



Economic policy in a year of uncertainty

**Financial Standard Chief Economists Forum
Danielle Wood, Grattan Institute
5 & 7 February 2020**

Economic policy outlook for 2020 and beyond

Fiscal policy: back in fashion

- Surplus out, stimulus in?
- Government loosed the spending straightjacket
- Investment allowance, age care spending, and perhaps more....

Monetary policy: a year of leaning

- Another cut then 'wait and watch'?
- Adopting a flexible approach to inflation target with an eye to house prices and debt

Lower wage growth the new normal?

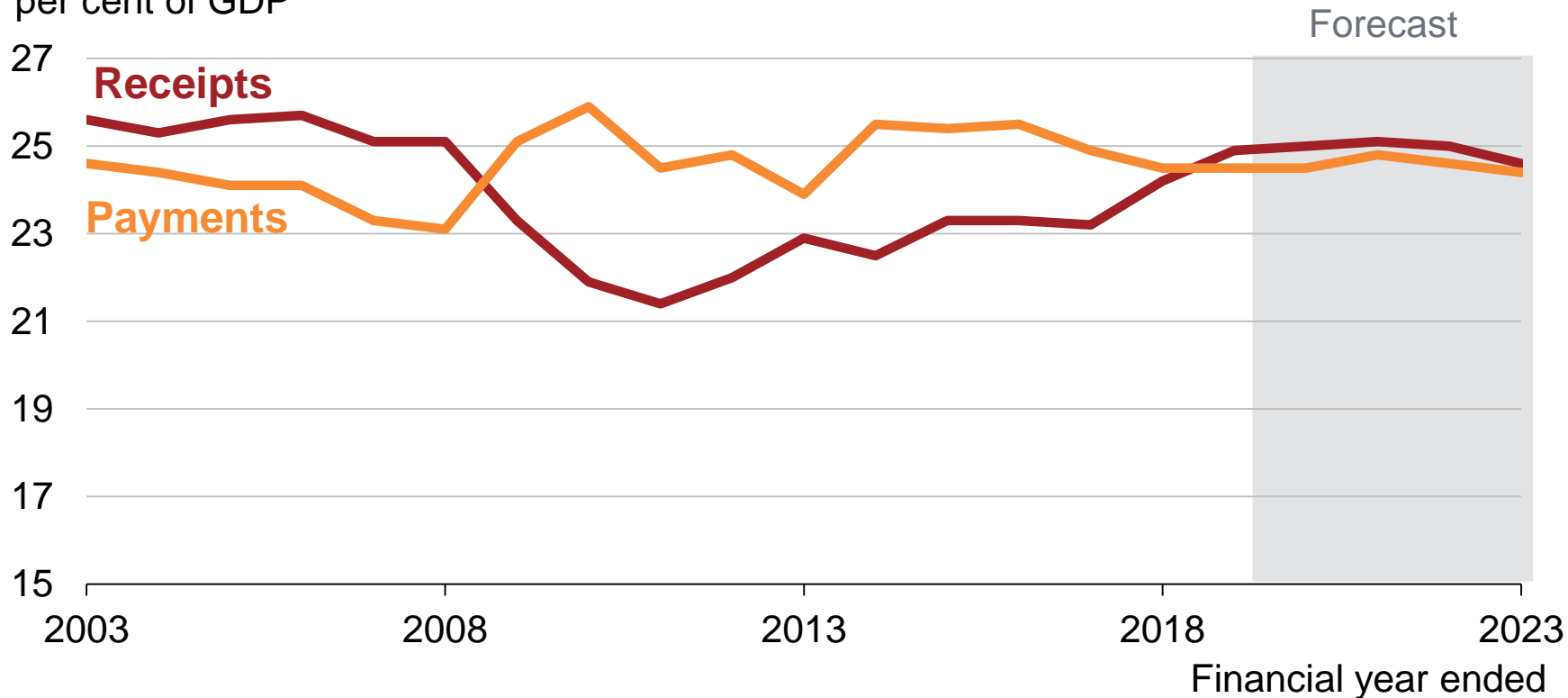
- Both Treasury and RBA revised down their forecasts
- Don't forget the supply side - excess capacity despite strong jobs growth

Longer-term outlook will be in the spotlight

- Intergenerational Report will restart conversation about long term pressures
- Climate change is the gaping hole – will government build in climate risk? 2

Long-promised surplus on its way?

Commonwealth receipts and payments
per cent of GDP



Source: 2019-20 MYEFO.

What a difference 6 months makes....



“Tonight, I announce that the Budget is back in the black and Australia is back on track”

Josh Frydenberg, April 2019 Budget speech

The budget surplus is “non-negotiable”

Josh Frydenberg, August 2019



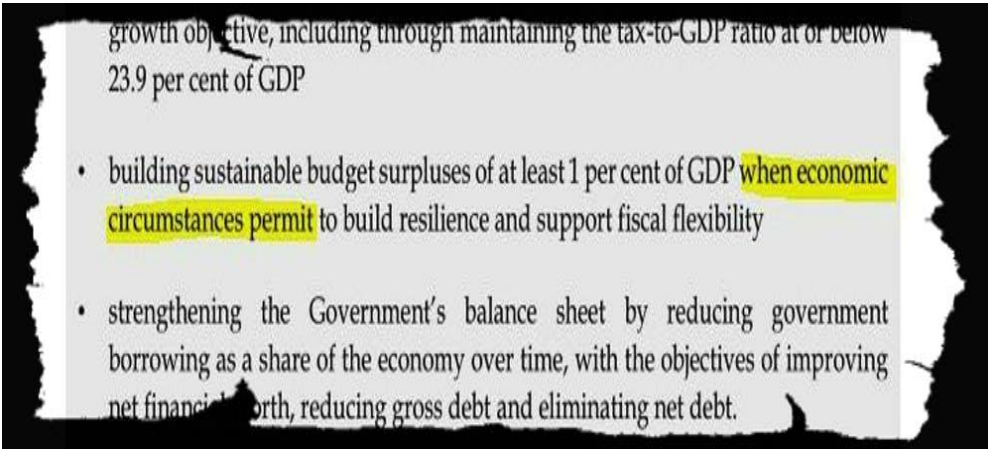
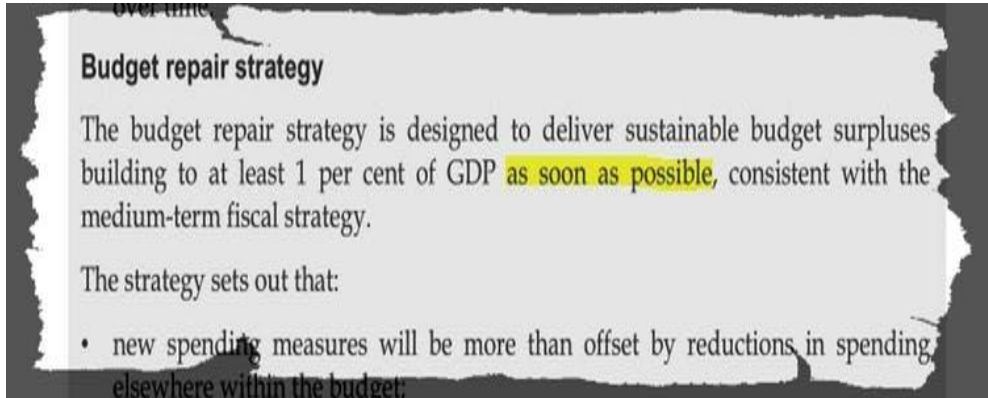
“The surplus is of no focus for me” ... “What matters to me is the human cost and meeting whatever cost we need to meet.”

Scott Morrison, January 2020

Collector's items?



What happens beyond that? A close reading of budget papers signals a change



Others targets have been 'disappeared'...

- New spending initiatives will be more than offset by reductions in spending elsewhere in the budget
- Improvements in the budget position due to favourable economic circumstances will be banked to the bottom line
- Spending will be reduced as a share of GDP

Predictions for 2020-21 budget....

- Close to balance, government will do what it can to land on the surplus side of the ledger
- Fires will show up as higher spending (but mainly in the short-term) and lower growth. Coronavirus also a hit to growth. How big?
- Bets are off for 2020-21 and beyondexpect to see new spending and tax changes:
 - Investment allowance – will \$2 billion be enough to get investment moving?
 - More age-care spending – responding to Royal Commission will be expensive
 - Other spending inc injections to tourism sector?

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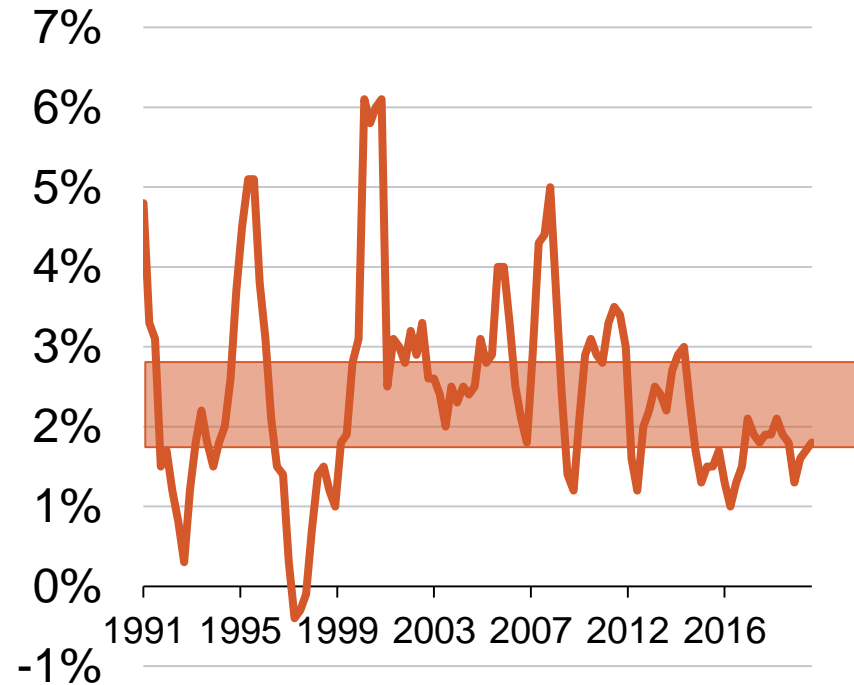
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Predictions for 2020 monetary policy

- Expect to see another cut before the May budget, then 'wait and watch'
- RBA will happily embrace the breathing room if federal government shifts to more stimulatory settings
- RBA clearly taking 'flexible' approach to inflation target with an eye to financial stability
- Macroprudential loosening plus low interest rates potent combination house prices....

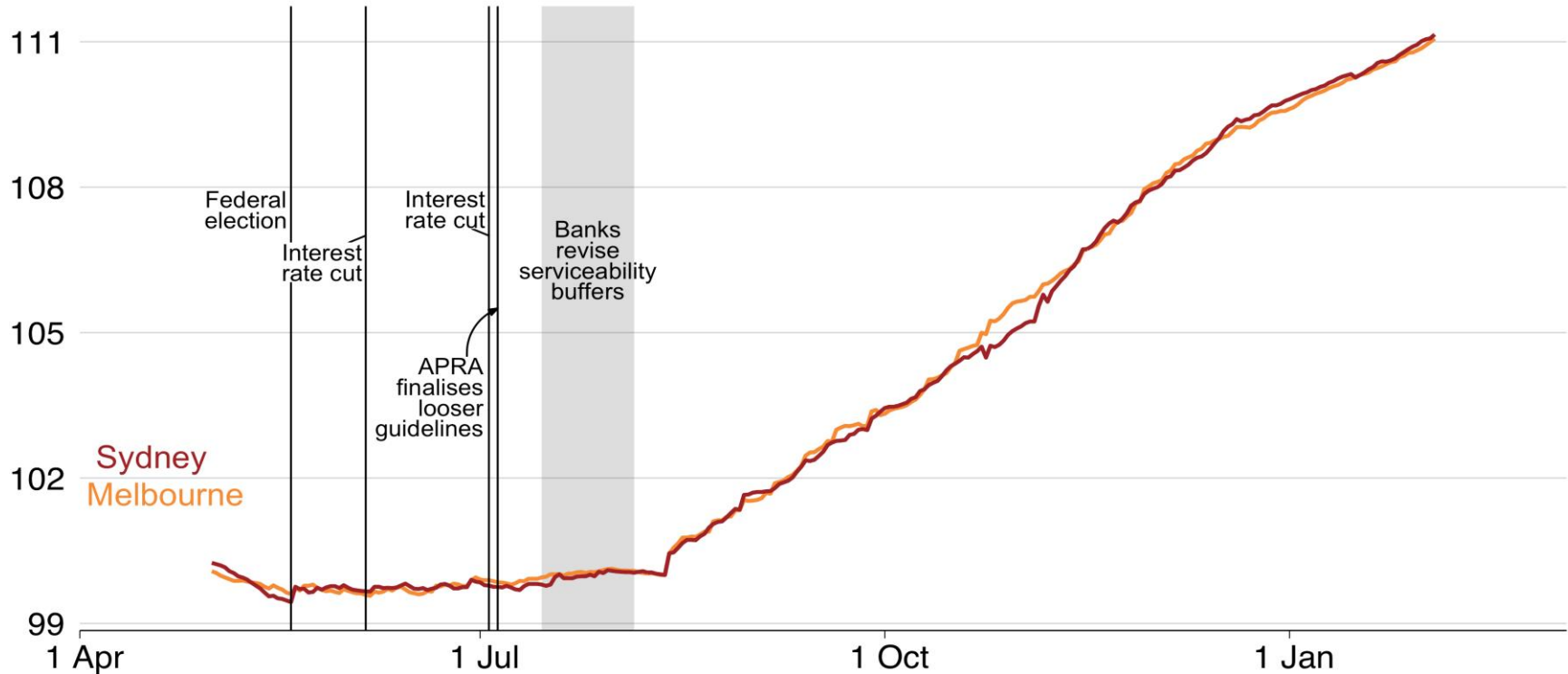
Annual change in the consumer price index



Source: ABS 6401.0

Macroprudential loosening combined interest rate cuts a powerful combination

Corelogic daily house price index (12 August 2019 = 100)



Sources: Corelogic. Dates for banks' revised serviceability buffers based on advice provided to mortgage brokers.

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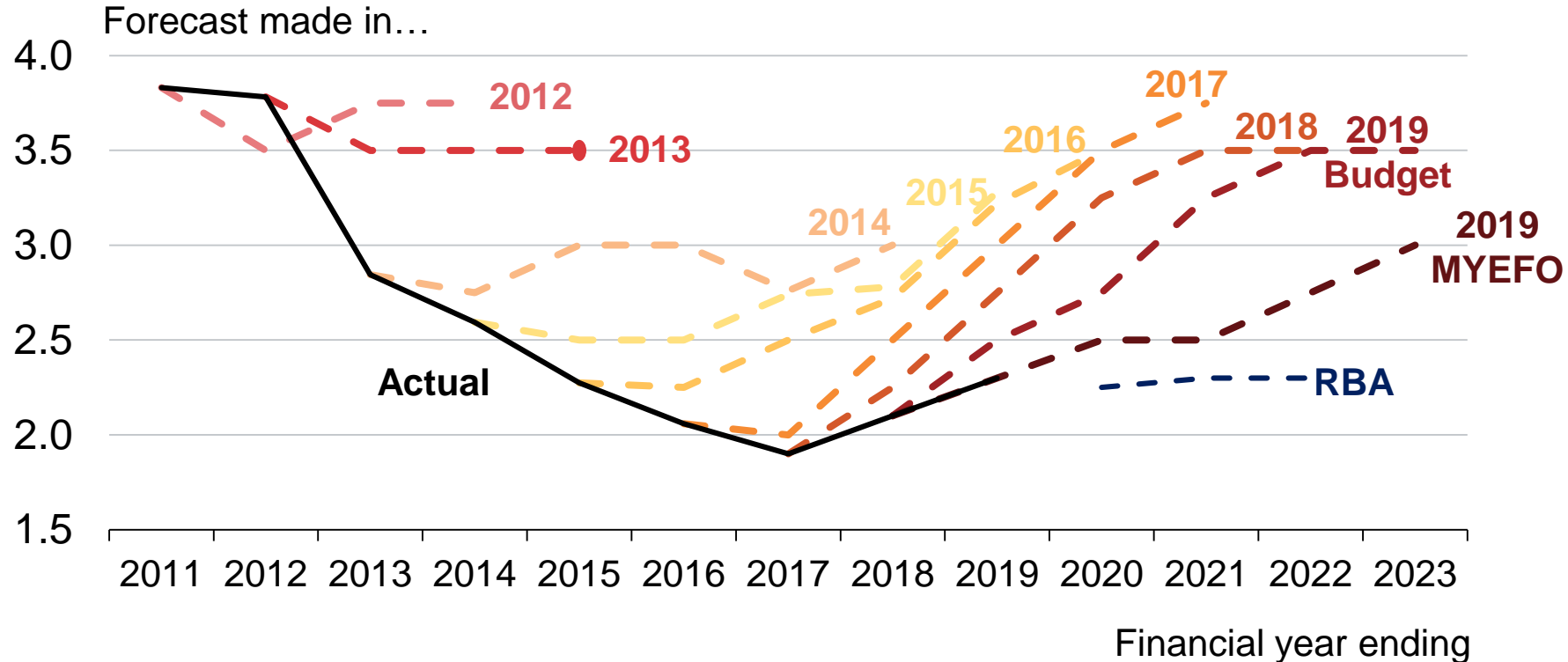
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Treasury and esp RBA forecasting lower wages growth for foreseeable future

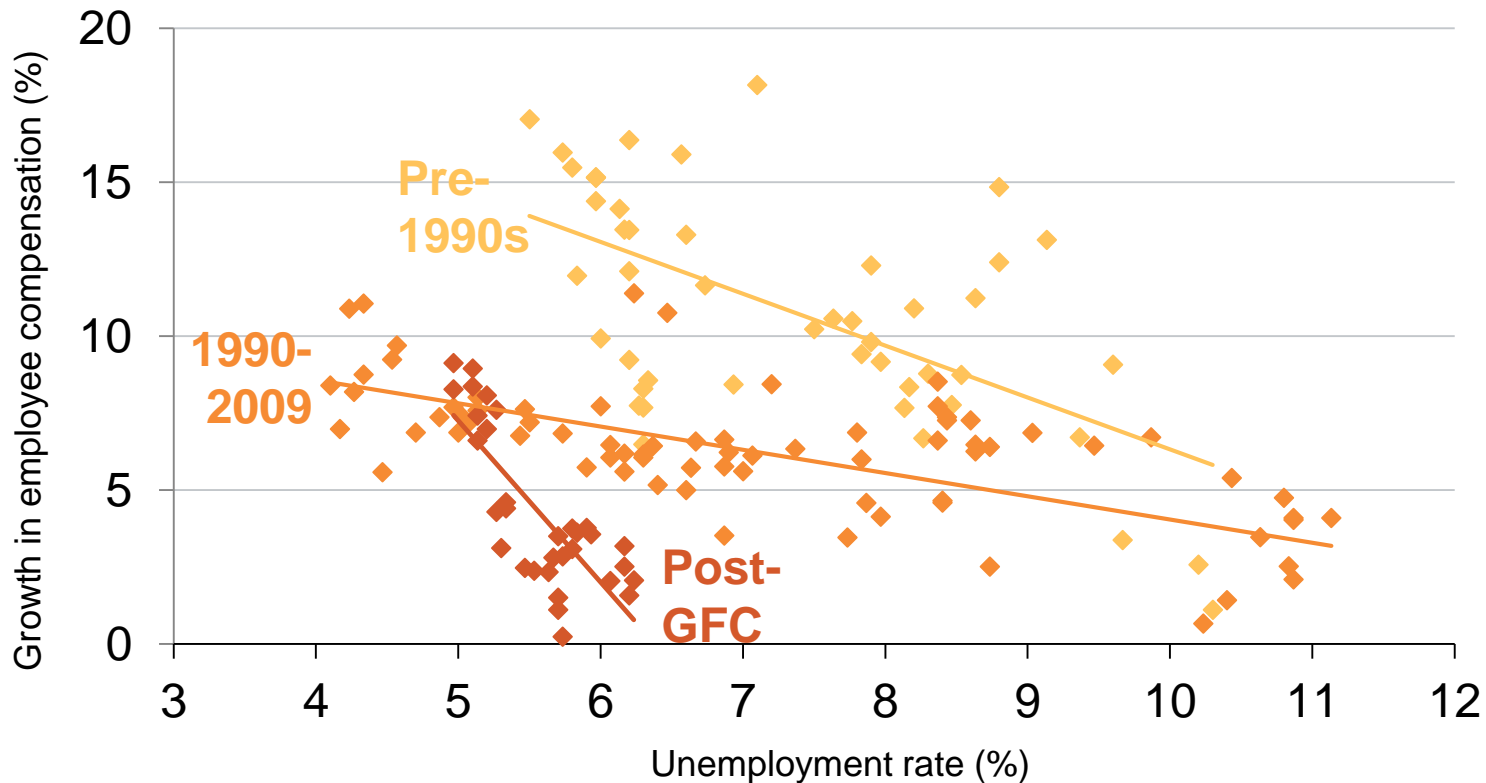
Actual and forecast growth in wages, per cent



Note: Total hourly rates of pay excluding bonuses, private and public wages.

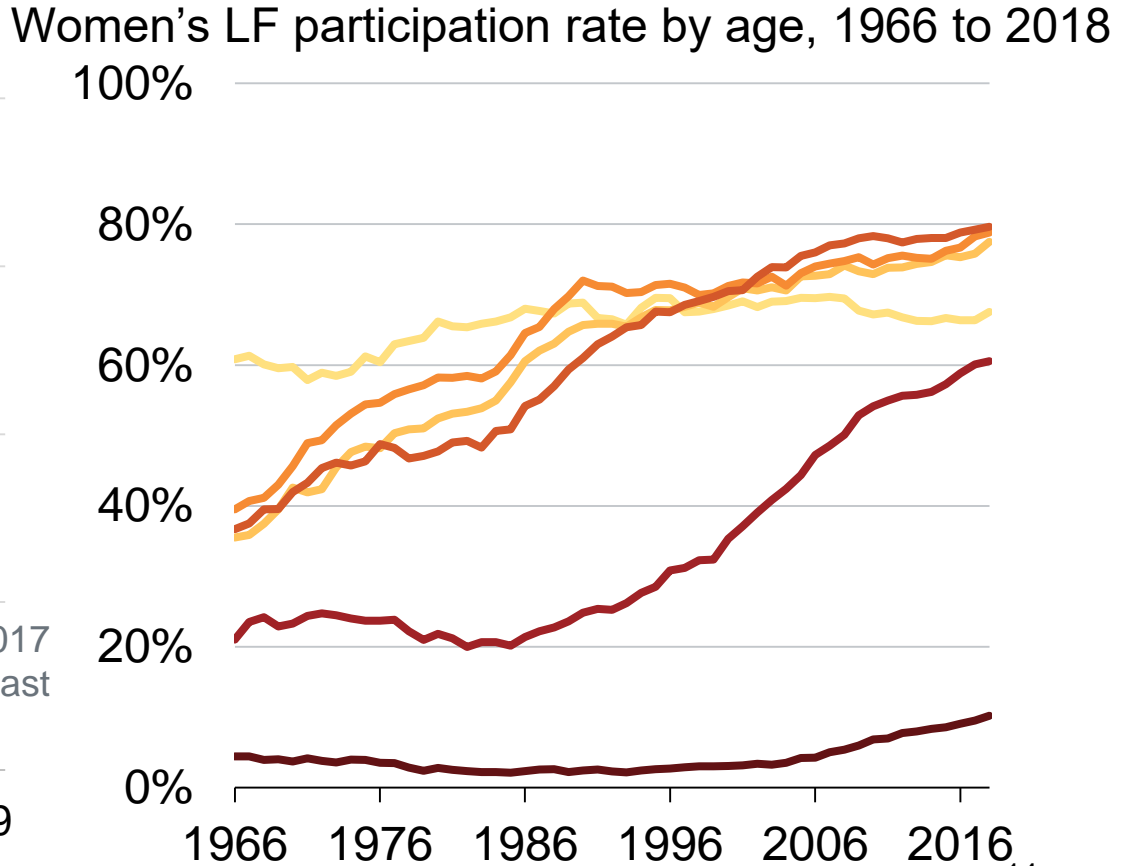
Source: Grattan analysis of Commonwealth Budget Papers 2010-11 to 2019-20 and MYEFO 2019-20.

RIP the Phillips curve.....



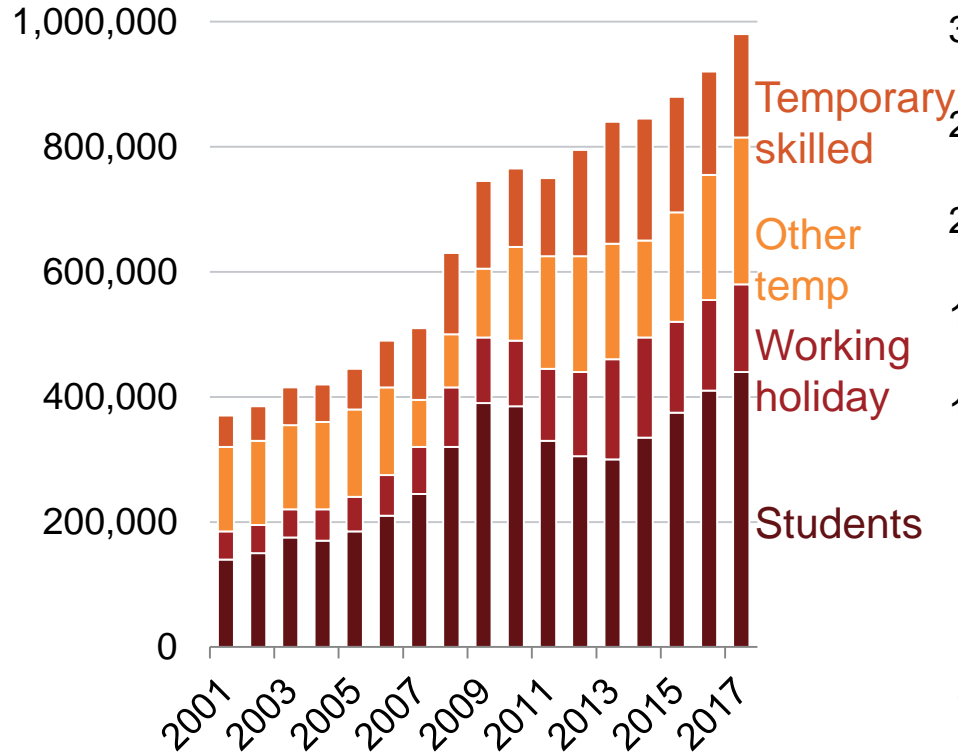
Notes: Employee compensation is total remuneration of employees including wages, ad hoc bonuses, termination payments and in-kind benefits
Source: Based on NAB and Grattan analysis of ABS Labour Force data

Participation been much higher than expected – particularly for older women

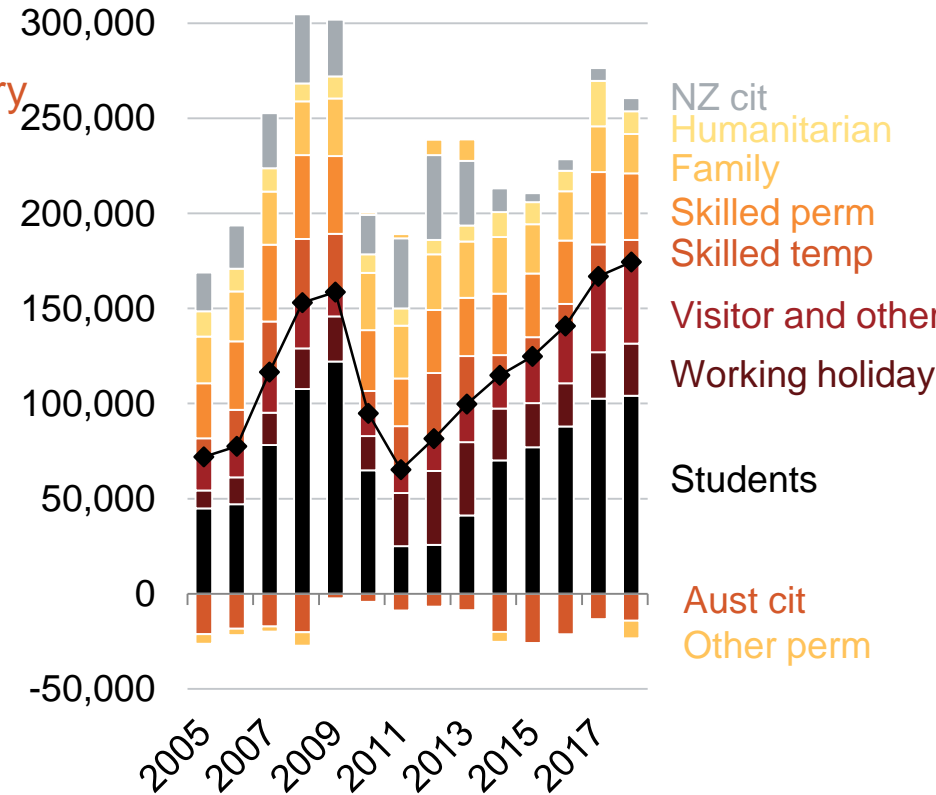


Temporary migration has substantially boosted supply of unskilled workers

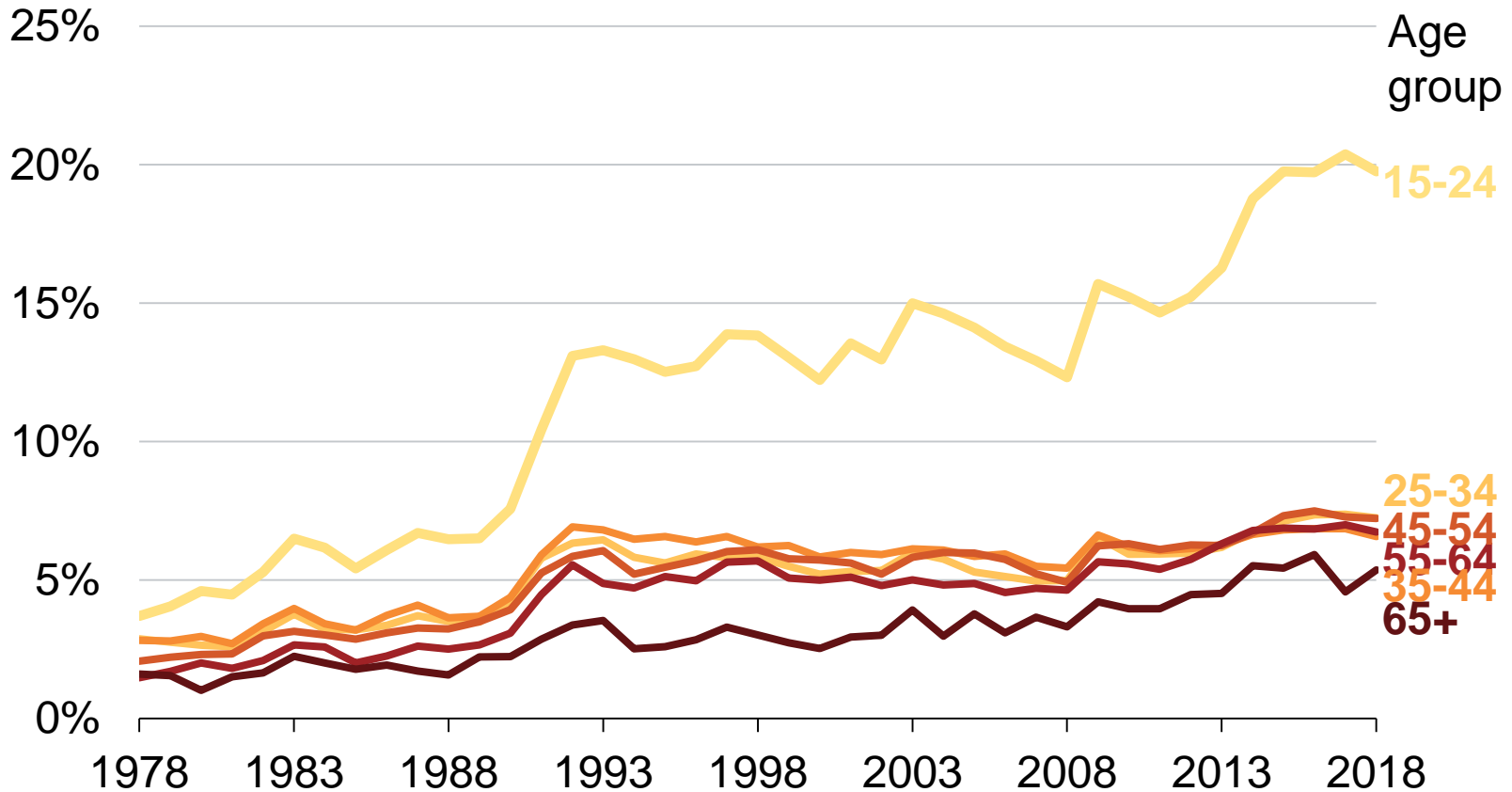
Stock of temporary migrants (ex NZ)



Net overseas migration, FY ended



And underemployment is on the rise for young people



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- Maintaining a flexible approach to inflation target with an eye to house prices and debt

Lower wage growth the new normal?

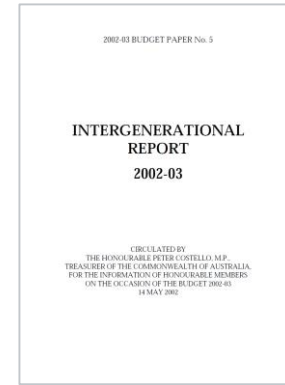
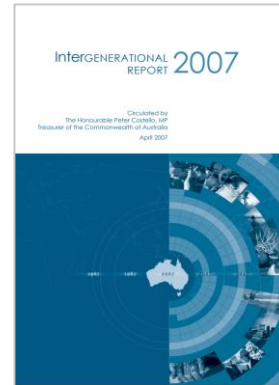
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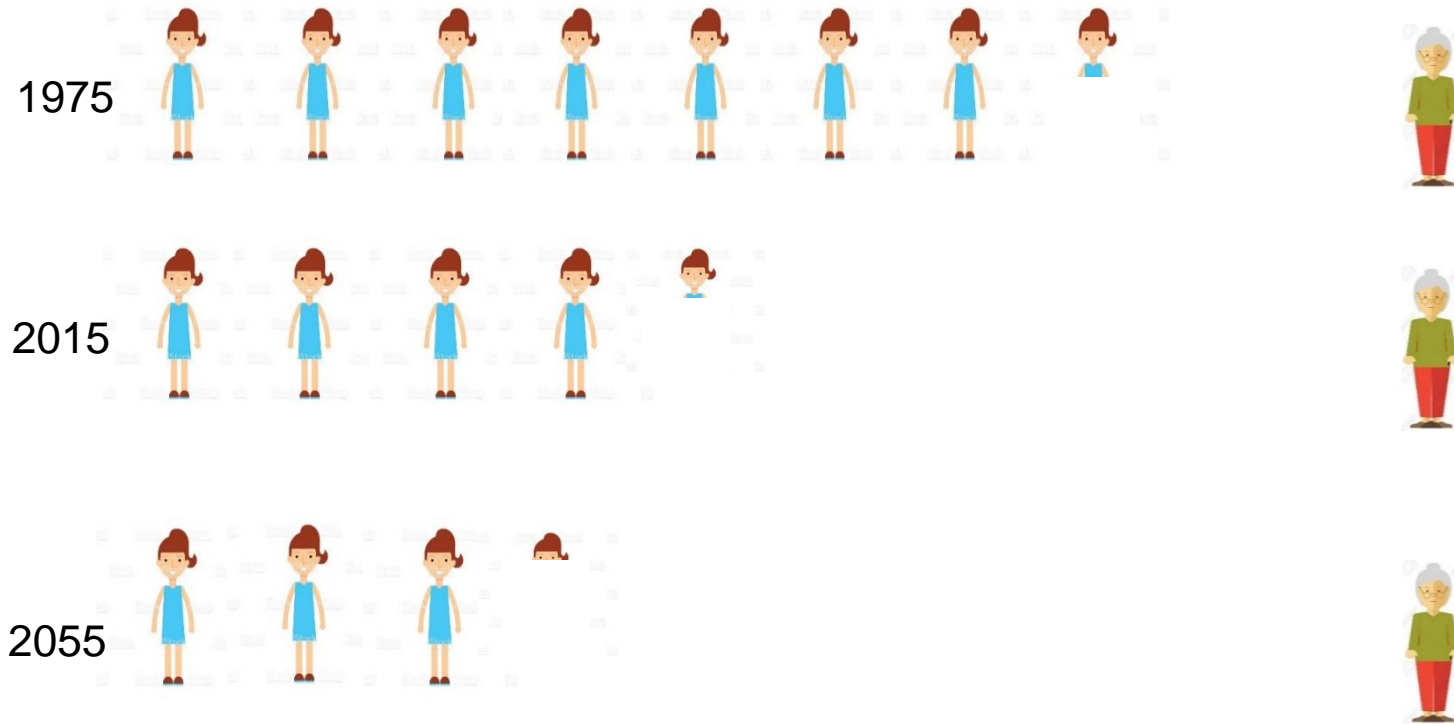
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2020 means release of another Intergenerational Report

Commonwealth Charter Budget Honesty requires the government release an IGR every five years



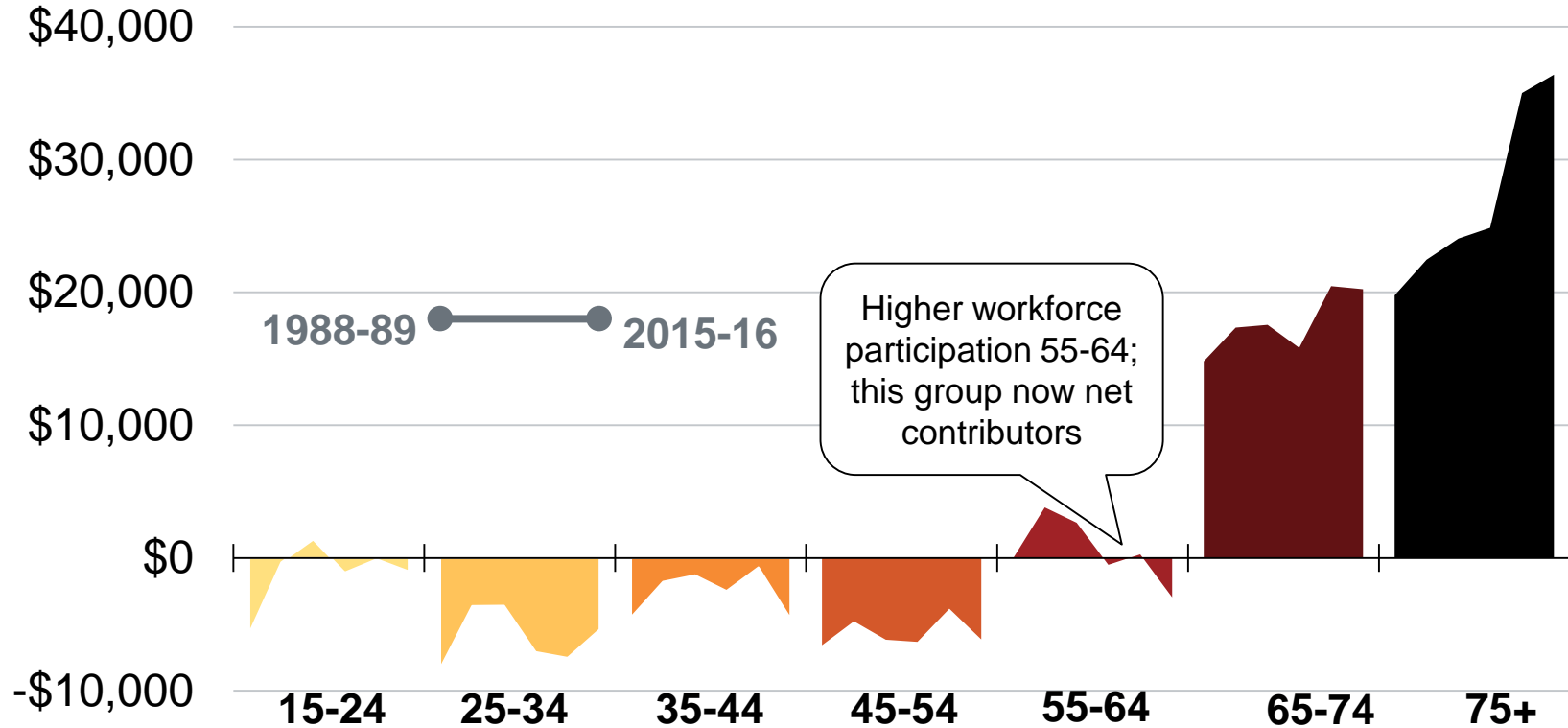
Highlight future pressures on government budgets from population ageing



Australians aged 15-64 for every Australian 65+

Governments have supercharged these pressures

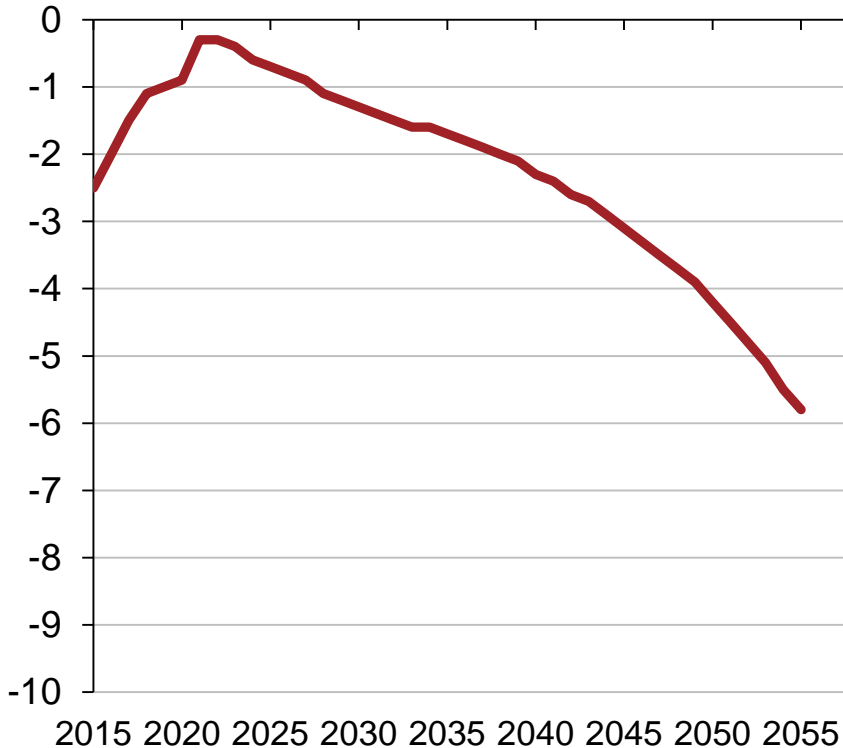
Average annual net benefits per household, 2015-16 \$, by age of head of HH



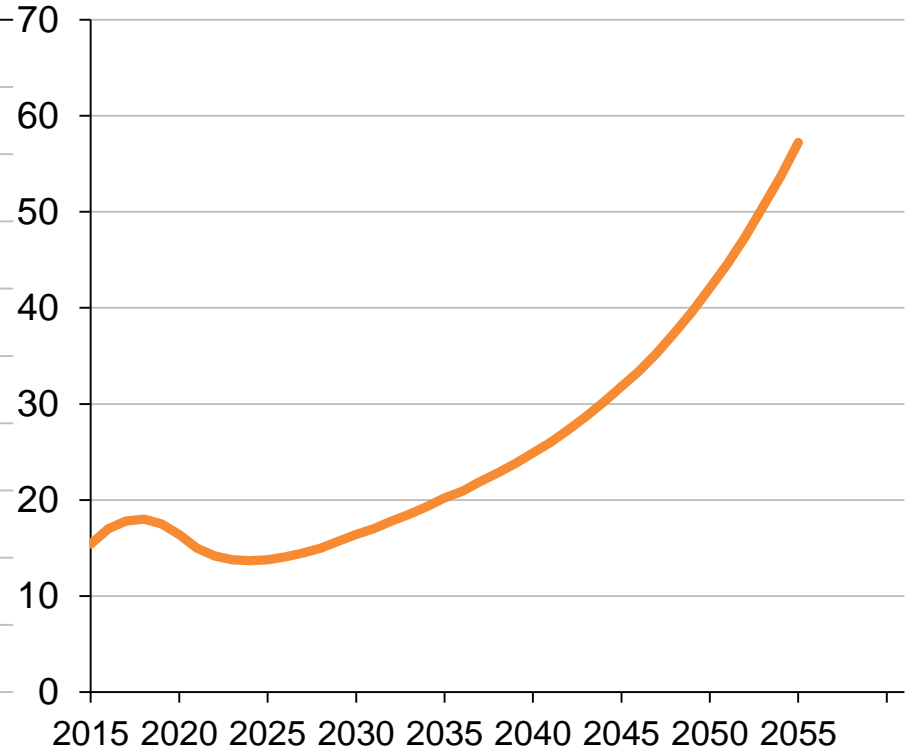
Notes: Net benefits are social assistance benefits in cash plus support in kind minus income and sales taxes. Equivalisation accounts for households of different sizes. Age group is the age of the household reference person. Source: ABS (2018b).

That's why business as usual could look ugly

Projected Commonwealth cash balance under 2015 legislated policy (per cent of GDP)



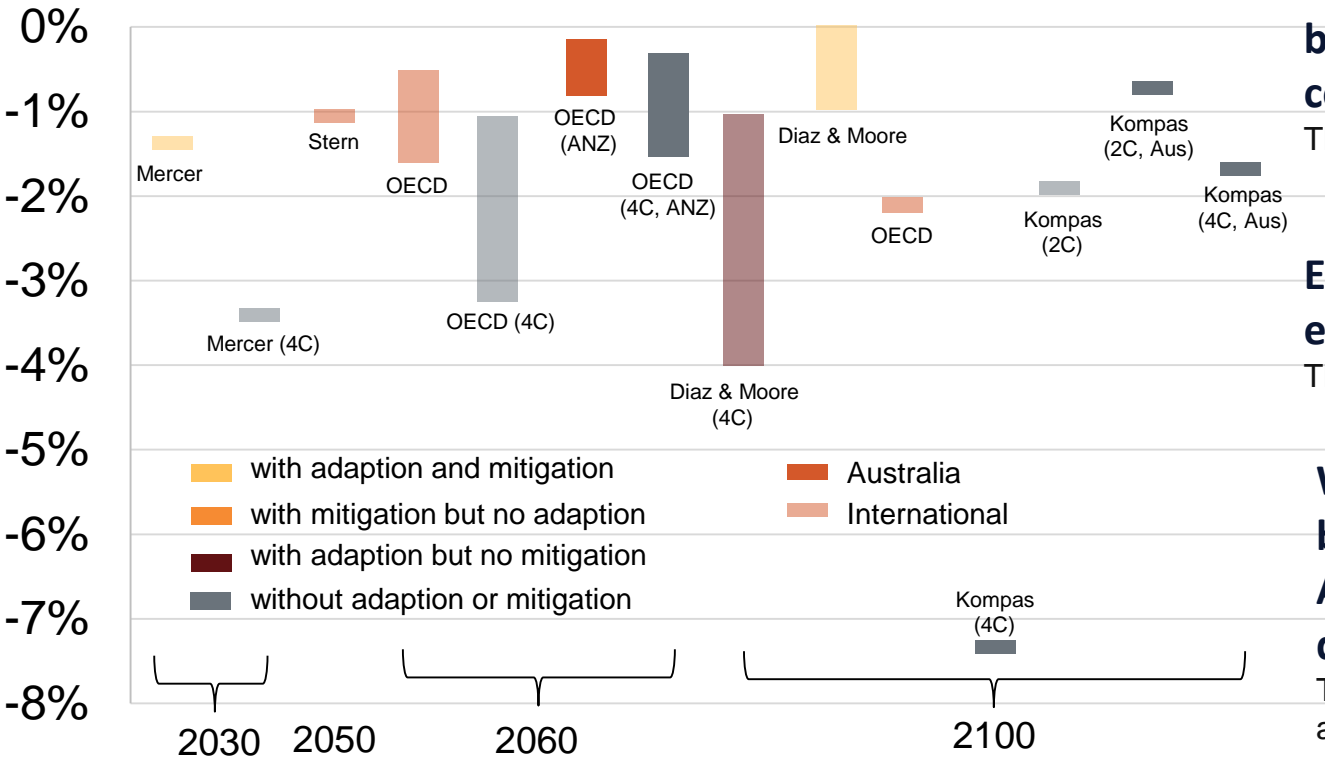
Projected Commonwealth net debt under 2015 legislated policy (per cent of GDP)



Source: Commonwealth Government, Intergenerational Report (2015)

But demographic change not only long-term pressure

Economic effects of climate change could be large



Economic impact of Australia's bushfires set to exceed \$4.4bn cost of Black Saturday

The Guardian – estimates by Moody's

Economic cost of bushfires estimated at \$2 billion and rising

The Age – estimates by SGS

With costs approaching \$100 billion, the bushfires are Australia's costliest natural disaster

The Conversation – estimates by Read and Dennis

Australia risks being significantly out of step

Top 5 global risks, World Economic Forum

	2007	2009	2011	2013	2015	2017	2019							
Probability	I/str break	Asset crash	Asset crash	Asset crash	Extreme weather	In-equality	In-equality	In-equality	I-nat conflict	Forced migrat'n	Extreme weather	Extreme weather	Extreme weather	Extreme weather
	Chronic disease	ME war	China crash	China crash	Extreme weather	Fiscal crash	Fiscal crash	Extreme weather	Extreme weather	Extreme weather	Forced migrat'n	Natural disaster	Climate change	Climate change
	Oil price shock	Failed states	Chronic disease	Chronic disease	Corruption	Climate change	Climate change	Unemployment	Nat'l gov'ce	Climate change	Natural disaster	Cyber	Natural disaster	Natural disaster
	China crash	Oil price shock	Global gov'ce	Fiscal crash	Bio-diversity	Cyber	Water short	Climate change	State collapse	I-nat conflict	Terrorism	Data fraud	Data fraud	Bio-diversity
	Asset crash	Chronic disease	Deglobalisation	Global gov'ce	Climate change	Water short	Ageing	Cyber	Unemployment	Natural disaster	Data fraud	Climate change	Cyber	Enviro-disaster
Impact	Asset crash	Asset crash	Asset crash	Asset crash	Fiscal crash	Finance crash	Finance crash	Fiscal crash	Water short	Climate change	WMD	WMD	WMD	Climate change
	Depopulation	Depopulation	Depopulation	Depopulation	Climate change	Water short	Water short	Climate change	Pan-demic	WMD	Extreme weather	Extreme weather	Climate change	WMD
	I-nat conflict	China crash	Oil price shock	Oil price shock	I-nat conflict	Food short	Fiscal crash	Water short	WMD	Water short	Water short	Natural disaster	Extreme weather	Bio-diversity
	Pan-demic	Oil price shock	Chronic disease	Chronic disease	Asset crash	Fiscal crash	WMD	Unemployment	I-nat conflict	Forced migrat'n	Natural disaster	Climate change	Water short	Extreme weather
	Oil price shock	Pan-demic	Fiscal crash	Fiscal crash	Energy prices	Energy prices	Climate change	I/str break	Climate change	Energy prices	Climate change	Water short	Natural disaster	Water short

Economic
 Social
 Geopolitics
 Technology
 Environment

Source: World Economic Forum, *Global Risk Report*. Note some risks recoded for consistency