

ECONOMICS & MARKETS

Big-spending Federal Budget set to spur on the recovery

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By Dr Shane Oliver
Head of Investment Strategy and Economics and Chief Economist, AMP Capital
Sydney, Australia

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The 2021 Federal Budget harks back to the immediate post GFC budgets in some ways, with the Treasurer resisting any temptation to start early on the task of budget repair and doubling down on stimulus. The government has announced \$96 billion of extra spending over the next four years, but the run of deficits will still be lower than was predicted last October, making this a bit of a “have your cake and eat it too” budget. Enabling this largesse is an anticipated \$104 billion revenue windfall, thanks largely to a stronger than expected economic rebound and strength in commodity exports over the past year.

That said, projected deficits over the forward estimates haven’t changed much, meaning that the government has allocated away most of the improved revenue position for coming years (although they’re operating under pretty conservative assumptions, particularly in relation to iron ore prices). It is very clear that at least in the short term, the emphasis will be gradual budget repair through growth rather than austerity. We’re all

Keynesians now, although it hasn't been lost on many observers that some of those cheering on this budget were arguing for fiscal restraint in the years after the GFC.

Within this framework, the budget has a number of immediate objectives: to provide continued support for the recovery on the road to full employment, higher wages and improved living standards; to boost participation and productivity and help the economy grow faster; and to address specific challenges in areas such as aged care, and women's economic security.

There were also significant announcements in infrastructure – including \$2 billion in funding for ambitious tunnelling projects under the Blue Mountains – more help for home buyers and an extension of the instant asset write-off for businesses. There are lots of winners from a budget like this, sending a strong signal about the possibility of an election within the next year if the vaccine rollout improves and the government manages to avoid further scandals. On the losing side are future taxpayers and recipients of Australian foreign aid, which was cut for this year and across the forward estimates.

What the budget says about the economy

Federal Budgets are always an interesting look at the state of the economy from Treasury's perspective. This year, they've upgraded their growth forecasts, indicating that economic activity is returning to a "new normal" faster than predicted. This certainly matches the lived experience around

the streets of our cities, and most sectors outside of tourism and education are probably approaching business as usual. Borders remain closed, but from a purely economic perspective this isn't as much of an impediment as one might think, given that before the pandemic Australia was a net importer of tourism i.e. our tourists spent more overseas than international tourists spent here.

We think the government's growth forecasts are a little conservative, and there would seem to be more room for a surprise here on the upside than the downside. The same could probably be said for their unemployment forecasts which now have us heading for 4.5% unemployment by 2023-24, which is an improvement of more than 1% on expectations of late last year.

The outlook from here

Barring another outbreak we appear to be through the riskiest period of the recovery, which spanned the winding back of the large direct fiscal stimulus programs that occurred in stages at the end of September and December 2020, and at the end of March 2021; and the transition to private investment and more indirect forms of stimulus. Although spending promises to be much lower going forward than through this financial year, there is still a step change in the ratio of expenditure to income compared to pre-COVID levels, and given that the government has signalled that they won't take tax as a proportion of GDP beyond 23.9% some of the future work to balance the budget will likely come in the form of spending cuts.

There's not much of a hurry on this front – Australia is still well placed in terms of public debt in relation to our international peers. The interest rate on debt looks likely to remain lower than forecast nominal GDP growth, meaning that current debt levels are eminently sustainable, and the government has made the right call in not contemplating the kind of austerity programs that followed the GFC across a number of developed economies. The only real risks are the prospect of interest rates and bond yields rising dramatically, but for the moment that's still a way off.

What are the takeaways for markets?

The amount of stimulus in this budget is likely to contribute to some extent to pressure on the RBA to raise rates earlier than anticipated, but that's still not likely before 2023, and even after a rate hike or two we're still likely to remain in what will historically be a very low-rate environment.

From that perspective, there aren't a lot of implications for long-term bond markets, which aren't offering much in the way of returns at the moment anyway. Equities might be a different story, given share market affinity for stimulus, but the budget probably serves to reinforce current dynamics, rather than changing the narrative, and given the strong run we've had there is a risk of a correction in the coming months albeit against the backdrop of a still rising trend.

Residential property was a key focus for the budget, with measures to lower barriers to entry for new homeowners. In the absence of supply-side

reform past experience shows that these initiatives can simply inflate prices further, but it was encouraging to see the extension of the downsizer scheme as part of this package.

Finally, the stimulus is likely to help drive the Australian dollar higher over time, but probably pales in comparison to the influence that high commodity prices and a falling US dollar are having on our currency at this point in time.

Important notes

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