NAB'S VIEW ON FISCAL POLICY 23 JULY 2020

A LARGE DETERIORATION IN THE BUDGET POSITION AND A PESSIMISTIC ECONOMIC OUTLOOK

NAB Economics

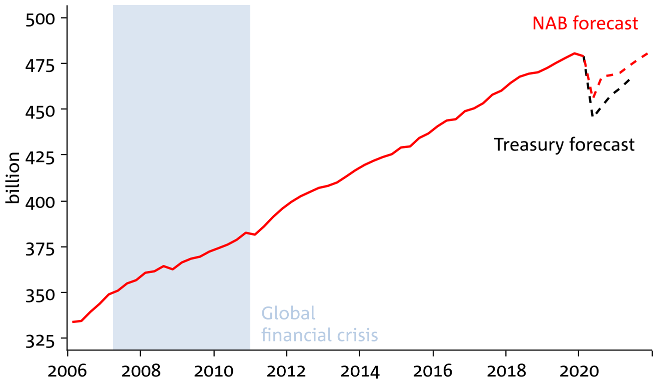
The government has released an updated set of budget estimates and economic forecasts for 2019/20 and 2020/21, showing the massive impact from the pandemic. The massive fiscal stimulus announced to date and fall in tax receipts on the back of very weak economic conditions means that Treasury now expects a budget deficit of $185b (10% of GDP) in FY21. On the economic outlook, Treasury's forecasts are a little weaker than our view with growth of -0.3% in FY20 (NAB: +0.3%) and -2.5% in FY21 (NAB: -0.7%). Consequently, the government forecasts unemployment of 9% by year's end, while we expect a peak of just over 8%.

Overall, these forecasts appear pessimistic and suggest the government is starting from a conservative position on the pace of recovery. However, there is exceptionally high uncertainty around all forecasts at this point and our own forecasts embody a relatively optimistic recovery in consumption despite ongoing labour market fallout. Like Treasury, we think the key risks to these forecasts include the future spread of the virus, the degree of labour market scarring and risks around both consumer and business confidence.

- **The government has announced it expects the largest budget deficit since WWII of $185b in 2020-21, or 10% of GDP.** This follows an underlying cash deficit of $86b in 2019-20, or 4% of GDP. This is a sharp deterioration in the fiscal position relative to the small $5-6b surpluses expected at MYEFO late last year, reflecting the massive impact of the coronavirus pandemic. The large fiscal stimulus measures already announced saw $58b spent in FY20 and Treasury expects an additional $114b will be spent in FY21. Further, the weak economy suggests tax receipts will collapse by $59b in FY21, after a $32b hit in FY20. In particular, for FY21 Treasury expects much less revenue from income taxes (down $27b), company tax (-$12b) and GST (-$8b).
- **The government forecasts a 7% decline in GDP for Q2 which will see a full-year outcome of -0.3% in 2019/20 before a sharp -2½% decline in 2020/21.** These forecasts are slightly weaker than ours in the near term, where we expect a 5% decline in Q2 (for a +0.3% annual figure), while we see a faster recovery and better overall outcome of -0.7% in 2020/21. These forecasts are driven by sharp declines across the private sector with consumption, dwelling and business investment seeing sharp falls. The key differences to our forecasts are that Treasury expects a weaker outlook for consumption of -2½% over the next year (NAB: -½%), partly offset by a more optimistic, though still weak, -12½ for business investment (NAB: -28%). Treasury estimates slightly stronger public-sector spending of 4½% (NAB: 4%).
- **Treasury expects the unemployment rate to rise from 7.4% currently to just over 9% in Q4 before a gradual recovery to 8¾% in H1 2021.** While Treasury's GDP forecasts encompass a relatively fast recovery in activity compared with history – the outlook for the labour market recovery is only gradual. The update emphasises the measurement issues with unemployment at present, given the large exodus from the labour force and the support provided by JobKeeper, but nevertheless notes that a high degree of spare capacity will remain for some time. Consequently, wage growth has seen a large mark-down compared with MYEFO and is expected to slow to 1¼% (MYEFO: 2½%, NAB: 0.8%).
- **On issuance, Treasury estimates the face value of Australian Government Securities (AGS) will increase from $684b as at June 30 2020 to $852b by June 30 2021.** The $168b increase in outstandings suggests that weekly AOFM tender issuance for Treasury bonds and Treasury notes may end up being at the lower end of the ranges provided in the 2020-21 Issuance Program Guidance that the AOFM published on July 3rd. That said, overall the outlook is not too dissimilar to market expectations and so the impact on bond yields should be limited.
- **The government's key assumptions around the virus include a continued gradual opening up of restrictions from here, although it accounts for the current 6-week lockdown in Victoria.** Further, it assumes that the international border will remain closed for some time, but that from early 2021 it will allow the entry of some international students. The update also shows Treasury expects a very sharp slowing in population growth to just 0.6% in 2021, from around 1.5% in the lead-up to the pandemic.
- **The key risks highlighted in the update are broadly in line with our own considerations.** Future developments around the spread of the virus and health impacts remain highly uncertain. Economy-wise, the degree of labour market scarring – where it is difficult for people to regain work - presents a risk to the speed of jobs growth. The impact of health concerns and global uncertainty on consumer and business confidence will continue to play a role in the speed of recovery. Lastly, the government has highlighted the

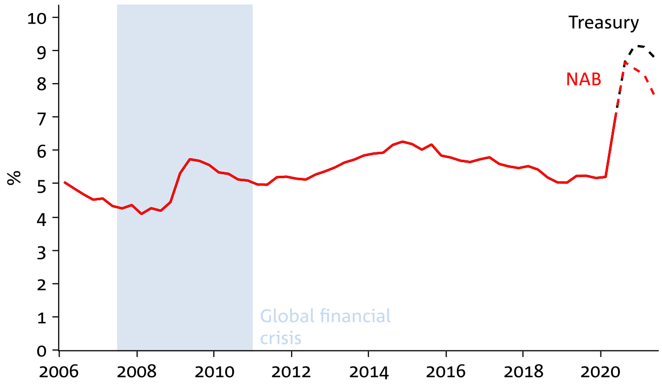
risk around structural changes, triggered by ongoing border closures and changes to behaviour based on health concerns such as a move to working from home. We also consider a large risk stemming from weaker demand for commercial property, particularly CBD retail and offices.

REAL GDP



Source: National Australia Bank, Australian Bureau of Statistics, Treasury

UNEMPLOYMENT RATE



Source: National Australia Bank, Australian Bureau of Statistics, Treasury

Fiscal and Economic Forecasts		2019-20	2020-21
Fiscal			
Underlying cash balance	$b	85.8	184.5
Share of GDP	%	4.3	9.7
MYEFO	$b	5	6.1
Net debt	$b	488.2	677.1
Share of GDP	%	24.6	35.7
MYEFO	$b	392	379
Economic			
GDP annual growth	%	- 1/4	-2 1/2
MYEFO	%	2 1/4	2 3/4
NAB	%	0.3	-0.7
Unemployment rate*	%	7	8 3/4
MYEFO	%	5 1/4	5 1/4
NAB	%	7.1	7.2
Headline CPI**	% y/y	- 1/4	1 1/4
MYEFO	% y/y	2	2 1/4
NAB	% y/y	-0.4	3
Wage price index**	% y/y	1 3/4	1 1/4
MYEFO	% y/y	2 1/2	2 1/2
NAB	% y/y	1.9	1

* June quarter average, **Year-ended to June

Source: National Australia Bank, Treasury

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