Strategic Wealth Market Update

7th October 2020

strategicwealth

Strategic Wealth FY 2020-21 Federal Budget Summary

The delayed 2020/21 Federal Budget is the most significant in decades. The aim is that it will go down in history as the Budget that lifted Australia's economy out of recession via a government-backed jobs recovery program.

The overriding thrust of the Budget is about transitioning the economy away from unsustainable welfare payments (JobKeeper) via a heavy emphasis on policies that support job creation (JobMaker).

As widely anticipated, the Federal Treasurer announced the bringing forward of personal income tax cuts already legislated as a cornerstone of the FY2020-21 Federal Budget. These changes will deliver tax relief to low and middle-income earners for the 2020-21 income year of up to $2,745 for individuals and up to $5,490 for dual income families.

The Treasurer also announced a range of taxation benefits for small and medium businesses, intended to stimulate the business sector leading to jobs growth.

Debt levels are set to increase significantly but this is unavoidable and a necessary response given the size of the economic hit and the ongoing headwinds that this has created.

The Winners and Losers from the Budget are as follows:

Winners:

- Low/Middle income earners – pull forward second stage of Personal Income Tax Plan, retain low and middle income tax offset (LAMITO).
- Businesses – heavily incentivised to hire younger staff (JobMaker, apprenticeships), cash flow boost from instant asset write-offs and $2b for R&D Tax Incentive.
- Property – expansion of the First Home Loan Deposit Scheme (FHLDS) and CGT relief for granny flats.
- Infrastructure – $10b in funds available to the States, focus on 'shovel-ready' projects (roads, councils).

Losers:

- High income earners – tax relief remains long-dated (2024) with no pull forward as initially speculated.
- Welfare – the transition away from JobKeeper will be difficult for those that may not have a job to return to when the program expires in March 2021.
- Mega-caps – Businesses with annual turnover >$5b will miss out on support measures.
- Superannuation was largely untouched which is a good outcome as it provides retirees with some certainty. There is a major review of the retirement income funding underway and until the outcomes of this review are known, there are likely to be no major changes in the superannuation area (probably until 2022).

This is a positive Budget and it will most likely be greeted with enthusiasm despite the depth of the problems it seeks to address. The Government has shown a clear willingness to kick-start the recovery while putting aside concerns about soaring debt levels.

Investors will most likely welcome this pro-growth Budget which addresses 'fiscal cliff' concerns, pulls forward tax-cuts and looks to turbo-charge the recovery via job creation.

Please continue over the page.

If you would like to know more then please view the **FPA Budget Summary** for a detailed report on all of the announcements and please view the **Shane Oliver Comments** for comments on the economic implications of the Budget measures and debt outcomes.

Please do not hesitate to contact us if you have any questions on the above of how the announcements may impact your situation.

Kind regards,

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FINANCIAL PLANNING ASSOCIATION *of* AUSTRALIA

BUDGET WRAP-UP

2020-21

Overview

The 2020-21 Budget was delivered on 6 October 2020, having been deferred from its original date of 12 May 2020 due to the COVID-19 pandemic. The budget is firmly focussed on supporting Australia's recovery from the first recession since 1991 and worst economic performance since 1959.

The budget revealed that real GDP is projected to shrink by 1.5 percent in 2020-21, before rebounding in the following years. Similarly, the unemployment rate is set to peak this year at 7.25 percent and will take at least two years to fall below 6 percent.

Given the fall in tax revenue and increase in spending, the 2020-21 Budget is projected to be in deficit by $213.7 billion, with the deficit falling to $66.9 billion by 2023-24. Net debt will increase to $703 billion this year and peak at $966 billion or 44 percent of GDP in 2024.

Central to the Government's plans for economic recovery is the JobMaker package, which includes significant tax relief measures for households and businesses, a boost to infrastructure investment and a hiring credit for new employees.

The Government has brought forward it's stage-two income tax cuts by two years from their original start date of 1 July 2022 to 1 July 2020. The stage-two tax cuts lift the income threshold at which the 19 per cent tax rate applies - from $41,000 to $45,000 - and the rate at which the 32.5 per cent rate applies - from $90,000 to $120,000.

Major support for businesses with a turnover of less than $5 billion includes immediate expensing of capital investment for businesses; temporary carry-back of current and future losses to 2018-19; and insolvency reforms to assist stressed businesses to restructure.

The Government has also proposed a range of reforms to superannuation to reduce the cost of duplicate accounts, improve performance of MySuper funds and increase transparency in fund management.

Further details of these measures follow.

First published 7 October 2020

Personal Income Tax

Bringing forward the Personal Income Tax Plan and retaining the low and middle income tax offset.

The Government will bring forward the second stage of its Personal Income Tax Plan by two years to 1 July 2020 while retaining the low and middle income tax offset (LMITO) for 2020-21.

The changes are intended to provide immediate tax relief to individuals and support the economic recovery and jobs by boosting consumption by providing around $17.8 billion in tax relief to around 11.6 million Australians, including $12.5 billion over the next 12 months.

The top threshold of the 19 per cent personal income tax bracket will increase from $37,000 to $45,000. The top threshold of the 32.5 per cent personal income tax bracket will increase from $90,000 to $120,000.

Rate (%)	2017-18 tax thresholds Income range ($)	Current tax thresholds From 1 July 2018 Income range ($)	**New tax thresholds From 1 July 2020 Income range ($)**	Rate (%)	**New tax thresholds from 1 July 2024 Income range ($)**
Tax free	0 — 18,200	0 — 18,200	**0 — 18,200**	**Tax free**	0 — 18,200
19	18,201 — 37,000	18,201 — 37,000	**18,201 — 45,000**	**19**	18,201 — 45,000
32.5	37,001 — 87,000	37,001 — 90,000	**45,001 — 120,000**	**30**	45,001 — 200,000
37	87,001 — 180,000	90,001 — 180,000	**120,001 — 180,000**	**-**	-
45	>180,000	>180,000	**>180,000**	**45**	>200,000
LITO	Up to 445	Up to 445	**Up to 700**	**LITO**	Up to 700
LMITO	-	Up to 1,080	**Up to 1,080***	**LMITO**	-

* The LMITO will only be available until the end of the 2020-21 income year.

Even with quick passage of legislation the tax measures will be backdated by around four months. As a result, reduction in PAYG tax for the remainder of the financial year will be around 1.5 times the ongoing rate.

The low income tax offset (LITO) will increase 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.

The LMITO provides a reduction in tax of up to $1,080. It provides a reduction in tax of up to $255 for taxpayers with a taxable income of $37,000 or less. Between taxable incomes of $37,000 and $48,000, the value of the offset increases at a rate of 7.5 cents per dollar to the maximum offset of $1,080. Taxpayers with taxable incomes between $48,000 and $90,000 are eligible for the maximum offset of $1,080. For taxable incomes of $90,000 to $126,000, the offset phases out at a rate of 3 cents per dollar.

Stage three of the Personal Income Tax Plan is unchanged and scheduled to commence in 2024-25.

INCREASING THE MEDICARE LEVY LOW-INCOME THRESHOLDS

The Government has increased the Medicare levy low-income thresholds for singles, families, and seniors and pensioners from 2019-20. The increases take account of recent movements in the consumer price index so that low-income taxpayers generally continue to be exempted from paying the Medicare levy.

- The threshold for singles has increased from $22,398 to $22,801.
- The family threshold has increased from $37,794 to $38,474.
- For single seniors and pensioners, the threshold has increased from $35,418 to $36,056.
- The family threshold for seniors and pensioners has increased from $49,304 to $50,191.
- For each dependent child or student, the family income thresholds increase by a further $3,533, instead of the previous amount of $3,471.

Business Support

The Government has announced a significant suite of business supports intended to kick-start investment and help businesses manage the current economic downturn. Notably, the measures that provide financial support are temporary, so as not to affect the long term fiscal outlook.

TEMPORARY FULL EXPENSING TO SUPPORT INVESTMENT AND JOBS

In a major initiative to promote business investment, the Government has announced it will allow eligible businesses to immediately deduct the full cost of eligible capital assets acquired between now and 30 June 2022. The initiative will be limited to businesses with a turnover of less than $5 billion.

Full expensing in the year of first use will apply to new depreciable assets and the cost of improvements to existing eligible assets. For small and medium sized businesses (with aggregated annual turnover of less than $50 million), full expensing also applies to second-hand assets.

Businesses that hold assets eligible for the enhanced $150,000 instant asset write-off will have an extra six months, until 30 June 2021, to first use or install those assets.

This initiative is expected to provide $26.7 billion in tax relief for businesses over the next four years, with $1.5 billion in the current financial year.

TEMPORARY LOSS CARRY-BACK TO SUPPORT CASH FLOW

In another initiative intended to allow eligible businesses to better manage the current economic downturn, the Government has announced that eligible businesses will be able to carry back tax losses from 2019-20 to 2021-22 to offset previously taxed profits from 2018-19 or later years. The initiative will be limited to businesses with a turnover of less than $5 billion.

The carry back allowable must not be greater than the profit taxed in the earlier year and a carry back will not generate a franking account deficit.

This initiative is expected to provide around $4.9 billion in support over the forward estimates and, as it is a time limited measure, will not have a significant long term impact on the budget.

JOBMAKER HIRING CREDIT

To support employment, the Government has announced a weekly payment for businesses who hire eligible new employees. The payment will last for twelve months and is available immediately. To be eligible, new employees must be between 16 and 35 years old. For employees between 16 and 30, the business will be eligible for $200 per week. For employees between 30 and 35 years old, the business will be eligible for $100 per week. Employees must be engaged for at least 20 hours per week and all businesses (except for the major banks) are eligible.

INSOLVENCY REFORMS TO SUPPORT SMALL BUSINESS

The Government had previously announced a new, quicker and lower-cost process to allow small businesses to address insolvency. This measure is intended to help small businesses to restructure, avoid liquidation and continue trading. This process will be available to businesses with liabilities under $1 million which represent around 76 percent of all insolvencies.

INCREASE THE SMALL BUSINESS ENTITY TURNOVER THRESHOLD

The Government will expand access to a range of small business tax concessions by increasing the small business entity turnover threshold for these concessions from $10 million to $50 million. Businesses with an aggregated annual turnover of $10 million or more but less than $50 million will have access to up to ten further small business tax concessions in three phases up to 1 July 2021.

DIGITAL BUSINESS PLAN

The Government is continuing its support for digital uptake in Australian businesses through its $796.5 million Digital Business Plan. Measures included in this plan will support the roll-out of the Consumer Data Right, assist in the commercialisation of regtech and fintech, and support Australian businesses using technology to reduce regulatory compliance costs.

Superannuation

Despite much speculation, the Government has not made any unexpected changes to the superannuation system for the 2020-21 financial year. Previously announced COVID-19 measures in relation to early access to super and pension drawdown relief will continue.

The Government has otherwise continued its commitment to the Your Future, Your Super package which will see super funds follow members as they change jobs, new interactive comparison tools, active management of underperforming funds, and increased trustee transparency and accountability.

COVID-19 RESPONSE PACKAGE

Temporary early access to superannuation

The Government is allowing eligible Australian and New Zealand citizens and permanent residents affected by the financial impacts of COVID-19 to access up to $10,000 of their superannuation in 2019-20 and a further $10,000 in 2020-21 to help support them during COVID-19. The 2020-21 application period for the measure will cease on 31 December 2020.

Temporarily reducing superannuation minimum drawdown rates

The Government has reduced the superannuation minimum drawdown requirements for account-based pensions and similar products by 50 per cent for the 2019-20 and 2020-21 income years. Minimum payment amounts are calculated on the basis of asset values on 1 July of each income year.

YOUR FUTURE, YOUR SUPER

The Government will provide $159.6 million over four years from 2020-21 to implement reforms to superannuation to improve outcomes for superannuation fund members. The reforms will reduce the number of duplicate accounts held by employees as a result of changes in employment and prevent new members joining underperforming funds.

Commencing 1 July 2021, the Your Future, Your Super package will improve the superannuation system by:

- Having your superannuation follow you: preventing the creation of unintended multiple superannuation accounts when employees change jobs by “stapling” super funds members.
- Making it easier to choose a better fund: members will have access to a new interactive online YourSuper comparison tool which will encourage funds to compete harder for members’ savings. This tool will be developed and maintained by the ATO, and enable new employees to select the right MySuper fund for themselves when they start work.
- Holding funds to account for underperformance: to protect members from poor outcomes and encourage funds to lower costs the Government will require MySuper products to meet an annual objective performance test. Those that fail will be required to inform members. Persistently underperforming products will be prevented from taking on new members.

- Increasing transparency and accountability: the Government will increase trustee accountability by strengthening their obligations to ensure trustees only act in the best financial interests of members. The Government will also require superannuation funds to provide better information regarding how they manage and spend members' money in advance of Annual Members' Meetings.

RETIREMENT INCOME REVIEW

The Retirement Income Review was speculated to be released with the budget, however this has not occurred. The Government did announce however that the Retirement Income Covenants which would have required superannuation trustees to have a strategy in place to support the retirement income needs of members from 1 July 2020 has been delayed to 1 July 2022.

Social Security

As the country finds itself in a recession, much of the focus for the 2020-21 Budget has been on social security measures to support Australian's who are out of work. The Government has confirmed announced extensions to the JobKeeper payments, provided clarification around COVID-19 payment supplements to those on JobSeeker, will make two $250 payments for eligible social security recipients, and a developed a new JobMaker Hiring Credit for employers who bring on younger Australian's who have been on JobSeeker.

JOBKEEPER PAYMENT EXTENSION

The JobKeeper Payment extension announced on 21 July 2020 provides continued support until 28 March 2021, with the Payment targeted to those businesses that continue to be most significantly affected by the economic downturn. The level of the JobKeeper Payment is being tapered to enable businesses to transition towards their longer-term plans and a two-tiered payment is also being introduced to better match the Payment with the incomes of employees. The ATO will also be given additional resources to manage the JobKeeper and JobMaker programs.

COVID-19 RESPONSE PACKAGE — FURTHER ECONOMIC SUPPORT PAYMENTS

The Government will provide two separate $250 economic support payments, to be made from November 2020 and early 2021 to eligible recipients of the following payments and health care card holders:

- Age Pension
- Disability Support Pension
- Carer Payment
- Family Tax Benefit, including Double Orphan Pension (not in receipt of a primary income
- Carer Allowance (not in receipt of a primary income support payment)
- Pensioner Concession Card (PCC) holders (not in receipt of a primary income support payment)
- Commonwealth Seniors Health Card holders
- eligible Veterans' Affairs payment recipients and concession card holders.
- The payments are exempt from taxation and will not count as income support for the purposes of any income support payment.

COVID-19 RESPONSE PACKAGE — INCOME SUPPORT FOR INDIVIDUALS

Since 27 April 2020, the Government established a new time-limited Coronavirus Supplement to be paid at a non-income tested rate of $550 per fortnight. This is paid to both existing and new recipients of JobSeeker Payment, Youth Allowance, Parenting Payment, Austudy, ABSTUDY Living Allowance, Farm Household Allowance, Special Benefit, and recipients of the Department of Veterans' Affairs Education Schemes, Military Rehabilitation and Compensation Act Education and Training Scheme and Veterans' Children's Education Scheme.

From 25 September 2020 this supplement will change to $250 per fortnight and continue to 31 December 2020.

The income free area will also change to $300 per fortnight with a 60 cents taper for income earned above the income free area for JobSeeker Payment (except principal carer parents who have an income free area of $106 and a taper rate of 40 cents) and Youth Allowance (other) recipients.

Payment eligibility which was relaxed on a temporary basis, with the One Week Ordinary Waiting Period waived from 12 March 2020, and a range of further exemptions applied from 25 March 2020, including waiving the Newly Arrived Residents' Waiting Period, Assets Test, Liquid Assets Waiting Period and Seasonal Work Preclusion Period, will all be reinstated from 25 September 2020 except the Assets test and Liquid Assets Waiting Period which will be reinstated from 31 December 2020.

Eligibility criteria for JobSeeker and Youth Allowance (Other) has also been extended to allow sole traders and the self-employed to access the payments provided they meet income test requirements.

Finally, mutual obligations will be changed to give job seekers greater flexibility to count education and training toward their activity requirements.

WOMEN'S ECONOMIC SECURITY

The Government is investing in women's economic security and supporting increased female workforce participation through the 2020 Women's Economic Security Statement. The Government will provide $240.4 million over five years from 2020-21.

The Government is supporting new parents whose employment was interrupted by COVID-19. As a result, 9,000 individuals will gain eligibility for Parental Leave Pay and 3,500 for Dad and Partner Pay. This change will extend the work test period from 13 months prior to the birth or adoption of the child to 20 months prior, enabling access to Paid Parental Leave (PPL) where eligibility has been impacted by COVID-19. The Government is supporting disadvantaged parents on Parenting Payment through a $24.7 million expansion of the ParentsNext program.

Aged Care

With the Aged Care Royal Commission recently handing its interim report to Government, the expected adoption of recommendations and new support measures for the aged care sector have been implemented. The Government is introducing close to $3 billion of measures to address the recommendations as well as address the unfortunate COVID-19 related issues which have emerged in the aged care sector.

ADDITIONAL FUNDING TO SUPPORT THE AGED CARE SECTOR'S RESPONSE TO COVID-19

The Government will provide $2.0 billion over four years from 2020-21 to further support older Australians accessing aged care by providing additional home care packages as well as continuing to improve transparency and regulatory standards. Funding includes:

- $1.6 billion over four years from 2020-21 for the release of an additional 23,000 home care packages across all package levels
- $125.3 million over three years from 2020-21 to replace the Commonwealth Continuity of Support Programme with a new Disability Support for Older Australians program
- $91.6 million over two years from 2020-21 to continue the reform to residential aged care funding
- $4.6 million over two years from 2020-21 to review the support care needs of senior Australians who live in their own home and determine how best to deliver this care in the home.

SUPPORTING OLDER AUSTRALIANS THROUGH COVID-19

The Government will provide $812.8 million over four years from 2019-20 to support older Australians throughout the COVID-19 pandemic. Funding includes:

- $70.0 million over two years from 2019-20 to provide access to short-term home support services through the Commonwealth Home Support Program to senior Australians who are frail or have self-isolated due to a high risk of contracting COVID-19
- $59.3 million over two years from 2019-20 to guarantee the supply of food, including groceries and prepared meals, for senior Australians who are frail or have self-isolated due to a high risk of contracting COVID-19
- $71.4 million in 2020-21 to support residents of aged care facilities who temporarily leave care to live with their families.

SUPPORTING OLDER AUSTRALIANS — EXEMPTING GRANNY FLAT ARRANGEMENTS FROM CAPITAL GAINS TAX

The Government will provide a targeted capital gains tax (CGT) exemption for granny flat arrangements where there is a formal written agreement. The exemption will apply to arrangements with older Australians or those with a disability. The measure will have effect from the first income year after the date of Royal Assent of the enabling legislation.

CGT consequences are currently an impediment to the creation of formal and legally enforceable granny flat arrangements. When faced with a potentially significant CGT liability, families often opt for informal arrangements, which can lead to financial abuse and exploitation in the event that the family relationship breaks down. This measure will remove the CGT impediments, reducing the risk of abuse to vulnerable Australians.

Regulators

With an ever increasing focus on a user paid system for covering the costs of regulators, the budget contains a number of funding allocations to regulators of financial planners including FASEA, ASIC and AUSTRAC, as well as a commitment to the implementation of the financial services Royal Commission by Treasury.

FINANCIAL ADVISER STANDARDS AND ETHICS AUTHORITY

The Government will provide the Financial Adviser Standards and Ethics Authority (FASEA) with $4.08m in 2020-2021 under the existing funding arrangements from the banks and AMP. The budget did not contain any further clarity on the long term funding of FASEA after the 2020-21 financial year.

AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION

The Government is providing the Australian Securities and Investments Commission's (ASIC) budget with a budget and resource increase in 2020-21. ASIC will have approximately $773m in funding allocated, up from $662million in 2019-20 and an additional 102 staff. This increase is primarily related to special appropriations related to the regulations of banks and insurance companies and additional staffing.

AUSTRAC CAPABILITY UPLIFT

The Government will provide $104.9 million over four years from 2020-21 (including $48.9 million in capital funding) to the Australian Transaction Reports and Analysis Centre (AUSTRAC) to strengthen its capacity to combat serious financial crime and to protect Australia's financial system from criminal activities. This funding would also support the development of a new financial data reporting system to assist industry in meeting its reporting obligations under the Anti-Money Laundering and Counter-Terrorism Financing Act 2006.

The cost of this measure will be offset over ten years by an increase in the Australian Transaction Reports and Analysis Centre Industry Contribution Levy.

REFOCUSING AUSTRALIA'S APPROACH TO FINANCIAL CAPABILITY

The Government will provide $7.1 million over four years from 2020-21 to support improved financial capability through the transfer of policy responsibility for national financial capability coordination from ASIC to the Department of the Treasury. This transfer will better facilitate engagement between the Commonwealth and state and territory governments. The cost of this measure will be partially met through ASIC's existing resources.

COVID-19 RESPONSE PACKAGE

The Government will provide $82.9 million over five years from 2019-20 to the Treasury portfolio, including to the Australian Bureau of Statistics and to the Office of Parliamentary Counsel, to help support the transition from the economic impact of COVID-19 and continue the delivery of the Government's legislative program. The funding will support:

- the production of statistical information that informs the development and delivery of the Government's response
- addressing the existing backlog of legislation and escalation in Treasury's legislative program
- the Financial Services Reform Taskforce implementing the recommendations from the Financial Services Royal Commission.

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AMP CAPITAL

The 2020-21 Australian Budget – spend, spend, spend as the focus remains on recovery and jobs, jobs, jobs

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EDITION 35

Key points

> The Government now expects the Federal budget deficit to peak at a record $213.7bn this financial year. That's around 11% of GDP, its highest since the end of WW2. The risk is the deficit will be worse at around $230bn.

> Key measures include earlier tax cuts, massive tax breaks for investment & a new wage subsidy scheme.

> Providing more stimulus & holding off on budget repair are the right thing to do. But it will be a long hard slog to get the deficit back down and stabilise public debt.

Introduction

The 2020-21 budget is a long way from the 2019-20 "back in black and back on track" budget. Last year, it was all about delivering the long-awaited budget surplus. This year it's all about spurring recovery. So, the focus is on providing more stimulus to boost demand and in the process get unemployment back down to acceptable levels. As such, the projected budget deficit has blown out to a record $213.7bn and while it should fall from next year as emergency programs come to an end, the Government won't shift the focus to budget repair until the unemployment rate is comfortably below 6%, which is likely to be at least three years away, and even then, a return to surplus is likely at least a decade away.

Policy stimulus

The key fiscal measures are:

- a bring forward of the July 2022 tax cuts to July 2020. This will raise the start of the 32.5% tax rate bracket to $45,000 from $37,000 and raise the start of the 37% tax rate bracket out to $120,000 from $90,000 and increases the low income tax offset. It will mean tax cuts of $83 a fortnight for someone on $80,000 and $99 a fortnight for someone on $140,000 and refunds for higher tax already paid since July;
- instant expensing for tax purposes for any investment undertaken by businesses with turnover up to $5bn until 30 June 2022 and the ability to offset losses against previous profits to generate a tax refund;
- a reinstatement of R&D tax breaks;
- a new JobMaker wage subsidy tied to employing young people to partly replace JobKeeper;
- $1.2bn to subsidise 100,000 new apprentices;
- an extra $3bn in infrastructure spending to state governments on a "use it or lose it" basis;
- more support for housing with an expansion of the First Home Loan Deposit scheme;
- $1.3bn in initial funding to help encourage manufacturing;
- more health spending and on aged care; and
- more stimulus payments for welfare recipients.

There was little in the way of economic reform in this budget although some red tape will be removed for businesses.

The additional $83bn in stimulus measures since the July Economic and Fiscal Update takes total direct coronavirus support to $257bn. Along with loans & guarantees total Government and RBA support is now worth $507bn or 25% of GDP, spread over 5 years.

Economic assumptions

The Government is forecasting the economy to contract this financial year by -1.5%. But this masks a "record" -7% contraction in June quarter GDP and a gradual recovery from the second half of this year. The Government is a bit more optimistic than we are in terms of economic growth and unemployment. A big factor constraining growth is that net immigration is expected to be negative resulting in population growth of just 0.2%, the lowest since 1917.

Economic assumptions

		2019-20	2020-21	2021-22	2022-23
Real GDP	**Govt**	**-0.2**	**-1.5**	**4.75**	**2.75**
% year	AMP	-0.2	-2.3	4.1	2.3
Inflation	**Govt**	**-0.3**	**1.75**	**1.5**	**1.75**
% to June	AMP	-0.3	1.8	1.5	1.75
Wages, %yr	**Govt**	**1.8**	**1.25**	**1.5**	**2.0**
	AMP	1.8	1.1	1.6	1.75
Unemp Rate	**Govt**	**7.0**	**7.25**	**6.5**	**6.0**
% June	AMP	7.0	8.0	7.2	6.5

Source: Australian Treasury, AMP Capital

Budget deficit projections

The Government's revised budget projections are shown in the next table. The hit to the economy and hence revenue and expenditure since the Mid-Year Economic and Fiscal Outlook last December is now estimated to be $59.9bn for this financial year and is shown in the line called "parameter changes". This has actually been revised down from $72bn in the July Update reflecting stronger growth forecasts but is now expected to worsen over time reflecting much slower wage and population growth. Policy stimulus (mainly due to coronavirus) since last December is shown in the line labelled "Total stimulus". It's now running at $159.8bn for this year, up by another $41.4bn since July which is more than we were assuming. As a result of the fiscal response and the hit to revenue from the downturn, the Government projects the budget deficit to blow out from $85bn in 2019-20 to a record $213bn this financial year. At 11% of GDP, this will be the highest since WW2.

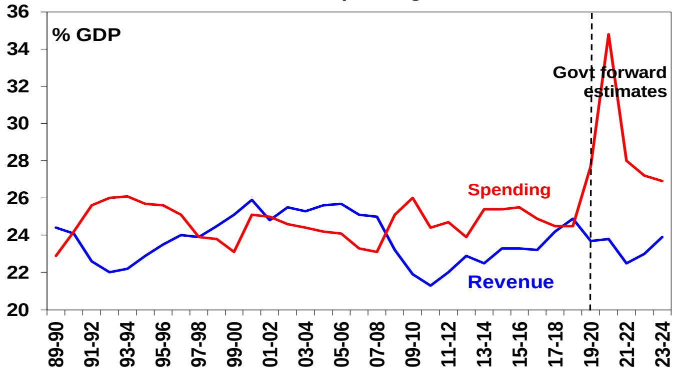
Underlying cash budget balance projections

	2019-20	2020-21	2021-22	2022-23	2023-24
2019-20 MYEFO, $bn	5.0	6.1	8.4	4.0	14.9
Parameter chgs, $bn	-32.6	-59.9	-66.5	-69.7	-84.5
Total stimulus, $bn	-57.7	-159.8	-53.9	-22.2	2.6
Projected budget, bn	**-85.3**	**-213.7**	**-112.0**	**-87.9**	**-66.9**
% GDP	**-4.3**	**-11.0**	**-5.6**	**-4.2**	**-3.0**

Source: Australian Treasury, AMP Capital

Over the forward estimates to 2023-24 the deficit is projected to fall rapidly as temporary support programs phase down. As can be seen in the next chart Government support programs have blown spending as a share of GDP out to 35% from 25%.

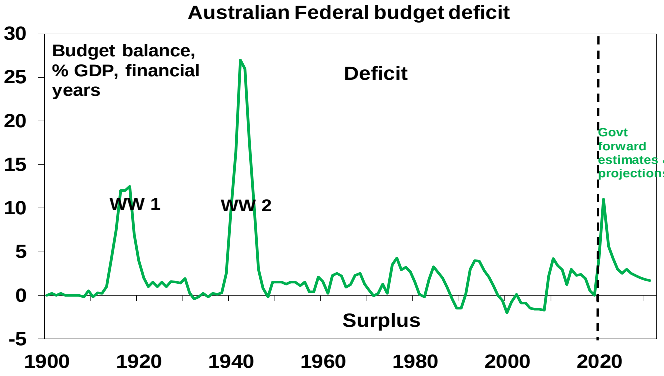
Federal Government spending and revenue



Source: Australian Treasury, AMP Capital

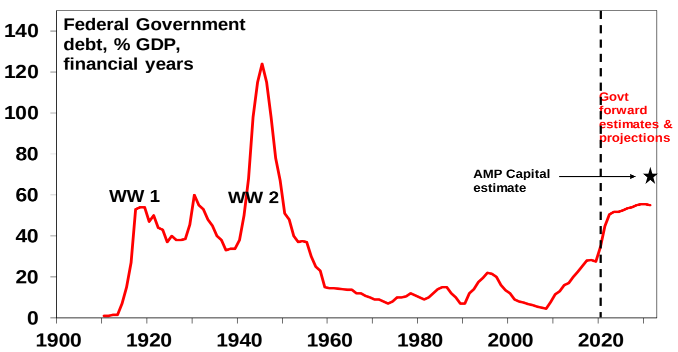
But with the economy smaller than previously expected, not helped by the hit to net immigration (which is now estimated to be -72,000 persons this year from a norm in recent years of 240,000), it's going to be a long hard slog back to surplus. The next two charts show the Government's budget deficit and debt projections out to 2031 and show the budget remaining in deficit. Even if the post GFC "budget repair" experience is replicated, budget balance is unlikely until around 2032 and that is optimistic, as the GFC did less damage to the budget.

Australian Federal budget deficit



Source: RBA, Australian Treasury, AMP Capital

Australian Federal gross debt



Source: RBA, Australian Treasury, AMP Capital

Federal debt as a share of GDP is already at its highest since the 1950s. While productivity enhancing reforms will help grow the economy its unlikely to be anywhere near enough to achieve anything like the rapid post WW2 decline seen in the debt to GDP ratio. In fact, in our view the debt to GDP ratio is likely to continue to rise in the years ahead and is likely headed to around 70% of GDP early next decade or nearly $2 trillion.

Assessment

The latest stimulus takes Australia's total level of coronavirus related fiscal stimulus this year up to 10% of GDP, which is at the high end of comparable countries. This along with ongoing stimulus into next year should aid the economic recovery. However, a test lies ahead as direct income support and the bank payment holiday taper and it's questionable whether the extra stimulus in the Budget will be enough, given the long tail of unemployment and underemployment. Hence, we still see the risk of a slight further deterioration in deficit projections.

More broadly, our assessment remains that the blow out in the budget deficit is appropriate and affordable. First, it's absolutely necessary, without the stimulus the short term hit to businesses, jobs and incomes and the long-term scarring would have been far greater and the recovery a lot slower.

Second, while much of the economy has reopened, big parts of it (like parts of education, travel and retailing) have not and will take much longer to recover. Hence the need for ongoing government help in providing stimulus and jobs.

Third, the support programs are targeted at current needs so shouldn't lead to permanently higher government spending.

Fourth, while some of the brought forward income tax cuts will be saved, they see a bigger percentage income boost to low and middle income earners who save less than high income earners, also being permanent are more likely to be spent than a once off payment & they are part of a package of measures.

Fifth, Australia's starting point for net public debt last year was low at 23% of GDP compared with other advanced countries averaging 83%. And even with projected budget deficits it will remain relatively small.

Sixth, borrowing to finance the budget deficit is in Australian dollars and we are not dependent on foreign creditors, so we are not vulnerable to a "foreign currency crisis."

Finally, the cost of Government borrowing is very low at around 0.85% for ten years and 0.25% for three years.

Implications for Australian assets

Cash and term deposits – with the cash rate likely fall to 0.1%, cash & bank deposit returns will remain low for a long time.

Bonds – the surge in public debt would all other things being equal, point to higher bond yields, but this is offset by massive spare capacity, low private sector borrowing and low inflation, so it's hard to see a lot of upside in bonds yields. If coronavirus comes under control, it's hard to see much downside either, so medium-term bond returns are likely to be low.

Shares – the ongoing addition of stimulus will further aid the recovery, at the same time that interest rates are very low, all of which is supportive of shares.

Property – high unemployment, the phasing down of income support and the hit to immigration still point to more downside in prices in Melbourne and Sydney, but continuing government property support measures will offset – particularly in houses, outer suburbs and cities less impacted by immigration.

The $A – ongoing fiscal stimulus at the high end of comparable countries coming at a time of rising commodity prices and a declining US dollar point to more upside for the $A.

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