1. The International Environment

Following a strong rebound in global activity in the September quarter, the economic recovery lost a little momentum late last year following a resurgence of COVID-19 infections and a significant tightening in activity restrictions in some economies. But in China and a small number of other economies where infection numbers have remained low, economic activity has rebounded strongly to pre-pandemic levels. The unprecedented fiscal and monetary policy response continues to support activity in many economies, including in Australia.

The approval of a number of effective vaccines in recent months raises the prospect of a more rapid improvement in health outcomes, but it will take some time for vaccines to be rolled out on a sufficient scale to contain the virus. While global growth forecasts for the coming year have increased a little relative to the November *Statement on Monetary Policy*, the significant disruption to the global economy from the pandemic, and consequent substantial spare productive capacity, is likely to keep inflation low for some time.

Monetary policy settings remain very accommodative globally and central banks have indicated that they will remain so for some time. Broader financial conditions continue to support economic growth. Credit risk premiums have narrowed, equity prices have rallied and investment flows to emerging markets have increased. These developments reflect positive sentiment around the ongoing rollout of vaccines, new fiscal stimulus measures, as well as expectations of ongoing monetary policy accommodation. Sovereign bond yields remain at historically low levels, although they have risen in a number of countries, reflecting expectations of further fiscal stimulus and the improvement in the outlook.

The resurgence in infections in late 2020 has slowed the global recovery, although the rollout of vaccinations is supporting the outlook

The resurgence in COVID-19 cases since late last year has affected many economies and a number have seen hospitalisations surpass their earlier peaks (Graph 1.1). Containment measures have been tightened and extended in many locations. In parts of Western Europe, lockdown measures have become almost as restrictive as they were during the initial wave of the pandemic and are likely to remain in place for much of the Northern Hemisphere winter. The rollout of vaccines should start to reduce the effects of the virus, but just how quickly this occurs will depend on the speed of production and distribution. Access to vaccines is currently very limited in most emerging market economies.

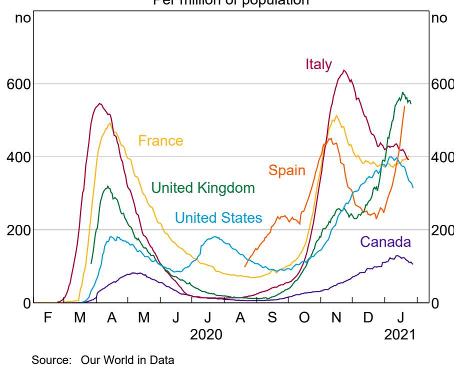
The resurgence in infections and the tightening of containment measures dampened economic activity around the turn of the year (Graph 1.2). Population mobility has remained well below pre-pandemic levels (Graph 1.3). Nevertheless, the economic impact of the resurgence of infections and associated lockdowns is expected to be smaller than during the initial outbreak. There are various reasons for this: current lockdowns are generally more targeted; businesses and households have adapted to

carrying on economic activity during lockdown conditions; and personal protective equipment (PPE) is more readily available. Consumer spending will also be supported by ongoing fiscal and monetary policy measures and the prospect of the pandemic moving into a less disruptive phase as mass vaccinations roll out. To date, reported GDP outcomes for the December quarter have been stronger than expected in many economies.

Graph 1.1

COVID-19 Hospitalisations

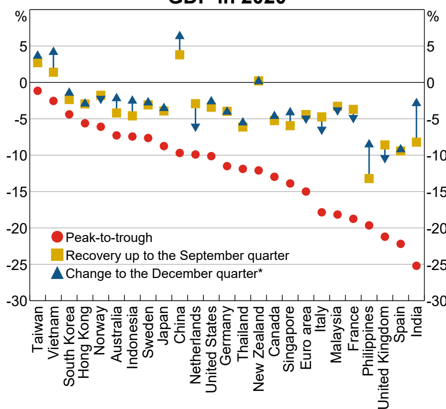
Per million of population



Source: Our World in Data

Graph 1.2

GDP in 2020



* Forecasts used where December quarter GDP has not yet been reported

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

Global trade and production have continued to recover

The resilience in goods demand supported the recovery in global goods trade and industrial production during the second part of 2020 (Graph 1.4). This partly reflects consumers substituting towards goods as spending on consumer services has fallen. Demand for electronics has been especially strong, driven by remote working. This has boosted exports from China and other east Asian economies, as the region is a significant producer of semi-conductors and other electronics. A shortage of shipping capacity from Asia has lengthened supplier delivery times to other regions and the broader recovery in goods consumption has pushed up producer input prices globally.

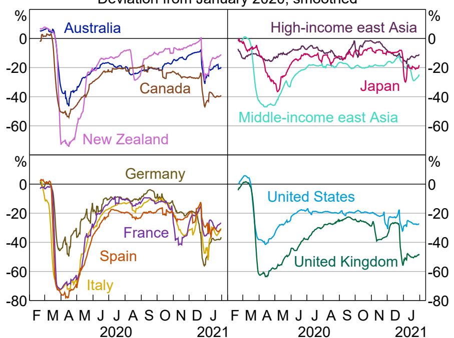
Global trade arrangements continue to evolve

Some of the political tensions of recent years that affected global trade are in a period of transition. The European Union and the United Kingdom reached a trade agreement in late December, which should limit large-scale disruptions to a key trading relationship following Brexit. Meanwhile, it is yet to be seen how the US–China trade relationship will evolve under the new US Administration following

Graph 1.3

Population Mobility

Deviation from January 2020, smoothed



Sources: Google LLC (2021), 'Google COVID-19 Community Mobility Reports', available at https://www.google.com/covid19/mobility/ viewed on 4 February 2021; RBA

years of significant trade tensions. China appears unlikely to have met their purchase commitments under the 'Phase One' trade deal with the United States; as of November, China had only met a little over half of the 2020 target.

Demand for manufactured goods has supported east Asia's recovery …

The broad-based strength in east Asian goods exports has supported growth in the region (Graph 1.5). Demand from China has been resilient and exports to the major advanced economies surpassed pre-pandemic levels by November 2020. However, the recovery in domestic spending has been slowed by a resurgence in COVID-19 infections and tighter containment measures across the region. Population mobility associated with retail and entertainment activity has declined in most of these economies since late 2020 (Graph 1.6).

… while domestic activity has recovered to above pre-pandemic levels in China

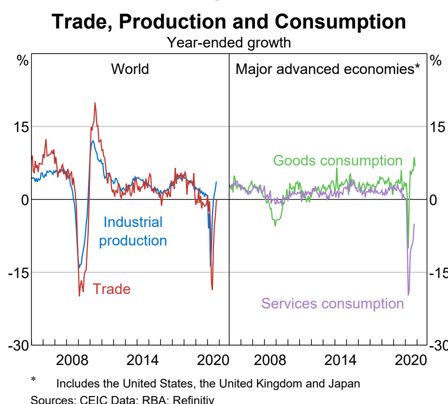
After contracting sharply in early 2020, the Chinese economy has largely recovered, growing by 6.5 per cent in 2020 in year-ended terms. Activity is now well above pre-pandemic levels in most parts of the economy. This economic resilience has stemmed from China's ability to avoid large-scale outbreaks of the virus since early 2020 and to effectively target economic policy support measures. The early stages of the recovery were driven by construction-related investment and production, partly because fiscal spending was largely directed towards infrastructure projects. Consistent with this, production of construction-related products, such as steel, rose notably over 2020 (Graph 1.7). Fixed asset investment also continued to recover in the December quarter, albeit moderating from the very high growth rates seen earlier in the year.

Consumption continued to recover in the December quarter and consumption patterns

Graph 1.4

Trade, Production and Consumption

Year-ended growth

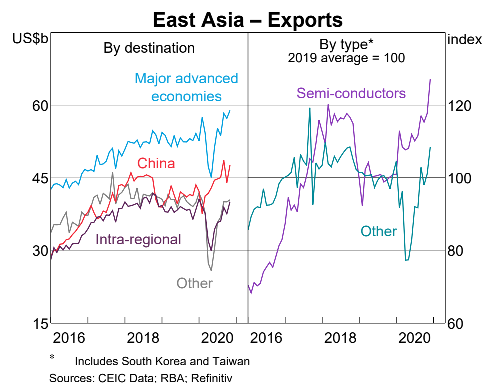


* Includes the United States, the United Kingdom and Japan

Sources: CEIC Data; RBA; Refinitiv

Graph 1.5

East Asia – Exports



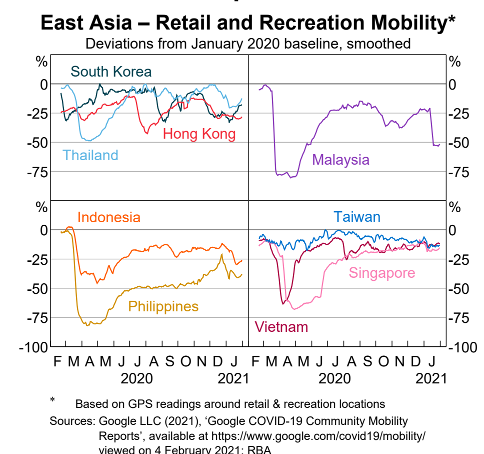
* Includes South Korea and Taiwan

Sources: CEIC Data; RBA; Refinitiv

Graph 1.6

East Asia – Retail and Recreation Mobility*

Deviations from January 2020 baseline, smoothed



* Based on GPS readings around retail & recreation locations

Sources: Google LLC (2021), 'Google COVID-19 Community Mobility Reports', available at https://www.google.com/covid19/mobility/ viewed on 4 February 2021; RBA

have begun to normalise. Household consumption of essential items, such as food and rental services, remained relatively stable over 2020, while consumption of discretionary services, such as eating out and cultural & entertainment services, only reached pre-pandemic levels in the December quarter. Consumption of these services could decline again if restrictions are tightened materially in response to the small resurgence of COVID-19 cases in north-east China.

Chinese export growth picked up over 2020 and contributed significantly to overall growth (Graph 1.8). Among the drivers of this growth in exports has been strong global demand for goods and the swift rebound in industrial production in China. Earlier in 2020 demand was strongest for PPE, medical supplies and computers; more recently the growth has been more broad based. Imports also picked up in the second half of 2020, but by a smaller margin than exports.

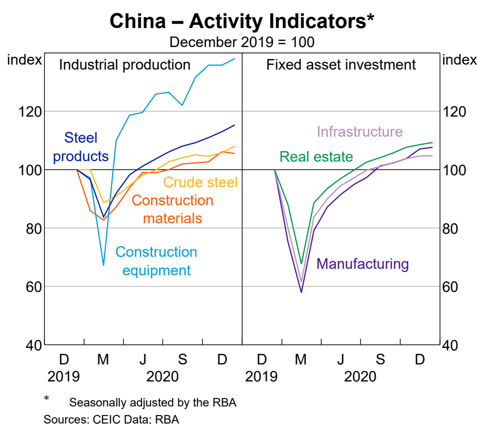
Chinese financial conditions remain accommodative but authorities are alert to financial risks

Financial conditions in China continue to support growth and employment. The People's Bank of China (PBC) is maintaining a moderately accommodative monetary policy stance as it seeks to balance assistance for China's economic recovery with limiting the build-up of risks in the financial system.

Chinese policymakers have overseen some tightening of conditions in financial markets alongside the economic recovery so far, while maintaining other stimulatory policies. In particular, bank lending rates and reserve requirement ratios (RRRs) remain low, and a raft of other measures aimed at encouraging the flow of credit to small and private businesses remain in place (Graph 1.9). These measures saw growth in total social financing (TSF) increase over 2020, consistent with the stated goal of authorities to support the recovery with notably higher credit growth (Graph 1.10). The faster pace of TSF growth over 2020 was also partly driven by strong issuance of government bonds, a high share of which was related to infrastructure activity. This was partly offset by a reduction in lending by the more opaque channels of the financial system, following actions by regulators.

Though corporate financing conditions remain accommodative in general, there was a tightening in the corporate bond market around the turn of the year. Corporate bond spreads rose and issuance became more difficult following defaults in November by several

Graph 1.7



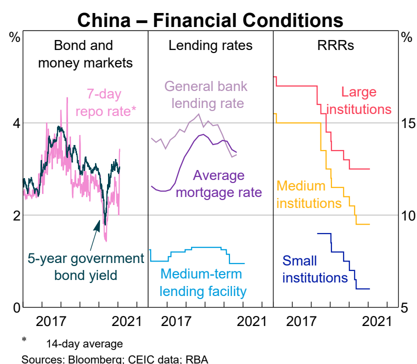
enterprises owned by local governments, which have historically benefited from substantial government support (Graph 1.11). Authorities have warned that more defaults will occur in the future to help ensure that markets price risks appropriately.

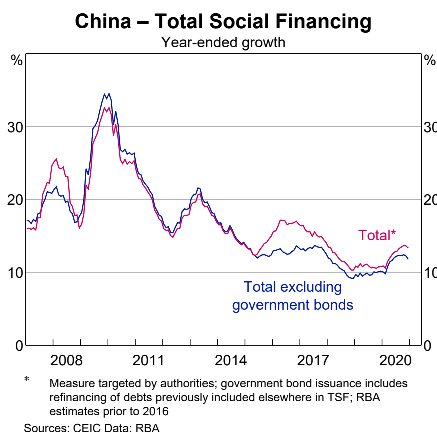
Authorities have affirmed that reducing risk in the financial system remains a key policy objective and that it will be necessary to tighten monetary conditions further at some point during the recovery. However, authorities have also emphasised that any reduction in policy accommodation will be gradual. In particular, policymakers have indicated that targeted measures supporting certain segments of the economy such as smaller firms are likely to stay in place for some time. TSF growth is expected to moderate over 2021 as authorities aim to keep overall debt levels in the economy stable relative to GDP.

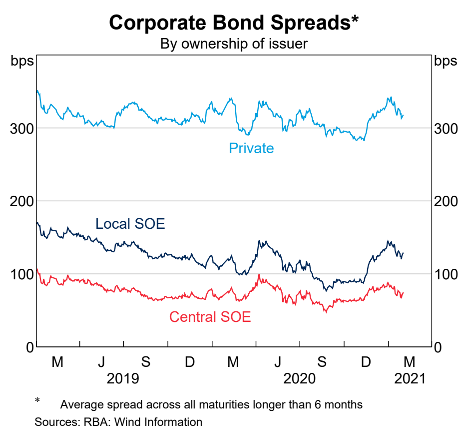
The renminbi has appreciated further

The renminbi has appreciated since mid last year reflecting the recovery in Chinese economic activity and higher interest rates relative to those of advanced economies, which have encouraged bond and equity inflows. This has occurred alongside a broad-based depreciation in the US dollar, and the renminbi has appreciated by around 11 per cent against the US dollar to its highest level since 2018 (Graph 1.12).

Capital inflows have also been associated with China's inclusion in some global fixed income benchmarks last year and gradual improvements in foreign access to securities markets. Foreign holdings of renminbi-denominated assets have increased further, although foreign participation remains low by international standards (Graph 1.13). Since the beginning of the year, authorities have eased restrictions on Chinese cross-border lending and tightened restrictions for cross-border borrowing, while quotas for portfolio investment abroad have been increased. These adjustments



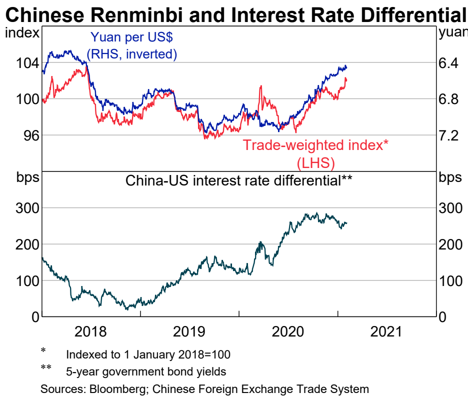


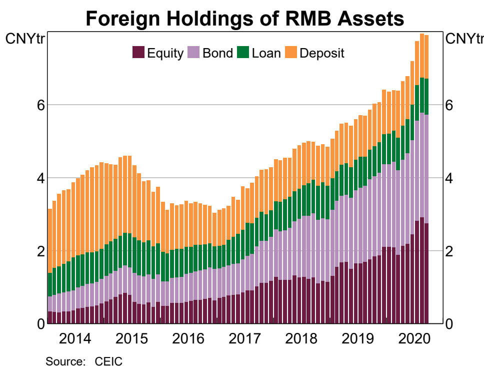


have been consistent with the stated goals of promoting a two-way opening of the capital account and having a more flexible, market-determined exchange rate.

India's economic recovery has gained momentum

In India, the pace of economic recovery has strengthened alongside a decline in COVID-19 cases and a further relaxation of restrictions. Following severe disruptions during India's initial lockdown, industrial production has continued to recover and steel production is now around pre-pandemic levels. Steel demand is supporting an increase in demand for Australian coking coal exports to India (Graph 1.14; see 'Domestic Economic Conditions' chapter).





Nonetheless, overall economic activity is still below pre-pandemic levels, particularly in parts of the services sector.

To date, concerns around fiscal space and high inflation have limited the amount of fiscal and monetary support provided by the Indian authorities. However, the recent Indian budget suggests fiscal expenditure will increase this year and further declines in headline inflation, as currently forecast, could provide scope for further monetary policy easing if required.

The recovery in industrial demand has led to a sharp increase in commodity prices

The ongoing recovery in industrial production in China and parts of Asia is supporting the price of commodities, including some key exports for Australia. Iron ore, coal and oil-related commodity prices have all increased sharply over the past 3 months, and most other commodity prices are also higher. That said, momentum in some commodity prices has moderated more recently.

The benchmark iron ore price has increased by around 30 per cent since the previous *Statement* (Table 1.1). Although the price has eased a little since late January, it remains around its highest level since 2013 (Graph 1.15). This has reflected

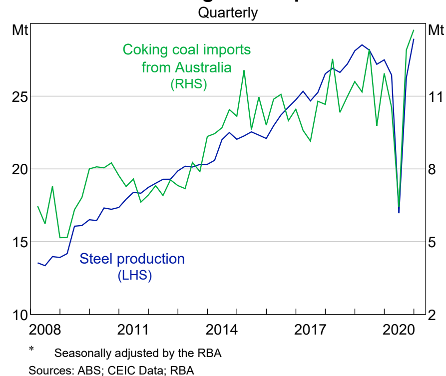


Table 1.1: Commodity Price Changes[a]

Per cent

	Since previous *Statement*	Over the past year
Bulk commodities	36	58
– Iron ore	31	83
– Coking coal	45	1
– Thermal coal	58	35
Rural	9	10
Base metals	6	18
Gold	–7	12
Brent crude oil[b]	46	7
RBA ICP	16	20
– Using spot prices for bulk commodities	23	27

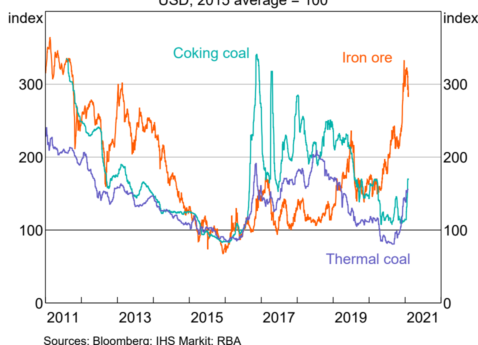
(a) Prices from the RBA Index of Commodity Prices (ICP); bulk commodity prices are spot prices

(b) In US dollars

Sources: Bloomberg; IHS Markit; RBA

ongoing strength in Chinese steel production and supply issues, including a weaker outlook for Brazilian production and, to a lesser extent, scheduled maintenance and weather-related disruptions in Australian supply. The surge in prices in December prompted China's Dalian Commodity Exchange to tighten limits on trading, reportedly to address speculative activity in the iron ore futures market.

The Newcastle thermal coal spot price has increased sharply since late 2020 because of stronger demand outside China and previous disruptions to Australian supply arising from weather-related damage to port infrastructure. Coking coal prices have also increased sharply in recent weeks but remain at a significant discount relative to domestic Chinese prices, partly reflecting uncertainty surrounding Chinese demand for Australian coal. Higher demand for coking coal elsewhere, particularly from India, has provided support to prices.



The price of Brent crude oil has increased by around 45 per cent since the previous *Statement* and is now back around levels observed prior to the onset of the pandemic (Graph 1.16). The price received by Australian Liquefied Natural Gas (LNG) exporters is linked to oil prices with a lag and will therefore increase over the next couple of quarters. The Asian LNG spot price spiked to a record level in mid January following strong Northern Hemisphere winter demand and concerns of a global supply shortfall. The price has since decreased, amid an easing in peak demand and greater availability of spot cargoes.

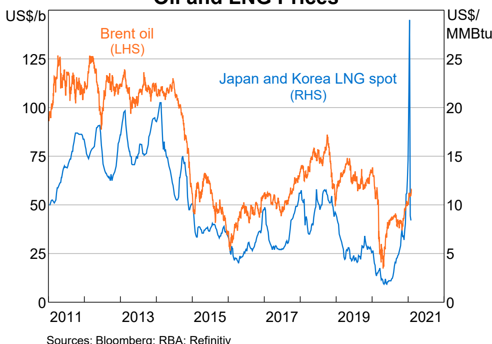
There is significant spare capacity in advanced economies, keeping inflation low

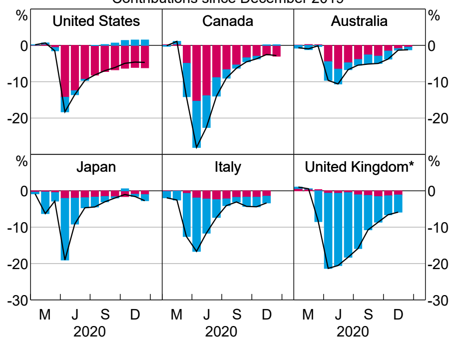
Economic activity at the end of 2020 remained below pre-pandemic levels across advanced economies. Significant spare capacity remains in labour markets in advanced economies despite the rebound in global activity in the September quarter. The extent of this shortfall has varied across economies, depending on health outcomes and the stringency of restrictions, the size of the services sector (which has faced significant headwinds throughout the pandemic) and the scale of fiscal and monetary support.

Wage subsidy programs have operated in many advanced economies throughout the pandemic, with the United States a key exception. These subsidies have supported the retention of workers and kept many businesses afloat. In line with the intent of these programs, the labour market adjustment in these economies has occurred largely through a reduction in average hours worked rather than a fall in employment (Graph 1.17). This has resulted in a smaller increase in unemployment rates than otherwise. The number of workers supported by wage subsidies had significantly fallen by mid last year, but reliance on these programs has increased again in some economies that have tightened containment measures.

Spare capacity in labour markets, evident in broad measures of underutilisation, will weigh on wages growth and underlying inflation for some time. While inflation in the prices of goods has picked up in most advanced economies since June, reflecting both supply disruptions and increased demand, this has been offset by disinflation in services prices; services inflation has been volatile due to policy changes to support spending in the sector, including temporary consumption tax reductions. In the case of headline inflation, the increase in oil prices since November will provide a boost, but the effects will be offset in part by the significant easing in food inflation as production disruptions have subsided.

Inflation remains low. It is expected to pick up towards central bank targets, but only very gradually as the global recovery gains traction and spare capacity in labour markets is eventually absorbed. Market-based and economists' inflation expectations have increased (Graph 1.18). Prospects of significantly more expansionary US fiscal policy in recent months and very accommodative monetary policy have also supported the increase in market-based inflation expectations.

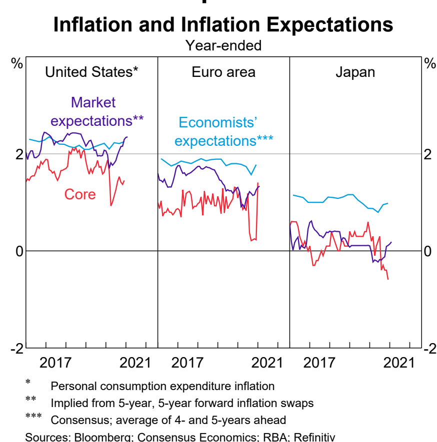




Fiscal policy support has been extended

Fiscal policy has provided critical support to household and business incomes throughout the pandemic, particularly in advanced economies. This support is likely to be required for some time as a result of the latest upswing in COVID-19 infections, the recent period of intensive lockdowns and the significant amount of spare capacity remaining in many economies.

European governments have increased fiscal support measures, mainly through extended wage subsidies and business transfers. The US authorities approved a further large expansion of fiscal policy (4 per cent of GDP) in late 2020, which extended unemployment benefits, reintroduced forgivable loans to businesses that maintain employment levels and provided another round of direct transfers to households (Graph 1.19). The prospects of a further fiscal expansion have increased significantly after the Democrats secured a majority in both chambers of the United States Congress. Many advanced economies have announced substantial funding for their mass vaccination programs. And some economies, including Japan, the European Union and Canada, have announced very sizeable fiscal policy measures for the recovery phase that emphasise 'green' and digital investment.



Central banks in advanced economies continue to provide significant monetary policy support

Monetary policy settings in advanced economies remain highly accommodative and are expected to remain so for some time given significant spare capacity and subdued outlooks for inflation. Indeed, in recent months, several central banks have extended the timeframe for which existing monetary stimulus will be in place. The European Central Bank (ECB), Bank of England (BoE), Bank of Japan (BoJ) and Swedish Riksbank recently expanded the size of their asset purchase programs and extended their horizon until the end of 2021 or later (Table 1.2). The Chair of the US Federal Reserve (Fed) indicated that, consistent with the Fed's updated forward guidance, any tapering of Fed asset purchases was unlikely in the near term, and would be gradual and signalled well ahead of time.

A number of central banks have also made changes to their lending facilities, or launched new facilities, to encourage the flow of credit to the real economy (Graph 1.20). The ECB extended by a year the period during which banks will receive a discounted interest rate on borrowings under its term funding scheme and

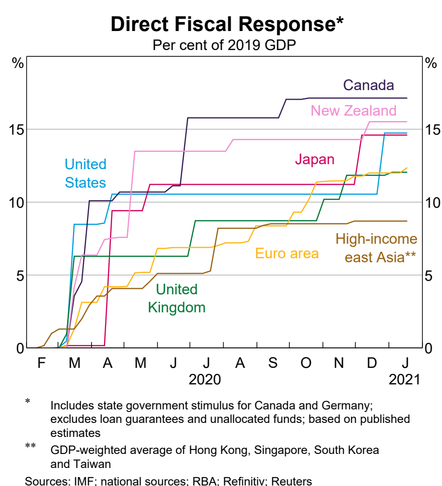


Table 1.2: Central Bank Government Bond Purchase Programs[(a)]

Programs announced since 3 March 2020

	End date	Purchase target	Purchases to date	
			Nominal	Per cent of GDP
Fed	Open-ended	Unlimited	US$2.3tn	11
ECB	March 2022	€1850bn[(b)]	€982.7bn	8
BoJ	Open-ended	Unlimited (yield curve control)	¥44.3tn	8
BoE	End 2021	£440bn	£313.8bn	15
BoC	Open-ended	Unlimited	C$294.2bn	13
RBNZ	June 2022	NZ$100bn	NZ$45.8bn	13
Riksbank	End 2021	SEK700bn[(b)]	SEK123.3bn	3
RBA	Open-ended	Unlimited (3-year yield target)	A$72.3bn	4
	April 2021	A$100bn	A$55bn	3
	September 2021	A$100bn	A$0bn	0

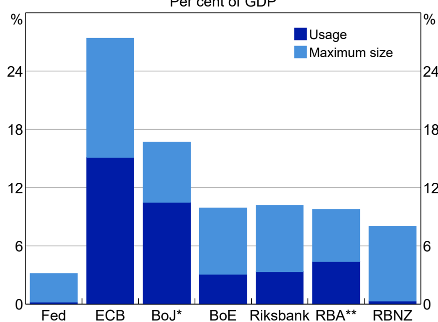
(a) Includes state and local government debt. Includes purchases to alleviate market dysfunction and purchases made as part of pre-announced bond purchase programs; RBA purchases to alleviate market dysfunction are included in 3-year yield target purchases

(b) Includes private sector asset purchases

increased the borrowing limit. The BoE extended the duration of its term funding scheme by 6 months to October 2021, while the BoJ extended the duration of its lending facilities and removed the upper limit on loans provided to each bank for some facilities. Also, the Reserve Bank of New Zealand (RBNZ) introduced a Funding for Lending Programme (FLP). The FLP will provide funding for 3-year terms at a floating interest rate equal to the prevailing policy rate, with the borrowing limit tied to a bank's volume of lending to the non-financial private sector.

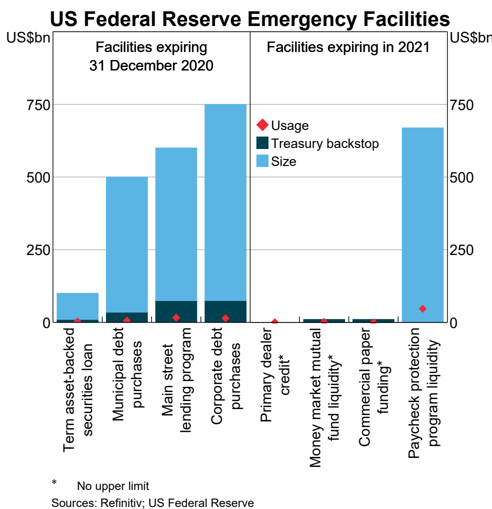
While broad-based stimulus is expected to continue for some time, central banks have continued to scale back measures aimed at alleviating dysfunction or supporting the flow of credit in particular markets as conditions in these markets have improved. A number of Fed emergency lending facilities were closed in December (Graph 1.21). The ECB reduced its holdings of commercial paper and has lowered the pace of private sector asset purchases. The Bank of Canada (BoC) discontinued its purchases of provincial money market securities, and reduced its primary market purchases of Treasury Bills.

Central banks continue to signal that policy rates will remain at very low levels until there is sustained progress towards employment and inflation goals. In the United States, most members of the Federal Open Market Committee (FOMC) expect the policy rate to remain unchanged until at least 2023, consistent with forward guidance that the policy rate will



not be increased until the labour market has reached maximum employment and inflation has risen to 2 per cent and is on track to moderately exceed 2 per cent for some time. In Europe and Japan, rates are expected to remain at current or lower levels for the foreseeable future. In the United Kingdom market pricing suggests that the BoE will lower the policy rate by 10 basis points to zero per cent by end 2021 (Graph 1.22). In New Zealand, market participants expect the policy rate to remain unchanged in 2021.

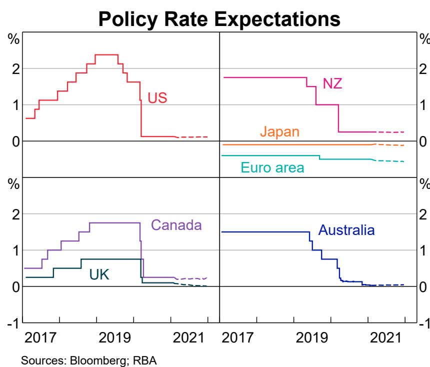
Some central banks will undertake or announce the results of reviews of monetary policy frameworks and tools in the coming year. An independent review of the BoE's approach to quantitative easing (QE) found that the programs had been delivered effectively, but recommended more work to improve technical understanding and build public understanding and trust in QE as a monetary policy tool. Meanwhile, the BoJ is reviewing the sustainability of its policy measures given that it has accumulated a large share of equity exchange traded funds and government bonds on issue. The ECB expects to conclude its monetary policy strategy review in the second half of the year.

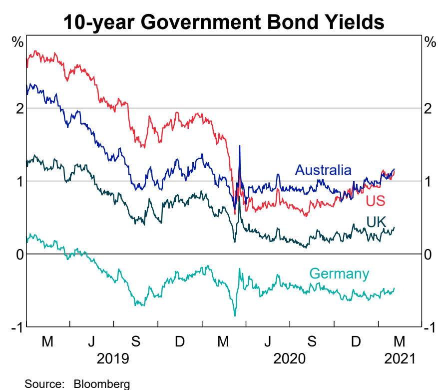


Government bond yields have increased, but remain low

Long-term government bond yields have increased in most advanced economies since the end of November (Graph 1.23). This is partly because the economic outlook has improved, related to the rollout of COVID-19 vaccines, although this has been tempered by rising COVID-19 cases and new containment measures in some economies. Expectations of new fiscal stimulus measures, particularly in the United States, have also contributed to higher government bond yields.

The recent rise in government bond yields has mostly been reflected in an increase in inflation





compensation, whereas real yields have declined or remained stable at low levels (Graph 1.24). This is consistent with expectations that policy rates will not be raised until there is a substantial and sustained increase in inflation, in line with strong forward guidance from central banks, most notably the Fed.

Sovereign debt issuance is expected to remain elevated to fund ongoing fiscal deficits. Most major central banks have purchased (in secondary markets) the equivalent of more than half of net government debt issuance since the start of the pandemic, which has contributed to keeping bond yields low and stable (Graph 1.25; Graph 1.26). In most cases, central banks have indicated that they expect to continue purchasing at around the same pace until at least the end of 2021, which is likely to comprise a significant share of new issuance this year.

Corporate funding conditions in advanced economies are highly accommodative

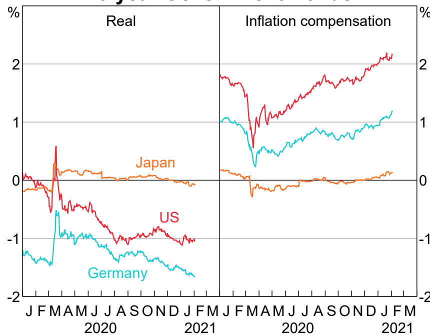
Corporate funding conditions have been supported by expectations that widespread vaccination will allow economic activity to normalise in the second half of 2021, alongside ongoing fiscal and monetary support. Conditions have improved further despite the recent resurgence in infections and containment measures in a number of major economies.

Corporate bond yields and credit spreads have declined further in recent months (Graph 1.27). Borrowing costs are currently around record lows in the United States and Europe, and issuance conditions remain favourable for both investment grade and sub-investment grade borrowers.

Equity prices have increased significantly over recent months. Bank share prices have outperformed other sectors, especially in the

Graph 1.24

10-year Government Bonds

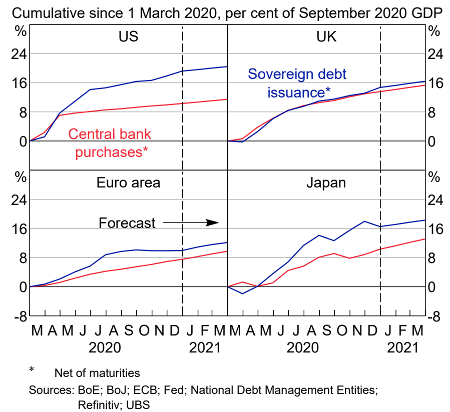


Sources: Bloomberg; RBA

Graph 1.25

Sovereign Debt Issuance and Central Bank Purchases

Cumulative since 1 March 2020, per cent of September 2020 GDP



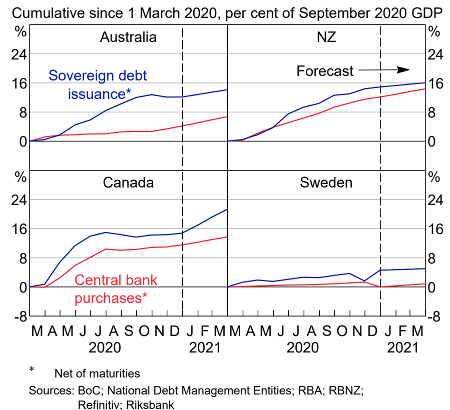
* Net of maturities

Sources: BoE; BoJ; ECB; Fed; National Debt Management Entities; Refinitiv; UBS

Graph 1.26

Sovereign Debt Issuance and Central Bank Purchases

Cumulative since 1 March 2020, per cent of September 2020 GDP

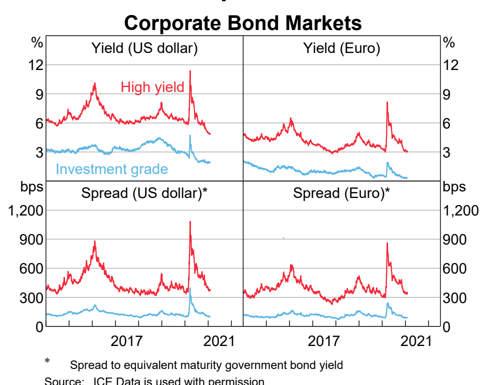


* Net of maturities

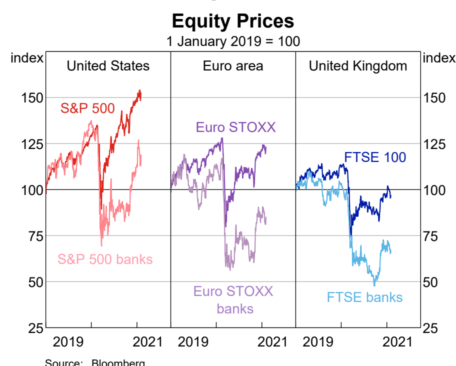
Sources: BoC; National Debt Management Entities; RBA; RBNZ; Refinitiv; Riksbank

United States, amid a substantial recovery in profits for the December quarter (Graph 1.28). The improved economic outlook is expected to support bank profits via lower loan losses (and loss provisioning), a steeper yield curve and potentially greater lending activity. Bank share prices have also benefited from an easing in restrictions on share buybacks in a number of countries. In the United States, shares in a number of small companies experienced sizeable swings in prices in early 2021 alongside heightened retail investor activity. As a result of this volatility, brokers faced significantly higher margin requirements to clear equity trades in certain companies; in response, some online brokers restricted purchases of these shares to reduce their own exposures.

Graph 1.27



Graph 1.28



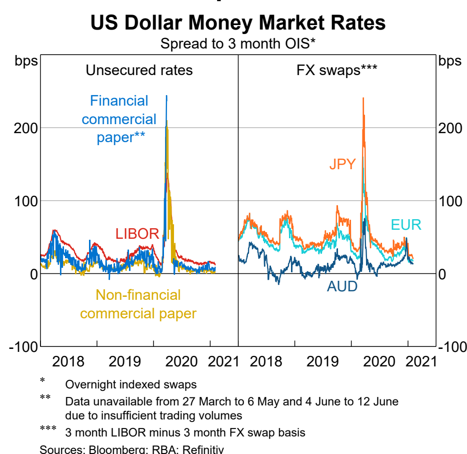
Conditions in short-term US dollar funding markets remain accommodative. The cost of borrowing US dollars in foreign exchange swap markets increased towards the end of 2020, although year-end funding pressures were less acute than in some previous years. These funding pressures can emerge because regulatory factors discourage large banks in the United States and Europe from intermediating activity over the year-end period. In contrast, unsecured borrowing rates in US onshore markets remained low and stable over this period (Graph 1.29).

The US dollar has depreciated significantly

The US dollar has depreciated further on a trade-weighted (TWI) basis since early November and is around 11 per cent lower than its peak in March 2020 (Graph 1.30). Since early November, the depreciation of the US dollar has been consistent with expectations of a stronger recovery in global growth and a general improvement in risk sentiment.

The euro has been little changed over recent months, while the UK pound appreciated in the lead-up to the post-Brexit trade deal that was reached in December; even so the UK pound

Graph 1.29



remains well below its level prior to the Brexit referendum in 2016. The currencies of most other advanced economies, including Australia, have also appreciated over recent months (see 'Domestic Financial Conditions' chapter for recent developments in the Australian dollar).

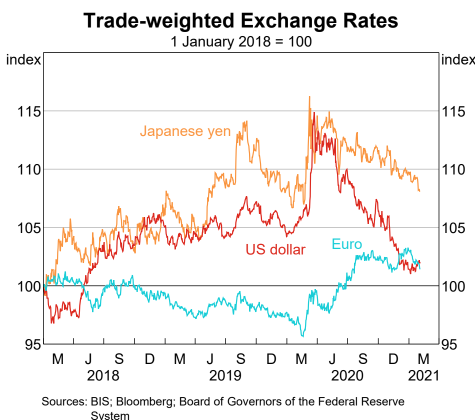
Financial conditions in emerging markets have improved

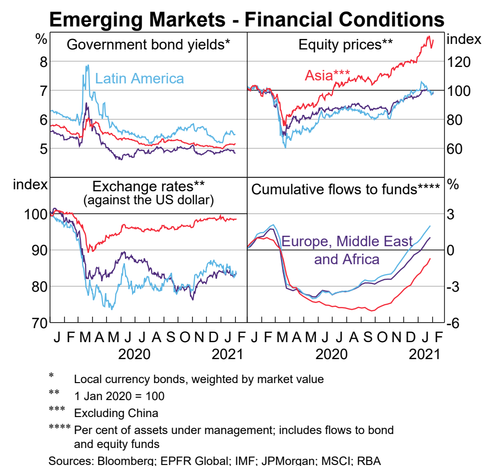
Financial conditions in emerging market economies (EMEs) have improved in recent months. Policy rates for most EMEs have been little changed at low levels and a number of EME central banks have indicated that the scope for further policy easing is limited. Yields on bonds denominated in local currency remain around record lows for most EMEs, despite recent increases in Latin America. Equity prices have risen further, there have been large investment inflows and currencies have generally appreciated against the US dollar. Spreads on government and corporate bonds denominated in US dollars have continued to narrow but remain above their pre-pandemic levels.

Financial conditions in emerging Asia have generally been more favourable than in other regions over the past year (Graph 1.31). That is because the region has benefited from the recovery in global trade and production as well as having entered the crisis with stronger fundamentals than other regions, including stronger economic growth and more fiscal space.

Some EMEs remain vulnerable to changing conditions related to the health and economic crisis. While there has been a general improvement in financial conditions since the onset of the pandemic, they remain tighter for more vulnerable EMEs, most notably South Africa and Turkey. Developments over the past year in these 2 countries have exacerbated pre-existing vulnerabilities such as weak economic growth, large fiscal deficits and reliance on external financing.

The International Monetary Fund (IMF) has continued to expand its provision of financial assistance. In general, IMF lending is beginning to transition from emergency support to longer-term, reform-based programs. In recognition of the particular challenges faced by low-income countries, G20 members agreed upon a common framework to guide the restructuring of official sector debt in those countries facing debt distress.





Ongoing policy support and mass vaccinations should enable a durable economic recovery

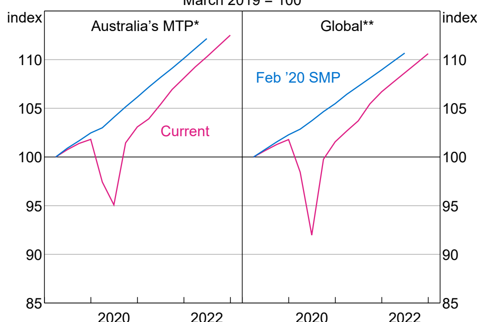
A successful rollout of mass vaccinations globally should allow a durable unwinding of social distancing measures and an increase in economic activity over the course of 2021. Even still, the level of global economic activity is expected to remain below its pre-pandemic trajectory which will keep inflationary pressures low and mean that fiscal and monetary policy support will be required for some time.

Australia's major trading partners' GDP is expected to grow by 7 per cent in 2021 and by 4½ per cent in 2022 in year-average terms (Graph 1.32). The outlook is a little stronger than at the time of the November *Statement*. Part of this upgrade stems from a better starting point: activity was generally stronger than expected in the September quarter and recent virus outbreaks do not appear to have fully offset this. Further out, improved prospects for the mass rollout of vaccines have also contributed to a stronger outlook.

However, the outlook remains highly uncertain due to near-term pandemic developments, the effectiveness of the rollout of vaccinations and uncertainty around the path and traction of future policy support:

Graph 1.32

Global GDP Outlook



* Australia's major trading partner GDP; weighted by Australia's export shares

** Weighted by purchasing power parity GDP

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

- Some economies may have to tighten containment measures further or keep them in place for longer, which raises near-term downside risks. Challenges posed by virus mutations are increasing, as more contagious variants of the virus are spreading globally and the high level of infections increases the possibility that further new mutations may emerge.
- Further out, the outlook assumes that vulnerability to the virus in advanced economies will have fallen significantly by the second half of 2021 owing to the rollout of vaccinations. Achieving this time frame will require significant mobilisation of resources.
- Fiscal policy could be significantly more expansionary than expected, especially in the United States, which should boost growth but may also put upward pressure on bond yields and tighten financial conditions. Conversely, a premature winding-down of policy support could precipitate a downturn before the recovery was complete.

The economic recovery is likely to be faster than typical but still incomplete

Overall, global economic activity is expected to recover faster than in a typical recession because much of the weakness has been the result of mandated constraints rather than weak demand. Also, in many advanced economies the scarring effects on the labour market are likely to have been more limited than usual because of proactive fiscal and monetary policy responses. Support for private incomes, constrained consumption opportunities and precautionary motives have led to a considerable build-up in savings, which could significantly boost consumption when the pandemic recedes.

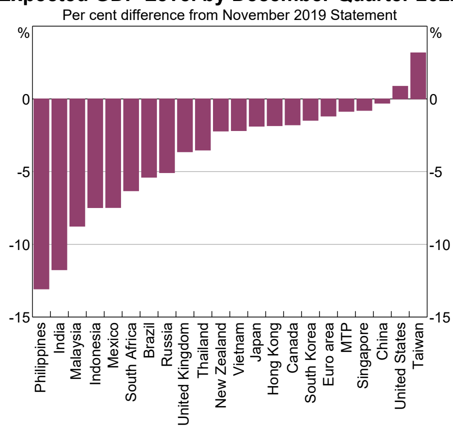
Despite the more positive outlook, the sheer scale of the economic contraction in the first

half of 2020 will mean that global activity and labour markets will take considerable time to recover. The global recovery will also remain uneven. In a small number of economies, including China and the United States, the level of GDP is expected to have recovered to around its pre-pandemic trajectory by the end of 2022. But for many others, the pandemic is expected to have a longer lasting effect on activity. This is particularly the case for some emerging market economies that have had less policy flexibility in responding to the crisis and/or that face significant challenges in administering large scale vaccine programs (Graph 1.33).

Graph 1.33

Expected GDP Level by December Quarter 2022

Per cent difference from November 2019 Statement



Sources: CEIC Data; Consensus Economics; RBA; Refinitiv