COVID-19 Economic Impact Analysis

In comparison to other developed nations, Australia has been more successful in containing the inevitable aftereffects caused by the Covid-19 pandemic. The key to Australia's success has been the combination of strong health response largely centred on social distancing and also a great public acceptance and compliance to follow the restrictive policies put forward by the government. Australia's Covid-19 health policies have had both positive and negative economic effects. Firstly, the country's death tolls are very minimal and as consequence has helped to keep Australia's long run potential output at pre pandemic levels. For this reason, in figure 1, the LRAS curve has not shifted left or right.

Secondly, even though Australia did better than most countries as it pertains to Covid-19, however the government could not stop the country from going into a recession. According to Australian Bureau of Statistics (ABS), in March 2020 (the month in which business restrictions were started to be put in place), GDP fell by 0.3% [1]. Furthermore, by July 2020 GDP declined by record 7% and unemployment peaked at 7.5% [1]. The decrease in GDP and increase in unemployment is the result of a decrease in Australia's aggerate demand (AD) and aggregate supply (AS). AD decreased because of a decline in consumer spending caused by a reduction in consumer confidence and disposable income. Furthermore, increasing uncertainty around future economic prospects also contributed to Australia's declining AD by reducing investments. Net exports also declined due to border closures and as consequence further decreased Australia's AD. Border closures also contributed to Australia's decreasing AS. Closures to borders resulted in a positive price shock cause by supply chain shortages. The decrease in Australia's AS and AD is shown in figure 1 through the leftward shifts of AS0 and AD0 resulting in a overall increase in inflation and a decrease in output.

To counteract the recessionary consequences of the Covid-19 lockdowns, the Australian government has two policy tools which it could have used to improve its economic situation. The first of these policy tools which the government can alter are its fiscal policies. A government's fiscals policy involves deciding on the level of government spending as well setting the current tax rate. In relation to Covid-19 the Australia government could have increased its spending and at the same time also decreased its tax rate. By decreasing the tax rate, a government can increase the level of disposable income available to consumer which in theory will help to increase AD. Similarly, increasing government spending will increase AD directly given that it is one of the factors contributing to a country's AD.

The other policy tool that can be used by governments to improve recessionary economic situations are controlled by the central bank and fall under the umbrella of monetary policies.

At its core monetary policies revolve around manipulating a country's money supply. Central banks can control the level of money supply through the combinations of open market operations, discount policy and reserve requirements. In order to help the Australian economy to rebound from the recession caused by Covid-19 pandemic, the RBA could have put in place an expansionary monetary policy. An expansionary monetary policy should be composed of an increase in open market purchase and decrease in both the discount rate, as well as the reserve requirement. An expansionary monetary policy will lead to an increase money supply leading to a decrease in the nominal interest rate, which in turn will help to increase AD by increasing investments.

In reality, the Australian government used both an expansionary fiscal and monetary policies to help the Australian economy rebound from the recession caused by the Covid-19 pandemic. According to the International Monetary Fund (IMF), in the first quarter of 2020, at a commonwealth level, a fiscal stimulus package had been put in place worth $267 billion with the majority of the stimulus to be used over the 2020-21 financial year [2]. The fiscal stimulus includes, "JobKeeper wage subsidies, income support to households, cash flow support to businesses, investment incentives, and targeted measures for affected regions and industries" [2]. Similarly, to facilitate an economic recovery, the RBA since the start of the pandemic had decreased the cash target rate twice, first to 0.25% and later 0.1% [2]. To get to its target cash rate, the RBA tried to increase the money supply by making open market purchases and setting up a term funding facility.

The Australian government's fiscal and monetary policies have largely been successful in helping to increase AD and as consequence aggregate output. This is shown by the fact that according to the ABS, by September 2020 the Australian economy started showing signs of recovery with an increase in GDP by 3.4% [1]. Also, with the further easing of restrictions, stresses to supply chains were slightly reduced resulting in an increase to AS. However, for some industries the monetary and fiscal policies have not been successful in increasing their demand. For instance, ABS reports that in December 2020 industries such as accommodation and food services were still going through a tough time [1]. Also, in a recent article from ABS news, there still remains some stresses to supply chain processes due to import restrictions [3]. Since some industries are still facing reduced demand and supply restrictions, the graph in figure 1 depicts an increase in AD and AS caused by strong government intervention, but only to a level where the new short run equilibrium is slightly lower than the long run potential level of output.

The upward slopping nature of the yield curves for 2021 indicate a positive outlook for future economic conditions in the US. As previously mentioned, according to the expectations theory an upward sloping yield curve is the result of investors expecting future short-term rates to be higher, Investors would expect interest rates to be higher when they believe the economy will be in a relatively stronger position in the future.

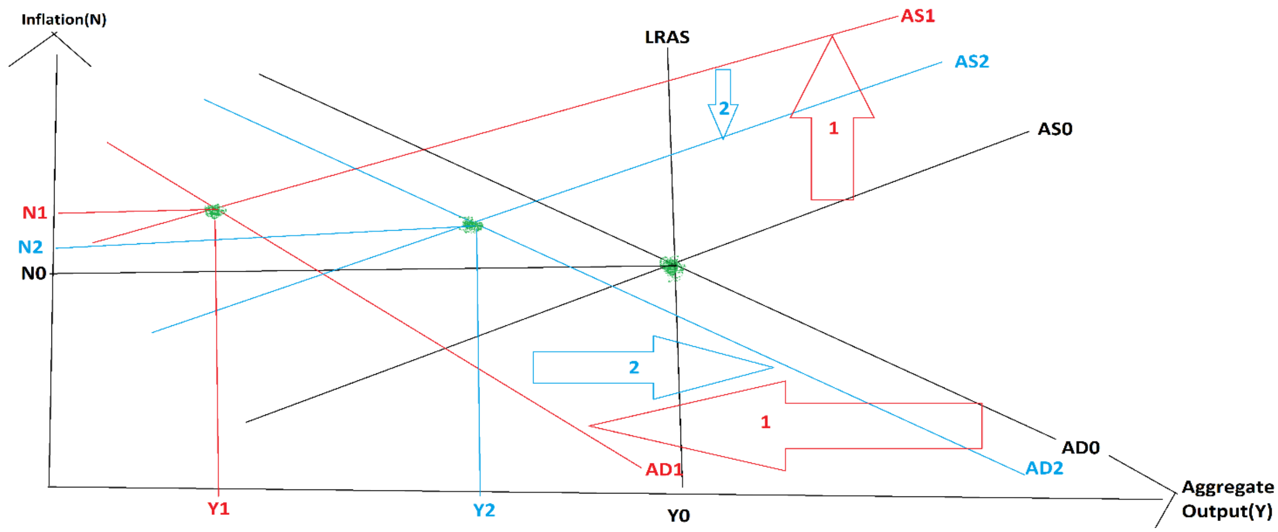

Figure 1