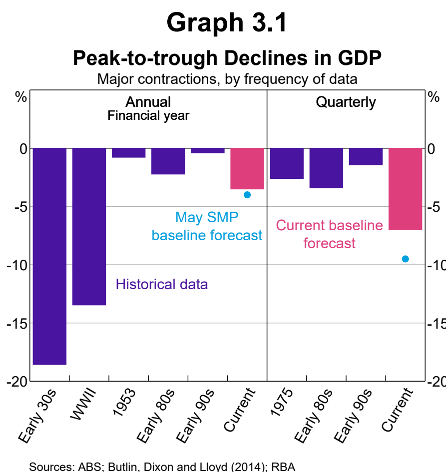
3. Domestic Economic Conditions

The outbreak of COVID-19 has caused the largest shock to economic activity in Australia since the 1930s (Graph 3.1). The peak-to-trough decline in GDP that has occurred over the first half of 2020 is expected to have been around 7 per cent. There have been correspondingly large declines in total hours worked and employment, and the rate of labour force underutilisation is the highest since the 1990s recession. Around 30 per cent of Australia's working-age population is receiving JobKeeper, JobSeeker or equivalent payments. Although a gradual recovery is underway, the nature and speed of the recovery remains highly uncertain and the pandemic will have long-lasting effects on the economy.

The decline in economic activity has been historically large but it is less than was assumed in the 'baseline' scenario at the time of the May *Statement on Monetary Policy*. Economic activity and the labour market have both picked up since May as activity restrictions eased. Highly expansionary fiscal and monetary policy have also supported the recovery, including measures targeting household cash flow and employment. Household finances have also been supported by temporary measures including mortgage payment deferrals and early access to superannuation balances.



However, the pandemic and associated containment measures continue to weigh on activity. Even prior to the most recent set of restrictions applied in Victoria, the outlook for much of the economy was very uncertain, and forward indicators of activity and the labour market were weak. It will take a considerable period of time to recover the lost output and employment resulting from the COVID-19 outbreak.

Activity picked up as restrictions were eased, but the pace has slowed recently

Governments began to ease social distancing and other containment measures in May, following a decrease in the number of COVID-19 cases. Restrictions on activity were gradually lifted – including allowing larger public gatherings and permitting higher patron numbers at pubs, cafes and restaurants – and, by early June, most states were allowing regional travel. Capital city mobility indicators and a range of other indicators of economic activity picked up quite quickly over May and June as restrictions were eased (Graph 3.2).

The number of COVID-19 cases in Victoria increased in June, and accelerated further in July (Graph 3.3). In response, the Victorian Government reintroduced strict containment measures and remote schooling and, in early August, further tightened restrictions on large parts of the state's economy in order to sharply reduce the spread of infections. The Victorian border has effectively been closed, and some other restrictions on interstate movements have been introduced or reinstated. Mobility indicators for Melbourne started to slow in late June as the number of COVID-19 cases increased, and declined further as activity restrictions were reimposed; mobility is expected to have fallen sharply since the start of August.

Case numbers in New South Wales (and, to a lesser extent, some other states) have also increased, resulting in some targeted tightening of containment measures, including further restrictions on inter-state movements. Mobility indicators remain well above their April levels in capital cities other than Melbourne, although have moderated recently in Sydney.

In line with the initial recovery in activity, survey measures of business sentiment picked up sharply from their April lows, although business conditions were still below average in June (Graph 3.4). Similarly, measures of consumer sentiment have lifted from their April lows, but remain well below average and dipped in July as containment measures were reimposed in some states.

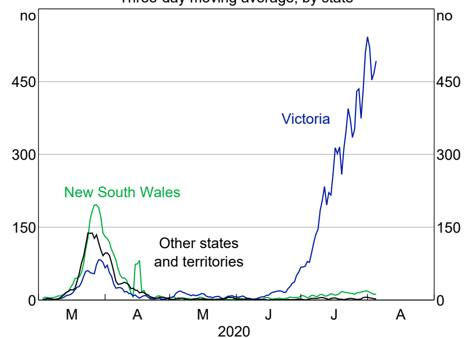
The recovery in employment has been uneven …

The COVID-19 outbreak has severely affected the labour market. Employment fell by around 870,000 people over April and May (Graph 3.5). Some of these job losses have since been recovered as restrictions have been lifted and activity has picked up, but employment remains around 5 per cent lower than in mid March. Weekly ABS payroll data showed a large

Graph 3.3

Confirmed COVID-19 Cases in Australia

Three-day moving average, by state

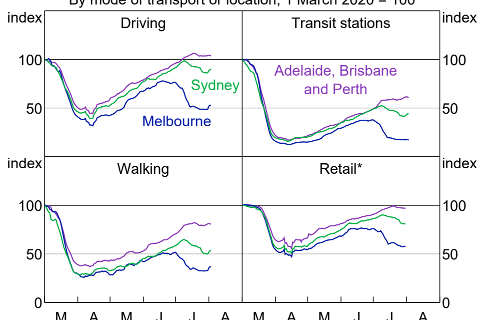


Sources: covidlive.com.au; government health departments; RBA

Graph 3.2

Mobility Indicators

By mode of transport or location, 1 March 2020 = 100



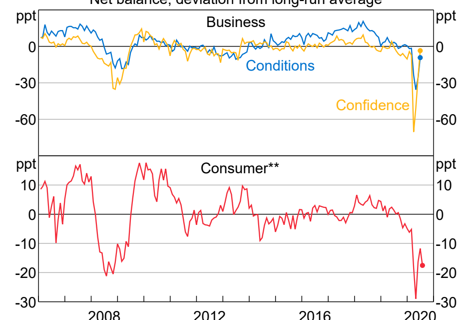
* Retail data are state based

Sources: Apple; Google LLC (2020), 'Google COVID-19 Community Mobility Reports', available at https://www.google.com/covid19/mobility/ viewed on 5 August 2020; RBA

Graph 3.4

Business and Consumer Sentiment*

Net balance, deviation from long-run average



* Latest observations are June 2020 for business confidence and conditions and July 2020 for consumer confidence

** Average of Westpac–Melbourne Institute and ANZ–Roy Morgan surveys

Sources: ANZ–Roy Morgan; NAB; RBA; Westpac–Melbourne Institute

recovery in the number of paid jobs over May and June, but improvements have been mixed since late June. Compared to March, an additional 800,000 people are currently receiving JobSeeker support payments (around 1½ million people in total). The Australian Government's JobKeeper program introduced in March is currently subsidising around 3½ million jobs; in the absence of this program, employment would have declined much further.

Around two-thirds of the jobs lost in April and May were casual jobs. This reflects the large share of casual workers in hospitality-related industries, as well as some restrictions in casual workers' eligibility for JobKeeper payments. As social distancing restrictions have been eased since May in many parts of the country, the recovery has been largest in industries that had initially lost the most jobs, most notably in the accommodation & food services and the arts & recreation industries (Graph 3.6).

A number of other industries that were not as directly affected by activity restrictions – such as construction and business services – experienced relatively smaller initial declines in employment. In some of these industries, however, payrolls data indicate there has been some further weakness in recent weeks, in part because of ongoing subdued demand. Full-time employment continued to decline in June, and accounts for over half of the job losses since March, though this is still less than the full-time share of total employment.

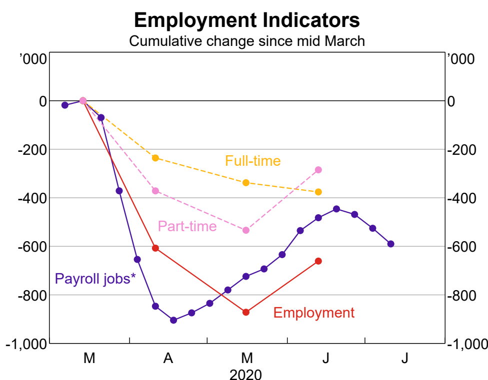
Across age groups, job losses have been much more pronounced for younger workers aged 15–24 years old (Graph 3.7). While younger workers are typically more affected by weak labour markets than are other age groups, this pattern has been exacerbated in the current episode by the concentration of job losses in hospitality-related industries that have a higher share of younger workers.

The pattern of job losses and initial recovery was similar across states in March and April, but has since become more varied (Graph 3.8). In

Graph 3.5

Employment Indicators

Cumulative change since mid March

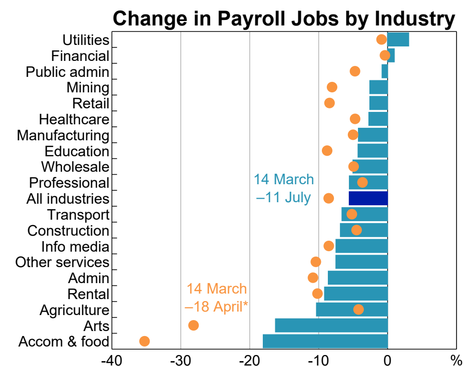


* ABS Weekly Payroll Jobs; excludes firms not reporting through single-touch payroll and self-employed persons

Sources: ABS; RBA

Graph 3.6

Change in Payroll Jobs by Industry

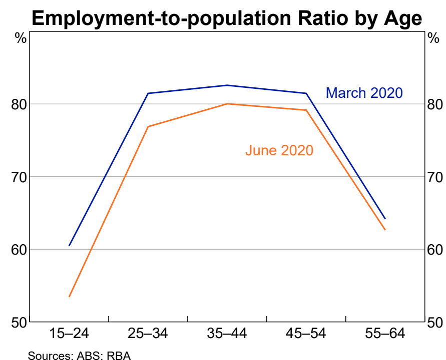


* The lowest weekly value of the aggregate payroll jobs index

Sources: ABS; RBA

Graph 3.7

Employment-to-population Ratio by Age



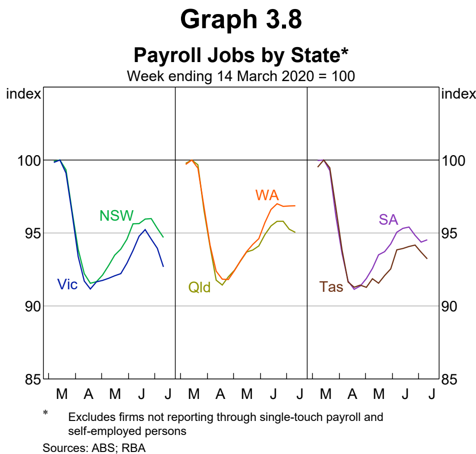
Sources: ABS; RBA

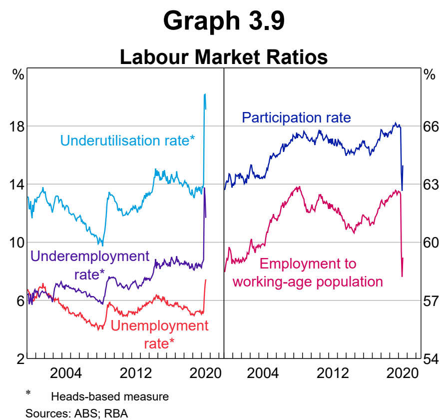
Victoria – which experienced a relatively subdued initial recovery, in part because restrictions had been eased more slowly – job numbers again turned down ahead of and during the reinstatement of activity restrictions in early July. Job losses in Victoria are likely to increase further in coming weeks as a result of the further tightening in activity restrictions in early August.

… and labour market underutilisation remains very high …

The unemployment rate increased from 5.2 per cent in March to 7.4 per cent in June (Graph 3.9). Increases in the measured unemployment rate in April and May were not as large as they could have been. This was mainly because an unusually large share of people who left employment had exited the labour force altogether, resulting in a considerable decline in the participation rate rather than a surge in the measured unemployment rate. The number of people temporarily leaving the labour force increased because social distancing restrictions made searching for work difficult over April and May, and also because job search requirements for receiving the JobSeeker unemployment benefit were temporarily waived. Among this group of people, an increasing number have started to actively search for work again as labour market conditions pick up and job search requirements for JobSeeker are gradually reintroduced. This contributed to the rise in the unemployment rate in June (when net employment gains were recorded), and further rises are expected over coming months as labour force participation increases and employment contracts.

Total hours worked in the economy fell by 10½ per cent from March to May, before recovering somewhat in June. A large part of this decline is because full-time workers worked fewer hours on average in recent months – only around half of the initial decline in full-time workers' average hours has been recovered. Part-time workers' average hours had declined sharply in April, but have now mostly recovered (Graph 3.10). In June around 1 in every 10 workers remained on reduced hours for economic reasons. Of these, around 230,000 workers worked zero hours; in the absence of the JobKeeper program, some of these workers would have lost their job. The underemployment rate was around 12 per cent in June, after spiking in April to its highest rate since the labour force survey series began in 1978. Measures of underutilisation remain around record high rates.





… while the near-term outlook for jobs remains uncertain

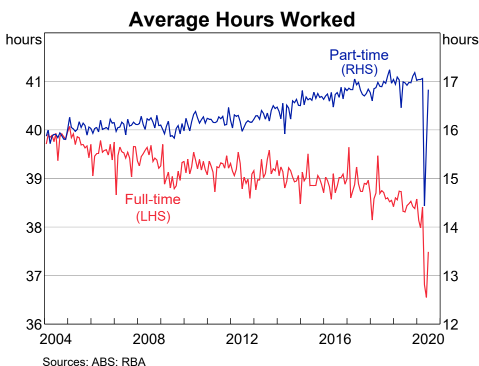
Forward-looking indicators of labour demand suggest that labour market conditions will remain subdued for some time. Job advertisements have picked up modestly since May, but remain around 30 per cent lower than earlier in the year (Graph 3.11). Increases in advertisements have been strongest in industries that had been most directly affected by social distancing restrictions and for which restrictions have begun to ease, such as accommodation & food and retail/wholesale trade. Surveys indicate that firms' hiring intentions remain weak, and information from business liaison suggests that hiring decisions are highly dependent on how activity restrictions and policy support measures evolve, as well as the outlook for demand conditions more broadly.

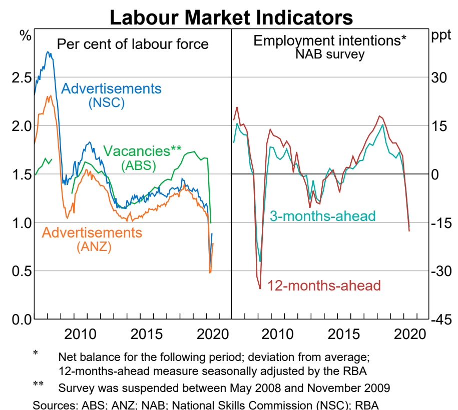
Policy measures have supported the labour market and household cash flow …

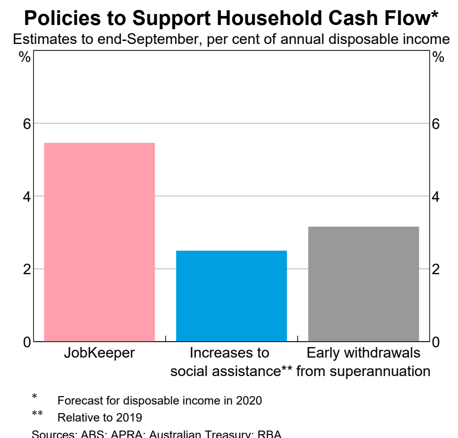
Declines in employment have reduced households' labour income, but much of this is being offset by policies that are providing substantial income support and aiding the recovery. Support for household cash flow has primarily come from the JobKeeper program, increased social assistance payments and early withdrawals from superannuation accounts (Graph 3.12).

The Australian Government introduced the JobKeeper program in April. This has provided a fortnightly wage subsidy of $1,500 per worker for a wide range of employers adversely affected by the COVID-19 outbreak. This program had been due to expire in September, but in July the government announced an extension until March 2021, with some downward adjustments to subsidy rates and changed eligibility criteria.

Other additional government payments have been supporting incomes of a large number of people over recent months. Since April,







payments to recipients of JobSeeker and a range of other social assistance programs have been substantially boosted by a fortnightly $550 Coronavirus Supplement. This supplement has also been extended beyond September, after which payments will be at a lower rate and subject to tighter eligibility criteria. Through April and May, around 6½ million existing recipients of social assistance payments received an Economic Support Payment of $750, and around 5 million people received a second $750 payment in July.

The combination of these newly introduced measures and existing fiscal policy settings has seen government payments as a share of GDP increase sharply. In the Australian Government's July economic and fiscal update, government payments were estimated to have been around 28 per cent of GDP in 2019/20 (compared to an average of around 25 per cent over the previous 30 years), and payments were forecast to increase further in 2020/21, to 34 per cent (Graph 3.13). Households and businesses have also paid less tax in recent months as their incomes have declined. The net positive fiscal impact of these increased outlays and reduced tax revenues set out in the July update were equivalent to around 4 per cent of GDP growth in 2019/20; a further 5 per cent change was expected in 2020/21.

State and territory governments have also been providing support to households and businesses, mostly in the form of relief from taxes and fees and increased funding for public services. Following the stringent lockdowns in Victoria in early August, the Australian and Victorian governments introduced a pandemic leave disaster payment to support workers required to self-isolate. Government income support measures have been complemented by private sector measures, such as policies to allow mortgage holders to defer their regular payments, and rent deferrals and discounts by residential and commercial landlords.

Eligible households have also supplemented their income with early withdrawals from their superannuation accounts. In the June quarter, around 2½ million eligible individuals made an average early withdrawal of nearly $8,000 from their superannuation. A second tranche of superannuation withdrawals became available after 1 July. Just under 40 per cent of those who applied in the first tranche have reapplied in the second. As at the end of July, around $30 billion had been withdrawn under this policy.

… which has supported spending on some consumption items

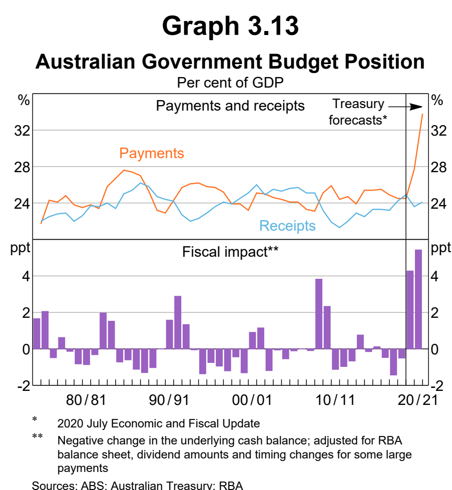
A range of partial indicators suggest household spending (including on retail sales, purchases of motor vehicles and discretionary services) fell sharply in the month of April but has since rebounded. The turnaround in spending on these items was supported by the easing in restrictions on activity and policies to bolster household cash flow.

Consumption patterns have shifted considerably as households and retailers have adjusted to different types of restrictions over recent months. In March and April, spending at cafes, restaurants and takeaway outlets fell markedly as restrictions on public gatherings and eating out were imposed (Graph 3.14). This was more than

Graph 3.13

Australian Government Budget Position

Per cent of GDP



* 2020 July Economic and Fiscal Update

** Negative change in the underlying cash balance; adjusted for RBA balance sheet, dividend amounts and timing changes for some large payments

Sources: ABS; Australian Treasury; RBA

offset by a very large increase in spending on food and beverages as households increased consumption at home and stocked up. Growth in food sales has since slowed, but remains much higher than a year ago, in part because many people continue to work from home and eating out options remain restricted.

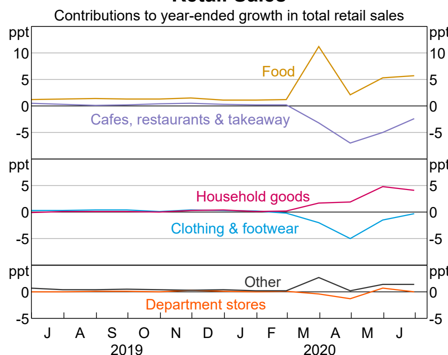
Sales of many types of household durables, including goods for home entertainment, appliances, furniture, and goods for home renovation, grew very strongly in May and June. Information from the Bank's liaison program suggest sales of these categories remained strong in July. By contrast, clothing & footwear spending – much of which typically involves in-person and close-contact shopping – was very weak in April and May but has increased recently. Households have also adapted to restrictions by making more of their purchases online; online retail sales accounted for around 10 per cent of the total value of retail sales in the June quarter, up from an average of around 6 per cent in 2019. Motor vehicle sales to households were very strong in July.

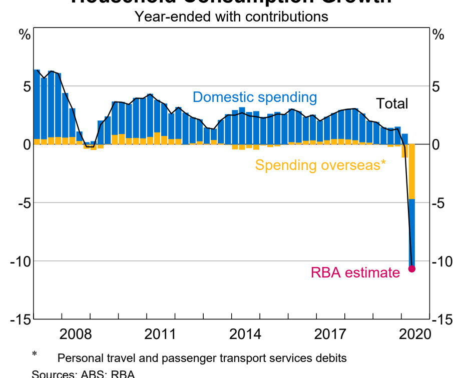
Despite the recent pick-up in some categories of retail spending, overall household consumption is estimated to have declined by around 10 per cent in the June quarter (Graph 3.15). Activity restrictions heavily weighed on domestic spending on discretionary services, such as recreation and personal care. However, a disproportionate share of the contraction came from reduced spending on overseas travel, given the restrictions on international travel. Spending by Australians travelling overseas typically accounts for around 5 per cent of nominal consumption, although the effect on overall GDP is offset by corresponding imports.

The lower overall level of household consumption, combined with the large boost to household cash flow from income support measures, led to a very large increase in the household saving rate in the June quarter. Reflecting this, household bank deposits have grown very strongly over recent months and credit card debt has declined (see the 'Domestic Financial Conditions' chapter and 'Box D: Recent Growth in Money Supply and Deposits').

Conditions in established housing markets have been mixed

Housing prices in most capital cities have declined a little since the May *Statement*, while Melbourne price declines in recent months have been larger (Graph 3.16). Prices in some smaller cities (Adelaide, Canberra and Hobart) have been resilient to the downturn observed elsewhere. New residential property listings declined markedly in April as activity restrictions and uncertainty weighed on the property





market; listings in Sydney have since increased to be broadly in line with their average level for this time of year, but they remain below average elsewhere (Graph 3.17). The reinstatement of restrictions in Melbourne in early July, including restrictions on in-person auctions and open houses, weighed on new listings and resulted in auction clearance rates in Melbourne declining to 45 per cent in July, to be a bit above the level seen in April. The introduction of further restrictions in Melbourne in early August will further reduce activity in the housing market over coming weeks. By contrast, following a strong bounce-back, auction clearance rates in Sydney have remained relatively stable in the recent period, at a bit above 60 per cent.

The modest decline in established housing prices at the national level, and the partial recovery in financial asset prices such as equities since March, mean that household wealth was broadly unchanged in the June quarter and increased a little over the past year.

Rental markets remain challenging for landlords and favourable for tenants

Rental vacancy rates rose further in recent months in Melbourne and Sydney, and advertised rents continued to move lower (Graph 3.18). The increase in the vacancy rate in Sydney has been driven by a larger number of vacant properties – primarily apartments – in the inner and middle ring suburbs. One important factor affecting rental market conditions has been the decline in international visitors and domestic business travel because of travel restrictions. This has encouraged some landlords to offer their short-term rental accommodation on the long-term market, increasing the available rental stock.

New residential bond lodgements rose sharply in May in Sydney, consistent with some tenants entering into new leases to realise lower rents. Nationally, around 5 per cent of residential tenants have obtained rental discounts over recent months. Instances of rent deferrals remain much higher than usual. Lower rental income could present cash flow challenges for some property investors if these conditions persist, and is also likely to weigh on investor demand for new properties.

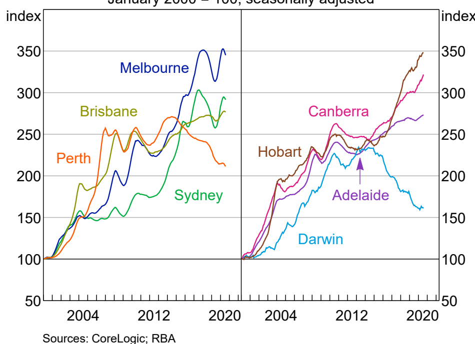
Policy measures are providing some support to residential construction, but overall conditions remain weak

In June, the Federal Government introduced the HomeBuilder scheme, which provides a grant of $25,000 to owner-occupiers undertaking eligible new building work over the rest of the calendar year. Survey information and liaison with

Graph 3.16

Housing Prices

January 2000 = 100, seasonally adjusted

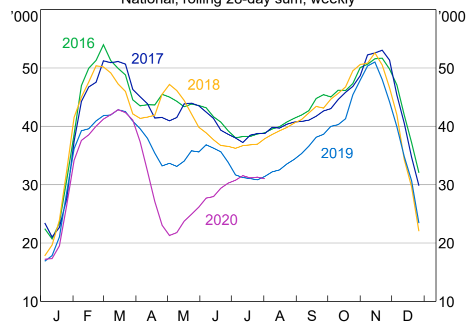


Sources: CoreLogic; RBA

Graph 3.17

New Residential Property Listings*

National, rolling 28-day sum, weekly

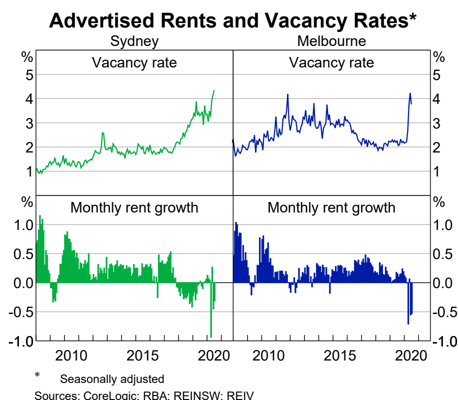


* Properties advertised for sale across multiple sources or multiple times in the same 28-day period are only counted once

Sources: CoreLogic; RBA

property developers indicated a large increase in enquiries for detached houses when this scheme was announced and sales of titled greenfield lots have increased to be around pre-outbreak levels (Graph 3.19). New home sales increased particularly strongly in Western Australia in June, following the announcement of HomeBuilder and the state government announcement of 'building bonus grants' of $20,000.

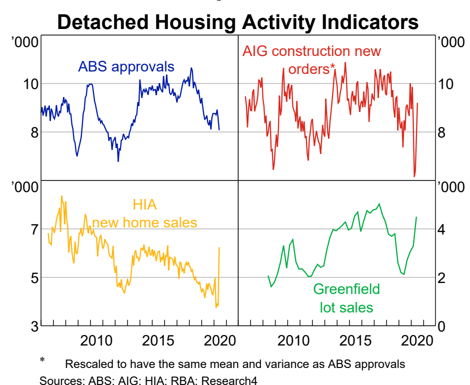
Despite this near-term boost to some parts of the new housing market, overall conditions remain weak. Construction activity in Melbourne will be significantly curtailed by restrictions on the number of workers allowed on residential construction sites in August and September. More broadly, residential building approvals for both detached and higher-density housing have declined over recent months. Furthermore, since the HomeBuilder scheme requires that work commences within three months of the contract date, higher-density construction projects are less likely to qualify. Developers have reported that sales of off-the-plan apartments have remained very soft, and some developers are delaying commencements of planned projects. The pipeline of residential work to be done declined over the past year because completions outpaced new approvals.



Non-mining investment intentions remain very weak …

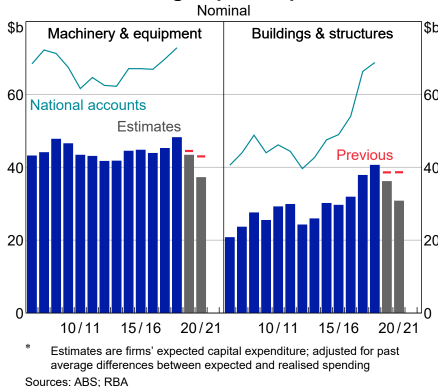
Non-mining investment declined by 6 per cent over the year to March, and is expected to fall further over the next year or so. Information from liaison suggests that firms have deferred or cancelled planned discretionary investment to preserve liquidity in response to weak current and expected demand. As well as near-term business conditions being highly uncertain, firms are also having to assess the implications of large shifts in consumer behaviour and economic activity (such as an elevated share of online retail expenditure, an increased prevalence of working from home, and a switch to domestic tourism over international travel). Should some of these shifts persist beyond the outbreak being contained, changes to the pattern and geographical distribution of activity will need to be incorporated into firms' investment (and employment) decisions.

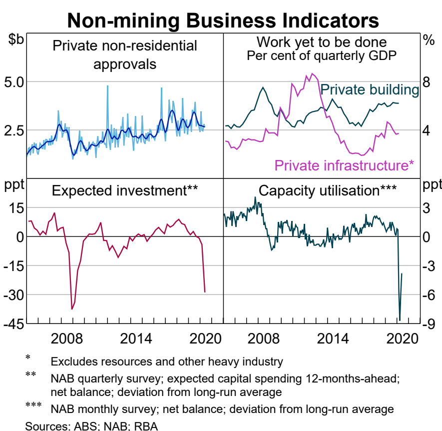
Survey measures of non-mining investment intentions were subdued prior to the pandemic and have been revised down further, consistent with weaker demand and heightened uncertainty. The ABS Capital Expenditure (Capex) survey, which was conducted in April and the first half of May, indicates that non-mining investment in both machinery & equipment and buildings will fall sharply over



the next year or so (Graph 3.20). That said, liaison indicates that the Australian Government's expanded instant asset write-off scheme – which is available for assets up to $150,000, and has been extended to December 2020 – supported a significant increase in commercial vehicle sales in June. In general, though, other survey indicators of expected business investment and capacity utilisation remain weak, and building approvals remain well below their levels in 2019 (Graph 3.21).

The near-term outlook for machinery & equipment investment is particularly weak, given this category of investment spending is sensitive to near-term demand conditions. Non-residential construction investment is expected to decline sharply over the second half of the year. In part, this reflects the introduction of limits on worker numbers at non-residential construction sites in Melbourne as part of the Victorian Government's response to the COVID-19 outbreak. In other states, work on already commenced projects is expected to continue. However, liaison information suggests that many building projects that were scheduled to commence have been put on hold.





… but governments are planning to 'fast-track' infrastructure projects to support activity

Over recent months, governments have announced plans to expedite approvals for both public and private construction projects. The Australian Government has announced that approvals for around $70 billion of projects have been prioritised, to allow construction activity to commence sooner; these include a range of electricity, mining, rail, road and water infrastructure projects. Most states have also announced an intention to fast-track a number of smaller 'shovel-ready' projects.

The pipeline of infrastructure work yet to be done has been broadly steady as a share of GDP over the past couple of years, supported by public infrastructure projects (Graph 3.22). In contrast, the pipeline of private non-mining infrastructure work has declined a little over the past year, led by roads and renewables. Expedited approval times for select private projects could bring forward some private construction investment, which would partly offset an expected decline in the pipeline of private infrastructure projects over the next few quarters. The accelerated spending could also provide a modest indirect boost to business investment; for example, if private contractors increase spending on machinery & equipment to facilitate work on these projects.

Mining investment is expected to increase a little over the next year

Mining investment increased by 10 per cent over the year to March, as replacement iron ore projects commenced and construction at the remaining LNG projects was completed. Information from the Capex survey and the Bank's liaison program indicate that investment is expected to increase slightly over the year ahead as work on iron ore and coal projects ramps up, although growth is expected to be more moderate than was anticipated at the start of the year (Graph 3.23). Further out, mining investment is expected to ease as a result of less work on iron ore and coal projects, and the deferral of final investment decisions on some large LNG projects.

Resource exports were broadly unchanged over the year to March; strong growth in LNG exports was largely offset by lower export volumes of non-monetary gold and a range of metal ores. Partial trade data indicate that iron ore exports picked up in the June quarter as exporters sought to benefit from high iron ore prices, including by running down inventories that had been built up in previous months because of weather-related shipping disruptions (Graph 3.24). Disruptions to Brazilian iron ore production have supported demand for Australian iron ore, especially from China. However, coal exports declined; demand for coal has been particularly weak from India and Japan.

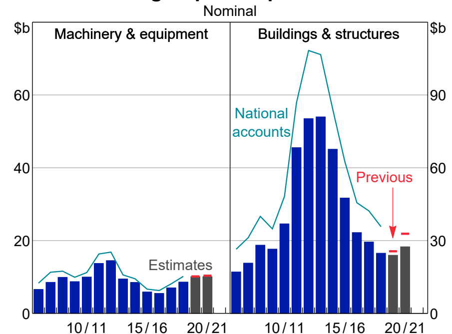
Service exports fell sharply in the June quarter

Travel and transport service exports collapsed over the first half of the year, following the introduction of international travel restrictions in February and March (Graph 3.25). Education travel exports declined sharply in the March quarter, as some students, mainly from China, were forced to delay their arrival, or were unable to commence their studies. However, the majority of international students who were in

Graph 3.23

Mining Capital Expenditure*

Nominal



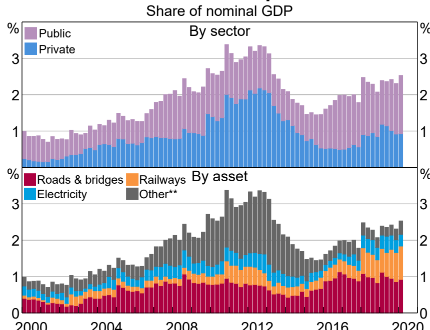
* Estimates are firms' expected capital expenditure; adjusted for past average differences between expected and realised spending

Sources: ABS; RBA

Graph 3.22

Infrastructure Pipeline*

Share of nominal GDP



* Includes some resource-related work (for example, some railways, harbours, and pipelines have been associated with resource projects)

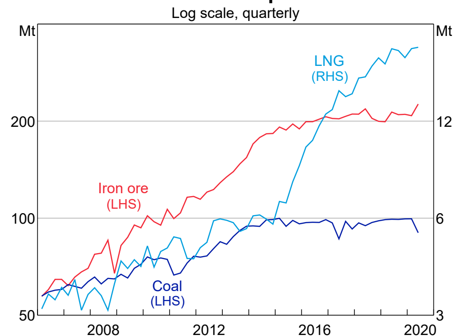
** Includes harbours, pipelines, water, sewerage, telecommunications, recreation and other infrastructure projects

Sources: ABS; RBA

Graph 3.24

Resource Exports*

Log scale, quarterly



* Seasonally adjusted by the RBA

Sources: ABS; RBA

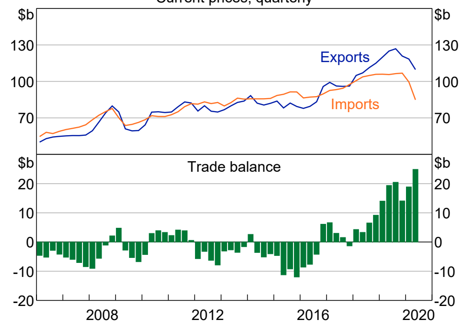
Australia when travel restrictions were introduced have remained in Australia, and this supported service exports in the June quarter. Tourism travel exports were close to zero in the June quarter because almost no foreign travellers were permitted to enter Australia. Service exports will not pick up materially until international travel restrictions begin to be lifted.

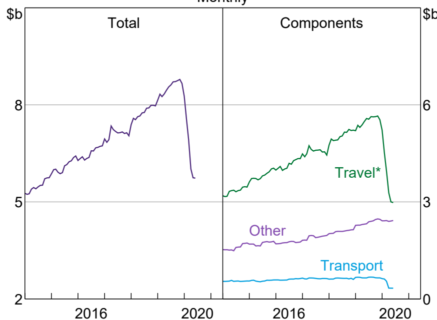
Likewise, reduced overseas travel by Australians resulted in a sharp fall in import volumes over the first half of the year. The fall in private domestic demand, particularly consumption and private business investment, also contributed to the decline in imports; the value of both consumer and capital goods fell in the June quarter.

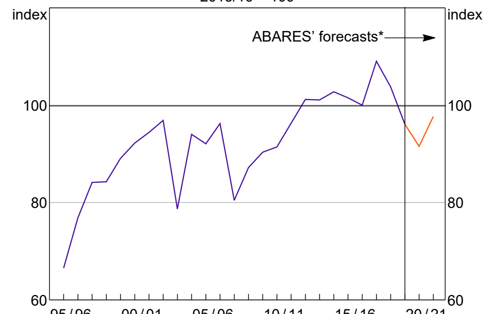
The trade surplus increased further in the June quarter, to around $25 billion or around 5 per cent of nominal GDP (its highest share since 1959 when quarterly data began), as import values fell by more than export values (Graph 3.26). The current account is therefore likely to have recorded its fifth consecutive quarterly surplus.

The outlook for the rural sector is favourable

After several years of severe drought, weather conditions have been mostly favourable since the start of the year, particularly in New South Wales and Victoria. The latest climate outlook published by the Bureau of Meteorology indicates that favourable conditions are likely to continue, with higher-than-average rainfall expected across most of Australia until at least October. Consistent with this, the Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) expects farm production volumes to increase strongly in 2020/21, led by a strong recovery in the production of winter crops, such as wheat and canola (Graph 3.27; Graph 3.28). This is expected to more than offset a decline in livestock-related production as farmers rebuild herds and flocks following recent rainfall.

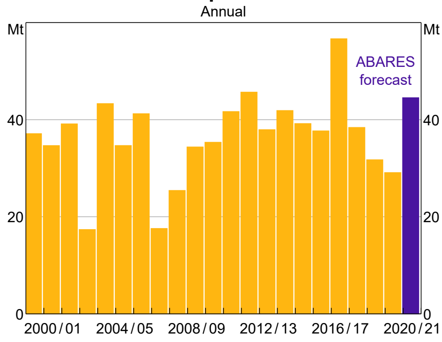






Graph 3.28

Winter Crop Production*



* Includes wheat, canola, barley, pulses, oats, safflower and triticale

Source: ABARES