

1. International Economic Conditions

The COVID-19 pandemic has led to the largest contraction in global economic activity in decades. Labour markets have been severely disrupted, and inflation has declined. However, since around May, global economic conditions have begun to recover as containment measures have been relaxed, supported by substantial fiscal and monetary policy easing. Global financial conditions have also stabilised after an earlier period of disorderly market conditions (see 'International Financial Conditions' chapter).

While global economic activity has picked up, a high degree of uncertainty surrounds the recovery. As set out in the 'Economic Outlook' chapter, the main source of uncertainty relates to the evolution of the virus and potential medical advances; already, a resurgence in new cases has seen the recovery lose some momentum, partly because of a reinstatement of containment measures and an increase in voluntary social distancing in some economies, including Australia. It is expected that the global economy will take some time to recover, given the significant economic disruption that has occurred, but how large or persistent these scarring effects will be is uncertain. Geopolitical and trade tensions have also escalated again, adding further uncertainty to the outlook.

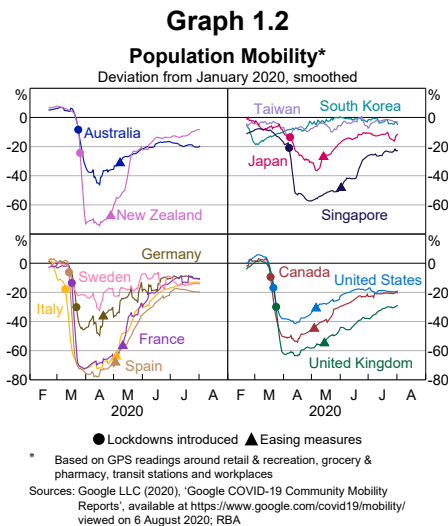
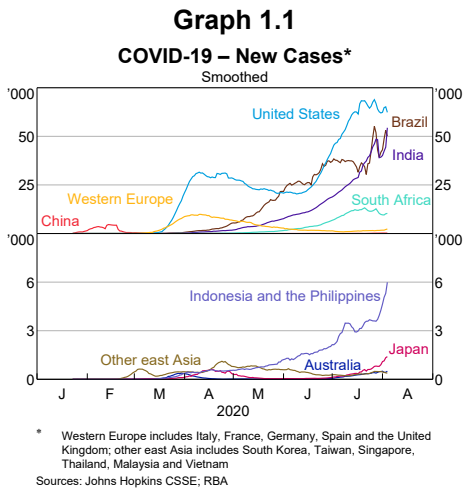
Success in containing the COVID-19 pandemic has varied, affecting the prospects of economic recovery

COVID-19 infection rates have varied significantly across the world. Case numbers have picked up sharply in a number of countries in recent weeks (Graph 1.1). Some of these economies started easing containment measures before infection rates had been reduced to a low level. Infections in much of the United States have increased sharply since the middle of June, leading some states to reinstate restrictions. Infections have increased significantly in Spain, Japan and Hong Kong more recently. Infections have also risen to very high levels in parts of Eastern Europe and the Middle East, prompting a tightening of some public health measures there, while infections in Latin America and parts of south Asia have continued to grow rapidly. By contrast, infections in New Zealand and much of Western Europe and east Asia were brought down by May, which has allowed restrictions to be substantially relaxed. In China, the authorities have managed to quickly contain a handful of localised outbreaks in recent months without resorting to widespread lockdowns.

High-frequency mobility indicators increased from April for many economies in response to the easing in restrictions at that time (Graph 1.2). However, mobility generally remains below pre-pandemic levels and, in places where infection rates are still rising, its recovery has slowed or even reversed.

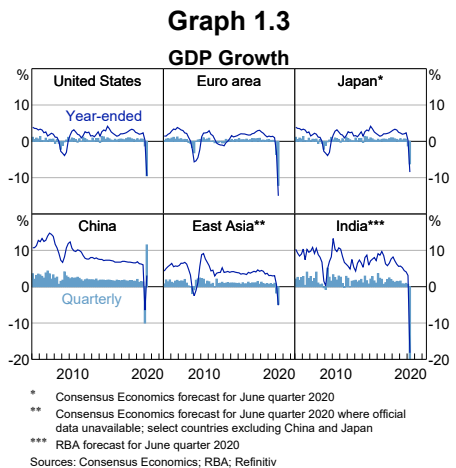
The economic contraction in the first half of 2020 was the most severe in decades

The pandemic led to a very severe contraction in global economic activity in the first half of 2020. The downturn was both sharper and more widespread than during the Global Financial Crisis. The contraction was generally concentrated early in the June quarter, with China, which experienced an earlier outbreak and lockdown, the main exception (Graph 1.3).



GDP fell by 11 to 15 per cent in both the United States and the euro area in the first half of the year; the contraction in UK GDP is estimated to have been similar. In the euro area, the GDP decline was largest in Spain, France and Italy; these economies were more severely affected by COVID-19 cases and therefore introduced stricter and longer-lasting containment measures. In Japan, where containment measures were more targeted, a smaller decline in GDP is estimated to have occurred in the first half of the year. Across the large advanced economies, consumption fell sharply because of mandated and voluntary social distancing, a decline in household income and weak labour market conditions. Prospects of lower demand, heightened uncertainty and production disruptions curtailed business investment.

In east Asia, GDP declined by around 4 per cent in the first half of the year. The decline was larger in economies with stricter containment measures, such as Singapore and the Philippines, compared to economies with more targeted restrictions, such as South Korea and Vietnam. Chinese GDP rebounded strongly in the June quarter to a little above pre-COVID-19 levels, reflecting success to date in containing the virus and an earlier easing in restrictions compared with other countries.



In other emerging economies, including some large economies like Brazil, Russia and India, domestic demand has been severely affected by the pandemic. In some of these economies, healthcare systems have been under intense strain, containment measures have been only partly effective and fiscal policy has had limited room to support household incomes.

The pandemic has interrupted global trade ...

International trade in both goods and services contracted sharply in the first half of 2020, weighed down by the weakness in demand and travel restrictions in most parts of the world (Graph 1.4). Merchandise trade declined by 18 per cent over the year to May. The weakness has been broad based by type of goods. Survey measures of new export orders have picked up since June, suggesting that global merchandise trade may have troughed late in the second quarter.

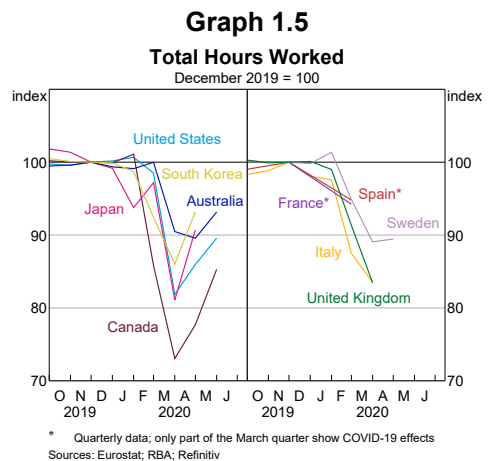
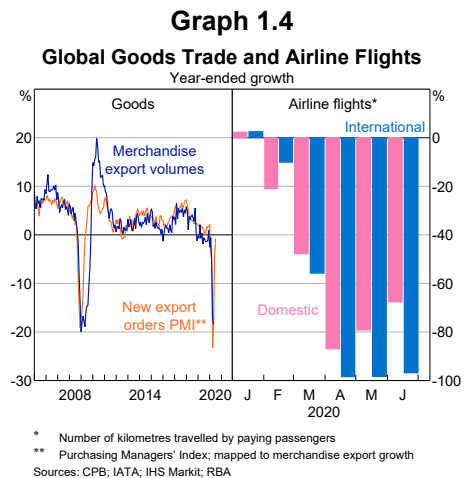
Services trade, for which timely data are limited, has also declined sharply as international travel has come to a near standstill. By contrast, domestic airline travel has picked up a little, especially in economies where the pandemic has been better controlled, such as China and parts of east Asia. US domestic airline travel has also increased a little since May despite high infection rates in parts of the country. Some international travel is also restarting, albeit with very low demand. The European Union (EU) reopened its internal borders in June and later allowed inbound travel from a number of non-EU countries with low infections. Cross-border travel is tentatively resuming in parts of Asia, initially limited mostly to business travel between selected destinations.

... and has severely disrupted labour markets

Labour markets have been severely disrupted everywhere. Officially reported labour market

outcomes have varied widely across countries because of differences in policy support, measurement approaches and country-specific requirements for receiving unemployment benefits. However, overall hours worked have declined significantly in all economies (Graph 1.5).

Unemployment rates have increased sharply in advanced economies that have used their existing unemployment insurance systems to cushion the COVID-19 shock; for example, the unemployment rate in the United States has been the highest since the late 1940s (Graph 1.6). The inclusion of temporary lay-offs



in reported unemployment has contributed to the sharp increase in unemployment rates in the United States and a few other economies. In contrast, unemployment rates have remained relatively low in economies that have used wage subsidies to support their labour markets, including most economies in Europe, Japan and New Zealand (see 'Box A: Using Wage Subsidies to Support Labour Markets through the COVID-19 Shock'). However, average hours worked have declined sharply in these economies, as elsewhere.

Spare capacity in the labour market has increased significantly given the combined increase in the number of people unemployed and underemployed. Participation rates have declined across advanced economies. Some workers stopped looking for work because they did not expect any jobs to be available during the height of restrictions. Some could also have been reluctant to seek work because of health concerns or caregiving responsibilities (for example, because children are learning from home). Job search requirements were also waived for some unemployment benefit recipients. Labour market conditions started to improve as containment measures were eased, with unemployment rates declining in Canada and the United States after a particularly sharp increase. But around the world, surveyed employment intentions remain low and the demand for labour is likely to remain subdued for some time.

In emerging economies, wage subsidy or unemployment insurance programs have been less feasible as a response to the pandemic's effects on labour markets because fiscal space is generally more limited and workers in the informal economy are hard to reach with these programs. The International Labour Organisation estimates that hours worked have declined substantially in the first half of the year in these economies.

The economic recovery is expected to be protracted and uneven

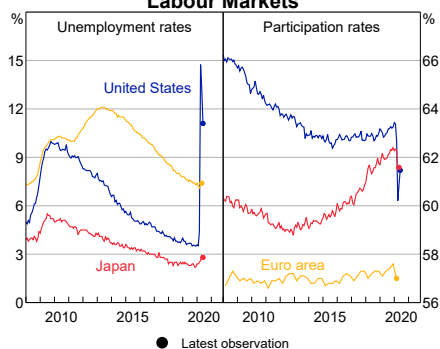
The global economic outlook remains highly uncertain. It depends on the evolution of the pandemic, including changes in social distancing and medical advances, fiscal and monetary policy support and behavioural changes among households and businesses.

In year-average terms, the GDP of Australia's major trading partners is expected to contract by around 3 per cent in 2020, with the trough in activity in the second quarter, followed by an increase of around 6 per cent in 2021 (Graph 1.7). This would leave the level of major trading partner GDP around 3 per cent below what had been expected before the outbreak. The central forecast is for an economic recovery that is protracted and uneven but assumes that a widespread and synchronised global resurgence in infections is avoided.

The global economic recovery is expected to be protracted for a variety of reasons: ongoing social distancing that constrains some activities, persistent precautionary behaviour by consumers, lower business investment, scarring effects in labour markets and a rise in business bankruptcies. It is also expected to be uneven because economies remain susceptible to fresh outbreaks that require restrictions to be reinstated, as has already occurred in some

Graph 1.6

Labour Markets



Sources: RBA; Refinitiv

places. The sustainability of the recovery remains particularly uncertain in economies where there has already been a significant resurgence in infections.

Weak external demand and restrictions on international tourism will weigh in particular on the recovery in export-oriented economies, including many emerging economies. Underdeveloped healthcare systems and more limited fiscal space are contributing to the subdued outlook for many emerging market economies, including in a number of the larger emerging economies where infections are high or growing rapidly. The IMF expects GDP in emerging market and developing economies (excluding China) to contract by around 5 per cent in 2020 and to recover more slowly than advanced economies.

The rebound in Chinese economic activity in the June quarter is expected to continue in the second half of the year, though at a slower pace. The recovery is being supported by low case numbers and, of particular relevance to Australia, is being driven by a recovery in industrial production to above pre-COVID-19 levels. However, the recovery in consumption has lagged the recovery in industrial production and ongoing weakness in consumer demand presents a downside risk to growth in the second half of the year. Higher

than usual uncertainty about the outlook has led the Chinese authorities to refrain from setting a target for annual economic growth for the first time since 1990.

Overall, the risks to the global outlook remain skewed to the downside. The main downside risk is from widespread resurgences in infections – whether that is because of near simultaneous lockdowns across a number of economies or a sequence of more localised events – leading to renewed lockdowns and other containment measures. Significant uncertainty regarding external demand will weigh on the outlook for export- and tourism-oriented economies. Separately, trade, technology and other geopolitical tensions remain an important ongoing risk to the outlook. The main upside risk relates to the swift development of effective and widely available vaccine and medical treatments.

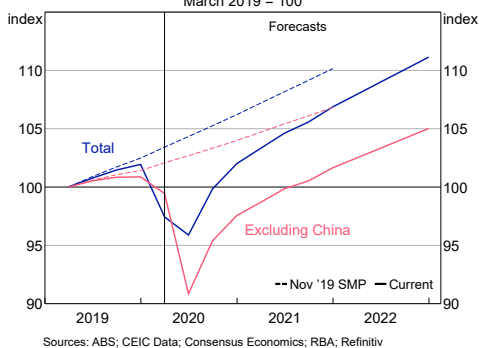
In China, industrial production has recovered but households remain cautious

The strong recovery in Chinese economic activity in the June quarter was particularly evident in steel-intensive sectors that are most relevant for Australia's exports of bulk commodities (Graph 1.8). Measures of industrial production have generally recovered to be around or above pre-outbreak levels, including production of construction equipment and automobiles. Investment in the infrastructure and real estate sectors has also rebounded to around pre-outbreak levels, but has been slower to recover in the manufacturing and service sectors. Conditions in the residential property market have normalised, with monthly floor space sales around their highest level since early 2018 and growth in prices continuing to pick up modestly.

The rebound in consumption has been slower than for production, reflecting caution among households and a decrease in household

Graph 1.7

Australia's Major Trading Partner GDP
March 2019 = 100



income (Graph 1.9). Most of the decline in retail sales has now been reversed, reflecting a steady increase in purchases of discretionary and durable goods. Spending at restaurants and cafes has also picked up but, as of June, remained well below pre-outbreak levels. Similarly, there has been only a partial recovery in the number of local public transport and longer-distance trips, suggesting some ongoing reluctance to move about in public.

Fiscal and monetary policy has helped to support the economic recovery in China and will continue to do so in the second half of 2020. China's consolidated fiscal deficit is expected to widen by just over 5 per cent of GDP in 2020, reflecting the effect of the budget's automatic

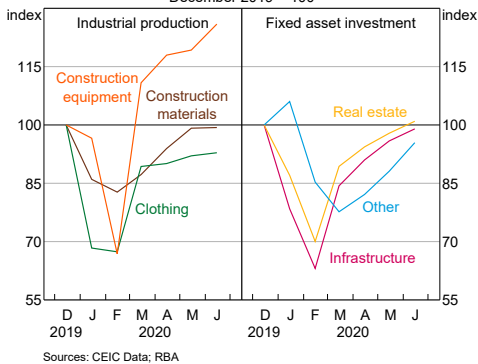
stabilisers and discretionary policy support, including tax and fee cuts and increased spending (Graph 1.10). Fiscal spending has been mostly directed towards infrastructure projects; authorities have indicated a reluctance to direct stimulus towards property. Local governments in some areas have eased property restrictions to encourage purchases, although these remain fairly targeted and authorities have also been willing to tighten restrictions when necessary to limit speculative activity. Most of the other announced policy support has been targeted at businesses – particularly small businesses – which should indirectly benefit households by supporting employment and household income. In contrast to many advanced economies, little direct government support has been provided to households so far; some cities have issued consumption vouchers to encourage spending at restaurants and on other retail goods, but these measures have been limited in size.

Beyond fiscal policy measures, the People's Bank of China has provided increased monetary support to the economy this year and credit growth has started to pick up (see 'International Financial Conditions' chapter). The State Council has also directed banks to forgo a large share of their annual profits by lowering borrowing costs for businesses.

Graph 1.8

China – Activity Indicators

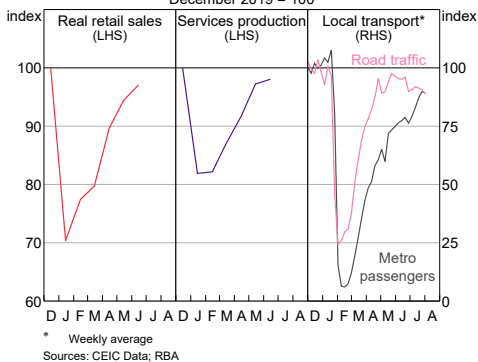
December 2019 = 100



Graph 1.9

China – Consumption Indicators

December 2019 = 100



A tentative recovery is underway in advanced economies but is reliant on policy support

Activity in advanced economies recovered in May following the slowing in new infections around that time, an easing of containment measures, reductions in voluntary social distancing and sizeable policy support. The recovery has been led by consumption, primarily of goods, which has been less constrained by social distancing measures that remain in place. By contrast, services consumption has remained very weak (Graph 1.11). The

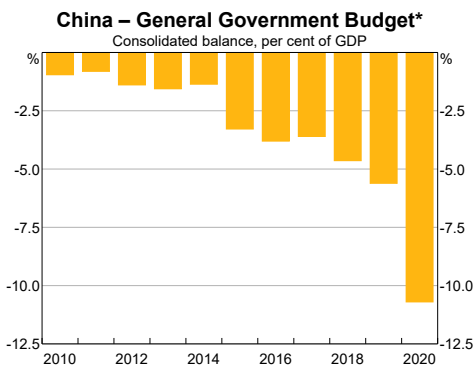
ongoing pace of the consumption-driven recovery depends on the evolution of the pandemic, with some indications that consumption has already slowed in places where infections have increased.

Surveyed business conditions point to an uneven recovery in activity across countries and sectors (Graph 1.12). Conditions in the services sector, which were especially weak, recovered to pre-COVID-19 levels in July in the euro area and the United Kingdom, but remain low in Japan.

Behavioural changes are also shaping the recovery and may have long-lasting effects. Household saving rates have increased sharply, reflecting the combined effects of constrained

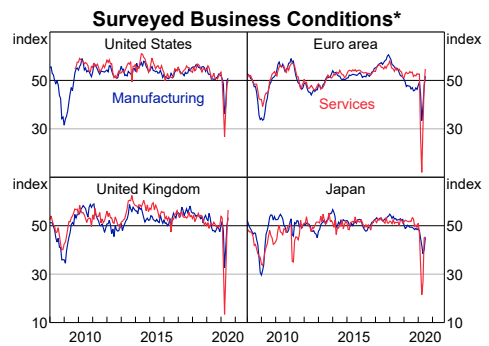
consumption, income support from fiscal measures and increased uncertainty. Consumer confidence has recovered a little since May in some advanced economies, including the United States and the euro area, but remains very low (Graph 1.13). Firms' investment intentions have declined sharply since March in response to weak demand and increased uncertainty. Some industries, such as international travel, tourism and hospitality, may have to significantly adjust their operations to meet new social distancing and other health requirements. Governments in many advanced economies are beginning to tailor their support to such sectors.

Graph 1.10



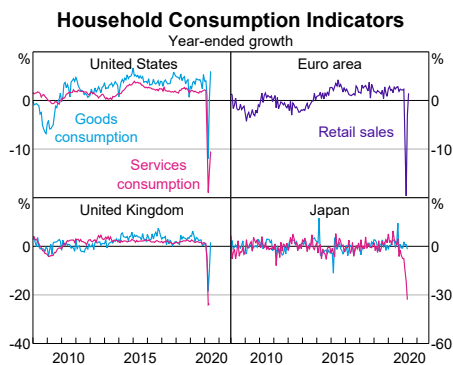
* Government budget balance including all levels of government and government-managed funds; special government bonds are treated as deficit financing; values for 2020 are projections and assume nominal GDP level implicit in the Budget documents
Sources: CEIC Data; MoF; RBA

Graph 1.12



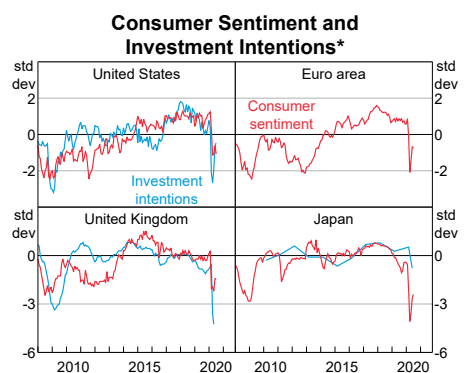
* Purchasing Managers' Index; below 50 indicates that activity is contracting
Sources: IHS Markit; RBA

Graph 1.11



Sources: RBA; Refinitiv

Graph 1.13



* Standard deviations from post-2000 average
Sources: Bank of Japan; RBA; Refinitiv

Unlike in typical recessions, household incomes have held up relatively well so far because of large and timely fiscal policy support. In the United States, household income increased sharply in April and May due to sizeable direct transfers and enhanced unemployment benefits. Unemployment benefits were raised to around the level of average full-time earnings until the end of July; many people recently classified as unemployed have therefore been receiving more in benefits than they earned in their previous job. The income support in European economies has been more modest, and household incomes are likely to have declined, because the wage subsidy schemes used there compensate only for part of the lost income from reduced hours (for further details see 'Box A: Using Wage Subsidies to Support Labour markets through the COVID-19 Shock'). Japan's sizeable support to household incomes initially faced administrative hurdles, but as these were overcome, income is expected to have been boosted to be above its pre-pandemic level.

Ongoing fiscal support will be important in determining the speed and shape of the recovery in advanced economies. So far, fiscal policy has mainly focused on supporting incomes of households and businesses (Graph 1.14). Governments in most advanced economies have extended many of the original support measures to avoid derailing the initial recovery. However, the US authorities are still to agree on an extension of the expanded unemployment benefits. Some economies where infections have subsided, including Germany, New Zealand and the United Kingdom, have begun a second stage of fiscal policy measures to support the recovery beyond its initial phase; these measures are aimed at directly stimulating demand through infrastructure and other public investment but also include consumption incentives, such as temporary consumption tax reductions (see 'Box B: Fiscal Policy Support for the Recovery

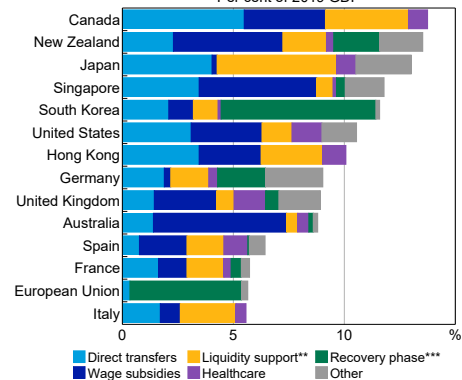
Phase in Advanced Economies'). Relatedly, the EU has established a recovery fund supporting public investment between 2021 and 2023, targeted at less developed and more heavily impacted member economies.

Weak demand and the resulting spare capacity in labour markets are putting downward pressure on inflation in advanced economies

Inflation has declined in year-ended terms since the outbreak of COVID-19 reflecting the decline in oil prices and weak aggregate demand, which have outweighed upward inflationary pressure from supply chain disruptions and temporary demand increases for some staple and medical goods (Graph 1.15). With excess capacity in labour markets expected to remain for some time, inflationary pressures are likely to remain low even with substantial fiscal and monetary policy support. As discussed in the 'Economic Outlook' chapter, the longer-term trajectory of inflation is more uncertain than the near-term outlook as it is unclear at this stage how the supply-side of the economy will evolve in the period ahead.

Graph 1.14

Direct Fiscal Response*
Per cent of 2019 GDP



* Excludes subnational governments, loan guarantees and unallocated funds; based on published estimates
 ** Deferred or reduced tax, social contributions and debt payments
 *** Investment, job training programs and consumption incentives
 Sources: IMF; national sources; RBA; Refinitiv

Economic conditions vary widely in east Asia ...

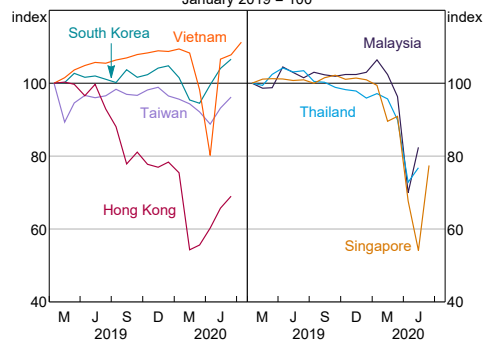
Domestic demand started to improve earlier in the Asian economies where case numbers are low and containment measures have eased. The recovery has been led by a pick-up in consumption (Graph 1.16). Some economies in the region have navigated the challenges of the virus better than most globally, in part reflecting their previous experience with the 2003 SARS outbreak. Infection rates came down quickly in South Korea and Vietnam, among others and, consequently, retail sales have recovered to be close to or above their pre-outbreak levels in these economies. Consumption started to recover in Hong Kong as well, but economic activity remains subdued there, hampered by social unrest and the fall in tourism from mainland China. In other regional economies, where stricter containment measures were in effect or outbreaks took longer to control, domestic activity fell further and the recovery has been slower. As discussed below, infection rates remain high for some economies in the region. Further fiscal policy measures have been announced in Singapore and South Korea in recent months to support their economic recovery.

Weak external demand, especially from large advanced economies, has weighed on production and exports in the region. Overall, exports have declined despite a pick-up in exports to China since March and resilient demand for IT products due to increased remote working (Graph 1.17). Surveyed measures of output and export orders in the manufacturing sector remain subdued, suggesting that this weak global demand will continue to slow the recovery in the near term. But if consumer spending globally remains tilted towards goods over services, it could provide some offsetting support for the region's exports.

As elsewhere, labour markets in east Asia have been severely disrupted by the pandemic.

Graph 1.16

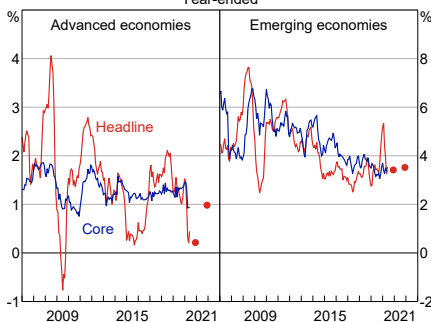
East Asia – Retail Sales
January 2019 = 100



Sources: CEIC Data; RBA

Graph 1.15

Global Inflation*
Year-ended

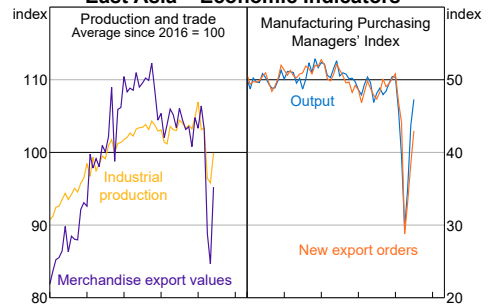


* PPP-weighted; sum of emerging and advanced economies accounts for around 80 per cent of world GDP; dots indicate year-average estimates derived from IMF forecasts

Sources: Bloomberg; CEIC Data; IMF; RBA; Refinitiv

Graph 1.17

East Asia – Economic Indicators*



* Excludes Hong Kong, Indonesia and the Philippines

Sources: CEIC Data; IHS Markit; RBA; Refinitiv

Unemployment rates have increased markedly in some economies, although wage subsidy schemes have helped temper the increase in Singapore and Malaysia (Graph 1.18).

... with a number of populous Asian economies being most severely affected

The more populous emerging economies of India, Indonesia and the Philippines continue to record significant numbers of new COVID-19 cases. This is despite a period of strict lockdown in India and some parts of the Philippines and Indonesia. Containment measures have led to sharp contractions in production and consumption (Graph 1.19). In April, industrial production fell by around two-fifths in India and the Philippines; timely data are not available for Indonesia. Production began to recover gradually in May as restrictions eased. There are few timely measures of consumption in India, but in June there was very little travel by air or rail due to restrictions on movement and, while credit card spending recovered slightly, it remains around half its pre-lockdown level. In Indonesia, retail sales in June were around 9 per cent below their levels of a year ago. There were also large declines in employment in these countries, including in Indonesia where containment measures were less stringent in much of the country. In India, timely data point to a recovery in employment as restrictions

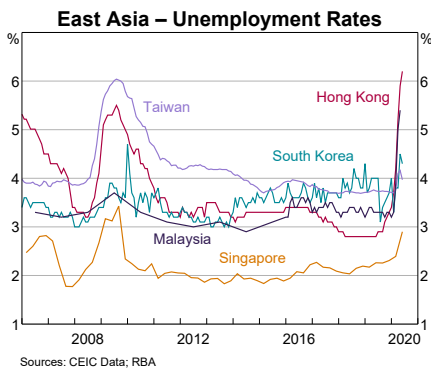
eased; some migrant workers fled urban areas during the initial lockdown and appear to have regained employment under the government’s rural work guarantee programmes, which reported a doubling of person-days worked in May and June. Direct fiscal support has been smaller in these emerging economies than in advanced economies and largely targeted at supporting vulnerable individuals and smaller firms.

Oil prices have partly reversed the falls earlier in the year

The price of Brent crude oil has increased since the previous *Statement*, but remains almost 35 per cent lower than at the start of the year (Graph 1.20). Over recent months, prices have been supported by a pick-up in global demand and global oil production being cut to its lowest level in almost a decade, driven by the cuts agreed by the OPEC+ group (Graph 1.21). The remaining schedule of agreed production targets will allow production to increase somewhat over the next few years.

The partial recovery in oil prices will support the revenues of Australian LNG exporters in the period ahead as the bulk of Australia’s LNG exports are sold via long-term contracts linked to oil prices at a 1–2 quarter lag. The earlier low

Graph 1.18



Graph 1.19

Economic Indicators

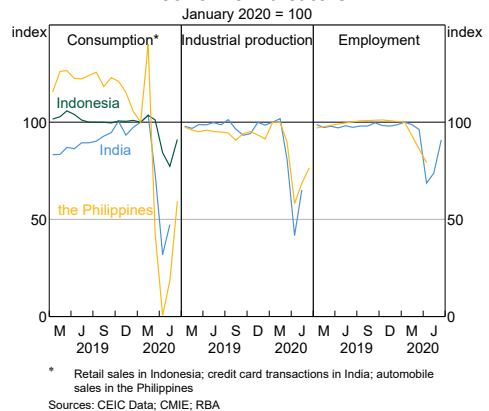


Table 1.1: Commodity Price Changes^(a)

Per cent

	Since previous <i>Statement</i>	Since start of the year
Bulk commodities	21	11
– Iron ore	32	28
– Coking coal	–2	–21
– Thermal coal	–7	–27
Rural	–3	–9
Base metals	15	–1
Gold	15	32
Brent crude oil ^(b)	63	–33
RBA ICP	2	0
– Using spot prices for bulk commodities	13	4

(a) Prices from the RBA Index of Commodity Prices (ICP); bulk commodity prices are spot prices

(b) In US dollars

Sources: Bloomberg; IHS Markit; RBA

prices will weigh heavily on revenues in the near term, however. For exporters that sell LNG in the spot market, prices have remained very low; the global oversupply of gas has been driven by earlier increases in capacity in Australia, the United States and Russia, and reduced demand since the outbreak of COVID-19.

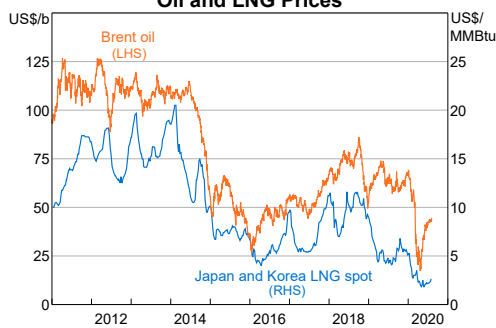
Iron ore prices have increased significantly in recent months

The benchmark iron ore price has increased by 32 per cent since the previous *Statement*

(Graph 1.22; Table 1.1). Chinese demand for imported iron ore has been strong, driven by increased construction activity and industrial production in China. Chinese authorities have also announced fiscal stimulus focused on infrastructure and this has further supported the outlook for steel demand. At the same time, iron ore supply from Brazil has been subdued as a result of earlier measures to contain COVID-19 in important mining regions, as well as operational issues and weather-related disruptions since the start of the year.

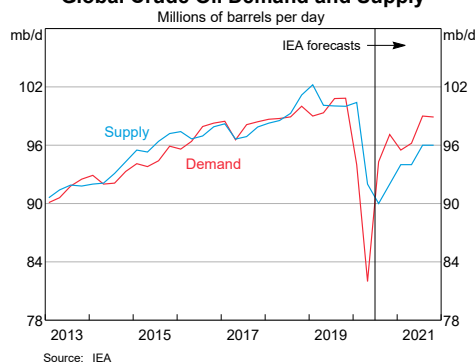
Graph 1.20

Oil and LNG Prices



Graph 1.21

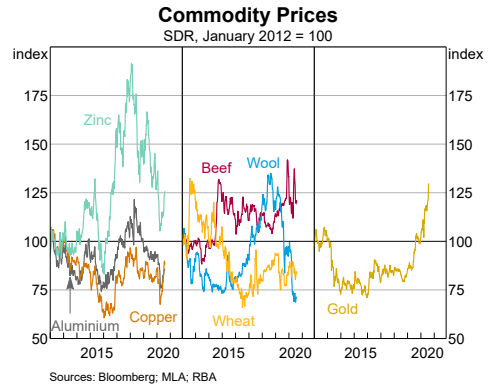
Global Crude Oil Demand and Supply



Coking and thermal coal prices have remained at low levels since the previous *Statement* because demand has been weak, particularly outside China. Steel production in India remains well below the levels at the start of the year, despite a recent pick-up, and this has continued to weigh on coking coal prices. At the same time, demand for thermal coal from key markets, especially in east Asia and India, has remained weak as a result of subdued industrial production. Thermal coal shipments from various countries have reportedly also taken longer to clear Chinese customs in recent months, which has added further uncertainty to the outlook for thermal coal demand.

Base metal prices have increased since the previous *Statement*, as economies have eased containment measures, thereby supporting some recovery in industrial activity (Graph 1.23). In particular, copper, which is a key input for a range of industrial processes, has more than recovered its falls earlier in the year. At the same time, the price of gold, which many investors view as a safe asset, has continued to increase. The prices of rural commodities have decreased since the previous *Statement*. Wool prices are around 35 per cent lower than at the start of the year, reflecting the negative effect of lockdown measures on clothing demand and the associated fall in demand for textiles. ❖

Graph 1.23



Graph 1.22

Bulk Commodity Prices
Free on board basis

