Tuesday, 6 October 2020

Federal Budget 2020-21

First Thoughts: A Budget for Our Time

- Tonight's Budget aims for a deficit in 2020-21 of $213.7 billion. This follows a deficit in 2019-20 of $85.3 billion. This is a Budget for our times. It aims to fill the hole in demand, ripped out by the COVID-19 pandemic. It gives job-creating incentives to businesses, provides support for individuals, and support for those employers hard hit by government-imposed restrictions.

- When last year's budget was crafted, COVID-19 had not been identified. It looked forward to a budget surplus on the back of modest economic growth. Courtesy of the pandemic, neither was achieved.

- How will tonight's Budget aid business? There is a deep awareness within the Budget that businesses create jobs. JobKeeper and the Cash Boost cushioned the initial blow from COVID-19. The Budget now looks forward. The manufacturing, housing, agricultural, energy, health and aged care sectors have been targeted for further assistance. In addition, the instant asset write-off provisions have been extended and temporary 'loss carry-back' tax provisions have been introduced for businesses. There are also some refundable R&D tax offset changes.

  Personal tax cuts will boost demand throughout the economy, as will the focus on infrastructure spending. A sustainable lift in demand will be required to generate new, job creating, business investment. The Budget has laid a good foundation, but the path to recovery will be long and, in many cases, difficult. *For an overview of the measures, see below.*

- Will the Budget aid in rebuilding the economy? Stimulus measures such as those in the Budget, combined with an expected easing of monetary policy next month by the Reserve Bank (RBA) should underpin demand and lift confidence. There may be some doubts about the fiscal measures chosen but they will add to demand, boost confidence, and create jobs.

- Can we afford such a large deficit? Part 1 An alternative question might be, 'can we afford not to'? Without doubt, the COVID-19 pandemic is the largest hit to our economy in 90 years. To do nothing, or to do little, risks leaving future generations with a severely degraded economy and lower living standards. We cannot risk a depression.

- Can we afford such a large deficit? Part 2 The simple answer is 'yes'. While the deficit and the accompanying debt will reach record proportions, our saving grace is that interest rates are at historical lows. The government can borrow money for 10 years at the miserly rate of around 0.85%. Such low rates make debt servicing far easier than it might have been in the past. As debt built up after the 1990s recession, debt servicing as a proportion of government revenue reached 7.1%. On tonight's figures, debt interest payments are expected to reach $13.3bn or 2.9% of revenue in 2020-21.

- When does the Budget return to surplus? The name of the game today is rebuilding the economy, not cuts to spending and belt tightening. Those policies were tried during the depression and added to everyone's misery. Times have changed and so has the Budget. Jobs and livelihoods come before economic dogma. If we could achieve a surplus in the next decade, based on solid economic growth, it would be a job well done and would put us in a position to weather the next crisis. But the Budget never returned to surplus after the GFC, so it could be a long time coming.

- What about the forecasts? The government forecasts the economy to move out of recession and pick up from late 2020, assuming COVID-19 is effectively contained. However, the challenges and uncertainty for the economy from COVID-19 remain significant. The government forecasts a contraction of 1.5% in real GDP in 2020-21 before growth of 4.75% in 2021-22 and growth of 2.75% in 2022-23. The forecasts for 2020-21 are reasonable and similar to our forecasts. However, the recovery in 2021-22 appears too optimistic. We expect growth will print lower in 2021-22 at 4.20%. The unemployment rate is forecast to peak at 8.0% in the December quarter of this year, before falling to 6.5% by the June quarter of 2022. Whilst we anticipate the peak to be 8.0% early next year, we expect the unemployment rate is likely to remain above 7.0% by the June quarter of 2022. The JobKeeper scheme is still due to expire at the end of March 2021.

- Is our AAA credit rating at risk and does it matter? Credit rating are important, but markets must deal with relative risk. Our debt may be massive by our standard but among our peer nations our debt levels remain modest. Policies are in place to encourage recovery and barring further outbreaks of COVID-19 cases, our credit rating seems unlikely to change.

- What does the Budget mean for economic growth in 2020-21? There is a recovery under way across much of Australia, but it remains uneven and bumpy. The budget stimulus measures are aimed at supporting this economic recovery through boosting household incomes and reviving business investment. Without these measures, the contraction of 1.5% outlined for economic activity in 2020-21 would be deeper. The scarring on the jobs market would also be more severe.

- The Budget and interest rates. The RBA has targets for its cash rate and for the 3-year government bond yield. We expect these targets to be reduced by 15 basis points to 0.10% in early November. Tonight's Budget does not alter that view. Economic recovery will come with a mix of fiscal (budgetary) policy and monetary (RBA) policy. Given the pandemic's hit to the economy, both arms of policy need to work hard and in unison. The Budget is playing its part, and the RBA will add to its earlier efforts, most likely at its next board meeting.

- The Budget and the AUD. The initial reaction from investors in the foreign exchange market was muted with the AUD edging only a touch higher on the night. The AUD/USD rose from 0.7149 at 6.30pm to 0.7157 at 7:30pm and then to 0.7162 by 8:30pm. The direction of the AUD over the next six months will depend on the direction of the US dollar; the policies of key central banks and governments in the major economies, including China; the path of the virus and whether a viable vaccine becomes widely available, as well as iron ore prices. Any further stimulus from the RBA will also have a bearing on the AUD's value. We continue to expect the AUD to hit US 80 cents before the end of 2021.

- Nature of the Budget. A defining feature of tonight's Budget is that many of the measures outside of the plans for infrastructure and personal income tax are temporary in nature. They can be switched off and the deficit reduced if the economic trajectory goes to plan. With uncertainty very high and no viable global vaccine yet available, there is room for plans to go astray.

Key Budget Aggregates and Parameters					
	Actual	Forecasts			
	2019-20	2020-21	2021-22	2022-23	2023-24
Budget Aggregates					
Underlying cash balance ($bn)	-85.3	-213.7	-112.0	-87.9	-66.9
% of GDP	-4.3	-11.0	-5.6	-4.2	-3.0
Net debt ($bn)	491.2	703.2	812.1	899.8	966.2
% of GDP	24.80	36.1	40.4	42.8	43.8
Major Economic Parameters					
Real GDP	-0.20	-1.50	4.75	2.75	3.00
Employment	-4.30	2.75	1.75	1.00	1.75
Unemployment rate	7.00	7.25	6.50	6.00	5.50
Consumer price index	-0.30	1.75	1.50	1.75	2.00
Wage price index	1.80	1.25	1.50	2.00	2.25
Nominal GDP	1.70	-1.75	3.25	4.50	5.00

Real GDP and nominal GDP are percentage change on preceding year. The consumer price index, employment and the age price index are through the year growth to the June quarter. The unemployment rate is for the June quarter.

<u>Budget Overview</u>

Supporting Business and Investment

- Investment allowance - temporary instant asset write-offs for non-mining businesses with turnover up to $5bn. Available from 6 October 2020 to 30 June 2022. Businesses will be able to deduct the full cost of eligible depreciable assets of any value in the year they are installed. The cost of improvements to existing eligible depreciable assets made during this period can also be fully deducted. This is expected to apply to $200bn of investment – worth $12.9bn in 2021 and 2022 and a further $18.1bn in 2023.
- Temporary loss carry-back for businesses with turnover up to $5bn – allows the write-off of any losses incurred until June 2022 against profits made on or before 2018-19.
- Treasury estimates that these two measures will create around 50k jobs by the end of June 2022 and boost GDP by around $2.5bn.
- For small business claimants with turnover of under $20mn, the government will increase the refundable R&D tax offset and there will no longer be a cap on annual cash refunds. For larger claimants, the intensity test will be streamlined and the non-refundable R&D tax offset will be increased from $100mn to $150mn per annum from July 2021.
- Help for small business operators worth $24.7mn to use technology, including providing an extra 10k places for the Australian Small Business Advisory Service – Digital Solutions program.

Personal Tax Cuts

- The bringing forward by two years (and the back dating) of Stage 2 personal income tax cuts to 1 July 2020.
- Stage 2 includes the top threshold of the 19% personal income tax bracket increasing from $37,000 to $45,000.
- It also includes increasing the low-income tax offset (LITO) from $445 to $700. The increased LITO will be withdrawn at a rate of 5 cents per dollar between taxable incomes of

$37,500 and $45,000. The LITO will then be withdrawn at a rate of 1.5 cents per dollar between taxable incomes of $45,000 and $66,667.

- Moreover, the top threshold of the 32.5% personal income tax bracket will increase from $90,000 to $120,000.
- The Government will also retain the low and middle income tax offset (LMITO) for the 2020-21 income year.
- Stage 3 of the tax plan remains unchanged and starts in 2024-25 as legislated.
- An additional $2.6bn in payments to pensioners, the disabled and carers - two additional $250 payments in December 2020 and March 2021 for eligible recipients.

Tax Cuts for Low- and Middle-Income Earners				
	Actual	2020-21		
Taxable Income ($)	Tax Liability ($)	Tax Liability ($)	Change in Tax ($)	Change in Tax (%)
40,000	4,947	3,887	-1,060	-21.4
60,000	12,147	9,987	-2,160	-17.8
80,000	19,147	16,987	-2,445	-11.3
100,000	26,632	24,187	-2,745	-9.2
120,000	34,432	31,687	-2,565	-8.0
140,000	42,232	39,667	-2,565	-6.1
160,000	50,032	47,467	-2,565	-5.1
180,000	57,832	55,267	-2,565	-4.4
200,000	67,232	64,667	-2,565	-3.8

JobMaker and JobTrainer replace JobKeeper, JobSeeker

- JobMaker – includes a hiring credit of $200 per week for newly hired 16-29 year olds and $100 per week for 30-35 year olds. Available to employers from 7 October 2020 over the next 12 months.
- JobTrainer Fund – $500mn to support job sellers to reskill and upskill and help school leavers have access to training.
- Apprenticeships' Wage Subsidy – support up to 100k new apprentices and trainees by paying eligible businesses up to 50% of an apprentice or trainee's wages. Subsidies are capped at $7k per quarter, per eligible apprentice or trainee.
- JobKeeper – support reduced and set to expire from end March 2021.
- JobSeeker supplement – already reduced from $750 to $500 set to phase out after December 31 – no extension.

Infrastructure

- States and territories to receive $2.5bn under a 'use it or lose it' approach.
- Roads and safety upgrades or "shovel-ready" projects worth $3bn over the next two years.
- National water grid support of $0.2bn in 2020-21 and a further $0.8bn in later years.

Industry Policy

- Modern Manufacturing Strategy worth $1.3 billion – the government will co-invest in six sectors: defence, space, food and beverages, recycling and clean energy, medical products, resource technologies and critical minerals processing industries - $0.5bn in 2020-21 and a further $1bn from 2022-24.

- Exporters – removing red tape for agricultural exporters by delivering improving digital services. The government will also simplify and modernise border systems for all exporter, including overhauling outdated regulations and streamlining compliance processes.
- Energy - $250mn to accelerate three electricity transmission projects and a $1.9 billion package to support the first Low Technology Statement released by the Government.

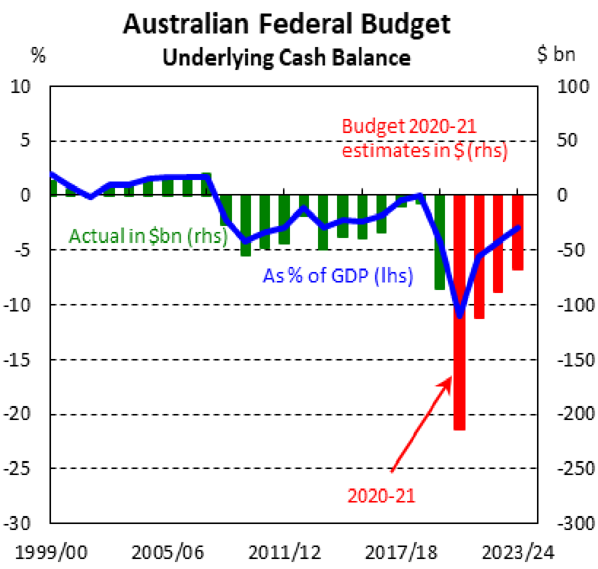
Housing Construction

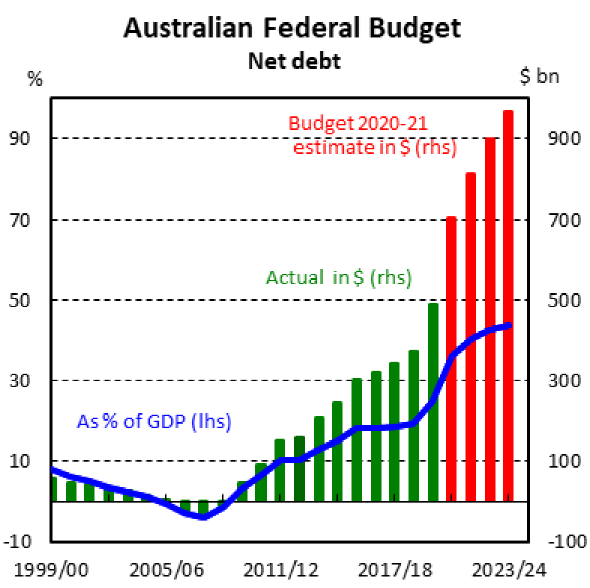
- An extension of the First Home Loan Deposit Scheme by providing an additional 10k places to first-home buyers to buy a new home sooner. This will allow first home buyers to secure a loan to build a new home or purchase a newly built home with a deposit of as little as 5%, with the Government guaranteeing up to 15% of a loan.
- The HomeBuilder $25k grants are still set to phase out in December; that is, the Budget made no changes to the HomeBuilder scheme.

Health and Aged Care

- $2.1 billion in 2020-21 for tele-health and mental health services.
- An extra 23k additional home care packages to be provided in aged care at a cost of $2.0bn over the next 4 years.

The Key Macro Budget Charts





Bank of Melbourne Economics
Ph: 02-8254-8322

Contact Listing

Chief Economist
Besa Deda
dedab@bankofmelbourne.com.au
(02) 8254 3251

Senior Economist
Hans Kunnen
hans.kunnen@bankofmelbourne.com.au
(02) 8254 1316