ECONOMIC UPDATE

PETER MUNCKTON – CHIEF ECONOMIST

WEEK ENDING 11TH MARCH 2022

Key points

- **The Australian economy has done relatively well over COVID by global standards;**
- **Weaker productivity growth has become an issue over the past decade;**
- **Government consumption has become a bigger part of economic growth over recent years**
- **Stronger investment should mean productivity will improve in coming years;**
- **And this should result in stronger income growth.**

Summary

By global standards the Australian economy has performed well through COVID. The massive fiscal and monetary support played an important role. But interestingly there looks to have been little correlation between the rise in national debt (and economic performance across economies. This suggests other factors have played a role in Australia's strong economic performance.

While the Australian economy has performed well in aggregate outcomes have been very mixed between sectors. Agriculture has done best helped by good weather and being minimally impacted by COVID. Other sectors (retail, road transport) have benefitted from the switch in consumer spending from services towards goods. For some sectors (such as IT services) strength is a reflection of an ongoing trend (digitisation). For about one-third of sectors economic activity was lower at the end of 2021 than at the end of 2019. Mostly that was the service sectors most impacted by COVID.

Taking a longer lens the Australian economy has performed well for much of the past three decades. This is why Australia's GDP per person (capita) is high by world standards. Since the end of the mining boom the growth of Australia's GDP per capita has lagged the US. Partly that reflected some decline in the terms of trade. More important has been weaker productivity growth. Weaker investment spending was a key factor. This meant that consumption has to become an increasingly important driver of economic growth.

The good news is that strong economic growth and full order books has meant that firms are boosting the size of their capex budgets. This is in addition to the trend rise of spending on digitisation by many companies. Governments' (particularly the states) are spending up big on infrastructure. The result should be stronger productivity growth in coming years. And that should mean higher income growth for Australia.

Economic impact of the crisis

This week I travelled by plane for the first time this year. There was decent amount of activity at the airport. The plane was about two-thirds full. The cafes in the Gold Coast (my destination) were reasonably busy in the mornings. So life is starting to return back to its pre-COVID norms.

Society and the economy has gone through a tough period over the past couple of years. By global standards though the Australia economy has done pretty well. I noted last week that the Australian economy has returned to its pre-COVID growth path. That is a great achievement after the size of the economic shock experienced over the past couple of years. That pre-COVID growth path though was not steep enough. We need to do better.

The massive fiscal and monetary support played an important role in Australia's good economic performance. But interestingly there looks to have been little correlation between the rise in national debt (reflecting big budget deficits and the incentive to borrow provided by rock-bottom interest rates) over the past couple of years and economic performance across economies.

This suggests other factors have played a role in Australia's strong economic performance. Perhaps the better health outcomes provided Australia's consumers' and firms with more confidence to spend. Certainly high commodity prices (notably iron ore and a number of agricultural products) would have been a big benefit.

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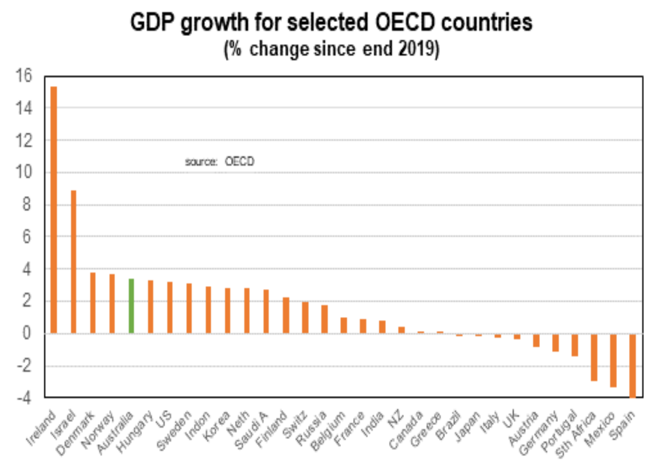
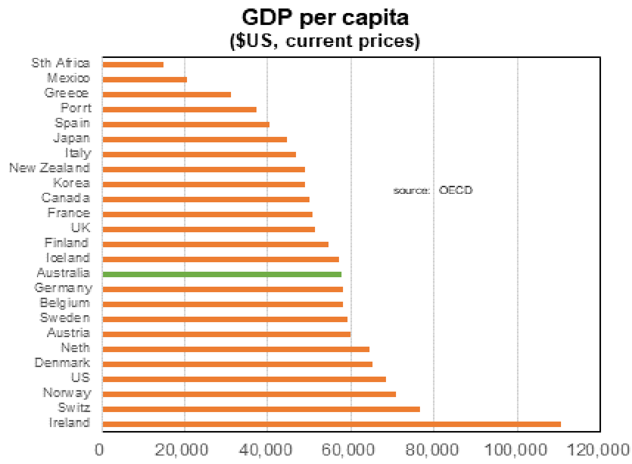
The Australian economy has performed relatively well by global standards over COVID.

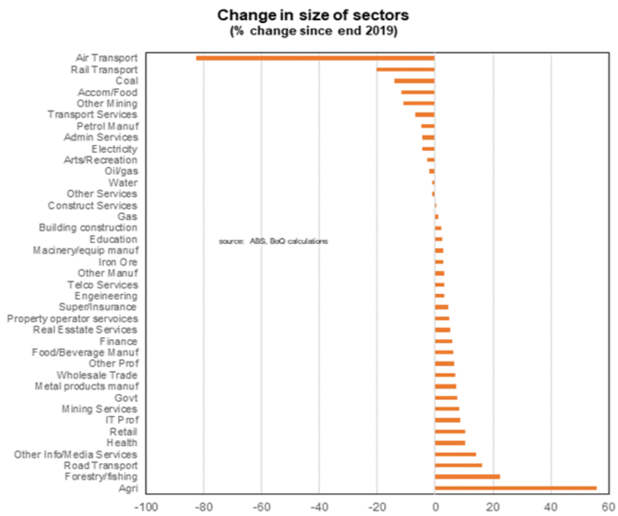


And rates high in GDP per capita.

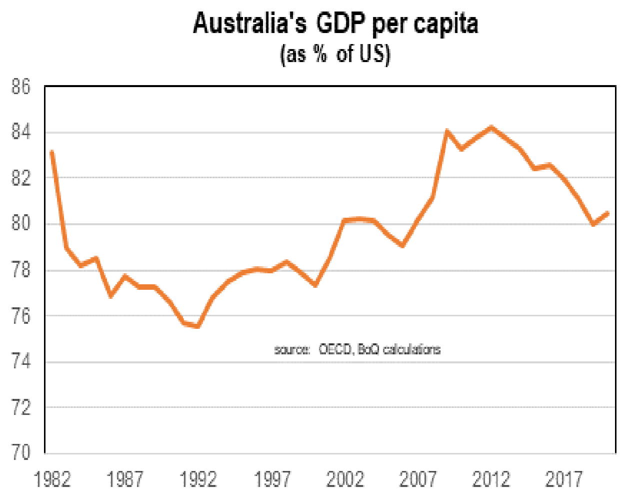


While the Australian economy has performed well in aggregate outcomes have been very mixed between sectors. Agriculture has done best helped by good weather and being minimally impacted by COVID. Other sectors (retail, road transport) have benefitted from the switch in consumer spending from services towards goods. For some sectors (such as IT services) strength is a reflection of an ongoing trend (digitisation). For about one-third of sectors economic activity was lower at the end of 2021 than at the end of 2019. Mostly that was the service sectors most impacted by COVID.

But sector performance has been very mixed over the past couple of years.



Australia's economy has underperformed the US since the end of the mining boom.



Taking a longer lens the Australian economy has performed well for much of the past three decades. This is why Australia's GDP per person (capita) is high by world standards. For the twenty years from the 1990s the Australian economy outperformed the US (and much of the rest of the OECD). In the second half of that period the outperformance reflected the benefits of the mining boom and Australia not suffering a recession during the GFC. The outperformance in the 1990s though was a reflection of a stronger productivity performance underpinned by the microeconomic reforms undertaken in the 1980s (as well as the benefit of the bounce back in economic activity from the 1990s recession).

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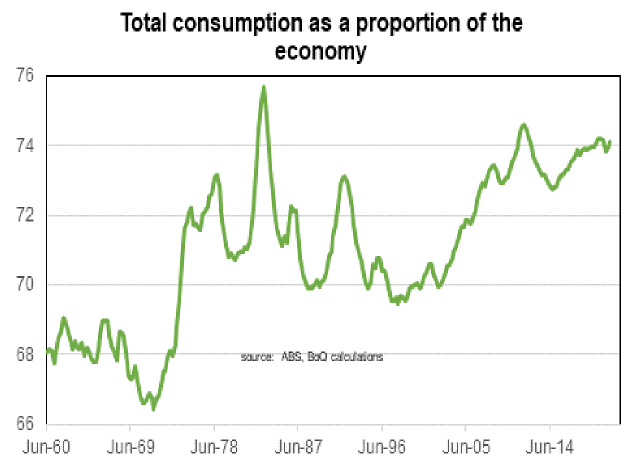
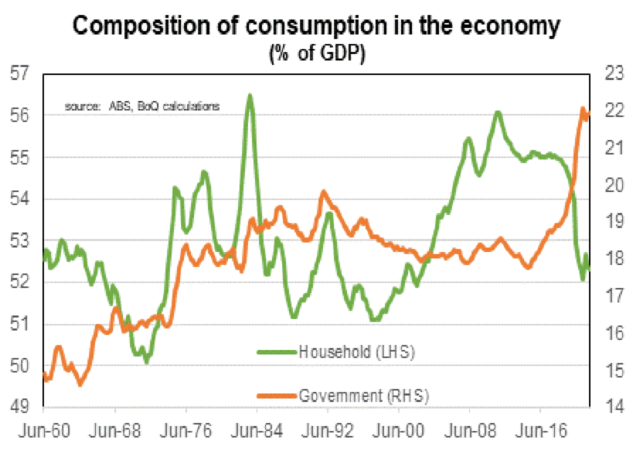
Since the end of the mining boom the growth of Australia's GDP per capita has lagged the US. Partly that reflected some decline in the terms of trade. More important has been weaker productivity growth. Weaker investment spending was a key factor. This meant that consumption has to become an increasingly important driver of economic growth.

Partly the slowdown of capex spending reflected the end of the construction phase of the mining boom. But also firms did not wish to invest given the moderate pace of economic growth. Much of the rise in consumption over recent years has been due to more spending by governments (particularly the Federal Government). The introduction of the NDIS (as well as higher spending on health, education and defence) all played a role.

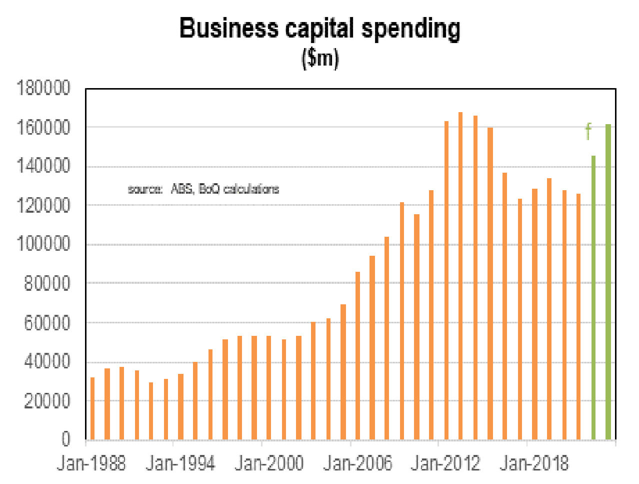
Consumption has become a bigger part of the Australian economy.



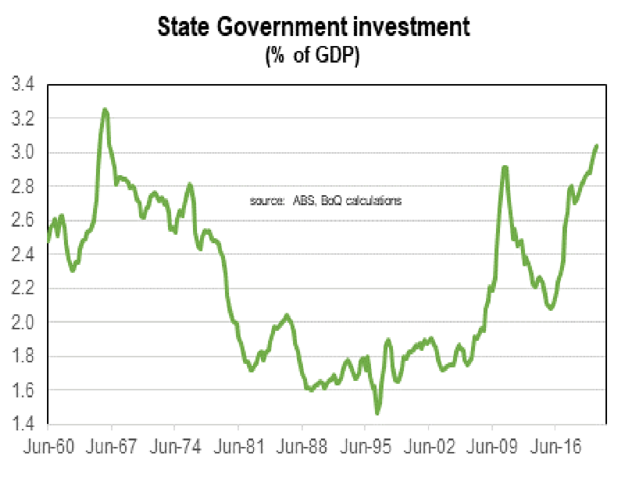
And a lot of that has reflected higher spending by governments.



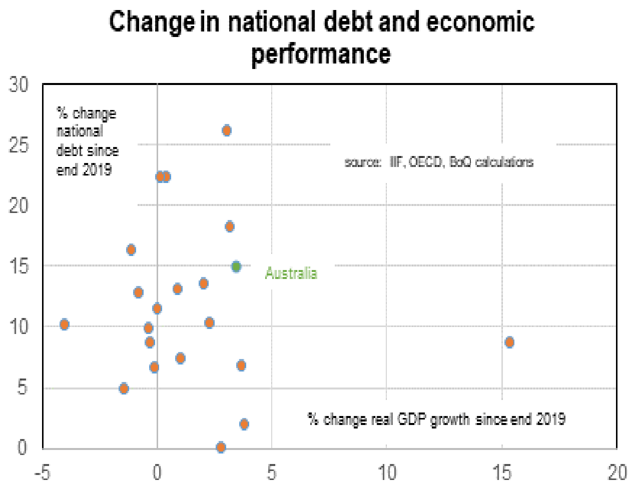
Business investment is picking up.



And this comes on top of very strong infrastructure spending.



The good news is that strong economic growth and full order books has meant that firms are boosting the size of their capex budgets. This is in addition to the trend rise of spending on digitisation by many companies. Governments' (particularly the states) are spending up big on infrastructure. The result should be stronger productivity growth in coming years.

Productivity growth has been declining since the end of the mining boom.	There has been little correlation between changes in national debt and economic performance over COVID.
	

The Australian economy has performed well over COVID. This has been no mean performance given the size of the economic shock. But the test will be whether we can sustain that strong economic performance. Pre-COVID the economic growth path was not steep enough due to weak productivity growth. Stronger business investment gives hope that productivity growth will be better in coming years. And that should mean higher income growth for Australia.

We live in interesting times.

Regards

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