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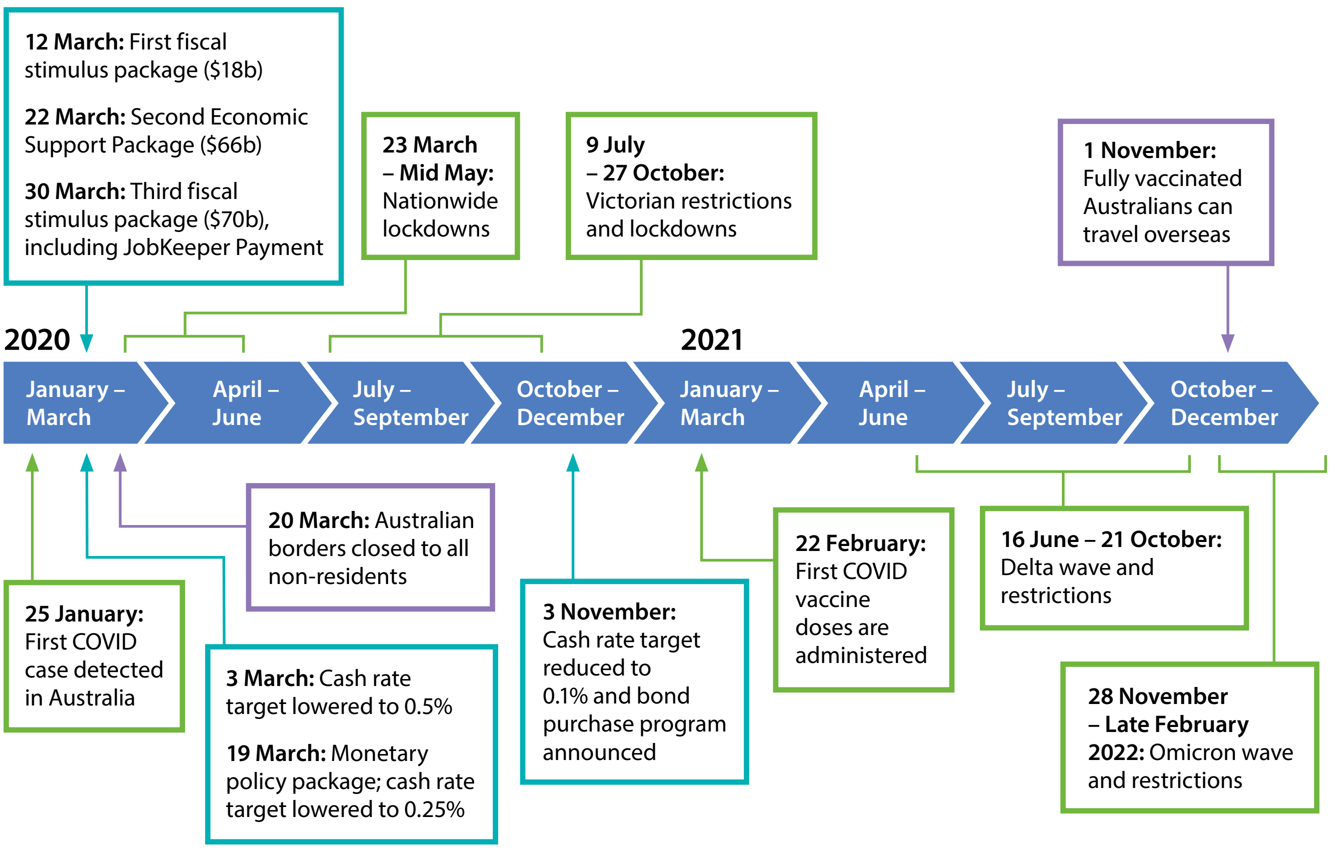
The COVID-19 Pandemic: 2020 to 2021

The COVID-19 pandemic was an historically significant global event in which a new and highly contagious virus spread across the world. The public health measures introduced in response to the pandemic had significant economic consequences for the Australian and world economies. The containment of the virus required the immediate suspension of many economic activities and restrictions on the movements of people and economic activity. Many economies saw output fall sharply and unemployment rates spike. Substantial fiscal and monetary policy support measures were introduced, which were unprecedented in scale and speed of implementation. Economic activity rebounded as COVID-19 restrictions were lifted, vaccination programs were rolled out, and households and businesses were supported by historically large monetary and fiscal stimulus.

This Explainer summarises the main economic effects of the COVID-19 pandemic in Australia and how the economy subsequently recovered. It also describes how policymakers responded to it in Australia. It covers the period from 2020 to 2021.

Key Dates of COVID-19 Timeline in Australia: 2020 – 2021*



* This is a simplified timeline that only covers selected events and policy responses.

What were the economic effects of the pandemic?

Initial COVID-19 wave in Australia

Australia recorded its first COVID-19 case in late January 2020. As the number of COVID-19 cases in Australia increased, the Government implemented public health measures to contain the spread of the virus. This included:

- restrictions on domestic and international travel
- the suspension or closure of non-essential businesses and activities (such as indoor sporting facilities, entertainment activities, pubs, clubs and dining facilities)
- 'stay at home' orders where people were only able to leave their homes for essential reasons (such as essential work and grocery shopping)
- social distancing rules, quarantine periods for those exposed to the virus and other health measures.

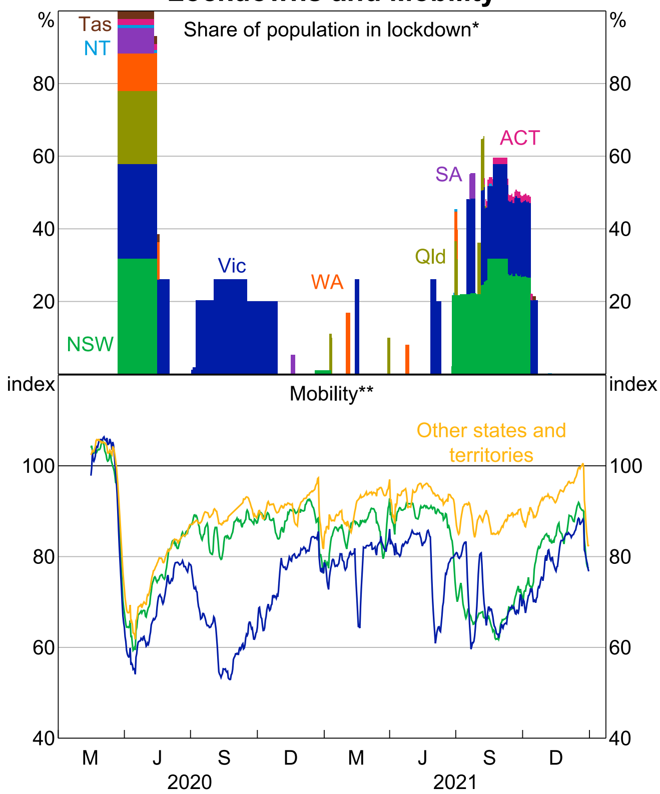
These strict restrictions on household activity were commonly referred to as 'lockdowns'. There was also a shift to remote schooling and work from home arrangements.

Box: COVID-19 Lockdowns in Australia

Australians experienced several periods of lockdown during 2020 and 2021. A national lockdown took place in March 2020, which lasted six weeks and saw various measures of the movement of people (that is, population mobility) fall sharply. From mid 2020, shorter and more targeted lockdowns were imposed by State and Territory Governments to manage outbreaks of the virus in their jurisdictions. For example, as restrictions eased in the second half of 2020 and mobility measures began to recover in most states, Melbourne re-entered lockdown to control an outbreak of COVID-19 cases there.

Later, the outbreak of Delta variant cases in mid 2021 led to the reintroduction of lockdowns in New South Wales, Victoria and the Australian Capital Territory, with around half of the Australian population under significant restrictions for most of the September quarter of 2021. Fewer restrictions were imposed following the outbreak of the Omicron variant in late 2021, but mobility measures still declined as many people chose to take precautions.

Lockdowns and Mobility



* Population estimated using statistical area that most closely corresponds to announced lockdown area.

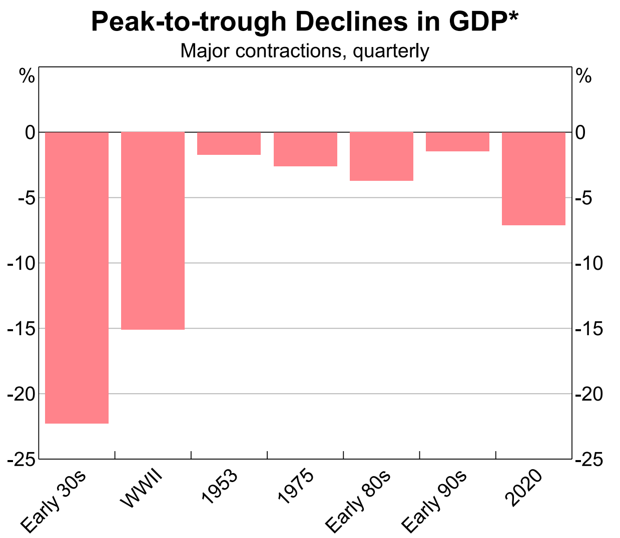
** Seven-day moving average of Google mobility data; average from 3 January to 6 February 2020 = 100.

Sources: ABS; CEIC Data; RBA; state and territory governments.

Economic activity contracted

The introduction of public health measures, coupled with people and businesses taking their own precautionary actions, significantly reduced economic activity. On the supply side, these containment measures severely limited the operations of firms and in many cases stopped them from operating altogether. On the demand side, containment measures reduced both the opportunity and need for households to consume some goods and services, and the incentive for businesses to invest. The uncertainty about how severe and prolonged the public health crisis would be, and how containment measures might evolve, weighed on spending by households and businesses. For these reasons, the pandemic was unconventional in that it combined aspects of both aggregate supply and aggregate demand shocks.

The result was a large and near-simultaneous economic contraction around the world. Australia's Gross Domestic Product (GDP) fell by a substantial 7 per cent in the June quarter of 2020. This was the largest contraction of the Australian economy since the end of the Second World War.



* Declines before 1960 are based on RBA estimates of quarterly data for these periods.

Sources: ABS; Butlin, Dixon and Lloyd (2014); RBA.

The largest contributor to the decline in GDP in 2020 was a fall in household consumption, but a reduction in exports and business investment also contributed. This was partly offset by an increase in government spending and a fall in imports.

- **Consumption** contracted sharply as lockdowns and activity restrictions reduced households' opportunities to consume, particularly services. Households substituted spending on services (like dining out and attending live entertainment) with goods consumption that supported being housebound (like long-life food and home office items). Households also dramatically increased their savings. This reflected the lower overall level of consumption and greater precautionary savings by some households concerned about the future, as well as the large boost to household incomes from government support payments (explained further below).
- **Business investment** declined because many businesses decided to delay or cancel planned investment to preserve cash, given reduced demand for their products and increased uncertainty about the future.
- **Government spending** increased as part of the fiscal policy response to the pandemic (explained further below).
- **Net exports** increased because imports fell by more than exports. Exports fell because international travel restrictions resulted in arrivals of international tourists and students falling to almost zero. This had the largest impact on tourism and education exports. Imports also fell because Australians were restricted from travelling overseas and because Australian households and businesses reduced their consumption and investment of imported goods.

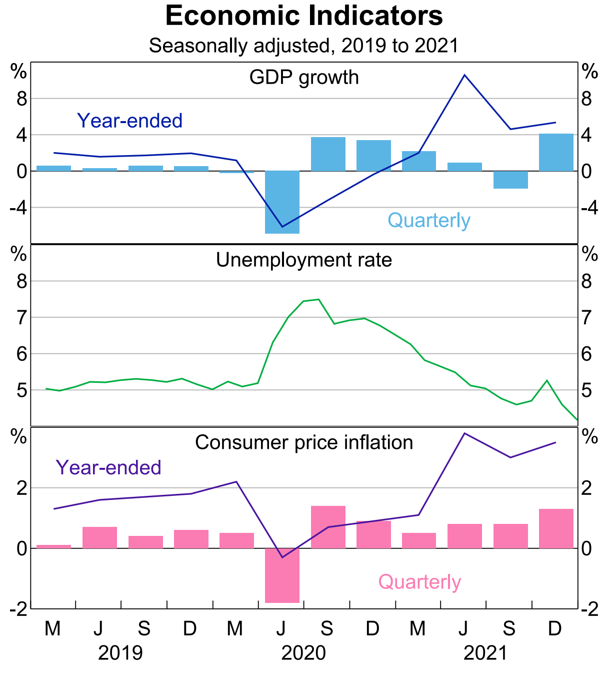
Unemployment increased

Reduced economic activity and the containment measures resulted in an immediate and large rise in unemployment. Many businesses faced closures or struggled to maintain operations amid reduced consumer demand and restrictions on their operations, contributing to a large increase in layoffs. People working in contact-intensive industries (such as hospitality, entertainment or tourism) were most affected by job losses, as well as younger people and female workers. There was also a significant reduction in the number of hours worked by many people who retained their jobs. The unemployment rate rose rapidly to a peak of 7.5 per cent in June 2020, while the underemployment rate rose even higher.

The unemployment rate would have increased by even more had it not been for the JobKeeper Payment and the way that the unemployment rate is measured. The JobKeeper Payment was a wage subsidy paid by the Australian Government to eligible employers to help them keep their employees; even if these employees did not work any hours, they were not counted as unemployed because they were still connected to their employer. In addition, many workers who were laid off did not actively search for another job for a time so were not considered unemployed.

Inflation declined

The fall in economic activity and the increased number of people wanting more hours of work in the economy reduced inflationary pressures. But the pandemic also saw some large, temporary movements in many prices included in the Consumer Price Index (CPI). Notably, governments made childcare and pre-school free for much of the June quarter 2020, which directly reduced the price of these services. There were also large falls in petrol prices and rents in the quarter. These temporary movements in prices led to a decline in the CPI in the June quarter of 2020 and, as a result, year-ended inflation was negative for the first time since the early 1960s.



Source: ABS; RBA.

Policy responses

There was an historically large and coordinated monetary and fiscal policy response to the significant disruptions caused by COVID-19 and the deterioration in the economic outlook. These policies were designed to support aggregate demand and employment. They were introduced from March 2020 onwards, initially to limit the immediate negative economic effects on households and businesses of public health measures to control the virus and then later to support the economic recovery. The exceptionally stimulatory nature of these policies in Australia was in line with the actions of other central banks and governments around the world.

Monetary policy

The Reserve Bank of Australia (RBA) implemented a comprehensive policy package in March 2020 to support households and businesses. Like other central banks, the RBA eased monetary policy by lowering its policy rate. The cash rate target was reduced twice in March to 0.25 per cent. Given the extraordinary near-zero level of the cash rate, the RBA decided to implement unconventional monetary policy measures for the first time. (See Explainer: Unconventional Monetary Policy on the difference between conventional and unconventional monetary policy.) This included:

- providing forward guidance
- introducing a target for the three-year Australian Government bond yield
- providing low-cost long-term funding to banks
- adjusting market operations.

These policy measures worked collectively to reduce funding costs across the financial system. This, in turn, flowed through to lower borrowing costs for households and businesses. As a result, this:

- supported the flow of credit and boosted cash flow for households and businesses
- supported asset prices, including housing prices, which boosted household wealth and hence spending in the economy
- put downward pressure on the Australian dollar, which was stimulatory for the economy.

Additional measures were announced over the course of the pandemic. For example, in November 2020, the RBA implemented a further package of measures to support the economy, including a reduction in the cash rate target to 0.1 per cent and the introduction of a program of government bond purchases. (See Illustrator: Monetary Policy and COVID-19 for a one-page summary of the monetary policy response to the COVID-19 pandemic.)

Fiscal policy

The Australian Government implemented significant fiscal stimulus packages in March 2020, which included substantial support payments to households and businesses.

- The largest measure was the JobKeeper Payment, which gave employers a wage subsidy for eligible employees to help keep employees and firms connected. The program played a crucial role in supporting employment and income over the first half of 2020.
- Other government payments, such as the Economic Support Payment (ESP) and the Coronavirus Supplement for those receiving the JobSeeker Payment, provided significant support to household incomes. Some households were also able to supplement their cash flows by withdrawing from their superannuation.
- Additional policy initiatives, such as Boosting Cash Flow for Employers and temporary enhancements to the instant asset write-off scheme, supported the cash flows and balance sheets of small and medium businesses.

Further policies were announced over the course of the pandemic, including the HomeBuilder program which provided grants to support the construction of residential homes. In response to virus outbreaks, the Australian Government extended disaster payments to affected households, and state governments introduced packages to support affected businesses. Overall, there was an historically large increase in spending by the Australian Government as well as State and Territory Governments. Alongside a decline in tax revenue, this resulted in the 2020/21 Australian Government Budget recording the largest deficit since the Second World War.

Economic recovery

The Australian economy rebounded as the spread of the virus was contained, COVID-19 restrictions eased, and vaccines were rolled out. The substantial and coordinated policy response also played an important role, allowing many households and businesses to build up financial buffers (an unusual outcome during an economic downturn). Overall, the recovery happened earlier and with more momentum than had been initially anticipated.

Household consumption recovered rapidly, as opportunities to spend on discretionary services – like dining out – became available again. A significant boost to household disposable income from government transfers also helped to support this recovery in spending. Business investment rebounded, supported by the recovery in demand and business confidence, and as firms responded to the tax incentives for investment from the Australian Government. By the March quarter of 2021, Australia's GDP had exceeded its pre-pandemic level.

Employment and hours worked recovered strongly as firms sought to refill a large number of jobs lost throughout the pandemic and hire new workers in parts of the economy experiencing strong demand. The unemployment rate declined to be below its pre-pandemic level by the middle of 2021.

Uneven economic recovery

The economic recovery was highly uneven across industries and regions. While some businesses were able to adapt their activities, those in a number of industries were significantly affected by the pandemic for some time. For example, the arts, hospitality and tourism industries were affected by employee illness and isolation requirements for an extended period. Looking at regions, a bounce-back in domestic tourism benefited regions within driving distance of population centres, while international tourism did not begin to recover until much later. Furthermore, the recovery in Victoria and New South Wales was more restrained than in other states and territories because their citizens spent a longer period in lockdowns and these states were more affected by the closure of international border closures.

Other disruptions and changes

By the end of 2021, conditions were in place for a sustained recovery in the Australian economy. Vaccination rates had risen to very high levels, borders had re-opened, restrictions on activity had been eased significantly and there was a return to more 'normal' conditions for households and businesses. In addition, both the household sector and the business sector now had stronger balance sheets than before the pandemic. Despite this, some disruptions and challenges induced by the pandemic persisted.

Supply chain disruptions

The COVID-19 pandemic caused major disruptions to global supply chains. Consumers shifted their spending away from services (which they were less able to consume due to the public health measures) and towards goods (which could be consumed in their homes). At the same time, the public health restrictions adversely affected the production and distribution of goods, with disruptions to logistics and transportation networks. The sudden spike in demand in goods overwhelmed supply chains that were not equipped to handle such rapid and extensive changes. This resulted in a sharp rise in the prices of a wide range of goods and commodities that contributed to higher inflation in many economies.

By the end of 2021, inflation in Australia was also stronger than expected, reflecting the impact of supply chain-related cost pressures and increased global and domestic demand. Labour shortages started to emerge across many industries, particularly in those experiencing strong demand or affected by labour availability issues caused by international border closures. Wages growth was strong for specific jobs where labour shortages were acute, such as some types of IT professionals, tradespersons and chefs.

Longer-lasting effects

The COVID-19 pandemic disrupted where people worked and learned, how they engaged in these activities and where they lived. There were also shifts in consumer preferences – such as an increase in online commerce, home delivery and digital services – that have been sustained well after lockdown restrictions eased. These changes have had flow-on effects in the economy, such as increasing demand for home office equipment and reducing demand for commercial office and retail space. Economists continue to analyse these shifts in order to understand whether they are temporary or permanent and whether they are having a positive or negative impact on the economy.