9 June 2020

AUSTRALIAN MARKETS WEEKLY

The PBO's budget outlook plus the potential impact of the new housing subsidy

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Analysis – The PBO's budget outlook plus the potential impact of the new housing subsidy

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- On the issue of more fiscal stimulus, the government is already tinkering with the JobKeeper wage subsidy which is due to end in September. Governor Lowe has warned of withdrawing fiscal stimulus too quickly and the treasurer has suggested the subsidy will continue, albeit in a more targeted form.
- The government has also announced a housing subsidy, covering about 27,000 grants of $25,000 apiece, to support the construction of new homes and substantial home renovations in an effort to avoid job losses in the sector later this year. There are limits to the scheme, but as an upper bound of the scheme's potential impact, we estimate it could bring forward housing activity worth about 0.5% of GDP. The other challenge facing the sector is the slump in population growth to its lowest level in a century. Growth will pick back up when Australia's border is re-opened, but that will likely take time.

The week ahead – AU home loans; NZ GDP partials; FOMC meeting

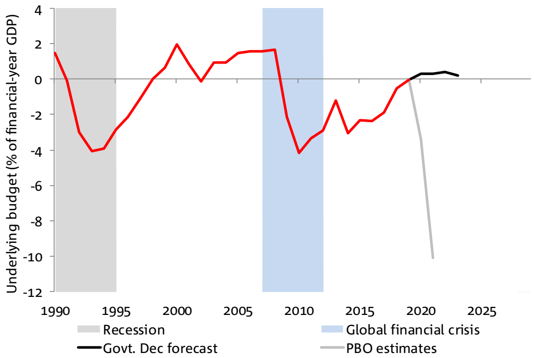
- **Australia:** A quiet week with home loan data due. The NAB business survey was released earlier today and showed some improvement as health restrictions were removed. Surveyed levels are still consistent with very weak activity, but further improvement is likely in June as more restrictions were relaxed. **NZ:** This week's data are a mix of timely indicators and more dated GDP partial indicators for Q1. The timely indicators are expected to show improvement, some markedly so, while the dated data is likely to show weakness. NZ data are likely to continue to improve over coming months given the move back to level 1, where social distancing is not required and only the international border is closed.
- **Global:** OPEC+ meets Tuesday and Wednesday. **US:** Wednesday's FOMC meeting will see an update on the Fed's economic outlook, with formal forecasts and scenarios. Friday sees the Michigan consumer sentiment preliminary June reading. **CH:** Aggregate financing figures that are due anytime in the week should show signs of stimulus hitting the economy.

Key markets over the past week

	Last	% chg week		Last	bp/% chg week
AUD	0.6954	0.8	RBA cash	0.14	0
AUD/CNY	4.92	0.9	3y swap	0.29	3
AUD/JPY	75.1	0.2	ASX 200	6,145	5.6
AUD/EUR	0.617	-0.1	Iron ore	101	3.2
AUD/NZD	1.066	-1.5	Brent oil	41.1	3.7

Source: Bloomberg

Chart of the week: PBO estimates of the budget



Kieran Davies

The PBO's budget outlook plus the potential impact of the new housing subsidy

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The Parliamentary Budget Office has published estimates of the impact of the virus on the budget

With the budget pushed back to October, the treasurer was due to release an economic and fiscal update although this has been delayed from some time this month to 23 July. In the meantime, the Parliamentary Budget Office (PBO) has published estimates of the impact of the virus on the underlying cash budget bottom-line.[1]

The PBO estimates span from 2019-20 to 2029-30 and are shown in Table 1. In lieu of updated Treasury economic forecasts, the PBO used the Reserve Bank's baseline, upside and downside economic scenarios from the latest Statement on Monetary Policy to estimate the near-term economic hit from the virus on the budget. The PBO then incorporated the government's coronavirus-related measures, adjusted for the $60 billion overestimation of the JobKeeper wage subsidy (the measures were assumed to be the same for all three economic scenarios). The long-term estimates were prepared using Treasury's long-term budget assumptions and did not incorporate any long-term effects from the virus, such as lower potential output if long-term migration fails to return to its pre-pandemic growth rate.

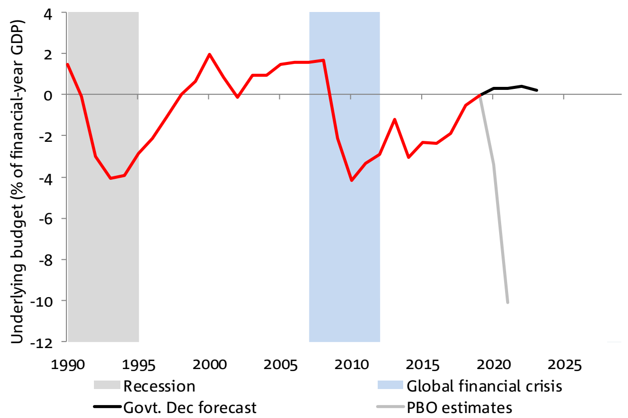
The PBO stresses that its estimates capture the combined effect of the weaker economy and policies on the budget relative to the pre-virus outlook and are not meant to be treated as forecasts of the budget position. However, we think they *can* be reasonably interpreted as updated budget estimates given monthly budget numbers prior to the pandemic pointed to a balanced budget at best this financial year.

In the baseline scenario, the PBO expects the pandemic to widen the budget bottom-line by about $70 billion in 2019-20 (3.4% of GDP) and about $190 billion (10.1% of GDP) in 2020-21.[2]

- In the upside scenario, the deterioration in the budget is also about $70 billion in 2019-20, increasing to about $170 billion in 2020-21.
- In the downside scenario, the deterioration in the budget is again about $70 billion in 2019-20, building to about $210 billion in 2020-21.

In the long term, there is an ongoing hit to the budget from the virus of about $10-30 billion per annum reflecting weaker revenue and higher government payments. Lower revenue is largely due to weaker income tax as wages and prices have not recovered to their pre-virus trend. Payments are higher in the medium term as unemployment remains high and the debt funding task increases with higher debt and a weaker economy.

Chart 1: The PBO estimates imply a record peace-time budget deficit



Note: See Table 1.
Source: Australian Bureau of Statistics, Department of the Treasury, Melbourne Institute, Reserve Bank of Australia, National Australia Bank

There is significant uncertainty around both the economic and fiscal outlook

The uncertainty around the PBO estimates, and indeed any economic and budget forecasts at the moment, is extreme given official data have only recently started to show the severe impact of the virus on the economy. The take-up of government policies is also unclear, as brought home by the $60 billion overestimation of the JobKeeper wage subsidy scheme. That said, the government's July economic and fiscal update could be a little more optimistic than the PBO's baseline numbers. The easing of restrictions is occurring sooner than

[1] See Parliamentary Budget Office, *Medium-term fiscal projection scenarios: impact of COVID-19 pandemic and response*, 5 June 2020.

[2] The shares of GDP were calculated using our approximation of the Reserve Bank's estimates of nominal GDP.

assumed in the Reserve Bank's baseline scenario, meaning that the economy is currently tracking somewhere between the bank's baseline and upside scenarios. Treasury also forecasts a very quick recovery in employment to almost pre-pandemic levels as lockdown measures are relaxed.

Comparing the PBO baseline estimates with NAB's forecasts, NAB's estimate for the budget deficit is much the same in 2019-20 at $70 billion (3.5% of GDP), but higher at about $210 billion (11.0% of GDP) in 2020-21. We would not make too much of this difference given the outlook is highly uncertain, but it likely reflects: (1) NAB's weaker forecasts for wages and inflation relative to the Reserve Bank's baseline scenario; and (2) the PBO estimates not including the government's recently-announced home builder scheme and other policies that are not related to the pandemic, such as reimbursing state spending on the bushfires.

It also seems likely to us that there will be additional fiscal stimulus over the coming six months. The government has already announced a new support package for the housing industry at a cost of $0.7 billion (<0.1% of GDP), while extending the instant asset write-off for business by six months to December at a cost of $0.3b (<0.1% of GDP). More importantly, the government is reviewing the JobKeeper wage subsidy, which is the largest single measure of the existing stimulus policies. The scheme is legislated to end in September and the government has already modified the scheme by replacing the subsidy for childcare workers with a "transition payment".[3] For his part, the treasurer has indicated he is considering more targeted support for industry past September, along with reducing the subsidy for part-time and casual workers.[4]

The importance of extending this scheme was brought home by Governor Lowe's recent testimony, where he said his "main concern is that we don't withdraw the fiscal stimulus too early".[5]

Table 1: The PBO's estimates of the impact of the coronavirus on the budget bottom-line

		2018-19	Forecasts: 2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Latest government forecasts													
Underlying budget balance	$b	-1	5	6	8	4	..	..	..	..	..	..	..
(as at Dec 2019)	% GDP	0.0	0.3	0.3	0.4	0.2	..	..	..	..	..	..	..
Parliamentary Budget Office estimates													
Impact of the virus on the underlying budget balance													
- baseline scenario	$b	-	-67	-191	-56	-43	-37	-30	-24	-18	-19	-20	-23
	% GDP*	-	-3.4	-10.1	..	..	..	..	..	..	..	..	..
- upside scenario	$b	-	-66	-172	-36	-25	-17	-15	-14	-12	-13	-14	-16
- downside scenario	$b	-	-68	-214	-80	-64	-55	-45	-35	-23	-25	-27	-30
NAB forecasts													
Underlying budget balance	$b	-	-70	-210	..	..	..	..	..	..	..	..	..
	% GDP	-	-3.5	-11.0	..	..	..	..	..	..	..	..	..
Market forecasts													
Underlying budget balance	$b	-	-105	-163	..	..	..	..	..	..	..	..	..
	% GDP	-	..	..	..	..	..	..	..	..	..	..	..

Note: The Parliamentary Budget Office estimates are based on economic forecasts from the Reserve Bank of Australia and the government's long-term assumptions. * as a share of the Reserve Bank's estimate of nominal GDP. ".." not available.
Source: Asia-Pacific Consensus Economic Forecasts, Australian Bureau of Statistics, Department of the Treasury, Reserve Bank of Australia, National Australia Bank

The new housing subsidy is an attempt to reduce the risk of job shedding in construction later this year

In terms of the new policy aimed at the housing market, the "Homebuilder" programme is directed at boosting the construction of new homes and renovations to existing homes.[6] The construction sector has already seen a 6% decline in the number of payroll jobs and the concern is that builders will shed more staff once work on existing projects is completed later this year. This risk is accentuated by the sector's heavy reliance on the JobKeeper wage subsidy, where 80% of construction companies had either registered for the scheme or planned to apply, as at April.

There is already extensive government support for the construction of new homes directed at first home-buyers (i.e., the First Home Owner Grant, the First Home Loan Deposit Scheme, the First Home Super Saver Scheme and state concessions on stamp duty). The Homebuilder scheme is broader in scope, applying to all owner-occupiers and extended to substantial home renovations. The scheme involves about 27,000 grants of $25,000 apiece for either:

- The construction of a new home up to a cost of $750,000, covering new builds, house and land packages and off-the-plan purchases; or
- The substantial renovation of an existing home at a cost of between $150,000 and $750,000, where the pre-renovation value of the home does not exceed $1.5 million and the renovation must improve the "accessibility, liveability and safety of the property".[7]

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[3] See Department of Education, Skills and Employment, *Transition arrangements for the end of the Early Childhood and Care Relief* Package, Media release, 8 June 2020.

[4] See Treasurer Frydenberg, *National accounts Q&A*, Transcript, Canberra, 3 June 2020.

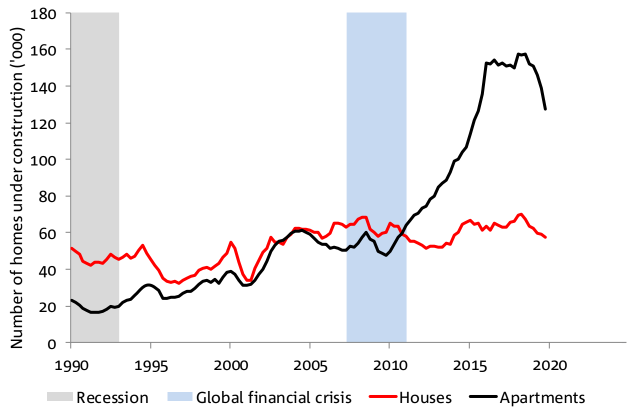
[5] See Senate Select Committee on COVID-19, *Australian government's response to the COVID-19 pandemic*, Proof committee Hansard, 28 May 2020.

[6] See Prime Minister Morrison, Treasurer Frydenberg and Assistant Treasurer and Minister for Housing Sukkar, *"Homebuilder" program to drive economic activity across the residential construction sector*, Joint media release, 4 June 2020.

[7] This excludes tennis courts, pools and sheds.

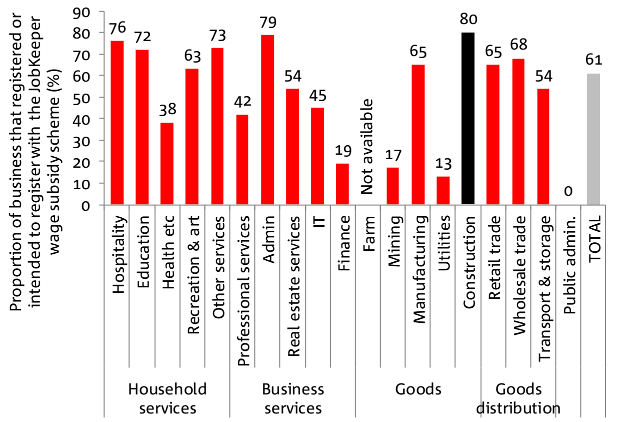
The decision by the government to include home renovations may seem unusual, but renovations are a significant part of total housing activity, on par with the construction of new houses. For example, over the past twelve months, renovations accounted for 36% of residential investment, compared with the construction of new houses at 35% and the construction of new apartments at 29%.

Chart 2: The pipeline of homes under construction peaked in 2018 ...



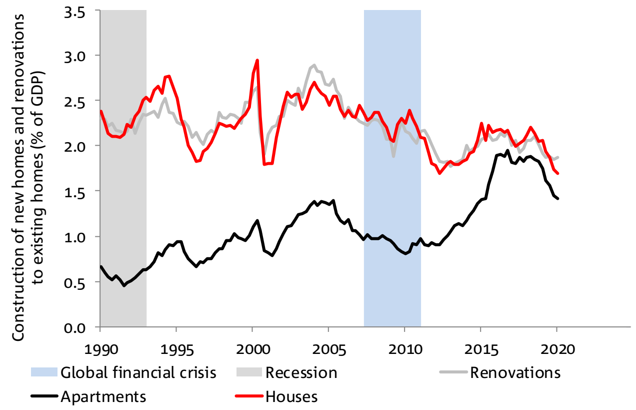
Note: Private-sector homes.
Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

Chart 3: ... while many builders are on the JobKeeper wage subsidy



Note: As at April 2020.
Source: Australian Bureau of Statistics, National Australia Bank

Chart 4: Renovations are a substantial part of the housing market



Note: Private-sector homes.
Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

There are income and time limits on the housing grant

The Homebuilder grant is available from now until 31 December. The grant is means-tested, but the income limits are not binding for most people. The income cap for an individual is $125,000 while the cap for a couple is $200,000. Based on the latest tax data, the $125,000 limit would exclude only 10% of taxpayers.

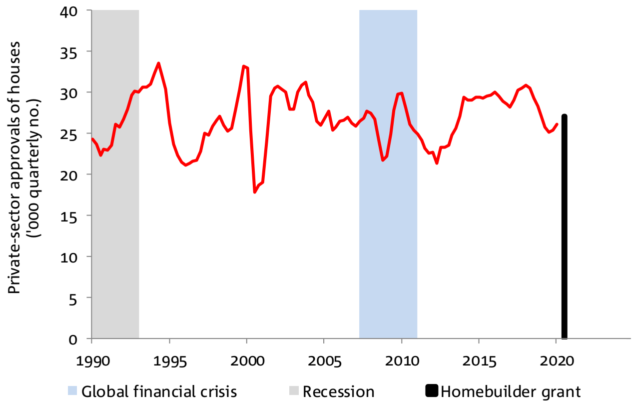
The more important constraint is the requirement that builders must start work within 3 months of the contract being signed. This likely skews the grant towards houses and renovations given that a developer of apartments and townhouse can take longer than 3 months to obtain enough sales to sign a building contract.

As an upper limit, the grant could bring forward housing activity worth almost 0.5% of GDP

In gauging the potential economic effect of the Homebuilder subsidy, at face value the scheme's total cost of $0.7 billion (<0.1% of GDP) points to a negligible impact on GDP. However, the total cost greatly underestimates the leverage involved with the scheme, with past experience showing the effectiveness of housing subsidies in bringing forward demand.

To get a sense of the possible bring-forward of demand, we arbitrarily assumed that all of the grants were used for building a new house (i.e., ignoring the possibility that some grants will be made for off-the-plan apartments or home renovations). On this basis, 27,000 grants are equivalent to about one-quarter of annual building approvals of houses. With the construction of houses currently 1.8% of GDP, this suggests that the grant could bring forward construction worth at most 0.5% of GDP over the next nine months.

Chart 5: The Homebuilder grants equate to about ¼ of annual building approvals for houses



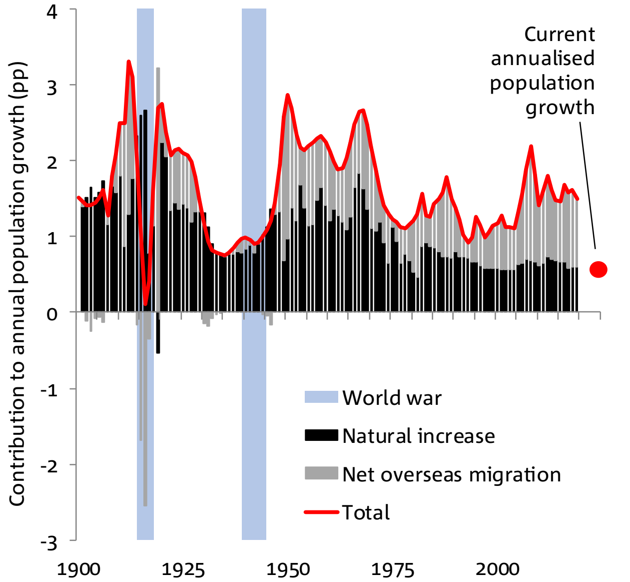
Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

This calculation should be treated with caution as it will overstate the potential bring-forward of activity if the grants are skewed to renovations valued at the low end of the allowable $150,000-$750,000 scale. On that score, 12,000 people have already registered for the subsidy, although we do not know the split of applications between construction and renovations.[8]

The closure of Australia's border is another challenge to the housing market

While the new housing grant is likely to be helpful in reducing job losses in the construction sector by bringing forward activity, the government is yet to announce its timetable for re-opening Australia's border. Migration has driven Australia's strong population growth over the past decade, but growth has slowed from 1.5% at the end of last year to an annualised rate of about 0.4% in Q2. Our expectation is that the government will resume long-term migration some time in the next twelve months, but until that happens weak population growth will be a drag on housing demand.

Chart 6: The closure of Australia's border has seen a sharp slowdown of population growth



Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

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[8] See Assistant Treasurer Sukkar, *Interview with Ben Fordham, 2GB*, Transcript, 9 June 2020.

CALENDAR OF ECONOMIC RELEASES

Country	Economic Indicator	Period	Forecast	Consensus	Actual	Previous	GMT	AEDT
Tuesday 09 June 2020								
OPEC+ meet				--		--		9 to 10 Jun
NZ	ANZ Truckometer Heavy MoM	May		--		-45	21.00	8.00
NZ	ANZ Business Confidence	Jun P		--		-41.8	0.00	11.00
AU	ANZ Job Advertisements MoM	May		--		-53.1	0.30	11.30
AU	NAB Business Conditions	May		--		-34	0.30	11.30
EC	GDP SA YoY	1Q F		-3.2		-3.2	8.00	19.00
US	NFIB Small Business Optimism	May		91.5		90.9	9.00	20.00
US	Wholesale Inventories MoM	Apr F		--		0.4	13.00	0.00
Wednesday 10 June 2020								
NZ	REINZ House Sales YoY	May		--		-78.5		10 to 14 June
CH	New Yuan Loans CNY	May		1515		1700		10 to 15 June
CH	Money Supply M2 YoY	May		11.3		11.1		10 to 15 June
JN	Core Machine Orders YoY	Apr		-13.7		-0.7	22.50	9.50
JN	PPI YoY	May		-2.4		-2.3	22.50	9.50
AU	Westpac Consumer Conf Index	Jun		--		88.1	23.30	10.30
CH	PPI YoY	May		-3.2		-3.1	0.30	11.30
CH	CPI YoY	May		2.6		3.3	0.30	11.30
US	CPI YoY	May		0.3		0.3	11.30	22.30
EC	ECB's de Guindos speaks at webinar						12.30	23.30
US	FOMC Rate Decision (Upper Bound)	Jun 10	0.25	0.25		0.25	17.00	4.00
US	Interest Rate on Excess Reserves	Jun 11		--		0.1	17.00	4.00
US	Fed's Powell post-meeting press conference	Jun					17.30	4.30
Thursday 11 June 2020								
AU	Consumer Inflation Expectation	Jun		--		3.4	0.00	11.00
US	PPI Final Demand YoY	May		-1.2		-1.2	11.30	22.30
Friday 12 June 2020								
NZ	BusinessNZ Manufacturing PMI	May		--		26.1	21.30	8.30
NZ	Food Prices MoM	May		--		1	21.45	8.45
JN	Industrial Production YoY	Apr F		--		-14.4	3.30	14.30
UK	Monthly GDP (MoM)	Apr		-18		-5.8	5.00	16.00
EC	Industrial Production WDA YoY	Apr		-30		-12.9	8.00	19.00
US	U. of Mich. Expectations	Jun P		--		65.9	13.00	0.00
US	U. of Mich. Sentiment	Jun P		76		72.3	13.00	0.00
Upcoming Central Bank Interest Rate Announcements								
US, Federal Reserve		Jun 10	0/0.25	0/0.25		0/0.25		
Japan, BoJ		Jun 16	-0.10	-0.10		-0.10		
UK, BOE		Jun 18	0.10	0.10		0.10		
New Zealand, RBNZ		Jun 24	0.25	0.25		0.25		
Australia, RBA		Jul 7	0.25	0.25		0.25		
Europe, ECB		Jul 16	-0.50	-0.50		-0.50		

GMT: Greenwich Mean Time; AEDT: Australian Eastern Daylight Time

FORECASTS

Economic Forecasts

	Annual % change				Quarterly % change											
					2019				2020				2021			
Australia Forecasts	**2019**	**2020**	**2021**	**2022**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**
Household Consumption	1.4	-5.3	2.2	--	0.4	0.3	0.1	0.4	0.5	-9.1	0.1	2.7	1.2	0.7	1.1	1.2
Underlying Business Investment	-2.0	-22.4	-8.1	--	0.6	-0.4	-1.8	-1.5	-4.7	-21.1	-1.5	-2.4	0.7	-0.3	0.1	0.3
Residential Construction	-7.1	-14.3	-4.3	--	-2.0	-3.5	-1.2	-3.4	-2.0	-7.5	-5.3	-3.4	-0.5	1.6	2.9	3.6
Underlying Public Spending	4.9	4.0	3.8	--	1.1	1.7	2.0	0.1	0.8	1.1	1.0	1.0	1.0	0.9	0.8	0.8
Net Exports (a)	1.1	2.5	-1.3	--	0.4	0.5	0.0	0.1	0.5	3.2	-0.4	-0.8	-0.3	-0.2	-0.3	-0.4
Inventories (a)	-0.2	-0.8	1.0	--	-0.1	-0.3	0.2	0.2	-0.3	-2.2	1.6	1.2	0.0	-0.1	0.1	0.0
Domestic Demand (q/q %)	--	--	--	--	0.3	0.4	0.4	0.1	0.0	-7.2	-0.1	1.4	1.1	0.8	1.1	1.2
Dom Demand (y/y %)	1.2	-4.7	1.6	--	1.2	1.2	1.2	1.3	1.0	-6.7	-7.1	-5.9	-4.9	3.2	4.4	4.2
Real GDP (q/q %)	--	--	--	--	0.5	0.6	0.6	0.5	-0.2	-8.4	1.0	4.1	2.0	0.4	0.8	0.8
Real GDP (y/y %)	1.8	-4.3	4.2	--	1.7	1.6	1.8	2.2	1.5	-7.6	-7.2	-3.9	-1.9	7.7	7.5	4.0
											3	3.5				
CPI headline (q/q %)	--	--	--	--	0.0	0.6	0.5	0.7	0.3	-2.0	0.6	0.7	0.2	0.2	0.1	0.3
CPI headline (y/y %)	1.6	0.4	1.6	--	1.3	1.6	1.7	1.8	2.1	-0.5	-0.5	0.5	0.5	2.7	2.3	0.9
CPI underlying (q/q %)	--	--	--	--	0.2	0.4	0.4	0.4	0.4	0.3	0.4	0.3	0.2	0.2	0.0	0.1
CPI underlying (y/y %)	1.4	1.5	0.9	--	1.5	1.4	1.4	1.4	1.6	1.5	1.6	1.5	1.3	1.1	0.6	0.4
Private wages (q/q %)	--	--	--	--	0.5	0.5	0.5	0.5	0.5	0.3	0.3	0.3	0.3	0.3	0.5	0.5
Private wages (y/y %)	2.3	1.7	1.2	--	2.4	2.3	2.2	2.2	2.1	1.9	1.6	1.3	1.1	1.0	1.3	1.5
Unemployment Rate (%)	5.1	10.1	8.6	--	5.1	5.1	5.2	5.1	5.2	11.7	11.8	11.7	10.7	8.7	7.6	7.2
Terms of trade	5.2	-11.9	-2.0	--	3.3	1.5	0.2	-5.3	-2.5	-5.8	-3.4	-1.2	0.8	2.0	-0.1	-0.1
Current Account (% GDP)	0.5	0.9	-0.3	--	-0.4	0.9	1.3	0.2	0.1	2.4	1.2	0.0	-0.2	0.0	-0.4	-0.8

Source: NAB Group Economics; (a) Contributions to GDP growth

Exchange Rate Forecasts

	9-Jun	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Majors						
AUD/USD	0.693	0.70	0.72	0.75	0.74	0.74
NZD/USD	0.65	0.64	0.66	0.67	0.68	0.69
USD/JPY	108	109	109	109	109	108
EUR/USD	1.13	1.13	1.15	1.17	1.18	1.19
GBP/USD	1.27	1.27	1.30	1.32	1.33	1.35
USD/CNY	7.08	7.10	7.05	6.95	6.85	6.80
USD/CAD	1.34	1.41	1.39	1.37	1.35	1.30
USD/CHF	0.96	0.97	0.96	0.96	0.95	0.95
Australian Cross Rates						
AUD/NZD	1.07	1.09	1.09	1.12	1.09	1.07
AUD/JPY	74.9	76	78	82	81	80
AUD/EUR	0.62	0.62	0.63	0.64	0.63	0.62
AUD/GBP	0.55	0.55	0.55	0.57	0.56	0.55
AUD/CNY	4.91	4.97	5.08	5.21	5.07	5.03
AUD/CAD	0.93	0.99	1.00	1.03	1.00	0.96
AUD/CHF	0.66	0.68	0.69	0.72	0.70	0.70

Interest Rate Forecasts

	9-Jun	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Australian Rates						
RBA cash rate	0.25	0.25	0.25	0.25	0.25	0.25
3 month bill rate	0.10	0.20	0.25	0.30	0.30	0.35
3 Year Swap Rate	0.29	0.25	0.30	0.30	0.30	0.30
10 Year Swap Rate	1.01	0.90	1.05	1.18	1.28	1.38
Offshore Policy Rates						
US Fed funds	0.25	0.25	0.25	0.25	0.25	0.25
ECB deposit rate	-0.50	-0.60	-0.60	-0.60	-0.60	-0.60
BoE repo rate	0.10	0.25	0.25	0.25	0.25	0.25
BoJ excess reserves rate	-0.10	-0.20	-0.20	-0.20	-0.20	-0.20
RBNZ OCR	0.25	0.25	0.25	0.25	0.25	0.25
10-year Bond Yields						
Australia	1.05	0.95	1.05	1.15	1.25	1.35
United States	0.83	0.70	0.80	0.90	1.00	1.10
New Zealand	0.96	0.88	1.03	1.28	1.38	1.63

Sources: NAB Global Markets Research; Bloomberg; ABS

Global GDP

	2019	2020	2021
Australia	1.8	-4.3	4.2
United States	2.3	-7.4	6.8
Eurozone	1.2	-8.4	6.3
United Kingdom	1.4	-7.6	6.6
Japan	0.8	-7.6	3.8
China	6.1	1.0	9.8
India	5.3	-1.5	8.0
New Zealand	2.3	-8.7	2.9
World	3.0	-3.8	6.5

Commodity prices ($US)

	9-Jun	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Brent oil	40.5	38	43	48	52	58
Gold	1702	1690	1700	1710	1710	1720
Iron ore	na	81	80	78	75	73
Hard coking coal*	110	145	148	151	147	145
Thermal coal	56	62	65	67	63	61
Copper	5681	5100	5300	5400	5500	5750
Aus LNG**	10	7	7	7	8	8

** FOB quarterly contract prices (thermal coal is JFY contract)*

*** Implied Australian LNG export prices*

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