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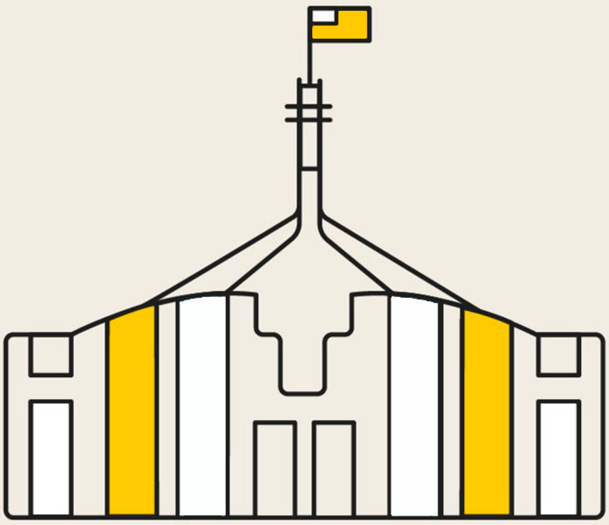
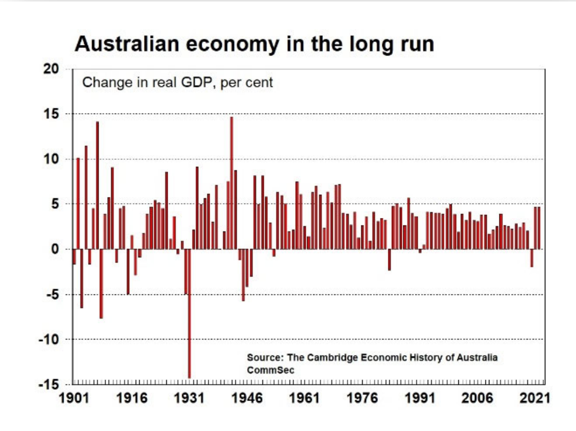


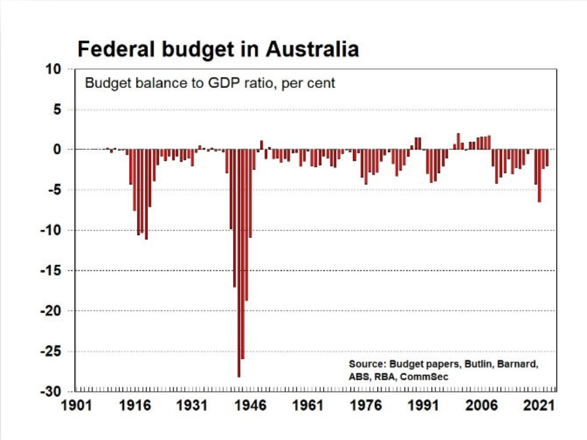
Economic Insights

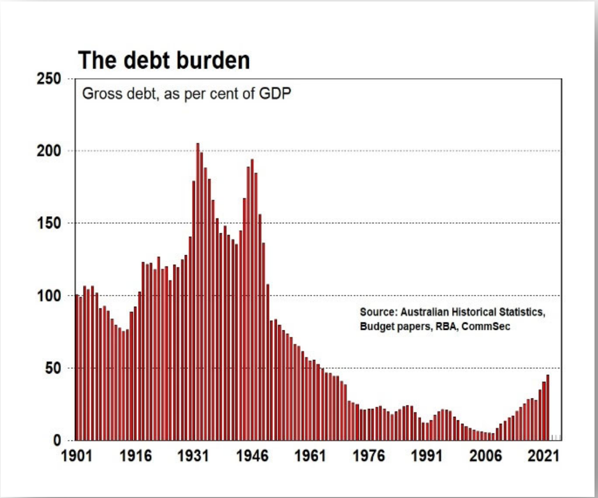
Australia's Budget *2022/2023*

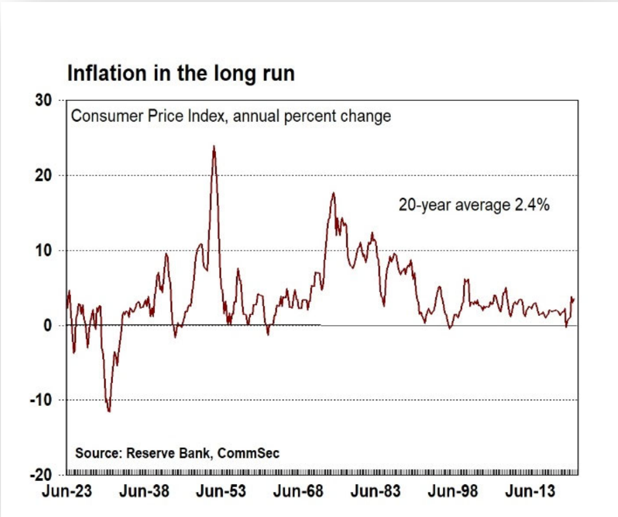
Economics | March 29, 2022

Australia's Budget *2022/2023*





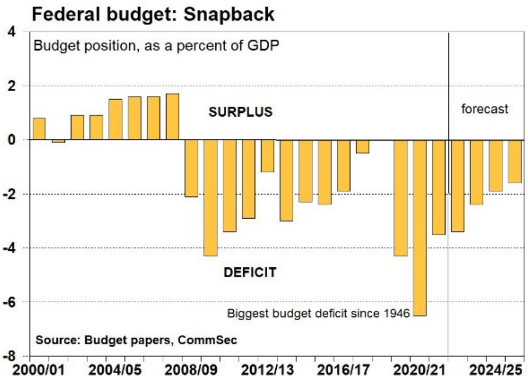




Your Essential Guide to Federal Budget *2022/23*

At a *glance*...

- Budget deficit of $79.8 billion (3.5% of GDP) expected this year (2021/22)
- Budget deficit of $78.0 billion (3.4% of GDP) expected next year (2022/23)
- Economy tipped to grow 3.5 per cent in 2022/23
- Net debt tipped at $714.9 billion (31.1 per cent of GDP) in 2022/23
- $17.9 billion lift in infrastructure spending (in excess of $120 billion over 10 years)
- Infrastructure details: https://minister.infrastructure.gov.au/joyce
- Focus is on cost of living relief for vulnerable Australians
- One-off cash payment of $250 for pensioners, welfare recipients, veterans and concession card holders
- Cut fuel excise by 50 per cent for six months
- Increasing low and middle income tax offset by $420 in 2021/22
- Bring forward of child care subsidy changes ($670m a year)
- $2.0 billion Regional Accelerator Program
- $7.1 billion investment in infrastructure projects in four key regions seen as export frontiers
- $9.9 billion over 10 years to deliver a Resilience, Effects, Defence, Space, Intelligence, Cyber and Enablers (REDSPICE) package
- Small business will be able to deduct a bonus 20% of the cost of business expenses and depreciating assets that support digital uptake
- $365 million to extend apprenticeship wage subsidies schemes
- $10 billion over two decades set aside for an east coast submarine base
- $1.2 billion over four years for an expanded Transition to Work scheme
- $800 million over 10 years for Antarctica
- $38 billion out to 2040 to recruit 18,500 new soldiers
- $875 million for 234 defence site projects including barracks and airfields
- Paid Parental Leave scheme integrating existing schemes
- $4.3 billion for a new dry dock facility in Western Australia
- $243 million for four projects under Modern Manufacturing Initiative
- Expanded home guarantee scheme
- $6 billion disaster support for flood relief in NSW and Queensland
- $480 million regional NBN upgrade
- $547 million for targeted mental health and suicide prevention initiatives.
- $331 million to promote the health of women and girls, including to support the National Women's Health Strategy.



At A Glance

	2021/22e	2022/23f
Underlying deficit ($ billion)	79.8	78.0
Underlying deficit (% GDP)	3.5	3.4
Net Debt (% of GDP)	27.6	31.1
Economic activity (GDP, %)	4.25	3.50
Nominal GDP (%)	10.75	0.50
CPI (year to June quarter %)	4.25	3.00
Wage price index (%)	2.75	3.25
Unemployment (June quarter %)	4.00	3.75

Source: Federal Treasury, CommSec

Analysis

Federal budget: What is it and why should we worry about it?

Families and companies alike sit down and track money coming in and money going out, and it's no different for the federal government. It does the same budgeting exercise on a much bigger scale. The government must try and marry up the dollars coming in via taxes and then determine where those dollars should be (or must be) spent. This includes spending on regular welfare payments as well as big purchases like new submarines.

Clearly the federal budget is hardly the most riveting document you are ever likely to read. Sure you know it's important, but the problem is that it's a huge document with countless facts, figures and tables. Then there is the jargon, concepts like 'underlying budget deficit', fiscal balance, 'net operating balance' – nirvana for accountants!

Just a budget

It's always important to remember that it is just a budget. Assumptions are made; forecasts are taken; and events can change. There can be huge disparities between the first estimates of the annual budget and the final outcome. Clearly, events like pandemics, wars and floods can't be predicted months or years ahead.

And then there is the small matter of politics. The budget is both an economic and political document. The government outlines the measures that it believes are important for the short and medium-term health of the economy. But given the absence of a majority in the Senate this means that the government needs to seek agreement with other parties for the measures to become law.

The added complication this year is that this is a pre-election budget. The community is crying out for support to alleviate cost of living pressures but with the budget in deficit, excessive spending could be criticised as electioneering. The test is whether the measures are targeted at groups in need and whether the support is temporary. And on those grounds, the measures this year can be seen as responsible, especially as the strong economy is providing healthy dividends.

The other thing to consider is that the government may not be returned to power and that would mean that the new government hands down its own budget by the end of the year.

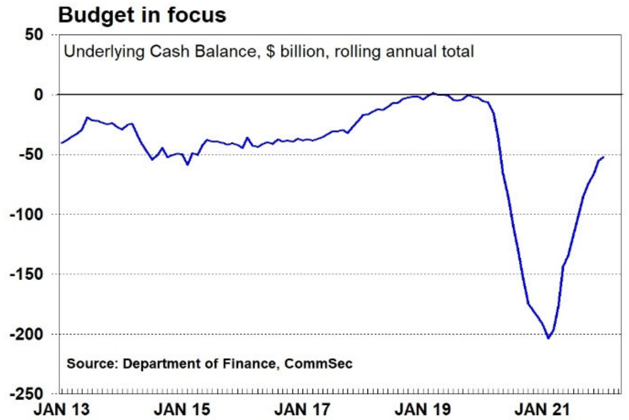
At the end of the day most people want to know whether it's a "good" budget and what's in it for them. It doesn't matter whether you are a student, pensioner or CEO of a major company. The problem is that everyone has different views on what the priorities should be.

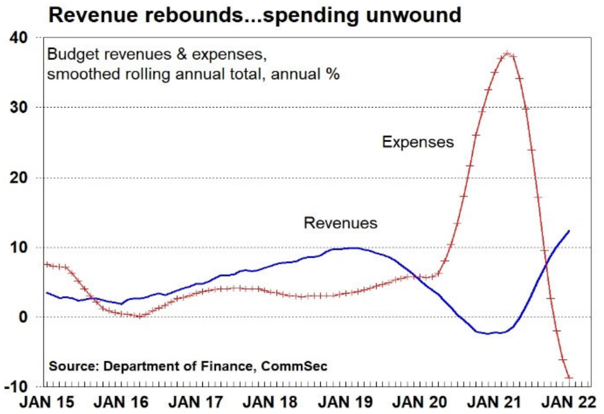
So how are we tracking?

Clearly events like the Covid-19 pandemic have had a dramatic impact on our finances. Going back just three years ago, the budget was in surplus. But the pandemic meant that extra dollars were required to support Aussies get through the crisis and this took its toll on the budget bottom line. Simply, more dollars going out than coming in.

In the year to February 2021, the budget deficit hit a record $203 billion, or 10.3 per cent of the size of the economy (gross domestic product) – the biggest budget deficit since the end of the Second World War.

The latest data shows that the budget deficit shrank to just over $52 billion in the year to January 2022 or 2.4 per cent of GDP. Companies are paying more tax on record profits. The profits are generated by a strong economy and high prices and demand for our key commodities like iron ore and coal. The record number of people in work means more tax revenue for the government and lower unemployment benefits.





Today the government has forecast the budget to be in deficit by $79.8 billion for the full year to June 2022 with the deficit shrinking to $78 billion in the year starting July 2002 (2023/23) and then to $56.5 billion in 2023/24.

What has driven the improvement?

Effectively the Government's strategy has worked. The dollars that were spent to keep Aussies in jobs (such as JobKeeper) and keep businesses stay in business achieved the objective. A record number of people are now in jobs and a record number of businesses are in operation.

Receipts from the tax on consumption (GST) are up 18 per cent over the year after declining for most of the last financial year (2020/21). Company tax receipts are up 32 per cent with personal tax receipts up around 6 per cent.

Those company tax receipts have been supported by high prices for the things we export – essentially raw materials (or commodities), products like iron ore. Personal tax receipts reflects more people in jobs and slightly higher wages.

Overall, revenues are rising at a 16 per cent annual rate – the strongest gain in 13½ years. At the same time, expenses have been falling in recent months – down just over 12 per cent over the past year, the biggest decline in 22½ years.

But the budget is still in deficit, so we have been borrowing more money?

Yes, the net value of debt (total loans less the assets we owe) stands at $631.5 billion or 27.6 per cent of GDP. And net debt is expected to rise further to $714.9 billion or 31.1% of GDP by June 2023. The government has to pay interest on that debt and that stands at $18 billion per year. Interestingly back in 2019 when the budget was back in surplus, the debt interest was just over $17 billion a year. Super-low interest rates have kept that debt servicing task in check.

What measures did the government announce and are they appropriate?

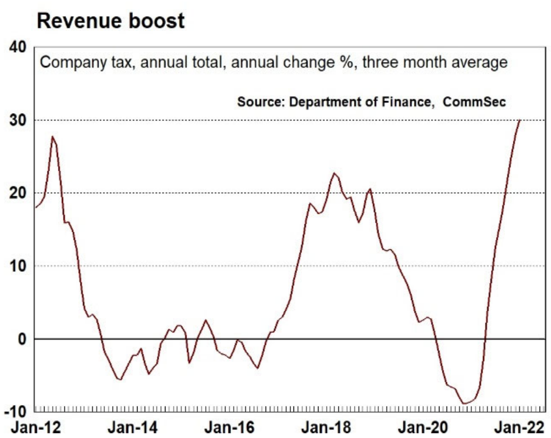
There has been a big focus in recent months on the rising cost of living. So the government has unveiled a number of measures that will support the incomes and spending of those doing it tough – the low and middle income earners and welfare recipients. To address the rising cost of living, the government is handing out $250 in one-off payments to pensioners and welfare recipients. And the low and middle income tax offset is increased by $420. The petrol excise is cut by 50 per cent for six months.

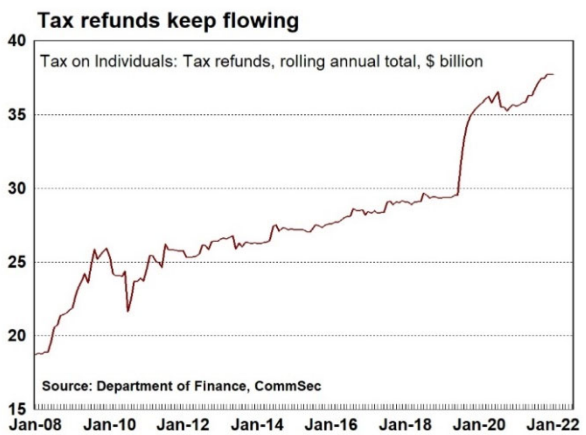
There is additional spending for defence in the very long run; 'housekeeping' spending on health and education. An extra $17.9 billion is to be spent on infrastructure. The apprenticeship wage subsidy schemes are important in boosting labour supply at a time when the labour market is super-tight.

The cost of living measures are temporary, targeted and justified. If the relief wasn't provided, the risk is that consumers may spend less, business revenues decline and the economy grows at a slower pace. That would run counter to the government's strategy. The Government is relying on strong and sustainable growth to repair the budget rather than lift taxes or cut spending. It is a strategy supported by the credit rating agencies.

Overall, the government has tip-toed through the mine field of support for the vulnerable, need for budget repair and pre-election political condiderations with its economic credentials left intact.

But while the spending measures can be justified, the risk is that the government may end up spending too much. Clearly, this will only be known with the benefit of hindsight. But its something to watch. Remember that payment & revenue measures made last year will add $25 billion to the bottom line in 2022/23. Also measures directed at business like the tax refund for carry-back losses and full expensing will still be in operation in the coming 2022/23 year.





The government is erring on the side of providing more, not less stimulus. And keeping the economy growing at a fast clip. If the oil price eases and supply-chain issues recede, there may be even more pressure on the Reserve Bank to lift interest rates to keep inflationary pressures at bay.

Where do we go from here?

Each year before the budget is handed down, the Federal Treasurer outlines his government's fiscal or budget strategy. Like every family or business, it makes good financial sense to have a plan.

During the pandemic, the budget strategy was revised. The government couldn't focus on building surpluses and cutting debt, it needed to provide enough support for businesses and families to get through the crisis.

The good news was not just that economic recovery was achieved, it is stronger than expected. The Government decided to adjust fiscal strategy to drive unemployment lower: "to not just pre-pandemic levels, but even lower. "

Of course, now that the economy is growing solidly, that support is no longer required.

But the government won't be aggressively cutting spending or lifting taxes to get the budget deficit down. Rather it will take a "gradual and measured approach" so that the economy can continue to grow.

The government has been on this path for some time, ending JobKeeper in March 2021, ending the Covid disaster payment in October 2021 and turning down requests for widespread economic support during the Omicron virus variant outbreak earlier this year.

The Treasurer says *"with our recovery well underway it is now time to move to the next phase of our fiscal strategy. This will see a focus on stabilising and then reducing debt as a share of the economy. Rebuilding our fiscal buffers without risking growth."*

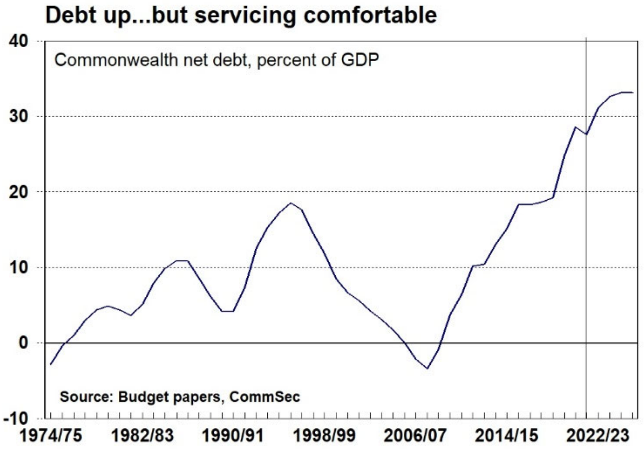
In other words, the Government wants to continue to reduce the size of the budget deficit. That means, initially taking on debt at a slower rate, and then cutting back on that debt over time when it is appropriate to do so.

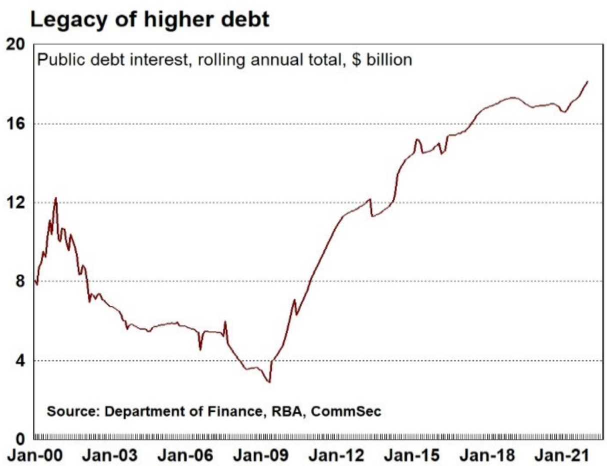
So it's now all about getting our debt under control?

Yes. The Treasurer says the government "will target a budget position that allows us to stabilise and then reduce debt as a share of the economy." Further, gross debt as a proportion of GDP will peak lower and earlier than forecast and will decline over the medium term.

A bit of jargon. The Treasurer says that provided nominal economic growth ('real' growth plus inflation) exceeds the nominal interest rate, economic growth will more than cover the cost of servicing our debt interest payments. As a result, by growing our economy we can maintain a steady and declining ratio of debt to GDP even without running surpluses."

Servicing of our debt is very manageable at present. As noted, interest on debt is around $18 billion a year or 0.7 per cent of GDP. But that $18 billion could be better utilised in other ways like education, health, and infrastructure. And if interest rates continue to lift, extra dollars may be needed to meet repayments.





Economy

Economic Assumptions

	Last year 2020/21	*This year* 2021/22	*Next year* 2022/23	*And* 2023/24
Economic growth (% change)	1.50	4.25	3.50	2.50
Inflation (% change to June quarter)	3.80	4.25	3.00	2.75
Wages (% change, year to June quarter)	1.70	2.75	3.25	3.25
Unemployment (%, June quarter)	5.10	4.00	3.75	3.75

Source: Budget papers, CommSec

What shape is the economy in?

Very strong shape. And the government wants this to continue. That is why the budget is focused on easing the cost of living pressures and keeping people spending. Now it's a case of keeping the economy growing at a solid clip, and sharing the dividends of solid growth in cost of living relief. "Full employment" is within touching distance!

The assumptions taken by Federal Treasury are all-important in determining what sort of dividend will be achieved, and we believe the forecasts are conservative.

Federal Treasury tips the economy to expand by an estimated 4.25 per cent in the current 2022 financial year ending in June and to grow by a slower – but still solid – 3.5 per cent in the coming year beginning July 2022.

'Normal' growth is around 2.5 per cent a year so certainly the economy has been recording solid growth – thus reflected in the lift in tax revenues.

By comparison, Commonwealth Bank (CBA) Group economists tip 3.9 per cent growth this financial year ending June and 4.6 per cent in the next financial year starting in July, so a stronger trajectory.

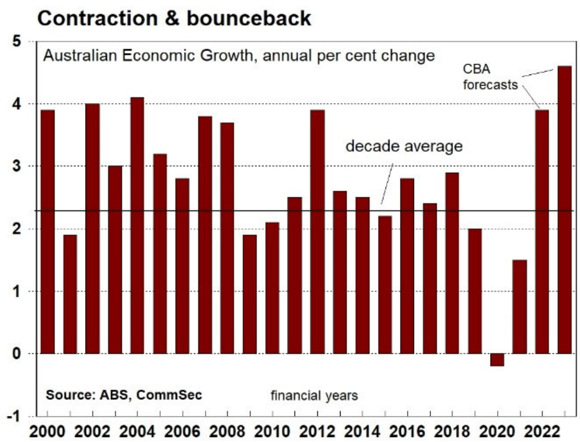
And the Reserve Bank tips the economy to grow by 4.75 per cent in the coming year beginning July 2022 after rising by an estimated 4.5 per cent in the current 2022 financial year – again more positive than Federal Treasury.

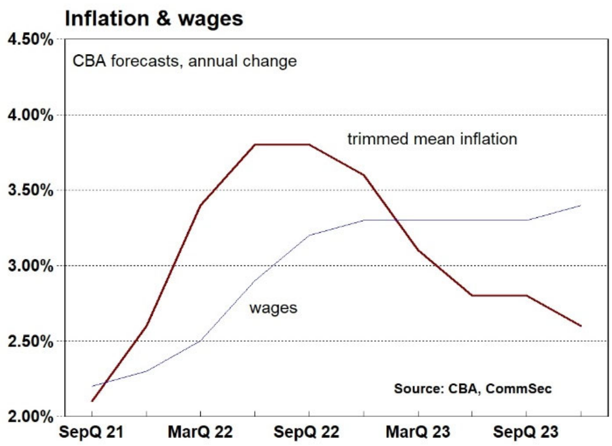
Now focussing on the coming 2022/23 year, Federal Treasury tips a lower inflation rate, lift in wages so real growth is achieved, and the lowest jobless rate since the 1970s.

Federal Treasury expects nominal GDP to rise by just 0.50 per cent in the coming year but after a super-strong 10.75 per cent this year (2021/22). This assumption is important for projected tax receipts.

One key assumption used by Federal Treasury in budget forecasts is the iron ore price. And this has been notoriously difficult to forecast. Federal Treasury continues to forecast the iron ore price to ease to US$55 a tonne. It has remained stubbornly high and currently stands near US$145 a tonne.

There are no shortages of risks. Will there be new strains of Covid-19? How long will the war in Ukraine last? How long will it take for supply-chain issues to be resolved? Will the Reserve Bank make mistakes in acting too quickly or too slowly in lifting interest rates? Clearly this is no time for economic austerity. Economic growth must be strong and sustainable.





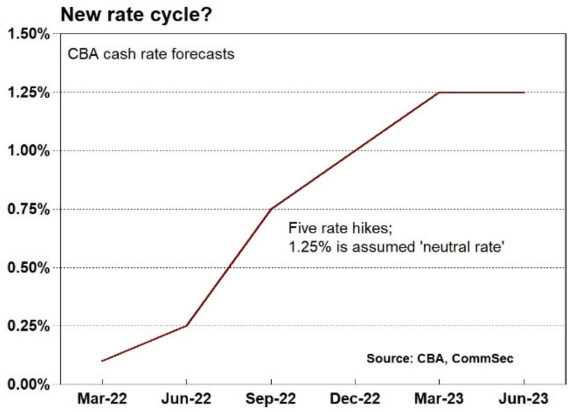
Impact: Interest rates, Aussie dollar & Shares

Where to for interest rates?

The days of record low interest rates are numbered. The Reserve Bank has already told Aussies to plan for higher interest rates. Just like fiscal (budget) policy, super-stimulatory monetary policy settings are no longer required with the economy performing strongly and with inflationary pressures building.

The hard part is the timing. The Reserve Bank says that a number of uncertainties need to be resolved before rates go up. Such as inflation being confirmed in the 2-3 per cent target band and wages growing at a 3 per cent plus annual rate.

Commonwealth Bank (CBA) Group economists believe that the pre-conditions for higher rates will be met in the next few months with the first rate hike to be delivered in June. Cash rates are tipped to rise over 2022 and 2023, reaching a resting point of 1.25 per cent in March 2023.



Any budget impact on the Australian dollar?

It's been some time since the federal budget has had an impact on the Aussie dollar. And this year is no exception. Bigger influences are at work. Influences such as commodity prices, especially the impact of the war in Ukraine and global economic growth. Then there is the state of relative interest rates between the US and Australia. And the performance of the US dollar in its own right.

CBA currency strategists tip the Aussie dollar to be at US80 cents by the end of 2022 and US78 cents by June 2023.

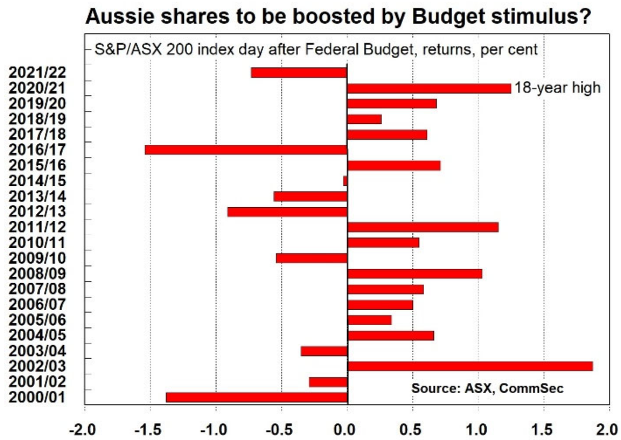
Sharemarket winners & losers?

A big spending pre-election federal budget is likely to have many winners and few losers. Budget deficits can be a positive for sharemarket returns as increased government spending (or less taxation) can boost company balance sheets either directly via contracting to government, or indirectly through increased household spending.

Government spending typically lifts in response to economic downturns – such as the 2020 pandemic recession – with consumer spending and business investment both generally lifting in response to sizeable fiscal stimulus. The boost to confidence is often supportive of risk sentiment and assets, such as shares. In fact, the benchmark S&P/ASX 200 index has soared by a massive 64.2 per cent since its pandemic nadir on March 23, 2020 (through to March 29, 2022), with government payments to individuals and businesses hitting 18.4 per cent of GDP since January 2020, according to data from the International Monetary Fund (IMF).

Government pandemic payments to households during lockdowns have boosted household savings. Data from APRA shows that deposits from households have increased by $249 billion between February 2020 and January 2022, hitting a record $1,238.1 billion. Excess savings, closed borders to international travel and rising home prices have supported consumer spending, so it's no coincidence that the ASX 200 Consumer Discretionary index is up by a whopping 97.7 per cent since March 23, 2020 – the third strongest performing sector behind Information Technology (up 113.4 per cent) and Energy (up 100.5 per cent) shares.

Ahead of tonight's federal budget, the S&P/ASX 200 index is up 0.3 per cent in 2022 year-to-date (March 29, 2022). The Aussie sharemarket has outperformed major global indexes (to March 28, 2022), including the US S&P 500 index (down 4 per cent), the pan-European STOXX600 index (down 6.9 per cent), Japan's Nikkei 225 index (down 2.2 per cent) and the MSCI Asia Pacific Index (down 7.6 per cent). That said, the UK FTSE 100 index is a relative outperformer, up 1.2 per cent (all returns are in local currency terms).



A lift in commodity prices and a strong earnings outlook, with profit estimates for the S&P/ASX 200 index up 13.1 per cent since December 31, 2021 (using forward 12-month Earnings Per Share, EPS to March 28, 2022). Profit upgrades for the ASX 200 index are expected to exceed peers in 2022, including the S&P 500 index (up 4.6 per cent, year-to-date) and STOXX Europe 600 (up 7.3 per cent, year-to-date).

Historical data shows that the S&P/ASX200 index has gained on average just 0.2 per cent the day following each federal budget since the year 2000. In fact, big spending budgets don't always guarantee a strong return the day after the budget, with the S&P/ASX 200 index down 0.7 per cent in 2021, following a 1.3 per cent gain in 2020, the strongest lift in 18 years.

In terms of the potential company and sharemarket beneficiaries of the 2022 budget, targeted government spending could benefit consumer, housing, defence and infrastructure-related shares. Specific policies and the possible sharemarket impact are detailed below:

Household spending: The government has cut its fuel excise by 50 per cent or 22 cents for six months. Low-middle income earners will receive a one-off cash bonus or 'Cost of Living Tax Offset' of $420 in 2021/22 to help with cost-of-living pressures. The budget has extended the tax offset for low-to-middle income households. There will also be a one-off payment of A$250 to eligible pensioners and welfare recipients. Consumer discretionary and consumer staples stocks, which includes supermarkets and electronics retailers, such as JB Hi-Fi, Harvey Norman, Premier Investments, Metcash, Coles and Woolworths, could be beneficiaries of increased consumer spending. Ampol could benefit from a lower fuel excise.

Infrastructure spending: The federal government has committed $17.9 billion for new and existing road, rail and community infrastructure projects. In regional Australia, the $2 billion Regional Accelerator Program will diversify growing regional economies and create jobs in new and existing industries; and $21 billion has been committed for regional transport, water and communications infrastructure. Building materials, residential and commercial property developers, such as Adbri, Bluescope Steel, Boral, Brickworks, Cimic, James Hardie, Mirvac and Stockland could be in focus for investors.

National security and defence: The government has increased defence funding to above two per cent of GDP; $38 billion by 2040 to lift the defence workforce by 18,500 personnel; $9.9 billion over 10 years to deliver a Resilience, Effects, Defence, Space, Intelligence, Cyber and Enablers (REDSPICE) package enhancing the offensive and defensive cyber and intelligence capabilities of the Australian Signals Directorate and doubling its size; and $270 billion in defence capability investment to 2029/30. ASX-listed companies Austal and Codan are key defence-orientated companies.

Domestic manufacturing: A manufacturing budget package worth more than $1 billion has been unveiled to accelerate investment in new industries, including onshore manufacturing capacity, semi-conductors, vaccines, and personal protective equipment and pharmaceuticals (PPE). Aussie manufacturers CSL, Incitec Pivot and Orora could be key beneficiaries.

Telecommunications: The federal government will invest $1.3 billion in funding to enhance regional telecommunications. Heavyweight 'telcos' Telstra and TPG Telecom will be amongst the biggest beneficiaries of the government spending, alongside broadband providers Uniti Group and Aussie Broadband.

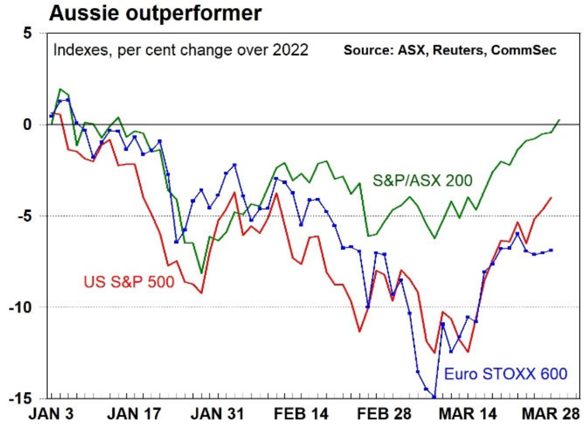
Housing: The government has pledged $8.6 million to expand the Home Guarantee Scheme to 50,000 places per year. Up to 35,000 places per year will be available for first home buyers. The Family Home Guarantee will be increased to 5,000 places per year. And a new Regional Home Guarantee will offer up to 10,000 places per year. This policy should see a continued investor focus on the 'big four' banks – ANZ Bank, Commonwealth Bank, National Australia Bank and Westpac Bank – alongside regional banks, such as Bendigo & Adelaide Bank and the Bank of Queensland.

Health care and disability: The federal budget includes $39.4 billion for National Disability Insurance Scheme; $6 billion extra for Covid-19, including a winter response plan. A further $368 million in additional funding over five years for Medicare. $547 million for targeted mental health and suicide prevention initiatives; $331 million to promote the health of women and girls, including to support the National Women's Health Strategy; and $28 million to commence work to establish Genomics Australia. Shares of health care providers Healius, Monash IVF, Sonic Healthcare and Virtus Health will be in focus for investors.

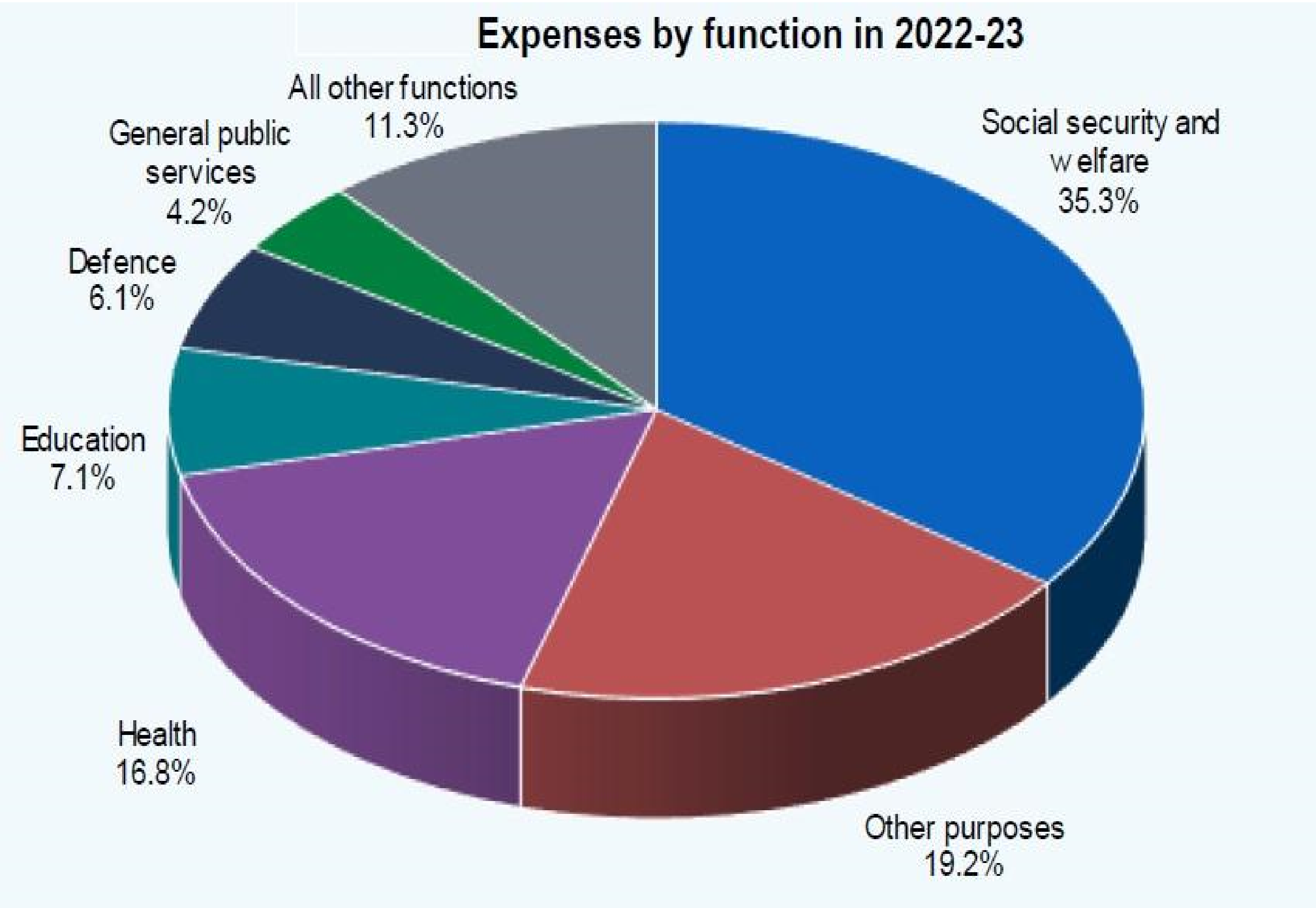
Aged care: $468.3 million extra to implement the royal commission's recommendations; and $345.7 million for residential aged care pharmacy services. Estia, Regis and Japara health care shares could lift on increased spending on aged care.

Small business: Small businesses (with aggregated annual turnover less than A$50 million) will be able to deduct a bonus 20 per cent of the cost of business expenses and depreciating assets that support digital uptake, up to $100,000 of expenditure per year; $2.8 billion for apprentices; and $2.2 billion to support Australian industries and universities to develop innovative companies and products. These initiatives could boost job hiring company Seek. Also, car sellers and auto parts companies carsales.com, Eagers and ARB could benefit.

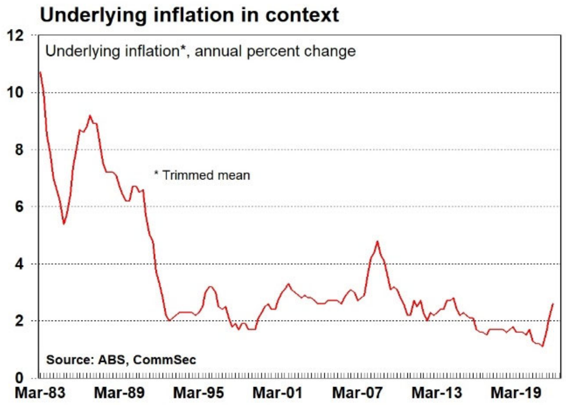
Aussie outperformer

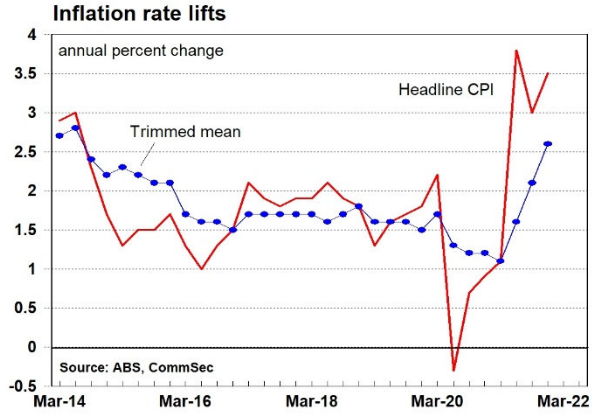


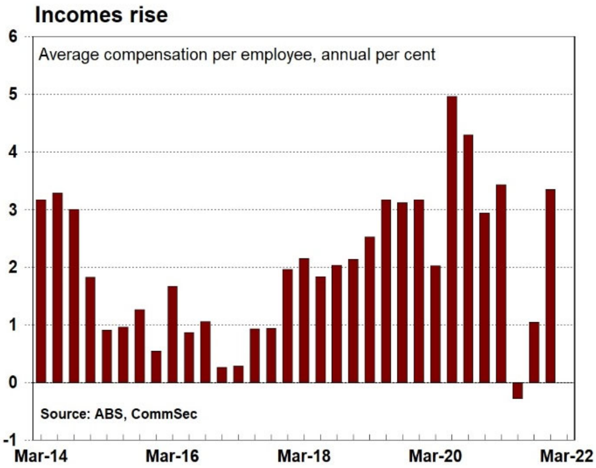
Outcomes, Payments & Revenues

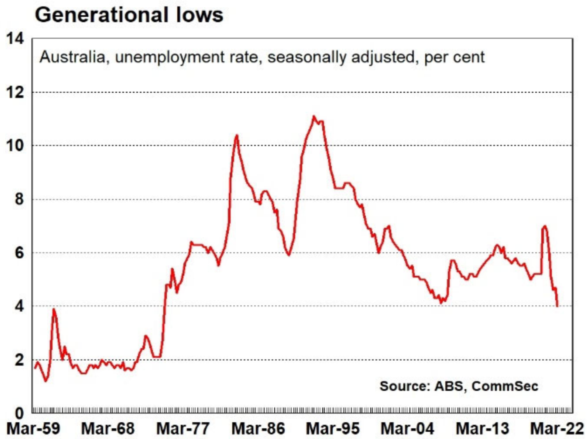


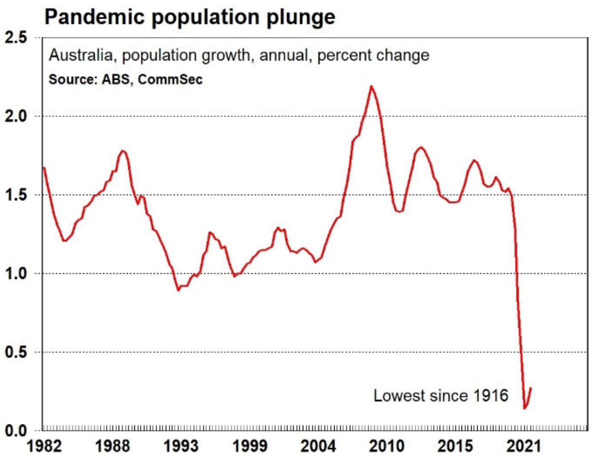
Selected Charts

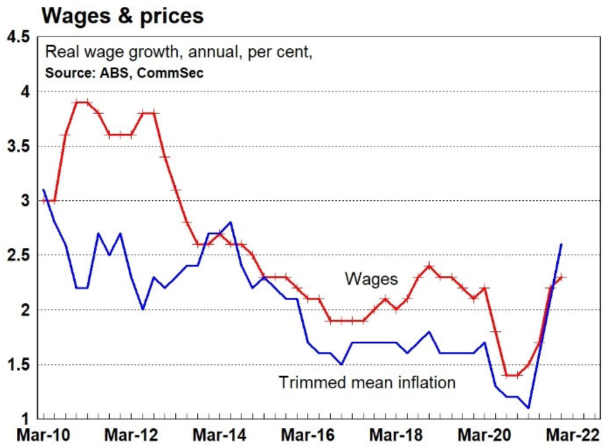












Appendix: The Budget Detail

Major Initiatives

(Source: Federal Budget)

Payment policy decisions

Policy decisions since MYEFO have increased total payments by $8.8 billion in 2022-23 and by $25.0 billion over the 4 years to 2025-26.

Significant measures in this Budget include:

- funding for priority road and rail projects across Australia to support economic recovery and jobs, which is expected to increase payments by $16.8 billion over 10 years from 2021-22
- funding for expanded cyber and intelligence capability to the Australian Signals Directorate to deliver a Resilience, Effects, Defence, Space, Intelligence, Cyber and Enablers package, which is expected to increase payments by $9.9 billion over 10 years from 2022-23
- investment in nationally significant water infrastructure projects to assist in developing regional communities, which is expected to increase payments by $6.9 billion over 12 years from 2021-22, and establishing the Regional Accelerator Program to drive transformative economic growth and productivity in regional areas, which is expected to increase payments by $2.0 billion over 5 years from 2022-23
- investment in strategic projects and programs in the 4 key regions of the Northern Territory, North and Central Queensland, Pilbara region in Western Australia and the Hunter region in New South Wales, with the potential to generate significant growth and employment opportunities in existing and emerging industries. This is expected to increase payments by $7.1 billion over 11 years from 2022-23
- new and amended listings on the Pharmaceutical Benefits Scheme and the Repatriation Pharmaceutical Benefits Scheme, which are expected to increase payments by $2.4 billion over 5 years from 2021-22
- funding to support communities and the recovery from the February – March 2022 floods in Queensland and New South Wales, which is expected to increase payments by $1.9 billion over 5 years from 2021-22
- provision of a $250 Cost of Living Payment to help eligible pensioners, income support recipients, veterans and concession card holders with higher cost of living pressures, which is expected to increase payments by $1.5 billion in 2021-22
- improved regional telecommunications as part of the Government's response to the *2021 Regional Telecommunications Review*, which is expected to increase payments by $1.3 billion over 6 years from 2021-22
- initiatives to reduce all forms of family, domestic and sexual violence against women and children, and to enhance support and recovery services to victims, which is expected to increase payments by $1.3 billion over 6 years from 2021-22.

In addition, since MYEFO the Government has provided funding for Rapid Antigen Tests (RATs) and Personal Protective Equipment (PPE), support to hospitals and health care services, continued funding for the distribution and uptake of COVID-19 vaccines and treatments and support for access to health care services, as it continues to address the health impacts of COVID-19, which is expected to increase payments by over $6.0 billion mainly in 2021-22 and 2022-23.

Craig James interprets 'big picture' economic and financial trends for customers and the general public.

He regularly appears on TV networks, and is often quoted in radio, digital and print media news reports. Craig has worked in banking, finance and journalism for more than 40 years and holds both Bachelor and Master degrees in Commerce (Economics) from UNSW.

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Ryan Felsman is responsible for the analysis of economic trends and developments in the Australian and global economy, as well as the likely impact on financial markets.

He writes regular commentaries and presents to the media and customers across the Commonwealth Bank (CBA) Group.

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For further information

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