The Silver (Gold-wrapped) Economic Linings

- How record gold prices, low interest rates and low inflation can help the COVID recovery -

As we face our worst recession in 80 years and economic records continue to be set for budgetary deficit, government debt and falls in inflation, could the combination of record gold prices and low interest rates be our silver lining?
Despite June's relatively encouraging economic data, there is no doubt Melbourne's second lockdown has the potential to derail the country's economic recovery and quickly turn what appeared in June to be a potential V-shaped recovery, into a W.

Given this, the extension of government fiscal support is very welcome and most necessary. However, additional fiscal support will result in even more government borrowing, so can we continue to rob Peter to pay Paul, or should we be concerned about our level of national debt and deflation?

Despite the recent jump in Australian Government gross debt to $684 billion[1] - 34% of annual GDP - Australia continues to retain its AAA credit rating from each of the three major ratings agencies. The only other country to do so - outside of Europe - is Singapore. Canada has recently exited this exclusive club thanks to its 115% gross debt to GDP forecast.

Similarly, since the start of the year, the Reserve Bank has grown its balance sheet by around $70 billion[2] thanks to Quantitative Easing (QE), which has in turn, reduced three-year government bond yields to 0.25 per cent - the same as the official cash rate. As a result, drawing on the national balance sheet at this time makes a lot of sense – a sentiment echoed the by RBA Governor, Phillip Lowe, last week.

While Governor Lowe was keen to put to bed any thoughts of the RBA monetising debt, he did point out the government has access to as much funding as it needs - at the lowest interest rates since Federation - for any further stimulus required. This, combined with the fluke of benign inflation has given our economy a free kick. No inflation means no stagflation – a huge silver lining.

The other is the record price of gold. Sparked by the near perfect storm of a pandemic, risk aversion, the sharp weakening of the US Dollar and QE, higher base metal and bulk commodity prices have been a boon for our exports. While our trading relationship with China remains tense, June goods exports set a new record in value for iron ore. With its price still above US$100 per tonne - in the budget it is only assumed it will retail at $55 - it will offset any further gains in the Aussie Dollar, as the US dollar continues to slide.

Deflation is not something to celebrate, but the 1.9% Consumer Price Index drop in Q2 - the largest in its 72-year history - is forecast to rebound sharply in Q3, and the RBA is expecting core inflation to remain between one and 2% for the next few years. This means the free kick of being able to afford ultra-low interest rates - and sharply higher debt levels - is still to our advantage.

COVID-19 has created the most challenging environment for businesses and policy makers in decades.
Businesses, in particular, need all the help they can get, so with Australia's national debt comparatively low, effective fiscal and monetary policy will be needed until the economy and the nation's health gets back on its feet.

In an era when we will need ongoing fiscal support - funded by government debt - we should welcome the coincidence of low interest rates and low inflation. Australia needs all the silver linings it can get.

Article written by:

David Robertson, Head of Economic and Market Research
Bendigo and Adelaide Bank Ltd

[1] https://budget.gov.au/2020-efu/downloads/fact_sheet_overview.pdf
[2] https://www.rba.gov.au/speeches/2020/sp-dg-2020-06-30.html

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