Part 2: Economic outlook

Overview

Australia's economic recovery is well underway. The economy grew strongly in the September quarter and recent data suggest this momentum has continued into the December quarter. This is consistent with Australia's success in controlling the spread of the COVID-19 virus and the staggered easing of restrictions. The labour market continues to strengthen alongside the lift in economic activity, with employment having recovered three-quarters of its fall at the height of the crisis. The recovery has been underpinned by the Government's economic support packages and strong health outcomes, which have helped drive a recovery in consumer and business confidence.

Nevertheless, there is a long way to go until the economy fully recovers and the unemployment rate is brought down comfortably below 6 per cent. While recent domestic outbreaks have been contained and a vaccine is assumed to become available in Australia by March 2021, the risk of virus outbreaks will continue to create uncertainty for both households and businesses.

The global economic recovery is also progressing, supported by the substantial fiscal and monetary support implemented this year. Initial phase vaccination programs are beginning to roll out in some countries which will further bolster confidence.

For countries that have been effective in containing the virus, the economic recovery has been rapid and the outlook is favourable (Chart 2.1). However, renewed outbreaks in some countries have led to a curtailment of activity, which will set back their economic recovery.

Following an expected fall of 4 per cent in 2020, global GDP is forecast to increase by 4¾ per cent in 2021. Nevertheless, economic activity in most major economies is expected to remain below pre-COVID-19 levels until at least 2022. Australia's major trading partners are forecast to grow by 5¾ per cent in 2021, supported by a strong rebound in economic activity in China.

Australia's real GDP grew by 3.3 per cent in the September quarter, its strongest quarterly growth rate since the March quarter 1976. Growth in the quarter was driven by a strong recovery in household consumption and growth in public spending. The rebound in growth was broadly based across states and territories where the virus was successfully contained. In contrast, activity in Victoria fell in the September quarter as a result of health measures to contain its second wave.

Recent indicators suggest that momentum has continued into the December quarter. This has been assisted by the easing of restrictions in Victoria with early signs that household consumption and labour market outcomes have improved noticeably in the state.

Real GDP in 2020 is expected to fall by 2½ per cent, before growing by 4½ per cent in 2021. Activity will be supported by the Government's economic measures and, over time, a gradual easing of social distancing restrictions and continued improvements in confidence. However, activity in industries dependent on international visitors and migrants, such as tourism and education, is expected to remain subdued until these flows recover.

Labour market conditions have improved substantially alongside the recovery in economic activity. Since May 2020, three-quarters of employment and almost two-thirds of hours lost at the height of the crisis have been recovered. Labour force participation increased to 65.8 per cent in October, close to its pre-COVID-19 level. The unemployment rate, which was 7.0 per cent in October, is forecast to peak at 7½ per cent in the March quarter 2021, below the peak of 8 per cent forecast in the 2020-21 Budget. It is then forecast to fall to 6¼ per cent by the June quarter 2022. Despite this improvement in conditions, the unemployment rate remains elevated and conditions are challenging for particular groups including young people and those in areas and industries most affected by containment measures.

There remain significant risks to the economic recovery. The risk of domestic outbreaks and ongoing disruptions to other major economies means the economic environment remains highly uncertain. The development of vaccines and other medical treatments, while progressing well, is still subject to uncertainty with respect to timing, distribution and efficacy in controlling the spread of the virus globally. Severe health and economic outcomes combined with higher debt levels in a range of countries may also put pressure on the global economic and financial system, which might lead to credit tightening and financial instability.

Domestically, ongoing uncertainty including from an elevated unemployment rate could lead to persistently high household saving and weaker-than-expected consumption growth. Other risks to the outlook include global trade tensions that could impact on Australia's export markets and trade flows. The extent of any longer-lasting economic effects from the COVID-19 pandemic remain difficult to predict.

Box 2.1: Key assumptions

The evolution of the health crisis and the potential reimposition of restrictions remain significant risks to the economic outlook. The key assumptions that underpin the economic forecasts are set out below. Outcomes could be substantially different to the forecasts, depending upon the extent to which these assumptions hold.

Consistent with the 2020-21 Budget, it is assumed that over the forecast period localised outbreaks of COVID-19 occur but are contained. It is assumed that a COVID-19 vaccine will be available in Australia by March 2021, with a population-wide vaccination program fully in place by late 2021. While vaccines are becoming available in some countries, it will take some time for activity restrictions to be eased globally.

These technical assumptions suggest a gradual easing of restrictions as progress is made in the medical treatment and control of the virus. The gradual easing of restrictions will help support consumer confidence and business activity.

Following a substantial easing of restrictions in the December quarter of 2020, Victoria's public health measures have broadly converged to those in other states.

It is assumed that there are no state border restrictions in place throughout 2021, with the Western Australian Government reopening its borders to other states this year, compared with April 2021 as assumed in the 2020-21 Budget. A gradual return of temporary and permanent migrants is assumed through the latter part of 2021. Inbound and outbound international travel is expected to remain low through the latter part of 2021, after which a gradual recovery in international tourism is assumed to occur.

Net overseas migration (NOM) is significantly affected by international travel restrictions and weaker labour markets domestically and globally. It is forecast to fall from around 154,000 persons in 2019-20 to be around -72,000 persons by the end of 2020-21, before gradually increasing to around 201,000 persons in 2023-24.

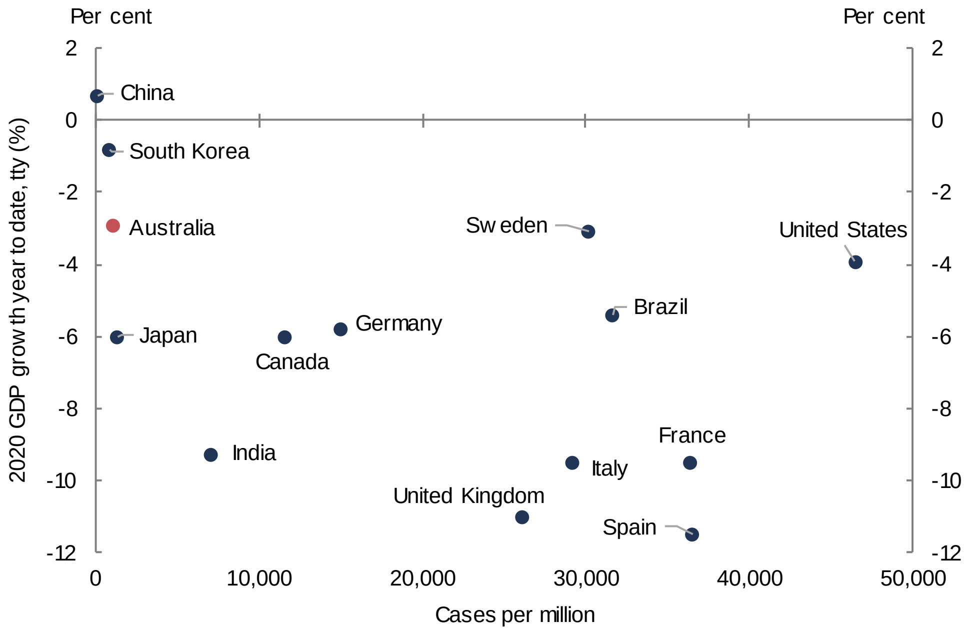
International economic outlook

COVID-19 continues to pose a significant challenge for the global economy, but vaccine developments are progressing well with initial phase vaccination programs beginning to occur, which will bolster confidence in the outlook. Nonetheless, success in containing the spread of the virus varies greatly and global cases continue to rise. The threat of further outbreaks is likely to continue to weigh on confidence and activity as the timing and efficacy of global vaccine distribution remain unknown, while renewed containment measures are setting back recoveries in some countries.

Around the world, the focus on strict containment of the virus saw many countries institute partial lockdowns of their economies in the first half of 2020. Most countries eased restrictions in the June quarter, which led to a strong rebound in global activity in the September quarter. However, the recovery has not been uniform across sectors in most economies. Rebounds in household consumption and exports were particularly strong, while the recoveries in service industries and business investment have generally been slower.

Since then, there has been a significant deterioration in health outcomes. Record increases in new COVID-19 cases have led to increased community-led restraint and the reimposition of restrictions in some countries. These factors will weigh on economic activity in the December quarter. However, recent lockdowns have generally had a less severe effect on activity than initial lockdowns, reflecting their more limited scope and that consumers and businesses are adapting to restrictions.

Chart 2.1: GDP growth and COVID-19 cases per million



Note: GDP data compares the growth of the first three quarters of 2020 over the same period in 2019 (year to date, through the year). Data for India and China is non-seasonally adjusted. Processes for testing and reporting COVID-19 caseloads are not standardised across countries: definitions, tests used and testing rates vary between countries. Cases per million accurate as at 11 December 2020.
Source: National statistical agencies, Johns Hopkins University, UN Population.

Global GDP is expected to fall by 4 per cent in 2020, a little better than forecast in the 2020-21 Budget. For 2020 as a whole, better-than-expected September quarter outcomes have outweighed the dampening effect on activity from the resurgence of cases in a number of countries. Major Trading Partner GDP is forecast to contract by 2½ per cent in 2020.

Global GDP is then forecast to recover over the remainder of the forecast period, growing by 4¾ per cent in 2021 and 3¾ per cent in 2022. The forecasts assume that, throughout 2021, economies reopen and confidence improves as progress is made in the medical treatment and control of the virus, with vaccine coverage expanding through 2022. However, activity in most major economies is expected to remain below its pre-COVID-19 level until at least 2022. Major Trading Partner GDP is forecast to grow by 5¾ per cent in 2021 and 4 per cent in 2022.

There remains substantial uncertainty around the global recovery. The efficacy, timing and take-up of vaccination programs globally are unknown and, until vaccination programs are completed, living with COVID-19 will likely involve sporadic outbreaks that will weigh on business and consumer confidence and could lead to periodic restrictions on activity. Nonetheless, a faster-than-expected availability and take-up of vaccines globally is an upside risk to the global outlook.

Significant uncertainty about the longer-run implications of the COVID-19 shock also persists. It will take time to rehabilitate labour markets and repair damaged household and business balance sheets, with the degree of scarring still unclear. There is also uncertainty around how persistent trade redirection and the reduced movement of people associated with this shock will be, with the risk that uneven recoveries will continue to weigh on global supply and demand for longer than expected. It remains to be seen what the related longer-run economic and social effects of poor health outcomes in some economies will be.

There also remains a risk that severe health and economic outcomes, along with higher debt levels, in a range of countries may put pressure on the global economic and financial system, which might lead to credit tightening and financial instability.

In **China**, GDP is forecast to grow by 1¾ per cent in 2020 and 8 per cent in 2021. China's economy continued to grow at a steady pace in the September quarter, underpinned by an expansion in industrial production, infrastructure and property investment, and exports. Over the remainder of the forecast period, China's economy is expected to strengthen further, though a slow recovery in consumption will continue to exert downwards pressure on growth.

In the **United States**, GDP is forecast to contract by 3¾ per cent in 2020, before growing by 3¼ per cent in 2021. While there was a rebound in the September quarter, driven largely by household consumption, record case numbers and hospitalisations across a majority of jurisdictions highlight challenges associated with balancing health and economic outcomes in a pandemic. Dealing with its significant caseload remains a key risk to the United States' outlook, while a major new stimulus package would represent an upside risk to the forecasts.

In the **euro area**, GDP is forecast to fall by 7½ per cent in 2020 before growing by 3½ per cent in 2021. The September quarter showed signs of a strong initial recovery as restrictions were relaxed, but surging infection rates have seen the reintroduction of containment measures, albeit with different levels of stringency. Nevertheless, this will set back Europe's recovery. The prospect of a no-deal Brexit remains a risk to the outlook for the United Kingdom and parts of the euro area with the transition period due to end this year.

Japan's GDP is expected to contract by 5¼ per cent in 2020, before growing by 2¾ per cent in 2021. In the September quarter, Japan's economy rebounded strongly from its record contraction in June, supported by growth in consumption and exports. The recovery is forecast to continue in 2021, assisted by government support, including Japan's recently announced third stimulus package. Confidence is expected to improve, while the economy should receive a boost in demand coinciding with the Tokyo Olympics. Japan's current third wave of domestic infections is a downside risk for activity should it cause an increase in community restraint, while COVID-19 cases are also rising in important export markets such as Europe and the United States. A weak outlook for investment is expected to further weigh on growth.

GDP for **Other East Asia** is forecast to fall by 2¾ per cent in 2020 and grow by 4½ per cent in 2021. All economies in the region had strong rebounds in growth in the September quarter, but have had varying success in containing the virus. Korea, Taiwan and Vietnam have experienced limited transmission while continuing production. For other economies, such as Indonesia and the Philippines, elevated infection rates suggest a slower recovery than elsewhere in the region. Although travel bans have been lifted across some domestic markets, international travel bans will continue to weigh heavily on growth across the board. Financial market volatility and renewed capital outflows from the region also present a potential future challenge.

India's GDP is expected to fall by 7¾ per cent in 2020, followed by growth of 9 per cent in 2021. Following the sharp contraction in growth in the June quarter 2020, India's economy rebounded strongly in the September quarter. Although case numbers are high, the recovery is expected to continue in 2021 as reopening continues. The strength of the recovery will depend on confidence and financial sector resilience, as well as whether the state and central governments can avoid further lockdowns amid the high caseload, with certain states having reimposed some restrictions. A weaker global outlook will also detract from growth, especially in areas such as foreign remittances and possibly services exports.

Table 2.1: International economy forecasts[(a)]

	Outcomes	Forecasts		
	2019	2020	2021	2022
China	6.1	1 3/4	8	5 1/4
India	4.9	-7 3/4	9	5 1/2
Japan	0.3	-5 1/4	2 3/4	1 3/4
United States	2.2	-3 3/4	3 1/4	3
Euro area	1.3	-7 1/2	3 1/2	3 1/4
Other East Asia (b)	3.7	-2 3/4	4 1/2	4
Major trading partners (c)	3.5	-2 1/2	5 3/4	4
World (c)	2.8	-4	4 3/4	3 3/4

(a) World and Other East Asia growth rates are calculated using GDP weights based on purchasing power parity (PPP), while growth rates for major trading partners are calculated using goods and services export trade weights.
(b) Other East Asia comprises the Association of Southeast Asian Nations group of five (ASEAN-5), comprising Indonesia, Malaysia, the Philippines, Thailand and Singapore, along with Hong Kong, South Korea, Vietnam and Taiwan.
(c) These growth rates are estimates in 2019 rather than outcomes.
Source: National statistical agencies, Refinitiv and Treasury.

Domestic economic outlook

Australia's economic recovery is well underway. The economy grew by 3.3 per cent in the September quarter and recent data suggest momentum has continued into the December quarter. The strong rebound has been underpinned by Australia's success in controlling the spread of the virus and the staged easing of restrictions, combined with substantial macroeconomic support.

The initial economic recovery has been stronger than was expected in the 2020-21 Budget. Following a fall in real GDP of 2½ per cent in 2020, the economy is expected to grow by 4½ per cent in 2021. In financial-year terms, real GDP is now expected to grow by ¾ per cent in 2020-21 before further recovering in 2021-22 to grow by 3½ per cent. The labour market is also recovering faster than expected. The unemployment rate is now expected to peak at 7½ per cent in the March quarter 2021, a lower level than forecast at the 2020-21 Budget, despite a stronger-than-expected increase in participation. Consistent with the pick-up in economic activity, the unemployment rate is expected to fall after the March quarter 2021, reaching 6¼ per cent by the June quarter 2022.

Australia's economic and health outcomes continue to compare favourably to other countries and the Australian economy is forecast to outperform all major advanced economies in 2020.

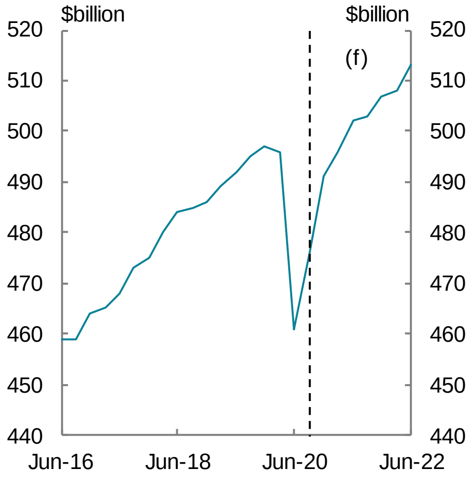
The Government's Economic Recovery plan has been crucial to the rebound in activity. JobKeeper and the Boosting Cashflow for Employers measure helped support business and household incomes through the peak of the crisis and kept employers and employees connected, contributing to the rapid recovery in the labour market as the virus caseload decreased and restrictions were eased. The Coronavirus Supplement and Economic Support Payments also bolstered household incomes.

While a large portion of household income was initially saved as a result of precautionary behaviour and restrictions on activity, increasing confidence to spend, alongside the personal income tax cuts announced in the 2020-21 Budget, will underpin the recovery in household consumption throughout 2021. The HomeBuilder program is supporting strong housing construction activity, and forecasts for dwelling investment have been upgraded substantially in the near term. The temporary full expensing and temporary loss carry-back measures announced in the 2020-21 Budget will encourage business investment during the recovery.

The recovery is also being supported by actions of the Reserve Bank of Australia to drive interest rates lower for an extended period to reduce the cost of business borrowing and household credit, which has been particularly notable for fixed-rate mortgages.

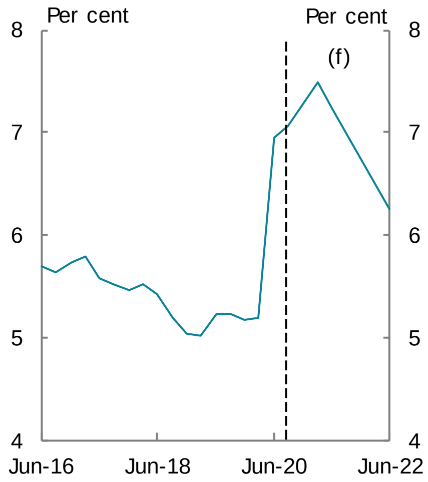
Economic growth is forecast to remain solid over the remainder of the forward estimates as both the domestic and international recoveries continue, with real GDP growth forecast to be 2½ per cent in 2022-23 and 2¾ per cent in 2023-24. The unemployment rate is forecast to fall below 6 per cent in 2023 and be 5¼ per cent by the end of the forward estimates.

Chart 2.2: Real GDP levels



Source: ABS Australian National Accounts: National Income, Expenditure and Product and Treasury.

Chart 2.3: Unemployment rate



Source: ABS Labour Force Survey, Australia and Treasury.

Since the 2020-21 Budget, there have been encouraging developments in relation to COVID-19 vaccine research. Australia has secured access to a number of global vaccine candidates, and will roll out vaccine candidates that prove safe and effective. However, there is still significant uncertainty with respect to vaccine timing, distribution and efficacy in controlling the spread of the virus. COVID-19 outbreaks, especially those that would necessitate further containment measures, remain a significant risk and even localised outbreaks could have an impact on consumer and business confidence weighing on consumption and investment. Substantial renewed outbreaks in key trading partners could also slow the domestic recovery, including further delaying the opening of international borders. In contrast, a faster-than-expected rollout of the vaccine in Australia poses an upside risk to the recovery.

Recent trade actions affecting Australia's exports have not yet had a material impact on the forecast economic recovery, despite significant impacts on specific firms and regions. However, ongoing global trade tensions present a key downside risk to the outlook.

The extent of any longer-lasting economic effects from the COVID-19 pandemic are difficult to predict. COVID-19 has driven greater use of online consumer and business platforms and reductions in use of retail and office spaces, particularly in the central business districts of major cities. It is unclear to what extent these changes will outlive the pandemic. The virus has also induced significant labour market dislocation and lower migration, which will have a permanent effect on the size of the population. The effect these factors will have on labour through scarring or on productivity in the medium term, and in turn on potential GDP, is also a source of significant uncertainty.

Further information on the sensitivity of the forecasts to these risks can be found in Box 2 of Budget Paper No. 1 Statement 2: *Economic Outlook* and Budget Paper No. 1 Statement 8: *Forecasting Performance and Scenario Analysis* in the 2020-21 Budget.

Table 2.2: Domestic economy — detailed forecasts(a)

	Outcomes(b)	Forecasts			
	2019-20	2020-21		2021-22	
		Budget	MYEFO	Budget	MYEFO
Real gross domestic product	**-0.2**	**-1 1/2**	**3/4**	**4 3/4**	**3 1/2**
Household consumption	-3.0	-1 1/2	1/2	7	5
Dwelling investment	-8.2	-11	-2	7	-2 1/2
Total business investment(c)	-2.1	-9 1/2	-8 1/2	6	5
By industry					
Mining investment	6.7	5 1/2	0	1 1/2	-1
Non-mining investment	-4.5	-14 1/2	-11	7 1/2	7 1/2
Private final demand(c)	-3.2	-3 1/2	-1	7	4 1/2
Public final demand(c)	5.5	5 3/4	6 3/4	2 1/2	3 1/4
Change in inventories(d)	-0.3	0	1/4	1/4	0
Gross national expenditure	-1.4	-1	1 1/4	6	4 1/4
Exports of goods and services	-1.8	-9	-7	2	3
Imports of goods and services	-7.4	-9 1/2	-6	8 1/2	7 1/2
Net exports(d)	1.1	- 1/4	- 1/2	-1	- 3/4
Nominal gross domestic product	1.7	-1 3/4	1	3 1/4	1 1/4
Prices and wages					
Consumer price index(e)	-0.3	1 3/4	2 1/4	1 1/2	1 1/2
Wage price index(f)	1.8	1 1/4	1 1/4	1 1/2	1 1/4
GDP deflator	1.9	- 1/4	1/4	-1 1/2	-2
Labour market					
Participation rate (per cent)(g)	63.4	65 1/4	66	65 1/2	66
Employment(f)	-4.3	2 3/4	4	1 3/4	1 3/4
Unemployment rate (per cent)(g)	7.0	7 1/4	7 1/4	6 1/2	6 1/4
Balance of payments					
Terms of trade(h)	0.8	-1 1/2	3/4	-10 3/4	-13 1/4
Current account balance (per cent of GDP)	1.7	2	2 1/2	-1 1/2	-1 1/4

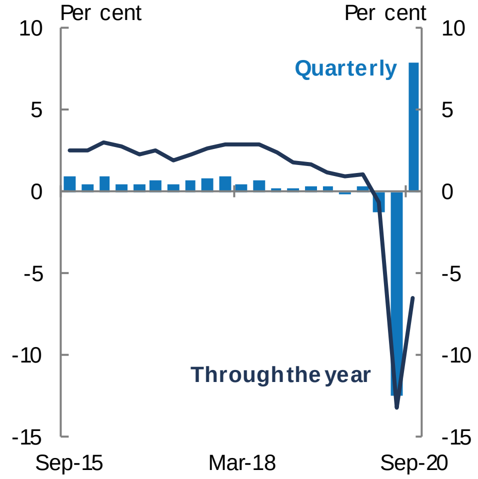
(a) Percentage change on preceding year unless otherwise indicated.
(b) Calculated using original data unless otherwise indicated.
(c) Excluding second-hand asset sales between the public and private sector.
(d) Percentage point contribution to growth in GDP.
(e) Through-the-year growth rate to the June quarter.
(f) Seasonally adjusted, through-the-year growth rate to the June quarter.
(g) Seasonally adjusted rate for the June quarter.
(h) The detailed forecasts are underpinned by price assumptions for key commodities: Iron ore spot price assumed to decline to US$55/tonne free-on-board (FOB) by the end of the September quarter 2021; metallurgical coal spot price assumed to remain at US$103/tonne FOB; and thermal coal spot price assumed to remain at US$61/tonne FOB.

Note: The outlook for the domestic economy is based on several technical assumptions. The exchange rate is assumed to remain around its recent average level — a trade-weighted index of around 61 and a $US exchange rate of around 73 US cents. Interest rates are assumed to move broadly in line with market expectations. World oil prices (Malaysian Tapis) are assumed to remain around US$41 per barrel. Population growth is assumed to be around 1.2 per cent in 2019-20, 0.2 per cent in 2020-21 and 0.4 per cent in 2021-22.
Source: ABS Australian National Accounts: National Income, Expenditure and Product; Balance of Payments and International Investment Position, Australia; Labour Force Survey, Australia; Wage Price Index, Australia; Consumer Price Index, Australia; unpublished ABS data and Treasury.

Household consumption rebounded by 7.9 per cent in the September quarter, partly unwinding the record fall of 12.5 per cent in the June quarter 2020 (Chart 2.4). Real-time data suggest that the recovery has continued in the December quarter, supported by ongoing easing of restrictions particularly in Victoria, continued Government income support and the recovery in the labour market. Consumer confidence has recovered rapidly, returning to its pre-crisis level much faster than seen in the global financial crisis and 1990s recession.

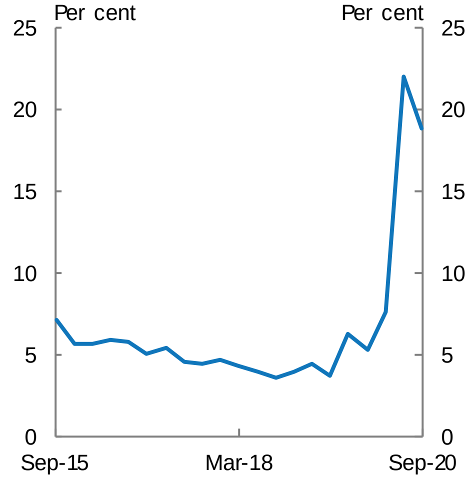
Household finances are also supportive of future consumption growth. Household disposable income increased in the September quarter, and remains above its pre-COVID-19 level, supported by an improvement in the labour market as well as continued support from the JobKeeper Payment and social assistance payments. As a result, the household saving ratio remained elevated at 18.9 per cent in the September quarter (Chart 2.5). Reliance on loan payment deferrals is decreasing, but that initiative and the early release of funds from superannuation continue to support household finances. Robust household balance sheets are expected to support consumption growth going forward.

Chart 2.4: Household consumption growth



Source: ABS Australian National Accounts: National Income, Expenditure and Product.

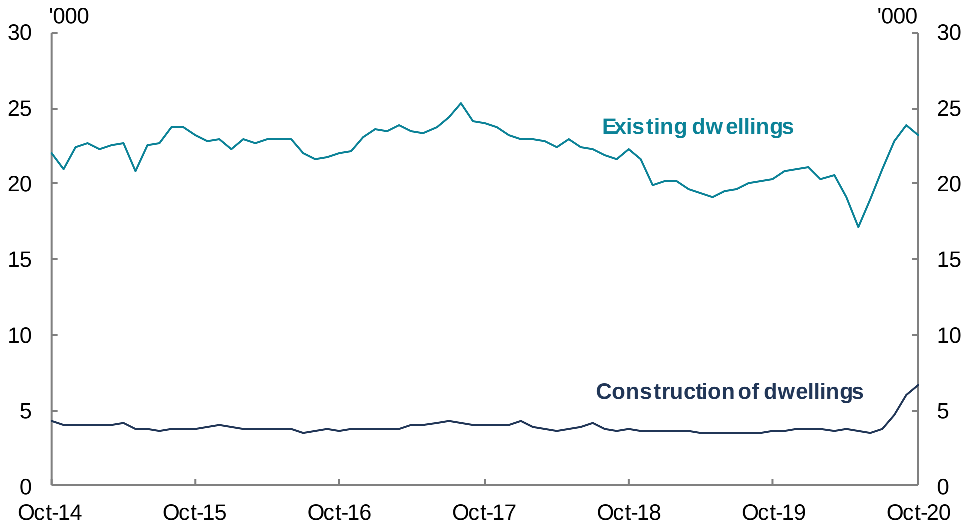
Chart 2.5: Household saving ratio



Source: ABS Australian National Accounts: National Income, Expenditure and Product.

Dwelling investment is forecast to fall by 2 per cent in 2020-21, which is a significant upgrade since the 2020-21 Budget, before falling by 2½ per cent in 2021-22. Following a significant fall in the June quarter 2020, dwelling investment increased by 0.6 per cent in the September quarter 2020, driven by a strong pick-up in alterations and additions. Looking forward, the construction of detached houses is expected to grow strongly in the near term. There has been a substantial increase in dwelling approvals for detached houses and in new lending to owner-occupiers, particularly first home buyers, who have responded to the HomeBuilder program together with other housing policies and lower interest rates (Chart 2.6). In contrast, the outlook for medium- and high-density dwellings remains subdued and construction is expected to remain weak to the June quarter 2022 as a result of reduced demand for inner-city high-density dwellings, which has led to higher vacancy rates and lower rents.

Chart 2.6: Number of new loan commitments for owner-occupier dwellings



Source: ABS Lending Indicators.

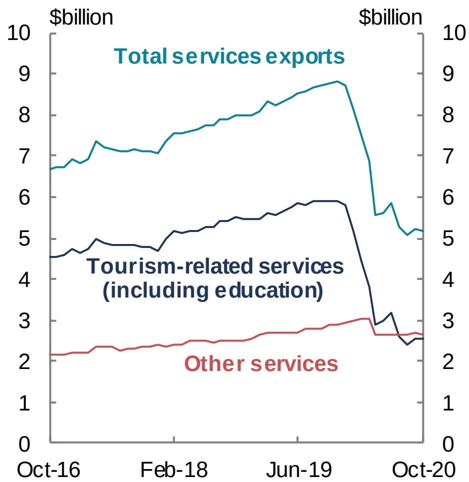
Business investment is expected to remain subdued in the near term as businesses defer investment due to continued uncertainty around the pandemic (including the impact on international supply chains), subdued domestic demand and weak export demand in certain sectors. As a result, new business investment is forecast to fall by 8½ per cent in 2020-21, before growing by 5 per cent in 2021-22.

Non-mining business investment is forecast to decline by 11 per cent in 2020-21, before growing by 7½ per cent in 2021-22. Following record falls in business conditions and confidence over the first half of 2020, non-mining business investment fell by 5.6 per cent in the June quarter 2020 and a further 3.7 per cent in the September quarter 2020. The easing of containment measures, recovering confidence as well as the Commonwealth and state and territory government policies announced in recent budgets are expected to support a recovery in business investment. Recent data from the ABS have already indicated an improvement in the outlook for non-mining investment intentions for 2020-21 following the release of the 2020-21 Budget in early October 2020. After growing by 6.7 per cent in 2019-20, **mining investment** is forecast to remain broadly flat in 2020-21, before declining by 1 per cent in 2021-22.

Public final demand will significantly bolster growth to the June quarter 2022. New public final demand is forecast to grow strongly by 6¾ per cent in 2020-21 and by a further 3¼ per cent in 2021-22. Commonwealth, state and territory budget updates have detailed a significant increase in infrastructure spending over the next four years, focusing on transport and public housing, along with school and hospital upgrades. Public consumption increased by 1.4 per cent in the September quarter to be 7.8 per cent higher through the year and is expected to remain elevated in the near term, reflecting expenditure on key frontline services to manage the health impacts of the pandemic.

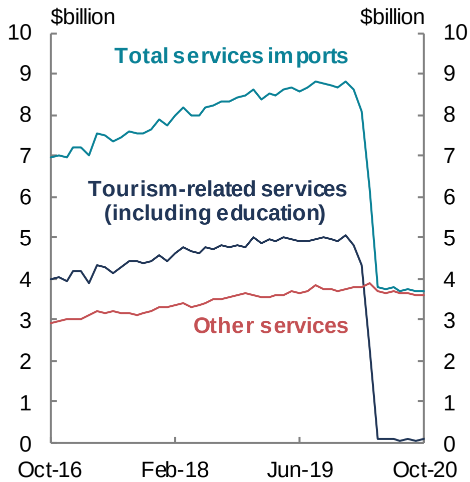
Net exports are forecast to detract ½ of a percentage point from real GDP growth in 2020-21 and a further ¾ of a percentage point in 2021-22. The forecast for net exports is significantly affected by assumptions regarding international travel flows, with services trade expected to remain subdued over most of the forecast period. Imports fell by more than exports in the first half of 2020, largely because the value of Australian tourism imports is greater than exports (excluding education). In the September quarter, tourism trade remained near zero while education exports continued to decrease as existing students finished their studies, and few new students were able to enter Australia (Chart 2.7 and 2.8).

Chart 2.7: Value of services exports



Note: Seasonally adjusted. Tourism-related services includes passenger transport, business and personal travel and education-related travel services.
Source: ABS, International Trade in Goods and Services.

Chart 2.8: Value of services imports



Note: Seasonally adjusted. Tourism-related services includes passenger transport, business and personal travel and education-related travel services.
Source: ABS, International Trade in Goods and Services.

Exports are forecast to fall by 7 per cent in 2020-21 and grow by 3 per cent in 2021-22. The fall in 2020-21 is driven by international travel restrictions while the increase in 2021-22 is driven by a lift in mining exports.

Recent trade actions on Australian exports have so far affected a relatively small proportion of total exports, despite material impacts on specific firms and regions. However, ongoing global trade tensions and the potential for further trade actions present a key downside risk to the outlook, notwithstanding significant opportunities for diversion of goods into alternative markets for some sectors.

Services exports are expected to fall by 32½ per cent in 2020-21 and by a further 3 per cent in 2021-22. Tourism drives most of the decrease in 2020-21, while international education exports drive the decrease in 2021-22 as the number of foreign student arrivals remains low and some existing students depart. Although services exports begin to recover once international travel picks up, they will take some time to return to pre-COVID-19 levels.

Mining exports are expected to fall by ½ per cent in 2020-21 and grow by 5 per cent in 2021-22. While coal and LNG exports have fallen recently due to lower demand arising from the pandemic, iron ore exports have been supported by robust demand from China. In the immediate term, coal export volumes are expected to continue to be subdued due to lower global demand. However, a pick-up in demand for Australia's mining commodities is expected in 2021-22 as the global economy recovers.

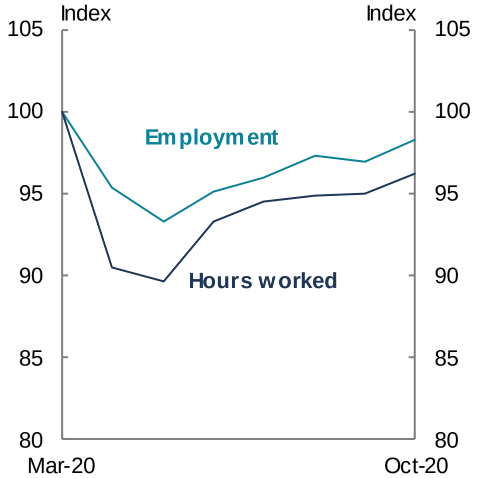
Rural exports are expected to grow by 1½ per cent in 2020-21 and by 2½ per cent in 2021-22. The recovery in export volumes reflects improved seasonal conditions leading to increased crop production. However, decreased exports of meat and meat products as herds and flocks are rebuilt are expected to partially offset the recovery in export volumes. Ongoing trade tensions present a downside risk to the outlook for rural exports.

Imports are forecast to fall by 6 per cent in 2020-21 and grow by 7½ per cent in 2021-22. The decrease in 2020-21 is mainly driven by large falls in services imports due to international travel restrictions severely limiting the number of Australians travelling overseas. Imports of goods are expected to increase by 5 per cent in 2020-21 and 5 per cent in 2021-22, driven by strong growth in consumption goods imports. Goods imports are forecast to grow more strongly than expected in the 2020-21 Budget, consistent with the stronger economic outlook and recovery in consumer and business confidence.

Since the 2020-21 Budget was published, **labour market** conditions have continued to improve, consistent with the recovery in activity and easing of restrictions. Outcomes for employment and labour force participation have exceeded expectations and the unemployment rate has not risen as much as anticipated.

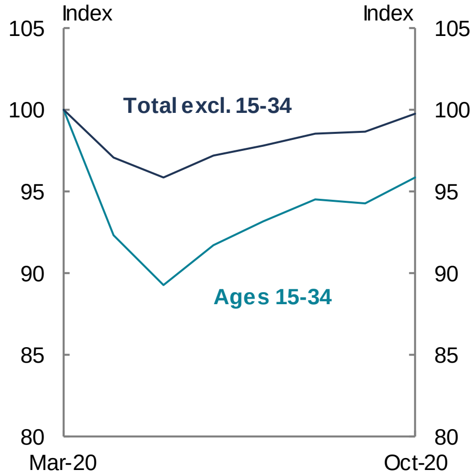
Nationally, around three-quarters of the initial falls in employment and almost two-thirds of hours lost have now been recovered (Chart 2.9). Between May and October, around 650,000 persons gained employment, and employment is now only 1.7 per cent below its March level. The additional number of employed people working zero hours for economic reasons has also fallen from its peak of around 720,000 people in April to be around 77,000 people in October. This has seen effective unemployment rates converge with measured unemployment rates across the country, with the exception of Victoria.

Chart 2.9: Employment and hours, indexed to March 2020



Source: ABS, Labour Force Survey, Australia.

Chart 2.10: Employment, indexed to March 2020



Source: ABS, Labour Force Survey, Australia.

Differences remain in the recovery across states and territories. Over the months of August and September, employment declined by 77,000 persons in Victoria, owing to renewed restrictions in the state. Employment in the state rebounded strongly in October, rising by 82,000 persons. In the rest of Australia, overall employment has continued to rise, increasing by 89,000 persons over September and October.

Female employment, which suffered a larger decline in the initial stages of the pandemic, has rebounded relatively strongly. Employment remains 127,000 persons (or 2.1 per cent) lower than the March level for females, and 96,000 persons (or 1.4 per cent) lower for males.

Younger workers were disproportionately affected during the pandemic and this has remained the case through the labour market recovery to date (Chart 2.10). Employment for 15-34 year olds is around 4.2 per cent lower than its March level while employment for the rest of the population is 0.1 per cent lower.

Employment outcomes in Victoria are expected to improve further in the near term, as people return to work in line with the continued easing of restrictions in the state. However, the broader recovery in employment is expected to face headwinds in the near term. This is due to ongoing international border closures, the possibility of further business restructuring as the recovery continues and as a range of policies transition from the support phase to the recovery phase.

The first phase of the JobKeeper Payment (March to September 2020) supported over 3.8 million employees/business participants in over one million businesses in one or more JobKeeper fortnights, with payments totalling nearly $70 billion over this period. The number of organisations receiving the JobKeeper Payment peaked in August at around 960,000 before falling in September, when around 950,000 businesses were receiving JobKeeper, covering around 3.6 million employees/business participants.

In October, the first month of the JobKeeper extension period (end of September 2020 to March 2021), around 1.6 million employees/business participants across 500,000 businesses received JobKeeper. A stronger economy than expected at the 2020-21 Budget is allowing businesses and employees to transition off the JobKeeper Payment sooner than previously expected. Initial indications suggest that most recipients who have transitioned off the JobKeeper Payment have maintained employment with their employer, but it is still too early to gauge the full labour market effects of these changes.

Following strong growth in the September quarter 2020, employment growth is expected to be more gradual over 2021. Employment growth will be aided by the policy measures the Government has put in place to support the economy and job creation, including the JobMaker Hiring Credit and Boosting Apprenticeship Commencements wage subsidy policies. Without the Government's support the unemployment rate would have risen much higher (see Budget Paper No. 1 Statement 4: *Fiscal Policy and Economic Growth* in the 2020-21 Budget for further information). Employment is expected to rise by 4 per cent through the year to the June quarter 2021, and 1¾ per cent through the year to the June quarter 2022, which is around its long-run average but still faster than expected population growth.

Forecasts for the **participation rate** have been revised upwards since the 2020-21 Budget, in line with stronger-than-expected outcomes. In October, the participation rate increased by almost one percentage point to be 65.8 per cent — almost back to its pre-pandemic level. The participation rate is now forecast to remain around 66 per cent through to the June quarter 2022, with large numbers of people having been encouraged to return to the workforce due to the improving economic conditions and a supportive policy environment.

The **unemployment rate**, forecast in the 2020-21 Budget to peak at 8 per cent in the December quarter, is now forecast to peak at 7½ per cent in the March quarter 2021, with both employment and the participation rate higher than expected. The unemployment rate is expected to fall to 6¼ per cent by the June quarter 2022, in line with the recovery in activity, reaching 5¼ per cent by the June quarter 2024.

The underemployment rate, which takes into account those people who are employed and seeking more hours, has fallen from its peak of 13.8 per cent in April to 10.4 per cent in October as the number of persons working reduced hours has decreased. While it is expected that average hours will continue to increase as the economy strengthens, spare capacity in the labour market is likely to remain elevated for an extended period.

Wage growth, as measured by the Wage Price Index (WPI), has slowed significantly since March 2020 and is expected to remain subdued over the forecast period, reflecting elevated spare capacity in the labour market. The Wage Price Index rose by 0.1 per cent in the September quarter 2020 to be 1.4 per cent higher through the year, a record low, reflecting fewer end-of-financial-year wage reviews, delayed enterprise agreement increases and the staggered implementation of award increases due to the COVID-19 pandemic. A declining unemployment rate beyond the March quarter 2021 is expected to support a gradual pick-up in wages over time. The Wage Price Index is forecast to grow by 1¼ per cent through the year to the June quarter 2021 and by 1¼ per cent through the year to the June quarter 2022, before gradually rising over the remainder of the forward estimates.

Measures of average earnings, such as Average Weekly Earnings and Average Earnings on a National Accounts basis, rose sharply in the June quarter 2020 as a result of the JobKeeper Payment and because employment in lower paid jobs experienced the sharpest declines. As employment continues to recover and policy shifts from the support phase to the recovery phase, these compositional effects will unwind, temporarily weighing on average earnings in the near term.

Consumer prices, as measured by the Consumer Price Index, rose by 1.6 per cent in the September quarter 2020 following the record fall of 1.9 per cent in the June quarter 2020. The September quarter rise reflected the reintroduction of childcare fees, increases in tobacco excise, continued price growth for durable goods and increasing automotive fuel prices, partially offset by falls in food prices and rents across most capital cities. The less volatile measures of underlying prices have remained subdued, with the trimmed mean and weighted median measures growing by 1.2 per cent and 1.3 per cent through the year, respectively.

Price pressures are expected to remain weak across the forecast period, reflecting the excess capacity in the economy. Consumer price inflation is forecast to increase to 2¼ per cent through the year to the June quarter 2021, driven by further unwinding of childcare policy changes and excise indexation. Consumer price inflation is forecast to be 1½ per cent through the year to the June quarter 2022, with measures of underlying inflation expected to remain near record lows over the first two years of the forecast period.

Nominal GDP is forecast to grow by 1 per cent in 2020-21 and by 1¼ per cent in 2021-22. The increase in nominal GDP in 2021-22 is not expected to be as strong as the recovery in real GDP growth in that year. This reflects a fall in the terms of trade as iron ore prices are assumed to decline to US$55 per tonne free-on-board (FOB) by the end of the September quarter 2021. In addition, wage and price growth is expected to be subdued across the forecast period, reflecting spare capacity in the labour market.

The **terms of trade** are forecast to rise by ¾ per cent in 2020-21, before falling by 13¼ per cent in 2021-22. Stronger-than-assumed commodity prices in the period since the 2020-21 Budget contribute to the small rise in the terms of trade in 2020-21, while the larger fall in the terms of trade in 2021-22 largely reflects the assumed decline in iron ore prices.

The forecasts for the terms of trade and nominal GDP are sensitive to assumptions about **commodity prices**. The assumptions regarding commodity prices are supported by market and industry consultation undertaken by Treasury.

Iron ore prices continue to be supported by strong Chinese demand, although there is still uncertainty around how long Chinese stimulus will persist and whether Brazil can recover to previous production levels in the near term. As such, the prudent judgement has been retained and the iron ore price is assumed to decline to US$55 per tonne FOB by the end of the September quarter 2021. This is one quarter later than was assumed in the 2020-21 Budget. Some market and industry participants have highlighted a risk that iron ore prices could remain elevated for an even longer period of time.

The metallurgical coal price assumption is for prices to remain at US$103 per tonne FOB and the thermal coal price assumption is for prices to remain at US$61 per tonne FOB.

Further information on the sensitivity of the economic forecasts to changes in the terms of trade and commodity price assumptions can be found in Box 4 of Budget Paper No. 1 Statement 2: *Economic Outlook* and Budget Paper No. 1 Statement 8: *Forecasting Performance and Scenario Analysis* in the 2020-21 Budget.

Medium-term projections

Potential GDP is estimated based on an analysis of trends for population, productivity and participation. As spare capacity in the economy is absorbed over time (that is, the output gap closes), real GDP converges towards its potential level and the unemployment rate converges towards the estimate of the non-accelerating inflation rate of unemployment (NAIRU). On the nominal side, key non-rural commodity export prices are projected based on cost-curve analysis. Domestic prices return over time to the mid-point of the RBA's inflation target band.

Potential GDP growth is estimated to fall below 2 per cent per annum in the near term before gradually returning to 2¾ per cent towards the end of the medium-term projection period. This is broadly unchanged since the 2020-21 Budget. The weak potential growth over the first half of the projection period largely reflects low population growth as a result of the COVID-19 pandemic, including through its effect on trend participation, detailed in the 2020-21 Budget.

Population growth is estimated to drop to 0.2 per cent in 2020-21 and 0.4 per cent in 2021-22, the slowest growth in over a century. As COVID-19 restrictions ease, population growth is projected to return to similar growth rates to those expected in the absence of COVID-19 (1.2 per cent by the end of the medium term), while the size of the population is expected to be around 4 per cent smaller by 2030-31 compared with what it would have been in the absence of COVID-19. Global migration flows, including those to Australia, could increase if there is a more rapid containment of the virus worldwide than assumed. This would in turn lead to increased population growth over the forward estimates period.

Labour productivity growth depends on both trends in underlying productivity and the productive capital stock. As in the 2020-21 Budget, underlying productivity growth is assumed to converge over a 10-year period to the average growth rate in labour productivity over the past 30 years of 1½ per cent per annum. The protracted period of weakness in business investment is expected to lower the capital stock and weigh on the future productive capacity of the economy.

Given the large output gap, spare capacity in the economy is expected to be absorbed over close to five years. Over broadly the same timeframe, inflation is expected to return to the mid-point of the RBA's inflation target band and the unemployment rate is expected to gradually converge to 5 per cent, the estimate of the NAIRU.