Economic outlook: 3 April 2020

What does the current macroeconomic environment with COVID-19 mean for the innovation community in Australia?

What is the current macroeconomic environment?

Before the global pandemic announcement for COVID-19, the macroeconomic environment was largely the same as described in the December 2019 Outlook (low economic growth, productivity growth, interest rates, inflation, real wages, increasing inequality, high household debt, weak business investment etc.).

With COVID-19 we are seeing the following additional features:

Global economic environment

COVID-19 is now in 206 countries/territories with 900,000 **confirmed cases** and 46,000 confirmed deaths (WHO, 3 April)

- **Restrictions of the movement** of people across borders as well as within countries and cities
- **Deep uncertainty** over the economic fallout resulting in high market volatility and withdrawn investment across all asset classes, large declines in equity prices and government bond yields, and pervasive restrictions across funding markets
- **Heavily constrained private sector spending** means worsening financial conditions for the public sector and threatens price stability
- **Growth projections** are very uncertain, but OECD now projects global annual GDP growth to drop 2% for each month of containment and that many economies will fall into recession (OECD, April)
- OECD also notes that in the medium to longer term, **strategic public investment is necessary**, particularly in areas with large positive externalities for the rest of the economy where under-investment is likely, such as health, education as well as digital and environmental infrastructure (OECD, 2 March)
- OECD projections already incorporate announced policy actions to support near term incomes. OECD recommends **macroeconomic policy stimulus** to help restore confidence as outbreak effects and supply-side disruptions decrease, and low interest rates to support demand, noting advanced economies have little room to lower rates further
- Although the outbreak appears to have slowed in China, the **impact on the Chinese economy** is worse

than initially expected, with growth expected to fall below 5% for 2020 (OECD, 2 March). Given Australia's close ties with China, declining growth will subdue demand for Australian exports, particularly in higher education and tourism

Declining growth in the Chinese economy will subdue demand for Australian exports including tourism and higher education

- Slowing job creation will limit income growth and heightened uncertainty will prolong already very **weak investment and productivity growth**, limiting real wage gains
- The **speed of the health threat and peak** will differ depending on the policy responses in each country and the economic, social, and wellbeing consequences will last much longer than the health threat.

Global assistance measures

- **Emergency financial assistance** is being provided by most governments, with the IMF and World Bank providing further assistance for low-income and emerging markets.
- **United States Congress** has issued a US$2.2 trillion U.S. stimulus package on 27 March. The **Federal Reserve** has cut interest rates to zero on 15 March and offered more than $3 trillion in loans and asset purchases (as of 3 April)
- The **European Central Bank** has announced assistance packages for €120B on 12 March and €750B on 18 March, plus up to €3 trillion in liquidity through refinancing operations and a cut to its main interest rate to -0.75% (19 March)
- Many see **Singapore** as providing a best practice response example, with their efficient bureaucracy, world-class universal health care, early action, and consistent, science-based messaging (see for example The Economist).

Australian economic environment and assistance measures

5,000 **confirmed cases** and 21 confirmed deaths (WHO, 3 April)

- **Interest rates** down to 0.25% and the Reserve Bank is providing $90B to increase bank lending (RBA, 19 March)
- ANU researchers project **Australian GDP loss** from a pandemic like COVID-19 of between 3 and 5% in 2020
- A **recession** is now very likely (see for example the Grattan Institute)
- **Australia's financial system is resilient** and well placed to deal with COVID-19; the banking system is well capitalised and in a strong liquidity position; substantial financial buffers are available if required to support the economy
- Australians are warned to prepare for **at least six months of disruption** to society (Prime Minister's Statement, 22 March)
- Federal Government has so far **announced three economic stimulus packages** of $17.6B on 12 March, $66.1B on 22 March, and $130B on 30 March. This is in addition to $2.4B for health sector support on 11 March, $715M for airlines and airports on 18 March, and $15B to deliver easier access to finance on 19 March. States and Territories have announced further packages worth approximately $12.8B.

How might macroeconomics impact the Australian innovation community?

The Australian innovation community earns its revenue from both the public and private sectors and for both R&D and professional services. The two sectors and two types of activity may be either proactive or reactive or even uncorrelated to macroeconomic conditions.

Private sector expenditure on R&D and professional services

- Traditionally, investment depends on (low) interest rates, (high) expected profits, policy and technology change
- Prior to COVID-19, Australia had low interest rates and continued profit increases but Australian business investment and expenditure in R&D continued to fall
- The impact so far plus the ongoing economic uncertainty from COVID-19 will further depress

business confidence around expected profits and business investment is likely to continue to fall
- The market and expenditure for professional services was growing before COVID-19 and focused on compliance, governance, risk management and responding to disruptions
- Post COVID-19, the market for professional services is likely to be patchy. High expenditure areas include health, risk management, debt advisory and insolvency services, and technology services (particularly cyber security as demand for remote technology services increases)
- With high uncertainty in the demand for R&D and professional services, it is prudent to expect at least a slight decline in demand and profitability over the coming year.

Public sector expenditure on R&D and professional services

- Like for the private sector expenditure, the innovation community may benefit from the current increase in public expenditure in so far as its work relates to this funding, particularly around primary services and infrastructure
- With announced public funding and activity such as those relating to bushfires and the three current Royal Commissions (into national natural disaster arrangements, disability arrangements and aged care), further demand is likely for professional services in those areas (risk management, environmental infrastructure, agriculture, health, disability and aged care), as public agencies and private sector organisations develop responses and operationalise recommendations

It is anticipated that there will be an increase in demand for professional services, especially in risk management, across private and public organisations

- However, given the competition for public funds and the high costs of economic stimulus measures to manage COVID-19, it is prudent to expect less expenditure available for other areas of R&D and professional services.

Conclusion

1. In the **short term**, the focus is on slowing the spread of COVID-19 and economically protecting Australian households and businesses, while funding vaccine development and related science

2. In the **long term**, focus should shift to how science, technology and innovation can lead the Australian economy's recovery.

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