an economic catastrophe: Policy responses to pay for Coronavirus (COVID-19) stimulus expenditure,' *https://www.thecie.com.au/how-to-fund-the-fiscal-response-to-a-global-pandemic-and-avoid-an-economic-catastrophe*

13 Australian Government 2019, 'Budget 2019-20: Mid-Year Economic and Fiscal Outlook – Part 4 Debt Statement,' p. 66, *Treasury,* https://budget.gov.au/2019-20/content/myefo/index.htm

- $379.2 billion in 2020-21, and
- $364.5 billion in 2021-22.

The unanticipated COVID-19 stimulus expenditure increases Australia's forecast net debt to:[14]

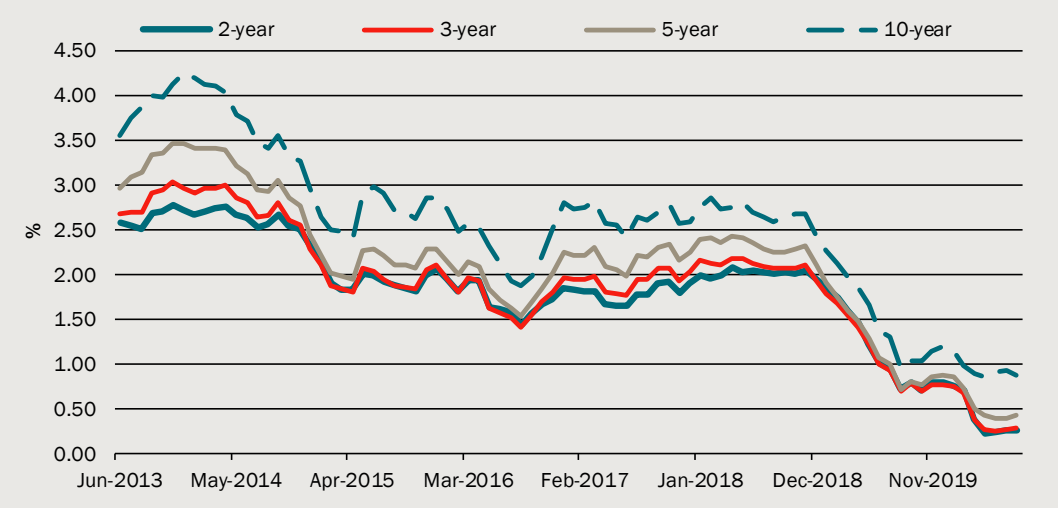
- $488.2 billion in 2019-20 (24.6 per cent of GDP), and
- $677.1 billion in 2020-21 (35.7 per cent of GDP).

The RBA contend that government (public) investment can mitigate the COVID-19 induced long-term economic downturn scars, without generating high inflation, crowding out private investment, or raising debt sustainability concerns, subject to:[15]

- significant amount of spare capacity in the economy
- low interest rates, and
- moderate public debt profiles.

Australia is forecast to satisfy the spare capacity and low interest rate criterion, in the short term at least, with a forecast unemployment rate high of 10 per cent in December 2020 (chart 1.14) and 10-year government bonds currently trading at historical lows at below 1 per cent (chart 1.13).

1.13 Australian government bond yields



Data source: RBA 2020, Capital Market Yields - Government Bonds Monthly F2.1, https://www.rba.gov.au/statistics/tables/#interest-rates

14 Australian Government 2020, 'Economic and Fiscal Update July 2020: Part 3: Fiscal outlook Table 3.1 – Budget aggregates,' p.45, https://budget.gov.au/index.htm

15 RBA 2020, 'Statement on Monetary Policy – August 2020: Box B: Fiscal Policy Support for the Recovery Phase in Advanced Economies,' https://www.rba.gov.au/publications/smp/2020/aug/box-b-fiscal-policy-support-for-the-recovery-phase-in-advanced-economies.html#fn2

It is less clear if a $488 billion net government debt (25 per cent of GDP) in 2020, forecast to grow to $677 billion in 2021 (36 per cent of GDP)[16], can be classified as moderate, given high economic and fiscal outlook uncertainty. This uncertainty was noted in the Treasury 2020 update as the reason for not publishing forecasts beyond 2021-22,[17] given the inherent difficulty to reasonably forecast taxation revenue and potential changes to government expenditure this financial year, let alone over the forward estimates.

Employment

Despite the significant monetary and fiscal policy stimulus, COVID-19 has had an unmistakeable and prolonged impact on the Australian labour force. The unemployment rate increased from 5.2 per cent in March 2020, to a 19 year high of 7.5 per cent in July. The RBA forecast the unemployment rate to peak at 10 per cent in December 2020, and gradually decline to 7 per cent in December 2022 (chart 1.14).

1.14 Unemployment rate

Note: Dashed line is RBA forecast for December 2020, June 2021, December 2021, June 2022 and December 2022.

Data source: ABS RBA 2020, Statement on Monetary Policy – August 2020: 'Economic Outlook Table 6.1: Output Growth and Inflation Baseline Forecasts,' https://www.rba.gov.au/publications/smp/2020/aug/economic-outlook.html

The July 2020 unemployment rate represents 1 million unemployed persons, the highest number recorded since the early 1990's recession (chart 1.15).

16 Australian Government 2020, 'Economic and Fiscal Update July 2020: Part 3: Fiscal outlook Table 3.1 – Budget aggregates,' p.45, https://budget.gov.au/index.htm

17 Australian Government 2020, 'Economic and Fiscal Update July 2020: Part 3: Fiscal outlook,' p.43, https://budget.gov.au/index.htm

1.15 Unemployed persons

Data source: ABS 6202.0 - Labour Force, Australia, Jul 2020

Economic recovery

The RBA note that the recovery projection of the Australian economy is highly ambiguous, as unlike previous economic downturns, our current economic situation is directly associated with the evolution of the COVID-19 health pandemic and a potential vaccine(s). Increased COVID-19 cases both domestically and overseas has resulted in the reinstatement of containment measures, which in turn have adversely impacted economic growth. There is also high uncertainty on household and business spending/investment responses going forward.[18]

Broadly speaking, economists anticipate one of two recovery paths:

1 **V-shaped** – An immediate increase in output, growth and employment, returning to pre COVID-19 levels within 12-18 months. This is predicated on containing COVID-19 health risks quickly and an immediate increase in consumer and business confidence.

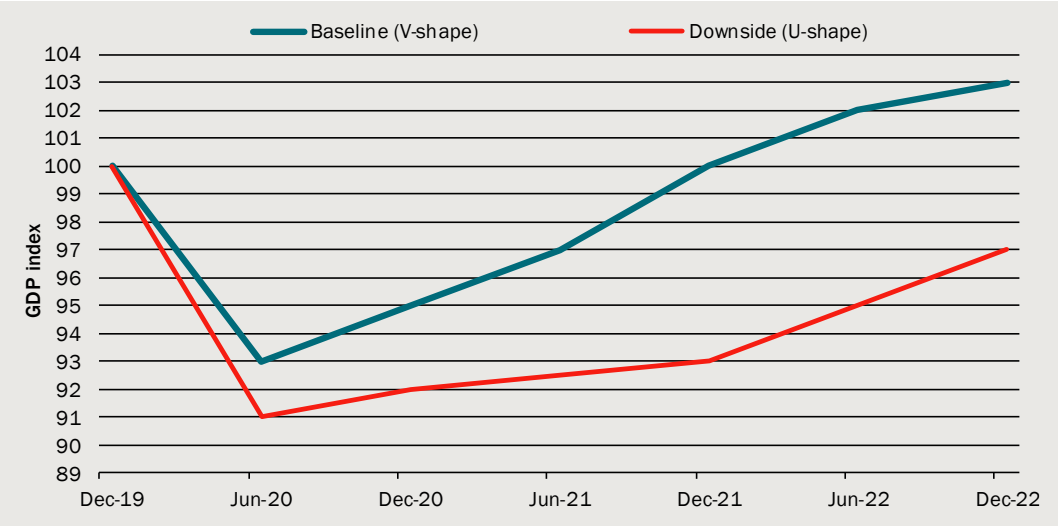
2 **U-shaped** – A protracted return (post two years) to pre COVID-19 output, growth and employment levels. This is associated with a long timeframe required to supress COVID-19 health risks and/or lingering consumer and business pessimism.

The RBA forecast a V-shape Australian economic recovery as the baseline scenario, and U-shape as the downside scenario (chart 1.16). The baseline V-shape scenario assumes Victoria's stage 4 restrictions, in which all non-essential businesses must not operate, remain in place for the announced six weeks and then gradually lifted. While restrictions in all other States and Territories are assumed to be gradually lifted with no return to "hard lockdowns". The down-side U-shape scenario assumes further COVID-19

18 RBA 2020, 'Statement on Monetary Policy – August 2020: Economic Outlook,' https://www.rba.gov.au/publications/smp/2020/aug/economic-outlook.html

outbreaks and associated restrictions on business activities and social gatherings during 2020 and 2021.[19]

1.16 Potential COVID-19 economic recovery paths



Note: Not to scale, for visual purposes only. December 2019 assumed to equal 100.

Data source: Stylised version of the RBA 2020, Statement on Monetary Policy – August 2020: Economic Outlook Graph 6.1: GDP forecast scenarios, https://www.rba.gov.au/publications/smp/2020/aug/economic-outlook.html

The actual economic recovery path is therefore contingent on suppression of COVID-19 health risks, which in turn will facilitate reduced economic restrictions, and greater certainty and business and consumer confidence.

19 RBA 2020, 'Statement on Monetary Policy – August 2020: Economic Outlook,' https://www.rba.gov.au/publications/smp/2020/aug/economic-outlook.html

2 *Australian business sectors and the challenges they face in the "new normal" paradigm*

Business challenges from the "new normal" COVID-19 paradigm

COVID-19 and the associated containment measures have introduced three unprecedented economic challenges to Australian business models:

1 uncertainty, in the form:
   – rapid changes in the health crises severity, and
   – unknown timeframe for a successful long-term COVID-19 suppression
2 restrictions on physical trade, social gatherings and the free movement of people beyond their primary place of residents, at times of heightened COVID-19 health risks, and across national and state borders
3 rapid fluctuations to consumer preferences, associated with 1 and 2.

These three challenges are independent of the success or otherwise of a businesses' historical financial management and marketing strategy and tactics. In other words, the fundamental economic model of every Australian business has suffered a significant, unexpected and unplanned shock.

Australian industries and their contribution to economic activity

Australian businesses are typically characterised by size (small, medium and large) and industry type. Business size is defined differently by different regulators and laws. The Australian Bureau of Statistics (ABS) define small, medium and large businesses based on the number of employees as follows:

- **Small** — less than 20 persons (including non-employing businesses)
- **Medium** — 20 to less than 200 persons, and
- **Large** — 200 or more persons.

Business industry classifications are more standardised according to the Australian and New Zealand Standard Industrial Classification (ANZSIC) codes. There are 19 ANZSIC division (table 2.1), which are broken down into subdivision, groups and classes.[20]

20 Refer to: https://www.abs.gov.au/ausstats/abs@.nsf/0/20C5B5A4F46DF95BCA25711F00146D75?opendocument

2.1 ANZSIC Divisions

ANZSIC Division	ANZSIC Division	ANZSIC Division	ANZSIC Division
AGRICULTURE, FORESTRY AND FISHING	WHOLESALE TRADE	FINANCIAL AND INSURANCE SERVICES	EDUCATION AND TRAINING
MINING	RETAIL TRADE	RENTAL HIRING AND REAL ESTATE SERVICES	HEALTH CARE AND SOCIAL ASSISTANCE
MANUFACTURING	ACCOMMODATION AND FOOD SERVICES	PROFESSIONAL, SCIENTIFIC AND TECHNICAL SERVICES	ARTS AND RECREATION SERVICES
ELECTRICITY, GAS, WATER AND WASTE SERVICES	TRANSPORT, POSTAL AND WAREHOUSING	ADMINISTRATIVE AND SUPPORT SERVICES	OTHER SERVICES
CONSTRUCTION	INFORMATION MEDIA AND TELECOMMUNICATIONS	PUBLIC ADMINISTRATION AND SAFETY	

Source: ABS 2008, 'Australian and New Zealand Standard Industrial Classification (ANZSIC), 2006 (Revision 1.0)', https://www.abs.gov.au/ausstats/abs@.nsf/0/20C5B5A4F46DF95BCA25711F00146D75?opendocument

In June 2019 Australia had an estimated 2.4 million businesses, employing 12.9 million Australians, with a value add of $1.3 trillion. Table 2.2 summarises the number, employment and value added of Australian businesses by industry.

- Number of business
  - Construction accounts for the largest number of businesses (16.6 per cent), followed by Professional, Scientific and Technical Services (12.4 per cent) and Rental, Hiring and Real Estate Services (8.9 per cent)
- Employment
  - Health care and Social Assistance employ the greatest proportion of Australians (13.4 per cent), followed by retail trade (9.9 per cent) and construction (9.1 per cent)
- Value add (contribution to GDP)
  - Mining contributes the largest value add to GDP (14.5 per cent), followed by Professional, Scientific and Technical Services (10.5 per cent) and construction (9.9 per cent)[21]

2.2 Australian business summary by industry (June 2019)

	Number of businesses		Employment		Value add	
	('000)	Per cent	('000)	Per cent	$m	Per cent
Agriculture, forestry & fishing	174	7.3	322	2.5	31 425	2.4
Mining	8	0.3	242	1.9	187 131	14.5
Manufacturing	86	3.6	874	6.8	112 271	8.7
Electricity, Gas, Water & Waste Services	7	0.3	163	1.3	51 414	4.0
Construction	395	16.6	1 177	9.1	128 003	9.9

21 Value add for Financial & Insurance Services not stated in ABS 2020, 8155.0 - Australian Industry, 2018-19.

	Number of businesses		Employment		Value add	
	('000)	Per cent	('000)	Per cent	$m	Per cent
Wholesale Trade	82	3.4	406	3.1	70 300	5.5
Retail Trade	133	5.6	1 280	9.9	78 927	6.1
Accommodation & Food Services	95	4.0	915	7.1	43 275	3.4
Transport, Postal & Warehousing	190	8.0	666	5.1	79 782	6.2
Information Media & Telecommunications	23	1.0	211	1.6	36 819	2.9
Financial & Insurance Services	212	8.9	447	3.5	[a]	0.0
Rental, Hiring & Real Estate Services	259	10.9	220	1.7	83 072	6.4
Professional, Scientific & Technical Services	294	12.4	1 157	8.9	135 745	10.5
Administrative & Support Services	96	4.1	468	3.6	67 285	5.2
Public Administration & Safety	8	0.3	818	6.3	6 477	0.5
Education & Training	33	1.4	1 088	8.4	30 756	2.4
Health Care & Social Assistance	142	6.0	1 734	13.4	97 275	7.5
Arts & Recreation Services	30	1.3	248	1.9	14 901	1.2
Other Services	102	4.3	507	3.9	34 420	2.7
Currently Unknown	6	0.3	-	0.0	-	0.0
Total	**2 376**	**100.0**	**12 941**	**100.0**	**1 289 278**	**100.0**

[a] Value add for Financial & Insurance Services not stated in ABS 2020, 8155.0 - Australian Industry, 2018-19.

Source: ABS 2020, '8165.0 - Counts of Australian Businesses, including Entries and Exits, June 2015 to June 2019,' https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/8165.0June%202015%20to%20June%202019?OpenDocument; ABS 2020, '6291.0.55.003 - Labour Force, Australia, Detailed, Quarterly, May 2020,' https://www.abs.gov.au/AUSSTATS/abs@.nsf/allprimarymainfeatures/5F60A449AE6DE5F6CA258090000ED52A?opendocument; ABS 2020, '8155.0 - Australian Industry, 2018-19,' https://www.abs.gov.au/ausstats/abs@.nsf/exnote/8155.0

COVID-19 impacts by industry

Economic cost

The economic impact has and will continue to vary across and within the different industry divisions, directly correlated to the COVID-19 restrictions on business enterprise, large social gatherings, free movement of people and fluctuating consumer preferences. Table 2.3 provides a qualitative assessment of COVID-19 business impacts by industry division.

2.3 Qualitative assessment of COVID-19 business impacts by industry

Industry	Restriction on trade & movement	Changing consumer preferences
Agriculture, forestry and fishing	Low	Medium
Mining	Medium	Low
Manufacturing	Medium	Low
Electricity, Gas, Water and Waste Services	Low	Medium
Construction	High	Low
Wholesale Trade	Medium	Medium
Retail Trade	Medium	High
Accommodation and Food Services	High	High
Transport, Postal and Warehousing	Medium	High
Information Media and Telecommunications	Medium	High
Financial and Insurance Services	Low	Low
Rental, Hiring and Real Estate Services	High	Low
Professional, Scientific and Technical Services	Medium	Low
Administrative and Support Services	Medium	Low
Public Administration and Safety	Medium	Low
Education and Training	High	Low
Health Care and Social Assistance	Medium	Medium
Arts and Recreation Services	High	Medium
Other Services	High	Medium

Sources: CIE

KEY: Low Medium High

Kompas, T et. al 2020[22] estimate a daily economic cost of $928 million for the government imposed COVID-19 control measures enacted over the March to May 2020 period. In absolute terms, this ranges from $120.9 million for mining to $7.0 million for Arts and Recreation services. When compared to value add, the top three impacted industries are:

- Retail Trade (8.2 per cent of value add)
- Accommodation and Food Services (7.0 per cent of value add), and
- Other Services (6.7 per cent of value add) (table 2.4).

22 Kompas, T et. al 2020, 'Health and Economic Costs of Early, Delayed and No Suppression of COVID-19: The Case of Australia', *medRxiv*, https://www.medrxiv.org/content/10.1101/2020.06.21.20136549v1

2.4 Economic cost of COVID-19 control measures by industry

Industry	Cost of control measures	Value add	Cost as a proportion of value add
	$m/day	$m/day[a]	Per cent
Agriculture, Forestry & Fishing	[b]	86	
Mining	121	513	4.2
Manufacturing	90	308	3.4
Electricity, Gas, Water & Waste Services	23	141	6.3
Construction	104	351	3.4
Wholesale Trade	36	193	5.4
Retail Trade	27	216	8.2
Accommodation & Food Services	17	119	7.0
Transport, Postal & Warehousing	40	219	5.4
Information Media & Telecommunications	25	101	4.1
Financial & Insurance Services	100	[b]	
Rental, Hiring & Real Estate Services	34	228	6.7
Professional, Scientific & Technical Services	89	372	4.2
Administrative & Support Services	48	184	3.8
Public Administration & Safety	[b]	18	
Education & Training	81	84	1.0
Health Care & Social Assistance	73	267	3.7
Arts & Recreation Services	7	41	5.8
Other Services	14	94	6.7
Total	**928**	**3 532**	

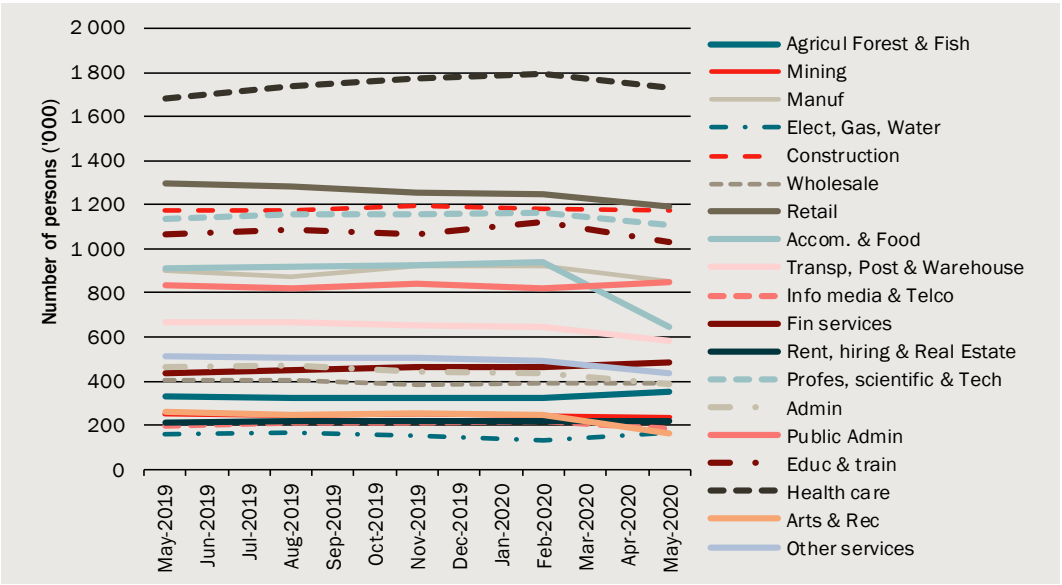
[a] Annual value add divided by 365. [b] Not reported.

Sources: Kompas, T et. al 2020, 'Health and Economic Costs of Early, Delayed and No Suppression of COVID-19: The Case of Australia', medRxiv, https://www.medrxiv.org/content/10.1101/2020.06.21.20136549v1; ABS 2020, 8155.0 - Australian Industry, 2018-19, https://www.abs.gov.au/ausstats/abs@.nsf/exnote/8155.0; CIE

Employment

Reducing employment levels were a common response by businesses to mitigate the heightened COVID-19 costs, particularly in the hardest hit industries. For example, the Accommodation and Food Services (36 per cent), Education and Training (11 per cent) and Arts and Recreation Services (11 per cent) industries accounted for 58 per cent of total job losses between February and May 2020 (chart 2.5 and table 2.6). This is associated with the COVID-19 enforced restrictions on social gatherings and international and domestic travel.

2.5 Employed persons by industry



Note: Seasonally adjusted figures

Data source: ABS 2020, 6291.0.55.003 - Labour Force, Australia, Detailed, Quarterly, May 2020, https://www.abs.gov.au/AUSSTATS/abs@.nsf/allprimarymainfeatures/5F60A449AE6DE5F6CA258090000ED52A?opendocument

2.6 Job losses by industry (February to May 2020)

Industry	Job losses	% of total job losses
	('000)	Per cent
Accommodation and Food Services	293	36
Education and Training	89	11
Arts and Recreation Services	88	11
Manufacturing	68	8
Transport, Postal and Warehousing	64	8
Health Care and Social Assistance	60	7
Professional, Scientific and Technical Services	57	7
Retail Trade	56	7
Other Services	53	7
Administrative and Support Services	45	6
Information Media and Telecommunications	33	4
Construction	9	1
Mining	8	1
Wholesale Trade	0	0
Rental, Hiring and Real Estate Services	-1	0
Financial and Insurance Services	-20	-3
Public Administration and Safety	-27	-3
Agriculture, Forestry and Fishing	-30	-4
Electricity, Gas, Water and Waste Services	-32	-4
Total	**-811**	**100**

Note: Negative figures indicate job gains.

Source: ABS 2020, 6291.0.55.003 - Labour Force, Australia, Detailed, Quarterly, May 2020, https://www.abs.gov.au/AUSSTATS/abs@.nsf/allprimarymainfeatures/5F60A449AE6DE5F6CA258090000ED52A?opendocument

Fluctuating consumer preferences

COVID-19 restrictions on business activities, travel and social gatherings, as well as economic uncertainty, has also changed consumer preferences. As COVID-19 associated restrictions and uncertainty increased, consumers substituted to goods and services that (chart 2.7):

- can be consumed in private settings and/or without the need for close social contact,
  - communications and furnishings
    - 2.4 and 1.5 per cent in increase in the March and June quarters respectively
  - household equipment
    - 1 and 10 per cent in increase in the March and June quarters respectively
  - electricity, gas and fuel
    - 4.8 per cent in increase in the June quarter
- are durable or non-perishable
  - food
    - 5.8 per cent increase in the March quarter
  - alcohol
    - 3.4 per cent increase in the March quarter
    - 13 per cent increase in the June quarter

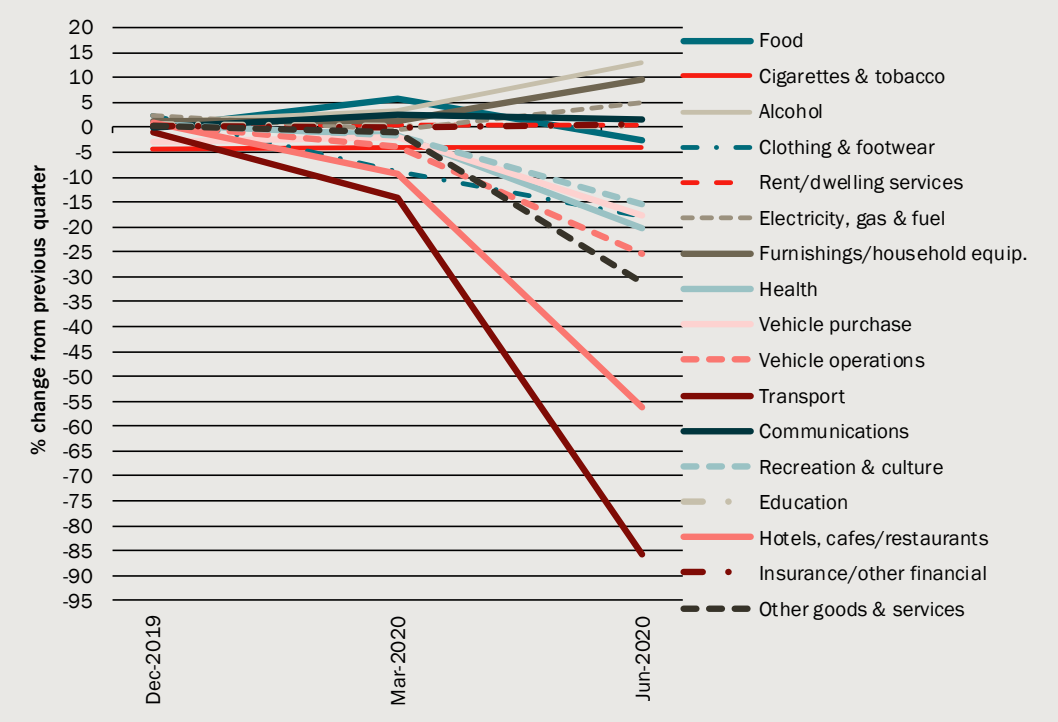
Conversely, consumers significantly reduced their consumption of:

- transport services
  - 14 per cent reduction in the March quarter
  - 86 per cent reduction in the June quarter
- hotels, cafes and restaurants
  - 9 per cent reduction in the March quarter
  - 56 per cent reduction in the June quarter
- clothing and footwear
  - 8.9 per cent reduction in the March quarter
  - 18 per cent reduction in the June quarter
- recreation and cultural services
  - 2 per cent reduction in the March quarter
  - 18 per cent reduction in the June quarter, and
- health services
  - 1.6 per cent reduction in the March quarter
  - 20 per cent reduction in the June quarter.

The fluctuating consumer preferences have therefore been uneven across industries, with some experiencing a sharp sudden decrease and others a significant increase. In some

cases, demand surges have proved challenging for some businesses to accommodate, particularly for non-perishable groceries.

2.7 Household consumption by type 2019-2020



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

3 *Business opportunities for long term success*

Arguably, businesses' control over the exogenous COVID-19 associated uncertainty is limited to following medical expert health advise and imploring for an expediated long term suppression strategy. However, opportunities exist for businesses to pivot to overcome the shocks associated with restrictions on physical trade, social gatherings, the free movement of people and changing consumer preferences. We consider innovation, customer retention and balance sheet management.

Innovation

Innovation is referred to as coming up with new ways to do things. This encompasses new products, ideas and processes.[23] Economists refer to the evolution of product and process innovation, by which new products, ideas and processes replace outdated ones, as creative destruction. It is broadly accepted that creative destruction results in economic growth. For example, Kogan, L et. al 2016[24] conclude that periods of rapid technological innovation, such as the 1920s, the 1960s, and the 1990s, lead to a measurable increase in overall productivity and economic growth.

New products, ideas and processes have been implemented by businesses to serve existing and new customers, given COVID-19 associated business restrictions and changing consumer preferences. For example:

- online sales accounted for 11.1 per cent of retail trade in April 2020, up from 7.1 per cent in March 2020[25]
- Woolworths Partnerships with Sherpa, Drive Yello, DHL and Australia Post to expand online pickup and delivery capacity
- Triple Eight Race Engineering, based in Brisbane, engineering ventilators when their racing season was postponed, and
- Australian Distilleries making Hand Sanitiser.

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23 https://www.business.gov.au/change-and-growth/innovation/what-is-innovation

24 Kogan, L et. al 2016, 'Technological Innovation, Resource Allocation, and Growth,' *Stanford Graduate School of Business*, https://www.gsb.stanford.edu/faculty-research/working-papers/technological-innovation-resource-allocation-growth?undefined

25 https://www.abs.gov.au/ausstats/abs@.nsf/7d12b0f6763c78caca257061001cc588/0aefe93da719d4aeca257c350010f212!OpenDocument

Customer retention

Research indicates that higher buying rates and lower service cost make it cheaper to service long term customers (customer retention management), compared to acquiring new ones (customer acquisition marketing).[26]

On the consumer side, it is known that individuals prefer familiar goods, status quo choices, and gambles with known outcomes, or which are easier to calculate. This is referred to as the familiarity bias. Familiarity bias is also evident in capital markets, where individuals favour known investments, value losses higher than gains (endowment effect) and hold strongly to past choices (inertia effect).[27]

Customer retention management and familiarity bias present a strong opportunity for businesses to increase sales, especially given the uncertain timeframe required to successfully supress COVID-19 and the associated economic recovery.

Further, recent increases to the household saving ratio[28] (chart 3.1) indicate that customers can increase their spending when consumer confidence improves. The increased household saving ratio was driven by a 42 per 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.

Berger-Thomson, L et. al 2009,[29] find that households with low incomes have a higher Marginal Propensity to Consume (MPC), consistent with the idea that these households are more likely to face liquidity constraints. That is, lower income households are more likely to have a higher change to consumption, in response to a temporary change in income. This is related to lower income households having less ability to borrow and smooth intemporal consumption in response to sudden income fluctuations.

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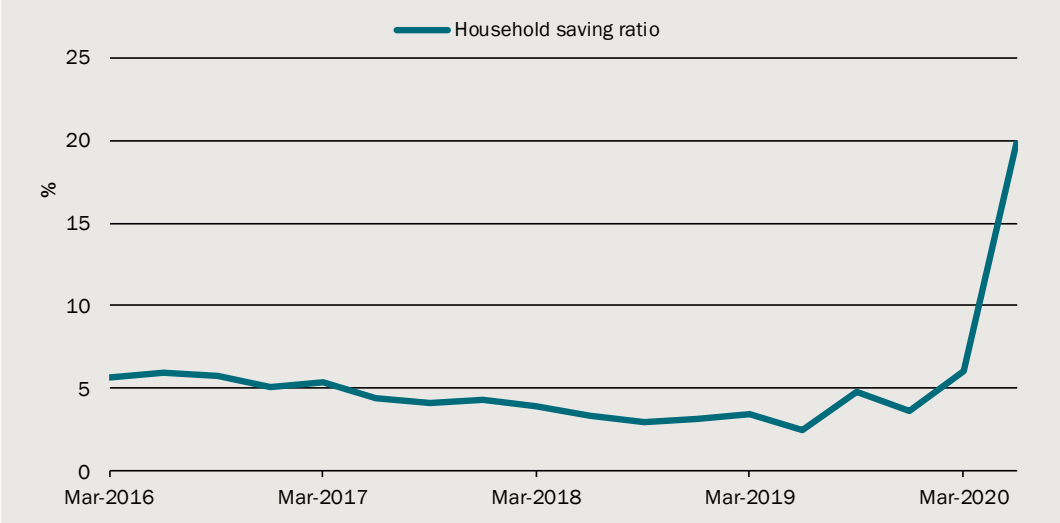
26 For example, Reichheld, F 2001, 'Prescription for cutting costs,' *Bain & Company*, https://media.bain.com/Images/BB_Prescription_cutting_costs.pdf

27 Cao, H et. al 2011, 'Fear of the Unknown: Familiarity and Economic Decisions,' *Review of Finance (2011) 15: 173–206*

28 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.

29 Berger-Thomson, L et. al 2009, 'Estimating Marginal Propensities to Consume in Australia Using Micro Data', RDP 2009-07, *Reserve Bank of Australia*, https://www.rba.gov.au/publications/rdp/2009/pdf/rdp2009-07.pdf

3.1 Household saving ratio



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

Balance sheet management

Despite business liquidity not being the initial cause of the current economic downturn, effective balance sheet management is crucial for any business to survive the current COVID-19 headwinds. For example, Australia experienced a sustained increase in monthly business insolvency and liquidations post the most recent economic downturn, the 2008 Global Financial Crises (GFC) (chart 3.2).

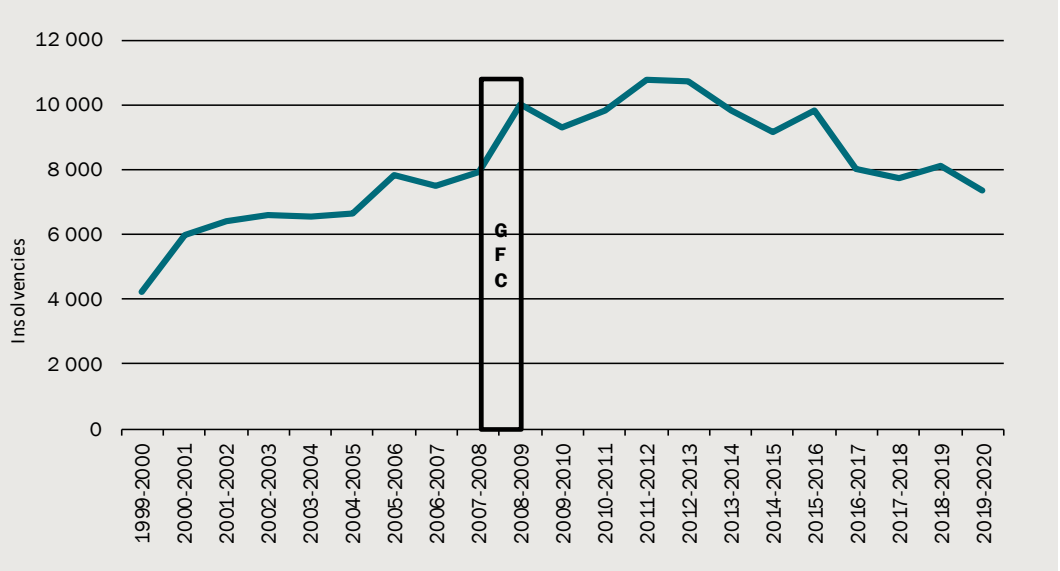
Interestingly, recent monthly insolvencies are down on historical trends (chart 3.3). For example, monthly insolvencies were 56 per cent lower in July 2020, compared to July 2019. The wholesale trade (77 per cent decline), construction (71 per cent decline) and manufacturing industries (65 per cent decline) experienced the largest fall in insolvencies over the July 2019 to July 2020 period.

The downward insolvency trend is attributed to:

- the temporary government fiscal stimulus and balance sheet measures discussed in chapter 2
- a temporary increase to the threshold at which creditors can issue a statutory demand on a company and the time companies have to respond to statutory demands they receive (box 3.4), and
- loan deferrals.[30]

30 https://www.ausbanking.org.au/covid-19-relief-faqs/

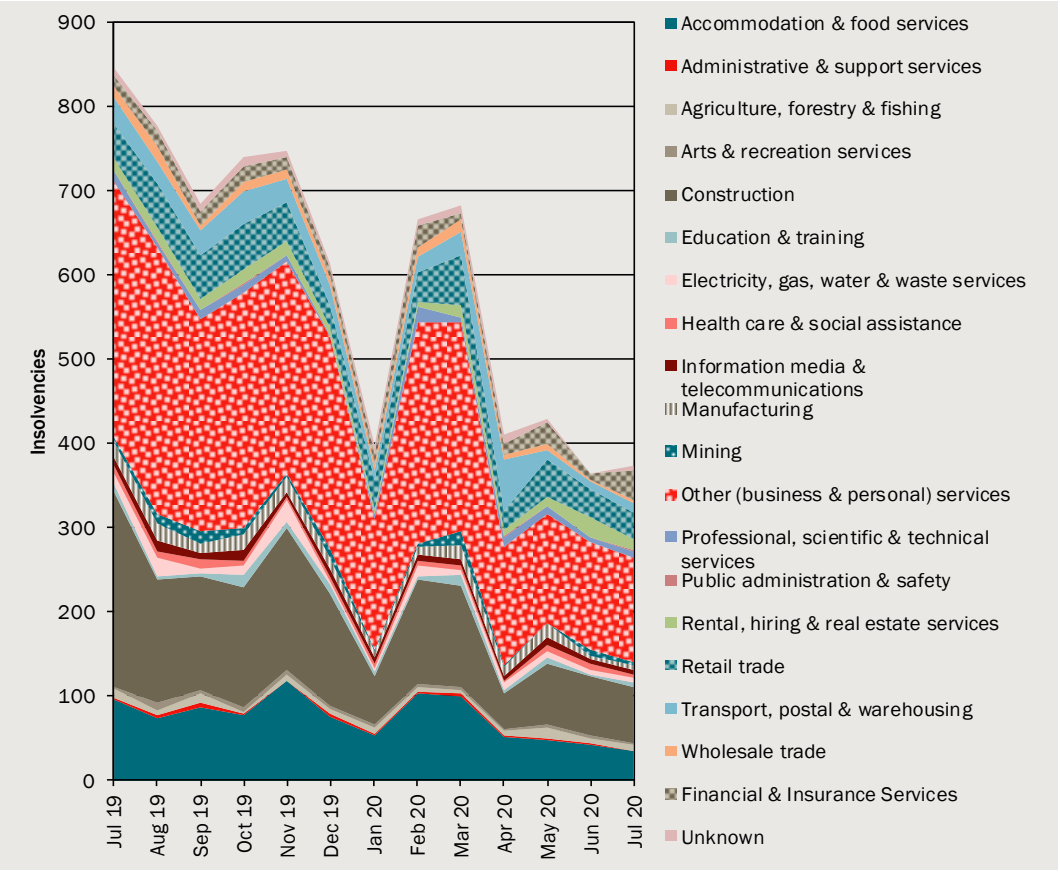
3.2 Annual time series of companies entering voluntary administration



Note: Financial years

Data source: ASIC 2020, 'Insolvency statistics - Series 1 Companies entering external administration,' https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-1-companies-entering-external-administration/

3.3 Monthly insolvencies by industry



Data source: ASIC 2020, 'Insolvency statistics - Series 1A Companies entering external administration - by industry', https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-1a-companies-entering-external-administration-by-industry/

3.4 Australian Government temporary relief for financially distressed businesses

The Australian Government has temporarily increased the threshold at which creditors can issue a statutory demand on a company and the time companies must respond to statutory demands they receive. This includes temporary relief for directors from any personal liability for trading while insolvent and providing temporary flexibility in the *Corporations Act 2001* (the Act) to provide temporary and targeted relief from provisions of the Act.

The elements of the package are:

- A temporary increase in the threshold at which creditors can issue a statutory demand on a company and the time companies must respond to statutory demands they receive
- A temporary increase in the threshold for a creditor to initiate bankruptcy proceedings, an increase in the time period for debtors to respond to a bankruptcy notice, and extending the period of protection a debtor receives after making a declaration of intention to present a debtor's petition
- Temporary relief for directors from any personal liability for trading while insolvent
- Providing temporary flexibility in the Act to provide targeted relief for companies from provisions of the Act to deal with unforeseen events that arise as a result of the COVID-19 health crisis.
- The Australian Taxation Office (ATO) will tailor solutions for owners or directors of businesses that are currently struggling due to the coronavirus, including temporary reduction of payments or deferrals, or withholding enforcement actions including Director Penalty Notices and wind-ups.[31]

It is therefore anticipated that insolvency and liquidations will increase when these temporary measures are wind down. However, it is an open debate as to what that future increase will look like.

Claiming available government business assistance

The Australian Government and State/Territory governments have facilitated short term business cash flow by implementing a range of supporting balance sheet measures, such as the 'Boosting cash flow for employers measure'[32] (box 3.5), business grants, waiver of taxes, licence fees and government charges.

31 https://business.gov.au/risk-management/emergency-management/coronavirus-information-and-support-for-business/temporary-relief-for-financially-distressed-businesses

32 https://treasury.gov.au/sites/default/files/2020-04/fact_sheet-boosting_cash_flow_for_employers.pdf

3.5 Boosting cash flow for employers

The Australian Government is providing two sets of tax-free cash flow boosts of between $20,000 and $100,000, delivered from 28 April 2020, to employing businesses with an aggregate annual turnover of less than $50 million, and not-for-profit organisations. The cash flow boosts will be delivered via credits in the activity statement system, when eligible businesses lodge their activity statements.[33]

Interestingly, not all eligible businesses have availed themselves of the government's business assistance. The ABS Business Impacts of COVID-19 Survey[34] indicates that 70 per cent of surveyed businesses are aware of the Boosting Cash Flow for Employers measure, with 61 per cent of surveyed employing businesses receiving it. Particular opportunity exists for businesses in the Arts and Recreation Services, Education and Training, Health Care and Social Assistance and Retail Trade industries, who exhibit the lowest recipient rates of employing businesses, despite knowledge of the available assistance (table 3.6).

3.6 Businesses that received support from the Boosting Cash Flow for Employers measure

Industry	All businesses (a)	Employing businesses (b)	Businesses that are aware of Boosting Cash Flow for Employers measure (c)	Businesses aware of measure and employing businesses receiving it (b) – (c)
	Per cent	Per cent	Per cent	Per cent
Mining	41	49	54	5
Manufacturing	68	71	83	12
Electricity, Gas, Water and Waste Services	47	54	59	5
Construction	53	61	70	9
Wholesale Trade	55	56	67	11
Retail Trade	64	67	80	13
Accommodation and Food Services	55	61	70	9
Transport, Postal and Warehousing	51	57	62	5
Information Media and Telecommunications	54	64	71	7
Financial and Insurance Services	74	78	88	10

33 Australian Government 2020, 'Economic response to the Coronavirus: Boosting cash flow for employers,' https://treasury.gov.au/sites/default/files/2020-04/fact_sheet-boosting_cash_flow_for_employers.pdf

34 ABS 2020, '5676.0.55.003 - Business Indicators, Business Impacts of COVID-19,' August 2020, https://www.abs.gov.au/ausstats/abs%40.nsf/mediareleasesbyCatalogue/49F8475B31112582CA25853600764041

Industry	All businesses (a)	Employing businesses (b)	Businesses that are aware of Boosting Cash Flow for Employers measure (c)	Businesses aware of measure and employing businesses receiving it (b) – (c)
	Per cent	Per cent	Per cent	Per cent
Rental, Hiring and Real Estate Services	63	68	73	5
Professional, Scientific and Technical Services	46	56	54	-2
Administrative and Support Services	34	41	53	12
Education and Training	46	48	68	20
Health Care and Social Assistance	53	57	73	16
Arts and Recreation Services	56	57	85	28
Other Services	56	69	79	10
Total	**54**	**61**	**70**	**9**

Source: ABS 2020, 5676.0.55.003 - Business Indicators, Business Impacts of COVID-19, August 2020, https://www.abs.gov.au/ausstats/abs%40.nsf/mediareleasesbyCatalogue/49F8475B31112582CA25853600764041

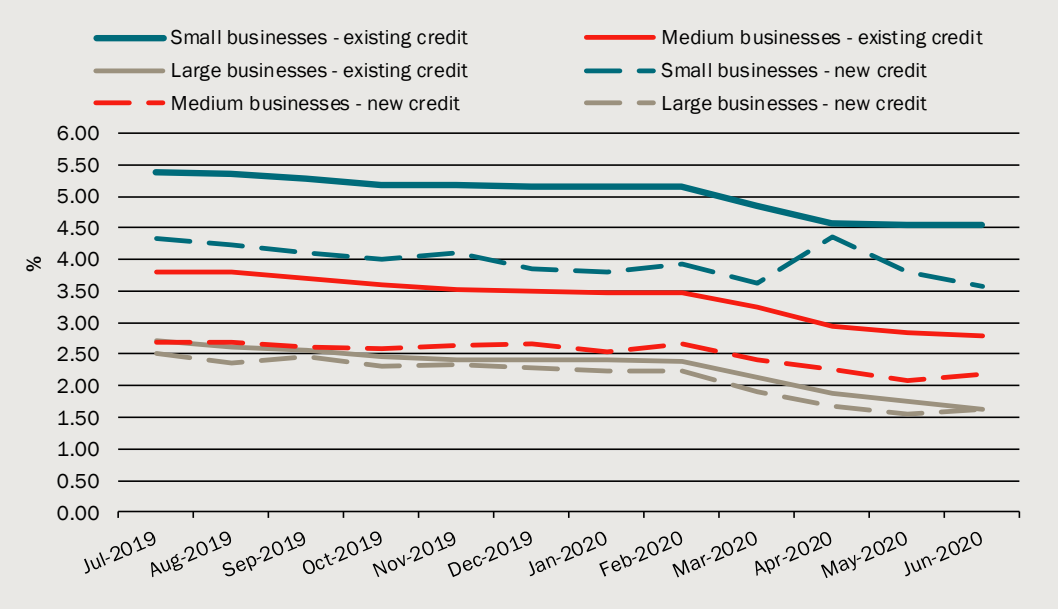
Debt and equity injections

Debt

Current low business interest rates provide a potential opportunity for affordable debt-financing, subject to the respective businesses' individual financial position. As noted in chapter 1, the RBA target cash rate has decreased to an historic low of 0.25 per cent. The cash rate reductions have coincided with falls on existing variable interest rate business loans, particularly to large businesses which have an average interest rate on existing credit of 1.63 per cent and 1.62 per cent for new credit. Medium sized businesses have an average interest rate of 2.78 per cent for existing credit and 2.19 per cent for new credit. Small businesses have an average interest rate of 4.54 per cent for existing credit and 3.57 per cent for new credit (chart 3.7).[35]

35 RBA 2020, *Statement on Monetary Policy – August 2020*: *Domestic Financial Conditions,* https://www.rba.gov.au/publications/smp/2020/aug/domestic-financial-conditions.html

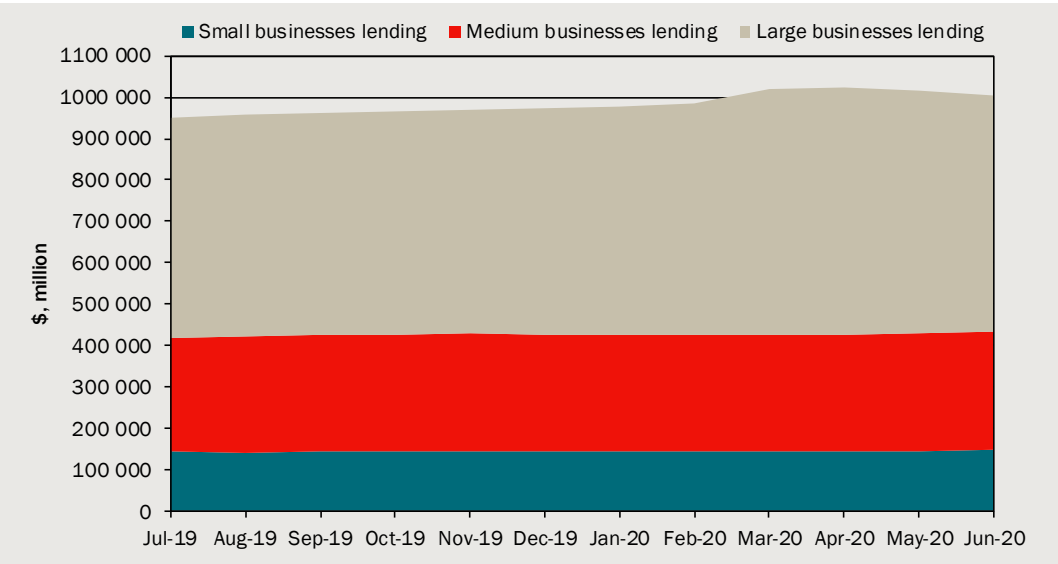
3.7 Business interest rates



Data source: RBA 2020, Statistical Tables: Business Lending rates – F7, https://www.rba.gov.au/statistics/tables/#interest-rates

Business lending increased for large businesses in March 2020, potentially to increase reserves to cover the impending business trading restrictions. In contrast, lending remained stable for medium and small businesses despite the lower interest rates, largely attributable to subdued demand for new loans (chart 3.8).

3.8 Business lending by size



Data source: RBA 2020, Statistical Tables: Lending to Business – Business Finance Outstanding by Business Size and Interest Rate Type – D14, https://www.rba.gov.au/statistics/tables/#interest-rates

Equity

As noted in chapter 1, the RBA has substantially increased financial market liquidity, via a step change in its open market operations and purchase of government bonds in

secondary markets. The increased financial market liquidity presents an opportunity for businesses to source an equity injection. For example, the increased financial liquidity has been linked to increases in stock market values, as the presence of more money in the hands of investors generates higher prices.[36] The ASX 200 has seen a 21 per cent increase between March and August 2020, following a sudden fall, despite the negative macroeconomic outlook (chart 3.9).

3.9 S&P/ASX 200

Data source: Yahoo finance, https://au.finance.yahoo.com/quote/%5EAXJO/history?period1=725846400&period2=1598659200&interval=1mo&filter=history&frequency=1mo

36 Sunder, S 2020, 'Liquidity Injections May Have Driven the Stock Market Recovery', June 17, *Yale Insights*, https://insights.som.yale.edu/insights/liquidity-injections-may-have-driven-the-stock-market-recovery

4 Summary of key findings

The World Health Organisation declared the COVID-19 global pandemic in March 2020. In response, the Australian Government, and State/Territory counterparts implemented immediate forced businesses closures for some industries, coupled with restrictions on large gatherings and other containment measures that limit economic activities.

Australian macroeconomic landscape post COVID-19

The Australian economy is undoubtedly impacted by the COVID-19 pandemic:

- officially entering its first recession in 30 years at the June 2020 quarter
- unemployment increased to a 19 year high of 7.5 per cent in July and is forecast to persist above this level until December 2022
- sudden and sharp falls in consumer expenditure on services, punctuated by converse expenditure on non-perishable goods, and
- accelerated declines in new capital expenditure in the March and June 2020 quarters.

Significant monetary and fiscal policy measures have been implemented in response to the COVID-19 induced economic downturn:

- **Monetary policy**
  - The RBA decreased the target cash rate to a record low of 0.25 per cent in March 2020, and
  - drastically increased the supply of liquidity to the banking system by scaling up its open market operations and purchasing government bonds in secondary markets.
- **Fiscal policy**
  - The Australian Government has provided $293 billion of COVID-19 economic spending ($168 billion of fiscal stimulus, and $125 billion of balance sheet measures) for the period 2019-20 to 2021-22, increasing net debt to $677.1 billion in 2020-21 (35.7 per cent of GDP).
  - State and Territories government have also implemented COVID-19 business assistance packages in the form of:
    - tax and licence fee waivers
    - grants to subsidise business fixed costs during imposed trading restrictions
    - grants to subsidise re-opening, upscaling, or diversify operations post COVID-19 imposed restrictions, and
    - subsidised re-training and upskilling.

Broadly speaking, economists anticipate one of two recovery paths:

1 **V-shaped** – An immediate increase in output, growth and employment, returning to pre COVID-19 levels within 12-18 months. This is predicated on containing COVID-19 health risks quickly and an immediate increase in consumer and business confidence.
2 **U-shaped** – A protracted return (post two years) to pre COVID-19 output, growth and employment levels. This is associated with a long timeframe required to supress COVID-19 health risks and/or lingering consumer and business pessimism.

COVID-19 associated business challenges

COVID-19 and the associated containment measures have introduced three unprecedented economic challenges to Australian business models:

1 uncertainty, in the form:
   – rapid changes in the health crises severity, and
   – unknown timeframe for a successful long-term COVID-19 suppression
2 restrictions on physical trade, social gatherings and the free movement of people beyond their primary place of residents, at times of heightened COVID-19 health risks, and across national and state borders
3 rapid fluctuations to consumer preferences, associated with 1 and 2.

These three challenges are independent of the success or otherwise of a businesses' historical financial management and marketing strategy and tactics. In other words, the fundamental economic model of every Australian business has suffered a significant, unexpected and unplanned shock.

Economic costs of restrictions

A daily economic cost of $928 million has been estimated for the government imposed COVID-19 control measures enacted over the March to May 2020 period. When compared to value add, the top three impacted industries are:

- Retail Trade (8.2 per cent of value add)
- Accommodation and Food Services (7.0 per cent of value add), and
- Other Services (6.7 per cent of value add).

Employment

Reducing employment levels were a common response by businesses to mitigate the heightened COVID-19 costs, particularly in the hardest hit industries. For example, the Accommodation and Food Services (36 per cent), Education and Training (11 per cent) and Arts and Recreation Services (11 per cent) industries accounted for 58 per cent of total job losses between February and May 2020. This is associated with the COVID-19 enforced restrictions on social gatherings and international and domestic travel.

Fluctuating consumer preferences

Consumer preferences have also been materially impacted by COVID-19 associated restrictions and uncertainty, with increased demand for goods and services that:

- can be consumed in private settings and/or without the need for close social contact (communications and furnishings and household equipment), and
- are durable or non-perishable (food and alcohol).

Conversely, consumers significantly reduced their consumption of:

- transport services
- hotels, cafes and restaurants
- clothing and footwear
- recreation and cultural services, and
- health services.

Business opportunities

Innovation, customer retention strategies and balance sheet management are three ways businesses can overcome the shocks associated with restrictions on physical trade, social gatherings, the free movement of people and changing consumer preferences.

Innovation

Economists refer to the evolution of product and process innovation, by which new products, ideas and processes replace outdated ones, as creative destruction. Periods of rapid technological innovation, such as the 1920s, the 1960s, and the 1990s, lead to a measurable increase in overall productivity and economic growth.

Customer retention strategies

Customer retention management and familiarity bias present a strong opportunity for businesses to increase sales, especially given the uncertain timeframe required to successfully supress COVID-19 and associated economic recovery.

Balance sheet management

Not all eligible businesses have availed themselves of the government's business assistance. Opportunity exists for businesses in the Arts and Recreation Services, Education and Training, Health Care and Social Assistance and Retail Trade industries to increase their use of available government COVID-19 cash flow measures.

Further, historical low business interest rates and increased financial market liquidity provide a potential opportunity for affordable debt financing and equity injections.

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