Ai GROUP SUBMISSION

Fair Work Commission

Annual Wage Review 2019-2020

Submission on National Accounts data for the March quarter

5 June 2020

About Australian Industry Group

The Australian Industry Group (Ai Group) is a peak national employer association representing and connecting thousands of businesses in a variety of industries and sectors across Australia. Our membership and affiliates include private sector employers large and small from more than 60,000 businesses employing over 1 million staff. Ai Group promotes industry development, jobs growth and stronger Australian communities. Our members have a common interest in creating more competitive businesses and a stronger economic environment. We provide advice, services, networks and advocacy to help members and industries thrive, and the community to prosper.

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1. Introduction

On 16 March 2020, the Australian Industry Group (**Ai Group**) filed its main submission in the *Annual Wage Review 2019-20*, on 4 May we filed a Reply Submission and answers to Questions on Notice, and on 29 May we filed a Supplementary Submission and answers to Supplementary Questions on Notice.

Our 29 May submission sets out Ai Group's position on the quantum of any minimum wage increase in this year's Annual Wage Review, i.e.:

- The Expert Panel should not award a minimum wage increase in this year's Review;
- If, despite Ai Group's submissions, the Expert Panel decides to award a minimum wage increase, the increase should not be operative before 1 January 2021; and
- Given the widespread negative impacts of the Pandemic on businesses in all industry sectors, it is not appropriate for the Expert Panel to award a different level of increase to businesses that are, or are not, eligible for the JobKeeper Scheme, or businesses in different sectors.

This submission deals with the National Accounts data for the March quarter and other data or research published after 29 May.

The deterioration in economic conditions evident in the March quarter, while only hinting at the full extent of the current crisis, reinforces the arguments previously made that the economy is in no position to sustain an increase in minimum wage rates.

Additional material provided by the Australian Bureau of Statistics (ABS) in the 3 June 2020 release is also relevant to the Panel's considerations. The Federal Government's injection of financial support for low-income households is currently providing a significant boost to household incomes. This income support is targeted to low income households including many such households whose members include low-paid workers.

2. March quarter National Accounts data

The ABS released the March quarter National Accounts on 3 June. As widely expected, the economy contracted during the first three months of 2020. GDP fell by 0.3% dragging down the annual rate of GDP growth for the year ended 30 March to 1.4%. This was the first quarterly fall in real GDP since the QLD floods and cyclones in 2011 and the slowest annual growth since the GFC (see chart 1).

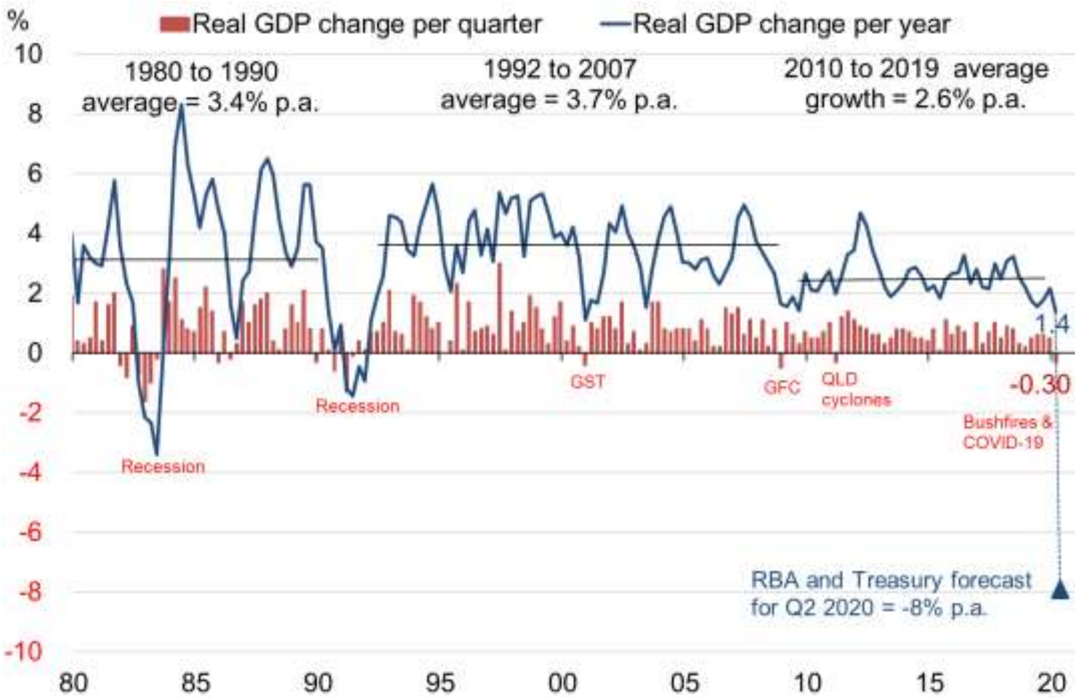
In releasing the National Accounts data, the ABS noted that several factors had contributed to the fall in activity including bushfires, other natural disasters and the outbreak of COVID-19. The ABS further noted that "[t]his was the slowest through-the-year growth since September 2009 when Australia was in the midst of the Global Financial Crisis and captures just the beginning of the expected economic effects of COVID-19."

While GDP data is always released with a lag, with conditions changing so rapidly at the moment and with all signs pointing to a much more precipitous deterioration in recent months, the sense of looking in the rear-view mirror is particularly acute with the latest data release.

The RBA and Treasury expect the largest impacts from COVID-19 to be evident in Q2, when GDP is expected to fall by 8% p.a., with further smaller falls expected in Q3 and Q4 of 2020. If this shrinkage in Q2 eventuates, it will be more than twice the size of the peak quarters of shrinkage in either the 1980s or 1990s recessions in Australia (chart 1). The unemployment rate is expected to peak at 10%.

The fall in gross value added in the market sector – a fall of 0.6% in the March quarter - was double the pace of decline of GDP. The year-on-year change in market sector gross value added was a paltry 0.3% - one fourth the size of GDP growth. Thus, even though the headline March quarter GDP outcome was poor, it was strongly supported by positive changes in public sector contributions to GDP which are insulated from market conditions to a much greater extent.

Chart 1: Australian GDP real annual growth*, 1980 to 2020



* chain volume measures. seasonally adjusted and inflation adjusted. Source: ABS, *National Accounts,* Mar 2020.

The composition of national expenditure in Q1 (see table 1) confirms substantial falls in private sector expenditure by households (household consumption -1.1% q/q/ and -0.3% p.a. and dwelling investment -1.7%q/q and -9.7% p.a.) and businesses (total business investment – 0.4% q/q and -2.9% p.a.) in Q1.

Even with the panic buying of some items, household consumption expenditure fell sharply in the opening months of 2020 as consumers reacted to the emerging circumstances with well-founded caution and as consumption possibilities shrank as social distancing and other restrictions began to be put in place.

In total, the ABS estimates that "*private demand detracted 0.8 percentage points from GDP, driven primarily by a 1.1% fall in household final consumption expenditure. Spending on services fell significantly, particularly where restrictions impacted most severely, such as air transport services, hotels, cafes and restaurants, recreation and culture. Spending on goods rose, most notably in food and pharmaceuticals, as households prepared for the introduction of restrictions".*

The *National Accounts* indicate that increased household income in Q1 (due to a 6.2% q/q increase in social assistance benefits including bushfire and COVID-19 support payments) was mostly saved (or used to reduce debt) rather than spent, with the household savings ratio rising to 5.5% of total aggregate household income in Q1.

Table 1: Composition of GDP: expenditure, trade and income, Q1 2020

seasonally adjusted	% change q/q	% change p.a.	Contribution to growth in the quarter, ppts
Real GDP	-0.3	1.4	**-0.3**
National expenditure			
Household consumption	-1.1	-0.2	-0.6
General government consumption	1.8	6.2	0.3
Total investment	-0.8	-2.4	-0.2
Dwelling investment	-1.7	-9.7	-0.1
Private Business investment	-0.4	-2.9	0.0
New building	-2.3	-4.4	-0.1
New engineering construction	1.7	-6.3	0.0
New machinery and equipment	-1.9	-3.3	-0.1
Intellectual property investment	-0.1	6.2	0.0
Public (government) investment	-0.7	2.1	0.0
Domestic final demand	**-0.5**	**0.5**	**-0.5**
Change in inventories	12885.7	-443.0	-0.2
International Trade			
Exports (volumes)	-3.5	-2.0	-0.8
Imports (volumes)	-6.2	-7.7	1.3
Net exports			**0.5**
Terms of trade (relative prices)	2.9	-0.9	
Real income and productivity			
Real net national disposable income	0.5	2.4	
Real GDP per capita	-0.7	-0.0	
Real GDP per hour worked	0.5	1.4	
Real output per hour worked in market sectors	0.8	1.4	
Nominal GDP	0.8	3.1	**Share of total factor income, %**
Nominal income (total factor income)	**0.6**	**3.1**	
Compensation of employees (wages & incomes)	0.5	4.4	52.5
Private sector gross operating surplus (profits)	0.9	3.5	29.0
Private sector financial corporations	1.5	3.9	6.6
Private sector non-financial corporations	0.7	3.9	21.6
Gross mixed income (unincorporated businesses)	-0.6	-4.1	8.2
Dwellings owned by persons	0.6	1.8	7.8

* chain volume measures. seasonally adjusted and inflation adjusted. Source: ABS, *National Accounts,* March 2020.

This contraction from the private sector was only partially offset by large increases in government spending and a 'contribution' from net exports (exports minus imports). The ABS notes that "*Government spending at all levels increased in response to the bushfires and the management of the COVID-19 pandemic*" in Q1.

Meanwhile, net trade 'contributed' to GDP in Q1 without any growth in the volume of exports or imports traded. Instead, it 'contributed' because imports fell by a larger margin than did exports. The ABS notes that "*falls in consumption and capital goods reflect weak domestic demand. Imports of services fell 13.6%, with travel services falling sharply in response to the global outbreak of COVID-19 and associated travel bans. Exports of services declined 12.8%, with restrictions on overseas arrivals reducing education related travel and tourism in Australia*."

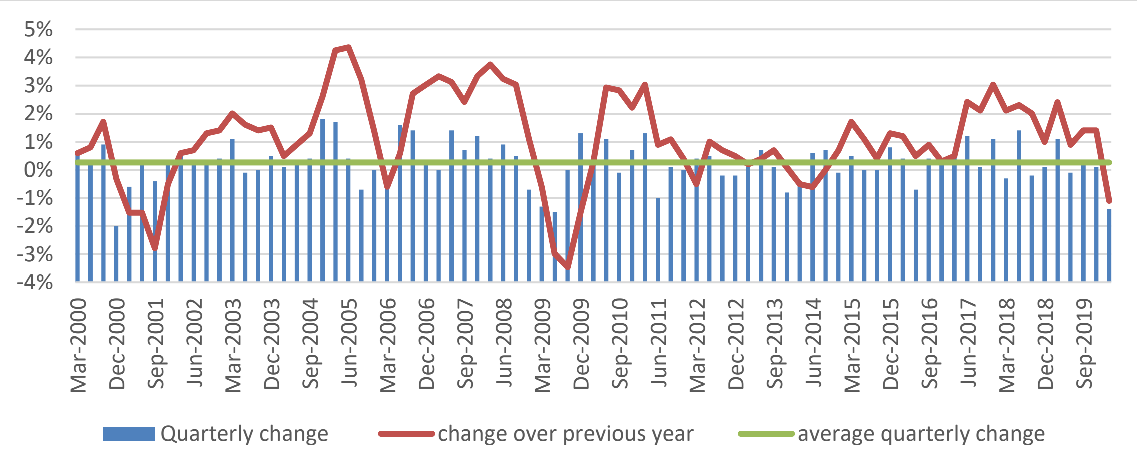
On the production side, industry output volumes shrank in 11 of Australia's 19 major industry groups in Q1 of 2020, with shrinkage over the year to Q1 in eight of them (chart 2). The impact of the first wave of COVID-19 activity restrictions were especially evident in hospitality (-7.6% q/q and -5.2% p.a.), transport (-4.9% q/q, -3.4% p.a.), personal services (-4.2% q/q, -3.2% p.a.), arts and recreation (-2.4% q/q, -2.5% p.a.) and administrative services (-3.7% q/q, -3.2% p.a.). Activity disruptions and loss of output due to drought and bushfire contributed to shrinkage in agricultural output (-2.1% q/q and -10.1% p.a.) and disruptions in construction (-0.5% q/q and -3.7% p.a.).

Chart 2: Industry output size and growth*, Q1 2020

* chain volume measures. seasonally adjusted and inflation adjusted. Source: ABS, *National Accounts,* March 2020.

These drops in output in Q1 were accompanied by even larger falls in hours worked across the economy (-0.9% q/q) and especially across the 'market sectors' (tradeable industries) (-1.5% q/q). (See chart 3). Rather perversely, this large drop in work hours meant that productivity measures appeared to improve in Q1, despite the absolute falls in GDP (-0.3% q/q) and GDP per capita (-0.7% q/q). Indeed, GDP per hour worked rose by 0.5% q/q in total 0.8% q/q in the market sectors.

Chart 3: Change in hours worked in the market sector (%) March 2020 to March 2020



National income supported by terms of trade, government transfers in 2020

At a national aggregate level, the key measures of Australian income were supported by a rise in the terms of trade in Q1 (+2.9% q/q, see Table1). As always, this source of income growth flowed primarily to the mining sector, in the form of company profits. As noted above, output and income for other key export sectors fell in Q1, including in agriculture, transport and education.

At the household level, the ABS notes the rise in aggregate compensation to employees (+0.3% q/q and 4.4% p.a.) in Q1 was concentrated in only 12 of Australia's 19 major industry groups. The most notable increases in employee income were in professional services (+1.6% q/q), public administration (+1.7% q/q) and healthcare (+0.9% q/q). Across states, the largest increase in compensation of employees was in the ACT (+1.7% q/q), reflecting growth in the public sector.

Household gross disposable income from all sources rose by 1.4% q/q and 3.8% p.a. in Q1, despite the falls in output and hours worked. The ABS notes that in addition to the rise in compensation of employees, household incomes were supported by:

- a large increase in total social assistance benefits to households (6.2% q/q), which contributed 0.6 percentage points to income growth; and
- slower growth in the tax payable by individuals (which had been rising steadily, as a share of household income) due to the introduction of the low to middle income tax offset in Q3 of 2019.

In some additional commentary to explain recent trends in household income (which unusually for an ABS *National Accounts* release, includes forecasts and data beyond Q1), the ABS notes that household income support from social assistance benefits will rise significantly in Q2, in terms of the number of households and the aggregate amount (charts 4 and 5).

Chart 4: social assistance benefits

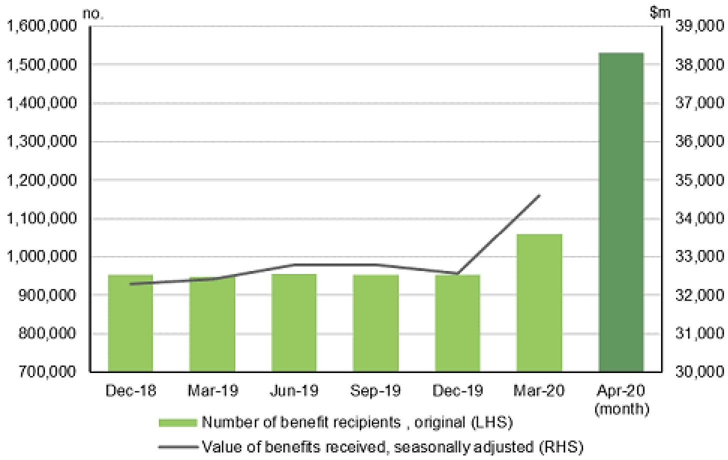
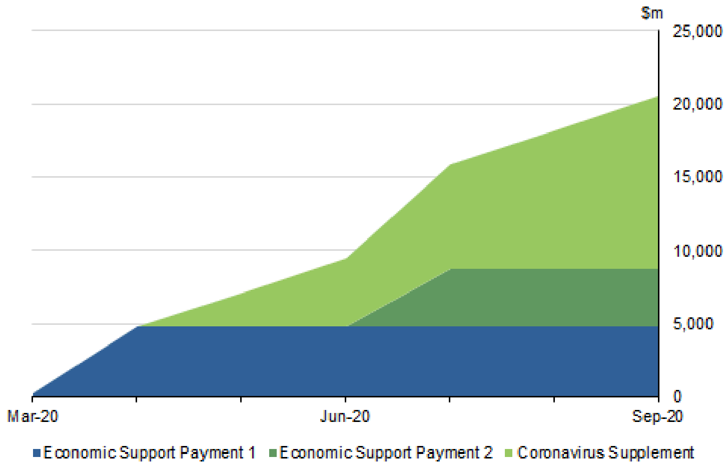


Chart 5: Government COVID-19 support



Source: ABS, "Insights into household income" *National Accounts,* March 2020.

The data presented in Chart 5 does not include the JobKeeper payments now flowing to low-wage employees of JobKeeper eligible employers earning less than $1,500 per fortnight.

The Federal Government's injection of financial support for low-income households is currently providing a significant boost to household incomes. This income support is targeted to low income households including many such households whose members include low-paid workers.

This additional income support for low-wage employees is highly pertinent to the Panel's considerations relating to the needs of the low paid and there relative living standards with the case for raising wages diminished by the quantum of non-wage income support being paid to low income households.

Business sales and income falls across key services industries in Q1 2020

The current structure of Australian growth means that private-sector income growth is closely tied to export revenue and especially to the terms of trade. The significance of mining export earnings and the terms of trade has implications for income distribution as well as for growth. Australia's large mining industry enjoys ongoing strong growth, but it is highly concentrated capital-intensive. In Q1 of 2020, mining accounted for 8.7% of value-added output volumes and over 40% of company gross operating profits but just 0.4% of employing businesses (3,438 businesses in June 2019) and 1.9% of the total workforce (243,000 directly employed workers in Feb 2020).

The ABS *Business Indicators* provide more detail about business sales, profits and wages up to Q1 of 2020. In the non-mining industries, aggregate sales, profits and wages have all tended to decelerate since the GFC (chart 6 and Table 2). Since 2011, non-mining aggregate business sales have grown by an average of 3.2% p.a. (and 2.2% p.a. in 2019), with profit growth slightly slower (3.1% p.a. on average) and wage growth slightly higher (3.4% p.a.) than sales growth.

In Q1 of 2020, the aggregate nominal value sales for non-mining businesses (excluding healthcare and education businesses) grew by 0.2% q/q and 1.6% p.a., which is lower than headline inflation over the same period (2.2% in Q1 of 2020). Business sales shrank over the quarter and over the year across large sections of the services industries (chart 7), including hospitality, transport, telecommunications, real estate services, administrative services, arts and recreation and personal & other services. These industries saw similar falls in aggregate profits and smaller falls in aggregate wages in Q1. Among the worst-hit industries in Q1, hospitality business sales fell by 7.6% q/q and 3.4% p.a. in Q1, company operating profits fell by 11.5% q/q and 5.2% p.a., and aggregate wages fell by 4.2% q/q (but remained 0.9% higher over the year).

Chart 6: non-mining business sales, profits and wages*, 2002-20

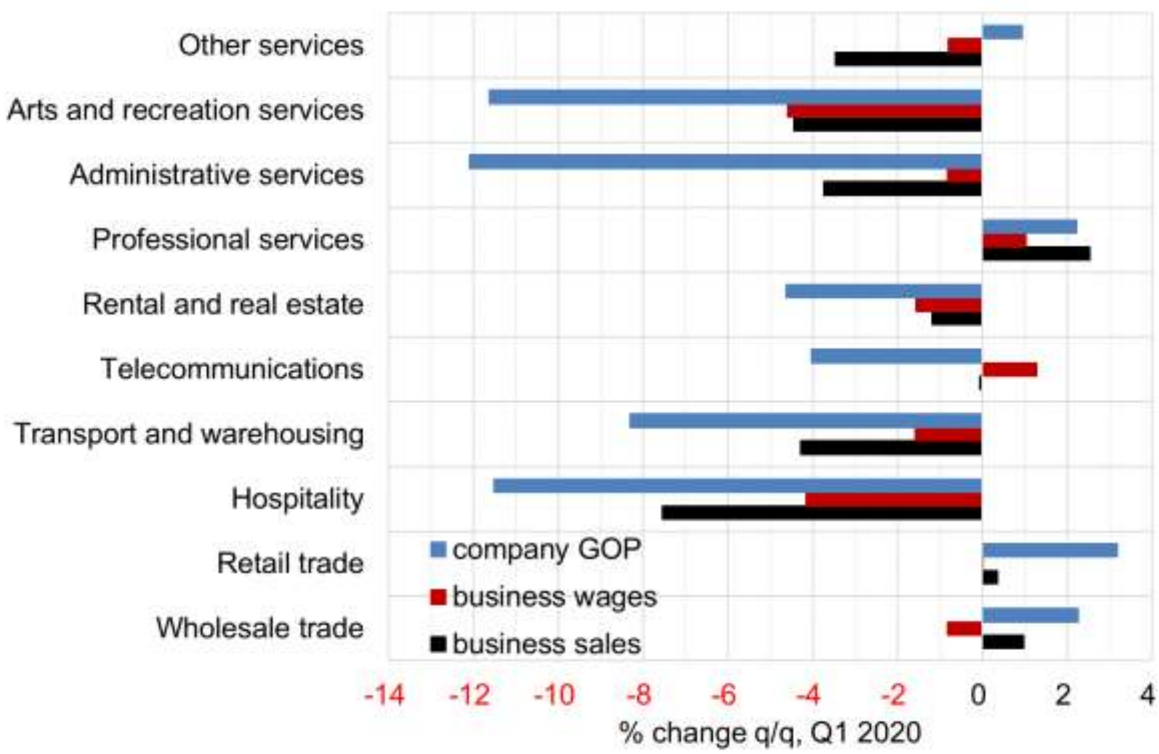
* nominal aggregate business sales, corporate profits and business wages for all industries that are included in the *Business Indicators* data series except education and healthcare. Source: ABS *Business Indicators*, Mar 2020.

Table 2: business sales, profits and wages for selected industries*, 2002-20

aggregate nominal dollars	2002-08 (pre-GFC)	2009-10 (GFC)	2011-19 (post GFC)	Mar 2020 (latest)
	average annual % change	average annual % change	average annual % change	annual % change
Mining				
Business Sales	17.5	10.0	7.4	3.6
Corp Profits	22.3	16.3	10.2	3.1
Business Wages	14.4	10.2	4.9	6.5
Manufacturing				
Business Sales	6.5	-3.9	-0.4	5.5
Corp Profits	8.2	0.7	-0.6	5.9
Business Wages	5.0	-0.6	0.5	5.3
Non-Mining				
Business Sales	7.2	0.4	3.2	1.6
Corp Profits	9.4	3.7	3.1	0.5
Business Wages	7.4	2.2	3.4	3.1
All industries*				
Business Sales	7.8	0.8	3.6	1.8
Corp Profits	11.3	4.4	4.5	1.5
Business Wages	7.6	2.5	3.5	3.3
Headline CPI	**3.0**	**2.3**	**2.0**	**2.2**

* nominal aggregate business sales, corporate profits and business wages for all industries that are included in the *Business Indicators* data series except education and healthcare. Source: ABS *Business Indicators*, Mar 2020.

Chart 7: Selected services industries: sales, profits and wages*, Q1 2020



* nominal aggregate business sales, corporate profits and business wages for all industries that are included in the *Business Indicators*

3. Latest RBA board meeting

This week, the Reserve Bank of Australia (RBA) left the cash rate at a record low of 0.25 and maintained its 3-year government bond yield target of 0.25%. In the accompanying statement, RBA Governor Lowe said *"it is possible that the depth of the downturn will be less than earlier expected …In the period immediately ahead, much will depend on the confidence that people and businesses have about the health situation and their own finance …* [however] *The Australian economy is going through a very difficult period and is experience the biggest economic contraction since the 1930s."* (The RBA's monthly board meeting statement is available here).

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