Thursday, 16 December 2021

Mid-Year Economic and Fiscal Outlook

Budget Boosted by Faster Recovery

- **The Budget bottom-line has improved by $2.3 billion over the forward estimates compared with the 2021-22 Budget, published in May. A stronger-than-expected recovery in the labour market and higher-than-expected iron ore prices have driven the upgrade to the Budget bottom-line.**
- **However, the Government has also increased spending to combat the impacts of the Delta lockdowns. Government spending to manage the health impacts of the outbreak and to support the economy amounted to $25 billion since the publication of the Budget.**
- **The Government has upgraded its economic forecasts, reflecting a faster-than-expected economic recovery. However, we are more optimistic, particularly on commodity prices. The conservative assumptions may lead to a favourable upgrade to the forecasts ahead of the federal election next year.**
- **The Government decided not to hand out too many early Christmas presents as it prepares for an election in 2022. New policy announcements, aside from the Delta support measures, were relatively minor as the Treasurer preferred to wait until next year to announce major initiatives.**
- **However, a possible $16 billion of future election spending promises, allocated over four years, have been budgeted for as 'decisions taken but not yet announced'. These may see the light of day ahead of the election.**

Key MYEFO Aggregates and Parameters*					
	Actual	Forecasts			
	2020-21	2021-22	2022-23	2023-24	2024-25
Budget Aggregates					
Underlying cash balance ($bn)	-134.2	-99.2	-98.9	-84.5	-57.5
% of GDP	-6.5	-4.5	-4.4	-3.6	-2.3
Net debt ($bn)	592.2	673.4	773.1	855.9	914.8
% of GDP	28.6	30.6	34.7	36.8	37.4
Major Economic Parameters					
Real GDP	1.5	3 3/4	3 1/2	2 1/4	2 1/2
Employment	6.5	1	2	1 1/2	1 1/4
Unemployment rate	5.1	4 1/2	4 1/4	4 1/4	4 1/4
Consumer price index	3.8	2 3/4	2 1/2	2 1/2	2 1/2
Wage price index	1.7	2 1/4	2 3/4	3	3 1/4
Nominal GDP	4.4	6 1/2	1 1/4	4 1/2	5

Source: 2021-22 MYEFO

* GDP data are percentage change on the previous year. The consumer price index, employment and wage price index are through the year growth to the June quarter. The unemployment rate is for the June quarter.

Earlier today, Federal Treasurer Frydenberg handed down the 2021-22 Mid-Year Economic and Fiscal Outlook (MYEFO) as the Federal Government begins to move into election mode with a federal election due by May 2022.

Since the publication of the 2021-22 Budget, the economy has gone through a number of challenges. Key among them were the Delta lockdowns across our two largest states and several other short disruptions as the country managed the outbreak of the Delta strain. This caused widespread disruption to economic activity over the September quarter and led to an increase in government spending as Federal and state government supported households and businesses.

However, despite the challenges, the economy was more resilient than expected, and growth looks set to return quickly as restrictions have eased.

Underlying Cash Balance

The Budget bottom-line has improved by $2.3 billion over the forward estimates compared with the 2021-22 Budget, published on 11 May 2021. The cumulative budget deficits over the forward estimates (2021-22 to 2024-25) are projected to amount to over $340 billion.

The underlying cash balance is now expected to be in deficit by $99.2 billion (or 4.5% of GDP) in 2021-22, a $7.4 billion improvement on the $106.6 billion deficit forecast at Budget. The deficit is expected to reduce over the forward estimates, with marginal improvement in 2022-23 to $98.9 billion before trending down to $57.5 billion (2.3% of GDP) in 2024-25.

A stronger-than-expected recovery in the labour market and higher-than-expected iron ore prices have driven the upgrade to the Budget bottom-line. Higher-than-expected iron ore prices contributed to an upward revision in tax receipts. A stronger-than-expected economic recovery has increased economic growth, and reduced government expenditure in the form of unemployment and other benefits.

However, the Government has also increased spending to combat the impacts of the Delta lockdowns, offsetting most of the improvement to the bottom-line from the stronger economy. Direct spending to manage the health impacts of the outbreak and to support the economy amounted to $25 billion since the publication of the 2021-22 Budget.

Together with other direct expenditure since the onset of the pandemic, government spending to manage the health impacts of the pandemic and support the economic recovery has now amounted to $337 billion (or 16.3% of GDP).

Looking further forward, growth in payments, including more funding for the National Disability Insurance Scheme, largely offset upgrades in tax receipts.

Gross and Net Debt

The profile for gross and net debt is lower than the May Budget. The improvement in the profile reflects a combination of a better outcome in 2020-21, smaller-than-expected deficits, an increase in the value of the Government's investments and market valuation adjustments.

Net debt is expected to be $673.4 billion (30.6% of GDP) in 2021-22, before increasing to a peak of $914.8 billion (37.4% of GDP) in 2024-25. This is down from a projected peak of $980.6 billion (40.9% of GDP) in the Budget. Over the medium term, net debt is expected to fall to 35.5% of GDP in 2031-32.

Gross debt is expected to be $919 billion (41.8% of GDP) in 2021-22, before increasing to $1,189 billion (48.6% of GDP) in 2024-25. Unlike net debt, gross debt is expected to stabilise at around

50% of GDP over the medium term, rather than fall.

Key Economic Forecasts

The Government has upgraded its economic forecasts since the Budget, reflecting a faster-than-expected recovery in the economy, particularly in the labour market.

The upgrade to the forecasts brings the Government's view on the economy closer to our own. However, our view is more optimistic than the numbers presented at MYEFO. This suggests that there is potential for an upgrade to the forecasts ahead of the federal election. In particular, the Government has maintained its conservative assumptions regarding the path of commodity prices. Should commodity prices remain at elevated levels, nominal GDP and tax receipts will be higher than currently projected.

Reflecting stronger-than-expected labour market outcomes, the Government has upgraded its labour market forecasts and reduced its estimates of the unemployment rate. The unemployment rate is expected to fall to 4½ per cent by June 2022 – note that it fell to 4.6% in November, following a much stronger-than-expected employment outcome in the month. The unemployment rate is expected to fall further to 4¼ per cent by June 2023, where it is expected to remain for the rest of the forward estimates. This would be the lowest level of unemployment since before the GFC. Indeed, should these forecasts be achieved, the unemployment rate would remain at such a low level for longer than any period since the 1970s.

While these forecasts are very optimistic, our view is that the unemployment rate will fall further and faster than forecast in the MYEFO. We expect the unemployment rate to fall over 2022, to a have a '3' at the front by the end of 2022. This would be the first time that Australia has sustained such a low unemployment rate since the 1970s.

Looking to real GDP, the forecasts have been downgraded in 2021-22, reflecting the impact of the Delta lockdowns, and upgraded in 2022-23, reflecting the subsequent recovery. Real GDP is forecast to be 3¾ per cent in 2021-22, 3½ per cent in 2022-23, before falling to settle around 2½ per cent in 2024-25, closer to the potential path of the economy.

Our forecasts for 2021-22 are similar, with real GDP growth of 3.6%. However, we expect stronger growth in 2022-23 of 5.6%.

The consumer price index (CPI) is expected to move towards the top part of the Reserve Bank's (RBA) 2–3% band in 2021-22, at 2¾ per cent, before falling to the middle of the RBA's band from 2022-23 onwards. We also expect CPI to move towards the top of the RBA's band in 2021-22 (2.9%), before moderating in 2022-23 (2.3%).

Wages are expected to pick up gradually over the forward estimates. The wage price index (WPI) is expected to increase from 2¼ per cent in 2021-22 to 3¼ per cent by 2024-25. This is above the 3% mark that has been mentioned on numerous occasions by RBA Governor Lowe as necessary for inflation to be sustainably within the band. We are also more optimistic on wages and expect wages growth to increase to 2.8% in the fourth quarter of 2022.

Migrants are expected to return at a faster rate. While net overseas migration is projected to decline by 41,000 people in 2021-22, it is expected to shoot up to 180,000 in 2022-23, up from the May Budget forecasts of 96,000. Net overseas migration is forecast to increase to 235,000 people by 2024-25, in line with levels immediately before the pandemic.

Key Initiatives

The Government decided not to hand out too many early Christmas presents this year as it prepares for an election in 2022. New policy announcements were relatively minor, aside from the large spending to support the economy during the Delta lockdowns, as the Treasurer has preferred to wait until next year to announce major initiatives. Most of the variations in the MYEFO were due to estimates variations – updates to revenue or spending estimates due to changes in economic and other parameters – rather than policy decisions.

However, a possible $16 billion of future election spending promises have been budgeted for as 'decisions taken but not yet announced'. These may see the light of day ahead of the election.

The spending to support the economy during the Delta lockdowns included over $13 billion on the National COVID-19 Disaster Payment, over $7 billion to support businesses, and around $3 billion on the health response.

Other key initiatives announced today include: $2.3 billion of funding for new and existing infrastructure projects; $500 million to support regional areas; almost $900 million in labour market programs; $1.1 billion to support Aboriginal and Torres Strait Islander people; and $1.1 billion over 10 years for emissions reduction programs.

Furthermore, $26.4 billion of additional funding has been budgeted for over the four years to 2024-25 to support the National Disability Insurance Scheme (NDIS). This reflected increased expenditure and a higher take up of the NDIS than previous expected.

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