committee for economic development of australia

ECONOMIC AND POLITICAL OUTLOOK

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committee for economic development of australia

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About CEDA

CEDA – the Committee for Economic Development of Australia – is an independent, membership-based think tank. CEDA's purpose is to identify policy issues that matter for Australia's future and pursue solutions that deliver better economic and social outcomes for the greater good.

We deliver on our purpose by:

- Undertaking research to understand the most important issues Australia faces.
- Creating platforms to inform, stimulate ideas and promote debate of critical issues.
- Facilitating collaboration to inspire innovative and progressive policy solutions.
- Influencing decision makers by delivering compelling evidence and recommendations and advocating in support of our positions.

CEDA has almost 700 members including leading Australian businesses, community organisations, government departments and academic institutions. Our cross-sector membership spans every state and territory.

CEDA was founded in 1960 by leading economist Sir Douglas Copland. His legacy of applying economic analysis to practical problems to aid the development of Australia continues to drive our work today.

The content in the 2021 Economic and Political Outlook was up-to-date at the time of printing. Due to the dynamic current economic and political environment, it may not address the most recent developments. CEDA's Economic and Political Outlook event series takes place around Australia to coincide with the publication's release, and provides the latest analysis from report authors as well as business and political leaders.

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FOREWORD

"On both health and the economy, Australia has done better than many of its global counterparts. That is in large part thanks to the spirit of collaboration that has seen business, government and the community pull together to halt the spread of the virus."

Melinda Cilento
Chief Executive, CEDA

2020 was a year of rapid and agile policy development in Australia. It brought twists and turns in decision-making as governments responded to a crisis that remains with us in 2021, as nations keep working to contain the COVID-19 pandemic.

On both health and the economy, Australia has done better than many of its global counterparts. That is in large part thanks to the spirit of collaboration that has seen business, government and the community pull together to halt the spread of the virus.

Despite periodic virus outbreaks around the country continuing into early 2021, confidence has rebounded and economic activity is rising. Small outbreaks are likely to continue to occur until the vaccine is fully rolled out, but we have started the year with renewed optimism.

A rapid and widespread vaccine rollout will be crucial to maintaining this momentum. In 2021, everything will flow from this, especially as governments wind back the income support programs that kept much of the economy afloat last year. A balance must be struck between unwinding this stimulus and providing targeted support to business and employment.

Another major economic challenge this year will be managing Australia's relationship with China. The nations remain at an impasse, and how this is resolved will have significant bearing on our economic prospects. Obviously, a new US administration is also casting a different light on bilateral and multilateral relationships. What interesting times ahead.

With a bit more headspace to address issues unrelated to the pandemic this year, some key policy debates are likely to re-emerge, although growth and jobs will dominate. Climate change will and should be front of mind, given its business, economic and social significance, as well as the global policy shifts driven by the new Biden Administration in the US.

There are clearly many question marks hanging over the policy landscape this year. CEDA's Economic and Political Outlook (EPO) 2021 provides valuable analysis to help our members and audiences understand and respond to these issues.

The economists and journalists who have shared their insights in this report each bring considerable expertise in their field and years of experience. We thank them for their contributions.

Our EPO 2021 contributors are:

- Phillip Coorey, Political Editor, Australian Financial Review
- Alan Oster, Group Chief Economist, NAB
- Cassandra Winzar, Senior Economist, CEDA
- Richard Yetsenga, Chief Economist and Head of Research, ANZ Banking Group

The launch of the EPO has marked the start of CEDA's annual research and events program for more than three decades. This year, our focus at CEDA is squarely on how we reimagine economic and social opportunity in Australia to drive a sustainable recovery that sets the nation up for long-term growth.

As we recover from the COVID-19 crisis, CEDA has a critical role to play as an independent, member-based think tank. Now, more than ever, our evidenced-based insights can help to shape Australia's development for the greater good.

Melinda Cilento
Chief Executive
CEDA

1.

ECONOMIC OUTLOOK

ECONOMIC TIMELINE

WHAT TO WATCH

JANUARY 2021

1 — **UK exit from the European Union complete**
Economic implications of this will play out throughout 2021.

MARCH 2021

28, 30 — **End of JobKeeper and JobSeeker subsidies**
Watch for announcements on replacements for these significant fiscal stimulus programs.

APRIL 2021

9 — **Reserve Bank Financial Stability Review**
Will show how household and business finances are holding up as government support is winding down.

IMF World Economic Outlook
A comprehensive update on how the global economy is tracking. Will provide early insight into the impact of the global vaccine rollout.

MAY 2021

Federal budget
Another historic budget that will likely contain further fiscal support measures to sustain the economic recovery.

MAY-AUGUST 2021

State budgets
Expect further spending on infrastructure and social programs to fuel recovery at the state level.

JUNE 2021

Bank For International Settlements Annual Economic Report
This report will analyse central banks' response to COVID-19, which could in turn shape future moves in global monetary policy.

JUNE-JULY 2021

Roughly half the Australian population expected to be vaccinated against COVID-19
Should correspond with a significant spike in consumer sentiment and private consumption.

AUGUST 2021

World Economic Forum Special Annual Meeting in Singapore
Touted as "the first global leadership summit to address the challenges of recovering from the pandemic." Will provide insight into the economic agendas of key global players.

NOVEMBER 2021

5 — **Reserve Bank Quarterly Statement on Monetary Policy**
The final RBA Quarterly Statement on Monetary Policy for 2021 – will provide key insights into inflation targets and the outlook for monetary policy in 2022.

1.1 DOMESTIC ECONOMIC OUTLOOK

Alan Oster
Group Chief Economist, NAB

Alan Oster joined NAB in 1992 from Federal Treasury, where he worked for 15 years - his special field being economic forecasting and monetary policy. He graduated with first class honours in economics from Newcastle University. He also holds a Masters degree in economics from the Australian National University.

Immediately before joining the bank, Alan was the Senior Adviser in Treasury responsible for economic forecasting and modelling. In 1987, he was seconded for nearly four years as Counsellor-Economic and Financial with Australia's delegation to the Organisation for Economic Co-operation and Development (OECD) in Paris. As Group Chief Economist, Alan is responsible for NAB's global economic and financial forecasts. He is also a highly respected and much quoted commentator on Australian and global economic trends and policy issues.

Despite considerable uncertainties, we expect a strong ongoing recovery in 2021.

If nothing else, 2020 has highlighted the difficulties of forecasting in an environment of heightened uncertainty. Forecasting largely relies on past relationships between economic variables, often identified using historical shocks. In 2020, we saw governments around the world impose strict lockdowns in the face of the COVID-19 pandemic. It was a health-driven response with significant economic spillovers. We saw sharp falls in economic activity and massive job losses – for Australia, the largest and fastest peacetime recession since at least the 1930s.

In response, the Federal Government and Reserve Bank of Australia (RBA) jumped into action. Government programs such as the JobKeeper wage subsidy helped keep unemployment

"Australia has emerged with much less economic damage than almost anyone expected, while managing the virus much better than most other countries."

rates much lower than anticipated – it now looks as if it peaked around 7.5 per cent. Backdated tax cuts also helped consumer cash flow, which jumped to multi-year highs and helped underpin spending despite a deteriorating labour market.

Importantly, the "snapback" in activity was incredible, especially considering the ongoing impacts of the prolonged lockdown in Victoria. Australia has emerged with much less economic damage than almost anyone expected, while managing the virus much better than most other countries.

Much now depends on virus-related issues both domestically and overseas. Our outlook is based on a number of assumptions, including:

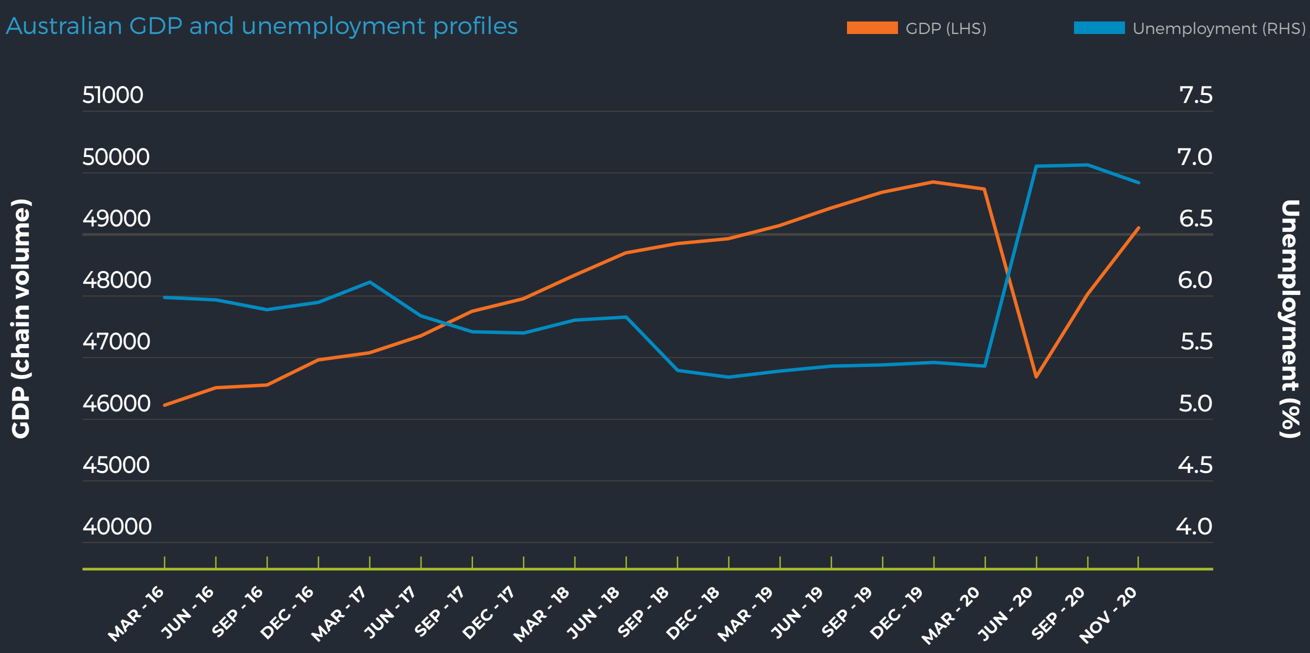
- The virus will continue to be contained domestically – without large-scale shutdowns;
- Around half the population will receive a vaccine by mid-year and the full adult population by year-end;
- We should see limited state border closures and the beginnings of a gradual opening of international borders by end-2021;
- The Federal Government will continue to provide substantial support for hard-hit sectors such as tourism and education; and
- The RBA will maintain its current settings for at least the next few years.

How did we end 2020?

Based on our assumptions of a reasonably strong level of activity (around two per cent growth in the December quarter) and ongoing strength in employment, it appears that around 95 to 98 per cent of virus-related output and employment losses have been recovered and unemployment ended the year at around 6.6 per cent.

FIGURE 1

Australian GDP and unemployment profiles



The main indicators in NAB's Monthly Business Survey (business conditions, business confidence and forward orders) have rebounded, and the majority are above long-run averages. Conditions are quite different across states, with Western Australia the strongest, and not surprisingly Victoria still catching up. Capacity utilisation is now near both the levels seen before the virus and its long-run average.

NAB's internal transaction data to 23 January 2021 suggests Christmas was reasonable for retailers, but January has seen a slower pace of growth. On the other hand, virus-induced shutdowns have hurt hospitality, with WA the strongest state, but New South Wales and Victoria around the middle of the pack. Overall, consumption growth in late January 2021 was broadly similar to growth in late January 2020.

FIGURE 2

Deviation from LR averages - trend

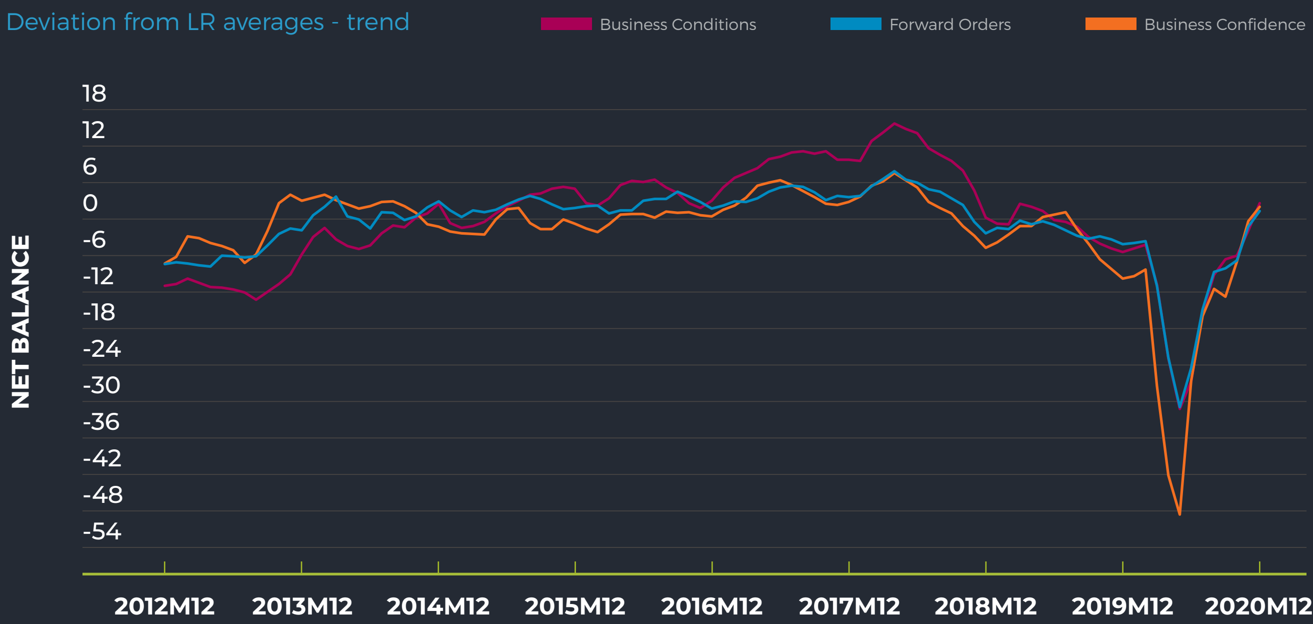
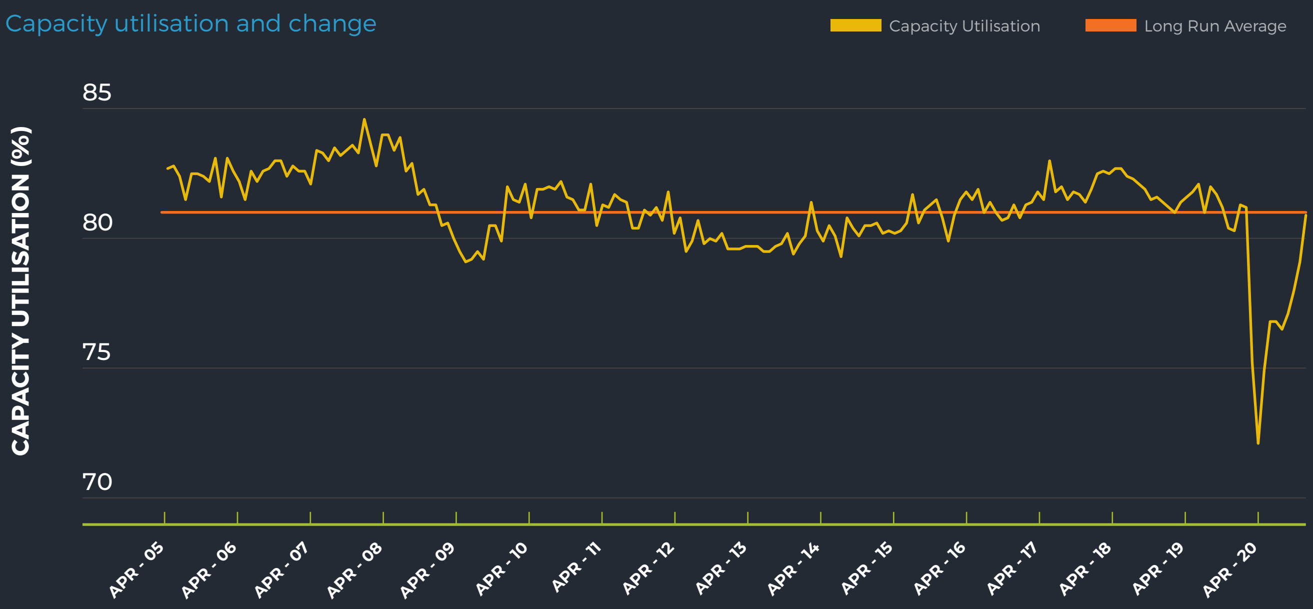


FIGURE 3

Capacity utilisation and change



Internal data for NAB business customers suggests inward credits (roughly revenue) rose by around nine per cent on this time last year, improving in mid-January, with strength in retail, agriculture and the public sector. Reliance on JobKeeper has basically washed out of the data. That is, excluding JobKeeper payments, inward credits were around 8.7 per cent. On the labour market, internal data also suggests there has been a continued fall in the number of NAB customers receiving the JobSeeker unemployment benefit.

FIGURE 4

Spend data: weekly

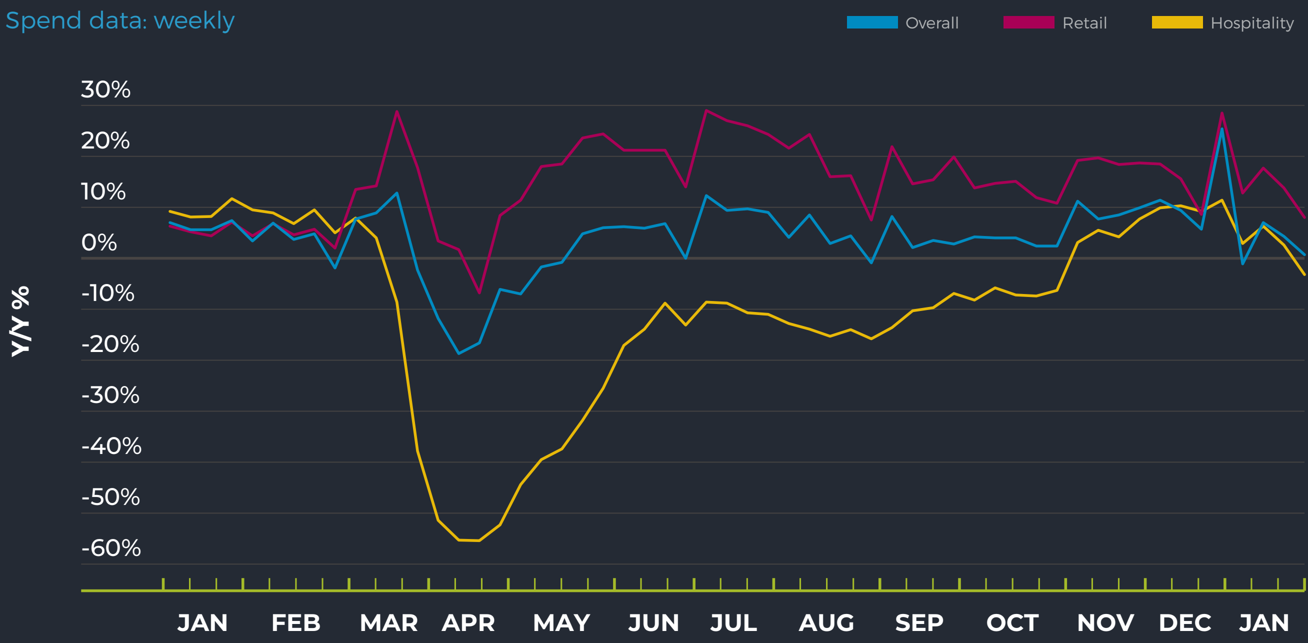
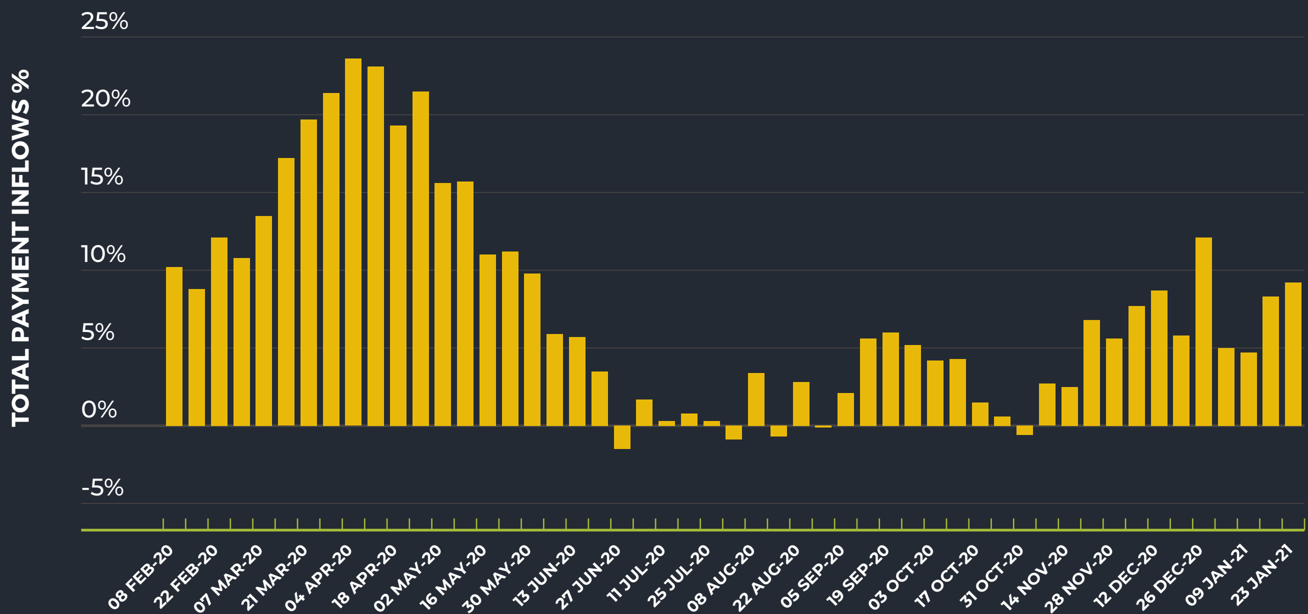


FIGURE 5

Payment inflows into NAB merchants (6-week moving average, % change over same week last year)



> *"Industries with large exposures to Chinese demand now have a clear incentive to actively look to develop new markets.*
>
> *That is an important medium-term challenge."*

Where to from here?

The bounce-back to date is very promising, but there are clearly many challenges and much uncertainty ahead. Beyond the risk of further virus outbreaks and the timing of the vaccine rollout, a significant amount of fiscal stimulus – notably the JobKeeper and JobSeeker payments – is due to taper. The loosening of bankruptcy laws and temporary tenant protection measures are also likely to be reversed.

Internationally, it now appears likely that Europe and the United Kingdom will record negative growth rates in both Q4 2020 and Q1 due to virus-related shutdowns. Also, in the United States, growth momentum seems to have slowed significantly and it is possible that despite a fiscal package of around nine per cent of GDP, growth rates will be moderate in early 2021. While not necessarily directly relevant to Australia, this weakness is not likely to help confidence in early 2021. It is also not certain how the new Biden Administration in the US will affect the path of both the US and global economies. Hopefully it is for the better in the long run.

Finally, another global factor of importance is the ongoing trade friction with China. At present, the impact on the broader economy is limited due to the high price of iron ore. However, there are obvious direct impacts on parts of the rural economy and coal. Limits on tourist numbers, while significant, would have happened anyway because of virus closures, but are clearly potentially more significant in the longer run. That said, the costs to education are already large. Hopefully these trade tensions will ease in the next six months or so. Regardless, industries with large exposures to Chinese demand now have a clear incentive to actively look to develop new markets. That is an important medium-term challenge.

The medium-term outlook

Despite these considerable uncertainties, we expect a strong ongoing recovery in 2021. As the economy reopens, consumers will likely continue to use their extra savings to boost spending. While there may be ups and downs associated with the withdrawal of income support, we still see private consumption growth of around eight per cent over the course of 2021. That is likely to be stronger mid-year as the vaccine boosts confidence, as does reasonable growth in house prices (up around five per cent during 2021). The residential construction sector is also likely to be past its worst by mid-2021 and farm output will increase strongly on the back of a big crop.

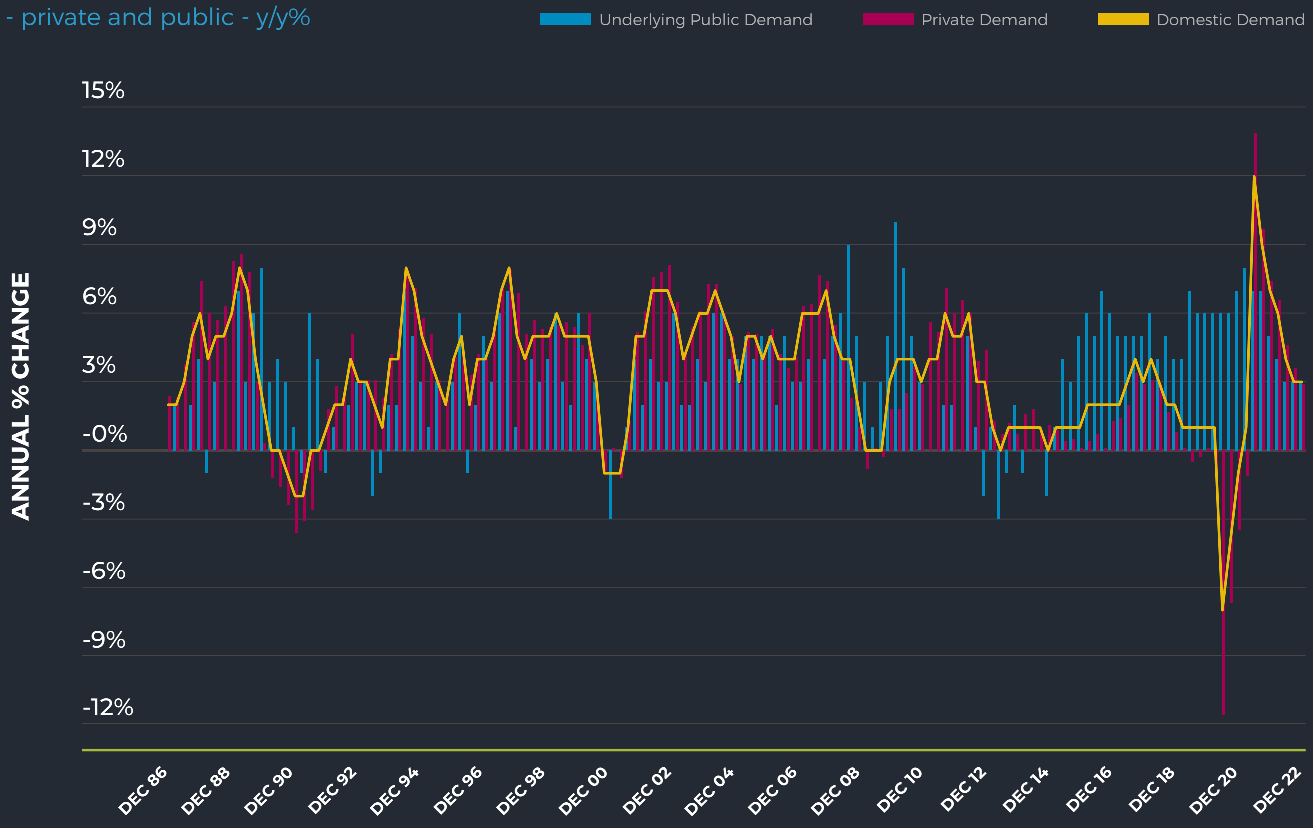
Against that, it is hard to see much boost to private investment, especially in the first half of 2021. We see business investment overall down by about five per cent in 2021. Business investment will depend heavily on business sentiment – unless business is convinced that there will be demand, it could well sit on its cash rather than invest. This also applies to employment beyond that justified by a more opened-up economy.

We also expect that the economic stimulus from public demand will moderate somewhat, as will the contribution to net exports, as imports increase and export volumes moderate in growth terms.

The following chart shows the dramatic increases we expect to see in private demand following its unprecedented falls in 2020.

FIGURE 6

Domestic demand - private and public - y/y%

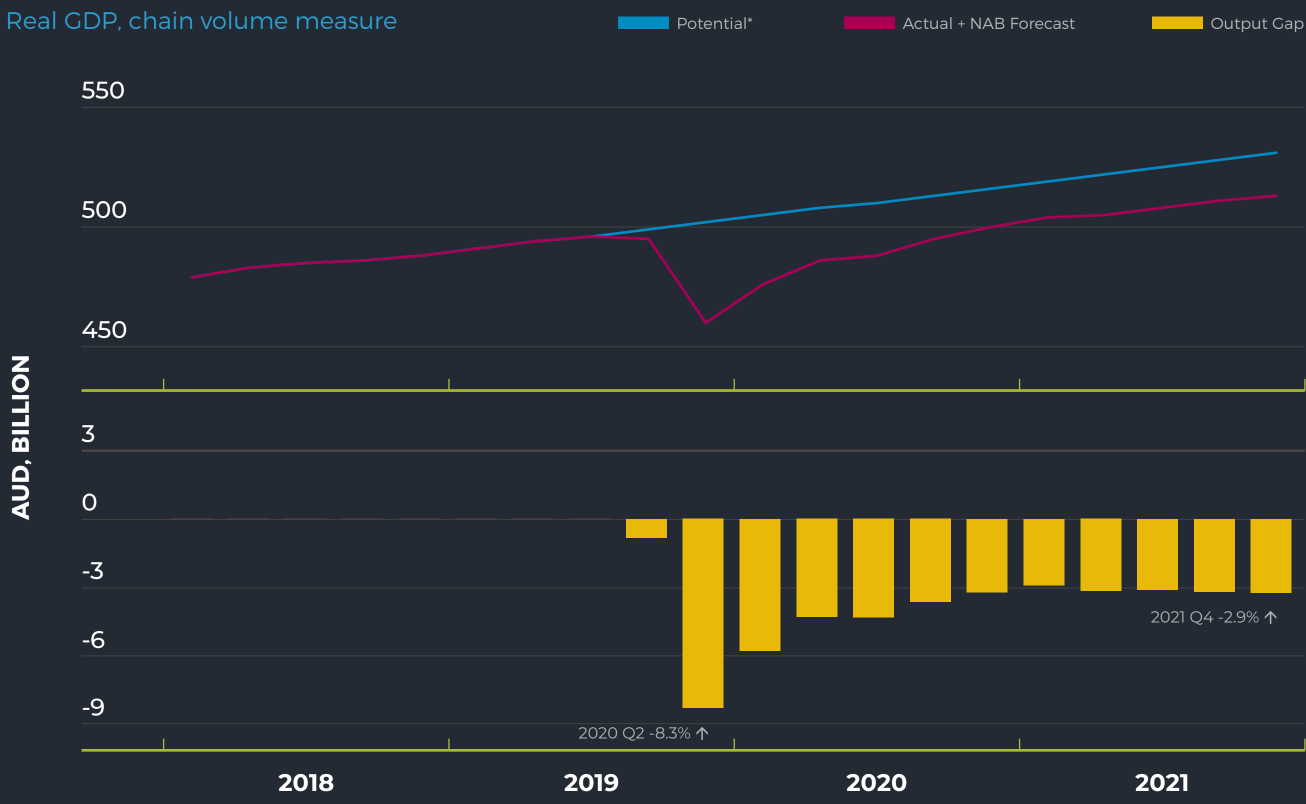


Overall, we are expecting growth of around four per cent through 2021, and similar rates in year-average terms. That would see GDP returning to pre-virus levels by mid-2021. However, if the virus had not happened and the economy had grown at its potential growth rate of around 2.25 per cent per annum, the losses to growth (on our current forecasts) would not be fully recovered until at least 2023 (see chart below).

For 2022, we expect the reopening boost will fade and growth will return to more normal rates. We expect annual growth rates of around 2.5 per cent in 2022 but closer to two per cent in through-the-year terms.

FIGURE 7

Real GDP, chain volume measure



*Applying a potential growth rate of 2.25% to Q4 2019. Assumes output gap was closed in Q4 2019.
Source: National Australia Bank, Australian Bureau of Statistics

Our projected growth path and the expected unemployment path are shown below.

On the labour market, it is clear from the chart below that we do not expect the unemployment rate to recover as quickly as output. That in part reflects the size of the hit to potential growth and a general unwillingness of employers to rehire until they are very confident there will be sufficient demand to justify the further expense. This is a very traditional labour market response to economic downturns.

FIGURE 8

Australian GDP

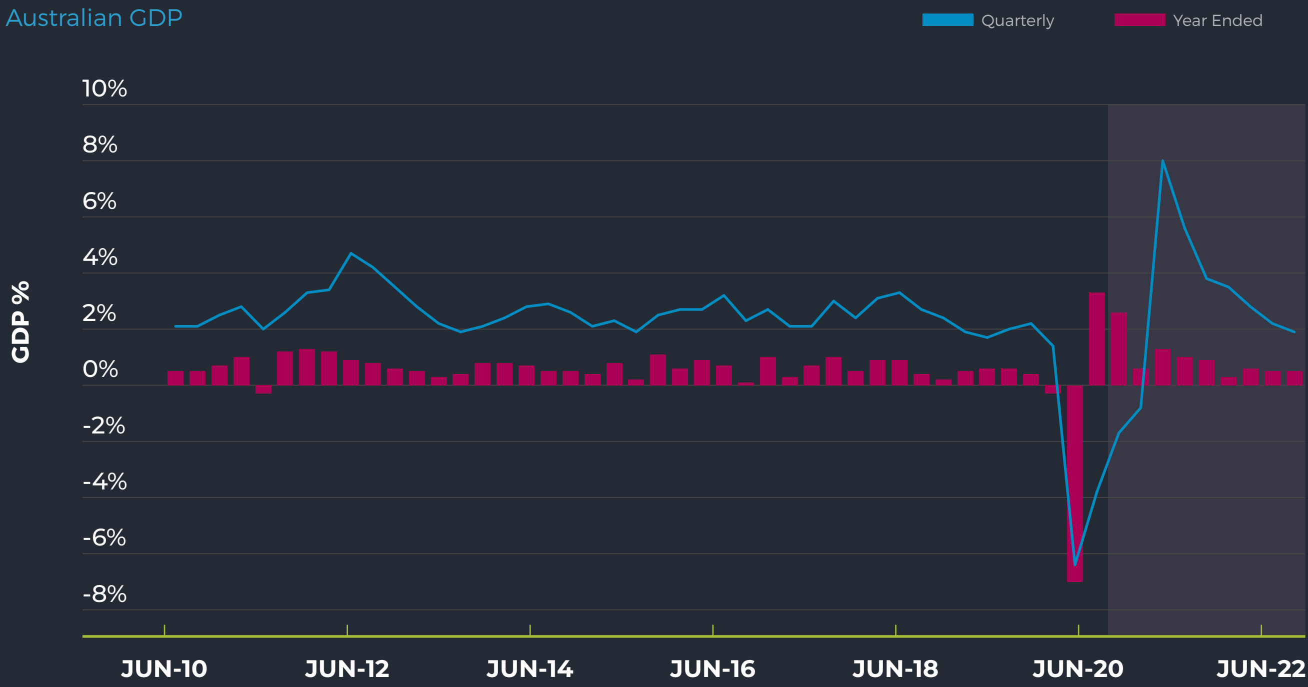


FIGURE 9

Unemployment profile

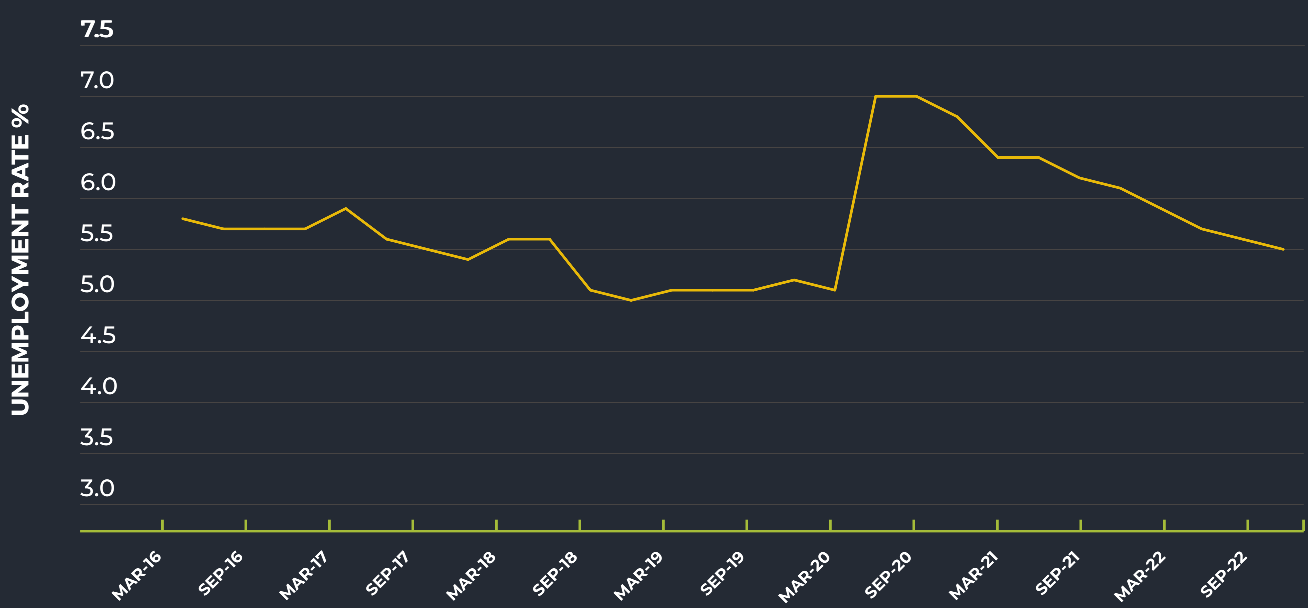
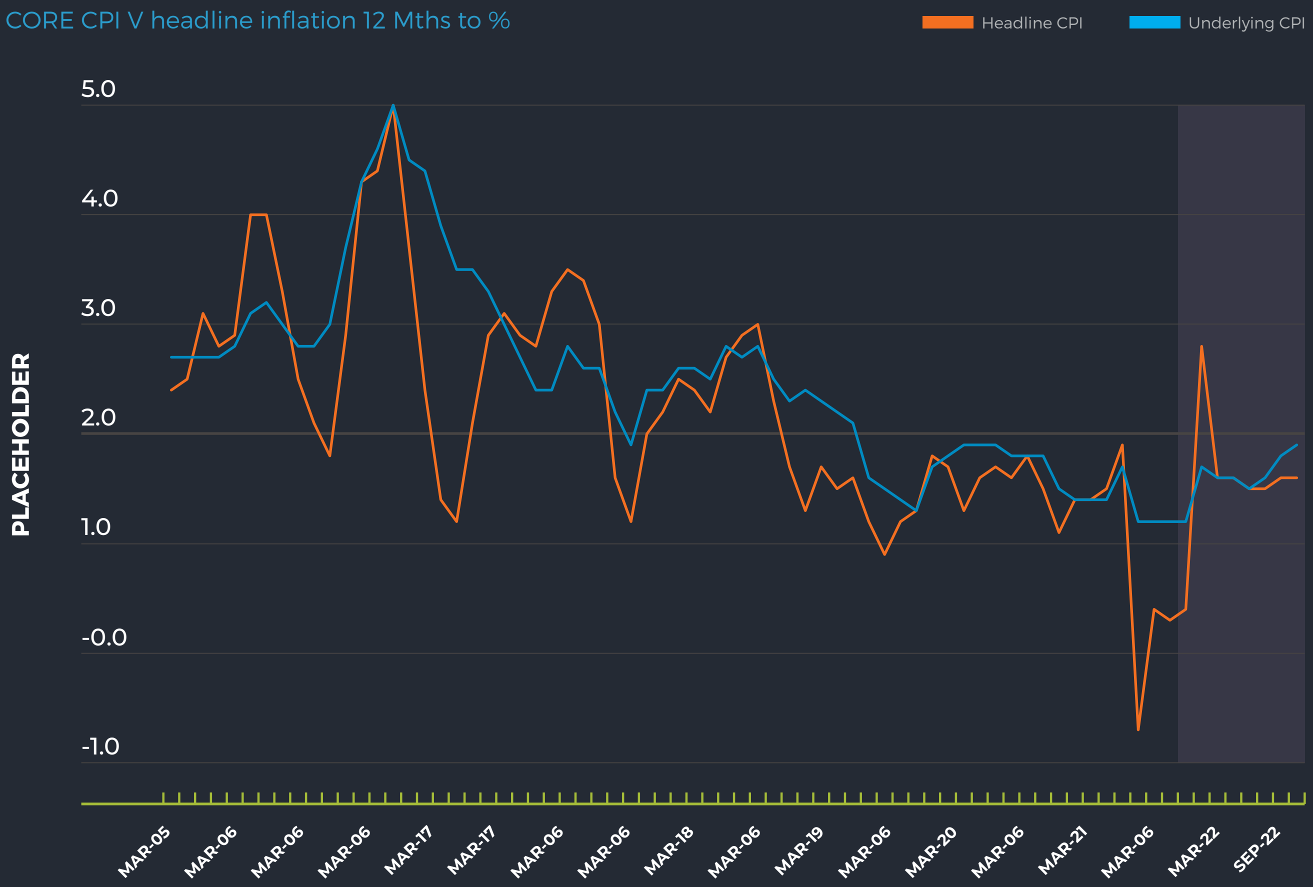


FIGURE 10

CORE CPI V headline inflation 12 Mths to %



Put bluntly, we are unlikely to see unemployment return to pre-virus levels until at least 2024 or later. That also means there will be very little upward pressure on wages. Thus, we do not see private sector wages growth above two per cent by 2023. That also means that the inflation rate, in underlying terms, will remain below the RBA's target for a long time. As shown above, we still see core inflation at only 1.75 per cent by the end of 2022. That is similar to current RBA forecasts.

Those forecasts also explain why the RBA does not expect to begin increasing the cash rate for at least three years or possibly longer. Wages growth of around two per cent is just not sufficient to get the core rate of inflation sustainably into the middle of the central bank's two-to-three per cent inflation target. We therefore expect the cash rate to remain on hold for an extended period, in line with this three-year target. In the near term, the RBA will likely maintain the target for three-year yields, but with an improving outlook the RBA will need to wind back the three-year target (and associated forward guidance) as time progresses and they become less confident rates will remain unchanged for a rolling three-year period. This implies a move to conditional forward guidance for the cash rate, a wind down of the three-year yield curve control (YCC) target by anchoring purchases to durations shorter than the 2024 bond.

Somewhat more pressingly, the RBA will need to make clear its intentions in the next few months about the future of its quantitative easing (QE) program. At present the planned $100 billion in purchases is slated to end in April. We think the RBA will extend this program but taper it, committing to a further $50 billion of purchases over the subsequent six months but leaving the door open to do more.

While Australia has suffered a crushing setback in 2020, I remain very optimistic about the medium-term prospects. From a public health perspective, Australia has handled the virus better than just about every other country and has mostly avoided very large scarring to its economy. Thus, once the world returns to more normal patterns, Australia will be seen as a very good place to live, invest and employ in. And the opportunities to diversify trade linkages will be large. Obviously, anything we can do to improve our fundamental performance, such as improve productivity, should also be seriously explored.

Next steps

In my view, in 2021, we should move towards performance-enhancing public policy reforms and away from survival mode.

This agenda should include:

- Ensuring that support is not withdrawn too early, especially in areas that are still suffering;
- Encouraging trade diversification;
- Building up better local industry supply chains;
- Maintaining strong support for productivity-enhancing infrastructure builds (including the internet);
- Reducing the cost of doing business through microeconomic reform;
- Looking to other areas that might encourage stronger investment, including corporate and personal taxation; and
- If possible, improving the operation of labour markets.

That should be the focus of the 2021 Federal Budget and National Cabinet.

1.2 INTERNATIONAL ECONOMIC OUTLOOK

Richard Yetsenga
Chief Economist,
ANZ Banking Group

Richard Yetsenga is Chief Economist and Head of Research at ANZ. He leads the bank's global research team, which focuses on Australia, New Zealand and Asia. Richard joined ANZ in 2011 from HSBC in Hong Kong, where he was Managing Director of Emerging Market Strategy. Prior to his seven years at HSBC, Richard held economics roles with Deutsche Bank and the Federal Government. Richard publishes on issues of broad economic relevance, including climate change, technology, inequality and the benefits of diversity. Richard regularly appears on CNBC, Bloomberg TV and other regional media. His work has been published by the Lowy Interpreter, and he is an editorial contributor in the Australian Financial Review, The Australian newspaper, The Wall Street Journal and the Hong Kong Economic Journal.

There will be no return to "normal" after COVID-19, and nor should we wish there to be.

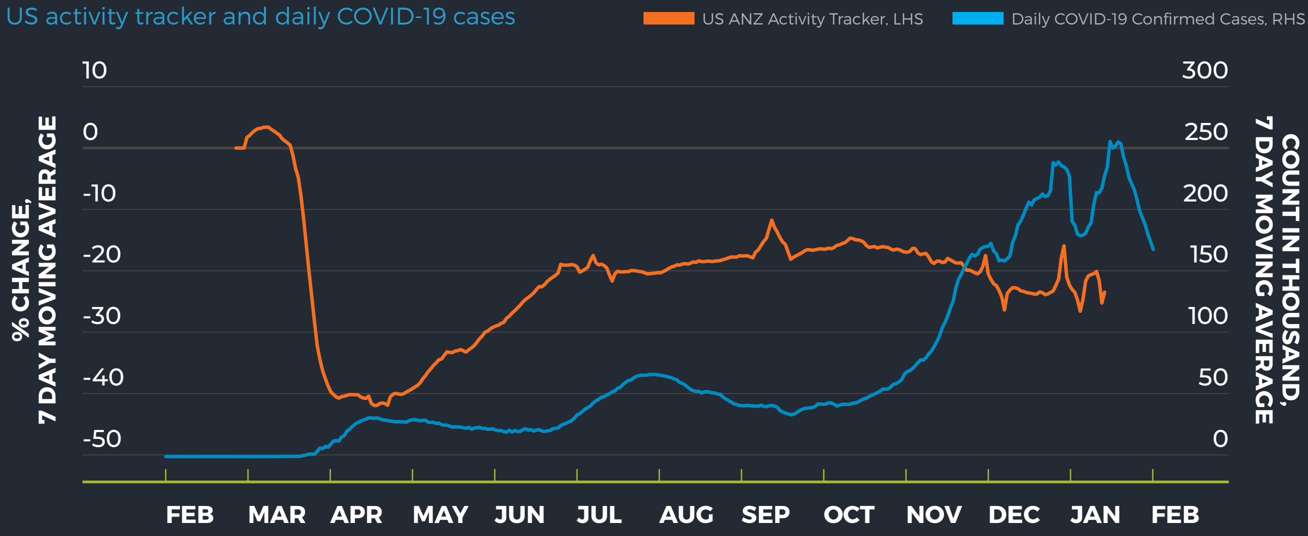
The environment for financial markets is becoming riskier, even as the risks for global economic growth diminish. The pace and rate of immunisation against COVID-19 is likely to dominate the near-term agenda, along with how the economies yet to control the pandemic manage their latest waves. But economic dynamics have shifted for the better, and suggest the environment will be more complicated for both policymakers and financial markets in 2021. The structural legacies of the pandemic will become increasingly apparent.

Challenging, but manageable, near-term conditions

The near-term challenges relate primarily to the economies facing ongoing waves of COVID-19. These challenges appear manageable at the global level, even if they soften the short-term outlook in the countries affected – particularly in the United States, the European Union and the United Kingdom. The link between the COVID-19 news flow – particularly the daily case count – and the economy has loosened substantially from its peak in the second quarter of 2020 (Figure 1, for the US). The result has been an extended run of positive global data surprises, as policy stimulus in many economies has increased with every subsequent lockdown (Figure 2).

FIGURE 1

US activity tracker and daily COVID-19 cases



Source: Macrobond, ANZ Research.

FIGURE 2

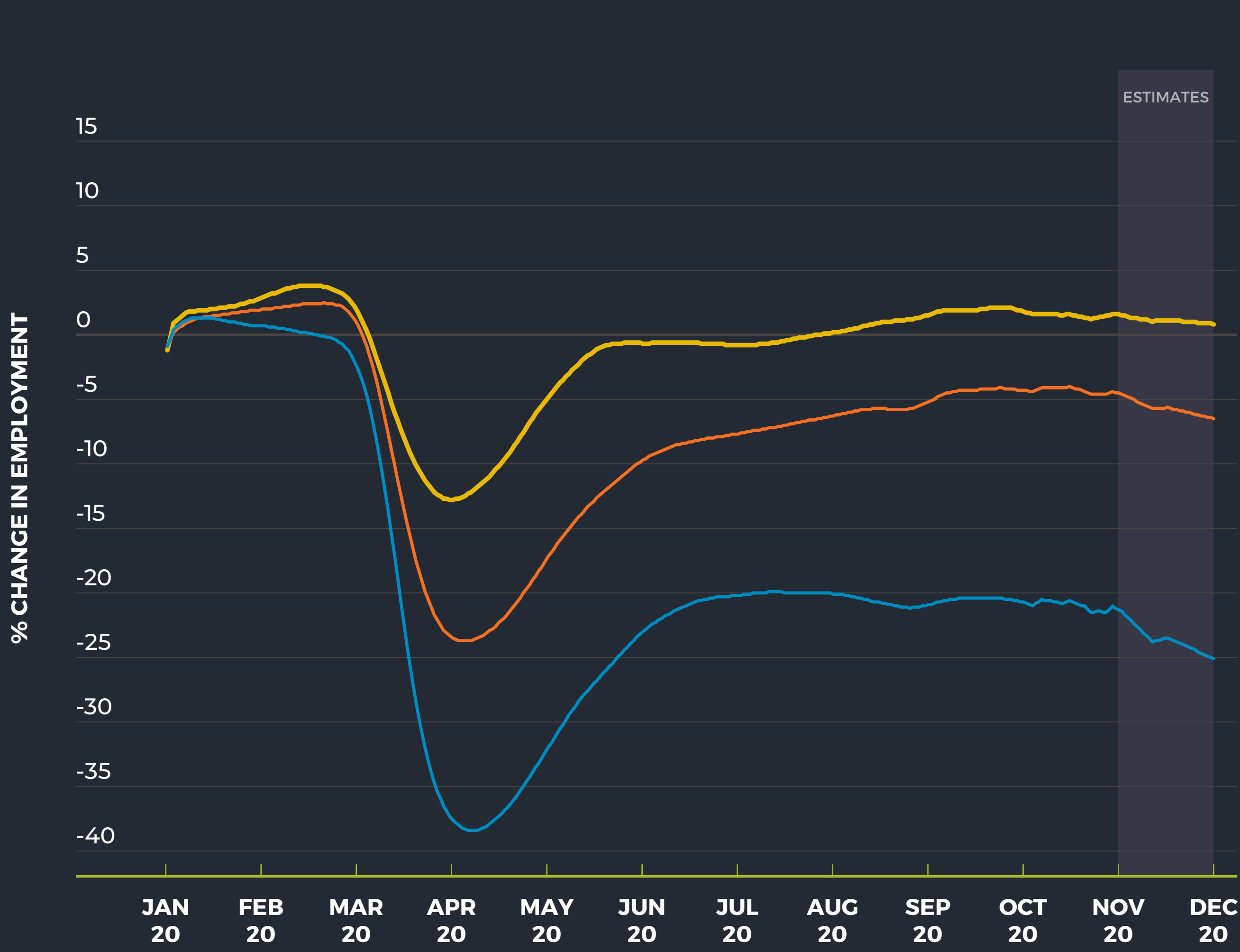
World data surprises

Source: Bloomberg, ANZ Research

In most cases, movement restrictions have been used more sparingly than during the early phases of the pandemic and the stimulus programs already in place will naturally dispense more support as required. Consumers and businesses are also reacting more calmly to rises in case numbers and to movement restrictions. As a consequence, job losses are increasingly concentrated in a narrower range of sectors directly affected by movement restrictions, rather than dispersed broadly throughout economies. Lower-paid roles are bearing the brunt (Figure 3, for the US). The inequality implications of these concentrated impacts will be one of COVID-19's more important legacies.

FIGURE 3

US employment by income



Source: Opportunity Insight's Economic Tracker; ANZ Research

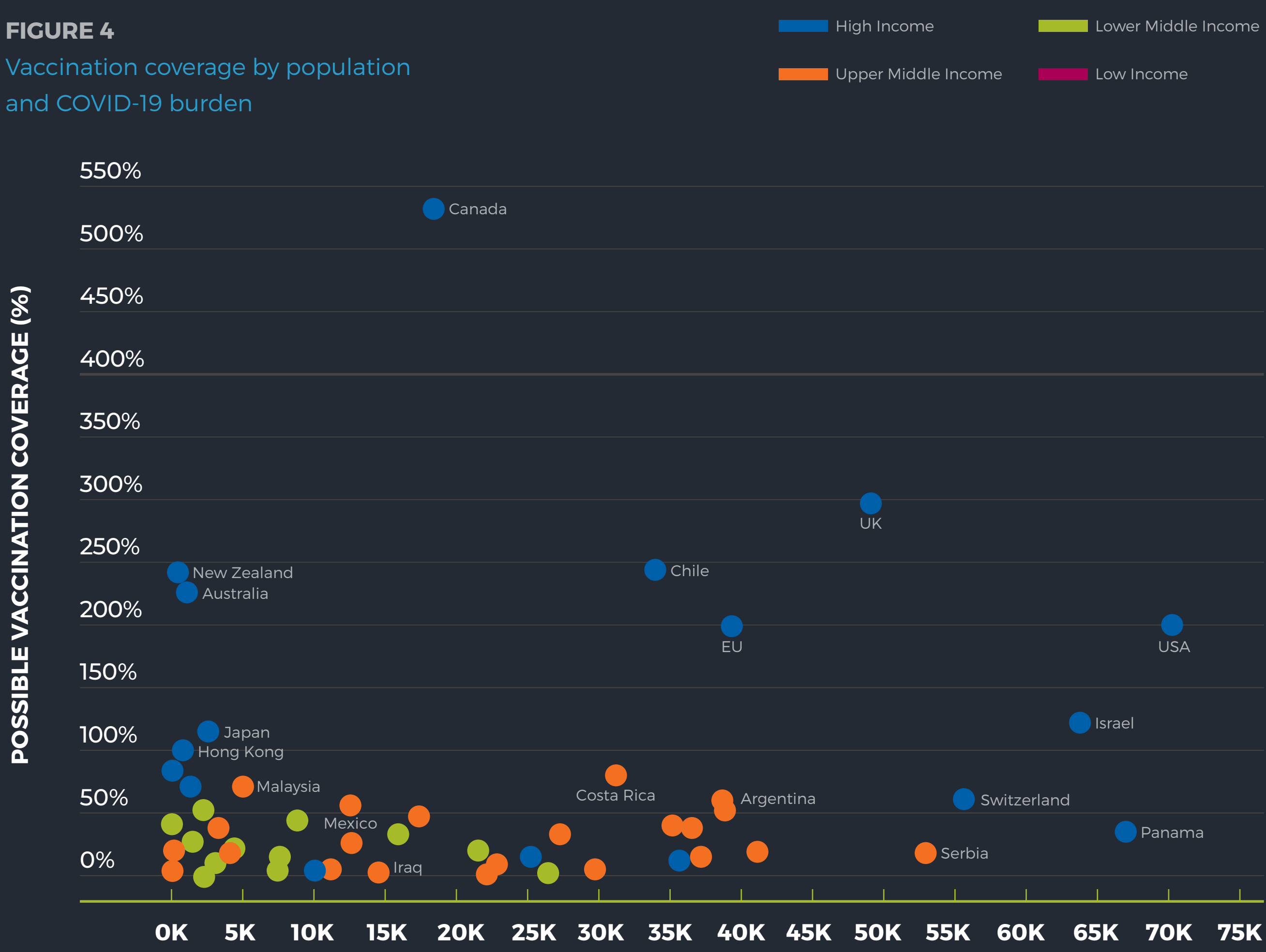
Vaccines to shape 'new normal'

Overlaying these near-term challenges is increased visibility around COVID-19 vaccines. There are significant practical issues with vaccine rollouts and their geographic impact will be uneven (Figure 4), but vaccine developments are an important and positive step forward. The vaccine rollout further reduces the risk of premature stimulus withdrawal, as it more clearly defines the timeframe during which support will be needed. It also offers the prospect of eventual recovery for those sectors particularly impacted by COVID-19, such as air travel, mass transit and cultural/leisure activities. Importantly, it gives businesses and consumers more confidence about making longer-term decisions. For the first time, we can more reliably assess when the worst of the COVID-19 pandemic will be behind us.

As vaccines offer the prospect of large parts of the world returning to some sort of normal over 2021 and 2022, they also raise important questions about the appropriate stance of monetary and fiscal policy. The year 2020 saw the largest policy easing in history, in terms of the synchronous nature of the easing across countries, the number of countries involved, the tools used and the scale of easing. The use of quantitative easing in a number of Asian economies for the first time is notable.

FIGURE 4

Vaccination coverage by population and COVID-19 burden



Source: Duke Global Health Innovation Center, Launch and Scale Speedometer, ANZ Research

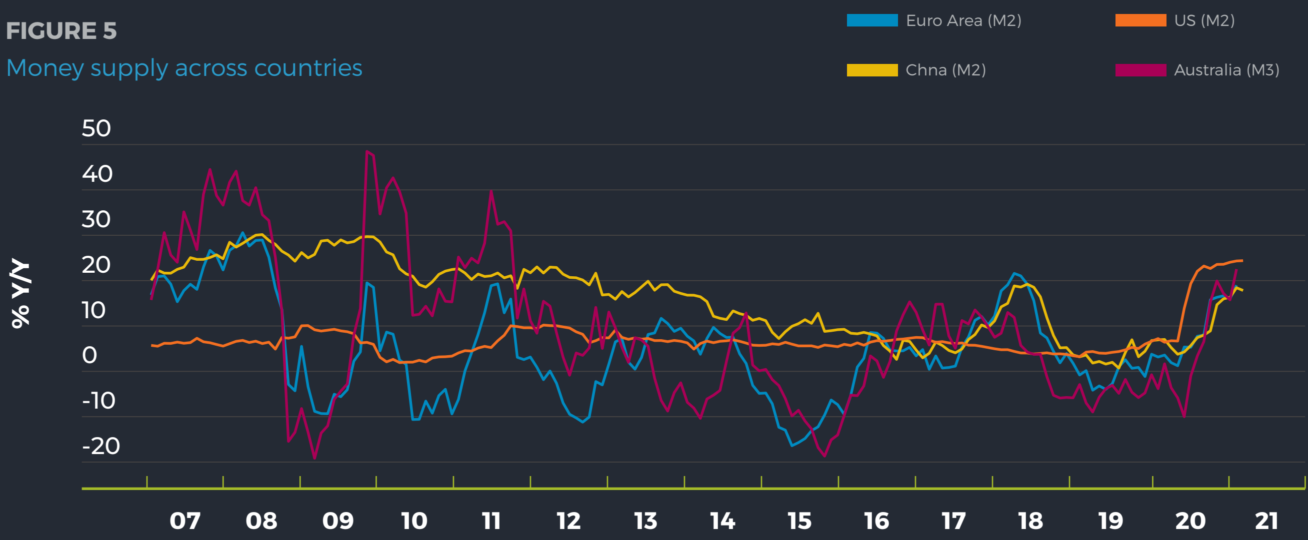
Money supply growth provides a useful framework to consider how policy might need to respond in the future (Figure 5). The synchronous rise in money supply in many economies during this crisis has been unprecedented, and has been enough to offset the worst impacts of the decline in the velocity of money (Figure 6, for the US). The result has seen financial markets performing relatively well through much of the crisis. Money growth, in fact, is the key reason this downturn has been a health and economic crisis, but not a broad-based financial crisis.

The 2009 Global Financial Crisis (GFC) was quite different, as policymakers were slower to react and did not ease as aggressively. Partly as a result of this, the economic downturn lasted much longer, and the GFC also had substantial structural impacts. Reflecting these structural effects, the decline in the velocity of money continued well after the acute phase of the crisis. Policy easing therefore continued for many years.

Vaccine developments suggest the macroeconomic effects of this crisis are likely to be in large part temporary. The velocity of money should therefore increase as economic normalisation occurs.

While not all sectors, geographies and income groups will return to their pre-COVID-19 levels, a meaningful share of the policy easing will likely need to be unwound at some point at the aggregate level. Calibrating this will be a difficult balancing act, particularly given how frothy asset and housing markets are likely to become.

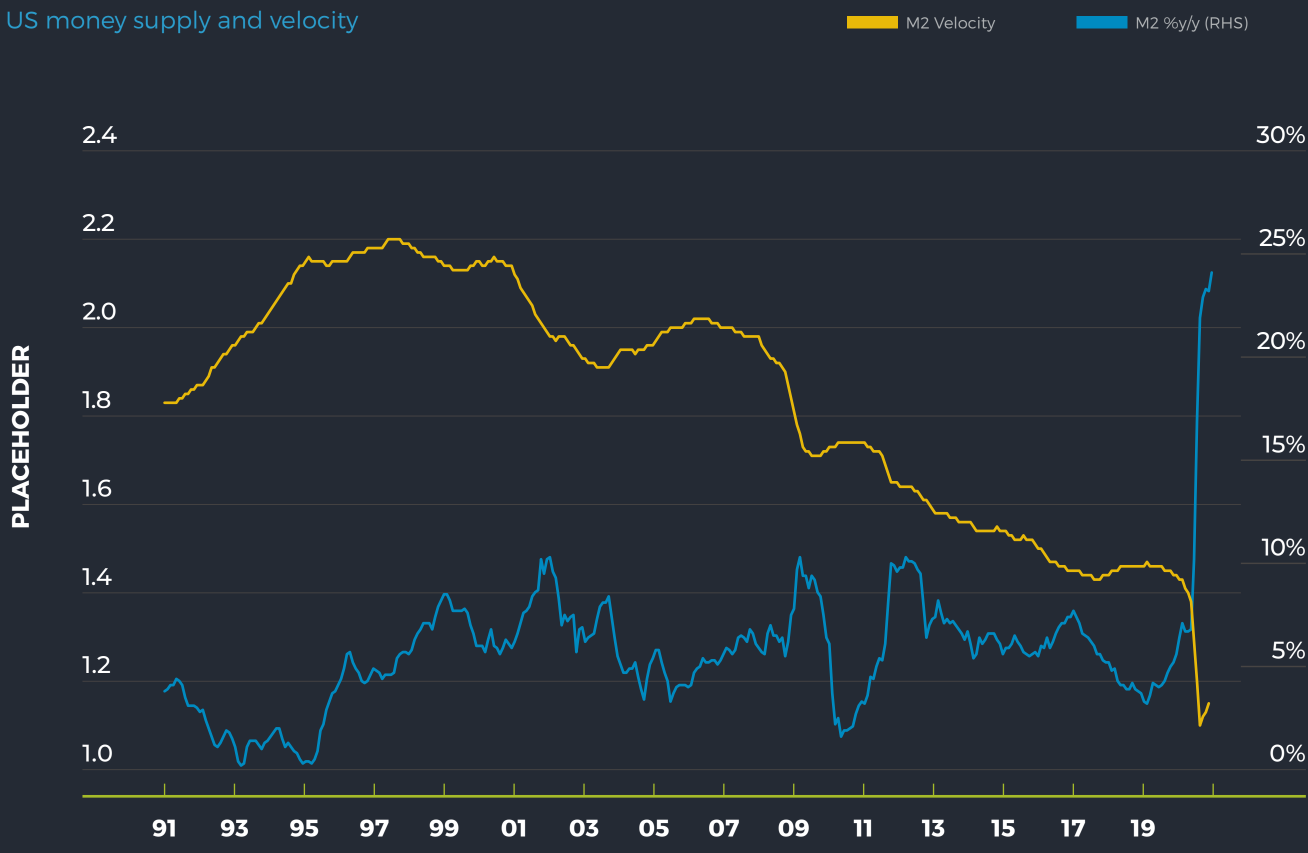
FIGURE 5
Money supply across countries



Source: PBoC, ECB, SingStat, BOK, Fed, RBA, Bloomberg, Macrobond, ANZ Research.

FIGURE 6

US money supply and velocity



Source: Macrobond, ANZ Research.

Taper tantrum 2021

Much of the commentary around policy relates to the appropriate stance of budget policy and the risk of premature withdrawal. This risk seems low. In the first instance, the popular narrative helps to reduce the risks of errors similar to the GFC, when policy was frequently tightened too early. The advice from organisations such as the IMF emphasises avoiding premature tightening. In Australia, Treasurer Josh Frydenberg has said the unemployment rate must fall "comfortably back under six per cent" before shifting the fiscal strategy towards budget repair.

Secondly, several countries' fiscal programs have been structured to wind down only when demand for assistance declines. And in many countries, the questioning of technocratic policy norms has increased the political cost of tightening too soon.

Our primary focus is monetary policy, where the policy adjustment is made somewhat more complicated by the changes in the approach of some central banks. The US Federal Reserve (Fed) and Reserve Bank of Australia (RBA) have shifted their inflation targets in order to raise interest rates at a slower pace than in previous cycles. The European Central Bank (ECB) is currently reviewing its policy framework and could make a similar change. It is at least partly for this reason that we don't expect any central banks to be raising interest rates in 2021.

Central banks delaying tightening is good for growth and the recovery. However, those intentions will likely be tested by the performance of asset prices. Property prices have been rising strongly in a number of countries, as have financial markets. They are likely to react uncomfortably to reduced liquidity, when it comes.

The level of policy support has already become a more prominent issue in New Zealand, particularly around property. Mainland China introduced leverage ratios and other tightening measures to the sector in Q3 2020. The People's Bank of China (PBoC) has signaled its exit from unconventional policies is pending. India and Taiwan have also taken tentative steps in this direction. The PBoC may offer something of a playbook, with efforts to tighten QE and other liquidity-enhancing measures occurring well ahead of any rate hikes. The commitments from the Fed and the RBA relate to rate hikes only. This is likely intentional.

Business unusual

There will be no return to the pre-pandemic "normal" after COVID-19, and nor should we wish there to be.

At a very macro level, inflation risks seem quite different coming out of this crisis than after the GFC, not just because policymakers are adopting a different "show me the money" approach. Commodity price weakness in the current crisis has been short-lived. Our forecasts envisage that oil prices, in particular, will continue to strengthen in 2021.

In many economies, the rise in unemployment has been much less sustained. In China, for instance, the unemployment rate is already back to pre-COVID-19 levels (Figure 7) and in the US it has retraced three quarters of its rise. US unemployment took a full decade to return to pre-crisis levels after the GFC. Sustained rises in unemployment can often exacerbate the structural legacies of a downturn (Figure 8).

Geopolitics, climate change and perhaps even COVID-19 itself seem to be playing a role in reorienting supply chains and de-globalising some markets and processes. This is having identifiable economic impacts. A measure of shipping-container availability, for instance, suggests containers have never been harder to find in Shanghai. Borders closed to people movement also imply potential growth will be lower for economies with strong pre-pandemic migration trends, at least for a period. Unemployment should consequently fall more quickly than it might in a standard recovery, and inflation should emerge earlier.

The pandemic has worsened the geopolitical environment, not least because it has severely constrained interactions between people in different countries. The number of countries that allow travellers to visit visa-free on any given passport has fallen 33 per cent globally due to the pandemic. It has fallen by 50 per cent for US passport holders. Distrust can ferment when people of different cultures do not physically interact.

"The World Bank estimates that in 2020, 100 million people may have been pushed into extreme poverty... meanwhile the world's billionaires saw their wealth increase by a quarter."

In addition, the macro policy framework has changed irrevocably. After several decades in which monetary policy dominated – four decades in the case of the US – fiscal policy has now assumed primacy. This is not simply an academic point. It means policy is likely to be more stimulatory over time as targets and accountability are more ambiguous. Fiscal policy also works more directly on the economy.

But budget policy has no blunt tool. It is the outcome of a range of individual decisions about where to spend, tax, and subsidise. This suggests the focus on distributional issues will naturally grow, especially as many countries have seen an eye-watering rise in inequality through the pandemic.

Addressing inequality

The World Bank estimates that in 2020, 100 million people may have been pushed into extreme poverty and in India, less than a third of schoolchildren accessed online education. Meanwhile, the world's billionaires saw their wealth increase by a quarter. Savings rates tend to rise, and hence growth decline, with increased inequality. It also raises financial vulnerabilities as those on lower incomes tend to borrow more. There is even evidence suggesting trust in science declines as inequality rises, complicating management of the kinds of challenges we are facing right now: pandemics, natural disasters and climate change.

Secular stagnation has been a feature of growth in many economies so far this century. Arresting and reversing this trend will likely require reconsidering the role of inequality in driving economic growth.

2. POLITICAL OUTLOOK

POLITICAL TIMELINE

WHAT TO WATCH

LATE FEBRUARY 2021

COVID-19 vaccinations begin
The speed, uptake and success of the vaccine rollout will shape the 2021 agenda of all levels of government.

MARCH 2021

13 — WA state election
Federal WA Liberals will watch how their state counterparts perform at the only election of 2021 given the popularity of Labor Premier Mark McGowan.

28 — End of JobKeeper wage subsidy
Businesses hope the Federal Government announces targeted stimulus to replace JobKeeper for industries hardest-hit by the pandemic.

30 — Labor's Special Platform Conference
Labor's triennial national conference will be held online over two days. It was delayed in 2020 due to COVID-19.

31 — End of JobSeeker supplement
The Government is under pressure to announce a permanent rise to the unemployment benefit.

APRIL 2021

Leaders' Climate Summit
US President Joe Biden will host a climate summit within his first 100 days of office, where Australia could face pressure to strengthen its climate commitments.

MAY 2021

Federal budget
The Federal Government has signalled a modest reform agenda is likely in 2021.

2022

Federal election
The next federal election is due by May 2022 but could be held in 2021.

2. POLITICAL OUTLOOK

Phillip Coorey
Political Editor,
Australian Financial Review

Phillip Coorey is the Political Editor of the Australian Financial Review. He joined the Canberra press gallery in 1998 as the Chief Political Correspondent with Adelaide's The Advertiser. He spent 2003 and 2004 in the US as News Ltd New York correspondent and covered the 2004 US primaries and presidential election. He was appointed Political Editor of The Advertiser upon his return to the press gallery in 2005. Coorey joined the Sydney Morning Herald in 2006 and was the paper's Chief Political Correspondent until late 2012 when joined Australian Financial Review. He won the Paul Lyneham award for press gallery excellence in 2012 and 2013.

Scott Morrison is ensuring that everything is in place for a poll later this year. It’s prudent to keep your options open.

Prime Minister Scott Morrison means it when he says he wants to go full term and hold the next election in 2022. When he told his party room late last year there would be no early election, his primary motive was to quash a growing view that everything being said and done in response to the COVID-19 pandemic was with a view to an impending poll. But there were broader reasons too.

With three-year terms, federal elections come around all too frequently in Australia. They are expensive for political parties and hard to win. Mr Morrison rightly described his 2019 election victory as a “miracle”, and fears that rushing to an early poll for no good reason other than the polls are in good shape could anger voters who, more than ever, want the Government focussed on them and the economic recovery.

"People are tired, and their lives have been turned upside down and inside out. Their time horizons have shrunk to little more than two weeks and they are yearning for nothing more than a return to life before COVID-19."

He began this year in the same frame of mind, saying in late January: "2022's the election year, that's when it's due, (there is) too much to do this year. This year is about jobs, and that's where my focus is."

Voters are tired of upheaval

Mr Morrison has confided to colleagues there would have to be a compelling reason for going early, for example if Labor blocked a measure of the size and import of the JobKeeper wage subsidy. But that opportunity is unlikely to arise because, as the Morrison Government begins political year 2021, it does not want to foist any more upheaval on the electorate.

People are tired, and their lives have been turned upside down and inside out. Their time horizons have shrunk to little more than two weeks and they are yearning for nothing more than a return to life before COVID-19. Just as former Prime Minister John Howard outlined a vision for a "comfortable and relaxed" Australia after all the excitement, reform and recession of the Hawke/Keating era, the Morrison Government is increasingly of a view that the last thing voters want is more upheaval. It's a view that won't please those who believe the crisis is an opportunity for some big reforms, all the more so given that this year, just one election is scheduled – in Western Australia in March – making it an ideal environment for some politically brave moves.

But the mood is to steer away from all that, be it tax reform, religious freedom, industrial relations, maybe even superannuation.

Vaccine rollout is key

Regardless, the challenges ahead are enormous. The Federal Government's number one fear is messing up the vaccine rollout. As the International Monetary Fund reported in its January World Economic Update, the success or otherwise of the vaccine rollout globally is the main factor underpinning newly optimistic global growth forecasts. These new forecasts reflect "additional policy support in a few large economies and expectations of a vaccine-powered strengthening of activity later in the year, which outweigh the drag on near-term momentum due to rising infections," the IMF said. The IMF cautioned there was "exceptional uncertainty" surrounding the projections, on both the upside and downside. Each was vaccine-related.

On the upside, global growth could turn out to be stronger than forecast if more vaccines and effective therapies were developed, increasing expectations of a faster end to the pandemic, thereby "boosting confidence among firms and households". "This would generate stronger consumption, investment and employment recoveries, with firms hiring and expanding capacity in anticipation of rising demand," it said.

On the downside, the IMF warns growth could be weaker than forecast "if the virus surge – including from new variants – proves difficult to contain, infections and deaths mount rapidly before vaccines are widely available and voluntary distancing or lockdowns prove stronger than anticipated."

This can also be extrapolated to the domestic economy, the state of which will be crucial to the Morrison Government's re-election prospects.

China trade tensions at an impasse

Not unrelated is another major economic challenge - trying to mend Australia's relationship with China.

The two nations remain at an impasse over Beijing's use of trade bans and tariffs in protest against moves to protect Australian sovereignty. There is no point treating these actions as legitimate trade gripes, because they are not. Beijing admitted as much late last year, when the Chinese Embassy in Canberra handed Nine Media a list of 14 reasons behind its actions. These included banning Chinese telecommunications equipment maker Huawei from the 5G contract, and implementing foreign interference rules and powers to veto deals between foreign powers and state and local governments, as well as universities.

Other gripes included: Australia having a free press; funding for "anti-China" research at the Australian Strategic Policy Institute; raids on Chinese journalists and academic visa cancellations; "spearheading a crusade" in multilateral forums on China's affairs in Taiwan, Hong Kong and Xinjiang; calling for an independent investigation into the origins of COVID-19; and blocking 10 Chinese foreign investment deals across the infrastructure, agriculture and animal husbandry sectors.

On China, Mr Morrison started 2021 as he ended last year. He was ready and willing to talk as soon as Beijing decided to pick up the phone, but none of the 14 conditions was negotiable.

The Federal Government will deliver its next budget in May and as well as the headline numbers, all eyes will be on the unemployment forecasts. The rate is currently 6.6 per cent.

The last budget update, released in December, says the jobless rate will not fall below 6 per cent to a forecast 5.75 per cent until 2022-23. But this is still not "comfortably below" the six per cent benchmark Federal Treasurer Josh Frydenberg has set before shifting the focus away from job creation to budget repair. In that vein, don't expect any significant belt tightening before the election.

Walking on climate eggshells

Climate change will be an ever-present issue for the Government.

Mr Morrison wants to push the party towards a net zero emissions target by 2050 but, like previous Coalition leaders, he is walking on eggshells. The Nationals are still talking up the virtues of coal, and if Mr Morrison pushes too hard, he'll fracture the party and harm his leadership.

With new US President Joe Biden going gangbusters on emissions reduction – including by making climate action a key element of US foreign policy interaction – to make up for the inaction of the Trump years, the Morrison Government can expect international pressure to build on this front.

Countering that is the lack of domestic political pressure thanks to the state of the Opposition. One of the most significant factors in the Coalition's favour at the start of this year is the parlous state of the Labor Party and the sagging leadership of Anthony Albanese.

Labor is riven by unhappiness and despair. Few believe Mr Albanese can win the next election, but there is far from a clear consensus as to who could. There are at least five contenders should Mr Albanese fall - Tanya Plibersek, Richard Marles, Jim Chalmers, Chris Bowen and Tony Burke.

In search of a circuit breaker, Mr Albanese started the year with a major reshuffle of his frontbench. The most significant element was to bow to pressure from the Right faction and dump his friend and ally Mark Butler from the climate portfolio and hand it to Chris Bowen. Albanese insists that does not mean Labor will be watering down its approach. It is already committed to net zero by 2050 and will take a mid-term target, probably for 2035, to the next election.

In the first major speech of his leadership, Mr Albanese said the sales pitch around climate policy had to broaden beyond environmental protection to include an economic argument, specifically about job creation. The argument is that Mr Bowen, as a former treasurer and shadow treasurer, should be able to do this. But the Right faction figures such as Joel Fitzgibbon who pushed to oust Mr Butler want more than just a different sales job – they want a more centrist policy so as not to alienate the blue-collar resources workers who have deserted the party in recent years.

This would require an approach closer to that of the Coalition, which relies on a technological shift to clean energy with gas as the transition fuel.

No mood for change

In the absence of a strong, united and robust Opposition, the Government has more room to move and even make mistakes. Australian voters are pretty happy with governments at the moment. Everyone likes their premiers, and there is a general view the Morrison Government has done a good job with the pandemic.

There is certainly no anger or mood for change in the electorate, and the longer there is a sense that things are getting better, that will remain the case. If anything, complacency is one of the Government's key enemies this year. Prime Ministers call elections when they think they have the best chance of winning. Mr Morrison is ensuring that everything is in place for a poll later this year. It's prudent to keep your options open.

How the above plays out will ultimately dictate the timing.

3.
POLICY OUTLOOK

POLICY TIMELINE

WHAT TO WATCH

26 FEBRUARY 2021

Royal Commission Into Aged Care Quality And Safety Final Report
Key here will be the Federal Government's response and how quickly it acts on the recommendations. Seventy-five per cent of Australia's COVID-19 deaths have been in aged care homes..

28 MARCH 2021

End of JobKeeper wage subsidy
Relatively strong employment growth suggests this is unlikely to be extended in its current form.

31

End of JobSeeker supplement
A permanent increase to the rate of JobSeeker is necessary and has community support.

31

End of HomeBuilder grants
Building contracts need to be signed by 31 March, but construction activity will flow on throughout 2021.

MAY 2021

Federal budget
Expect relatively high levels of stimulus spending, but not at the same quantum as 2020.

MAY-AUGUST 2021

State budgets
Expect more divergent policies and spending levels across the states as they recover at different paces.

MID 2021

Federal Intergenerational Report
This should show how stark the migration and population impacts of COVID-19 have been on the long-term outlook for the nation.

26 NOVEMBER 2021

UN Climate Conference
Look out for any changes to Australian Government policy influenced by a change in international policy outlook led by the Biden Administration.

3. POLICY OUTLOOK

Cassandra Winzar
Senior Economist, CEDA

Cassandra Winzar is Senior Economist (WA) at CEDA. Prior to joining CEDA she was Principal Economist at the WA Department of Communities (Housing Authority) where she focused on WA economic conditions and housing related research, including running the state government's Housing Industry Forecasting Group. Cassandra has also held roles as the WA based Economist for the Reserve Bank of Australia, and in Transfer Pricing at EY. Cassandra has a Bachelor of Economics (Honours) and Bachelor of Arts (Asian Studies) from the University of Western Australia.

It's time to consolidate the recovery to foster a dynamic economy and thriving community.

2020 was a year of rapid policy development never before seen in Australia, bringing twists and turns in decision-making as governments adapted to the ever-changing COVID-19 landscape. On both health and the economy, Australia has done better than many of its global counterparts. It has been more successful at both containing the virus and continuing economic activity than many thought possible at the start of the outbreak.

The pandemic will still be with us in 2021, and with it the need for strong policy responses. While vaccine rollouts provide hope for the future, managing the virus and the economic and policy challenges that come with it will continue to dominate in 2021. While short-term responses remain necessary, governments should also be looking towards co-ordinated long-term responses to critical policy challenges. Unless an early federal vote is called, there will be few elections in 2021, with the exception of Western Australia in March. Therefore, state and federal governments should put all their efforts into the health, social and economic recovery this year.

"While the widespread business support of 2020 – including the JobKeeper wage subsidy, insolvency changes and instant asset write offs – may no longer be required, targeted support will be critical."

Fiscal response

Federal and state budgets are due again in May 2021, not long after the delayed budgets of 2020. Ongoing fiscal stimulus will be necessary – particularly when dealing with industries or locations affected by recurrent COVID-19 related lockdowns and restrictions. There is a balance to be found between gradually unwinding the short-term stimulus of last year, while still supporting businesses and employment.

Some tapering of spending is required – the quantum of spending seen in 2020 was an appropriate response to the crisis, but is neither sustainable nor required longer term. However, governments should not be afraid to extend programs or provide targeted support where it is needed most. While the widespread business support of 2020 – including the JobKeeper wage subsidy, insolvency changes and instant asset write offs – may no longer be required, targeted support will be critical. There is no clear recovery in sight for sectors such as international education, tourism or aviation. Ongoing support will be required for many of these businesses and industries to survive the pandemic.

Governments should also seek policies and investments that secure the economic recovery and deliver long-term economic and social benefits. Social infrastructure, including investments in social housing, childcare and aged care should be high on the list. A permanent increase to the rate of JobSeeker has been necessary for some time and will support the recovery.

"The experience of 2020 showed that jurisdictions that managed the health impacts of COVID-19 best also had the strongest economic outcomes, solidifying the need for health policy to remain front and centre."

Health

Health policy will be critical in the second year of the pandemic as authorities continue to respond to emerging outbreaks. In particular, the speed and comprehensiveness of the COVID-19 vaccine rollout will be paramount. The experience of 2020 showed that jurisdictions that managed the health impacts of COVID-19 best also had the strongest economic outcomes, solidifying the need for health policy to remain front and centre. Rapid and comprehensive vaccine distribution will bring more certainty and hope to the community, thereby benefiting business and the economy. Nevertheless, it is likely to be some time until widespread global vaccination brings a return to previous levels of domestic and international mobility.

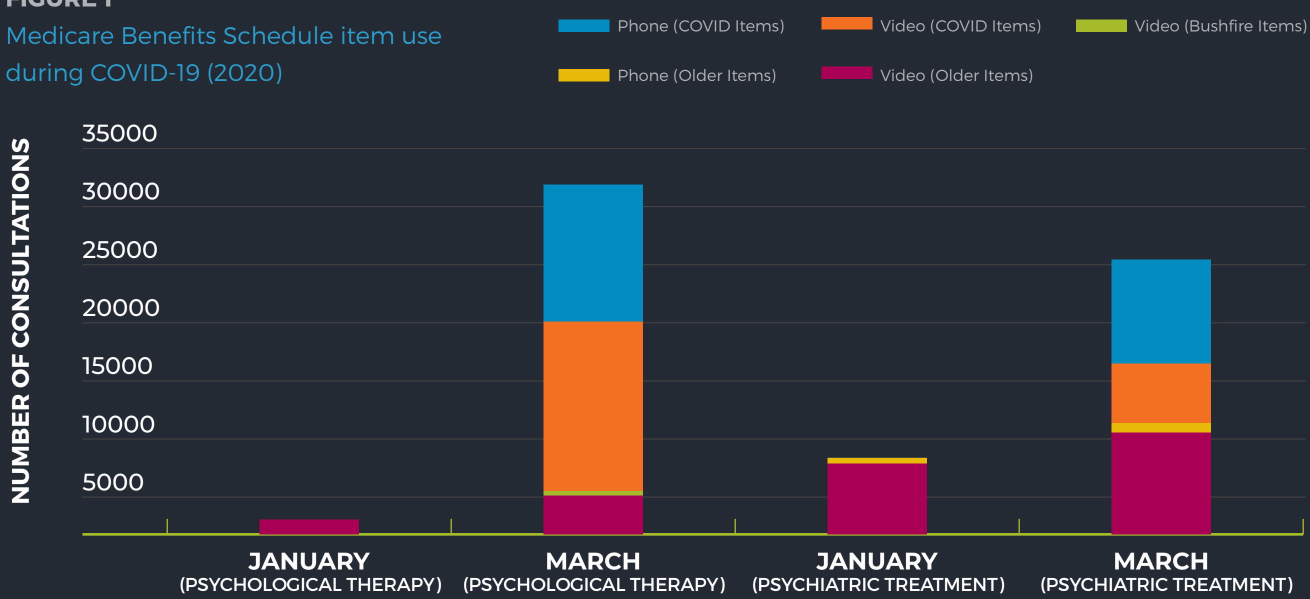
It should be noted that the pandemic saw some policy wins in the health space, most notably in the rapid expansion of telehealth. This is an important way to increase access to services, particularly in rural or regional areas. The Federal Government has recently announced it will become a permanent fixture of Medicare. This is a very positive outcome.

Mental health

Mental health must be a policy priority in 2021. It is of growing concern in the community and the impacts of COVID-19 on mental health will remain for some time. The Federal Government is yet to respond to the 21 recommendations of the Productivity Commission Inquiry Report on Mental Health, which was handed to the Government in June and publicly released in November 2020. Addressing mental health brings long-term benefits to economic and social participation and productivity. The Productivity Commission estimates that reform of the mental health system would increase people's quality of life to a value of up to $18 billion annually. Most of the benefits would come from adopting the priority reforms around early intervention, access to the right healthcare, strong community supports and mentally healthy workplaces. These should be implemented without delay.

FIGURE 1

Medicare Benefits Schedule item use during COVID-19 (2020)



Source: Productivity Commission.

Australia's ageing population

The release of the Federal Government's delayed 2020 Intergenerational Report (IGR) mid-way through this year should provide a blueprint for the future development of the nation. There will be lingering demographic impacts of COVID-19, with population growth dropping to rates not seen since 1916-17. The 2021 IGR is likely to result in a stark picture of the burdens facing future generations given its starting point: pressures on economic growth, growing costs of climate change, elevated net debt, continued ageing of the population without the same level of migration to offset it and a tax base overdue for reform.

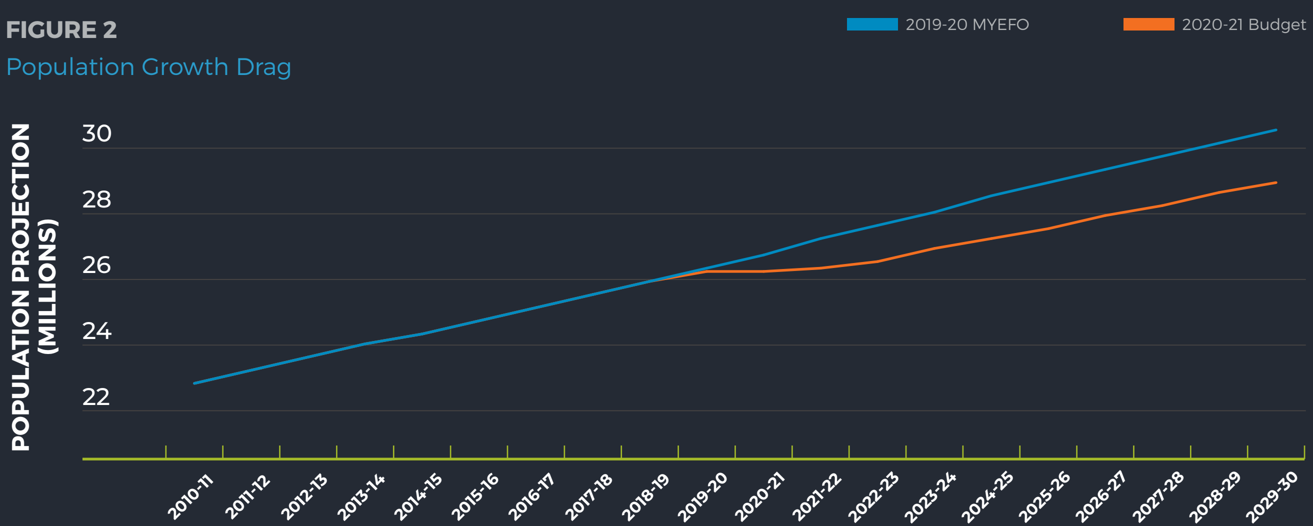
The role of migration will be important here. Migration has been a key pillar of Australia's economic success and will continue to be so into the future. But it is likely to be dramatically scaled back until 2022 at the earliest. The number of temporary visa holders in Australia has fallen from around 2.35 million at its peak to less than 1.8 million currently. The impacts of this are already being felt in many sectors such as agriculture, resources and aged care, and will continue to reverberate for some time. Federal and state governments should use this time to make Australia's migration program work better on the other side of COVID-19. In recent years, CEDA has argued that Australia's temporary skilled migration system can be made to work more effectively and in early 2021 we will be outlining how we can better utilise the skills of permanent migrants.

Australia must also do a much better job of looking after older Australians. February 2021 will bring the final report from the Royal Commission into Aged Care Quality and Safety. Interim reports and hearings have detailed systemic problems in the sector including abuse, neglect and improper care. The commission's recommendations are likely to be broad-ranging, but it remains to be seen how quickly or comprehensively the Federal Government will respond.

One clear finding of the commission so far is the need to boost staff ratios and training. It will be a challenge to attract, educate and adequately remunerate the required number of workers, especially with reduced levels of migration due to COVID-19. Policy support will be necessary to increase the workforce, including subsidies for training and development. This will also have the added benefit of boosting aggregate employment. With increasing demand for more and better-quality services, and an ageing population, health and social services are likely to drive job creation in the next few years.

FIGURE 2

Population Growth Drag



Source: Commonwealth of Australia.

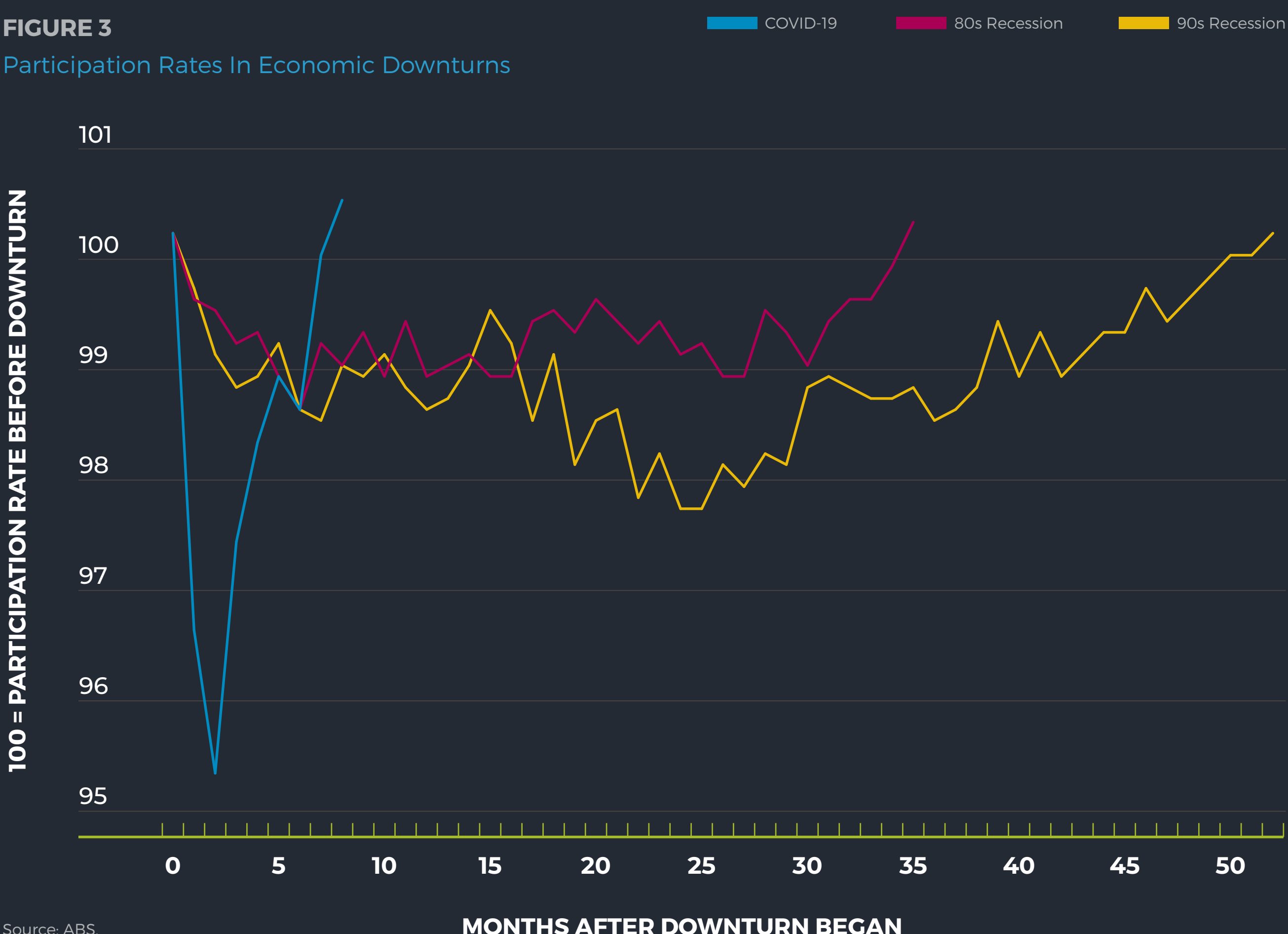
"The short-term recovery in the labour market has been positive, but we need to ensure momentum is not lost as the recovery progresses and early employment gains slow."

Workforce

Workforce participation and utilisation will be key to a strong economic recovery. There was a missed opportunity in the October budget to introduce policies that get more people into jobs and keep them there. The short-term recovery in the labour market has been positive, but we need to ensure momentum is not lost as the recovery progresses and early employment gains slow. After the 1990s recession it took 50 months for labour force participation to return to its pre recession levels. The current response has been much better but we cannot become complacent – long-term unemployment is detrimental at both an individual and community level. Governments must also focus on getting under-represented groups into the workforce. Youth and women should be front of mind. An expansion of early childhood education and childcare is a clear winner here and should be considered for the May Federal Budget. It frees parents to enter the workforce or increase their hours, while providing expanded employment for the sector and long-term social and economic benefits for children.

FIGURE 3

Participation Rates In Economic Downturns



Source: ABS.

Re-emergent policy themes: Climate change and housing affordability

With a little bit more headspace to consider non-COVID-19 issues, we are likely to see the re-emergence of some policy debates that had taken a back seat in 2020. Climate change in particular is likely to return to prominence in 2021, particularly given international policy shifts driven by the new Biden Administration in the US, which has already moved to rejoin the Paris climate agreement. Changing community attitudes have driven significant shifts by business and sustainability is now top of many corporate agendas. The business response has included improved transparency and reporting, with an increasing number of companies using the framework of the United Nations' Sustainable Development Goals and reporting against the recommendations of the Task Force on Climate Related Financial Disclosures. The financial sector has also launched the Climate Measurement Standards Initiative to collect more comprehensive data on the risks and exposures of climate change.

Greater transparency from both business and government around responses to climate change and sustainability more broadly is important to build community understanding and confidence, and promote constructive debate. The Australian Prudential Regulation Authority (APRA) introduced plans for climate risk vulnerability assessments in 2020 that were put on hold due to the pandemic. This should be picked up in 2021. It is important that we have consistent national policies that enable the most effective responses to climate change, including, importantly, through the opportunities presented by rapid technological developments including in renewables and energy storage.

Housing affordability is another issue that is likely to regain prominence. Despite initial predictions that the COVID-19-induced recession would drive house prices lower, they actually rose in most cities through 2020, particularly in regional areas attractive to a work-from-home workforce. State and federal home-building grants may have been an effective stimulus, and brought forward demand for new builds, but they have little to no impact on affordability and should not be extended beyond the current programs. Social and build-to-rent housing, as well as planning regulations, all must be considered. A move away from stamp duty towards land tax in NSW is positive, and similar reforms should be considered by other states. While voters were willing to focus on the health and economic response to the pandemic in 2020, these issues remain and are likely to gain prominence in the lead-up to the next Federal Election.

"Greater transparency from both business and government around responses to climate change and sustainability more broadly is important to build community understanding and confidence, and promote constructive debate."

FUTURE POLICY OUTLOOK

2020 saw a step-up in using real-time data to shape and manage the health and economic responses to the pandemic. This should be built on in 2021 to underpin evidence-based long-term policy developments. This is critical to ensuring better outcomes for all Australians as we emerge from the pandemic. Expanding the evidence base through improved data sharing and linkage will be required. This is much talked about by all levels of government, but there are few examples in practice so far. The Federal Government's Data Availability and Transparency Bill is a good starting point. This was introduced into Parliament in late 2020 and should be passed in 2021.

Australia had some short-term health and economic policy wins in 2020. Now, 2021 is the year to consolidate the recovery and work towards the future we want to see – a robust and dynamic economy and a thriving community.

ACKNOWLEDGMENTS

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South Australian Water Corporation
South East Water
South32
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Victorian Department of Treasury and Finance
Victorian Managed Insurance Authority
WA Department of Communities
WA Department of Health
WA Department of Jobs, Tourism, Science and Innovation
WA Department of Primary Industries and Regional Development
WA Department of the Premier and Cabinet
WA Department of Treasury
WA Department of Water and Environmental

Regulation

WA Super

WA Transport Portfolio

Water Corporation

WaterNSW

Wesfarmers

Western Power

Western Sydney University

Woodside Energy

Wyndham City Council

Business

Anglicare SA

AngloGold Ashanti Australia

BankSA

Bedford Group

Brightwater Care Group

Business Events Perth

CARA

Chevron Australia

Churchill Consulting

CITIC Pacific Mining

City of Prospect

Clean Energy Council

Clean Energy Finance Corporation

CoINVEST

EDGE Employment Solutions

Fair Work Ombudsman

Fairbridge WA Inc

Fisher Leadership

Hawker Britton

Hays

Health Partners

Hilton, Adelaide

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Melbourne Convention & Exhibition Centre

Mercer

Multicap

National Offshore Petroleum Safety and Environmental Management Authority

NGIS Australia

Pan Pacific Hotels Group

Paxon Group

People's Choice Credit Union

Queensland Department of State Development, Tourism and Innovation

Queensland Department of Youth Justice

Resource Capital Funds Management

Royal Flying Doctor Service of Australia

Royal Institution of Australia

RPS AAP Consulting

S&P Global Ratings

SAP Australia

Scitech

Scope Global

SenateSHJ

Seymour College

Shire of Serpentine-Jarrahdale

Shoal

Smarketer

Squire Patton Boggs

St Peters Collegiate Girls School

Step Beyond Strategy

Strategic Project Partners

StudyPerth

Suncare Community Services

Syrinx Environmental

TAE Aerospace

Telethon Kids Institute

The Bethanie Group

The Big Issue Australia

The Front Project

The Smith Family

Torrens University Australia

Townsville City Council

Townsville Enterprise

Translational Research Institute

Tri-Star Petroleum Company

WAI Group

Walter and Eliza Hall Institute of Medical Research

Western Australian Treasury Corporation

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