The economy is never as good as it looks and never as bad as it seems

- David James
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An aphorism sometimes used by professionals in the financial markets is that 'things are never as good as they look and never as bad as they seem.' That is perhaps worth remembering when the Federal Budget is delivered on 11 May. The expected economic devastation from the COVID-19 lockdowns — which caused deep harm to many sectors, especially tertiary education, travel and tourism — has not, at least in aggregate, led to the economy falling off a cliff. Things have not turned out to be as bad as they had seemed a year ago.

It has been an extraordinary financial experiment. What happens when the government prevents a large amount of economic activity by imposing lockdowns and then spends heavily on job and unemployment support to cushion the blow? It sharply increased federal government debt, but would it work?

The answer seems to be a qualified 'yes'. In particular the resilience in the labour market has shown how adaptive stressed markets can be. The current unemployment rate of 5.6 per cent is a level that treasury did not expect to reach until 2022-2023. It is not all good news, though. There will be an uptick in joblessness due to the winding back of JobKeeper, and the underemployment rate was 7.9 per cent in March, meaning the total under-utilisation rate is over 13 per cent. But a year ago an unemployment rate of 15 per cent seemed likely. It would have spelt deep trouble for the overall economy and had disastrous social consequences.

The Coalition threw away its 'balance the books' mantra last year, possibly learning from former PM Kevin Rudd's $42 billion stimulus package in 2008, the so-called 'cash splash', which proved to be a major factor in why Australia was about the only economy in the developed world to avoid a recession. The delivery mechanism was different; it went to businesses to pay employees rather than to consumers.

But although the Coalition will never admit it, it looks suspiciously like there has been some bipartisan institutional learning about how to manage financial crises. If you want to stimulate an economy in times of crisis put the money directly into the economy, either into people's pockets or to businesses who then pass it on to

workers. It works far better than giving it to government departments to spend inefficiently.
It does mean that government spending as a share of the economy is at its highest level since the early 1980s. Yet it seems to have led to a better outcome than those who persistently advocate austerity could have imagined. Projections for the Budget deficit in 2020-2021 are expected to be reduced from a December estimate of $A198 billion to $150 billion, 7.4 per cent of GDP, because of better than expected economic conditions and higher commodity prices, especially iron ore. For the next financial year analysts are forecasting the deficit to fall by half to $80 billion or 3.7 per cent of GDP.

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Australia's national debt has of course risen sharply because of the crisis response but this will not greatly increase interest payments because rates are at historic lows. Budget deficits are likely to continue to at least 2025 as the government attempts to stimulate, rather than rescue, the economy. Net debt is expected to peak at about 45 per cent of GDP, which, although relatively low compared with other developed economies, is almost double the level in 2019-2020.
Another indicator of economic improvement is that consumers are likely to start opening their wallets, which have been firmly shut over the last year. During the crisis the savings rate increased by a massive 22 per cent and consumption growth fell by about 14 per cent. That is likely to return to more normal levels.
If things have not been as bad as they looked a year ago, the recovery may not turn out to be as good as it currently seems. It has been shown that the government can cushion severe economic blows, but that is necessarily only a temporary measure. There has been a sound understanding of timing, but the clouds hanging over the global economy have not gone away.
Just before the pandemic, in late 2019, there were events in the financial system, in what is known as the repo market, that looked suspiciously like what happened in the lead up to the 2008 global financial crisis. Financial institutions started to lose trust in each other — and the system utterly depends on trust. The meltdown in the real economy distracted all attention away from that. Central banks and governments pumped extraordinary amounts of money into the system, much of which benefitted financial companies and banks. But the problems exposed in 2008, which have since been made more serious because of soaring global debt, have never been solved.

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Main image: Open sign behind wire (janicetea/Unsplash)