

Monday, 10 May 2021

Budget Bonanza

Tomorrow night the government will hand down the Federal Budget.

The budget is always important. But it is particularly important at the current juncture. The economic recovery is still heavily dependent on support from the government and the Reserve Bank (RBA) as we emerge from the COVID-19 recession. The economic recovery underway also needs to be sustained.

Analysts will be pouring over the documents into the early hours for all the details. Some policies have already been previewed over the past few weeks.

We expect a deficit of \$155 billion in 2020-21 or 7.5% of GDP, down from nearly the \$198 billion estimated by the government in the December Mid-Year Economic and Fiscal Outlook (MYEFO).

The massive improvement reflects the faster than expected recovery in the economy. The labour market has bounced back faster than expected, meaning the government has spent less than predicted on income support payments. Plus, commodity prices have surged much higher than expected back in December, boosting tax revenue.

For 2021-22 we expect a deficit of \$84 billion, down from over \$108 billion in MYEFO.

So what policies are we expecting?

The Budget will focus on generating growth and jobs. The Treasurer has emphasised his goal is to lift economic growth to attain an unemployment rate of 4.5% before turning to budget repair.

The government has already revealed expenditure plans for two pressing issues – child care and aged care. Reports suggest annual costings will be in the order of \$1.7 billion and \$2.5 billion, respectively.

We also expect the Low and Middle Income Tax Offset will be extended for another year. In effect, this provides a tax cut to people earning up to \$126,000.

Reports suggest that JobTrainer will also be extended by a year to September 2022. The program aims to train and reskill the workforce by providing free or low-fee courses to help drive down the unemployment rate.

Beyond these measures, we expect a focus on women, superannuation and infrastructure, as well as targeted support for industries hurt by pandemic-related restrictions.

Hot off the press, business conditions and confidence both rose to new record highs in April despite the expiry of JobKeeper at the end of March. The strong numbers from the business survey over recent months are an encouraging sign for business investment and jobs growth. And as we expected, the end of JobKeeper looks to be only a modest speed hump. In fact 105,000 people came off income support in April as the labour market continued its remarkable recovery.

Retail sales data for March were also released this morning, showing a 1.3% increase in value terms in the month. The result was slightly weaker than the 1.4% preliminary estimate. The rise

was led by reopening rebounds in WA and Victoria. There were also data on retail sales volumes for the March quarter in today's release. Sales volumes eased 0.5% in the quarter after surging in the second half of 2020.

In the run up to the Budget, it is worth taking a step back to look at the past year.

Australia's economic performance was a standout amongst the major economies in 2020. The strong outcome reflects our relative success in containing the virus and the wave of support from the RBA and the government.

The Federal Government went hard on stimulus. JobKeeper saved a huge amount of jobs – 700,000 according to RBA estimates. HomeBuilder contributed to an upswing in housing activity. And businesses are lifting equipment spending in response to tax incentives.

And yes, the government has spent a lot and will continue to do so. This means public debt is increasing. But we can afford it. And it is in the nation's best interests.

Debt in Australia relative to the size of the economy is much lower than in many other countries and is likely to remain so.

At some point in the future, we will need to think about repairing our fiscal buffers to manage the next downturn.

For now, we need to focus on ensuring the recovery stays on the right track.

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Forecasts

End Period:	2021				2022		
	Close (7 May)	Q2 (f)	Q3 (f)	Q4 (f)	Q1 (f)	Q2 (f)	Q3 (f)
Aust. Interest Rates:							
RBA Cash Rate, %	0.10	0.10	0.10	0.10	0.10	0.10	0.10
90 Day BBSW, %	0.04	0.05	0.07	0.09	0.10	0.10	0.10
3 Year Swap, %	0.31	0.40	0.40	0.45	0.60	0.80	0.90
10 Year Bond, %	1.68	1.85	1.95	2.10	2.20	2.30	2.40
US Interest Rates:							
Fed Funds Rate, %	0.125	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond, %	1.58	1.75	1.85	2.00	2.10	2.20	2.30
USD Exchange Rates:							
AUD-USD	0.7844	0.79	0.80	0.82	0.85	0.85	0.85
USD-JPY	108.60	109	109	110	111	111	111
EUR-USD	1.2166	1.21	1.21	1.23	1.25	1.26	1.27
GBP-USD	1.3984	1.40	1.40	1.41	1.41	1.41	1.42
NZD-USD	0.7278	0.73	0.73	0.74	0.76	0.76	0.76
AUD Exchange Rates:							
AUD-USD	0.7844	0.79	0.80	0.82	0.85	0.85	0.85
AUD-EUR	0.6453	0.65	0.66	0.67	0.68	0.67	0.67
AUD-JPY	85.2	86.1	87.2	90.2	94.4	94.4	94.4
AUD-GBP	0.5609	0.56	0.57	0.58	0.60	0.60	0.60
AUD-NZD	1.0776	1.08	1.10	1.11	1.12	1.12	1.12

	2019	2020	2021 (f)	2022 (f)
GDP, %	2.2	-1.1	4.5	3.0
CPI (Headline), %	1.8	0.9	2.2	1.8
CPI (Trimmed mean), %	1.5	1.2	1.5	1.6
Unemployment Rate, %	5.2	6.8	5.0	4.7
Wages Growth, %	2.2	1.4	1.8	2.0

AUD cross exchange rates have been rounded.

Financial forecasts are quarter end.

GDP, CPI, employment and wage growth forecasts are year end.

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The Detail

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