Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates

1 June – 3 June 2010

Question: BET 91

Topic: Dwelling Investment

Hansard Page: E26 (03/06/2010)

Senator HUMPHRIES asked:

Senator HUMPHRIES—I want to ask about the reference in Budget Paper No. 1, on page 217, under the heading 'Dwelling investment':

Demand in the sector is expected to be supported over the forecast period by strong population growth, rising incomes and a positive employment outlook, but tempered by higher mortgage interest rates.

Could you give me an idea of what sort of work Treasury has done to support that statement?

Dr Kennedy—Unfortunately, those questions would normally go to the Macroeconomics Group who prepare the forecast. I can talk in general terms, and I will, around the housing market forecast, but our Macroeconomics Group prepares the budget forecast and makes those assessments, although we feed into them. I am happy to make a couple of remarks. Were you particularly interested in an aspect of that assessment—the demand aspect?

Senator HUMPHRIES—I am particularly interested in the higher interest rates aspect. When you make reference to higher interest rates, do you have a projection or modelling on how high interest rates might go?

Dr Kennedy—I am sorry, Senator, but that is a question that would have to go directly to the Macroeconomics Group. They have a set of assumptions they use in preparing the forecasts. I am sorry that I cannot provide you with that detail, but I would be happy to take it on notice for you. I do know for a fact that they do not independently forecast those interest rates. They have an assumption that they use. In the past it was a 30-day average struck at the time when the forecasts were prepared. I noticed that in more recent times people have tended to use the forward curve—what the market is suggesting interest rates will be. I do not have those technical details with me. The assumptions are usually outlined in the section that discusses the forecast. I will ask one of my colleagues whether he can find that assumption for you.

Senator HUMPHRIES—Thank you. I could find assumptions about growth and unemployment but not one about interest rates. I would be grateful if you could direct me to that.

Mr Lonsdale—The key assumptions are outlined on page 2-7, but the issue of interest rates is not explicitly one of those.

Dr Kennedy—We will take that on notice for you and talk to our colleagues in Macro Group and tell you how that was derived.

Senator HUMPHRIES—Thank you very much.

Answer:

Like many other countries, dwelling investment in Australia is sensitive to movements in interest rates. In the 2010-11 Budget forecasts, interest rates are assumed to move in line with market expectations at the time.

The forecasting assumption for interest rates is explained in the note to Table 1 of Budget Statement 2 (page 2-7 of Budget Paper No. 1, 2010-11 Budget).