Tuesday, 21 July 2020

RBA & Federal Government Update

The Long Road to Recovery

- **The Federal Government announced an extension of the JobKeeper and JobSeeker packages today.**
- **The Reserve Bank (RBA) also released the minutes of its policy meeting earlier this month and RBA Governor Lowe gave a speech to the Anika Foundation.**
- **Policy makers are cautiously optimistic that the worst of the economic shock has passed but warn that the recovery will be long and bumpy.**
- **JobKeeper was extended to March 2021, but in a tiered form on a reduced rate with more onerous eligibility requirements.**
- **Governor Lowe indicated that the RBA was likely to retain its current monetary policy measures for now. However, he indicated that if conditions were to deteriorate, it would favour a reconfiguration of the package deployed in March. Lowe ruled out negative rates.**
- **Policy measures could entail lowering interest rates to 0.10%, changing the term funding facility or purchasing a specific quantity of bonds.**
- **The RBA highlighted that one of the keys to economic recovery, including in the jobs market, is confidence. Until confidence returns, fiscal and monetary policy can only do so much.**
- **The main takeaway from today's policy deluge is to buckle-in for a long and bumpy economic recovery. Without an easing of new infections the economic outlook remains highly uncertain.**

Today, the Reserve Bank (RBA) Governor Philip Lowe spoke at the Anika Foundation annual event via webcast. While Governor Lowe indicated that the RBA was likely to maintain its current monetary settings, Lowe provided some greater insight into the current thinking about potential future policy measures.

The Governor continued to rule out some alternative monetary policy measures and devoted a proportion of his speech to discussing their pitfalls. These measures included direct monetary financing of government debt, FX intervention and negative interest rates. On monetary financing of fiscal policy, Lowe said it was not an option for consideration in Australia. Lowe also maintained his earlier stance on negative interest rates in Australia and continued to view the policy as "extraordinarily unlikely".

However, Lowe elaborated on some measures that the central bank could adopt. The most likely path hinted at a reconfiguration of the current package which was deployed on March 19.

Policy measures could entail lowering interest rates to 0.10%, changing the term funding facility or purchasing more bonds. Lowe did not think that these changes were needed, preferring to see how the economic recovery plays out for now. The preferred course of action was to keep current policy settings unchanged, by leaving the cash rate at 0.25%, the three-year yield target at around 0.25% and maintaining the term funding facility. However, these amended measures could be "the right thing to do down the track".

Lowe showed little appetite for alternative policy options that have been in the policy debate in recent times, such as negative interest rates and debt monetisation. Lowe is increasingly placing the onus on the government to provide support to the economy through fiscal policy. Indeed, the RBA welcomed the policy change to extend JobKeeper and JobSeeker payments announced today.

Lowe expressed the importance of government spending to limit the large shocks to private incomes and, consequently, limit the long-term effects or "scarring" on the economy. Given that debt levels in the government sector were low relative to the size of our economy and in comparison to other countries, there was plenty of room for government spending to support the economy. Lowe called for a rethink in the aim of maintaining low deficits and low levels of public debt and suggested that borrowing in this environment was "entirely manageable and affordable and it's the right thing to do in the national interest". Lowe added the biggest policy mistake would be to withdraw support too early.

On the Australian dollar, Lowe expressed his ongoing preference for a lower currency, which would support jobs and boost the competitiveness of Australian goods and services in comparison to overseas. However, Lowe did not think that the Australian dollar was "mis-aligned" from fundamentals and that the RBA was not going to force it lower.

Labour market

The RBA noted the sharp deterioration in labour market conditions over April and May in the minutes of the July board meeting and in the Governor's speech.

Governor Lowe highlighted that conditions in the labour market are likely to remain subdued for some time. Moreover, the softer jobs market will be a major source of scarring for the economy. The unemployment rate rose to 7.4% in June, the highest in 21½ years. If it were not for a significant proportion of the labour force becoming discouraged from looking for jobs and, therefore, not counting as unemployed, the unemployment rate would have been even higher. Additionally, the introduction of the JobKeeper wage subsidy enabled many businesses to retain employees.

Hours worked declined by almost 10% over April and May, a figure Governor Lowe called "staggering". However, he pointed out that it was not as bad as first feared, defying the RBA's initial forecast of a 20% fall and the rates of decline seen overseas. Hours worked in Canada fell 28% and in the United States they declined by 19%.

In his speech to the Anika Foundation today, Governor Lowe made 3 main observations about the labour market:

- The path ahead for recovery in the labour market will be bumpy, as aggregate demand in the economy deteriorates and as firms reconsider their business models.
- There was also concern for some industries which would see their pipeline of work dry up, just as other parts of the economy were benefiting from the easing of restrictions. This would further weigh on employment prospects.
- The unemployment rate is likely to rise in the coming months, as discouraged workers

begin to search for employment and re-join the labour force.

- Confidence is key to the recovery.

The RBA sees the trough in the labour market as having occurred in May, albeit now embarking on a bumpy, uncertain recovery. Governor Lowe noted that hours worked improved by 4% in June. Businesses that were most affected by lockdowns, such as those in the hospitality sector have led the turnaround. Ominously, other sectors are now suffering from a broader lack of demand caused by the restrictions.

Through its business liaison, the RBA said that firms in the construction and professional services sector were able to retain their workforces at the height of the pandemic due to a sufficient pipeline of work. They have since experienced a decline in new orders and will reduce working hours if the pipeline is not soon replaced.

A plateau in the weekly payrolls jobs and wages data in late June suggest that the recovery is already slowing and this was acknowledged by the Governor in his speech.

The RBA highlighted that one of the keys to the labour market recovery is confidence. Firstly, confidence that COVID-19 can be contained. Secondly, that households regain confidence towards their own financial and employment prospects, and thirdly, that businesses become confident about future demand. Until confidence returns, fiscal and monetary policy can only facilitate so much of a recovery.

Lowe was very concerned with regards to the lockdown measures imposed in parts of Victoria. On the impact to forecasts, Lowe said that it was “too fluid to conjecture a number” and that an update would be provided in the next Statement on Monetary Policy in August.

JobKeeper 2.0

Today, the Federal Government announced an extension to the JobKeeper and JobSeeker support packages. The Government recognised that the economic recovery remains too fragile to withstand the withdrawal of support on the original September deadline.

The JobKeeper wage subsidy will be extended by six months from 27 September 2020 to 28 March 2021. The second wave of the scheme, dubbed “JobKeeper 2.0” will move from a flat $1,500 per fortnight to a tiered structure at a lower rate. The extension comes at an expected cost of $16 billion, bringing the total estimated cost of the scheme to $86 billion.

Under JobKeeper 2.0, full-time employees (those working more than 20 hours per week) will receive $1,200 per fortnight from 28 September 2020 to 3 January 2021 and then receive $1,000 per fortnight between 4 January 2021 and 28 March 2021. Part-time employees (those working fewer than 20 hours per week) will receive $750 and $650 per fortnight, respectively, over the same periods.

For a business to qualify for JobKeeper 2.0 they will still need to show their turnover has been reduced by 30% where aggregate annual turnover is $1 billion or less or reduced by 50% where aggregate annual turnover is greater than $1 billion.

However, eligibility will tighten. From 28 Sep 2020, eligible businesses will need to show that revenue declined in Q2 and Q3 of 2020. From 4 Jan 2021, businesses will need to show that revenue declined in each of the final 3 quarters of 2020.

For JobSeeker, the coronavirus supplement will be reduced from $550 to $250 and the payment will be extended to the end of this year. There will be a return to mutual obligation requirements and individuals will be able to earn $300 per fortnight before having their JobSeeker payment reduced.

Outlook

The main takeaway from today's policy deluge is to buckle-in for a long and bumpy economic recovery. The RBA indicated a little more wiggle room at the lower-bound of interest rates, saying that 0.10% across various interest rates was possible (including the cash rate), but not likely unless conditions warrant. The RBA suggested that further accommodative monetary policy would be less effective, and that fiscal support would prove more potent. On cue, the Federal Government's extension of the JobKeeper and JobSeeker support packages is a welcome development for the economic outlook and the labour market. However, confidence remains vital to the recovery. Without an easing of new infections the economic outlook remains highly uncertain.

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