2020-21 Federal Budget

The 2020-21 Federal Budget was unique and record breaking in both the size of fiscal stimulus and range of measures but was in line with the unique challenge of dealing with a global pandemic.

The budget deficit of $213.7 billion or 11 per cent of annual GDP is a peacetime record in absolute and relative terms but is proportionate to the size of the economic reality. It is a literal rebooting of the economy, and offers support and incentives for households, jobs and businesses alike.

The announcements of $1.5 billion for advanced manufacturing and $1.2 billion for apprentice wage subsidies had already been fully disclosed, as had the extension of the first home loan deposit scheme, however the biggest surprise came not from the personal income tax cuts, with stage two brought forward to the start of this financial year, but from the temporary full expensing of business investments. This will allow all businesses up to turnover of $5 billion to claim the entire cost of investments until June 2022, so will apply to around 3.5 million businesses, driving what is hoped to be around $200 billion worth of investment.

Ultimately this will see Australia's net debt to GDP ratio reach $703 billion this year and $966 billion by 2024, so gross debt to GDP is headed for over a trillion dollars, or 50 per cent of GDP. This may appear a scary ratio, however it should be kept in mind that most developed economies around the world had a much higher debt to GDP ratio even prior to the onset of COVID-19. The total level of fiscal and balance sheet support to the economy with this $98 billion from the Budget is now estimated at just over $500 billion.

The primary aims of these initiatives are job creation, job and business retention, and a boost to the economy via immediate spending demand. The bulk of the budget announcements appear likely to support these aspirations, given:

- The stage two income tax cuts are backdated to 1 July 2020, and include lifting the (19%) $37,000 tax bracket threshold to $45,000, and the (32.5 per cent) $90,000 threshold to $120,000

- Further support for aged pensioners and welfare recipients of $250 in December and another $250 in March, which is very likely to be spent rather than saved.

- Infrastructure spending ($14 billion in new and accelerated projects over the next four years) is targeted for 'shovel ready' projects

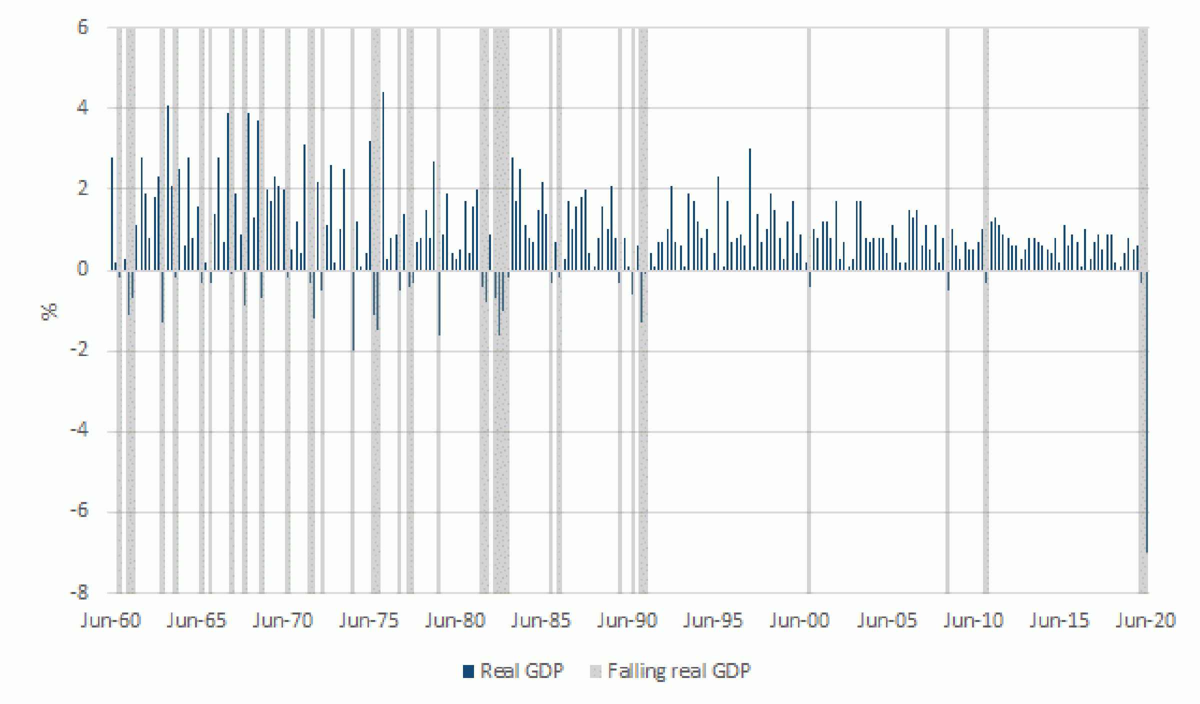
- The wage subsidies are directed to young workers, with the JobMaker Hiring Credit immediately available ($200 a week for eligible employees aged 16 - 29 years of age, $100 a week for 30 - 35-year olds).

- The full expensing of business investments is available to over 99 per cent of businesses and should be a major incentive for businesses to accelerate investment plans.

Arguably the missing pieces in the Federal Budget were a lack of focus on social housing and aged care, and less infrastructure spending in the short term for regional communities to support the trend we are observing towards regional property over higher population density locations.

The likely fall in immigration levels this year and next are a challenge for a number of parts of the economy including agriculture, and in the case of regional Australia the need for additional funding for healthcare, education and digital infrastructure remain a key driver to optimise Australia's productive capacity. Nevertheless, the measures outlined provide broad based support via the income tax cuts, business incentives and wage subsidies.

Given Australia is in its deepest recession in close to a century, this budget stimulus is vital. Our economy contracted seven per cent in the second quarter, the largest decline since quarterly GDP records began in 1959, and our first technical recession in 30 years.



Source: ABS

Since 1992, we have only had three single quarters of contraction, but the 2020 COVID-19 recession is unique in that it has been an intentional shutting down of the economy to deal with a health crisis, and not a result of asset price bubbles or 'boom bust' cycles. This has made it much deeper, but its unique nature makes the recovery profile challenging to predict.

Unemployment has risen sharply to 7.5 per cent - although improved to 6.8 per cent in August - and total employment (which was 13 million in February) fell to 12.1 million in May before recovering to 12.6 million in August. All states other than Victoria have bounced back thanks to the introduction of a range of support packages and stimulus measures. In many respects the total number of jobs, and 'total hours worked' are better measures than unemployment, but the Treasurer has made it clear that until the unemployment rate falls clearly below six per cent, fiscal stimulus is here to stay, and 'budget repair' can wait until that benchmark is reached.

In 2021 the economy is expected to rebound, although the extent of this recovery will depend on some factors that are impossible to predict, including the timing and efficacy of a vaccine, and our trading relationship with key partners (especially China). We expect real GDP to increase roughly three per cent in the second half of 2020, and then another three per cent in 2021 thanks to the range of policy measures outlined in the budget, and the various state government and industry support measures in place. Unemployment is likely to remain between 6.25 and 7.75 per cent for some time but will be dependent on health outcomes (e.g. avoiding second and third waves of COVID-19) and how quickly we can reopen borders.

Again, the crucial message from the government is that budget support (leveraging our AAA credit rating and very cheap government debt) is here to stay, until the economy is safely back on track.

Article written by:

David Robertson, Head of Economic and Market Research
Bendigo and Adelaide Bank Ltd