1. International Economic Conditions

The global economy is recovering from the initial COVID-19 shock. Monetary and fiscal policies have provided substantial support to households and businesses, and further sizable fiscal stimulus for the recovery phase has recently been announced in some economies. Among the major economies, the recovery in China is more advanced than elsewhere.

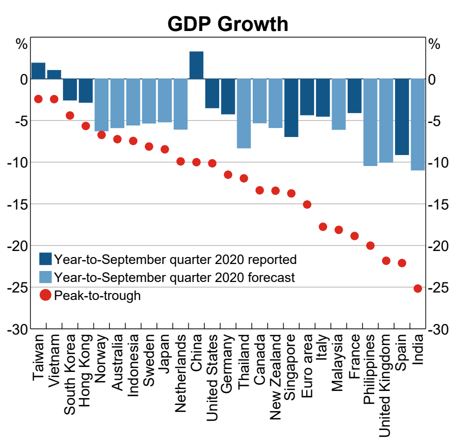
The pace of the global recovery has slowed and become more uneven in recent months. Goods consumption and production has led the global recovery, while activity in services industries remains curtailed by ongoing social distancing requirements. Resurgences in COVID-19 infection rates and the reintroduction of lockdown measures will reduce economic activity in many European economies over coming months.

Labour market conditions in most economies have improved over recent months, but significant spare capacity is expected to remain for some time. This will keep inflation low. As set out in the 'Economic Outlook' chapter, the nature of the pandemic means that the global outlook will remain uncertain and fragile in the period ahead, with the level of GDP in most economies likely to be below pre-pandemic forecasts for some years.

The global economy rebounded strongly

Global economic activity has picked up from its April low and labour market conditions have generally improved as public health restrictions were eased across most economies. After the June quarter recorded the biggest contraction in global GDP since the Second World War, global GDP growth in the September quarter was the strongest since at least this period (Graph 1.1). But the rebound in activity in the September quarter still left GDP well below pre-pandemic levels in the major economies, with China the notable exception. Goods consumption led the recovery, with retail sales above pre-pandemic levels in many economies. Global merchandise trade has bounced back quickly alongside the recovery in goods consumption, and new export orders suggest merchandise trade should continue to recover in coming months (Graph 1.2). In contrast, services trade has remained depressed because most international travel continues to be severely constrained.

Graph 1.1



Sources: CEIC Data; Consensus Economics; RBA; Refinitiv

The pace of recovery has slowed more recently due to the constraints from remaining social distancing requirements, behavioural changes and a resurgence in infections, particularly in Europe and the United States. The recent upswing in new cases of the virus in the northern hemisphere has increased risks to the outlook and highlighted that containment of the pandemic and ongoing policy support will be crucial to sustain the recovery.

New waves of COVID-19 infections have resulted in tighter restrictions in some economies

COVID-19 infections have increased rapidly in Europe since August, and are much higher than recorded earlier this year (Graph 1.3). Containment measures have been tightened in response, with many economies in the region imposing nationwide lockdowns in late October to stem the pressures on their health systems. As a result, population mobility, a high-frequency indicator, has started to decline (Graph 1.4).

Infection rates in the United States have started to increase again and are at elevated levels following a brief decline in July and August. They also remain high in some large emerging market economies such as Indonesia and Russia. Infection rates have started to decline in India, and remain low in most high-income east Asian economies.

Economic activity in China has continued to normalise

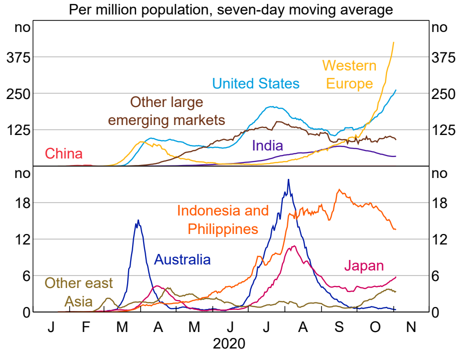
China has so far managed to avoid a major second wave of infections and this has allowed most restrictions on domestic economic activity to be lifted. Economic activity is now at or above pre-pandemic levels in many sectors.

The economic rebound continues to be led by construction-related investment and production. In particular, real estate and infrastructure investment recovered quickly and monthly growth rates remain higher than prior

Graph 1.3

COVID-19 – New Cases per Capita

Per million population, seven-day moving average

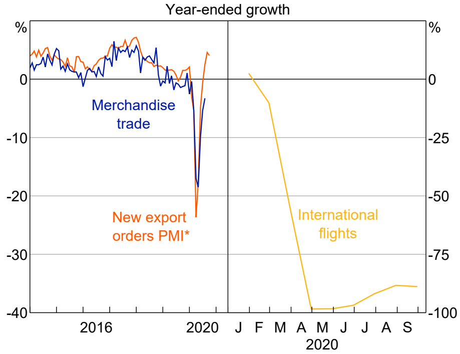


Sources: Johns Hopkins CSSE; RBA

Graph 1.2

Global Trade Indicators

Year-ended growth



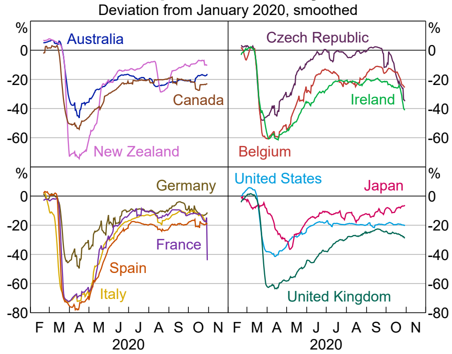
* Purchasing Managers' Index; mapped to merchandise trade growth

Sources: IATA; IHS Markit; RBA; Refinitiv

Graph 1.4

Population Mobility

Deviation from January 2020, smoothed



Sources: Google LLC (2020), 'Google COVID-19 Community Mobility Reports', available at https://www.google.com/covid19/mobility/ viewed on 4 November 2020; RBA to the pandemic, reflecting the relatively fast normalisation in property market conditions and the focus on public infrastructure as part of the stimulus program (Graph 1.5). Consistent with this, production of construction-related products, such as steel, has remained robust. A sustained rebound in exports has also supported the recovery. This has reflected increased demand for Personal Protective Equipment (PPE) and medical supplies, and the global shift to remote working has supported demand for goods such as home office equipment and household furniture (Graph 1.6).

Consumer demand has generally been slower to recover. However, there have been some more encouraging developments recently: public confidence around the health situation appears to have improved following months of low COVID-19 case numbers in China; most of the remaining public health restrictions have been removed; and household incomes have largely recovered after declining sharply at the onset of the pandemic. Recent data suggest that consumer demand continues to improve, although demand for some consumer services remains below pre-COVID levels.

Policymakers have indicated that they have been broadly satisfied with the speed of the economic recovery to date, which has lessened the case for additional policy support. The fiscal stimulus announced in the early stages of the recovery has also been deployed more slowly than projected, reflecting weaker-than-expected expenditure (Graph 1.7). Significant government bond issuance in recent months should support a pick-up in fiscal expenditure over the remainder of the year and provide further support to infrastructure investment. With the economic recovery well underway, authorities have turned their attention to the longer-run policy agenda. While details are yet to be finalised, authorities have noted that this policy agenda will focus on measures to increase domestic consumption, support innovation, improve supply chain self-sufficiency and attract foreign investment.

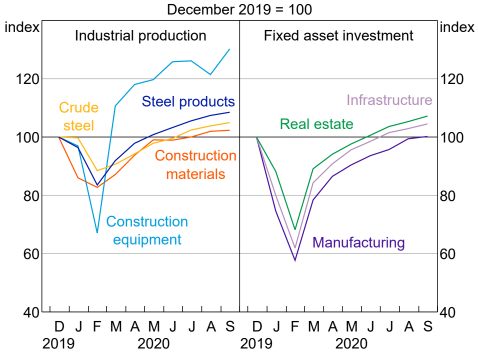
Geopolitical and trade tensions remain elevated between the United States and China. The US Government has sought in recent months to restrict the global supply to China of semiconductors made with US equipment or designs. This could significantly curtail such exports from the rest of Asia to China.

Elsewhere, trade disputes between the United Kingdom and European Union, and China and other economies including Australia, have continued in recent months.

Graph 1.5

China – Activity Indicators*

December 2019 = 100



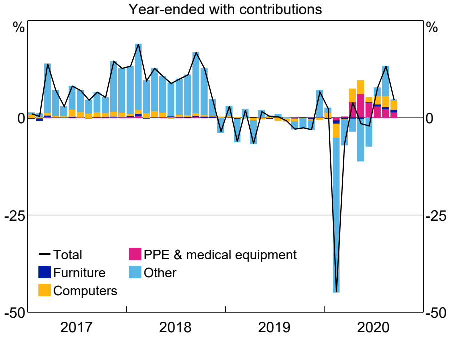
* Seasonally adjusted by the RBA

Sources: CEIC Data; RBA

Graph 1.6

China – Export Growth*

Year-ended with contributions



* Seasonally adjusted by the RBA

Sources: CEIC Data; RBA

External demand has supported the recovery in east Asia while domestic demand conditions have varied

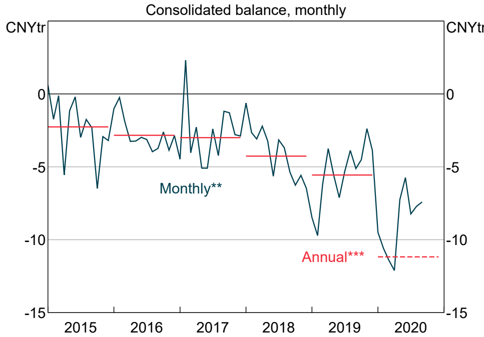
East Asian exports have rebounded in recent months, driven by the economic recovery in China, and the rebound in global goods consumption (Graph 1.8). Strong demand for electronics has boosted semiconductor production in key suppliers such as South Korea. Some economies in the region faced sluggish demand for their automotive exports for a number of months as global car sales fell sharply in the height of the pandemic. More recently though, global car sales have rebounded, returning to around pre-COVID levels in September.

Domestic demand has been more resilient in east Asian economies such as South Korea and Vietnam that successfully contained both the early outbreaks of COVID-19 and small resurgences in infections (Graph 1.9). In contrast, domestic demand has been weak or slower to recover in economies that experienced significant second waves of infections, notably Singapore, or where the pandemic has not yet been successfully contained, such as Indonesia and the Philippines.

Graph 1.7

China – General Government Budget*

Consolidated balance, monthly



* Government budget balance including government-managed funds; special government bonds are treated as deficit financing
** Seasonally adjusted by the RBA and annualised
*** Value for 2020 is a projection
Sources: CEIC Data; MoF; RBA

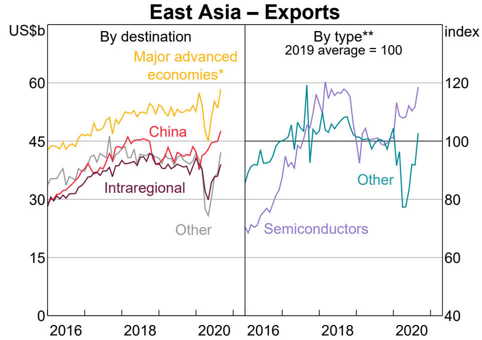
India's recovery has been impeded by elevated COVID-19 cases and a lack of policy space

Economic activity in India contracted sharply in the June quarter, due to the stringent nationwide lockdown between March and May. Activity was heavily restricted in many industrial sectors that were deemed non-essential, which resulted in a notable decline in steel demand and production. This led to a sharp fall in Australian coking coal exports to India, which fell to an eight-year low in June.

While activity has recovered somewhat since May, the pace of recovery slowed in July and August amid persistent increases in COVID-19 cases and the reintroduction of restrictions in

Graph 1.8

East Asia – Exports

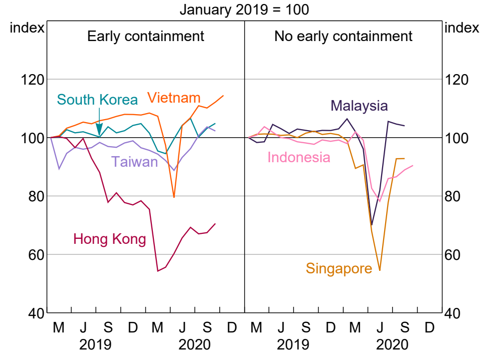


* Includes the United States, the European Union and Japan
** South Korea and Taiwan
Sources: CEIC Data; RBA; Refinitiv

Graph 1.9

East Asia – Retail Sales

January 2019 = 100



Sources: CEIC Data; RBA

some states. More recently, activity and mobility indicators suggest that the pace of recovery has picked up again alongside concerted efforts by authorities to encourage the re-opening of the economy, although activity still remains some way below pre-COVID-19 levels (Graph 1.10).

In recent weeks, COVID-19 cases in India have begun to decline meaningfully for the first time since the onset of the pandemic. If sustained, this could support a further recovery in activity. Nonetheless, policy settings have not been as accommodative as elsewhere. Concerns about fiscal space have limited the amount of direct fiscal support provided so far, while stubbornly high headline inflation has limited the degree of monetary policy support that the Reserve Bank of India has been willing to provide.

The recovery in advanced economies has slowed from the initial rebound and will rely significantly on further fiscal support

Strong fiscal and monetary policy responses have cushioned the impact of the pandemic on household and business incomes (see 'Box A: Income Support Policies in Advanced Economies during the COVID-19 Pandemic'). The government support has enabled a sharper recovery in some forms of consumption than would otherwise have been the case. In particular, the recovery has been led by goods consumption (Graph 1.11). As a result, conditions in the manufacturing sector have recovered quickly and industrial production has picked up strongly, although in most advanced economies manufacturing output remains below pre-pandemic levels (Graph 1.12).

Activity in many services industries remains constrained by ongoing social distancing. The resurgence in infections and the tightening of containment measures, particularly in Western Europe, has further weighed on services sector activity in recent times.

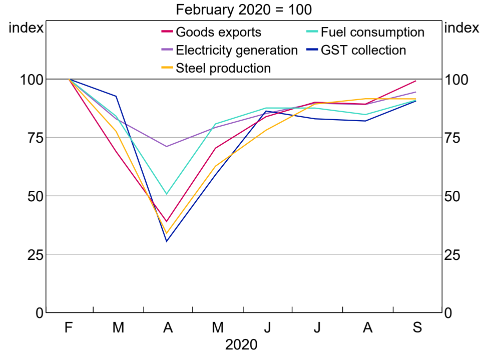
The recovery in business investment has been much less pronounced than in household consumption. Firms have reacted to reduced demand and heightened uncertainty about the outlook. Residential investment activity also contracted sharply, but has been more resilient, supported by historically low interest rates and increased demand for housing outside major cities.

The fiscal response to the initial COVID-19 shock was rapid and exceeded the fiscal response to economic contractions provided in any earlier peacetime episode. Fiscal support for labour markets and household incomes has been extended in most advanced economies, and European governments have announced

Graph 1.10

India – Activity Indicators*

February 2020 = 100



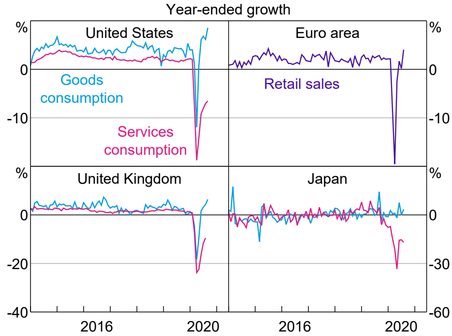
* Seasonally adjusted by the RBA, except for GST collection

Sources: CEIC Data; RBA

Graph 1.11

Household Consumption Indicators

Year-ended growth



Sources: RBA; Refinitiv

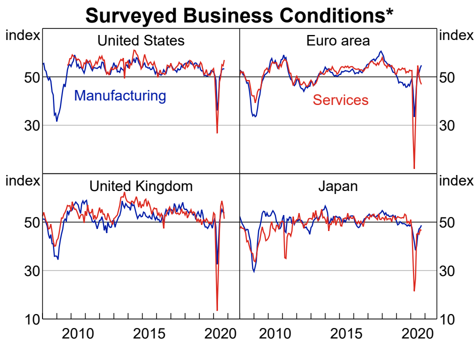
additional fiscal support as containment measures have been tightened. In contrast, the US authorities are still to reach an agreement on a new fiscal package (Graph 1.13). Continued fiscal support will be required to sustain the global recovery in the period ahead.

Labour market conditions have been improving slowly although significant spare capacity remains

Labour markets in advanced economies have been recovering alongside the pick-up in activity, but the recent tightening of containment measures in the northern hemisphere will slow progress in reducing the significant amount of spare capacity remaining. Total hours worked have increased since the June quarter but remain well below pre-pandemic levels (Graph 1.14). In the United States, most of the adjustment to total hours since the onset of the pandemic has occurred via large changes to employment. In most other advanced economies, the adjustment has occurred via changes to average hours worked by employees. Participation rates have also fallen sharply this year, as mobility restrictions, weak labour market conditions, health concerns and carer responsibilities have discouraged participation.

The share of the labour force supported by wage subsidies has trended down since the peaks in May, as people have returned to work or increased their hours after the nationwide lockdowns were lifted (Graph 1.15). The subsequent tightening in containment measures have so far modestly increased the take-up of wage subsidies, including in New Zealand in late August, and is expected to do so in Western Europe. Wage subsidy schemes have been extended in most economies as the recovery has progressed slowly and infections have increased again.

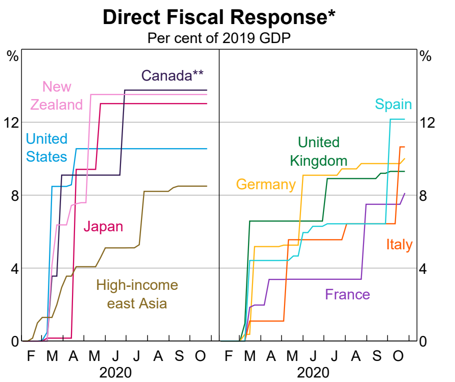
Graph 1.12



* Purchasing Managers' Index; below 50 indicates that activity is contracting

Sources: IHS Markit; RBA

Graph 1.13

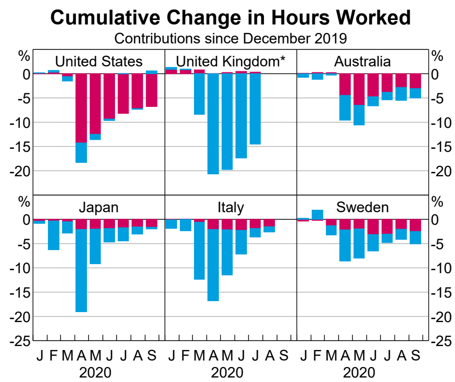


* Excludes subnational governments, loan guarantees and unallocated funds

** July increase represents budget changes to previously announced measures

Sources: IMF; national sources; RBA; Refinitiv

Graph 1.14



* United Kingdom data are derived from the weekly Labour Force Survey

Sources: CEIC Data; Office for National Statistics; RBA; Refinitiv

Inflation is likely to remain low but there have been large relative price changes

Inflation has declined since the start of the pandemic and is expected to remain low because of significant spare capacity. Core goods inflation has increased in many economies since the onset of the pandemic, consistent with the rebound in goods consumption. Food inflation has been quite high in a number of economies due to supply disruptions from the pandemic (Graph 1.16). However, services inflation (which has a relatively large weight in advanced economy consumer price indices) has been subdued alongside weaker demand from social distancing restrictions; in some economies, temporary consumption tax reductions or consumption incentives have also weighed on services prices.

The level of global economic activity is expected to remain below pre-pandemic forecasts for many years

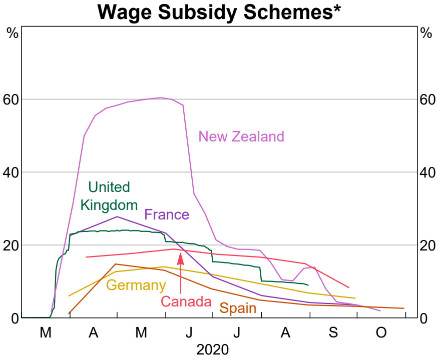
Economic activity in Australia's major trading partners is forecast to contract by 3 per cent in 2020, and gradually recover in coming years – with growth of 6 per cent in 2021 and 4 per cent in 2022 (Graph 1.17). Overall, the level of GDP in most economies outside China is expected to remain below pre-pandemic forecasts over the next couple of years because of the effect of continued social distancing restrictions and behavioural changes on business investment as well as consumption. Consumption of many services, including international travel, will be constrained at least until an effective vaccine has become widely available.

There is a high degree of uncertainty about the outlook for the global economy (see 'Economic Outlook' chapter). Risks are skewed to the downside and include: more countries introducing or extending lockdown measures as a result of a resurgence in infections; setbacks in the development and distribution of vaccines and medical treatments; and fiscal policy support that is withdrawn prematurely. Outside of the pandemic, geopolitical and trade tensions also pose downside risks to the global outlook.

The recovery is expected to be uneven across economies. In China, activity has returned to pre-pandemic levels in many sectors, and the level of Chinese GDP is now expected to return to pre-pandemic forecasts in early 2021. In the near term, China's success in containing COVID-19 should support a further normalisation in activity. Public infrastructure investment will also provide a boost as local governments spend the proceeds from the significant bond issuance that has occurred in

Graph 1.15

Share of Labour Force on Wage Subsidy Schemes*



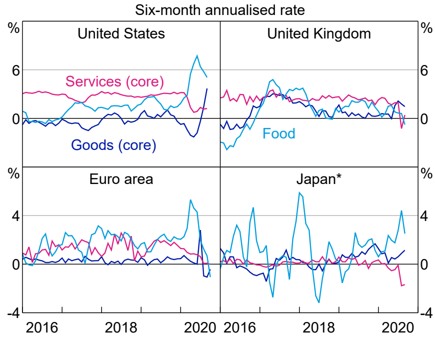
* Share of average labour force size over 2019; data may not yet be complete as in some economies claims can be retroactively submitted; data in some economies refer to number of jobs rather than heads

Sources: ifo Institute; national sources; RBA; Refinitiv

Graph 1.16

CPI Inflation

Six-month annualised rate



* Adjusted for consumption tax changes

Sources: RBA; Refinitiv

recent months. There remains uncertainty around the outlook for consumer demand in China, which has experienced a slower recovery than other areas of the economy, and whether the recent strength in exports can be sustained.

In the United States, most commentators are anticipating further fiscal stimulus, which will boost growth in 2021 and bring the level of GDP closer to pre-pandemic forecasts by 2023. The large fiscal support already announced for the euro area will support activity in the region over the next couple of years, although the recent resurgence in infection rates has slowed the recovery there and introduces a high degree of uncertainty for the outlook. Activity in advanced economies in east Asia should be supported by a sizable fiscal policy response, relative success to date in keeping infection rates low and continued strong global demand for technology products. The outlook for some emerging economies, including in east Asia, is more subdued because of higher infection rates, more limited fiscal support and the expected slow recovery in international tourism. The level of GDP in many of these emerging economies is expected to remain significantly below its pre-pandemic path for many years.

Bulk commodity prices have been mixed

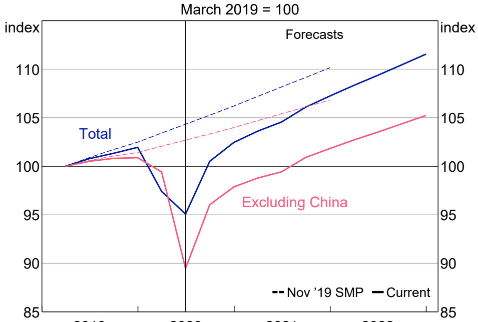
The benchmark iron ore price has remained elevated since the previous *Statement*, briefly reaching its highest level since 2014 in early September (Graph 1.18, Table 1.1). The iron ore price has been supported by continued strength in Chinese steel production, underpinned by public infrastructure and real estate construction. Port congestion in China has also supported prices, although this has eased more recently. The supply of iron ore from Brazil has increased following various disruptions earlier in the year, which has recently dampened the upward pressure on prices.

Coal prices have declined substantially this year. Coking coal prices are not far from their lows for the year. Recent reports that some Chinese utilities and steel mills have been instructed to stop importing Australian coal have led to increased uncertainty about the demand outlook for seaborne coal. By contrast, thermal coal prices have rebounded a bit of late, underpinned by gradually improving global demand and earlier supply cutbacks from producers. Some analysts have suggested that coking and thermal coal prices have also been supported by concerns that predicted increased rainfall over Australia – as a result of the La Niña weather pattern – will disrupt supply in coming

Graph 1.17

Australia's Major Trading Partner GDP

March 2019 = 100

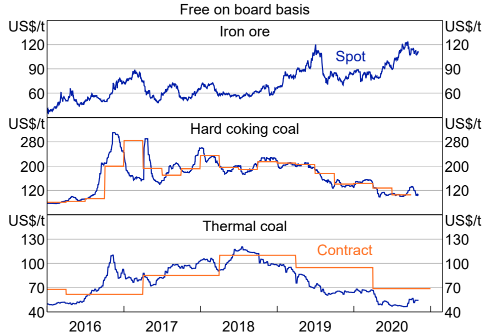


Sources: ABS; CEIC Data; Consensus Economics; RBA; Refinitiv

Graph 1.18

Bulk Commodity Prices

Free on board basis



Sources: Bloomberg; Department of Industry, Science, Energy and Resources; IHS Markit; RBA

Table 1.1: Commodity Price Changes[(a)]

Per cent

	Since previous *Statement*	Since start of year
Bulk commodities	–1	12
– Iron ore	–3	27
– Coking coal	–1	–22
– Thermal coal	14	–17
Rural	9	–2
Base metals	6	6
Gold	–8	23
Brent crude oil[(b)]	–9	–39
RBA ICP	3	0
– Using spot prices for bulk commodities	–1	0

(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

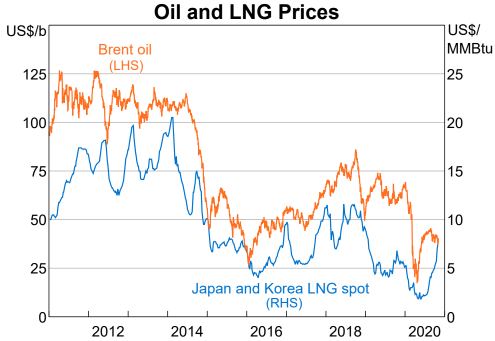
months; heavy flooding during Australia's last La Niña period led to a 20 per cent fall in Queensland's coal production in the March quarter of 2011.

The price of Brent crude oil has decreased since the previous *Statement* and is around 40 per cent lower than at the start of the year (Graph 1.19). The recent decline in the oil price has reflected concerns about a stalling in the recovery in global oil demand. As the oil price remains well above the record low levels in April, this will result in an increase in the average price received by Australian LNG exporters in the December quarter; the majority of Australia's LNG exports are sold via long-term contracts linked to oil prices at a 1–2 quarter lag. The Asian LNG spot price has also recovered over the past few months because of extended maintenance at some Australian LNG facilities and disruptions to US supply, while demand has also picked up.

Most base metal prices have increased since the previous *Statement* and are now above their levels at the start of the year (Graph 1.20). The price of gold has decreased, but remains around its record high. Gold does not offer a yield, so it is has become relatively more attractive in an environment where some measures of real yields, such as inflation-linked Treasuries, have become negative. The prices of rural commodities have increased since the previous *Statement*. Lamb prices have increased because of flock rebuilding and robust global demand for sheep meat. Wool prices have also increased of late, but remain around multi-year lows.

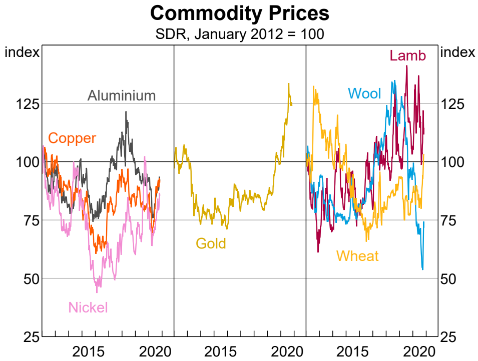
Graph 1.19

Oil and LNG Prices



Sources: Bloomberg; RBA; Refinitiv

Graph 1.20



Sources: Bloomberg; Landmark; MLA; RBA