Opening statement to the Economics Legislation Committee

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Thank you for the opportunity to make an opening statement.

Australians find themselves in the midst of three significant historical moments.

First, a once in a century pandemic that has seen more than 1.1 million die and wreaked economic havoc.

Second, a fundamental shift in the macroeconomic underpinnings of the global and domestic economies, the cause of which is still not fully understood.

Third, the continued re-emergence of a global super power that has a system of Government that is very different to our own – namely China.

In the long sweep of history similar moments have occurred before but there is little doubt that these are challenging circumstances for societies, governments and policy makers.

The recent Budget was the latest element of the Government's ongoing response to the pandemic in the light of our current and projected macroeconomic circumstances.

While we can take great strength from the way all Australian Governments have successfully suppressed the spread of COVID-19, the pandemic is far from over and ongoing vigilance will be required.

Moreover, the economic response, which has been of an unprecedented size and scope, will continue to need to be adapted to circumstances as they arise.

There are reasons to be hopeful.

The initial suite of measures including one of the largest fiscal programs in Australia's history – JobKeeper – have effectively mitigated the effects of shutdowns and the initial shocks.

The measures in the Budget will now support the economy as it continues to recover.

And our health system is continually improving in its capacity to respond to the pandemic.

This morning I will draw on the Budget to describe the evolution of the economy to date and our forecasts, before turning to the policy responses and the ongoing challenges facing the economy.

The COVID-19 shock and economic outlook

The pandemic is leading to a massive global economic shock.

Every G20 country experienced a significant quarterly fall in GDP this year. Global growth is expected to contract by 4½ per cent in 2020.

Global GDP is forecast to recover in 2021, growing by 5 per cent, before returning to growth of 3½ per cent in 2022.

The outlook for Australia's major trading partners is slightly better, with GDP expected to grow by 5¾ per cent in 2021. This is partly due to a strong outlook for China, which is forecast to grow by 8 per cent in 2021.

There remains great uncertainty around these forecasts.

We have seen second waves emerge in the UK, Euro area and elsewhere, which have prompted a tightening in health-related restrictions. Some countries in our region are also continuing to face enormous challenges in managing the virus, including India and Indonesia.

We know that health outcomes have been a key determinant of economic outcomes across the globe. Economies that have been relatively successful in containing and managing the virus have generally been less affected.

The pandemic is not the only risk to the global outlook. Ongoing trade and geopolitical tensions, in particular, tensions between China and the USA have the capacity to affect growth and increase volatility.

Australia has fared better than most other countries. This is due to our success in containing the virus. However, fiscal, monetary and regulatory responses have also been crucial.

Despite Australia faring better than others, the economic impact has been deeper and sharper than previous recessions and affected the demand and supply sides of the economy simultaneously.

It is a truly novel economic shock.

Real GDP contracted by 7.0 per cent in the June quarter 2020, the largest quarterly fall on record.

The effects on the labour market have been severe, with around 10 per cent of the labour force losing their job or being stood down on zero hours during the peak of the restrictions in April.

As a result, the effective unemployment rate peaked at around 15 per cent in the initial phases of the crisis.

However, as we have suppressed the spread of the virus there have been positive signs in the economy, with a rebound in activity now underway. Activity in states that experienced little spread of the virus, like Western Australia, have rebounded strongly, with confidence returning.

The number of Australians in employment has also increased significantly. Between May and September, around half of the employment lost in the initial months of the pandemic has been recovered.

Females and young workers suffered most acutely in the earlier stages of the pandemic, reflecting their higher shares of employment in casual employment and in heavily affected services-based industries such as accommodation and food services, hospitality, education, and health.

Female employment has recovered relatively faster compared with male employment, and by September the number of females in work was 3.2 per cent below their pre-COVID-19 level, whereas the number of males in work was down 3.4 per cent.

The shape of the hit to the labour market is changing, the impact is now looking much more like a general demand recession as the supply constraints are released.

The particularly strong impact on youth employment is persisting due to the sectors that will be last to see supply restrictions eased and the usual heavy impact on youth unemployment in recessions.

Having said this, the regional recovery in Australia has become uneven due to the outbreak of the virus and re-introduction of restrictions in Victoria.

In the face of such uncertainty, the Budget sets out the assumptions underlying the forecasts and provides sensitivity analysis.

Most materially, the forecasts assume that material localised outbreaks of COVID-19 occur but are largely managed without the need for widespread lockdowns.

Based on these assumptions, real GDP is expected to fall by 3¾ per cent in 2020 before recovering in 2021 to grow by 4¼ per cent.

The unemployment rate is forecast to peak at 8 per cent in the December quarter 2020, before falling to 6½ per cent by the June quarter 2022.

As for the global outlook, there remains significant uncertainty around the domestic outlook and the underlying assumptions.

Fiscal policy and strategy

As part of its initial response to the pandemic – the COVID-19 Economic Response Package – the Government provided support to households through JobKeeper and JobSeeker, and payments to welfare recipients, complemented by support to businesses.

As intended, economic support has had a significant effect on business and household incomes and was well targeted. Treasury analysis of Australian Taxation Office Single Touch Payroll data and Household Income and Labour Dynamics in Australia Survey data indicates that higher income households on average saw broadly no change in disposable income between the March and June quarters, while the average income of the lowest income households increased by 20 per cent.

Thus far, around $120 billion of support has been directly delivered to households and businesses, with significant additional support from these initial measures still to flow over the coming months. The assistance provided to date has exceeded the expected loss in GDP during this period, and has improved the balance sheets of households and businesses, which will assist during the recovery.

The 2020-21 Budget included $98 billion in additional support, including $74 billion under the JobMaker Plan to drive the economic recovery.

This brings the Government's direct economic support to $257 billion.

The focus of this Budget was on transitioning policy settings from a set of emergency response and support measures, to a set of measures that will support a strong recovery.

The Budget has deliberately used a very wide range of policies and levers to provide opportunities for all actors in the economy - government, business, households and the financial markets - to contribute to the recovery.

The key measures include:

- Boosting aggregate demand by providing assistance to Australian households, including through the bringing forward of personal income tax cuts and major new investments in infrastructure, transport and water.
- Lifting business confidence and providing a range of incentives for firms to invest, retain and hire.
- Providing incentives and training opportunities to help job seekers find pathways back into work, including through the JobMaker Hiring Credit which will give businesses incentives to take on additional employees aged 16 to 35 years.
- Making changes to a range of regulatory and insolvency arrangements to provide relief for businesses from these barriers to growth.

Treasury analysis indicates that the combination of Government direct economic support measures since the onset of the pandemic is expected to result in economic activity being 4½ per cent higher by 2021-22 and the peak of the unemployment rate being lower by around 5 percentage points than what otherwise would have occurred.

Ongoing challenges

The COVID-19 shock as for most recessions has the potential to generate medium-term challenges.

Historical experience here and overseas teaches us that it can take longer for labour markets to recover from a recession. After the 1990s recession, it took around two years for GDP to return to previous levels. However, it took 10 years before the unemployment rate fell back below pre-recession levels.

This reinforces the need for strong policy support. With policy support, we expect unemployment to fall to 6½ per cent by the June quarter 2022, but there is a risk that the substantial dislocation that has occurred in the labour market could result in persistently higher unemployment than forecast.

The COVID-19 pandemic is projected to lower Australia's potential output growth in the near term, by affecting all three supply-side drivers of growth: population, participation and productivity.

Australia's population growth is expected to slow to its lowest rate in over one hundred years, mainly due to a fall in net overseas migration, as well as some families delaying having children.

Lower population growth needn't lead to lower income per person. However, a smaller and older population may require governments to reconsider how taxation is raised to support essential services.

In addition, in the near term, weakness in business investment will lower growth in the capital stock and in turn labour productivity.

This challenge reinforces the need for policy to support business investment and productivity enhancing infrastructure, as well as business activity and dynamism through regulatory changes.

The COVID-19 pandemic is driving changes in the way we live our lives, and how our economy is structured. Not all firms and workers will return to the same activities—some businesses will close and some jobs will be permanently lost while other new business and employment opportunities will arise.

There will almost certainly be a greater shift to online consumer and business platforms, reductions in retail and office space, and ongoing effects on global supply chains and trade flows.

This reinforces the need to implement policies that enable a flexible and dynamic economy that allows capital and labour to shift to growing firms and sectors.

To this end, Treasury has been advancing a number of the Government's reforms including:

- Reforms to Australia's insolvency framework.
- Simplifying responsible lending obligations.
- Introducing the Consumer Data Right which will benefit banking, and in the future energy customers.
- Progressing technology neutral laws and permanently removing regulatory impediments that prevent businesses from embracing digital technologies.
- Superannuation changes to improve the superannuation system.
- Introducing a mandatory code addressing bargaining power imbalances between news media companies and digital platforms.

Lower receipts and additional spending in response to the COVID-19 pandemic have resulted in a sharp rise in debt. While this will lead to a higher debt-to-GDP ratio, Australia's fiscal policy remains sustainable and debt will remain low compared with most advanced economies. Borrowing costs are expected to remain low for some time, making it easier to service debt than in the past.

The current and projected debt levels would enable additional targeted and temporary fiscal support measures to be adopted should they be required.

Strong economic growth will make it easier to service debt by directly expanding the size of the economy relative to the amount of outstanding debt. Holding other factors constant, the debt to GDP ratio will fall when nominal GDP increases.

In addition, when growth is sufficiently high and borrowing costs sufficiently low, it is possible to reduce debt as a share of GDP, even without running budget surpluses. This is evident over the projection period, where nominal GDP growth makes a significant contribution to stabilising the debt to GDP ratio.

Nevertheless, in the longer term balanced budgets serve government's well. They encourage the careful application of the necessary trade-offs that all governments need to make in forming quality public policies. These include trade-offs associated with how any structural increases in spending will be financed. Once this discipline is lost, there are consequences not only for economic policy but for the democratic process.

Conclusion

I want to conclude by highlighting the hard work and dedication shown by Treasury staff over this past year. The Budget is always a massive undertaking.

We have been advising the Government on the economic outlook and Budget measures on a scale never seen in this country on an ongoing basis over the year.

Treasury has also been responsible for directly delivering a number of the Government's key programs and has significantly expanded our operations in other areas such as foreign investment screening. Over the period ahead we have a significant legislative and implementation agenda given our responsibility for key elements of the Government's deregulation agenda.

More broadly, the whole public sector, state and federal, has pulled together in the face of the crises to coordinate the unprecedented policy response.

Thank you for the opportunity to provide this statement.