

Tuesday 6 October 2020

Biggest Week of the Year

This week is among the busiest for economists. With a public holiday yesterday in many parts of Australia, the week kicks off with gusto today. We are calling it Super Tuesday because both the Reserve Bank board meet today and the Federal government hands down its Budget tonight.

A speech by Reserve Bank (RBA) Deputy Governor Guy Debelle last month cemented expectations that the RBA was readying to deploy more stimulus. The RBA could deliver more stimulus as soon as today or wait until its November meeting to do so. We favour the latter, but would not rule out some stimulus occurring today, namely a cash-rate cut, with the job being finished off in November.

We expect the further stimulus from the RBA before the end of this year to involve a 15 basis point cut to the cash rate, a 15 basis point cut to the 3-year bond yield target to 0.10%, as well as cuts to the rates on the exchange settlement funds account (EFA) and term funding facility (TFF). The implementation of a bond-buying program beyond the 3-year maturity is also possible.

A recent survey of 36 economists in Australia by Reuters late last week revealed 10 economists polled expect a cut to occur as soon as today. The majority expect a cut before the end of this year.

Fiscal support was critical in preventing a deeper recession in Australia. We expect this fiscal support to be extended and enhanced tonight when the Federal Budget is handed down.

The 2020-21 Budget will be like no other, but then the pandemic shock to the economy this year is like no other! We estimate that the government will be forecasting a record-sized budget deficit for 2020-21 of around \$240 billion, representing 12.5% of GDP.

The size of the deficit should not be the focus. The most important aspects of the Budget are the policies which the government plans to adopt to help the Australian economy repair and recover to a higher growth path. This should encourage a reduction in the unemployment rate. The Federal government would like to get the unemployment rate back down to 6% but ultimately whether that can be achieved will depend on successfully suppressing the virus and how soon a globally viable vaccine materialises. Reopening international borders and resuming international immigration will depend on these factors and play a heavy hand in steering economic activity and creating jobs.

The Federal Budget is likely to include a 'bring-forward' of personal income tax cuts, extensions and amendments to the JobSeeker and JobKeeper schemes, infrastructure investment, an expansion of the first-home buyer scheme and a bring forward of research funding for universities.

There is speculation a wage subsidy scheme for those under 35 years old might also be a part of the package tonight. Certainly, the pandemic has hit the youth hard. The youth unemployment rate stood at 13.8% in August, which is well above the national unemployment rate of 6.8%.

There will also be policies around generating improvements in business investment. The extension of the instant-asset write-off scheme is a strong possibility. There might also be small business start-up tax breaks and tax loss "carry back" benefits among other measures.

Some stimulus has already been announced, such as the manufacturing strategy of \$1.5 billion.

Trade data released earlier today is playing second fiddle to the bigger events due later today. International trade data for August was published earlier this morning. The theme of trade surpluses continued into August, but the trade surplus is down from recent highs. The surplus printed at \$2.6 billion for August, which is a narrowing from \$4.7 billion in July and the average monthly trade surplus of \$8.2 billion in the four months to June.

Tomorrow, the Australian Bureau of Statistics (ABS) releases its payrolls jobs and wages data for the week ending September 19, which will provide a better feel as to the recovery of the labour market through the middle of September. We expect the data could show some loss of momentum in the recovery in jobs.

Finally, on Friday, the Reserve Bank will release its semi-annual Financial Stability Review and housing finance data for August is published.

Housing finance approvals posted a strong rebound through June-July. The total value of approvals rose 8.3% in July and by nearly 16% over the two months to July to be just 3% below pre-COVID levels. Remarkably, the value of total approvals, excluding refinancing, is up 11.8% on a year ago. The data suggests the shock to housing lending activity from COVID-19 disruptions has been relatively mild and short-lived.

This broad theme is expected to carry into August, albeit with some renewed weakness associated with Victoria's second lockdown. That said, there is some uncertainty around the monthly move with reopening continuing in other states, some boost likely from the HomeBuilder scheme and potential lags in the way these factors play through to financing activity. For example, the bulk of the impact from the wider lockdown back in April came through in May. On balance, we expect the total value of approvals to fall 1.5% in the month, led by a decline in lending for investors.

Please find attached our key forecasts over the page.

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Forecasts

End Period:	2020		2021			
	Close (Oct 6)	Q4 (f)	Q1 (f)	Q2 (f)	Q3 (f)	Q4 (f)
Aust. Interest Rates:						
RBA Cash Rate, %	0.25	0.10	0.10	0.10	0.10	0.10
90 Day BBSW, %	0.09	0.05	0.05	0.05	0.10	0.10
3 Year Swap, %	0.14	0.08	0.08	0.08	0.08	0.08
10 Year Bond, %	0.83	0.80	0.90	1.00	1.05	1.15
US Interest Rates:						
Fed Funds Rate, %	0.13	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond, %	0.78	0.60	0.65	0.75	0.75	0.85
USD Exchange Rates:						
AUD-USD	0.7181	0.75	0.76	0.76	0.78	0.80
USD-JPY	105.75	105	105	106	106	106
EUR-USD	1.1783	1.21	1.22	1.23	1.24	1.25
GBP-USD	1.2979	1.33	1.34	1.35	1.37	1.39
NZD-USD	0.6646	0.67	0.66	0.66	0.68	0.70
AUD Exchange Rates:						
AUD-USD	0.7181	0.75	0.76	0.76	0.78	0.80
AUD-EUR	0.6097	0.62	0.62	0.62	0.63	0.64
AUD-JPY	75.94	78.8	79.8	80.6	82.7	84.8
AUD-GBP	0.5534	0.56	0.57	0.56	0.57	0.58
AUD-NZD	1.0805	1.12	1.15	1.15	1.15	1.14

	2019	2020 (f)	2021 (f)
GDP, %	2.2	-3.5	2.5
CPI (Headline), %	1.8	0.4	2.2
CPI (Trimmed mean), %	1.6	0.8	1.7
Unemployment Rate, %	5.2	7.7	7.6
Wages Growth, %	2.2	1.9	1.6

AUD cross exchange rates have been rounded.

Financial forecasts are quarter end.

GDP, CPI, employment and wage growth forecasts are year end.

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The Detail

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