FEDERAL BUDGET 2020 / PLOTTING A PATH TO ECONOMIC RECOVERY

Australia's federal budget for 2020-21 was delivered by Treasurer Frydenberg on 6 October 2020. A pandemic-led recession has already underpinned a sharp deterioration in the fiscal accounts, scuttling the prior year's budget plans for a prolonged period of surpluses. This year's budget (delayed from its usual May timing) announces a further $98 billion of economic stimulus, as the Government attempts to plot a path to recovery in 2021.

A stimulatory budget that plots a path to recovery

Unlike recent budgets, new spending this year is not being funded from any underlying improvement in the fiscal position. Instead, there is a further significant increase in debt as the budget moves from being balanced in 2018-19 to a record post World War II deficit of 11.0% of output in 2020-21. While the temporary nature of many of the recent stimulus measures will help the budget deficit fall in future years (to 3.0% by 2023-24), the Government has noted that 'budget repair' is a topic for another day (when the unemployment rate has fallen sustainably below 6%). Net debt rises to $966 billion, or 44% of output, in 2023-24—a level still well below that in many other developed countries.

Key new policies in this year's budget include accelerating (from mid-2022) the 'Stage 2' personal income tax cuts announced last year and backdating them to mid-2020; significant incentives for all businesses to boost investment (via an instant asset write-off policy); subsidies for employers to hire young people, apprentices and trainees and efforts to spur infrastructure investment, particularly by state governments. Additional funding for the health sector (covering aged care, home care and vaccine roll-out programs), the housing sector (via an expanded first homeowner loan deposit scheme and incentives for affordable housing construction) were also announced.

The 2020-21 budget is very stimulatory, with $41 billion added to the economy in 2020-21 (2.1% of output) and a further $46 billion added for 2021-22 (2.3%). After a forecast decline of 3.75% in 2020, the Government expects economic growth to recover to 4.25% in 2021, and the unemployment rate to fall from a peak of around 8% at the end of 2020 (trimmed from 9.25% previously) to 6.5% by mid-2022. The budget assumes that state borders are open—and Victoria's lockdown finished—by the end of this year, and that overseas students and migration gradually recover through 2021. Still, population growth is only seen rising from 0.2% in 2020-21 to 0.4% in 2021-22, well below the 1.5% pace over the past several decades.

The budget is likely to be relatively well received by markets

With the stimulus well flagged, the equity market has already risen about 3% this week prior to the budget's release. Those equity sectors linked to the consumer, business capex and infrastructure sectors may see further gains (while the small business tax relief may lift sentiment toward banks at the margin). The additional fiscal stimulus and recent easing of mobility restrictions (on the back of falling COVID-19 case trends) suggest an improving outlook for growth and support our tactical preference for domestic over international equities. This, together with the preservation of Australia's AAA credit rating (albeit 'on watch' due to the fiscal deterioration), is a likely positive for the Australian dollar (little changed post the budget). While bond yields will likely remain low and contained due to global quantitative policy (central bank bond buying), the additional debt issuance and potentially stronger growth outlook may add upward pressure to yields, though this appears some way away.

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Personal tax measures

Bringing forward personal tax relief

The Government will bring forward previously legislated 'Stage 2' of the 'Personal Income Tax Plan' from financial year 2022-23 to financial year 2020-21.

Stage 2 provides for:

- increasing the low-income tax offset (LITO) from $445 to $700;
- increasing the top threshold of the 19% bracket from $37,000 to $45,000; and
- increasing the top threshold of the 32.5% bracket from $90,000 to $120,000.

The Government will also provide additional support to low- and middle-income earners. In 2020-21, low and middle-income earners will benefit from bringing forward tax cuts in 'Stage 2', as well as a 'one-off' additional benefit from the low- and middle-income tax offset (LMITO). The one-off additional LMITO is worth up to $1,080 for individuals and $2,160 for dual income couples.

New personal tax rates and thresholds (excluding Medicare)

TAX RATES (%)	CURRENT THRESHOLDS ($)	NEW THRESHOLDS FROM 1 JULY 2020 [STAGE 2] ($)	NEW THRESHOLDS FROM 1 JULY 2024 [STAGE 3] ($)
Nil (tax-free)	0-18,200	0-18,200	0-18,200
19	18,201-37,000	18,201-45,000	18,201-45,000
30	-	-	45,001-200,000
32.5	37,001-90,000	45,001-120,000	-
37	90,001-180,000	120,001-180,000	-
45	>180,000	>180,000	>200,000
INCOME TAX OFFSETS ($)			
Low-income tax offset	Up to 445	Up to 700	Up to 700
Low and middle-income tax offset	Up to 1,080	Up to 1,080	-

Summary of expected tax savings

Individual tax relief from bringing forward 'Stage 2' and providing the additional LMITO in financial year 2020-21 compared with financial year 2017-18 is summarised below.

	FY 2017-18	FINANCIAL YEAR 2020-21		
TAXABLE INCOME ($)	TAX LIABILITY ($)	TAX LIABILITY ($)	CHANGE IN TAX ($)	CHANGE IN TAX (%)
40,000	4,947	3,887	-1,060	-21.4
80,000	19,147	16,987	-2,160	-11.3
120,000	34,432	31,687	-2,745	-8.0
160,000	50,032	47,467	-2,565	-5.1
200,000	67,232	64,667	-2,565	-3.8

*Table is based on the tax payable for an individual, excluding any transfer payments. The tax liability and tax relief are calculated only taking into account the basic tax scales, low income tax offset, low-and-middle-income tax offset and the Medicare levy (with 2017–18 Medicare levy single low-income threshold). Actual outcomes for individuals and households may differ.

'Stage 3' tax cuts will remain on the original 2024-25 time frame, where the 32.5% tax rate will reduce to 30%, which aligns the middle tax bracket more closely with corporate tax rates and the 37% tax rate will be eliminated.

The rate reduction builds on the changes the Government has already legislated—increasing the top threshold of the middle tax bracket from $120,000 to $200,000 and abolishing the 37% tax bracket. This will result in a simpler system comprising three tax rates: 19%, 30% and 45%.

Business cash flow support

Temporary full expensing of depreciable assets

The Government will allow a 'temporary' full expensing of depreciable assets for businesses with turnover below $5 billion, with no limit on the value of assets that are eligible. This measure is expected to assist around 3.5 million businesses (around 99% of businesses) and applies to eligible assets purchased from 7:30pm on 6 October 2020 and first used or installed by 30 June 2022. The cost of improvements to existing eligible depreciable assets made during this period can also be deducted in full. This will reduce the after-tax cost of new investments and provide cash flow benefits.

This builds upon the enhanced $150,000 instant asset write-off and the Backing Business Investment measures introduced on 12 March 2020 as part of the Government's response to COVID-19. Businesses that acquire eligible assets that qualify for the enhanced $150,000 instant asset write-off will now have up until 30 June 2021, an extra six months, to first use or install eligible assets.

Temporary loss carry-back

Companies with turnover up to $5 billion will be able to temporarily offset tax losses against previous profits and tax paid. This measure has been introduced to assist companies in loss positions due to the COVID-19 pandemic and should provide a much needed cash flow boost.

Companies with turnover up to $5 billion can apply tax losses incurred during the 2019-20, 2020-21 and/or 2021-22 income years to offset tax paid in 2018-19 or later income years.

Tax break for small business

The Government is expanding access to a range of small business tax concessions for small to medium businesses by lifting the aggregated annual turnover threshold from $10 million to $50 million.

Businesses with an aggregated annual turnover between $10 million and $50 million will have access to up to 10 tax concessions. These changes are expected to apply to around 20,000 small businesses.

These concessions will apply in three phases:

- **01 July 2020**—Eligible businesses will be able to immediately deduct eligible start-up expenses and prepaid expenditure.
- **01 April 2021**—Eligible businesses will be exempt from the 47% fringe benefits tax on car parking provided to employees, and multiple work-related portable electronic devices (i.e. phones or laptops) provided to employees.
- **01 July 2021**—Eligible businesses will be able to access the simplified trading stock rules, remit pay as you go (PAYG) instalments based on GDP-adjusted notional tax and settle excise duty and excise-equivalent customs duty monthly on eligible goods.

Superannuation reforms

The Government has held its election promise that there will be no adverse tax changes to the superannuation system. In addition, there were no measures specifically relating to SMSFs in this year's budget. The key superannuation reform is the introduction of a new default system where superannuation will follow an individual when they change jobs, reducing the number of duplicate accounts held by employees.

Reducing multiple super accounts

Employees will keep their super fund when changing jobs, stopping the creation of unintended multiple super accounts and the erosion of super balances. A new super account will no longer be created automatically every time a new job is started.

By 1 July 2021:

- If an employee does not nominate a new account when starting a new job, an employer will pay their superannuation contributions to their existing fund.
- If an employee does not have an existing superannuation account and does not make a decision regarding a new fund, the employer will pay the employee's superannuation into their nominated default superannuation fund.

This measure is projected to result in 2.1 million fewer unintended multiple accounts over 10 years, saving approximately $2.8 billion in duplicate fees, insurance and lost earnings across that time.

Online YourSuper tool

A new, interactive, online YourSuper comparison tool will help members decide which super product best meets their needs.

By 1 July 2021, the YourSuper tool will:

- Provide a table of simple super products (MySuper) ranked by fees and investment returns.
- Provide a link to super fund websites to choose a MySuper product.

This tool will make it easier to compare the fees and performance of super funds. The measure is projected to result in $3.3 billion in higher member balances over a decade.

Holding funds to account for underperformance

The Government will ensure retirement savings are protected from underperforming super funds.

By 1 July 2021, MySuper products will be subject to an annual performance test. By 1 July 2022, annual performance tests will be extended to other superannuation products. Across the entire industry, holding underperforming funds to account is projected to result in at least $10.7 billion more in retirement savings over 10 years.

Increasing accountability and transparency

The Government will ensure superannuation trustees are more accountable and transparent as to how they manage retirement savings of their members.

By 1 July 2021:

- Super trustees will be required to comply with a new duty to act in the best financial interests of members.
- Trustees will provide members with key information regarding how they manage and spend their money.

This measure is projected to add an extra $1.1 billion in retirement savings through increased transparency and accountability over 10 years.

What does it mean for investors?

Equity market implication: A market-friendly budget that should be well received

Overall, the measures introduced in the budget should be well received by investors. In conjunction with continued market speculation that the Reserve Bank of Australia (RBA) will cut the cash rate and potentially lower the interest rate on the Term Funding Facility, the significant fiscal and monetary support being provided to the economy should ensure a pro-cyclical impetus for domestic portfolios. If COVID-19 mobility restrictions are eased further, it should pave the way for the S&P/ASX 200 index to break out of its four-month trading range (5,700–6,200).

Consumer discretionary: Backdated tax cuts and SME capex incentives to fortify fiscal cliff fears

The Government has backdated, to 1 July 2020, the 'Stage 2' tax cuts that were due to start in July 2022, effectively bringing forward $23.8 billion in tax savings for income taxpayers over the 2020-21 and 2021-22 years. That means that taxpayers earning over $50,000 will be between $1,080 and $2,565 better off. On the budgeted numbers, the income tax cuts are a circa 1.6% benefit to household disposable income over the next 12 months. In conjunction with wage subsidies for apprentices, additional support for 2.5 million pensioners, and the previously announced extension to the JobSeeker and JobKeeper payments (to December 2020 and March 2021, respectively), it is likely that the retail sector is a key beneficiary of this year's budget. The budget also increases the small and medium-sized business instant asset write-off. This will support near-term demand for motor vehicles, technology products, office equipment and the like.

Housing: Positive but not enough to offset the migration hole left by COVID-19

An expanded first home buyer scheme will provide an extra 10,000 first home buyers with financing to build or buy a newly built home with a deposit of as little as 5%. However, this will need to be put in the context of the significant hole that COVID-19 has created in terms of migration support. Recent forecasts from the Treasury indicate annual population growth across Australia is set to slow from around 1.4% pre-COVID to 0.6% through the 2020-21 financial year. In raw numbers, that implies Australia's annual population growth will reduce from around 350,000 in 2019 to 154,000 over the year ending June 2021—a reduction of 56% relative to 2019 levels. If the Treasury forecasts are right, this means the rate of population growth (a proxy for underlying housing demand) will be the lowest since 1917. Continued low interest rates will assist affordability, but dwelling construction looks set to fall sharply until such time as a vaccine is found.

Non-residential construction: Infrastructure spend to benefit contractors

The states will gain billions in use-it-or-lose-it infrastructure payments designed to encourage them to spend by providing more for those who get the money out the door the quickest. Along with measures announced during the coronavirus crisis, $14 billion has also been earmarked for new and accelerated infrastructure. Fast-tracked infrastructure spend was something that RBA Governor Lowe has previously called for and federal and state governments have already ear-marked or fast-tracked $14 billion of job-intensive infrastructure projects from existing budgets. The Government is also providing an additional $3 billion towards 'shovel-ready projects', which includes $2 billion to deliver small-scale road safety projects, as well as an additional $1 billion of funding for the Local Roads and Community Infrastructure Program. Overall, transport infrastructure across the nation will receive a $7.5 billion investment boost. Contractors and developers stand to benefit, as well as machinery and equipment leasing, and maintenance service businesses.

Banks: Small business relief (and income tax cuts) should help lift sentiment towards the bank sector

With the Government looking to fortify the small business and household sector, the banks sector, currently trading at depressed price-to-book levels, should see sentiment improve to the extent that an economic recovery can be priced with more certainty and bad debt exposure can be reduced. This was a particularly business-friendly budget, with considerable incentives to support business investment and cash flow. Specifically, for the business sector, the following measures were proposed:

- **Tax loss 'carry back' benefits**: This allows small businesses to offset current losses against previously paid taxes to boost cash flow. Companies with turnover up to $5 billion will be able to offset losses incurred in the 2020-21 and 2021-22 years against previous profits from and including the 2018-19 financial year.
- **Wage subsidies:** The JobMaker hiring credit is available to employers for each new job created over the 12 months from 7 October 2020. The subsidy is $200 per week if the person employed is 16 to 29 years old and $100 per week if the person employed is 30 to 35 years old. Employers must demonstrate an overall increase in employment over 12 months.
- **R&D tax breaks:** for small companies, with total annual turnovers of less than $20 million, the refundable R&D tax offset will be set at 18.5 percentage points above a company's tax rate, and the $4 million cap on annual cash refunds will be abolished. Meanwhile, for larger firms, with annual turnovers of $20 million or more, the Government said it will reduce the number of intensity tiers from three to two small business start-up tax breaks. The budget will spend $105 million on 10 tax breaks for operators with turnover between $10 million and $50 million. They include no FBT on car parking, phones or laptops, simpler trading stock rules and easier PAYG instalments.

Aged care: Larger reforms still to come

An extra $1.6 billion will be spent on a further 23,000 home care packages in the federal budget as part of health measures that defer large-scale reform for now. Only a small portion of the funding will keep older Australians out of residential aged care, with 2,000 of the packages at level four—the highest level of care—with 8,000 at level three, 8,000 at level two and 5,000 at level one.

Healthcare: Largely inconsequential for listed exposures

There was some additional pathology funding for COVID-19 detection. Increasing the maximum age of dependants on family PHI policies from 24 to 31 years will likely help curtail participation declines in this age cohort. However, as younger policyholders have lower hospital utilisation rates, this is unlikely to change the outlook for hospital volume growth. Changes to the R&D tax incentive will be a small positive for companies like COH with large, domestically-based R&D programs.

Fixed income and currency: record debt issuance, but no near-term rise in yields

The Government forecasts gross debt on issue to rise from $684 billion (35% of output) in 2019-20 to $872 billion (45%) in 2020-21 before reaching $1.14 trillion (52%) in 2023-24. Net debt rises from 25% to 44% of total output. Despite the increase, demand for Australia's government debt is likely to be well supported by the positive (though low) cash rate and a significantly stronger relative debt position than other developed economies. While bond yields will likely remain low and contained due to global quantitative policy (central bank bond buying), the additional debt issuance and potentially stronger growth outlook may add upward pressure to yields, though this appears unlikely before mid-2021. The further stimulus to economic growth, as well as policies directed at improving corporate profitability (such as the tax loss 'carry back' policy), are also likely, at the margin, to be supportive for domestic credit markets.