



COPING WITH COVID-19: RETHINKING AUSTRALIA

Taking the Pulse of the Nation 2020

1. The New Normal: Navigating an Economic Recovery



1 THE NEW NORMAL: NAVIGATING AN ECONOMIC RECOVERY

Guay Lim, Viet Nguyen, Tim Robinson, and Sam Tsiaplias

Strong household consumption growth is crucial for a domestic-led recovery in the face of a bleak global outlook and low population growth. Actual and expected spending patterns have improved, but consumption growth is likely to be uneven across Australia. Improving wage growth will help the majority of Australians vulnerable to financial stress, but lifting living standards also requires improving productivity and participation.

On the road to economic recovery, a pick-up in household consumption is key, but GDP growth could be weighed down by low growth in population and wages.

Australia is a small-open economy, and is materially affected by developments abroad, through trade in goods and services, financial factors, and the international movement of people.

COVID-19, lockdowns, and the closure of borders have had a massive negative pervasive impact on Australia's economic performance in 2020. Overall, GDP plummeted by a record 7 percent in the June quarter following a small fall of 0.3 percent in the March quarter (Australian National Accounts, June Quarter 2020). Australia entered its first technical recession since 1991, with hours worked falling heavily, and underemployment spiking.

Low expected population growth may constrain the pace of economic recovery

An important consequence of the pandemic is that Australia is expected to have its lowest population growth in 100 years, slowing from 1.2 percent in 2019/20 to an anticipated 0.2 percent in 2020/21, and 0.4 percent in 2021/22 (Parliamentary Budgetary Office, October 2020). This has serious implications for the economic outlook as it will simultaneously reduce growth in demand for housing, goods and services, as well as growth in the labour force (potentially of skilled working age migrants).

In the face of a weak global outlook, and low population growth, economic recovery in Australia during 2021 will rely heavily on domestic conditions. Growth in household consumption, which accounts for around 60 percent of GDP, is critical, given the likely absence of strong growth in business investment amid considerable economic uncertainty.

A household's ability and intention to spend depends critically on current and expected disposable income, however low real wage growth has been a drag on consumption growth for several years (and well before the appearance of COVID-19). This would likely increase the vulnerability of lower and middle-income Australian households to adverse income shocks. Low productivity growth has been a contributing factor to the low real wages growth.

Taking a closer look at how we are spending and working our way to economic recovery is also important for improving the living standards of Australians. In this regard, it is important to identify those who are experiencing difficulties paying for essential goods and services, and who are likely to be in need of additional income support.

The New Normal: Navigating an Economic Recovery.

Consumption, Wages and Financial Vulnerability

In the *Taking the Pulse of the Nation* (TTPN) survey we asked respondents to consider the change in their actual and expected spending relative to January 2020. In particular, whether they have spent more, the same or less in six months' time. The questions were asked in three waves: Wave 14 (6-10 July), Wave 18 (31 August-6 September) and Wave 22 (2-8 November).

Figure 1.1 shows that the proportion of Australians spending more has increased, while the proportion spending less has decreased, between July and November. For both actual and expected spending, the response "spending less" outweighed "spending more" until November. In November, when asked about likely spending in May 2021, the proportion expecting to "spend more" outweighed the proportion expecting to "spend less" indicating that household beliefs about economic conditions have improved over the course of the year. Nevertheless, the majority of respondents expect to spend the same or less suggesting that growth in spending over the first half of 2021 will likely be weak.

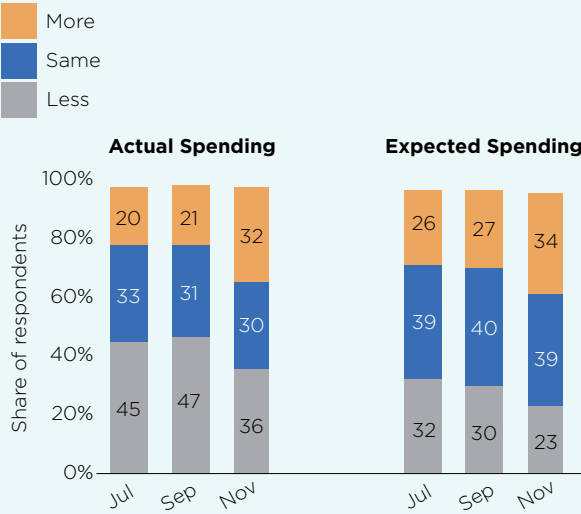
Focusing on the spending prospects across the states, namely the net balance of the responses (i.e. "expect to spend more" minus "expect to spend less" in percentage points), reveals a stark difference between the likely growth paths of consumption in each state.

Figure 1.2, based on Wave 22 about expected spending in 2021, shows that the balances are favourably large for NSW (13 ppts), VIC (15 ppts), and SA (23 ppts), but negligible for QLD (1 ppt) and WA (3 ppts). This suggests a two-speed recovery in domestic spending led by the non-resource intensive states (NSW, VIC and SA).

The pace of economic performance of Australian states often differs markedly reflecting the states' different industry profiles. NSW and VIC are often described as the service states, with sectors such as financial, real estate and insurance-related services, IT and educational services being dominant. WA and QLD are usually referred to as the resource states and are more dependent on trade in commodities and tourism. During the commodity boom years, the resource-rich states outperformed the rest of Australia.

The survey insights about spending across the states suggest the possible re-emergence of a 2-speed economy, but this time, growth in WA and QLD likely lags growth in the rest of Australia.

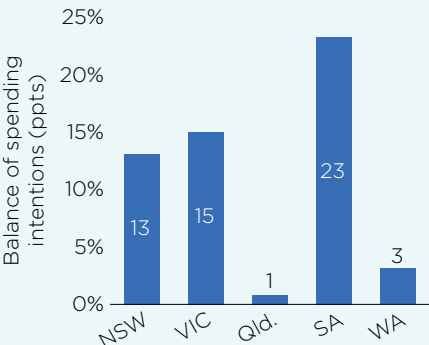
Figure 1.1 Proportions (%) Spending, More, Same or Less (Relative to January 2020): Actual and Expected



Source. *Taking the Pulse of the Nation* (TTPN) survey (Melbourne Institute), Wave 14 (6-10 Jul), Wave 18 (31 Aug - 6 Sep) and Wave 22 (2-8 Nov).

Notes for Figure 1.1. The sample size is 1,200 per wave.

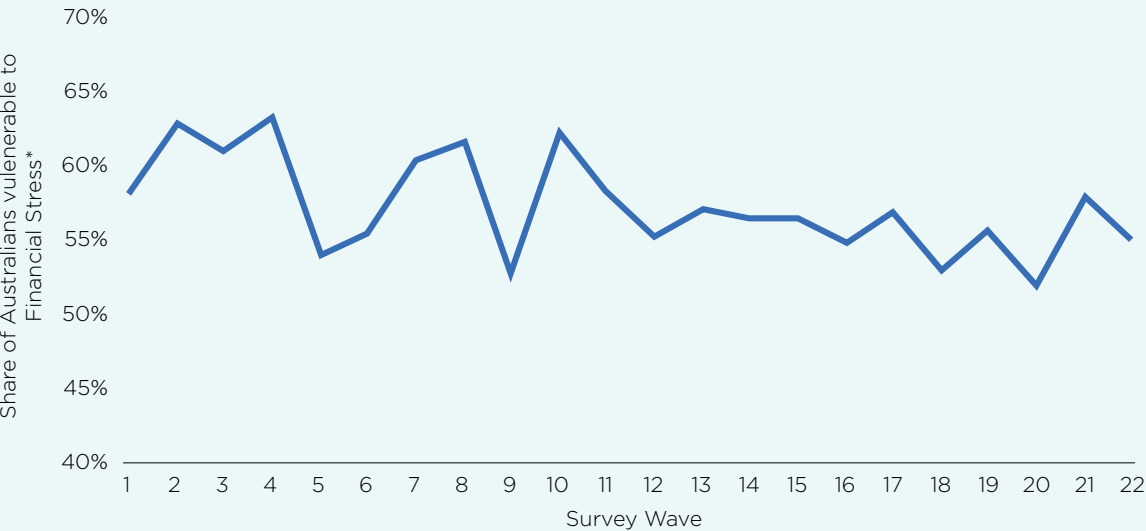
Figure 1.2 Balance of Spending Intentions (ppts) Across the Mainland States



Source. *Taking the Pulse of the Nation* (TTPN) survey (Melbourne Institute), Wave 22 (2-8 Nov).

Notes for Figure 1.2 Balance of spending intentions is defined as 'Expect to Spend More' minus 'Expect to Spend Less'. The sample size is 1,200 per wave.

Figure 1.3 Proportion of Australians who are Financially Vulnerable*



Source. *Taking the Pulse of the Nation* (TTPN) survey (Melbourne Institute), Waves 1-22 (6 Apr-8 Nov).

Notes for Figure 1.3 *Financial stress refers to the situation of having difficulties paying for essential goods and services while financial vulnerability refers to being in financial stress or making ends meet. The sample size is 1,200 per wave.

In general, consumption growth would be facilitated by higher income growth. Since wages and salaries are the main income stream for the majority of Australians, and lowering financial stress is likely to be associated with more spending, it follows that greater wage growth for financially stressed households would likely stimulate additional spending (rather than saving).

A closer look at the TTPN survey data reveals that the majority of Australians are financially vulnerable, and therefore are highly sensitive to adverse income shocks, such as a drop in wages due to reduced hours worked. Figure 1.3 shows that the combined proportion of respondents experiencing difficulties in paying for essential goods and services and the proportion only 'making ends meet' has exceeded 50 percent throughout the 8 months of the survey.

Improving productivity and labour force participation will be crucial to lifting the standard of living of Australians

A weak global outlook and closed borders suggest that any economic recovery will likely be domestic-led, with a focus on household consumption. The TTPN survey provides evidence that spending will improve, although unevenly across Australia, with the possible re-emergence of a 2-speed economy. Policies to boost income growth and mitigate financial vulnerability may be challenging but beneficial as the majority of Australians report difficulty in paying for essential goods and services or report only making ends meet.

While stimulating demand to reduce unemployment is critically important in the near term, Australia also faces medium-term challenges. Lifting the living standards of Australians calls for policies aimed at increasing labour force participation and improving productivity growth (such as creating jobs in high-value industries to help promote real wages growth).

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Researchers at the Melbourne Institute have been informing and shaping economic and social policy in Australia since its establishment in 1962. The Melbourne Institute's list of longstanding accomplishments includes the creation of such things as: the Henderson Poverty line, the blueprint for Medicare, the Household, Income and Labour Dynamics in Australia (HILDA) Survey, the Australian Economic Review, and the Consumer Sentiment Index. Melbourne Institute researchers have engaged in analyses on critical issues such as poverty, economic growth and inflation, housing and family structure, healthcare and wellbeing, employment and skill development, and tax and transfer policies.

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The *Taking the Pulse of the Nation* survey was created for the purpose of being able to track the economic and social wellbeing of Australians and to provide measures of attitudes and willingness to take on risk given the coronavirus pandemic. These data have been used to provide timely insights that track behaviour and inform policy.

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