

21 August 2020

Updated medium-term fiscal scenarios: impact of COVID-19 pandemic and response

Major fiscal impact from COVID-19 to extend over the next decade and beyond

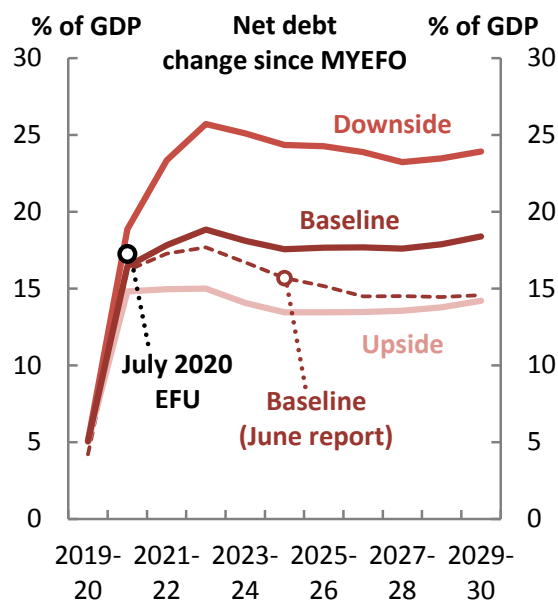
The future economic and fiscal impact of the COVID-19 pandemic remains highly uncertain and recent forecasts have had particularly short shelf lives due to the rapidly changing nature of the situation. It is clear, however, that the impact will be major and extend over the medium-term. To support an understanding of the likely magnitude of the budget impact based on the latest information, this update of the medium-term fiscal projection scenarios¹ incorporates the Reserve Bank of Australia's (RBA) August economic forecasts² and policy decisions included in the Commonwealth Government's July 2020 Economic and Fiscal Update (EFU).

Three fiscal scenarios are presented based on the economic scenarios published by the RBA in the near-term and standard budget assumptions thereafter: a baseline of a gradual economic recovery; an upside scenario of a faster recovery (resulting in less additional debt); and a downside scenario of a slower recovery (resulting in more additional debt). The results are shown as a deviation from December's Mid-Year Economic and Fiscal Outlook (MYEFO), which was the last full Budget update. While not equivalent to budget forecasts, these scenarios represent a reasonable range for the impact of COVID-19 over the next decade.

The analysis shows that the impact of COVID-19 may result in Commonwealth Government net debt in 2029–30 being between 14 and 24 per cent of GDP (up to \$800 billion) higher than it would have been otherwise, as shown in the chart.

The pandemic results in higher net debt due to lower receipts from slower economic growth and the significant policy response in 2019–20 and 2020–21. The resultant impact of increased borrowing endures through to 2029–30.

The 'baseline' result is around 4 per cent of GDP higher by 2029–30 than presented in our June fiscal scenarios report (also shown on the chart). This is largely because our June report did not include the impact of lower migration on Australia's future population. Our updated scenarios incorporate the estimated permanent impact on population from lower migration due to border closures in 2019–20 and 2020–21, as published in the EFU.

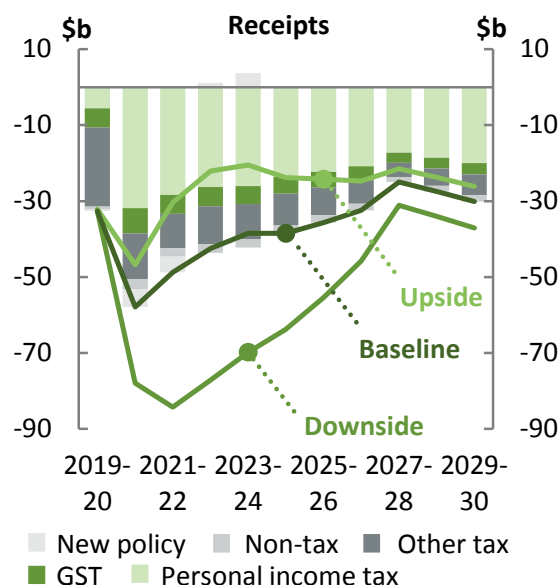


Source: RBA published data and PBO calculations

¹ *Medium-term fiscal projection scenarios: impact of COVID-19 pandemic and response*, published 5 June 2020. The methodology for this report remains unchanged from that outlined in the technical appendix to the previous report, except where noted.

² RBA forecasts as published in the *Statement on Monetary Policy* for August. Beyond 2022–23, the PBO has followed the standard budget assumption that the economy returns to its long-run potential.

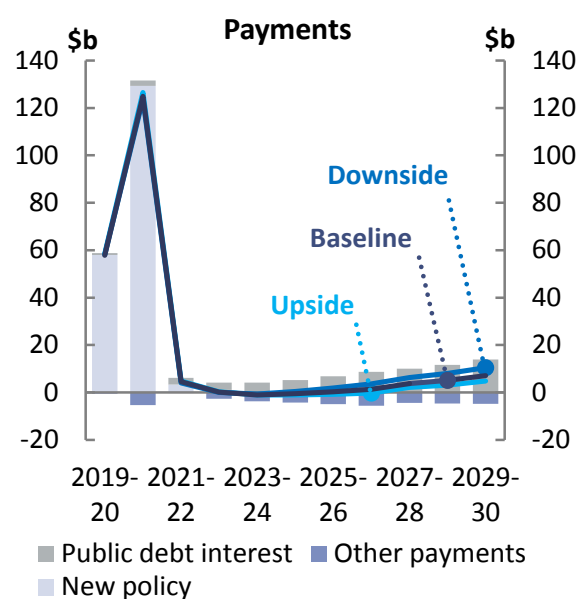
Impact of scenarios on key fiscal aggregates



Receipts are estimated to be between \$26 billion and \$37 billion lower in 2029-30 in each of the three scenarios, compared to the 2019-20 MYEFO. This is primarily a result of receipts being closely tied to growth in the economy.

As noted in our June report, nominal GDP is permanently lower under each scenario because the RBA's forecast lower prices in the short term result in enduring lower levels for prices and wages.

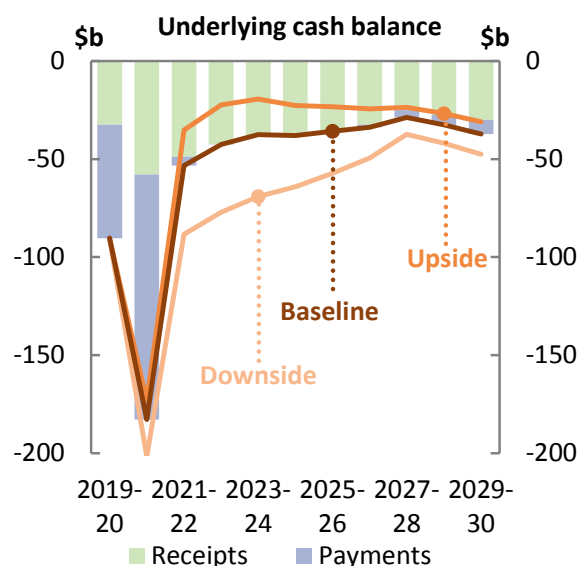
In this update, GDP is also lower over the medium-term owing to lower net overseas migration in 2019-20 and 2020-21. While it is assumed that population growth returns to trend in 2021-22, the future population level will be permanently lower than projected prior to the pandemic. This flows through to lower nominal GDP and receipts over the medium-term. The impact of lower migration alone results in around \$16 billion less receipts in 2029-30 compared to the pre-pandemic levels.



Payments are higher under each scenario, by between \$5 billion and \$10 billion in 2029-30, compared to the 2019-20 MYEFO. The initial increase in payments is due to the impact of the Government's policy measures, detailed in the EFU and worth around \$192 billion (including capital and the JobKeeper Payment extension), which are due to be largely wound down by 2022.

The increase in payments over the medium-term is a result of higher public debt interest due to higher net debt levels, and higher JobSeeker recipients.

The impact on payments is similar to our June report. Given that the majority of migrants tend to be of working age, the lower population level in the medium-term reduces payments by only a small amount compared to the impact on revenue.



The **underlying cash balance (UCB)** deteriorates by between \$31 billion and \$48 billion in 2029-30 under the three scenarios, compared to the 2019-20 MYEFO.

In 2019-20 and 2020-21, the impact is mainly due to the policy measures and their effect on payments (shown in blue in the chart).

Once the policy measures wind down, the lower UCB is due primarily to the effect on receipts of slower-than-previously-forecast economic growth (shown in green in the chart).

In this update, the larger deterioration in the underlying cash balance is mostly due to weaker receipts from the impact of lower population levels over the medium-term.

Key uncertainties and risks

No enduring economic impact from the downturn is factored into the scenarios, except for the permanently lower price level and the effect of lower net overseas migration in 2019–20 and 2020–21 on potential economic growth. Any additional ongoing negative impact on economic growth, such as on workforce participation rates or productivity growth, could result in a further significant deterioration in fiscal aggregates.

The Government's COVID-19 policy response measures are assumed to be temporary. The PBO's fiscal scenarios incorporate the Commonwealth Government's published costs for all measures taken since the 2019–20 MYEFO, including the impact of COVID-19, as published in the EFU. Additionally, the scenarios include the \$15.6 billion impact of the JobKeeper Payment extension as announced on 7 August 2020.³ Any new spending measures, unless offset by other savings, would result in a further deterioration in the fiscal aggregates in these scenarios.

These scenarios are sensitive to key assumptions such as interest rates returning to their long-run average over the medium-term, consistent with the 2019–20 MYEFO methodology. The impacts are also sensitive to future paths for domestic and international prices.

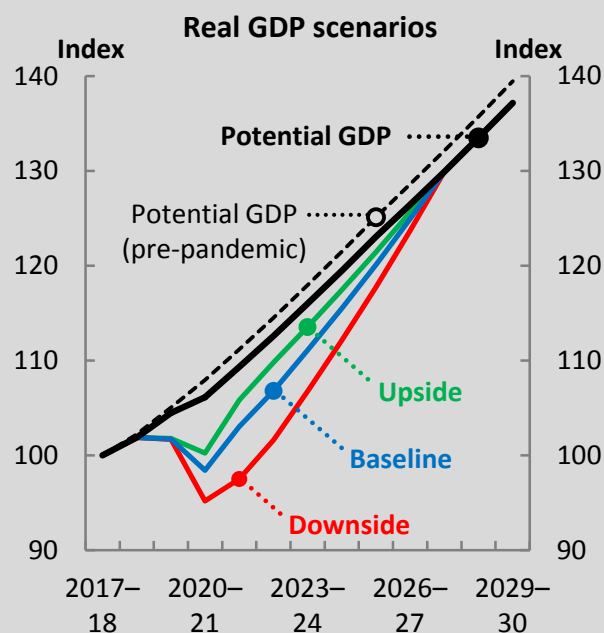
How did we prepare the fiscal scenarios?

This analysis uses the three economic forecast scenarios (baseline, upside and downside) published by the RBA in the August 2020 *Statement on Monetary Policy*. It compares these with the forecasts in the February *Statement*, prior to the main impact of COVID-19, to estimate the economic impact of the pandemic.

In each of the scenarios, the RBA forecasts real GDP growth to be slower to 2021–22. The three scenarios primarily vary depending on the virus and the associated timing and extent of domestic activity restrictions.

The baseline scenario assumes the current restrictions in Victoria are in place for the initially announced six weeks and then gradually lifted. Restrictions in other parts of the country are gradually lifted, although restrictions on international departures and arrivals are assumed to stay in place until mid 2021. In the upside scenario, the virus is assumed to be rapidly controlled domestically and activity restrictions are lifted (with the exception of international travel), leading to a faster recovery in consumption, investment and employment. The downside scenario is one where Australia faces further periods of outbreaks and heightened restrictions in certain areas. In this scenario, domestic activity would take longer to recover.

The scenarios incorporate the fiscal impact of the Commonwealth Government's policy responses to the pandemic, as well as broad economic impacts on revenue and expenses. In the medium-term, we assume GDP returns to its long-run potential, consistent with the approach in the budget. This long-run potential is lower than prior to the COVID-19 pandemic, due to the effect on potential GDP of lower net overseas migration in 2019–20 and 2020–21 because of international travel restrictions. The scenarios use the population assumptions published in the EFU and do not assume a later offsetting increase in migration.



Source: RBA published data and PBO calculations

³ Media release, *More support for businesses and workers*, 07 August 2020, <https://www.pm.gov.au/media/more-support-more-businesses-and-workers>