

2021 – onward and upward

Last year was a massive shock to all of us, with a health crisis and the resulting economic crisis delivering our first recession in 30 years and it revealed the folly of making firm economic predictions based on a static view of the world. Given no one predicted a global pandemic, there were few predictions from a year ago that resembled reality. However, economic forecasting should never be limited to fixed (and somewhat arbitrary) numbers and percentages; it is most insightful when it considers scenarios and argues for relative probabilities. As Keynes said, when the facts change, I change my mind; so, the ever-changing landscape means forecasts need to be dynamic and scenario-based, not binary outcomes.

Fortunately, the likelihood of a shock to the economy of the scale of COVID-19 again this year is very low, so when considering the shape of the recovery from last year's recession the recent economic data seems a sound foundation from which to project. We are still highly dependent on managing the health crisis- keeping hot spots in check, and then the vaccine rollout will be crucial. How quickly will it be made available, how willing will Australians be to receive it, and how effective will it be? We can defer to medical experts on its efficacy, but barring any unexpected issues on the vaccine front, the economic data is the best starting point for projecting how 2021 will pan out. And as of today, that data is pointing in one direction - up.

Why is the economy looking so strong so soon after the recession? Only six months ago the unemployment rate was 7.5 percent and the RBA was forecasting 10 percent and higher- and the 'second wave' of COVID cases in Melbourne brought the desperate images from overseas much closer to home. But the policy response from all levels of government turned out to be highly effective- health policies managed the case numbers; government fiscal policy was massive (around a quarter of a trillion dollars in direct economic support) and monetary policy from the RBA gave us three rate cuts in 2020. This has done the trick- all of a sudden business confidence and consumer sentiment is at multi-year highs, housing loan approvals are the highest on record, and payrolls data shows the jobs market back to pre-pandemic levels. Nationally, job vacancies ended last year 12 % above where they were a year before.

Cynics may suggest these figures are artificially and only temporarily inflated by the fiscal stimulus, which is tapering down quickly, but this misses the fact that around \$200 billion of this stimulus is now 'accrued' in savings and yet to be spent, according to Treasury analysis. The JobKeeper program is scheduled to be wound down by March, but the number of workers supported by it has fallen dramatically, and the sharp rise in job advertisements suggests that the JobMaker hiring scheme can support this transition- and more targeted government support may be on its way, in particular for hospitality and tourism dependent businesses.

Mid last year the RBA published its economic forecasts with a baseline economic recovery and 'upside and downside scenarios' that have turned out to be too pessimistic- back then almost all commentary was leaning to the risks being on the downside. It's human nature to think the worst when times are tough, but now all of a sudden, the predictions for 2021 are pointing to upside- hindsight is 20/20, but the mistake many forecasters made then was dismissing the probability of upside surprises, that have followed thick and fast since September.

So, what can we predict today with confidence? The scenario that I believe is most likely for Australia's economy (again assuming the vaccine rollout all goes smoothly) is onward and upward:

- Asia and Oceania enjoying the sharpest economic rebound, ahead of the advanced economies in Europe and North America
- Our jobs market to continue to rebound, with unemployment steadily trending back to below 6 percent
- The property market also continuing to recover, especially in regional locations (with better use of technology to allow lifestyle choices and working from home options)
- Interest rates should remain at rock bottom this year and next, helping the recovery this year (although at some stage they will need to normalise, which will risk a bubble or two on the way)

And downside scenarios? Export markets will be challenged by a deteriorating political relationship with China and will probably be faced with an even stronger Aussie Dollar as the US spend their way out of trouble- so our exports need to diversify if they are too reliant on Chinese demand. So far, our trade numbers are holding up strongly, but beyond COVID risks, this may be the largest challenge.



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