2. THE ECONOMY

- The NSW economy has faced unprecedented challenges over the last 12 months. The devastating bushfire season was followed by a global pandemic that has plunged the world economy into deep recession.
- In line with the sharp contraction in the national economy, the NSW economy has recorded its first recession in nearly 30 years.
- The recession in New South Wales has been less severe than witnessed overseas. The State's containment measures and world class health system have been effective in slowing the virus and the worst of the shock appears to be behind us. The careful easing of restrictions in New South Wales and coordinated policy support from the Reserve Bank, Commonwealth and state governments have put the economy in a position to rebound strongly.
- Following a contraction of 1 per cent in 2019-20, economic activity is expected to fall by a further ¾ per cent in 2020-21. Growth is then expected to rebound to 2½ per cent in 2021-22, and continue to grow at an above-trend rate throughout the forward estimates, reflecting the positive effects of unprecedented stimulus and successful management of the pandemic. However, the level of economic activity is not expected to recover to pre-COVID-19 levels until 2021-22.
- Unemployment is likely to rise in coming months, as key Commonwealth support measures unwind, and is not expected to return to pre-COVID-19 levels over the forecast horizon. But, record levels of stimulus from the NSW Government are expected to support a decline in the unemployment rate to 5¼ per cent by June quarter 2024.
- The closure of international borders has lowered the state's population growth to the slowest rate in more than 100 years. This will weigh heavily on short-term economic growth and severely impact the state's education and tourism exports.
- The economic outlook in this Budget is subject to an unusually high degree of uncertainty and risk. The Commonwealth has linked the timing of an effective vaccine for COVID-19 to the reopening of international borders. The recent resurgence of COVID-19 cases overseas also highlights the precarious nature of virus containment.
- A careful balancing of containment measures and the progressive resumption of economic activities—supported by the NSW Government's comprehensive stimulus plan, productivity enhancing reforms, and record investment in infrastructure—will be critical to the continued rebound in confidence and employment in New South Wales.

Table 2.1: NSW - economic performance and outlook(a)

	2018-19 Outcome	2019-20 Outcome (d)	2020-21 Forecasts	2021-22 Forecasts	2022-23 Projection	2023-24 Projection
Real state final demand	2.1	-1¾ (2)	-1½ (2¼)	2½	2¼	3¼
Real gross state product	1.9	-1 (1¾)	- ¾ (2¼)	2½	2¼ (2½)	2¾
Employment	3.3	0 (1½)	-1 (1¼)	1¼	1 (1¼)	1
Unemployment rate (b)	4.6	6½ (4¾)	6½ (4½)	6 (4½)	5¾ (4½)	5¼
Sydney consumer price index	1.7	1 (1¾)	1 (1¾)	1¼ (2)	1½ (2)	1½
Wage price index	2.4	2 (2¼)	1¼ (2½)	1¼ (2¾)	1½ (2¾)	1¾
Nominal gross state product	3.7	-½ (3½)	1¼ (4)	4 (4½)	3¾ (4½)	4¼
Population (c)	1.3	0.9 (1.5)	0.0 (1.5)	0.2 (1.4)	0.7 (1.4)	1.1

(a) Per cent change, annual average unless otherwise stated. Previous forecast (HYR 2019-20) in parenthesis where different.
(b) June quarter, per cent.
(c) Per cent change through the year to 30 June. Forecasts are rounded to the nearest 0.1 percentage points.
(d) Real gross state product and population for 2019-20 are NSW Treasury estimates.

Sources: ABS 5206.0, 5220.0, 6202.0, 6401.0, 6345.0, 3101.0 and NSW Treasury

2.1 The economy is rebuilding with policy stimulus support

State Final Demand, the broadest measure of NSW economic activity, first contracted in the March 2020 quarter. This initial contraction was driven by disruptions caused by bushfires, combined with restrictions on the arrival of foreign students and tourists in the early days of the COVID-19 outbreak.

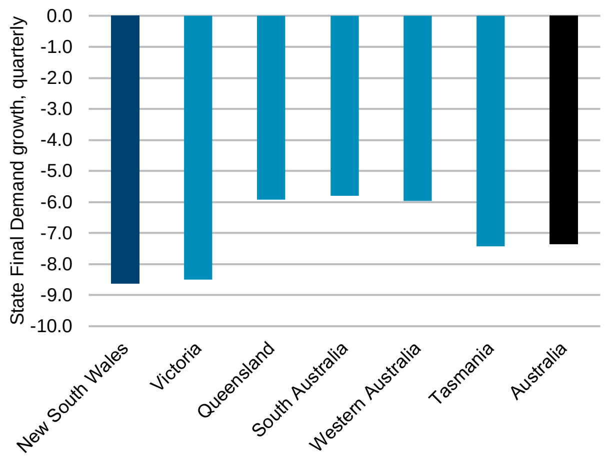
The full economic impact of COVID-19, however, was felt in the June quarter. The introduction of containment measures in late March successfully lowered the number of new COVID-19 cases in New South Wales but came at significant economic cost. State Final Demand fell by 8.6 per cent in the June quarter, the most significant contraction ever recorded for the state.

The impact of the virus on the state's labour market has been equally severe. Almost 270,000 people lost their jobs in New South Wales between March and May. Many thousands more saw their hours of work reduced. However, the volume of job losses was contained by government initiatives aimed at keeping businesses afloat and workers attached to their jobs.

While the downturn in the NSW economy has been significant, the experiences of major advanced countries around the world have been more severe (see Chart 2.6). For example, the United Kingdom lost nearly 20 per cent of its output in the June quarter, and New Zealand's GDP fell by more than 12 per cent.

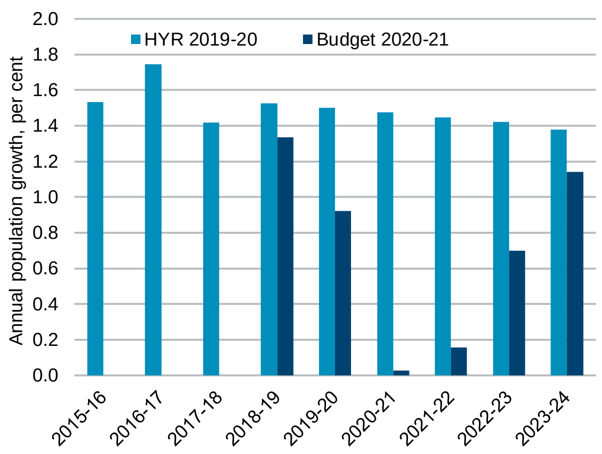
The International Monetary Fund (IMF) expects a V-shaped recovery for the global economy in the short term. Beyond 2021, growth will continue, but the pace will slow.

Chart 2.1: Economic impact of COVID-19 around Australia (June Qtr)



Source: ABS 5206.0 and NSW Treasury

Chart 2.2: Plunge in net overseas migration has slowed NSW population growth to a crawl



Source: ABS 3101.0 and NSW Treasury

For New South Wales, the re-opening of the economy is well underway. This is expected to deliver a short-term rebound in economic growth. The economic outlook hinges heavily on the timing of the removal of the remaining restrictions put in place to contain the virus, as well as public perceptions around the health risks. The lingering impacts from closed international borders and elevated rates of unemployment suggest a slower pace of recovery after the initial boost, rather than a rapid return to pre-COVID-19 levels of activity.

Based on current Commonwealth policy settings, it is assumed that closed international borders through to the end of 2021 will result in a permanent reduction in population.[1] This would permanently lower the expected productive capacity of the economy. The population effect alone means the economy is forecast to be more than 5 per cent smaller by the end of the projection period than was forecast at the 2019-20 Half-Yearly Review.

[1] This is consistent with the Commonwealth's technical assumption of no change to the current migration policy setting once borders reopen.

The recovery in the labour market will be gradual. Policy support measures in 2020, such as the JobKeeper wage subsidy, helped cushion the short-term impact of the pandemic. By extension their gradual removal is expected to see employment growth soften in coming months. From next year, employment growth is then expected to accelerate in line with an improvement in aggregate demand and eventual reopening of international borders.

The NSW unemployment rate is expected to peak close to 7½ per cent towards the end of 2020, before gradually declining. As with previous downturns, it will take more than four years to recover to pre-COVID-19 levels.

Government support will continue to play a key role in the economic recovery. Stimulus by the Commonwealth government, combined with the NSW Government's stimulus plan and a record capital program, will help generate jobs and accelerate the economy's recovery. They should help offset the impact of other measures being wound back over coming months.

NSW Government's stimulus and economic support measures are estimated to support around 27,000 jobs per year in the four years to 2023-24. Without the significant level of State Government assistance NSW Treasury estimates that the unemployment rate could have been as much as 1.0 percentage point higher in June 2021.

The outlook presented in this Budget is subject to a greater degree of uncertainty than normal. The economic recovery will likely encounter speedbumps along the way. For example, a renewed wave of global infections and the unwinding of key Commonwealth government support measures present risks to the near-term outlook.

Box 2.1 Health assumptions that underpin the economic outlook

The working assumption of NSW Treasury, in line with the Commonwealth Government's assumption, is that a vaccine for COVID-19 will start to roll out in NSW from around the middle of 2021, with 20 per cent of people vaccinated by the end of the September quarter. Vaccination rates are expected to build from there.

It is assumed that some social distancing restrictions will continue until a vaccine is widely available, noting the uncertainty around the timing and efficacy of the vaccine and the possible need to extend social distancing restrictions beyond this time.

The assumptions on Australia's international border restrictions underpinning the demographic/macroeconomic forecasts broadly align with those in the Commonwealth's recent Budget. This reflects the fact that policy levers around Australia's international borders and the rollout of a vaccine are largely held by the Commonwealth Government.

Australia's international borders are expected to re-open in the December quarter 2021, in line with the assumed timing of a widely available vaccine. A gradual return of international students and permanent migrants is assumed from 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.

Some inbound travel of New Zealand tourists to NSW without quarantine restrictions has resumed. It is assumed that NSW tourists will be permitted to travel to NZ from around the March quarter 2021.

All interstate border restrictions are expected to be removed by the end of 2020.

2.2 The pandemic had a significant initial impact on the economy

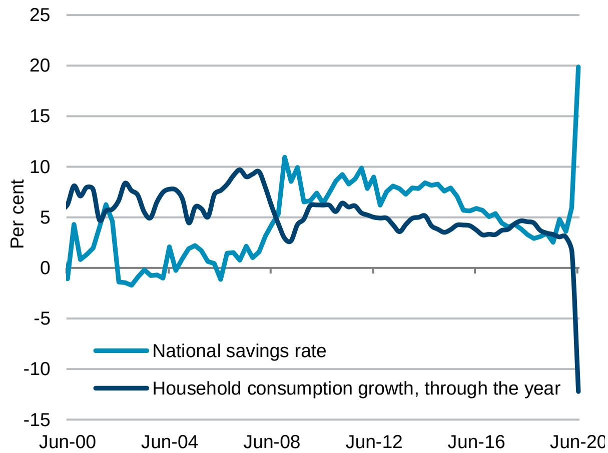
Consumer spending was hardest hit from the initial shutdown

Household spending has been impacted by a number of factors, including social distancing restrictions, changes to business operations, major job losses and volatile confidence. The result was a plunge in household consumption of more than 13 per cent in the June quarter. This contributed to around three-quarters of the decline in State Final Demand. That was despite the introduction of significant income support measures by the Commonwealth Government. The combined effect of lower consumption and increased government transfers to households saw the national household saving ratio jump to 19.8 per cent in the June quarter, the highest rate since June 1974 (Chart 2.3).

Consumer spending on discretionary goods and services has been hit especially hard. Spending on transport services (which includes domestic airline travel) fell by 84.2 per cent over the June quarter. Spending at hotels, cafes and restaurants dropped by almost 60 per cent. However, not all consumption has fallen during the pandemic. One side-effect of the lockdown had been increased spending on essential items such as food. Meanwhile, spending on furnishings and household equipment (including home office, entertainment, and renovation) increased, along with spending on household utilities as people spent more time at home.

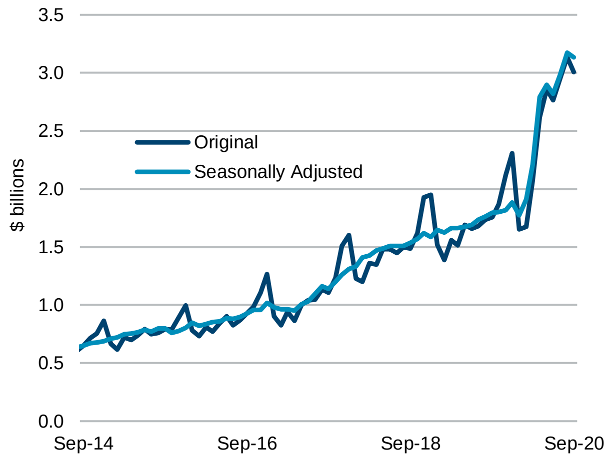
At the same time, there has been a notable shift toward more online shopping, including click-and-collect, with several retailers quickly adopting online sales channels. Total online sales remained elevated in September at 10.6 per cent of total sales in Australia. This is broadly in line with the peak seen in April 2020, when restrictions were in place across the whole country, and is significantly higher than the 6 per cent level seen in January.

Chart 2.3: Consumers have chosen to save during the pandemic



Source: ABS 5206.0 and NSW Treasury

Chart 2.4: Online spending accelerated as people were forced to stay at home



Source: ABS 8501.0 and NSW Treasury

Heavy disruption to business and the labour market

Business confidence plunged with the onset of COVID-19 and the introduction of containment measures, as over half of all Australian businesses reported reduced revenues since March 2020. Lacklustre demand throughout the economy led to a drop in firms' capacity utilisation rates from 82 per cent to 75 per cent, below the levels needed to generate widespread incentives to invest. Intended investment spending for 2020-21 has subsequently been revised down by almost 10 per cent. It is also likely that containment measures had a negative impact on productivity, at least initially. For example, health orders to work from home (where possible) may have caused disruption for some workers, particularly for those who were unprepared for such an arrangement and/or were required to care for children unable to attend school or childcare.

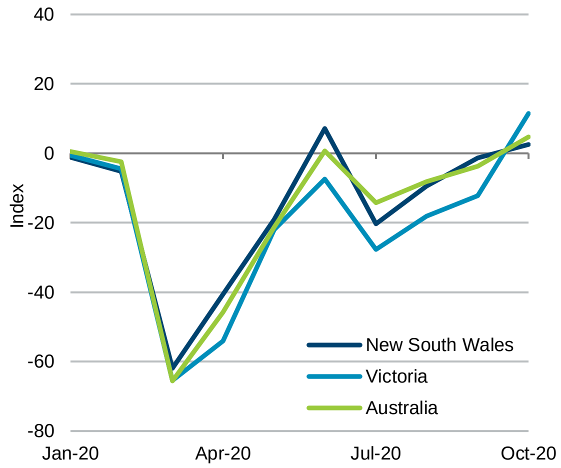
Fortunately, the easing of restrictions from late May has helped drive a rebound in business confidence in New South Wales (Chart 2.5). If sustained, this bodes well for an eventual rebound in investment as final demand improves.

The weakness in final demand weighed heavily on the NSW labour market. Around 270,000 workers lost their jobs in New South Wales during the peak of the virus containment phase in April and May. The unemployment rate subsequently jumped to 6.4 per cent in May. The result was tempered by the fact that most workers laid off in April and May temporarily left the labour market, driving the participation rate down to a more than 15 year low.

The outcome for the labour market was cushioned by the Commonwealth Government's *JobKeeper* program, which kept many workers employed or notionally attached to their employers. In April, 230,000 additional people reported being employed while working zero hours. Were it not for Government support measures and people dropping out of the labour market, the unemployment rate would have increased to 15.8 per cent in April. That is more than double the official unemployment rate.

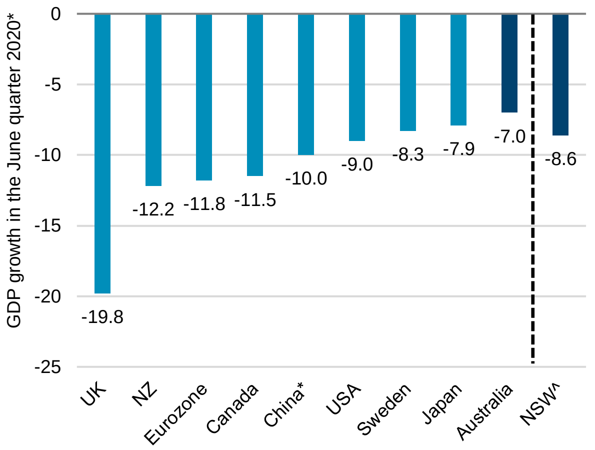
Labour market outcomes have been quite different for young workers, including the youth (aged 15 to 24 years) and those aged 25 to 29, compared to other age cohorts. Employment for 15-29 year olds remained 5.6 per cent below its pre-COVID-19 level in September (non-seasonally adjusted) compared to a decline of 0.2 per cent for all other age cohorts. Participation of this cohort in the labour market has also fallen by 39,000 (non-seasonally adjusted) since the pandemic started, whereas it has increased by 25,000 on net for all other age groups.

Chart 2.5: Business confidence stabilises



Source: NAB and NSW Treasury

Chart 2.6: GDP growth in selected countries



**China GDP is for the March quarter 2020*
^NSW State Final Demand is presented here. GSP is not available quarterly.
Source: Bloomberg and NSW Treasury

Australia has been a standout compared to many major global economies

The COVID-19 pandemic is having an immense impact on economies around the globe, many of which are experiencing the largest contraction in decades. In the first half of this year, economic activity contracted severely across the globe as most governments imposed restrictions to contain the virus.

The direct link between containment measures and economic activity, however, is complex (See Box 2.2). In the June quarter, the United States economy contracted by 9 per cent, with the unemployment rate hitting a peak of almost 15 per cent, more than double the rate seen in New South Wales. Meanwhile, the eurozone economy shrank by more than 15 per cent in the first half of 2020. The weakness in activity was even more stark for the United Kingdom, which contracted by 20 per cent in the June quarter alone, more than double the rate of decline in NSW State Final Demand (Chart 2.6). Reflecting this, for the first time in history, the IMF expects that both advanced economies as well as emerging markets and developing economies will shrink in 2020 in aggregate terms.

Box 2.2 How the response to COVID-19 has impacted economies around the world

COVID-19 related restrictions on activity expanded rapidly in New South Wales at the end of March, before peaking on 2 April, as stay at home orders were expanded across the country.

While strict and instrumental in the sharp economic contraction in the June quarter, the magnitude of containment measures was relatively 'mid-range' when compared to other advanced economies.

The stringency index, produced by Oxford University, is a standardised measure of the strictness of 'lockdown style' policies that primarily restrict people's behaviour (on a scale of 0-100). The containment measures in Australia early in the June quarter resulted in an average stringency index around 69.

However, international evidence on the correlation between containment measures and economic outcomes is not clear cut. Countries such as Japan and Sweden had a much more relaxed response to the pandemic, yet experienced a similar economic contraction to Australia in the June quarter—although each experienced very different rates of infection in the quarter. In contrast, South Korea imposed stricter measures than Sweden and Japan, but had much lower rates of infection and a smaller negative impact on the economy.

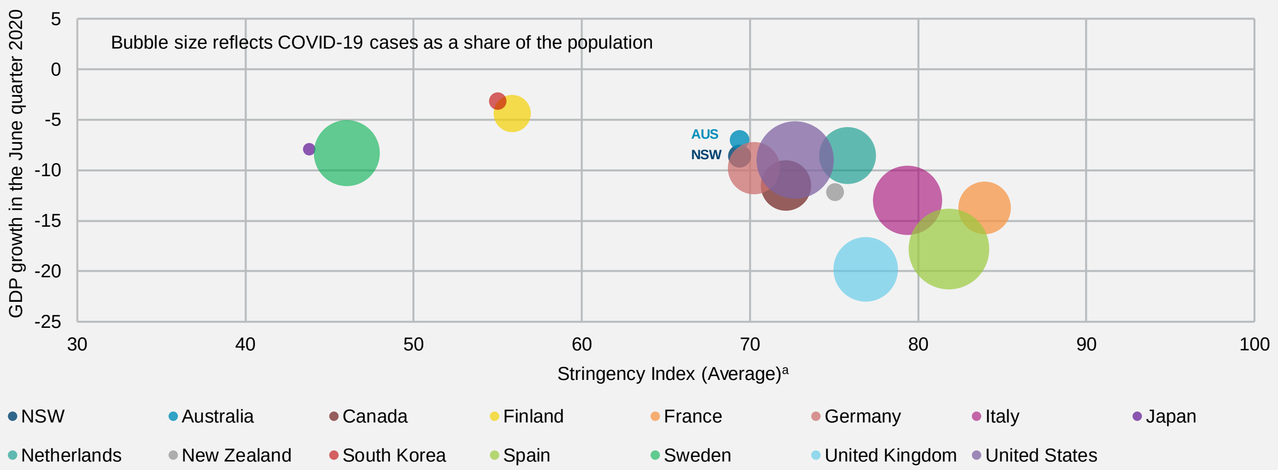
In other countries where infection rates were high, the negative correlation between containment measures and economic outcomes becomes more apparent.

Recent analysis by the IMF found that "the adoption of lockdowns was a significant factor in the recession, but voluntary social distancing in response to rising infections also contributed very substantially to the economic contraction." The IMF concluded that "although easing lockdowns can lead to a partial recovery, economic activity is likely to remain subdued until health risks abate."

This analysis indicates that containing the virus remains instrumental in maintaining an environment conducive to business success and jobs growth. Containment will provide the conditions for (i) minimal restrictions, and (ii) ensuring the population has the confidence to move and consume, to the full extent permitted.

The NSW Government has emerged as a global leader in response to the COVID-19 pandemic, in terms of positive health outcomes and achieving one of the lowest economic impacts in comparison to peers. NSW's capabilities in quarantine and tracing will remain key to re-opening the economy while protecting public health.

Chart 2.7: The correlation between containment and economic impact is mixed



(a) The stringency index is a standardised measure of the extent to which containment measures have been applied in each jurisdiction (most relaxed measures have an index = 0). The chart above uses an average index for April and May 2020. The Australian stringency index has been applied to NSW.

Source: OECD, Oxford University and NSW Treasury

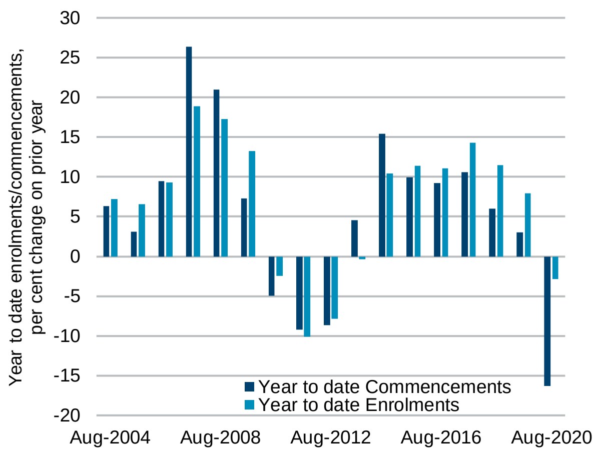
The easing of COVID-19 restrictions in several countries has triggered a partial rebound in economic activity. Business surveys of purchasing managers suggest a continued strong rebound in global manufacturing activity through the September quarter. The rebound in activity outside manufacturing, however, has subsequently softened in many countries, particularly Europe, reflecting a second wave of infections and subsequent renewed restrictions.

Border restrictions will determine the recovery in services exports

Services exports have been hit hard as international border closures limit the number of students, tourists and other travellers arriving in Australia. The recovery in services exports will hinge on the re-opening of international borders, which is set to be one of the final restrictions lifted by the Commonwealth Government (see Box 2.1 on COVID-19 assumptions).

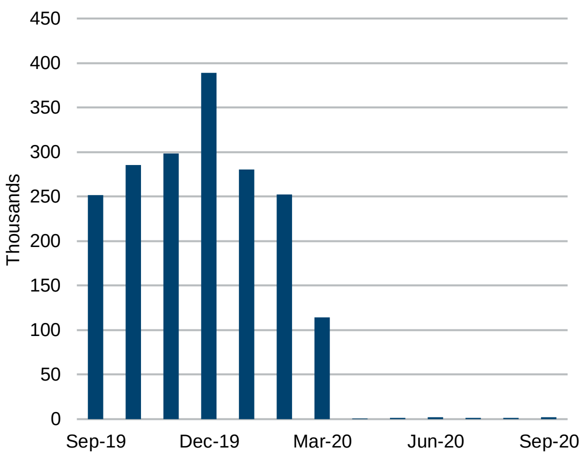
International education is the single largest services export for New South Wales, adding $13.9 billion to the NSW economy in 2018-19. While there are still a considerable number of international students studying in New South Wales, the future pipeline of students is shrinking. International student commencements in New South Wales have fallen 16.7 per cent in the first eight months of 2020 compared to the same period in 2019, the largest fall observed in the 18-year history of the data. The majority of spending by international students is on goods and services in the economy, rather than fees. Thus, the sharp drop in international students creates flow-on effects to other sectors of the economy, including demand for dwelling and accommodation services.

Chart 2.8: International students in NSW



Source: Department of Education and NSW Treasury

Chart 2.9: Number of monthly overseas arrivals in NSW



Source: ABS 3401.0 and NSW Treasury

International tourism exports are the state's second largest services exports, adding $7.7 billion to the NSW economy in 2018-19. This is expected to drop to a historical low in 2020-21 amid international border closures. The number of tourist arrivals to NSW has effectively fallen to zero (Chart 2.9). A gradual recovery is expected with the initial opening of a trans-Tasman bubble with New Zealand and, later, a lifting of international border restrictions more broadly. Re-opening of borders is likely to at least partly depend on the health outcomes of other countries, as well as the arrival and implementation of a vaccine. Nevertheless, it may take several years for tourism exports to return to their pre-COVID-19 levels. The International Air Transport Association expects global air travel will not return to pre-COVID-19 levels until 2024.

2.3 The Government's strategy for navigating out of the pandemic

The removal of containment measures is allowing firms to get back to business

The containment of health risks has allowed for a successful re-opening of the economy. During the peak of restrictions in April, indicators of peoples' movements, or mobility, more than halved compared to pre-COVID-19 levels. Public transport patronage, based on the number of Opal trips taken in New South Wales, slumped by 75-80 per cent. Similarly, Google Maps data showed that travel to workplaces dropped by 82 per cent as many workers began working from home, while travel to retail and recreation venues (such as restaurants, shopping centres and cinemas) was 72 per cent below normal levels.

As restrictions were relaxed, mobility data for June and July revealed that individuals had started to travel again for a range of purposes, albeit below normal levels.

The success in bringing COVID-19 under control clearly has buoyed confidence in New South Wales. The Westpac-Melbourne Institute consumer confidence index in NSW has surged over 40 per cent since the trough seen in April. This in turn has improved the outlook for businesses. Fewer businesses reported a decrease in revenue in October (31 per cent), compared to July (47 per cent). Additionally, the proportion of businesses that expected to see a decline in the number of employees in October (7 per cent) was much lower compared to July (13 per cent).

The successful re-opening of the economy has helped many businesses re-open their doors, allowing people to return to work and driving increased optimism in the labour market. New South Wales has regained 65 per cent (174,000) of the employment previously lost at the height of the pandemic. Together with the reintroduction of mutual obligation requirements for Commonwealth income support, this has seen a return of those workers who left the labour market during the shutdown, with the participation rate rebounding to above pre-COVID-19 levels (at 65.4 per cent in September). The higher participation rate has caused the unemployment rate to rise above 7 per cent in recent months, more than 2 percentage points higher than the pre-COVID-19 level, despite the strong rebound in employment.

Successful management of the public health risks has supported the safe re-opening of the economy and will continue to be a key factor in maintaining and improving business and consumer confidence and spending.

Providing near-term support through the worst of the impacts

A coordinated effort at both the State and Commonwealth levels of government to support the economy has been instrumental in smoothing the severity of the downturn.

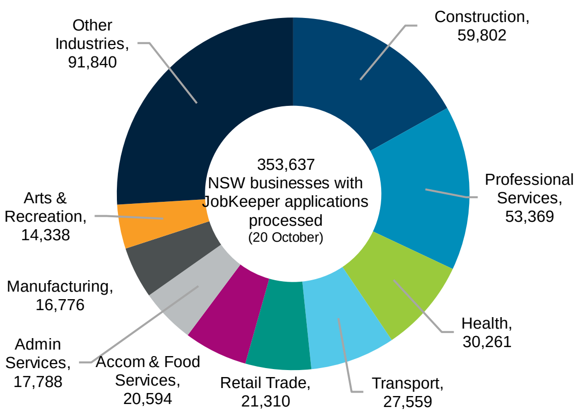
Commonwealth support has been principally delivered through the JobSeeker and JobKeeper programs, which have provided direct income support to households and businesses. These programs have been critical in keeping people connected to their workplace. They have supported broader confidence in the economy and buoyed consumption throughout the crisis.

Around 354,000 NSW businesses have had applications for JobKeeper processed as of 20 October. More than 1 million individuals were estimated to be receiving the JobKeeper payment, representing a quarter of all employed people in New South Wales. The number of businesses in New South Wales receiving JobKeeper has remained relatively steady throughout the pandemic.

The construction industry represents the largest share, at 16.9 per cent, of all businesses in New South Wales on the JobKeeper scheme. This is followed by businesses in professional services (15.1 per cent) and health (8.6 per cent).

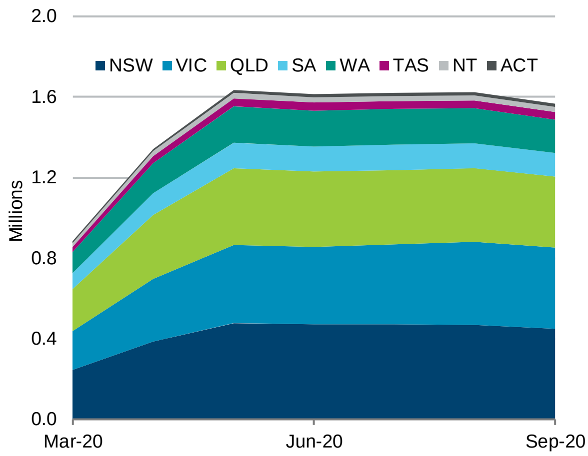
In September, there were almost 450,000 individuals living in New South Wales receiving JobSeeker income support. This represents around 28.7 per cent of all recipients across the country (Chart 2.11). This is slightly lower than was the case back in May. While significant, this is lower than New South Wales' share of the national working age population.

Chart 2.10: NSW businesses on JobKeeper



Source: Commonwealth Treasury

Chart 2.11: Individuals on JobSeeker



Source: Commonwealth Treasury

Looking ahead, the unwinding of these measures presents a key risk to the outlook. Spending from those on JobSeeker and JobKeeper will likely have fallen since September when payment rates were reduced. A further easing of spending from those receiving support from these policies is expected as these JobSeeker payments are scheduled to revert back to pre-COVID-19 levels and the JobKeeper scheme winds up. Notably, payrolls data show a drop in employee jobs and a fall in wages in the immediate aftermath of the tapering of JobKeeper payments at the end of September.

To manage this risk and assist the transition away from emergency support measures, governments have accelerated other measures to bolster demand within the economy. Personal income tax cuts have been brought forward by the Commonwealth Government to support household disposable income. NSW residents are expected to receive around $5.7 billion in income tax relief over the next two years, with almost half expected to flow onto additional consumption. Increased spending in turn is expected to improve business confidence and encourage firms to create more jobs and invest.

To complement these measures, and provide necessary additional near-term support to the economy, the NSW Government has provided additional stimulus worth almost $29 billion (including spending in the 2019-20 fiscal year).

The focus of these measures is to provide timely and temporary support to the economy at a time when private demand remains relatively weak. Combined, these measures are expected to have a significant impact on the labour market, supporting an average of 27,000 jobs per annum over the next four years, with particular focus in the next 12-18 months. This is expected to assist a reduction in the unemployment rate, with NSW Treasury estimating that the unemployment rate could have been as much as 1.0 percentage point higher in June 2021 in the absence of NSW stimulus measures.

This is in addition to the NSW Government's record infrastructure pipeline and ambitious reform agenda to drive future economic growth, which in addition to providing support to activity is also serving to lift the long run productive capacity of the economy (see Section 2.5 for details on the role of reform in the economic recovery).

Combined, these measures will assist the recovery in the labour market, which is projected to result in a 270,000 increase in employment by 2024. This is forecast to contribute to a decline in the unemployment rate to 5¼ per cent by June 2024.

Encouraging business to drive the long-run recovery

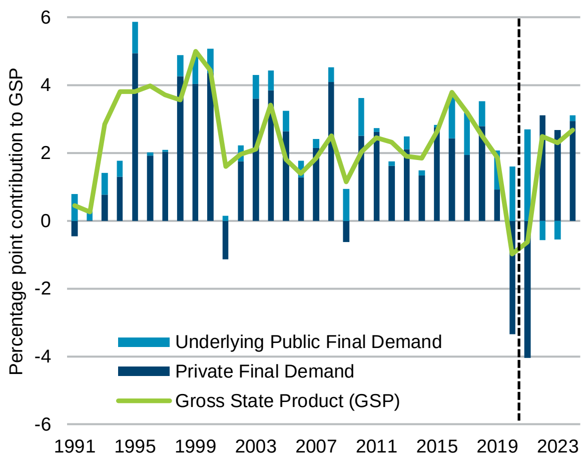
Both the Commonwealth and the NSW Government have shifted from emergency response to propelling a swift recovery, putting in place policies to support business and encourage them to employ and invest. This in turn will support jobs and households. Businesses will benefit from reduced red tape, faster planning approvals, reforms to credit, insolvency and labour laws, subsidised training, improvements in labour mobility, loss carry back provisions and full asset write-offs. Business investment will be critical to productivity growth, which will in turn fuel the economic growth needed to fully recover from the pandemic and reduce the burden from higher debt.

Equipment investment typically ebbs and flows in line with quarterly economic growth. The rebound in household demand is thus expected to support a recovery in equipment investment from early 2021. The recovery will be bolstered by the Commonwealth Government's full asset write-off incentive and support for the manufacturing sector.

On the other hand, construction-related investment lags the business cycle, as the pre-existing pipeline of projects allows work to continue. Once this pipeline becomes depleted, activity can slump for a prolonged period, long after other sectors have recovered. Without support from the public sector this would create a long and deep drag on employment, given that construction is one of the State's largest sources of employment and has a large spill over effect on other industries. Additionally, the pandemic may shift the composition of construction investment and activity, stemming from changes in the way we shop, work and do business. These changes may have implications for demand for offices, short-term accommodation and retail space, all of which had been reasonably robust in recent years.

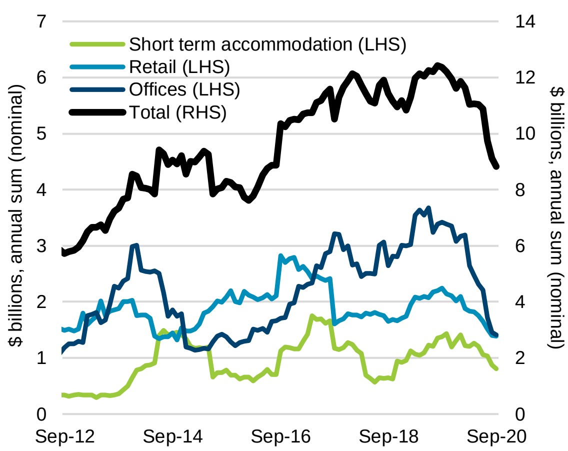
Commonwealth and state governments have mobilised to fill the gaps left by private industry through increased public investment, including the NSW Government's record $107.1 billion infrastructure pipeline. Supporting the construction sector — through direct expenditure and improvements in the planning system—while private investment gradually returns is key to the NSW Government's stimulus and recovery strategy.

Chart 2.12: Public demand stepped in as private demand weakened



Source: ABS 5220.0 and NSW Treasury

Chart 2.13:NSW non-residential building approvals plummet



Source: ABS 8731.0 and NSW Treasury

2.4 The economy still faces major challenges to the outlook

New outbreaks could threaten the global economic recovery

As is the case in New South Wales, easing restrictions has seen the beginning of a recovery in many other economies. The IMF revised up its expectation for growth in the global economy in its October World Economic Outlook. The IMF expects a 4.4 per cent rate of contraction in 2020 (a 0.8 percentage point smaller decline as compared to the June report) largely due to better than expected results in the first half of 2020. The upward revision was most evident in major advanced economies, but growth in NSW's major trading partners, including China, was revised only modestly higher. India saw a heavy downward revision—India's economy now is expected to contract by 10.3 per cent in 2020.

Global growth is forecast to be 5.2 per cent in 2021 as economies reopen, although this is modestly weaker than what the IMF expected in June. The IMF notes that there would have been a stronger upward revision if not for the persistent social distancing and stalled re-opening in the second half of the year as infections re-accelerated across the northern hemisphere.

Beyond 2021, the global recovery is likely to be drawn out, with the economy making slow progress towards catching up to the path of activity expected before the onset of the pandemic. This is most stark for advanced economies, where the IMF is forecasting growth in GDP per capita between 2019-2025 to be only half the rate expected pre-COVID-19.

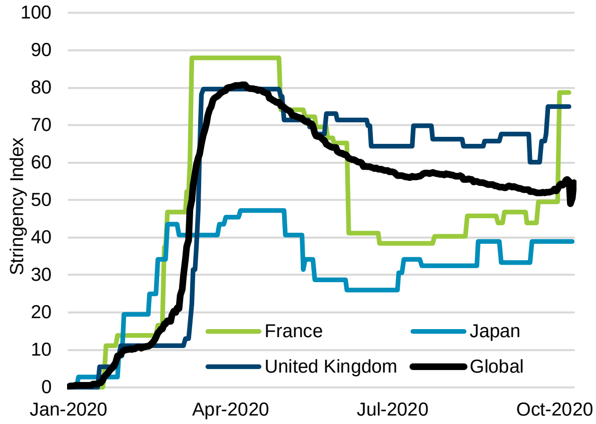
The outlook is subject to a greater degree of uncertainty than normal, especially as new outbreaks in COVID-19 infections throughout Western Europe have prompted many countries to delay the removal of, or even reinstate, some containment measures (Chart 2.14).

Several countries have re-introduced a raft of measures in an effort to stop the spread of the virus. These include curfews, reduced caps at weddings, and strict limits or bans for gatherings of people indoors (outside of work or education). Workers, meanwhile, are being encouraged to work from home where possible throughout the European winter.

A second round of infections is likely to have negative impacts on economic activity, irrespective of government restrictions. This is due to increased voluntary social distancing associated with health risks. IMF analysis shows that in the first seven months of the pandemic, the impacts of voluntary social distancing and government-imposed lockdowns were comparable. Ultimately the impact on economic activity will depend on health risks from the virus.

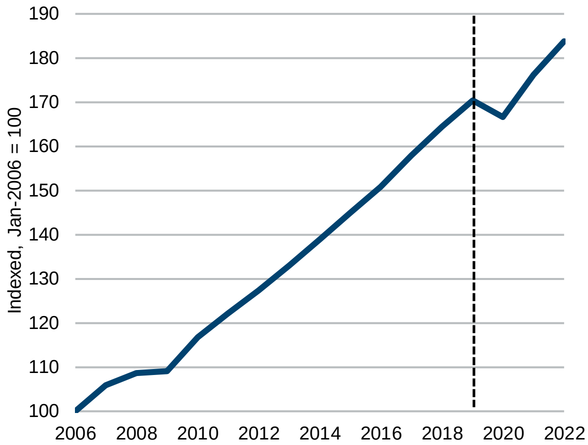
After a sharp contraction in GDP of NSW's major trading partners in the first half of 2020, a recovery is expected to be underway from the September quarter. GDP growth is expected to be negative in 2020, followed by a rebound in 2021.

Chart 2.14: The pace of easing containment measures has slowed



Source: Oxford University and NSW Treasury

Chart 2.15: Major trading partner GDP outlook



Source: IMF and NSW Treasury

Lower population growth will continue to weigh on the construction industry

International border closures have implications beyond the direct disruption to overseas students and tourists. A positive for regional areas and some other retailers has been the influence on domestic spending patterns as savings from international holidays are partly redirected into regional travel and other household expenditure. However, sectors which are more exposed to tourism flows such as accommodation and food services and transport services, are still performing well below pre-pandemic levels.

The closure of the international border is also reducing the level of net international migration to New South Wales, which weighs on the outlook for dwelling investment and household consumption. Net international migration to New South Wales is now expected to be negative in both 2020-21 and 2021-22, while the fertility rate is also expected to be lower. NSW's population in June 2024 has been revised down by 376,000 since the 2019-20 Half-Yearly Review.

The reduction in population growth is a drag on housing demand and, therefore, is a headwind to the outlook for dwelling investment. Dwelling investment in New South Wales has now already declined for eight consecutive quarters since reaching a record high in mid-2018. A high level of new dwelling completions combined with rapidly diminishing population growth, reductions to income and jobs due to COVID-19 and a shift of short-term rentals into the long-term market are all placing upward pressure on the rental vacancy rate in Sydney. As a result, rents in Sydney are falling, and Sydney dwelling prices have shown moderate falls since the start of the pandemic. While low interest rates and government stimulus measures will provide some support, dwelling investment is expected to be weak over the forecast period.

Box 2.3 Population policy is critical to the outlook

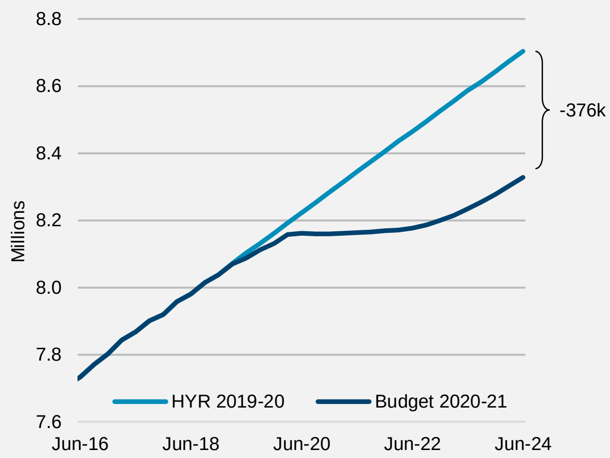
Re-opening international borders will be a critical step towards achieving a full economic recovery from COVID-19. Decisions around the timing of re-opening and the subsequent migration policy—both levers controlled by the Commonwealth government—has the potential to signficantly affect a successful recovery.

The Commonwealth Budget in October indicated that almost no population growth was expected for the next two years, largely due to weak net overseas migration (NOM). A net outflow of migration is expected for the first time since 1946, with no catch-up in subsequent years, leaving the level of population permanently lower than expected prior to the pandemic.

Based on current Commonwealth policy settings and assumptions, this will reduce NSW population in 2023-24 by around 376,000 people compared to projections at the 2019-20 Half Yearly Review (Chart 2.16).

Closed borders are the most significant remaining health restriction in place, in terms of the impact on population growth and flow-on effects for GSP over the forecast period.

Chart 2.16: NSW population revisions

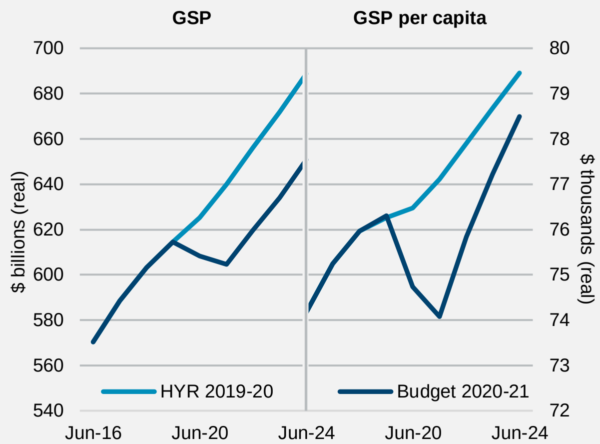


Source: ABS 3101.0 and NSW Treasury

The decline in population growth (other things being equal) is expected to reduce the level of GSP in NSW by around 5 per cent by 2023-24 (or almost $34 billion).

This population effect is a major reason why, despite a strong recovery in per-capita GSP, the overall economy is not expected to fully recover to its pre-COVID-19 trajectory over the forward period (Chart 2.17).

Chart 2.17: GSP & GSP per capita revisions



Source: ABS 5220.0 and NSW Treasury

Migration has a direct impact on the supply of labour and, by extension, the productive capacity of the economy. In the nine months to November 2019, around 50 per cent of migrants arriving in Australia gained employment, many of whom filled critical skill shortages within New South Wales.

The impact on GSP is not set in stone, and will hinge on border and migration policy decisions by the Commonwealth in coming years. As a downside risk, any delay in the rollout of a vaccine and re-opening of international borders will result in an even larger negative impact on GSP (see Appendix F). In contrast, progress towards developing safe ways to allow for a higher level of migration intake in the future would support stronger growth in the economy.

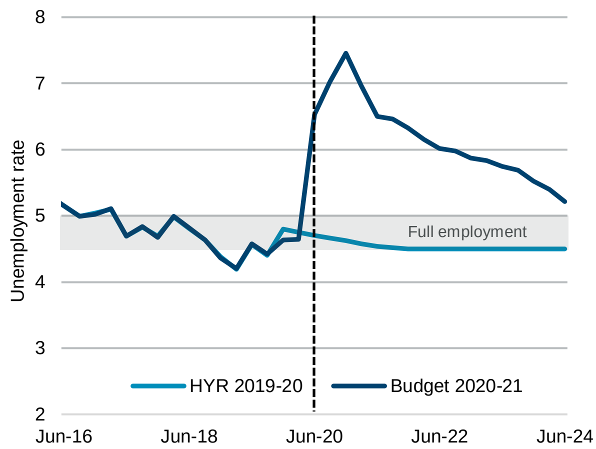
The labour market gradually moving back towards full employment

The outlook for employment growth depends on a range of factors which, on balance, suggest a slow recovery in the near-term, followed by an acceleration in growth from next year as demand recovers. Jobs will continue to be supported by further easing of domestic restrictions in the near-term. Recently announced Commonwealth measures including the hiring credit and incentives to boost apprenticeships are supportive. By contrast, the winding down of the JobKeeper scheme, closed international borders and weak population growth will remain a headwind. Overall, employment is expected to fall 1 per cent in 2020-21, before recovering 1¼ per cent in 2021-22 in line with the recovery in aggregate demand.

The unemployment rate is expected to peak at 7½ per cent by the end of 2020, before falling thereafter as demand picks up. As with previous recessions, it will take quite some time to reverse all of the increase in the unemployment rate seen during COVID-19. The unemployment rate is forecast to ease to 5¼ per cent by June quarter 2024.

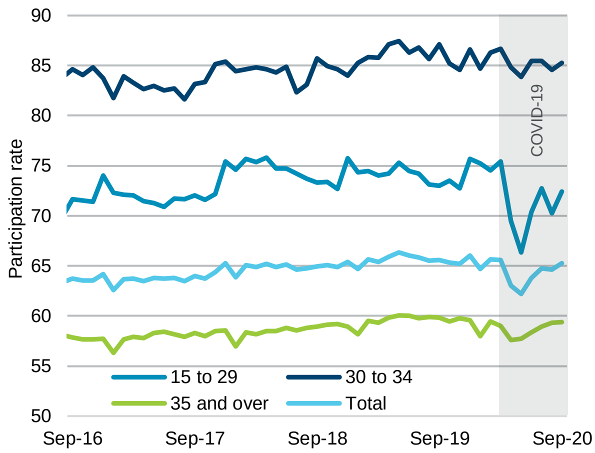
Wages growth in New South Wales eased sharply to 1.8 per cent through the year to the June quarter 2020. Given the weakness in the labour market, private sector wages growth is expected to ease through the course of 2020-21, before gradually picking up as the labour market strengthens. Growth in NSW public sector wages will also be lower than in previous years, reflecting the NSW Industrial Relations Commission recent decision to grant a 0.3 per cent increase for many NSW public sector employees in 2020-21. Scheduled annual increases of 0.5 per cent in the superannuation guarantee starting from 1 July 2021 are also expected to detract from wages growth.

Chart 2.18: NSW unemployment rate to improve gradually



Source: ABS 6202.0 and NSW Treasury

Chart 2.19: Participation rate by age-cohort - NSW



Source: ABS 6291.0 and NSW Treasury

Spare capacity in the economy will keep inflation subdued

The near-term outlook for inflation is dominated by three factors: the Commonwealth Government's policy to provide free childcare; a gradual recovery in global oil prices, following a sharp fall earlier in the year; and material weakness in the housing sector, particularly rents. These factors combined to push annual headline inflation into negative territory for the first time since 1997—Sydney headline CPI fell 1.0 per cent over the year to the June quarter 2020.

Moving forward, the unwinding of these short-term effects and continued removal of COVID-19 restrictions over the next couple of months should produce a rebound in consumer prices which will see a temporary spike in June 2021 up to 3 per cent. This forecast is also predicated on oil prices rebounding moderately from current levels and the waiver of childcare fees in Victoria not extending much beyond the end of this year.

Further out, several factors will work to constrain consumer price growth over the medium term including limited wage and rental price growth, excess global industrial capacity, the easing of drought conditions and a gradual appreciation of the Australian dollar.

2.5 Reform will be crucial in sustaining our long-term recovery

Swift and unprecedented government action has mitigated the worst of the immediate economic and health impacts from COVID-19 in New South Wales. While fiscal stimulus will be needed to support the economy in the short-term, it will be most effective when combined with productivity reforms. Such reforms can support the economy through its post-COVID-19 adjustment, and underpin economic growth over the medium-term, as stimulus is gradually withdrawn.

Productivity reform is the most powerful tool we have for supporting sustained economic growth and drive improvements in living standards. With COVID-19 impacting other major drivers of economic growth, boosting the State's productive capacity has never been more urgent and relevant.

Productivity reforms can improve the speed and efficiency of adaption to new conditions. They also can encourage businesses to be more innovative and competitive, and make it easier to develop or adopt new technologies. Productivity growth enables higher wages for workers and supports revenue growth to fund essential services and minimise public debt. Importantly, in a post-crisis environment, reform can be a powerful tool to boost business investment, support investor confidence and encourage a business-led recovery.

One of the key lessons of the response to the Global Financial Crisis is that reform delayed is reform denied. Economic stimulus was not backed up with longer-lasting productivity reforms. The result has been mediocre productivity growth over the past decade, placing government budgets under pressure and constraining real income growth.

Recognising the need to lay the foundations of a strong economic recovery, the NSW Government has introduced a suite of productivity reforms in this Budget. Many of these are drawn from the NSW Productivity Commission's recent *Green Paper* and are designed to:

- support individuals and businesses to rapidly adapt to the new environment
- make it easier to do business by removing hurdles to investment and innovation, and
- leverage the opportunities from COVID-19 and adopt new technologies.

Supporting individuals and businesses to rapidly adapt

As the structure of the post-COVID-19 economy takes a more definite shape, it is important that labour and capital are free to move to where they are needed most. COVID-19 has impacted heavily on the female-dominated hospitality, retail and tourism industries and many women will see the transition into a secure new job, such as trade, as a good option.

The NSW Productivity Commission has, however, highlighted chronic skills shortages and gender imbalance in the trades. Most trades workers are men, particularly in areas with serious skills shortages (e.g. construction, refrigeration, automotive and electrotechnology, where men comprise around 98 per cent of workers). Trades training is currently limited to apprenticeships and is not being delivered in flexible ways suitable for women or mature workers.

To address these structural problems, the NSW Government has allocated an additional $57.4 million over four years to establish a Trades Skills Pathways Centre that will:

- initially focus on the construction industry to tap into the potential of experienced workers who lack a qualification
- develop new and flexible training pathways for 'non-traditional' groups such as women and mature-aged workers to enter trades, and
- establish accelerated pathways into trades qualifications that are suitable for experienced workers.

Together with the Commonwealth, New South Wales is also leading work on a new national automatic mutual recognition scheme, enabling occupational licensees to be recognised in other jurisdictions without having to apply, or pay fees. Licence holders will be able to undertake the activities they are licensed for in their home jurisdiction, and regulators will be able to take any necessary enforcement action under local laws. This will reduce costs and promote the free flow of labour between jurisdictions. In this Budget, the NSW Government is providing $10 million to support implementation and administration of the new scheme, which is expected to start in mid-2021.

In addition, to help small businesses start or pivot their business model with the changing needs of the economy, the NSW Government has committed an additional $39.3 million over four years to Business Connect.

Making it easier to do business and innovate

Business investment will be critical to a sustainable recovery. The NSW Government is supporting businesses affected by COVID-19 to adapt, innovate, and invest in new activities.

The NSW Government's targeted relaxation of trading hours and other regulations at the height of the pandemic has helped businesses pivot to alternative models and encouraged the uptake of new technology. The Treasurer will lead a whole-of-government evaluation of the costs and benefits of retaining some of these temporary changes to promote a stronger recovery.

The Government is also proactively reviewing regulations with the aim of giving businesses more room to innovate, including more freedom to adopt new technologies, while still ensuring compliance with safety and other important standards. The Government is exploring wide-ranging reforms to how we regulate across all sectors, including reforms recommended by the NSW Productivity *Green Paper,* such as:

- delivering greater competition in the e-conveyancing market by leading the development of a national interoperability framework, and
- improving the operation of competition policy and introducing regulatory reforms in areas identified by the NSW Productivity Commission such as drones, micro-mobility devices, retail trade and agriculture.

The planning system has an important role to play by supporting the private sector to invest in job-creating construction projects that will grow the economy as we rebuild. The NSW Productivity Commissioner's *Green Paper* has identified scope to improve the planning system by reducing delays in processing and approvals. To do this, the 2020-21 Budget allocates $258.5 million of new funding over four years to deliver the NSW Planning Reform Action Plan, which includes:

- making planning processes more efficient to reduce assessment times
- simplifying the system to accommodate new business models and changing needs
- improving the interface between industry and the Government with a 'one stop shop'
- investing in ePlanning to bring council processes into the twenty-first century, and
- developing an integrated digital tool to transform the way stakeholders interact with the infrastructure contributions system ($14.8 million).

This is in addition to reforms to the infrastructure contributions system arising from the NSW Productivity Commission review currently underway.

These reforms will increase NSW businesses and citizens' capacity to: adapt to the new economic conditions, be more innovative and competitive, and develop or adopt new technologies. Doing so will drive productivity growth, support the economy, help balance budgets, lift wages and improve living standards for the people of New South Wales.

2.6 Key risks to the outlook

In addition to the greater than usual uncertainty around the forecasts, there are several key risks that, if realised, could significantly affect the outlook. There are risks both to the upside and downside, although in the current environment the downside risks tend to be the most apparent.

Critical to the recovery will be the development of an effective vaccine. Expedited development and distribution of a vaccine could lead to a faster recovery in trade-exposed sectors such as education and tourism and a quicker than expected removal of remaining social distancing restrictions. This would see higher consumer spending and lower unemployment than expected. Conversely, an effective vaccine may never eventuate, or could be delayed, impacting service export industries for far longer than currently envisaged.

On the downside, re-opening the economy could contribute to a spike in infections, which would either heavily impact people’s willingness to leave home, or trigger a re-tightening of containment measures. Either of these outcomes would have a substantial negative impact on the economy and the labour market. The longer containment measures persist, the more enduring the impact on incomes and structural rates of unemployment.

There also is a high level of uncertainty about what will happen once temporary fiscal support, including JobKeeper, are scaled back from the December quarter (with JobKeeper slated to end after March 2021). Recently announced stimulus measures are helping to mitigate this risk. Cash flow enhancing measures, debt repayment holidays and insolvency relief have masked much of the business failure and mortgage default risk that overshadows the economy, with current levels of insolvencies only around half their usual level. Available data suggests that $179 billion in loans nationally (6.7 per cent of loans), including $133 billion in mortgages, have received a repayment deferral. These policies are buying time for the economy to recover, allowing households and businesses that otherwise would have remained viable (if not for COVID-19) to repair their balance sheets.

Geopolitical tensions with China materialising in the form of substantial restrictions on NSW exports is another tail risk. China already has placed a travel warning on Australia. If this travel warning is still in place after the international borders open to Chinese students and tourists, there will likely be a noticeable impact on services exports and population growth. There have also been reports that China will impose restrictions on the import of certain Australian goods such as coal, timber, copper ore and concentrates, barley, sugar, lobster and wine. Any further escalation in such restrictions could have a material impact on NSW exports.

Migration to Australia could be permanently higher or lower than expected. This could be demand driven (demand from migrants coming to Australia) or policy driven (changes in Commonwealth Government immigration policy). Population growth has been an important driver of the construction industry and consumer demand over the last few decades. A protracted downturn in construction activity is already expected given the dramatic decline in migration. A further decline in population growth would extend this downturn, while an earlier or larger increase in population growth would support a sooner than expected recovery in construction activity.